KPMG

DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT AND TOURISM

STATE OF HAWAII

Basic Financial Statements and Single Audit Reports

Year ended June 30, 2004

(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, 2004

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SECTION I

INTRODUCTION

KPMG

KPMG LLP
PO Box 4150
Honolulu, HI 96812-4150

February 28, 2005

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, 2004. 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 opinions on the fair presentation of the Department's basic financial statements and the schedule of expenditures of federal awards as of and for the year ended June 30, 2004 in accordance with accounting principles generally accepted in the United States of America.
2. To consider the Department's internal control over financing reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the basic financial statements.
3. To perform tests of the Department's compliance with laws, regulations, contracts, and grants, including applicable provisions of the Hawaii Public Procurement Code (Chapter 103D, Hawaii Revised Statutes), that could have a direct and material effect on the determination of financial statement amounts.
4. To consider 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.
5. To provide an opinion on the Department's compliance with applicable laws, regulations, contracts, and grants that could have a direct and material effect on each major program.
6. To report on the status of prior year findings and questioned costs.

To the Director of the
Department of Business,
Economic Development and Tourism
State of Hawaii
February 28, 2005

SCOPE OF AUDIT

We performed an audit of the Department's basic financial statements and schedule of expenditures of federal awards as of and for the year ended June 30, 2004, 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 for financial and compliance audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and the provisions of Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

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 as of and for the year ended June 30, 2004, and our report thereon.
3. Section III, entitled "Compliance and Internal Control over Financial Reporting," contains our report on the Department's internal control over financial reporting and on compliance and other matters 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

KPMG

KPMG LLP
PO 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, 2004, 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 did not audit the financial statements of the Hawaii Tourism Authority (the Authority), a blended component unit of the Department, which represent 75% and 76% of the assets and revenues, respectively, of the governmental activities, and which represent 35% and 84% of the assets and revenues, respectively, of the Economic Development Special Revenue Fund. Those financial statements were audited by other auditors whose report has been furnished to us, and our opinions, insofar as they relate to the amounts included for the Authority, are based solely on the report of the other auditors.

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 and the report of the other auditors provide 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 of Hawaii (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 as of June 30, 2004, 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, based on our audit and the report of the other auditors, 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, 2004, 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 28, 2005 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 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 5 through 12 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.

KPMG LLP

February 28, 2005

DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT AND TOURISM

STATE OF HAWAII

Management's Discussion and Analysis

June 30, 2004

As management of the Department of Business, Economic Development and Tourism, State of Hawaii (the Department), we offer readers of the Department's basic financial statements this narrative overview and analysis of the financial activities of the Department for the fiscal year ended June 30, 2004.

Financial Highlights

- The assets of the Department exceeded its liabilities at June 30, 2004 by $387.5 million (net assets).
- Of the total net assets, the amount of $48.8 million, or 12.6 % was unrestricted and may be used by the Department for its operations and activities in achieving its goal of sustainable growth of Hawaii's economy.
- The Department's liabilities reported in the statement of net assets decreased during the current fiscal year to $21 million, a decrease of $3.9 million or 15.7% from the prior year.
- At June 30, 2004, the Department reported combined ending fund balances of $51.1 million. Of this amount, $26.6 million or 52.1% of the total fund balances is available for spending at the Department's discretion (unreserved fund balance) and the remaining $24.5 million represents amounts reserved for specific purposes.

Overview of the Basic Financial Statements

This discussion and analysis is intended to serve as an introduction to the Department's basic financial statements. The Department's basic financial statements are comprised of three components: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to basic financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

Government-Wide Financial Statements

The government-wide financial statements are designed to provide readers with a broad overview of the Department's finances, in a manner similar to a private sector business.

The statement of net assets presents information on all of the Department's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Department is improving or deteriorating.

The statement of activities presents information showing how the Department'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 related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected tax revenue and unused vacation leave).

(Continued)

Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Department uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The funds of the Department can be divided into two categories, Governmental Funds and Fiduciary Funds.

Governmental Funds

Governmental Funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, Governmental Funds financial statements focus on near-term inflows and outflows of spendable resources, as well as on the balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating the Department's near-term financing requirements.

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 for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the Department's near-term financing decisions. Both the Governmental Funds balance sheet and the Governmental Funds statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between Governmental Funds and governmental activities in the government-wide financial statements.

Information is presented separately in the Governmental Funds balance sheet and in the Governmental Funds statement of revenues, expenditures, and changes in fund balances for the General Fund, Economic Development Special Revenue Fund, and Capital Projects Fund.

The Department adopts an annual appropriated budget for its General Fund and Economic Development Special Revenue Fund. A budgetary comparison statement has been provided for these funds to demonstrate compliance with this budget. The budgetary comparison statement for the General Fund and the Economic Development Special Revenue Fund is located in the basic financial statements.

Fiduciary Funds

Fiduciary Funds are used to account for resources held for by the Department in an agency capacity.

Notes to Basic Financial Statements

The notes to basic financial statements provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

Government-Wide Financial Analysis

The following is a financial analysis on the governmental activities of the Department. Net assets are a useful indicator of a government's financial position. For the Department, total assets exceeded liabilities by $387.5 million, and decreased $6.1 million or 1.5% over the course of this fiscal year's operations.

The following table was derived from the government-wide statement of net assets.

Net Assets

June 30, 2004 and 2003

(Amounts in thousands)

	FY 2004	FY 2003
Assets:		
Current and other assets	$ 69,834	$ 74,859
Capital assets	338,673	343,615
Total assets	$ 408,507	$ 418,474
Liabilities:		
Long-term liabilities	$ 1,690	$ 1,718
Other liabilities	19,355	23,239
Total liabilities	$ 21,045	$ 24,957
Net assets:		
Invested in capital assets, net of related debt	$ 338,673	$ 343,615
Unrestricted	48,789	49,902
Total net assets	$ 387,462	$ 393,517

(Continued)

Analysis of Net Assets

By far the largest portion of the Department's net assets ($338.7 million or 87.4%) reflects its investment in capital assets (e.g., land, buildings, and equipment), less any related debt used to acquire those assets that is still outstanding. The Department uses these capital assets to provide governmental services to the public and businesses; consequently, these assets are not available for future spending. Although the Department's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

The remaining balance of unrestricted net assets of $48.8 million, or 12.6% of the total net assets, may be used to meet the Department's ongoing obligations for its operations relating to business and economic development.

Current and other assets decreased by $5 million, or 6.7% from the prior fiscal year, due primarily to the cash transfer of $4.9 million to the State General Fund as legally mandated by Act 178, SLH 2003. This decrease was offset by an increase of the transient accommodations tax receivable for the Hawaii Tourism Authority (the Authority).

During the current fiscal year, Capital assets decreased by $4.9 million, or 1.4% due primarily to the recording of current year depreciation expense, which was offset by current year additions for capital improvement projects of the Foreign-Trade Zone Division, Natural Energy Laboratory of Hawaii Authority (NELHA), and the High Technology Development Corporation.

Total liabilities decreased during FY 2004 by $3.9 million, or 15.7% from the prior fiscal year, due primarily to a $5.2 million decrease in vouchers payable offset by a $1.5 million increase in deferred revenues.

(Continued)

Changes in Net Assets

The following financial information was derived from the government-wide statement of activities and reflects how the State's net assets changed during the fiscal year.

Changes in Net Assets

For the fiscal years ended June 30, 2004 and 2003

(Amounts in thousands)

	FY 2004	FY 2003
Revenues:		
Program revenues:		
Charges for services	$ 16,822	$ 12,107
Operating grants and contributions	11,816	11,617
General revenues:		
Transient accommodations tax	93,752	91,852
State allotted appropriations	11,038	15,746
Other	2,718	1,475
Total revenues	136,146	132,797
Expenses:		
Hawaii Tourism Authority	104,426	103,463
Natural Energy Laboratory of Hawaii Authority	9,526	10,698
High Technology and Strategic Development	4,476	3,851
Office of Planning	3,602	4,061
Energy Development and Management	3,361	3,686
General Support for Economic Development	2,961	2,933
Economic Planning and Research for Economic Development	2,736	2,995
Business Services and Development	2,520	2,817
Foreign-Trade Zone	1,645	1,415
Aloha Tower Development Corporation	1,530	1,485
Land Use Commission	470	486
Office of the Hawaiian Affairs Public Land Trust	—	241
Total expenses	137,253	138,131
Change in net assets before transfers	(1,107)	(5,334)
Transfers	(4,948)	(6,208)
Change in net assets after transfers	(6,055)	(11,542)
Net assets, beginning	393,517	405,059
Net assets, end	$ 387,462	$ 393,517

Analysis of Changes in Net Assets

The Department's net assets decreased by $6.1 million or 1.5% during the fiscal year ended June 30, 2004 primarily due to the required cash transfer of $4.9 million to the State General Fund in accordance with Act 178, SLH 2003 and the current fiscal year's total expenses exceeding the current fiscal year's total revenues.

Total revenues for the Department were $136.1 million for FY 2004. Of this total, the amount of $93.8 million, or 68.8% was from the transient accommodations tax revenues received by the Authority. Revenues generated by program charges for services were $16.8 million, or 12.4% of the total, the State allotted appropriations made up 8.1% of the total, and federal grants and other sources provided the balance in total revenues.

Total expenses for the Department were $137.3 million for FY 2004. The expenses were for the following programs administered by the Department: the Authority, NELHA, Office of Planning, High Technology and Strategic Development, Energy Development and Management, Business Services and Development including the Strategic Marketing and Support Division and the Arts, Film and Entertainment Division, Economic Planning and Research for Economic Development, General Support for Economic Development, Aloha Tower Development Corporation, and the Foreign-Trade Zone. The largest expenses were for the Hawaii Tourism Authority of $104.4 million, or 76.1% of the total expended.

Financial Analysis of the State's Individual Funds

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

Governmental Funds

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

As of the end of the current fiscal year, the Department's Governmental Funds reported combined ending fund balances of $51.1 million, a decrease of $1.2 million or 2.2% from the prior fiscal year. Approximately $26.6 or 52.1% of this total amount constitutes the unreserved fund balance, which is available for spending at the Department's discretion in the coming fiscal year.

The General Fund is the Department's primary operating fund. At the end of the current fiscal year, the fund balance of the Department's General Fund was $0.9 million, which reflects an increase of 2% over the prior fiscal year.

The Economic Development Special Revenue 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. At the end of the current fiscal year, the fund balance of the Economic Development Special Revenue Fund was $44.7 million, of which $26.9 million was unreserved and available for the Department's expenses.

The Capital Projects Fund accounts for financial resources used for the acquisition or construction of major capital facilities. The fund balance of the Capital Projects Fund at the end of the current year was $5.5 million.

Fiduciary Funds

The Department maintains an Agency Fund for the funds held in the bank account for out-of-state operations and security deposits for the Foreign-Trade Zone Division, NELHA, and the High Technology Development Corporation.

General Fund Budgetary Highlights

There was no difference between the General Fund original budget and the final budget of $11.1 million. Actual expenditures were $10.4 million for FY 2004 resulting in a variance between the final budget and actual expenditures on a budgetary basis of $0.7 million.

Capital Assets

The Department's investment in capital assets as of June 30, 2004 amounted to $338.7 million (net of accumulated depreciation of $74.7 million). This investment in capital assets includes land, buildings and improvements, machinery, and equipment. Major capital improvement project expenses for the fiscal year ended June 30, 2004, included the Onshore Distribution System and the HOST Park infrastructure upgrade projects at NELHA, the Manoa Innovation Center Renovation and Security System project at the High Technology Development Corporation, and the Pier 2 Warehouse and Office Improvements project at the Foreign-Trade Zone Division.

Additional information on the Department's capital assets can be found in note 7 of the notes to basic financial statements.

Due to State Department of Budget and Finance

At the end of the current fiscal year, the outstanding principal and interest amounts required to be reimbursed by the Authority to the State Department of Budget and Finance (Budget and Finance) was $310.9 million and $244.1 million, respectively. This entire amount was comprised of general obligation bonds which are backed by the full faith and credit of the State and whose proceeds were used to fund the construction of the Hawaii Convention Center.

(Continued)

The Authority's ability to reimburse Budget and Finance is contingent upon continued receipt of future transient accommodations tax allocations from the State. In addition, the ultimate responsibility for debt service payments to the bondholders of the general obligation bonds remains with the State through Budget and Finance. Accordingly, the obligation to reimburse Budget and Finance for debt service as described above has not been recorded in the Department'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 Authority.

For the current fiscal year, the Authority was required to reimburse Budget and Finance $26.4 million for debt service. At the end of the current fiscal year, the unpaid amount due to Budget and Finance was $5.4 million.

Additional information on the Department's due to State Department of Budget and Finance can be found in note 8 of the notes to the basic financial statements.

Economic Factors and Next Year's Budget

The Council on Revenues in March 2005 estimated that the State's General Fund tax growth rate would be 10.0% in fiscal 2005, 5.0% in fiscal 2006, and 4.9% in fiscal 2007. While the current condition of Hawaii's economy is good, the projected growth in tax revenues remains a concern. Based on this concern and increasing fixed costs, the Governor has imposed a 1% across-the-board restriction on all General Fund discretionary expenditures of all Executive Branch departments and agencies for fiscal 2005. Consultant and personal services contracts greater than $25,000 and the filling of nonessential positions continue to require the approval of the Governor and other expenditure controls implemented in fiscal 2004 continue to be in force.

Updates to revenue projections issued by the Council on Revenues will impact the Governor's policy on budget formulation, and accordingly, the Department's future budget.

Requests for Information

Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Director, Department of Business, Economic Development and Tourism, P.O. Box 2359, Honolulu, Hawaii 96804. General information about the Department can be found at the State's website, http://www.hawaii.gov/dbedt.

DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT AND TOURISM

STATE OF HAWAII

Statement of Net Assets

June 30, 2004

Assets				
Cash:				
Cash in state treasury (note 4)			$	39,063,792
Cash in bank (note 4)				217,026
Petty cash				40,050
Total cash				39,320,868
Receivables:				
Accounts, net (note 5)	$	248,068		
Loans, net (note 5)		3,450,310		
Interest		36,122		
Due from grantor		1,460,828		
Transient accommodations tax		12,340,374		
Due from Hawaii Convention Center		1,956,196		
Total receivables, net				19,491,898
Investment in venture capital limited partnerships, at cost (note 2)				11,021,172
Capital assets (note 7):				
Land and construction in progress		155,347,235		
Other capital assets, net		183,325,971		
Capital assets, net				338,673,206
Total assets				408,507,144
Liabilities				
Liabilities:				
Vouchers payable				5,866,396
Accrued payroll				529,627
Due to State Department of Budget and Finance (note 8)				5,381,209
Due to other state agencies (note 6)				4,829,000
Due to State General Fund				40,050
Deferred revenues				2,123,835
Accrued vacation (note 9):				
Due within one year				584,810
Due in more than one year				1,690,486
Total liabilities				21,045,413
Commitments and contingencies (notes 6, 8, 9, 10, 11, 12, and 13)				
Net Assets				
Invested in capital assets		338,673,206		
Unrestricted		48,788,525		
Total net assets			$	387,461,731

See accompanying notes to basic financial statements.

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

STATE OF HAWAII

Statement of Activities

Year ended June 30, 2004

		Program Expenses (Notes 7, 9, 10, 11, and 13)		Program Revenues: Charges for Services		Program Revenues: Operating Grants and Contributions		Net Expense and Changes in Net Assets
Governmental activities:								
Hawaii Tourism Authority (note 8)	$	104,425,489	$	9,964,135	$	—	$	(94,461,354)
Natural Energy Laboratory of Hawaii Authority		9,525,594		1,700,433		7,395,392		(429,769)
General Support for Economic Development		2,960,721		—		—		(2,960,721)
High Technology and Strategic Development		4,476,405		1,190,255		1,691,812		(1,594,338)
Energy Development and Management		3,360,721		6,715		1,043,147		(2,310,859)
Economic Planning and Research for Economic Development		2,736,342		1,344		—		(2,734,998)
Business Services and Development		2,520,478		56		—		(2,520,422)
Office of Planning		3,602,094		—		1,685,548		(1,916,546)
Aloha Tower Development Corporation		1,529,988		2,389,015		—		859,027
Foreign-Trade Zone		1,644,988		1,569,740		—		(75,248)
Land Use Commission		469,817		—		—		(469,817)
Total governmental activities	$	137,252,637	$	16,821,693	$	11,815,899		(108,615,045)
General revenues:								
Transient accommodations tax								93,751,661
State allotted appropriations, net of reversions and lapses								11,037,982
Lapsed appropriations related to previous years								(349,333)
Interest								1,074,140
Nonimposed employee fringe benefits (note 11)								1,971,733
Other								22,029
Total general revenues								107,508,212
Transfers								(4,948,506)
Change in net assets								(6,055,339)
Net assets at July 1, 2003								393,517,070
Net assets at June 30, 2004							$	387,461,731

See accompanying notes to basic financial statements.

DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT AND TOURISM

STATE OF HAWAII

Balance Sheet – Governmental Funds

June 30, 2004

Assets	General	Economic Development Special Revenue	Capital Projects	Total Governmental Funds
Cash in state treasury (note 4)	$ 1,388,619	$ 32,104,563	$ 5,570,610	$ 39,063,792
Cash in bank (note 4)	—	217,026	—	217,026
Petty cash	11,000	29,050	—	40,050
Receivables:				
Accounts, net (note 5)	—	248,068	—	248,068
Loans, net (note 5)	—	3,450,310	—	3,450,310
Interest	—	36,122	—	36,122
Due from grantor	—	1,460,828	—	1,460,828
Transient accommodations tax receivable	—	12,340,374	—	12,340,374
Due from Hawaii Convention Center	—	1,956,196	—	1,956,196
Investment in venture capital limited partnerships, at cost (note 2)	—	11,021,172	—	11,021,172
Total assets	$ 1,399,619	$ 62,863,709	$ 5,570,610	$ 69,833,938
Liabilities and Fund Balances				
Liabilities:				
Vouchers payable	$ 181,022	$ 5,572,998	$ 112,376	$ 5,866,396
Accrued payroll	277,331	252,296	—	529,627
Due to State Department of Budget and Finance (note 8)	—	5,381,209	—	5,381,209
Due to other state agencies (note 6)	—	4,829,000	—	4,829,000
Due to State General Fund	11,000	29,050	—	40,050
Deferred revenues	—	2,123,835	—	2,123,835
Total liabilities	469,353	18,188,388	112,376	18,770,117
Fund balances (deficit):				
Reserved for encumbrances	1,232,565	17,660,516	5,381,834	24,274,915
Reserved for capital projects	—	—	76,400	76,400
Reserved for other purposes	—	90,278	—	90,278
Unreserved (note 12)	(302,299)	26,924,527	—	26,622,228
Total fund balances	930,266	44,675,321	5,458,234	51,063,821
Total liabilities and fund balances	$ 1,399,619	$ 62,863,709	$ 5,570,610	
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				338,673,206
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				(2,275,296)
Net assets of governmental activities				$ 387,461,731

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, 2004

	General	Economic Development Special Revenue	Capital Projects	Total Governmental Funds
Revenues:				
Transient accommodations tax	$ —	$ 93,751,661	$ —	$ 93,751,661
State allotted appropriations, net of reversions and lapses	10,449,041	—	588,941	11,037,982
Charges for current services	—	16,821,693	—	16,821,693
Intergovernmental	—	11,815,899	—	11,815,899
Nonimposed employee fringe benefits (note 11)	1,971,733	—	—	1,971,733
Interest	—	1,074,140	—	1,074,140
Other	—	22,029	—	22,029
Total revenues	12,420,774	123,485,422	588,941	136,495,137
Expenditures (notes 7, 9, 10, 11, and 13):				
Hawaii Tourism Authority	15,000	98,255,436	—	98,270,436
Natural Energy Laboratory of Hawaii Authority	686,625	8,811,300	—	9,497,925
General Support for Economic Development	2,574,736	—	—	2,574,736
High Technology and Strategic Development	1,176,900	2,607,360	—	3,784,260
Energy Development and Management	1,282,586	2,104,135	—	3,386,721
Economic Planning and Research for Economic Development	1,129,821	1,622,330	—	2,752,151
Business Services and Development	2,863,663	223,260	—	3,086,923
Office of Planning	1,853,724	1,738,847	—	3,592,571
Aloha Tower Development Corporation	—	1,568,125	—	1,568,125
Foreign-Trade Zone	—	1,435,914	—	1,435,914
Land Use Commission	465,940	—	—	465,940
Capital outlays	—	—	1,935,522	1,935,522
Total expenditures	12,048,995	118,366,707	1,935,522	132,351,224
Excess (deficiency) of revenues over expenditures	371,779	5,118,715	(1,346,581)	4,143,913
Other financing sources (uses):				
Transfers in	—	286,500	—	286,500
Transfers out	(286,500)	—	—	(286,500)
Transfer to the State Department of Accounting and General Services	—	(4,948,506)	—	(4,948,506)
Lapsed appropriations related to previous years	(67,127)	—	(282,206)	(349,333)
Total other financing uses, net	(353,627)	(4,662,006)	(282,206)	(5,297,839)
Excess (deficiency) of revenues and other financing sources over expenditures and other financing uses	18,152	456,709	(1,628,787)	(1,153,926)
Fund balances, July 1, 2003	912,114	44,218,612	7,087,021	
Fund balances, June 30, 2004	$ 930,266	$ 44,675,321	$ 5,458,234	
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 depreciation exceeded capital outlays in the current period				(4,941,997)
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				40,584
Change in net assets				$ (6,055,339)

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, 2004

	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	$ 11,131,548	$ 11,131,548	$ 10,449,041	$ (682,507)	$ —	$ —	$ —	$ —
Other	—	—	—	—	123,680,909	123,680,909	110,881,921	(12,798,988)
Total revenues	11,131,548	11,131,548	10,449,041	(682,507)	123,680,909	123,680,909	110,881,921	(12,798,988)
Expenditures:								
Hawaii Tourism Authority (note 8)	—	—	—	—	109,000,000	109,000,000	107,710,003	1,289,997
Natural Energy Laboratory of Hawaii Authority	597,510	597,510	560,402	37,108	2,607,180	2,607,180	1,367,896	1,239,284
General Support for Economic Development	1,935,045	2,062,765	2,017,255	45,510	—	—	—	—
High Technology and Strategic Development	1,178,663	1,178,663	1,160,518	18,145	4,007,485	4,007,485	1,216,683	2,790,802
Energy Development and Management	1,160,057	1,160,057	1,022,080	137,977	—	—	—	—
Economic Planning and Research for Economic Development	922,104	922,104	880,655	41,449	1,305,904	1,305,904	1,287,161	18,743
Business Services and Development	3,284,572	3,226,852	2,874,054	352,798	2,163,600	2,163,600	260,029	1,903,571
Office of Planning	1,601,676	1,531,676	1,530,859	817	120,000	120,000	—	120,000
Aloha Tower Development Corporation	—	—	—	—	1,525,689	1,525,689	569,613	956,076
Foreign-Trade Zone	—	—	—	—	1,951,051	1,951,051	1,373,372	577,679
Land Use Commission	426,921	426,921	388,218	38,703	—	—	—	—
Hawaii Tourism Office	25,000	25,000	15,000	10,000	—	—	—	—
Emergency Appropriation – Heavy Rain and Flood	—	—	—	—	1,000,000	1,000,000	—	1,000,000
Total expenditures	11,131,548	11,131,548	10,449,041	682,507	123,680,909	123,680,909	113,784,757	9,896,152
Excess of revenues over expenditures	$ —	$ —	$ —	$ —	$ —	$ —	$ (2,902,836)	$ (2,902,836)

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, 2004

		Agency Funds
Assets:		
Cash in state treasury (note 4)	$	252,773
Cash in bank (note 4)		34,553
Total assets		287,326
Liabilities:		
Deposits payable		287,326
Net assets	$	—

See accompanying notes to basic financial statements.

(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.

(Continued)

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.

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.

(Continued)

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 \$11,021,172 at June 30, 2004. The fair value of these investments approximated \$5,161,388 at June 30, 2004. 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 \$704,000 at June 30, 2004.

(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.

(Continued)

(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 economic development special revenue funds are those estimates as compiled and reviewed by the Department. Budgeted expenditures are derived primarily from the General Appropriations Act of 2003 (Act 200, Session Laws of Hawaii (SLH) 2003), and from other authorizations contained in the State Constitution, HRS, and other specific appropriations acts in various SLH. 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.

All expenditures of these appropriated funds are made pursuant to the appropriations in the fiscal 2003 – 2005 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.

(Continued)

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, 2004, 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.

A reconciliation of the budgetary to GAAP basis operating results for the fiscal year ended June 30, 2004 follows:

	General	Economic Development Special Revenue
Excess of revenues over expenditures – actual (budgetary basis)	$ —	$ (2,902,836)
Reserved for encumbrances at year-end	1,232,565	9,723,999
Expenditures for liquidation of prior year encumbrances	(1,212,573)	(17,652,785)
Net accrued revenues and expenditures	(1,840)	11,633,694
Unbudgeted revenues and other financing sources net of expenditures and other financing uses	—	(345,363)
Excess of revenues and other financing sources over expenditures and other financing uses – GAAP basis	$ 18,152	$ 456,709

* Amounts reflects the balances related to budgeted programs only.

(Continued)

(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.

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 $217,026 equals the bank balance and was uncollateralized at June 30, 2004. 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.

(Continued)

(5) Accounts and Loan Receivable

At June 30, 2004, accounts and loans receivable consisted of the following:

	Accounts Receivable	Loans Receivable
Foreign-Trade Zone Division	$ 228,291	$ —
Natural Energy Laboratory of Hawaii Authority	185,868	—
High Technology Development Corporation	76,077	—
Financial Assistance Branch:		
Hawaii Capital Loan Program	—	6,796,912
Hawaii Community-Based Development Loan Program	—	114,749
Hawaii Innovation Development Loan Program	—	157,156
Hawaii Disaster Commercial Loan Program	—	20,994
	490,236	7,089,811
Less allowance for doubtful accounts	(242,168)	(3,639,501)
Accounts and loans receivable, net	$ 248,068	$ 3,450,310

(6) Due to Other State Agencies

The Aloha Tower Development Corporation (the ATDC), a blended component unit of the Department, 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, 2004, 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, 2004. Pursuant to the ATDC lease, the ATDC owes Harbors approximately $4,829,000 as of June 30, 2004. This amount is reflected in the economic development special revenue fund in the Department's basic financial statements.

(7) Capital Assets

Changes in capital assets during the fiscal year ended June 30, 2004 were as follows:

	Balance July 1, 2003	Additions	Deductions	Balance June 30, 2004
Capital assets not being depreciated:				
Land	$ 134,446,508	$ —	$ —	$ 134,446,508
Construction in progress	18,965,205	1,935,522	—	20,900,727
Total capital assets not being depreciated	153,411,713	1,935,522	—	155,347,235
Other capital assets:				
Land improvements	311,128	—	—	311,128
Buildings and improvements	251,408,199	681,677	—	252,089,876
Equipment	4,310,145	1,417,326	(133,047)	5,594,424
Total other capital assets	256,029,472	2,099,003	(133,047)	257,995,428
Less accumulated depreciation for:				
Land improvements	(217,790)	(20,742)	—	(238,532)
Buildings and improvements	(62,792,891)	(8,402,741)	—	(71,195,632)
Furniture, fixtures, and equipment	(2,815,301)	(513,696)	93,704	(3,235,293)
Total accumulated depreciation	(65,825,982)	(8,937,179)	93,704	(74,669,457)
	190,203,490	(6,838,176)	(39,343)	183,325,971
	$ 343,615,203	$ (4,902,654)	$ (39,343)	$ 338,673,206

During the fiscal year ended June 30, 2004, depreciation expense was charged to functions of the Department as follows:

Hawaii Tourism Authority	$	7,105,542
High Technology and Strategic Development		757,133
General Support for Economic Development		425,344
Business Services and Development		405,085
Foreign-Trade Zone		154,642
Natural Energy Laboratory of Hawaii Authority		81,725
Office of Planning		2,992
Energy Development and Management		1,573
Economic Planning and Research for Economic Development		1,191
Land Use Commission		1,093
Aloha Tower Development Corporation		859
Total depreciation expense	$	8,937,179

(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, 2003, 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), a blended component unit and 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 of the general obligation bonds referred to above remains with the State through Budget and Finance.

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, 2004, the outstanding principal and interest amounts required to be reimbursed by the Authority was $310,930,289 and $244,095,963, respectively. The scheduled payments to maturity for each of the next five years and thereafter in five-year increments are as follows:

	Principal	Interest	Total
2005	$ 7,780,000	$ 18,655,817	$ 26,435,817
2006	8,245,000	18,189,017	26,434,017
2007	8,740,000	17,694,317	26,434,317
2008	9,265,000	17,169,917	26,434,917
2009	9,815,000	16,614,017	26,429,017
2010 – 2014	58,650,000	73,496,787	132,146,787
2015 – 2019	78,475,000	53,661,687	132,136,687
2020 – 2024	105,025,000	27,118,287	132,143,287
2025	24,935,289	1,496,117	26,431,406
	$ 310,930,289	$ 244,095,963	$ 555,026,252

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 Department'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, 2004 the Authority was required to reimburse Budget and Finance $26,430,917 for debt service. At June 30, 2004, the unpaid amount due to Budget and Finance was $5,381,209, which is recorded as due to Budget and Finance in the accompanying basic financial statements.

(Continued)

(9) Accrued Vacation

Changes in accrued vacation payable during the fiscal year ended June 30, 2004 were as follows:

Balance, July 1, 2003	$	2,315,880
Additions		887,915
Deletions		(928,499)
Balance, June 30, 2004		2,275,296
Less current portion		(584,810)
	$	1,690,486

(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.

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 years ended June 30, 2004 and 2003, the Department was required to make contributions amounting to $1,087,891 and $1,079,240, respectively. No contributions were required and made by the Department for the fiscal year ended June 30, 2002.

(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, 2004, the Department's contribution for post-retirement health care and life insurance benefits was approximately $840,000.

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.

(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 $1,971,733 for the fiscal year ended June 30, 2004, 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, 2004 of $302,299. The deficit resulted from recognition of expenditures under GAAP in 2004 and will be funded with 2005 state allotted appropriations.

(13) Commitments and Contingencies

(a) Leases

The Department leases office facilities and equipment under various operating leases expiring through 2009. Future minimum lease commitments of noncancelable operating leases as of June 30, 2004 were as follows:

Fiscal year ending June 30:		
2005	$	158,900
2006		101,100
2007		23,400
2008		14,400
2009		5,000
Thereafter		200
	$	303,000

The Department's rental expenditures for the fiscal year ended June 30, 2004 were approximately $182,000.

(Continued)

(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, 2004, accumulated sick leave approximated $7,244,000 for the Department.

(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 damage, tsunami, and volcanic action coverage with a deductible of 3% of loss subject to a $250,000 minimum. The limit of loss per occurrence is $100,000,000, except for flood and earthquake which is $25,000,000. This policy also includes terrorism coverage whose limit of loss per occurrence is $50,000,000 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 $4,000,000 deductible per occurrence. The annual aggregate per occurrence is $10,000,000.

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

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

KPMG
KPMG LLP
PO Box 4150
Honolulu, HI 96812-4150

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*

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

We have audited the 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, 2004, which collectively comprise the Department's basic financial statements, and have issued our report thereon dated February 28, 2005. Our report indicates that we did not audit the financial statements of the Hawaii Tourism Authority (the Authority), a blended component unit of the Department, and our opinions thereon, insofar as they relate to the amounts included for the Authority, are based solely on the report of the other auditors. In addition, the Department has not presented management's discussion and analysis that accounting principles generally accepted in the United States of America has determined is required to supplement, although not to be a part of, the basic financial statements. 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.

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 opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements 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 the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

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 grant agreements, 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 audits, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance and other matters that are required to be reported under *Government Auditing Standards*.

We noted a certain matter that we reported to management of the Department in a separate letter dated February 28, 2005.

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

February 28, 2005

SECTION IV

COMPLIANCE AND INTERNAL CONTROL OVER FEDERAL AWARDS

KPMG

KPMG LLP
PO 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, 2004. 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.

As described in Findings 04-01 and 04-02 in the accompanying schedule of findings and questioned costs, the Department did not comply with requirements regarding matching and subrecipient monitoring that are applicable to its Energy Efficiency and Renewable Energy Activities program. Compliance with such requirements is necessary, in our opinion, for the Department to comply with the requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, 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, 2004. The results of our auditing procedures also disclosed an instance of noncompliance with those requirements, which is required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying schedule of findings and questioned costs as Findings 04-03 and 04-04.

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 the internal control over compliance in accordance with OMB Circular A-133.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the Department's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs as Findings 04-01 and 04-02.

A material weakness is a reportable condition in which the design or operation of one or more of the 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 caused by error or fraud 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. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions, and accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities and each major fund of the Department as of and for the year ended June 30, 2004, and have issued our report thereon dated February 28, 2005. Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise the Department's basic financial statements. 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

February 28, 2005

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

STATE OF HAWAII

Schedule of Expenditures of Federal Awards

Year ended June 30, 2004

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	MDA972-97-2-0001	$ 31,707,564	$ 171,859	*
		MDA972-97-2-0002	17,197,000	4,701,915	*
Total Department of Defense				4,873,774	
DEPARTMENT OF TRANSPORTATION					
Research and Technology Development:					
Hawaii Electric Vehicle Demonstration Project	12.910	DTRS56-99-T-0017	4,009,129	541,020	*
U.S. AIR FORCE					
Research and Technology Development:					
Hawaii Electric Vehicle Demonstration Project	12.910	OSMORD03270371	888,700	845,591	*
		OSMORD04270281	1,800,000	54,500	*
				900,091	
Total Research and Development Cluster				6,314,885	
OTHER PROGRAMS					
DEPARTMENT OF COMMERCE					
Coastal Zone Management Administration Awards:					
Hawaii Coastal Zone Management Program	11.419	NA17OZ2333	2,295,000	301,277	
		NA17OZ1600	400,000	104,148	
		NA17OZ1121	1,620,000	238,651	
		NA03NOS4190082	2,311,000	963,992	
				1,608,068	
Coastal Services Center:					
NOAA 2002 Coral Reef Conservation Program	11.473	EA133C-02-ON-0050	162,000	20,935	
NOAA 2002 Coastal Services Center Grant		NA160C2636	50,000	44,958	
				65,893	
Economic Adjustment Assistance:					
Economic Diversification Infrastructure Plan	11.307	076905370	100,000	31,842	
High Technology Development Corporation:					
Manufacturing Extension Partnership	11.611	7ONANB3H2000	437,066	342,773	
Total Department of Commerce				2,048,576	

(Continued)

DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT AND TOURISM

STATE OF HAWAII

Schedule of Expenditures of Federal Awards

Year ended June 30, 2004

Federal Grantor/Pass-Through Grantor/Program Title	CFDA Number	Grant Number	Federal Program Award Amount	Federal Expenditures
OTHER PROGRAMS (continued)				
ENVIRONMENTAL PROTECTION AGENCY				
Brownfield Pilots Cooperative Agreements:				
Brownfields Economic Redevelopment Hawaii Assessment Demonstration Pilot	66.811	BP-98966301	$ 200,000	$ 63,087
Brownfields Cleanup Revolving Loan Fund Grant		BL97943301-0	2,000,000	6,100
Total Environmental Protection Agency				69,187
DEPARTMENT OF ENERGY				
State Energy Programs:				
Formula Grant	81.041	DE-FG51-02R021337	379,294	318,869
Special Projects:				
Distributed Energy	81.119	DE-FG51-01R021287	100,000	19,855
Building Guide		DE-FG51-97R020881	50,000	7,123
Rebuild America 4		DE-FG51-01R021285	170,000	71,341
Photovoltaic Power at Mauna Loa		DE-FG51-01R021286	50,000	27,273
Power Parks		DE-FC51-02R021399	450,000	87,329
Rebuild America 6		DE-FG51-03R021496	95,346	1,500
Commercial Guidelines		DE-FG51-99R021082	200,000	12,587
Evaluating Bulk Energy Storage		DE-FC51-02R021383	70,000	20,000
Managing DER as a Microgrid on Hawaii		DE-FC51-02R021380	100,000	23,000
Promulgation of Codes and Standards		DE-FC51-02R021376	30,000	29,061
Rebuild America 5		DE-FG51-02R021401	106,244	33,150
Subtotal CFDA 81.119				332,219
Distributed Energy Resources Center:				
NELHA Gateway Project	81.049	DE-FG02-00CH11066	3,945,000	2,208,296

(Continued)

DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT AND TOURISM

STATE OF HAWAII

Schedule of Expenditures of Federal Awards

Year ended June 30, 2004

Federal Grantor/Pass-Through Grantor/Program Title	CFDA Number	Grant Number	Federal Program Award Amount	Federal Expenditures	
OTHER PROGRAMS (continued)					
DEPARTMENT OF ENERGY, continued					
Energy Efficiency and Renewable Energy Information Dissemination, Outreach, Training, and Technical Analysis Assistance:					
NELHA Energy Efficiency and Renewable Energy Activities	81.117	DE-FC51-02R021359	$ 450,000	$ 373,572	*
GeoPowering the West		DE-FC51-02R028607	10,000	9,715	
SEP Initiatives 2		DE-FC51-01R028606	19,200	9,645	
Wind Support 2		DE-FC51-02R028608	10,000	5,339	
Subtotal CFDA 81.117				398,271	
Regional Biomass Energy Program:					
Bioenergy Program Support 2	81.079	DE-FC51-02R021318	83,861	2,389	
Total Department of Energy				3,260,044	
Total Expenditures of Federal Awards				$ 11,692,692	

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

See accompanying notes to schedule of expenditures of federal awards and 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, 2004

(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:

Program Title	CFDA Number	Amount Provided to Subrecipients
Economic Adjustment Assistance:		
Economic Diversification Infrastructure Plan	11.307	$ 30,000
Coastal Zone Management Administration Awards:		
Hawaii Coastal Zone Management Program	11.419	777,464
Brownfield Pilots Cooperative Agreements:		
Brownfields Economic Redevelopment Hawaii Assessment Demonstration Pilot	66.811	51,683
State Energy Programs:		
Formula Grant	81.041	96,869
Special Projects	81.119	143,254
Distributed Energy Resources Center:		
NELHA Gateway Project	81.049	2,200,431
Energy Efficiency and Renewable Energy Information Dissemination, Outreach, Training, and Technical Analysis Assistance:		
NELHA Energy Efficiency and Renewable Energy Activities	81.117	173,072

(1) 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: **Yes. Findings 04-01 and 04-02**

Material weaknesses: **None noted**

(e) The type of report issued on compliance for major programs: **Qualified opinion**

(f) Any audit findings which are required to be reported under Section .510(a) of OMB Circular A-133: **Yes. Findings 04-01 to 04-04**

(g) Major programs:

***Research and Development Cluster*:**

Department of Defense:

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

Department of Transportation:

12.910 – Hawaii Electric Vehicle Demonstration Project

U.S. Air Force:

12.910 – Hawaii Electric Vehicle Demonstration Project

Other Programs:

Department of Energy:

81.117 – NELHA Energy Efficiency and Renewable Energy Activities

(h) Dollar threshold used to distinguish between Type A and Type B programs: **$350,781**

(i) Auditee qualified as a low-risk auditee under Section .530 of OMB Circular A-133: **Yes**

(Continued)

(2) Findings and Questioned Costs Relating to Federal Award

Department of Energy
NELHA Energy Efficiency and Renewable Energy Activities
CFDA No. 81.117
Federal Award No. DE-FC51-02R021359
Award Period: August 1, 2002 to March 31, 2005

Finding 04-01 Matching

Condition: During our matching, level of effort, and earmarking testwork, we noted that the Department's Energy Efficiency Renewable Energy Activities program was unable to provide documents supporting the program's compliance with matching requirements.

Criteria: In accordance with the U.S. Department of Energy Notice of Financial Assistance Award, the Department's Energy Efficiency Renewable Energy Activities program's cost sharing requirement is $57,500.

Effect: The Department's Energy Efficiency Renewable Energy Activities program was not in compliance with the matching requirements.

Cause: The Department's Energy Efficiency Renewable Energy Activities program did not have policies and procedures to ensure compliance with matching requirements.

Questioned Costs: $373,572 which represents the current fiscal year's federal expenditures that no State matching was made.

Recommendation: We recommend that the Department adhere to matching requirements. Policies and procedures should be established to ensure that the Department identifies all grants with matching requirements. In addition, adequate documentation to evidence its compliance with those matching requirements should be retained by the Department.

Views of Responsible Officials and Planned Corrective Actions: The Natural Energy Laboratory of Hawaii Authority (NELHA) acknowledges the auditors' finding and understands the resulting recommendations. NELHA will adhere to federal contract and grant rules and procedures to improve operations in order to ensure compliance with matching requirements.

NELHA will establish written policies, procedures, and documentation format to ensure that all State matching requirements on federal grants are easily identifiable and tracked. Also, NELHA staff time spent on federal grant management will be tracked and documented.

(Continued)

Finding 04-02 Subrecipient Monitoring

Condition: During our subrecipient monitoring testwork, we noted that the Department's Energy Efficiency Renewable Energy Activities program was unable to provide evidence that it complied with subrecipient monitoring requirements for one of its two subrecipients.

Criteria: In accordance with the OMB Circular A-133, the program is responsible for (1) identifying federal awards made and providing the federal award information and applicable compliance requirements; (2) monitoring the subrecipient's activities to provide reasonable assurance that the subrecipient administers federal awards in compliance with federal requirements; (3) ensuring required audits are performed and requiring the subrecipient to take prompt corrective action on any audit findings; and (4) evaluating the impact of subrecipient activities on the pass-through entity's ability to comply with applicable federal regulations.

Effect: The Department's Energy Efficiency Renewable Energy Activities program was not in compliance with the subrecipient monitoring requirements.

Cause: The Department did not retain any documentation to evidence that the Department's Energy Efficiency Renewable Energy Activities program complied with the subrecipient monitoring requirements for one of its two subrecipients.

Questioned Costs: $156,572 which represents the current fiscal year's amount provided to the subrecipient that the Department did not retain documentation to evidence compliance with subrecipient monitoring requirements.

Recommendation: We recommend that the Department adhere to subrecipient monitoring procedures. Policies and procedures should be established to ensure that appropriate monitoring at subrecipients are performed. Adequate documentation to evidence its compliance with subrecipient monitoring requirements should be maintained.

Views of Responsible Officials and Planned Corrective Actions: NELHA acknowledges the auditors' finding and understands the resulting recommendations. NELHA will adhere to federal contract and grant rules and procedures to improve operations in order to ensure compliance with sub-recipient monitoring requirements.

NELHA will develop written policies and procedures for federal grants to document evidence of sub-recipient monitoring. Procedures will ensure that sub-recipients are in compliance with contract specifications and are within federal guidelines allowed under the grant. Documentation will be maintained and updated on a monthly basis to reflect that monitoring of sub-recipients was conducted, including documentation that a sub-recipient was given notice to take corrective actions on any audit finding. In addition, all corrective actions will also be documented by visits to the sub-recipient's project site.

(Continued)

Finding 04-03 Reporting

Condition: During our reporting testwork, we noted that the Department's Energy Efficiency and Renewable Energy Activities program failed to submit two (for the quarters ended December 31, 2003 and March 31, 2004) Financial Status Reports (Short Form) (SF-269) and Federal Assistance Program/Project Status Report (DOE F 4600.6) to the U.S. Department of Energy (DOE) on a timely basis. Further, the program is required to submit SF-269 not SF-269A.

Criteria: In accordance with the cooperative agreement between the Department and the DOE, the Department is required to submit SF-269 and DOE F 4600.6 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 Energy Efficiency and Renewable Energy Activities program is not in compliance with the terms of the grant agreement between itself and the DOE.

Cause: We were informed that the Department's Energy Efficiency and Renewable Energy Activities 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.

Views of Responsible Officials and Planned Corrective Actions: NELHA acknowledges the auditors' finding and understands the resulting recommendations. NELHA will adhere to federal contract and grant rules and procedures to improve operations in order to ensure compliance with reporting requirements.

NELHA will reassign responsibilities for the federal financial reporting requirements from the Project Managers to the NELHA Fiscal Office. The NELHA Fiscal Office staff will ensure that reports are filed in a timely manner by working with the Project Managers for timely information and compliance.

(Continued)

Finding 04-04 Cash Management

Criteria: The cooperative agreement for the Energy Efficiency and Renewable Activities program requires the Department to maintain funds in interest bearing accounts. The cooperative agreement also specifies that interest earned be remitted back to the federal granting agency if in excess of prescribed limits.

Condition: During testwork on cash management, we noted that the Department received advanced funding from a federal granting agency. These funds were not deposited into interest bearing accounts.

Effect: The Department did not earn interest on funds advanced from federal granting agencies. As a result, the Department was unable to offset program costs or remit excess interest earnings to the federal granting agency.

Questioned Cost: While there are questioned costs associated with this finding, the Department is currently unable to estimate the amount of foregone interest.

Recommendation: We recommend that the Department maintain federal funds in interest bearing accounts. The Department should remit interest in excess of prescribed limits to the respective federal granting agency.

Views of Responsible Officials and Planned Corrective Actions: NELHA acknowledges the auditors' finding and understands the resulting recommendations. NELHA will adhere to federal contract and grant rules and procedures to improve operations in order to ensure compliance with the federal cash management act requirements.

NELHA will request that the grant funds be allowed to participate in the State Treasury Investment Pool System administered by the State Department of Budget and Finance. By participating in the investment system, the grant funds will be maintained in interest-bearing accounts and NELHA will ensure that interest earned in excess of prescribed limits will be remitted to the federal granting agency.