Financial statements and report of independent certified public accountants

State of Hawaii, Department of Transportation, Harbors Division

June 30, 2004 and 2003

C O N T E N T S

Report of Independent Certified Public Accountants

To the Director
Department of Transportation
State of Hawaii

We have audited the accompanying statement of net assets of the Harbors Division, Department of Transportation of the State of Hawaii, relating to the Public Undertaking (Harbors Division) as of June 30, 2004, and the related statements of revenues, expenses and changes in net assets, and cash flows for the year then ended. These financial statements are the responsibility of the management of the Harbors Division. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Harbors Division as of and for the year ended June 30, 2003 were audited by other auditors whose report, dated October 20, 2003, expressed an unqualified opinion on those statements. As discussed in Note C to the financial statements, the Harbors Division restated its 2003 financial statements during the current year to reflect the correction of certain assets and liabilities. The other auditors reported on the 2003 financial statements before the restatement.

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

As discussed in note A, the financial statements of the Harbors Division, are intended to present the financial position, and the changes in financial position and cash flows, of only that portion of the business-type activities of the State of Hawaii that is attributable to the transactions of the Harbors Division. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2004, and the changes in its financial position and its cash flows for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Harbors Division as of June 30, 2004, and the changes in its net assets and its cash flows for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

We also audited the adjustments described in note C to the financial statements that were applied to restate the 2003 financial statements. In our opinion, such adjustments are appropriate and have been properly applied.

As discussed in note P to the financial statements, the State of Hawaii is a defendant in a lawsuit filed by the Office of Hawaiian Affairs (OHA) related to the inclusion of certain revenues received by the State of Hawaii through the Harbors Division in determination of ceded lands payments due to OHA.

To the Director
Department of Transportation
State of Hawaii

In accordance with *Government Auditing Standards*, we have also issued our report dated November 15, 2004, on our consideration of the Harbors Division's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 5 through 10 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 supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements. The supplementary information included in Schedules 1 through 6 is presented for purposes of additional analysis 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 2004 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.

Grant Thornton LLP

Honolulu, Hawaii
November 15, 2004

State of Hawaii
Department of Transportation
Harbors Division

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2004

This section of the Harbors Division, Department of Transportation of the State of Hawaii, relating to the Public Undertaking (Harbors Division) financial report presents the reader with an introduction and overview of the Harbors Division's financial performance for the fiscal year ended June 30, 2004. This discussion has been prepared by management and should be read in conjunction with the financial statements, and the notes thereto, which follow this section.

The statewide system of commercial harbors consists of ten harbors on six islands. The system plays a vital role in Hawaii's economy as the ports serve as the primary means for goods to enter and exit the state. Hawaii imports approximately 80% of what it consumes, the majority of which enters the state through the commercial harbors system.

The Harbors Division generated steady revenues reflecting in part the State's improving economic performance in 2004 due to the strong housing market, robust construction activity and the resurgence of tourism.

FINANCIAL HIGHLIGHTS

- The Harbors Division's net assets increased by $25 million or five percent.
- Operating revenues increased by $1.2 million or two percent over the prior fiscal year.
- Total expenses for the fiscal year decreased by approximately $7.7 million or twelve percent over the prior fiscal year.

The majority of operating revenues are directly related to cargo and ship operations. Operating revenues, increased by 2% from $73.6 million in fiscal year 2003 to $74.8 million in fiscal year 2004.

Service revenues including wharfage, dockage and passenger fees generated $48.7 million in fiscal year 2004, an increase of $1.1 million or 2% over fiscal year 2003. The increase in revenue was primarily due to a $1.4 million increase in wharfage revenue. Matson Navigation, our largest customer, expanded its auto service and added, a roll-on/roll-off vessel enhancing its auto-carrying capability. Approximately 1.3 million passengers (inbound and outbound) passed through these harbors in fiscal year 2004, a decrease of 20% over fiscal year 2003's 1.6 million passengers. Passenger fee revenue for fiscal year 2004 and 2003 was $3.3 million and $4.2 million respectively. The drop in passengers and revenues are primarily the result of Norwegian Cruise Line's (NCL) reduction from two to one ship in 2004. NCL plans to bring additional vessels into service in 2005 and 2006.

Gross rental revenues in fiscal year 2004 and 2003, was $27.4 million and $25.4 million respectively, an increase of $2.0 million or 8%. The increase in rental revenue was primarily due to Matson Terminal Inc.'s rental of exclusive use of space to support their roll-on/roll-off operations. Net rental revenues after deducting the provision for doubtful accounts were $25.1 million for both 2004 and 2003.

Operating expenses excluding depreciation decreased by 20% from $37.1 million in fiscal year 2003 to $29.6 million in fiscal year 2004. This decrease of $7.54 million is primarily due to the reduction in ceded land assessments of $11.7 million (which included fiscal year 2003 and 2002 assessments) paid by the Harbors Division in fiscal year 2003 compared to $6.5 million paid in fiscal year 2004, a decrease of $5.2 million. The remaining $2.3 million decrease in operating expenses were primarily due to delays in completing special maintenance projects. These delays were due to problems encountered in obtaining permits and the long construction cycle to complete major projects.

The department issued $52,030,000 Harbor System Revenue Bonds, Series A and B, 2004, in June 2004 to refund bonds issued in 1993 and 1994 at higher interest rates. The refunding will realize cash flow savings of approximately $7.6 million over the next twenty years.

On September 18, 2003, outstanding $16,500,000 Special Facility Revenue Bonds, Matson Terminals, Inc., Refunding Series 1993 were redeemed in full at a price of 102% of the principal together with interest accrued to the redemption date. The remaining net investment in direct lease financing on the date of redemption was reclassified to buildings.

A summary of operations and changes in net assets for the fiscal years ended June 30, 2004 and 2003 follows:

Table 1
Condensed Statements of Revenues,
Expenses and Changes in Net Assets
(in thousands of dollars)

	2004	Restated 2003	Dollar change	Percent change
Operating revenues	$74,768	$73,605	$ 1,163	2%
Non-operating revenues	3,900	5,043	(1,143)	(23%)
Total revenues	78,668	78,648	20	0%
Depreciation	13,766	13,367	399	3%
Other operating expenses	29,575	37,119	(7,544)	(20%)
Non-operating expenses	11,102	11,698	(596)	(5%)
Total expenses	54,443	62,184	(7,741)	(12%)
Income before capital contributions	24,225	16,464	7,761	47%
Capital contributions	737	2,542	(1,805)	(71%)
INCREASE IN NET ASSETS	$24,962	$19,006	$ 5,956	31%

A condensed summary of the Harbors Division's net assets at June 30, 2004 and 2003 are shown below.

Table 2
Condensed Statements of Net Assets
(in thousands of dollars)

	2004	Restated 2003	Dollar change	Percent change
Current and other assets	$178,332	$184,524	$ (6,192)	(3%)
Capital assets	587,445	584,206	3,239	1%
Total assets	765,777	768,730	(2,953)	–
Long-term debt outstanding	192,509	219,406	(26,897)	(13%)
Other liabilities	14,146	15,164	(1,018)	(7%)
Total liabilities	206,655	234,570	(27,915)	(12%)
Net assets				
Invested in capital assets, net of related debt	397,549	367,169	30,380	8%
Restricted	10,898	10,898	–	–
Unrestricted	150,675	156,093	(5,418)	(3%)
Total net assets	$559,122	$534,160	$ 24,962	5%

The largest portion of the Harbors Division's net assets (71% at June 30, 2004) represents its investment in capital assets (e.g., land, wharves, buildings, improvements, and equipment), less related indebtedness outstanding to acquire those capital assets. The Harbors Division uses these capital assets to provide services to its users of the harbors system; consequently, these assets are not available for future spending. Although the Harbors Division's investment in its capital assets is reported net of related debt, the resources required to repay this debt must be provided annually from operations, since it is unlikely the capital assets themselves will be liquidated to pay such liabilities.

The change in net assets is an indicator of whether the overall fiscal condition of the Harbors Division improved or worsened during the fiscal year. The change in net assets may serve over time as a useful indicator of the Harbor Division's financial position. The total assets exceeded liabilities by approximately $559 million at June 30, 2004, and net assets increased by approximately $25 million from June 30, 2003.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

As of June 30, 2004, the Harbors Division had $587 million invested in capital assets as shown in Table 3. There was a net increase (additions, deductions and depreciation) of $3.2 million from the end of the prior fiscal year.

Table 3
Capital Assets
(in thousands of dollars)

	2004	Restated 2003	Dollar change	Percent change
Land and land improvements	$360,237	$347,038	$ 13,199	4%
Wharves	221,285	190,499	30,786	16%
Other improvements	74,908	74,636	272	0%
Buildings and improvements	51,077	48,425	2,652	5%
Equipment	10,769	10,876	(107)	(1%)
Subtotal	718,276	671,474	46,802	7%
Less accumulated depreciation	(157,697)	(144,101)	(13,596)	9%
Subtotal	560,579	527,373	33,206	6%
Construction in progress	26,866	56,833	(29,967)	(53%)
Total	$ 587,445	$ 584,206	$ 3,239	1%

Major capital asset additions to the statewide harbors system for the fiscal year ended June 30, 2004, included the following:

- $3.2 million reconstruction of Pier 3 Container Yard, Kahului Harbor, Maui.
- $19.9 million Pier P-7and Storage Yard S-6 Kalaeloa, Barbers Point Harbor.
- $8.7 million Commercial Fishing Village, Multi-user Building, Pier 36, Honolulu Harbor.
- $10.7 million Pier 1-C Extension, Kahului Harbor, Maui

In addition to these capital asset additions, the Harbors Division is currently constructing the following projects statewide:

- $4.3 million Ferry Terminal at Pier 19, Honolulu Harbor, Oahu.
- $799,000 methane mitigation, Piers 36-38, Honolulu Harbor, Oahu.
- $600,000 methane mitigation, Parcel 2 and 38, Honolulu Harbor, Oahu.

Finally, the Harbors Division is currently designing improvements, some of which include the following projects statewide:

- $21 million construction Pier 2 Cruise Terminal, Honolulu Harbor, Oahu.
- $20 million reconstruction of Pier 51B Container Yard, Honolulu Harbor, Oahu.
- $2.3 million Pier 1 Comfort Station, waterline and sewer line improvements, Kahului Harbor, Maui.
- $3 million reconstruction of Puunene Container Yard, Kahului Harbor, Maui.
- $3 million Pier 3 breasting dolphins and catwalks, Hilo Harbor, Hawaii.
- $6.2 million segmented Pier 3 improvements, Nawiliwili Harbor, Kauai.
- $2.5 million replacement of Pier 3 fendering system, Nawiliwili Harbor, Kauai.

The Harbors Division is committed under contracts awarded for construction totaling approximately $17.8 million.

Additional information regarding the Harbors Division's capital assets can be found in note E.

Indebtedness

Harbors System Revenue Bonds and Reimbursable General Obligation Bonds

As of June 30, 2004, $198,440,000 of harbors system revenue bonds was outstanding compared to $209,185,000 as of June 30, 2003. The last series of "new money" bonds to fund capital improvement projects, was issued in April 2000. The Harbors Division has managed its debt levels by issuing refunding bonds and defeasing bonds with unencumbered cash from the Harbors Revenue Fund. On June 10, 2004, Harbors issued Harbor System Revenue Bond Series 2004 A and B, in the amount of $52,030,000, for the purpose of refunding outstanding Harbor Revenue Bond Series 1994 and Refunding Series 1993.

As of June 30, 2004, $130,743 of reimbursable general obligation bonds issued for the harbors system was outstanding, compared to $149,772 as of June 30, 2003. These bonds are general obligations of the State. Since the proceeds were used to finance improvements to the harbors system, Harbors Division is required to reimburse the State General Fund for the payment of the principal and interest on such bonds. The State does not presently intend to issue additional reimbursable general obligation bonds for the harbors system.

Special Facility Lease and Revenue Bonds

As of June 30, 2004, there were no outstanding bond obligations compared to the June 30, 2003 outstanding balance of $16,500,000. On September 18, 2003, outstanding $16,500,000 Special Facility Revenue Bonds, Matson Terminals, Inc. (MTI), Refunding Series 1993 were redeemed in full by MTI at a price of 102% of the principal with interest accrued to the redemption date.

Additional information regarding the Harbors Division's indebtedness can be found in notes F, G, H, I, and J.

Credit Rating and Bond Insurance

All harbor system revenue bonds issued since 1997 have been issued with bond insurance. As of June 30, 2004, the underlying ratings for harbor system revenue bonds were as follows:

- Standard and Poor's A+
- Moody's Investors Service A1
- Fitch IBCA, Inc. A+

Ratings made by Standard and Poor's, Moody's Investors Service, and Fitch IBCA, Inc. may be changed, suspended or withdrawn as a result of changes in, or unavailability of, information. Ratings provided by these rating companies are not "market ratings," as the ratings are not a recommendation to buy, hold, or sell any security.

Bond Covenants

Bond covenants allow the issuance of additional debt, on parity, as to a lien on the net revenues of the Harbors Division provided certain net revenue ratios are met. Net revenues of the Harbors Division must be at least 1.35 or 1.25 times the debt service requirements under the 1990 and 1997 Harbor Revenue Bond Certificates, respectively. As a result of the issuance of Harbor System Revenue Bonds, Series A and B, 2004, none of the 1990 Certificate Harbors Revenue Bonds remained outstanding upon the issuance of the Series 2004 Bonds. No further bonds will be issued under the 1990 Certificate.

The Harbors Division currently enjoys a coverage ratio of 2.42 under the 1997 Harbor Revenue Bond Certificate as compared to the prior fiscal year's ratio of 1.98.

Prior-Period Adjustment

The statement of net assets for the fiscal year ended June 30, 2003 and the statements of revenues, expenses and changes in net assets of the public undertaking for the fiscal year ended June 30, 2003 have been restated to reflect the correction of certain assets, liabilities, revenues and expenses. Please refer to Note C of the financial statements for more details.

REQUEST FOR INFORMATION

The financial report is designed to provide a general overview of the Harbors Division's finances for all interested parties. Questions concerning any of the information provided in this report or requests for additional information should be addressed in writing to the Harbors Administrator, State of Hawaii, Department of Transportation, Harbors Division, 79 S. Nimitz Highway, Honolulu, Hawaii 96813, or by e-mail to *glenn.okimoto@hawaii.gov*.

State of Hawaii
Department of Transportation
Harbors Division

STATEMENT OF NET ASSETS OF THE PUBLIC UNDERTAKING

June 30,

ASSETS	2004	2003 As restated (note C)
CURRENT ASSETS		
Cash and cash equivalents (note B and D)	$ 76,192,844	$ 90,755,500
Receivables		
Accounts receivable, less allowance for doubtful accounts of $9,896,000 in 2004 and $7,912,000 in 2003	10,757,205	10,062,209
Interest	802,679	797,675
Grant	1,040,168	1,744,878
Other	299,631	309,234
Materials and supplies, at cost	45,495	37,596
Prepaid insurance and others	23,800	23,800
Total current assets	89,161,822	103,730,892
RESTRICTED ASSETS		
Current		
Cash and cash equivalents (notes B and D)	86,556,797	59,656,681
Total current restricted assets	86,556,797	59,656,681
Net investment in direct financing lease (note I)	-	18,768,174
Total restricted assets	86,556,797	78,424,855
HARBOR FACILITIES (notes B and E)		
Non-depreciable facilities		
Land	164,404,485	164,404,485
Land improvements	74,223,157	74,223,157
Other improvements	66,908	66,908
	238,694,550	238,694,550
Depreciable facilities		
Land improvements	121,542,847	108,342,951
Wharves	221,284,577	190,499,253
Other improvements	74,907,783	74,636,071
Buildings	51,077,048	48,425,083
Equipment	10,769,362	10,875,730
	479,581,617	432,779,088
Less accumulated depreciation	157,697,125	144,100,884
	321,884,492	288,678,204
Construction in progress	26,866,167	56,833,027
	587,445,209	584,205,781
OTHER ASSET		
Unamortized bond issue costs	2,613,075	2,369,292
	$765,776,903	$768,730,820

LIABILITIES AND NET ASSETS	2004	2003 As restated (note C)
CURRENT LIABILITIES (payable from current assets)		
Accounts payable	$ 2,112,272	$ 1,130,634
Contracts payable, including retainages	332,552	447,902
Accrued vacation (notes B and F)	525,105	500,610
Due to Department of Budget and Finance	1,261,993	1,261,993
Total current liabilities (payable from current assets)	4,231,922	3,341,139
CURRENT LIABILITIES (payable from restricted assets)		
Contracts payable, including retainages	1,759,953	1,560,477
Matured revenue bonds and interest payable	10,200	311,100
Revenue bonds payable, current maturities (note G)	14,859,313	15,471,776
General obligation bonds payable, current maturities (note J)	19,462	19,029
Accrued interest payable	4,191,580	5,944,492
Security deposits	2,606,788	2,500,658
Total current liabilities (payable from restricted assets)	23,447,296	25,807,532
LONG-TERM LIABILITIES		
Long-term debt, less current maturities		
Revenue bonds payable, net (note G)	177,518,867	187,284,351
Special facility revenue bonds payable (note I)	-	16,500,000
General obligation bonds payable (note J)	111,281	130,743
Accrued vacation (notes B and F)	1,345,363	1,506,582
Total non-current liabilities	178,975,511	205,421,676
Total liabilities	206,654,729	234,570,347
NET ASSETS		
Invested in capital assets, net of related debt	397,549,361	367,169,174
Restricted - reserved for revenue bond requirements	10,897,658	10,897,658
Unrestricted net assets	150,675,155	156,093,641
Total net assets	559,122,174	534,160,473
	$765,776,903	$768,730,820

The accompanying notes are an integral part of these statements.

State of Hawaii
Department of Transportation
Harbors Division

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
OF THE PUBLIC UNDERTAKING

Fiscal year ended June 30,

	2004	2003 As restated (note C)
Operating revenues, net		
Services	$ 48,657,768	$ 47,576,352
Rentals	25,125,270	25,123,372
Others	985,135	905,444
	74,768,173	73,605,168
Operating expenses before depreciation		
Personal services	10,756,552	10,630,145
Harbor operations	9,277,336	14,084,110
Maintenance	2,915,374	6,350,229
State of Hawaii, surcharge for central service expenses (note Q)	2,766,405	1,905,797
Fireboat operations (note Q)	1,704,790	1,308,058
General administration	1,420,991	1,878,278
Department of Transportation, general administration expenses (note Q)	733,531	962,692
	29,574,979	37,119,309
Income from operations before depreciation	45,193,194	36,485,859
Depreciation	13,766,433	13,366,629
Income from operations	31,426,761	23,119,230
Nonoperating income (expense)		
Interest income		
Deposits in investment pool	3,664,514	3,965,819
Investment in direct financing lease	236,050	1,076,979
Interest expense (note K)		
Revenue bonds	(10,246,336)	(9,391,992)
Special facility revenue bonds	(207,945)	(948,750)
General obligation bonds	(5,647)	(8,059)
Amortization of bond discount, issue costs and loss on refunding	(630,998)	(642,035)
Loss on disposal of harbor facilities	(12,064)	(707,439)
	(7,202,426)	(6,655,477)
Income before contributions	24,224,335	16,463,753
Capital contributions	737,366	2,542,449
INCREASE IN NET ASSETS	24,961,701	19,006,202
Net assets at beginning of year, as previously reported	-	505,154,378
Adjustment to amounts due to Department of Budget and Finance	-	9,999,893
Net assets at beginning of year	534,160,473	515,154,271
Net assets at end of fiscal year	$559,122,174	$534,160,473

The accompanying notes are an integral part of these statements.

State of Hawaii
Department of Transportation
Harbors Division

STATEMENTS OF CASH FLOWS OF THE PUBLIC UNDERTAKING

Fiscal year ended June 30,

	2004	2003 As restated (note C)
Cash flows from operating activities:		
Cash received from customers	$ 74,188,910	$ 69,578,388
Cash paid to suppliers	(17,760,562)	(26,703,630)
Cash paid to employees	(10,893,276)	(10,334,576)
Net cash provided by operating activities	45,535,072	32,540,182
Cash flows from capital and related financing activities:		
Government grants received in aid of construction	1,442,076	2,920,914
Acquisition and construction of capital assets	(14,721,646)	(15,894,044)
Proceeds from sale of revenue bonds	53,315,009	-
Principal paid on bonds	(63,094,929)	(7,906,949)
Premium paid on bond refunding	(949,330)	-
Interest paid on bonds	(12,004,895)	(10,232,197)
Bond issuance costs paid	(843,407)	-
Net cash used in capital and related financing activities	(36,857,122)	(31,112,276)
Cash flows from investing activities		
Interest received on investments	3,659,510	5,861,999
Net cash provided by investing activities	3,659,510	5,861,999
NET INCREASE IN CASH AND CASH EQUIVALENTS	12,337,460	7,289,905
Cash and cash equivalents at beginning of fiscal year	150,412,181	143,122,276
Cash and cash equivalents at end of fiscal year	$ 162,749,641	$ 150,412,181
Reconciliation of operating income to net cash provided by operating activities:		
Income from operations	$ 31,426,761	23,119,230
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation	13,766,433	13,366,629
Provision for doubtful accounts	2,253,832	277,000
Changes in assets and liabilities:		
(Increase) decrease in:		
Receivables, net	(2,939,225)	(4,202,548)
Materials and supplies	(7,899)	4,151
Increase (decrease) in:		
Payables	1,065,764	133,154
Accrued vacation	(136,724)	295,569
Due to Department of Budget and Finance	-	(480,000)
Security deposits	106,130	26,997
Net cash provided by operating activities	$ 45,535,072	$ 32,540,182
Supplemental disclosure of noncash capital and related financing activities:		
Principal payments relating to special facility bonds	$ 16,500,000	$ -
Interest payments related to special facility revenue bonds	207,945	948,750
Amortization of bond discount, issue costs and loss on refunding	630,998	642,035
Transfer of net investment in lease financing to harbor facilities	2,296,279	-

The accompanying notes are an integral part of these statements.

State of Hawaii
Department of Transportation
Harbors Division

NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING

June 30, 2004 and 2003

NOTE A – FINANCIAL REPORTING ENTITY

In 1959, the Harbors Division was established within the Department of Transportation of the State of Hawaii (DOT) effective July 1, 1961. All functions and powers to administer, control and supervise all State of Hawaii (State) harbors and water navigational facilities were assigned to the Director of DOT on that date.

The Harbors Division is part of DOT which is part of the executive branch of the State. The Harbors Division's financial statements reflect only its portion of the proprietary fund type. The State Comptroller maintains the central accounts for all state funds and publishes financial statements for the State annually, which include the Harbors Division's financial activities.

The "Certificate of the Director of Transportation Providing for the Issuance of 1997 State of Hawaii Harbor Revenue Bonds," dated March 1, 1997 (1997 Certificate), define the "Undertaking" as all of the harbor and waterfront improvements and other properties under the jurisdiction, control and management of the Harbors Division, except those principally used for recreation and the landing of fish.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Measurement Focus and Basis of Accounting

The accounting policies of the Harbors Division conform to accounting principles generally accepted in the United States of America as applicable to enterprise activities of governmental units as promulgated by the Governmental Accounting Standards Board (GASB). In accordance with GASB standards, the Harbors Division has elected not to apply the Financial Accounting Standards Board pronouncements on accounting and financial reporting that were issued after November 30, 1989.

An enterprise fund is used to account for the acquisition, operation and maintenance of government facilities and services that are entirely or predominantly supported by user charges. The Harbors Division's operations are accounted for on the flow of economic resources measurement focus and the accrual basis of accounting is utilized. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

2. Use of Estimates

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

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3. Cash and Cash Equivalents

Cash and cash equivalents, for the purpose of the statements of cash flows, include all cash and investments with original maturities of three months or less. Cash and cash equivalents also include investments of pooled cash balances. The Director of Finance invests state treasury cash surpluses where funds can be disbursed at any time without prior notice or penalty. As a result, the cash balances are not reduced for these investments.

4. Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are reported at their gross value when earned, reduced by an allowance for doubtful accounts.

Accounts are written-off upon the approval of the Department of the Attorney General, when it believes, after considering economic conditions, business conditions, and collection efforts, that the accounts are uncollectible.

The allowance for doubtful accounts is increased by charges to operating income and decreased by charge-offs (net of recoveries). Management's periodic evaluation of the adequacy of the allowance is based on the adverse situations that may affect the harbor user's ability to repay and current economic conditions. Past due status is determined based on contractual terms.

5. Risk Management

The Harbors Division is exposed to various risks for losses related to torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and injuries to employees. A liability for a claim for a risk of loss is established if information indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss is reasonably estimable.

6. Harbor Facilities and Depreciation

Harbor facilities are stated at cost. Depreciation of harbor facilities is computed using the composite straight-line method over the estimated useful lives of the assets. Depreciation is not provided for in the year of acquisition, but is provided for the entire year in the year of disposal. Disposals of assets are recorded by removing the cost and related accumulated depreciation from the accounts with the resulting gain or loss reflected in operations.

Harbor facilities and their related composite straight-line rates used to compute depreciation are as follows:

	Rates
Land improvements	1.0% – 4.0%
Wharves	1.0% – 10.0%
Buildings	1.5% – 20.0%
Other improvements	2.0% – 20.0%
Equipment	8.0%

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

6. Harbor Facilities and Depreciation (continued)

Maintenance and repairs, as well as minor replacements, renewals and betterments, are charged to operations; major renewals, replacements and betterments are capitalized. Interest cost is capitalized during the period of construction for all capital improvement projects except those projects funded by grants from the State or the federal government.

7. Bond Issue Costs

Costs relating to the issuance of bonds are recognized using the interest method over the term of the obligations.

8. Unamortized Debt Premium (Discount)

Debt premium (discount) is amortized ratably over the term of the related debt, and the unamortized balance is reflected as an offset against the related long-term liabilities in the statements of net assets.

9. Refunding of Debt

The difference between the reacquisition price and the net carrying amount of the old debt is deferred and amortized as a component of interest expense in a systematic and rational manner over the remaining life of the old debt or the life of the new debt, whichever is shorter. The deferred amount is reported as a deduction from or an addition to the new debt liability.

10. Accrued Vacation

The Harbors Division accrues all vacation and compensatory pay at current salary rates, including additional amounts for certain salary-related expenses associated with the payment of compensated absences (such as employer payroll taxes and fringe benefits), in accordance with GASB Statement No. 16, *Accounting for Compensated Absences*. Vacation is earned at the rate of 96 to 168 hours per calendar year, depending on employee's date of hire and years of service. Accumulation of such vacation credits is limited to 720 or 1,056 hours at calendar year end and is convertible to pay upon termination of employment.

11. Operating Revenues

Operating revenues are those that result from providing goods and services. It excludes revenues related to capital and related financing activities, noncapital financing activities, or investing activities. Operating revenues are reported net of the provision for doubtful accounts which were $2,253,832 and $277,000 for the years ended June 30, 2004 and 2003, respectively.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

12. Capital Contributions

The Harbors Division receives federal grants for capital asset acquisition and facility development, which are reported in the statement of revenues, expenses and changes in net assets, after non-operating revenues and expenses as capital contributions.

13. Reclassifications

Reclassifications have been made to the 2003 financial statements to conform to the classifications used in 2004.

NOTE C – PRIOR-PERIOD ADJUSTMENT

The statement of net assets of the public undertaking at June 30, 2003 has been restated to reflect the correction of an overstatement of cash of $122,697, an understatement of receivables of $3,624,647, an understatement of accrued interest expense of $29,599 and an overstatement of the due to Budget and Finance liability of $9,999,893. Net assets at July 1, 2002 increased by $9,999,893 as a result of the overstatement of the due to Budget and Finance liability of $9,999,893. Net assets at June 30, 2003 increased by $13,472,244 as a result of an increase in revenues of $3,501,950, an increase in interest expense of $29,599 and an increase due to an overstatement of the due to Budget and Finance liability of $9,999,893. The effects of the restatement were as follows:

	2003	
	As previously reported	As restated
Current assets		
Cash and cash equivalents	$ 90,878,197	$ 90,755,500
Receivables		
Accounts receivable	6,437,562	10,062,209
Total current assets	100,228,942	103,730,892
Total assets	765,228,870	768,730,820

NOTE C – PRIOR-PERIOD ADJUSTMENT (continued)

	2003	
	As previously reported	As restated
Current liabilities (payable from restricted assets)		
Accrued interest payable	$ 5,914,893	$ 5,944,492
Due to Department of Budget and Finance	9,999,893	–
Total current liabilities from restricted assets	35,777,826	25,807,532
Total liabilities	244,540,641	234,570,347
Total net assets	520,688,229	534,160,473
Total liabilities and net assets	765,228,870	768,730,820
Operating revenues		
Service	45,297,596	47,576,352
Rentals	24,195,148	25,123,372
Others	610,474	905,444
Income from operations before depreciation	32,983,909	36,485,859
Income from operations	19,617,280	23,119,230
Nonoperating expense		
Interest expense – revenue bonds	$ 9,362,393	$ 9,391,992
Net income before contributions	12,991,402	16,463,753
Increase in net assets	15,533,851	19,006,202

NOTE D – CASH AND INVESTMENTS

At June 30, 2004 and 2003, information relating to the insurance and collateral of cash deposits is not available since such information is determined on a statewide basis and not for individual departments or divisions. Cash deposits of the State are either federally insured or collateralized with obligations of the State or the United States. 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.

Statutes authorize the Harbors Division to invest, with certain restrictions, in obligations of the State or the United States, in federally insured savings accounts, time certificates of deposit and repurchase agreements with federally insured banks and savings and loan associations authorized to do business in the State. Money held as reserves may be invested in obligations of the United States, the State or any subdivision of the State. Investments are insured or collateralized with securities held by the State or by its agent in the State's name.

State of Hawaii
Department of Transportation
Harbors Division

NOTES TO FINANCIAL STATEMENTS OF THE PUBLIC UNDERTAKING (continued)

June 30, 2004 and 2003

NOTE E – CAPITAL ASSETS

The changes in capital assets were as follows:

	Balance July 1, 2003	Additions	Deductions	Balance June 30, 2004
Nondepreciable assets				
Land and improvements	$238,694,550	$ –	$ –	$238,694,550
Depreciable assets				
Land improvements	108,342,951	13,199,896	–	121,542,847
Wharves	190,499,253	30,785,324	–	221,284,577
Other improvements	74,636,071	271,712	–	74,907,783
Buildings	48,425,083	2,651,965	–	51,077,048
Equipment	10,875,730	75,888	182,256	10,769,362
Total at historical cost	671,473,638	46,984,785	182,256	718,276,167
Less accumulated depreciation for:				
Land improvements	23,803,713	4,130,575	–	27,934,288
Wharves	68,743,714	5,062,272	–	73,805,986
Other improvements	23,139,295	2,276,175	–	25,415,470
Buildings	20,229,924	1,542,358	–	21,772,282
Equipment	8,184,238	755,053	170,192	8,769,099
Total accumulated depreciation	144,100,884	13,766,433	170,192	157,697,125
Construction in progress	56,833,027	14,705,389	44,672,249	26,866,167
	$584,205,781	$47,923,741	$44,684,313	$587,445,209

	Balance July 1, 2002	Additions	Deductions	Balance June 30, 2003
Nondepreciable assets				
Land and improvements	$238,509,867	$ 184,683	$ –	$238,694,550
Depreciable assets				
Land improvements	107,381,230	1,625,613	663,892	108,342,951
Wharves	189,532,262	966,991	–	190,499,253
Other improvements	74,152,446	483,625	–	74,636,071
Buildings	42,347,414	6,077,669	–	48,425,083
Equipment	11,036,479	62,753	223,502	10,875,730
Total at historical cost carried forward	$662,959,698	$9,401,334	$ 887,394	$671,473,638

NOTE E – CAPITAL ASSETS (continued)

	Balance July 1, 2002	Additions	Deductions	Balance June 30, 2003
Total at historical cost brought forward	$662,959,698	$9,401,334	$ 887,394	$671,473,638
Less accumulated depreciation for:				
Land improvements	20,016,169	3,787,544	–	23,803,713
Wharves	63,547,342	5,196,372	–	68,743,714
Other improvements	20,837,658	2,301,637	–	23,139,295
Buildings	18,916,761	1,313,163	–	20,229,924
Equipment	7,596,281	767,913	179,956	8,184,238
Total accumulated depreciation	130,914,211	13,366,629	179,956	144,100,884
Construction in progress	50,971,396	16,409,702	10,548,071	56,833,027
	$583,016,883	$12,444,407	$11,255,509	$584,205,781

Depreciation expense was $13,766,433 and $13,366,629 for the fiscal years ended June 30, 2004 and 2003, respectively.

NOTE F – LONG-TERM LIABILITIES

The changes in long-term liabilities were as follows:

	Balance July 1, 2003	Additions	Deductions	Balance June 30, 2004	Current	Noncurrent
Accrued vacation	$ 2,007,192	$ 697,732	$ 834,456	$ 1,870,468	$ 525,105	$ 1,345,363
Revenue bonds	209,185,000	52,030,000	62,775,000	198,440,000	15,380,000	183,060,000
Special facility revenue bonds	16,500,000	–	16,500,000	–	–	–
General obligation bonds	149,772	–	19,029	130,743	19,462	111,281
	227,841,964	52,727,732	80,128,485	200,441,211	15,924,567	184,516,644
Less						
Unamortized discount	(2,854,894)	–	(800,494)	(2,054,400)	(142,940)	(1,911,460)
Unamortized premium	111,849	1,285,009	12,258	1,384,600	189,102	1,195,498
Unamortized deferred loss on refunding	(3,685,828)	(2,184,199)	(478,007)	(5,392,020)	(566,849)	(4,825,171)
	$221,413,091	$51,828,542	$78,862,242	$194,379,391	$15,403,880	$178,975,511

NOTE F – LONG-TERM LIABILITIES (continued)

	Balance July 1, 2002	Additions	Deductions	Balance June 30, 2003	Current	Noncurrent
Accrued vacation	$ 1,711,623	$ 717,808	$ 422,239	$ 2,007,192	$ 500,610	$ 1,506,582
Revenue bonds	216,600,000	–	7,415,000	209,185,000	15,675,000	193,510,000
Special facility revenue bonds	16,500,000	–	–	16,500,000	–	16,500,000
General obligation bonds	606,019	–	456,247	149,772	19,029	130,743
	235,417,642	717,808	8,293,486	227,841,964	16,194,639	211,647,325
Less						
Unamortized discount	(3,076,460)	–	(221,566)	(2,854,894)	(215,482)	(2,639,412)
Unamortized premium	125,133	–	13,284	111,849	12,258	99,591
Unamortized deferred loss on refunding	(3,999,430)	–	(313,602)	(3,685,828)	–	(3,685,828)
	$228,466,885	$ 717,808	$ 7,771,602	$221,413,091	$15,991,415	$205,421,676

NOTE G – REVENUE BONDS PAYABLE

Pursuant to authorization from the State Legislature, the Director of DOT issued the 1997 Certificate, which provide for the issuance of bonds at any time and from time-to-time upon compliance with certain conditions of the respective Certificate.

The harbor revenue bonds (Bonds) are collateralized by a charge and lien on the revenues of the Public Undertaking as defined in the 1997 Certificate.

The Bonds are subject to redemption at the option of the Director of DOT and the State during specific years at prices ranging from 102-1/2% to 100% of face value.

NOTE G – REVENUE BONDS PAYABLE (continued)

The following is a summary of the Bonds as of June 30, 2004:

				Current				
Year of issue	Final redemption date	Interest rates	Original amount of issue	Principal due July 1, 2004	Principal due January 1, 2005	Installment payments due in anticipation of principal Payments on July 1, 2005	Total current	Noncurrent
1997	July 1, 2027	3.95 – 5.75%	$ 56,290,000	$ 470,000	$ –	$ 485,000	$ 955,000	$ 52,915,000
2000	July 1, 2029	4.50 – 6.00%	79,405,000	2,035,000	–	2,140,000	4,175,000	66,145,000
2002	July 1, 2019	3.00 – 5.50%	24,420,000	1,920,000	–	2,010,000	3,930,000	18,290,000
2004	January 1, 2024	2.50 – 6.00%	52,030,000	–	4,125,000	2,195,000	6,320,000	45,710,000
			$212,145,000	$4,425,000	$4,125,000	$6,830,000	15,380,000	183,060,000
Less:								
Unamortized discount							(142,940)	(1,911,460)
Unamortized premium							189,102	1,195,498
Unamortized deferred loss on refunding							(566,849)	(4,825,171)
							$14,859,313	$177,518,867

The following is a summary of the Bonds as of June 30, 2003:

				Current			
Year of issue	Final redemption date	Interest rates	Original amount of issue	Principal due July 1, 2003	Installment Payments due in Anticipation of principal payments on July 1, 2004	Total current	Noncurrent
1993	July 1, 2008	4.50 – 6.40%	$ 16,525,000	$1,190,000	$1,260,000	$ 2,450,000	$ 5,760,000
1994	July 1, 2024	5.50 – 6.25%	54,010,000	2,215,000	2,345,000	4,560,000	45,765,000
1997	July 1, 2027	3.95 – 5.75%	56,290,000	445,000	470,000	915,000	53,400,000
2000	July 1, 2029	4.50 – 6.00%	79,405,000	1,935,000	2,035,000	3,970,000	68,285,000
2002	July 1, 2019	3.00 – 5.50%	24,420,000	1,860,000	1,920,000	3,780,000	20,300,000
			$230,650,000	$7,645,000	$8,030,000	15,675,000	193,510,000
Less:							
Unamortized discount						(215,482)	(2,639,412)
Unamortized premium						12,258	99,591
Unamortized deferred loss on refunding						–	(3,685,828)
						$15,471,776	$187,284,351

NOTE G – REVENUE BONDS PAYABLE (continued)

Debt service requirements to maturity for the Bonds are as follows:

Fiscal year ending June 30,	Principal	Interest	Total
2005	$ 15,380,000	$ 10,361,613	$ 25,741,613
2006	9,344,994	9,879,013	19,224,007
2007	9,802,510	9,462,459	19,264,969
2008	9,499,994	8,981,646	18,481,640
2009	7,992,502	8,522,734	16,515,236
2010 – 2014	42,417,498	36,171,469	78,588,967
2015 – 2019	44,237,502	24,358,251	68,595,753
2020 – 2024	41,855,000	11,361,153	53,216,153
2025 – 2029	17,910,000	2,480,288	20,390,288
	$198,440,000	$121,578,626	$320,018,626

On June 10, 2004, the Harbors Division issued $5,730,000 in Bonds, Series A of 2004, and $46,300,000 in Bonds, Series B of 2004. Series A of 2004 Bonds will mature through the year 2008 at an average interest rate of 4.20%, and Series B of 2004 Bonds will mature through the year 2024 at an average interest rate of 5.12%. The 2004 Series, totaling $52,030,000 were issued at an average interest rate of 4.98% to refund $5,760,000 of Bonds, 1993 Series (average interest rate of 6.09%) and $45,765,000 of Bonds, 1994 Series (average interest rate of 6.20%). Total net proceeds of $52,474,330 (including a premium of $1,285,009 and after payment of $840,679 in underwriting fees, insurance, and other issuance costs), along with an additional $5,323,718 from the debt service reserve account, was deposited into an irrevocable trust with an escrow agent to provide for the redemption of the refunded portion of the Bonds, 1993 Series and 1994 Series, on July 1, 2004.

Although the refunding resulted in the recognition of a deferred loss of $2,184,199, the Harbors Division in effect reduced its aggregate debt service payments by approximately $7,573,128 over the next 20 years and obtained an economic gain (difference between present values of the old and new debt service payments) of approximately $4,129,526.

NOTE H – HARBOR REVENUE BOND REQUIREMENTS

1. 1997 Certificate

a. Minimum Net Revenue Requirement

Pursuant to Section 6.03 of the 1997 Certificate, the Harbors Division covenants and agrees that so long as any of the Bonds remain outstanding, it will enforce and collect fees, rates, rents and charges for the

NOTE H – HARBOR REVENUE BOND REQUIREMENTS (continued)

1. 1997 Certificate (continued)

a. Minimum Net Revenue Requirement (continued)

Public Undertaking that will yield net revenue, as defined by the 1997 Certificate, for the immediately ensuing 12 months, in an amount at least sufficient to:

(1) The amount computed in accordance with Section 6.03 of the 1997 Certificate:

(a) Together with funds legally available therefore including any amounts on deposit in the harbor reserve and contingency account; an aggregate sum equal to at least 1.25 times the total amount of: (i) the interest payments for such 12 months on all the Bonds outstanding under the 1997 Certificate, (ii) the principal amount of the Bonds maturing by their terms during such 12 months and (iii) the minimum sinking fund payments for all Bonds required to be made during such 12 months; and

(b) Without consideration of other funds, shall be at least equal to 1.00 times the bond service for such 12 months.

The harbor revenue bond debt service requirements, including minimum sinking fund payments during the current fiscal year, computed in accordance with Section 6.03 of the 1997 Certificate totaled $21,316,613. Net revenues of the Public Undertaking amounted to $51,624,113 or 2.42 times the minimum net revenue requirement for the fiscal year ended June 30, 2004.

b. Harbor Special Fund

All revenues are deposited into this fund and applied in the order of priority set forth under the 1997 Certificate. Section 5.01 of the 1997 Certificate requires that the following accounts be established:

(1) Harbor Interest Account

Equal monthly installments sufficient to pay for the interest next becoming due on the Bonds are required to be paid into this account. This requirement was met as of June 30, 2004.

NOTE H – HARBOR REVENUE BOND REQUIREMENTS (continued)

1. 1997 Certificate (continued)

b. Harbor Special Fund (continued)

(2) Harbor Principal Account

Commencing with the first business day of each fiscal year, equal monthly payments are required to be made to this account sufficient to redeem the Bonds scheduled for redemption on the following July 1 and January 1. This requirement was met as of June 30, 2004.

(3) Harbor Debt Service Reserve Account

In order to provide a reserve for the payment of the principal and interest on the Bonds, the Harbors Division is required to deposit in the harbor revenue special fund an amount equal to the lesser of: (a) the average annual bond service on such series and (b) the amount permitted by the Internal Revenue Code of 1986 in order that the interest on such series is excluded from gross income for federal income tax purposes.

Furthermore, the Harbors Division is required to satisfy the reserve requirement of maximum aggregate bond service by no later than the first date on which a principal installment is payable (June 30, 2004).

In lieu of the credit of monies to the harbor debt service reserve account, the Harbors Division may cause to be so credited a surety bond or an insurance policy payable to the Harbors Division for the benefit of the holders of the Bonds of a series or a letter of credit in an amount equal to the difference between the reserve requirement and the amounts then on credit to the harbor debt service reserve account. In the event a surety bond, insurance policy, or letter of credit is secured to satisfy that portion of the reserve requirement allocable to a series of Bonds, so long as such surety bond, insurance policy, or letter of credit is in effect, the owners of such series of Bonds shall not be entitled to payment from or a lien on the funds on deposit in the harbor revenue special fund credited to the harbor debt service reserve account to satisfy that portion of the reserve requirement allocable to other series of Bonds, nor shall the owners of Bonds of such other series be entitled to any payment from such surety bond, insurance policy, or letter of credit. The surety bond, insurance policy, or letter of credit shall be payable (upon the giving of notice as required thereunder) on any date on which monies will be required to be applied from the harbor debt service reserve account to the payment of the principal or interest on any Bonds of such series and such withdrawals may not be made from amounts credited to the harbor debt service reserve account for such series of Bonds.

Prior to the use of a surety bond, insurance policy, or letter of credit pursuant to the provisions of this paragraph (other than any such use at the time of issuance of the 1997 Series bonds), DOT

NOTE H – HARBOR REVENUE BOND REQUIREMENTS (continued)

1. 1997 Certificate (continued)

b. Harbor Special Fund (continued)

(3) Harbor Debt Service Reserve Account (continued)

shall receive written confirmation from the rating agency that the rating on the Bonds outstanding as then in effect shall not be reduced as a result of such use. If a disbursement is made pursuant to a surety bond, an insurance policy, or a letter of credit provided pursuant to this paragraph, the Harbors Division shall be obligated either (a) to reinstate the maximum limits of such surety bond, insurance policy, or letter of credit or (b) to credit to the harbor debt service reserve account, funds in the amount of the disbursement made under such surety bond, insurance policy, or letter of credit, or a combination of such alternatives, as shall provide that the amount credited to the harbor debt service reserve account allocable to a series of Bonds equals that portion of the reserve requirement allocable to such series; provided, however, a failure to immediately restore such reserve requirement shall not constitute an event of default if the reserve requirement is restored within the time period permitted by Section 11.01(c) (90 days following the required notice). Notwithstanding the provisions of Section 11.01(c), the Harbors Division shall not permit any surety bond, insurance policy, or letter of credit which has been established in lieu of a deposit into the harbor revenue special fund for credit to the harbor debt service reserve account to terminate or expire prior to depositing to such fund for credit to such account the amount satisfied previously by the surety bond, insurance policy, or letter of credit.

(4) Harbor Reserve and Contingency Account

Monies on credit to the harbor reserve and contingency account may be used to make up any deficiency with respect to any series of Bonds in the harbor interest account, the harbor principal account and the harbor debt service reserve account. To the extent not used to make up any such deficiencies, monies on credit to the harbor reserve and contingency account may be used for any other purpose within the jurisdiction, powers, duties and functions of the Harbors Division.

NOTE I – SPECIAL FACILITY LEASE AND REVENUE BONDS

The State Legislature, in its 1980 session, authorized the issuance of special facility revenue bonds for the construction, acquisition, remodeling, furnishing and equipping of state-owned special facilities for lease to parties engaged in maritime operations.

Pursuant to this authorization, $15,700,000 or 8-1/2% special facility revenue bond anticipation notes were issued in 1981 to finance the construction of container terminal facilities on Sand Island for the exclusive use of Matson Terminals, Inc. In 1983, special facility revenue bonds of $16,750,000 were issued to refund the notes and to

NOTE I – SPECIAL FACILITY LEASE AND REVENUE BONDS (continued)

provide additional funds for construction. On April 15, 1993, special facility revenue bonds of $16,500,000 were issued to refund the outstanding 1983 Series bonds.

These bonds, which bear interest at 5.75% per annum, mature on March 1, 2013, subject to optional redemption on or after March 1, 2003 at prices ranging from 102% to 100% of face value. Matson Navigation Company, Inc., parent company of the lessee, has provided a guaranty agreement as to payment of principal and interest on the bonds.

On September 18, 2003, the bonds were redeemed in full at a price of 102% of the principal together with interest accrued to the redemption date. The remaining net investment in direct lease financing on the date of redemption was reclassified to buildings.

The special facility lease with Matson Terminals, Inc. was accounted for as a direct financing lease. The following lists the components of the net investment in direct financing lease as of June 30, 2004 and 2003:

	2004	2003
Total minimum lease payments receivable	$ –	$ 25,671,250
Estimated unguaranteed residual value	–	3,600,000
Less unearned income	–	(10,503,076)
Net investment in direct financing lease	$ –	$ 18,768,174

NOTE J – GENERAL OBLIGATION BONDS PAYABLE

The Harbors Division is required to reimburse the State General Fund for principal and interest on the following state general obligation bonds authorized and issued to finance certain capital improvement projects of the Public Undertaking:

Year of issue	Last installment due date	Interest rates	Original amount of issue	Current	Noncurrent
1992	March 1, 2012	5.15 – 6.40%	$ 12,870	$ –	$ 5,004
1993	November 1, 2010	4.00 – 5.00%	160,901	10,725	64,352
1998	April 1, 2009	5.00 – 5.25%	64,631	8,737	39,707
2001	August 1, 2015	3.40 – 5.50%	737	–	737
2002	February 1, 2015	3.60 – 5.75%	1,481	–	1,481
			$240,620	$19,462	$111,281

NOTE J – GENERAL OBLIGATION BONDS PAYABLE (continued)

Debt service requirements to maturity for general obligation bonds are as follows:

	Principal	Interest	Total
Fiscal year ending June 30,			
2005	$ 19,462	$ 5,065	$ 24,527
2006	20,688	4,318	25,006
2007	21,306	3,500	24,806
2008	21,799	2,668	24,467
2009	22,317	1,814	24,131
2010 – 2014	24,802	1,403	26,205
2015 – 2016	369	6	375
	$130,743	$18,774	$149,517

NOTE K – INTEREST COST

Total interest cost incurred for the fiscal years ended June 30, 2004 and 2003, amounted to $12,527,950 and $13,547,672, respectively. Of this amount, $1,437,024 and $2,556,836 were capitalized in the respective fiscal years as part of the construction cost of harbor facilities.

NOTE L – LEASING OPERATIONS

The Harbors Division's leasing operations consist principally of the leasing of land, wharf and building space under revocable permits and long-term leases. The revocable permits provide for tenancy on a month-to-month basis and are renewable annually at the option of the State. The long-term leases, which are classified as operating leases, expire in various years through 2058. These leases generally call for rental increases every five to ten years based on independent appraisals of the fair rental value of the leased property.

The following is a schedule of approximate future minimum lease rentals on noncancelable operating leases as of June 30, 2004:

	Amount
Fiscal year ending June 30,	
2005	$ 8,806,000
2006	8,664,000
2007	8,131,000
2008	8,004,000
2009	8,083,000
Thereafter	263,989,000
	$305,677,000

NOTE L – LEASING OPERATIONS (continued)

The above schedule does not include estimated future rental revenue for certain leases beyond their first 15 years. An estimate could not be made due to rental re-openings after the fifteenth year in which rental rates will be based upon the prevailing fair value.

The Harbors Division estimates that approximately 10% of the land area (excluding submerged lands) and floor space of the harbor facilities is leased or held for lease. Information regarding the cost and related accumulated depreciation of these facilities, which is required by Statement of Financial Accounting Standards No. 13, *Accounting for Leases*, to be disclosed, is not provided because the accumulation of such data was not considered practical and because the information, when compared to the future minimum lease rentals to be received, would not be an accurate indication of the productivity of the property on lease or held for lease, due to the methods by which and the long period of time over which the properties were acquired.

NOTE M – RETIREMENT BENEFITS

1. Employees' Retirement System

Substantially all eligible employees of the Harbors Division are required by Chapter 88, Hawaii Revised Statutes (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. The ERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to the ERS at City Financial Tower, 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813.

Members of the ERS belong to either a contributory or noncontributory option. Only employees of the Harbors Division hired on or before June 30, 1984 are eligible to participate in the contributory option. Members are required by State statute to contribute 7.8% of their salary to the contributory option and the Harbors Division is required to contribute to both options at an actuarially determined rate. Contributions by the Harbors Division for the fiscal years ended June 30, 2004, 2003 and 2002 were approximately $734,000, $738,000 and nil, respectively. The contribution rate for the fiscal years ended June 30, 2004, 2003 and 2002 was 9.14%, 8.87% and nil, respectively.

2. Post-Retirement Health Care and Life Insurance Benefits

In addition to providing pension benefits, the State provides certain health care and life insurance benefits to retired State employees. Contributions are financed on a pay-as-you-go basis. The Harbors Division's share of the expense for post-retirement health care and life insurance benefits for the fiscal years ended June 30, 2004 and 2003, was approximately $595,000 and $599,000, respectively.

NOTE N – COMMITMENTS

1. Construction Contracts

   The Harbors Division is committed under contracts awarded and orders placed for construction, expenses, supplies, etc. These commitments amounted to approximately $17,811,000 at June 30, 2004.

2. Accumulated Sick Leave Pay

   Employees earn sick leave credits at the rate of 10 or 14 hours for each month of service depending on the employee's hire date. Unused sick leave may be accumulated without limitation and is not convertible to pay upon termination of employment. Accordingly, no liability for sick pay is recorded. However, a public employee who retires or leaves government service in good standing with sixty days or more of unused sick leave, is entitled to convert these hours towards additional retirement service credit. Accumulated sick leave as of June 30, 2004 approximated $4,784,000.

3. 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 State's or Harbors Division's financial statements.

NOTE O – RISK MANAGEMENT

The Harbors Division is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; and workers' compensation. The State generally retains the first $250,000 per occurrence of property losses and the first $3 million with respect to general liability claims. Losses in excess of those retention amounts are insured with commercial insurance carriers. The limit per occurrence for property losses is $25 million ($10 million for earthquake, named hurricane, and flood) and the annual aggregate for general liability losses per occurrence is $7 million. The State also has an insurance policy to cover medical malpractice risk in the amount of $30 million per occurrence with no annual aggregate limit.

The State is generally self-insured for workers' compensation and automobile claims. The State's estimated reserve for losses and loss adjustment costs includes the accumulation of estimates for losses and claims reported prior to fiscal year end, estimates (based on projections of historical developments) or claims incurred but not reported, and estimates of costs for investigating and adjusting all incurred and unadjusted claims. Amounts

NOTE O – RISK MANAGEMENT (continued)

reported are subject to the impact of future changes in economic and social conditions. The State believes that, given the inherent variability in any such estimates, the reserves are within a reasonable and acceptable range of adequacy. Reserves are continually monitored and reviewed, and as settlements are made and reserves adjusted, the differences are reported in current operations. A liability for a claim is established if information indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss is reasonably estimable.

NOTE P – CEDED LANDS

In 1898, the former Republic of Hawaii transferred certain lands to the United States. Upon Hawaii's admission to the Union 1959, the United States reconveyed title to those lands (collectively, the ceded lands) to the State to be held as a public trust for five purposes: (1) public education; (2) betterment of the conditions of native Hawaiians; (3) development of farm and home ownership; (4) making public improvements; and (5) provision of land for public use. In 1978, the State Constitution was amended expressly to provide that the ceded lands were to be held as a public trust for native Hawaiians and the general public, and to establish the Office of Hawaiian Affairs (OHA) to administer and manage the proceeds and income derived from a pro rata portion of the ceded lands to better the conditions of native Hawaiians.

In 1979, the State Legislature adopted HRS Chapter 10 (Chapter 10), which, as amended in 1980, specified, among other things, that OHA expend 20% of all funds derived by the State from the ceded lands for the betterment of native Hawaiians.

In 1987, in *Trustees of the Office of Hawaiian Affairs v. Yamasaki*, 69 Haw. 154 (1987), the Hawaii Supreme Court concluded that Chapter 10 was insufficiently clear regarding the amount of monies OHA was entitled to receive from the public trust lands.

In 1990, in response to *Yamasaki*, the State Legislature adopted Act 304, Session Laws of Hawaii 1990, which (1) defined "public land trust" and "revenue," (2) reiterated that 20% of the now defined "revenue" derived from the "public land trust" was to be expended by OHA for the betterment of native Hawaiians, and (3) established a process for OHA and the Director of Finance to jointly determine the amount of monies which the State would pay OHA to retroactively settle all of OHA's claims for the period June 16, 1980 through June 30, 1991. Since fiscal year 1992 and until the first quarter of fiscal year 2002, the State, through its departments and agencies, paid 20% of "revenues" to OHA on a quarterly basis.

In 1993, the State Legislature enacted Act 35, Session Laws of Hawaii 1993, appropriating $136.5 million to pay the amount determined to be OHA's claims, with interest, for the period June 16, 1980 through June 30, 1991.

On January 14, 1994, OHA and its Board of Trustees (the Plaintiffs) filed suit against the State (*OHA, et al. v. State of Hawaii, et al.*, Civil No. 94-0205-01 (First Circuit)), claiming that the amount paid to OHA was inadequate and alleging that the State had failed to properly account for and fully pay the pro rata share of proceeds and income derived from the public land trust. Among other things, the Plaintiffs sought an accounting of all

NOTE P – CEDED LANDS (continued)

proceeds and income, funds and revenue derived from the public land trust since 1978, and restitution or damages amounting to 20% of the proceeds and income derived from the public land trust, as well as interest thereon. In its answer to OHA's complaint, the State denied all of the Plaintiff's substantive allegations, and asserted its sovereign immunity from suit and other jurisdictional and claim-barring defenses.

The Plaintiffs thereafter filed four motions for partial summary judgment as to the State's liability to pay OHA 20% of monies it receives from (1) the Department of Transportation Airports Division's in-bound duty free airport concession (including receipts from the concessionaire's off-airport sales operations), (2) the State-owned and operated Hilo Hospital, (3) the State's public rental housing projects and affordable housing developments, and (4) interest income, including investment earnings (collectively, the Sources). In response, the State filed a motion to dismiss on the basis of sovereign immunity and opposed Plaintiff's four motions on the merits and raised several affirmative defenses.

On October 24, 1996, the Circuit Court filed an order denying the State's motion to dismiss and rejecting its affirmative defenses. Also on October 24, 1996 the Circuit Court filed an order granting Plaintiff's four motions for partial summary judgment with respect to the State's liability to pay OHA 20% of the monies it receives from each of the Sources, and deferred establishing amounts owed from those Sources for further proceedings or trial. The State's motion for leave to file an interlocutory appeal from both the order denying its motion to dismiss and the order granting Plaintiff's four partial summary judgments was granted and all proceedings in the suit were stayed pending the Hawaii Supreme Court's disposition of the State's appeal.

On September 12, 2001, the Hawaii Supreme Court concluded that Act 304 was effectively repealed by its own terms, and that there was no judicially manageable standard by which to determine whether OHA was entitled to the revenues it sought from the Sources because the repeal of Act 304 revived the law which the Hawaii Supreme Court in *Yamasaki* had previously concluded was insufficiently clear to establish how much OHA was entitled to receive from the ceded lands. The Hawaii Supreme Court dismissed the case for lack of justiciability noting that it was up to the State Legislature to enact legislation to give effect to the right of native Hawaiians to benefit from the ceded lands under the State Constitution. Immediately thereafter, agencies ceased paying OHA the receipts from the ceded lands.

The State Legislature took no action during the 2002, 2003 and 2004 legislative sessions to establish a new mechanism for establishing how much OHA was entitled to receive from the ceded lands. On January 10, 2003, and pending legislative action to establish such a mechanism, the Governor issued Executive Order No. 03-03 directing state agencies to resume transferring 20% of receipts from leases, licenses and permits indisputably paid for the use of improved or unimproved parcels of ceded lands to OHA, if federal or state law did not preclude all or any portion of the receipt from being used to better the conditions of native Hawaiians, and the transfer of all or any portion of the receipt to OHA would not cause the agency to renege on a preexisting pledge, rate covenant, or other preexisting obligation to holders of revenue bonds or other indebtedness of the State or the agency. During the 2003 legislative session, the State Legislature appropriated moneys from the various funds into which the ceded lands receipts had been deposited after the decision by the Hawaii Supreme Court in 2001 was issued and agencies ceased making payments to OHA, and directed the agencies to pay them to OHA.

NOTE P – CEDED LANDS (continued)

OHA continues to pursue its claims for a portion of the revenues from the Sources and other ceded lands. On July 21, 2003, OHA filed a new lawsuit, *OHA et al, v. State of Hawaii et al.*, Civil No. 03-1-1505-07. The Plaintiffs sued the State for alleged breaches of fiduciary duties as purported trustee of the ceded lands public trust, alleged violations of Act 304, Chapter 10, and Article XII, Section 4, 5, and 6 of the Hawaii Constitution, alleged violations of the Contract Clause of the U.S. Constitution, and alleged misrepresentation and non-disclosure. The Plaintiffs claim that, accordingly, the State is liable to OHA for damages including, but not limited to: (1) the damages alleged by OHA in its lawsuit filed in 1994, and (2) amounts payable under Act 304 that have not been paid. Plaintiffs also seek declaratory and injunctive relief ordering the State to reinstate Act 304 (and enjoining the State and its agents, employees, and officials from opposing any of the above), and seeks appointment of an independent trustee to temporarily replace the State as trustee of the native Hawaiian public trust with respect to matters relating to reinstatement of Act 304.

The State filed a motion to dismiss OHA's complaint which the court granted in an order filed on December 26, 2003. The Court entered a final judgment on May 19, 2004, encompassing the order dismissing the complaint and several procedural orders. On June 8, 2004, OHA filed a notice of appeal from the portions of the May 19, 2004 judgment dismissing its complaint, denying leave to amend the complaint and denying a request for bifurcation of OHA's claims for liability and damages. On June 9, 2004, the State of Hawaii filed a notice of cross appeal from two discovery rulings set forth in the judgment. Opening briefs for appeal and cross appeal must be filed on or before October 18, 2004. Briefing for OHA's appeal will be completed by January 12, 2005. The State has withdrawn its cross appeal from the post-judgment discovery order.

The State intends to vigorously defend against all of OHA's claims. It is currently unable to predict with reasonable certainty the magnitude of its potential liability for such claims, if any. Accordingly, no estimate of loss has been recorded in the accompanying financial statements of the Harbors Division. The State Attorney General is of the view that the claims asserted by OHA in the above suit are meritless. Resolution of all of the OHA's claims could have a material adverse effect on the Harbors Division's financal condition.

In a third lawsuit, OHA filed a complaint for declaratory and injunctive relief on November 4, 1994 (*OHA v. Housing Finance and Development Corporation et al.*, Civil No. 94-4207-11 (First Circuit)) to enjoin the State from alienating any Ceded Lands or, alternatively, to preclude the extinguishing of any rights native Hawaiians may have in Ceded Lands that may be alienated.

In December 2002, following a trial on the issues, the trial court confirmed the State's authority to sell ceded lands, denied the declaratory ruling that the sale of ceded lands did not directly or indirectly release or limit Hawaiians' claims to those lands which the plaintiffs requested, and ordered that judgment be entered in the State's favor. The plaintiffs moved for and were granted leave to file immediate appeals from the court's rulings to the Hawaii Supreme Court. Those appeals are now pending. Trial to determine the sufficiency of the proceeds paid to OHA from the sale of the particular parcels of ceded lands at issue has not been scheduled.

Amounts paid and payable to OHA are treated as operating expenses of DOT's commercial harbors system. During the fiscal year ended June 30, 2003, payment to OHA was made by the State on behalf of various State

NOTE P – CEDED LANDS (continued)

departments, including the Harbors Division. The payment of $6,517,123 and $11,681,500 for the fiscal years ended June 30, 2004 and 2003, respectively, is included as an operating expense in the statements of revenues, expenses and changes in net assets.

NOTE Q – TRANSACTIONS WITH OTHER GOVERNMENT AGENCIES

The State assesses a surcharge of 5% for central service expenses on all receipts of the Harbors Division, after deducting any amounts pledged, charged or encumbered for the payment of bonds and interest during the fiscal year. The assessments amounted to $2,766,405 and $1,905,797 for the fiscal years ended June 30, 2004 and 2003, respectively.

The Harbors Division is assessed a percentage of DOT's general administration expenses. The assessments amounted to $733,531 and $962,692 for the fiscal years ended June 30, 2004 and 2003, respectively.

The Harbors Division incurred costs of $1,704,790 and $1,308,058 for fireboat operation services provided by the City and County of Honolulu during the fiscal years ended June 30, 2004 and 2003, respectively.

The Small Boat Harbors Boating Program (Program) was transferred from DOT to the Department of Land and Natural Resources (DLNR) in fiscal year 1992. Services performed by the Harbors Division for the Program are fully reimbursed by the Program. Services rendered to the Program during the fiscal years ended June 30, 2004 and 2003 amounted to $100,636 and $101,238, respectively.

NOTE R – ALOHA TOWER COMPLEX DEVELOPMENT

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

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. The sublease required the developer to construct, at the developer's cost, various facilities including a Marketplace. The developer and the Harbors Division entered into a capital improvements, maintenance, operations and securities agreement (Operations Agreement). The Operations Agreement allows the Harbors Division to operate the harbor facilities.

The developer later went into bankruptcy. The subsequent operator of the Marketplace assumed the obligations of the sublease and the Operations Agreement in March of 1998. Although the Marketplace construction was substantially completed, several items on a Harbors Division construction punchlist have yet to be completed.

NOTE R – ALOHA TOWER COMPLEX DEVELOPMENT (continued)

Revenues for the fiscal years ended June 30, 2004 and 2003 amounted to $1,763,995 and $1,726,011, respectively, and have been included in rental revenues in the respective fiscal year. As of June 30, 2004 and 2003, amounts due to the Harbors Division were $8,051,363 and $6,287,367, respectively.

NOTE S – TRANSFER OF LAND TO OTHER STATE AGENCIES

In the 1990 legislative session, the State Legislature enacted Act 86, which transferred certain lands at Kewalo Basin and Fort Armstrong under the jurisdiction of the Harbors Division to the Hawaii Community Development Authority (HCDA), a state agency which oversees the development of the Kakaako Community Development District (District).

Approximately 73 acres of the Harbors Division's land was transferred to HCDA under Act 86. Act 86 provides for HCDA to ensure due and adequate satisfaction of provisions for any covenant between the State or any county or any department or board thereof and the holders of bonds issued by the State or such county, department or board, if any.

As part of HCDA's development of the District, the western portion of the Kewalo Basin area is scheduled for redevelopment. With respect to Kewalo Basin, the Harbors Division expects to continue operating the harbor facilities, managing the adjacent land areas, and enforcing its applicable administrative rules. Improvements in this area which were constructed under former Harbors Division leases have either been demolished or are scheduled for demolition. Within the Fort Armstrong area, consisting of Piers 1 and 2 at Honolulu Harbor, HCDA has extended Ilalo Street and realigned Forrest Avenue, both of which are major circulatory roadways in the District. Because the realignment of Forrest Avenue affected certain facilities and improvements used by harbor users, HCDA has replaced such facilities and improvements at HCDA's cost. With respect to Fort Armstrong, the Harbors Division also expects to continue operating the harbor facilities, managing adjacent land areas, and enforcing its applicable administrative rules. The Harbors Division is and has been negotiating with HCDA to resolve issues relating to the Harbors Division's continued operation and management of Kewalo Basin and Fort Armstrong, including the amount of revenues to be retained by the Harbors Division, the costs attributable to such operation and management (such as security, maintenance and facility repair costs), the value of improvements that have been or are scheduled for demolition, and the responsibility for capital improvement projects.

NOTE T – KAPALAMA LAND DEVELOPMENT

Between 1990 and 1993, the State acquired three parcels of land totaling approximately 61.8 acres within the Kapalama Military Reservation area, comprised primarily of areas adjacent or near to Piers 39 through 41 at Honolulu Harbor (the "KMR site"). Governor's Executive Order No. 3497 set aside two parcels comprising 40.6 acres to the Harbors Division for harbor purposes on September 24, 2002. The set-aside of the remaining 21.2-acre parcel is pending. This parcel was purchased for approximately $34.9 million and involved the use of approximately $8.2 million of the Department of Transportation of the State of Hawaii Airports Division's (Airports Division) funds. There have been ongoing efforts between the Harbors Division and Airports Division

NOTE T – KAPALAMA LAND DEVELOPMENT (continued)

to designate the portion of the parcel to be used for their respective purposes. Discussions have also been explored regarding the possibility of the Airports Division selling its interest in the parcel to the Harbors Division. As a result, action on the issuance of a further Executive Order for the remaining parcel has been deferred until the matter has been resolved.

NOTE U – ARBITRAGE

The Harbors Division is required to annually calculate rebates to the U.S. treasury on the harbor revenue bonds issued from 1986. In accordance with the requirements of Section 148 of the Internal Revenue Code of 1986, as amended, rebates are calculated by bond series based on the amount by which the cumulative amount of investment income exceeds the amount that would have been earned had funds been invested at the bond yield. In the opinion of management, rebates payable as of June 30, 2004, if any, are not material to the financial statements. Accordingly, no rebates payable have been recorded in the accompanying financial statements.

NOTE V – CONTINGENCIES

1. Environmental Issues

   The Harbors Division is subject to laws and regulations relating to the protection of the environment. The Harbors Division has been identified by the State Department of Health as a potentially responsible party, for petroleum contamination in the Honolulu Harbor/Iwilei area. Pursuant thereto, the Harbors Division entered into a voluntary agreement with the Department of Health and other third parties to share in the responsibility for the investigation and potential remediation of petroleum contamination in the Iwilei District. This group of potentially responsible parties known as the Iwilei District Participating Parties ("IDPP"), has conducted various investigations to determine potential contamination in the Iwilei area from 1997 to present, which investigations have determined the existence of petroleum contamination at various locations. Potential remedial alternatives are still being studied. At this stage, the project has not yet advanced to the stage where total costs to the IDPP can reasonably be estimated, due to (1) the extent of environmental impact, (2) the undetermined allocation among the potentially responsible parties (3) the ongoing review of reasonable remediation alternatives, and (4) continued discussion with the regulatory authorities. As a result, it is not possible to reasonably estimate the amount of the potential cost to the IDPP and of the share of the Harbor's Division; and if there would be a material impact to the Harbor's Division's financial statements. Accordingly, no estimate of loss has been recorded in the accompanying financial statements.

2. Litigation

   The Harbors Division is subject to a number of lawsuits arising in the ordinary course of its operations. While the ultimate liabilities, if any, in the disposition of these matters are presently difficult to estimate, it is management's belief that the outcomes are not likely to have a material adverse effect on the Harbors Division's financial position. Accordingly, no provisions for any liabilities that might result have been made in the accompanying financial statements.

SUPPLEMENTARY INFORMATION

Schedule 1

State of Hawaii
Department of Transportation
Harbors Division

CASH AND CASH EQUIVALENTS OF THE PUBLIC UNDERTAKING

June 30, 2004

Unrestricted cash and cash equivalents	$ 76,192,844
Restricted cash and cash equivalents	
For construction	64,592,913
For matured revenue bonds and interest coupons payable	10,200
For general obligation bond debt service payments	10,401
For revenue bond debt service payments	8,480,413
For security deposits	2,565,212
For revenue bond harbors reserve and contingency account	10,897,658
	86,556,797
	$ 162,749,641
With Director of Finance, State of Hawaii	$ 162,723,941
With fiscal agents	10,200
On hand	15,500
TOTAL	$ 162,749,641

State of Hawaii
Department of Transportation
Harbors Division

CONSTRUCTION IN PROGRESS OF THE PUBLIC UNDERTAKING (continued)

Fiscal year ended June 30, 2004

Project	Balance at July 1, 2003	Additions by source of funds: Harbor Special Fund	Additions by source of funds: Harbor Revenue Bonds	Additions by source of funds: Capitalized interest	Transfer out	Balance June 30, 2004
Statewide:						
Removal of architectural barriers	$ 465,913	$ -	$ -	$ 21,853	$ 41,850	$ 445,916
Site survey and installation of controls	-	969	-	-	-	969
Various commercial harbor improvements	-	14,997	-	421	-	15,418
Honolulu Harbor:						
Repair and Repaint Exterior of CFS No. 2, Fort Armst	-	2,611	-	-	-	2,611
Petroleum, oil and lubricant remediation study	740,668	80,449	-	37,550	-	858,667
Lead paint and asbestos study	196,924	14,886	-	8,920	-	220,730
Sand Island tunnel feasibility study	989,247	109,999	-	11,906	-	1,111,152
Piers 24-29 shed demolition and site improvement	1,740,206	(20,660)	-	81,003	-	1,800,549
Sand Island container yard reconstruction	2,038,605	-	-	98,816	-	2,137,421
Domestic commercial fishing village	8,209,285	89,590	-	390,800	8,689,675	-
Harbor planning	242,227	-	-	11,220	-	253,447
Demolition of storage tanks	103,358	4,196	-	4,900	-	112,454
Site survey and installation of controls	969	(969)	-	-	-	-
Domestic commercial fishing village	-	500	-	-	500	-
Pier 19 ferry and cruise passenger terminal	5,320,918	369,572	-	102,307	-	5,792,797
Pier 2 cruise ship terminal	728,728	708,754	-	37,268	-	1,474,750
Risk assessment for Piers 36-38	386,133	55,965	-	21,954	-	464,052
Substructure Repairs at Piers 8 and 9	-	185	-	-	-	185
Replace lift station at Pier 27	353	228,573	-	36	-	228,962
Bulkhead improvements at Piers 25-28	253,257	759,747	-	73	-	1,013,077
Bullrail installation	419,966	645,698	-	40,914	-	1,106,578
Environmental investigation near Pier 32	6,622	-	-	349	-	6,971
Dredge Ewa end of Pier 51A	159,122	417,948	-	19,826	-	596,896
Environmental Remediations Piers 36-38	32,733	794,603	-	22,472	-	849,808
Revetment Repairs at Pier 39	-	92,440	-	21	92,461	-
Video monitoring system	77,490	217	-	4,028	-	81,735
Relamp floodlights at Piers 51-53	84,806	2,166	-	3	-	86,975
Pile improvements at Pier 40	985	132,948	-	3	-	133,936
Subtotal carried forward	$ 22,198,515	$ 4,505,384	$ -	$ 916,643	$ 8,824,486	$ 18,796,056

State of Hawaii
Department of Transportation
Harbors Division

CONSTRUCTION IN PROGRESS OF THE PUBLIC UNDERTAKING (continued)

Fiscal year ended June 30, 2004

Project	Balance at July 1, 2003	Additions by source of funds: Harbor Special Fund	Additions by source of funds: Harbor Revenue Bonds	Capitalized interest	Transfer out	Balance June 30, 2004
Subtotal brought forward	$ 22,198,515	$ 4,505,384	$ -	$ 916,643	$ 8,824,486	$ 18,796,056
Honolulu Harbor (continued):						
Reroof Pier 40 office building	34,833	(31,236)	-	-	-	3,597
Pavement improvements at Fort Armstrong	2,062	312,565	-	-	-	314,627
Risk assessment for Pier 29	23,118	30,320	-	2,112	-	55,550
Keehi Industrial Park drainage improvements	7,383	174,879	-	5,308	-	187,570
Methane Mitigation, Pier 38, Parcel 2	-	319,215	-	8,220	-	327,435
Replace Fenders at Pier 39	-	156,445	-	-	156,445	-
Pier 11 vehicle barriers	14,097	97,639	-	732	112,468	-
Piers 1-2 substructure barrier	18,000	13,008	-	1,180	-	32,188
Security surveillance system	39,289	485,446	-	3,483	-	528,218
Replace Rooftop air conditioning units at Pier 11	-	239,826	-	-	239,826	-
Reconstruction of Pier 51B Container Yard	-	9,336	-	262	-	9,598
Replace Fire Alarm system at Piers 19-21	-	1,239	-	-	-	1,239
Replace Fire Alarm System at Pier 32 Shed	-	901	-	-	-	901
Repair Roll-up Doors at Piers 13-14 Shed	-	1,314	-	-	-	1,314
Construction of Mooring Bollards at Piers 19-21	-	8,148	-	229	-	8,377
Replace Fenders at Pier 39E	-	263	-	-	-	263
Repair Gutter System at Pier 39 Shed	-	225	-	-	-	225
Environmental Soil Testing and Soil Disposal	-	109,844	-	3	-	109,847
Installation of RPM system at Fort Armstrong	-	1,472	-	41	-	1,513
Kewalo Basin:						
Catwalk replacement	-	204	-	-	204	-
Electrical improvements	103,928	-	-	-	-	103,928
Demolition of former GRG Enterprise	88,746	41	-	4,593	-	93,380
Electrical Repairs to Slips 105-118	-	489	-	-	489	-
Electrical repairs to Pier A	-	3,723	-	-	-	3,723
Substructure repairs to piers A and B	-	75	-	-	-	75
Kalaeloa Barbers Point Harbor:						
Modifications of Pier	-	467,700	-	23,653	-	491,353
Deep Draft Harbor improvements	20,233,323	(533,905)	15,000	166,147	19,880,565	-
Extend perimeter lighting to pier P-9	-	15,362	-	352	-	15,714
Repaint Light Poles and Service Enclosures a piers P-1, P-5, and P-6	-	113	-	-	-	113
Subtotal carried forward	$ 42,763,294	$ 6,390,035	$ 15,000	$ 1,132,958	$ 29,214,483	$ 21,086,804

State of Hawaii
Department of Transportation
Harbors Division

CONSTRUCTION IN PROGRESS OF THE PUBLIC UNDERTAKING (continued)

Fiscal year ended June 30, 2004

Project	Balance at July 1, 2003	Additions by source of funds: Harbor Special Fund	Additions by source of funds: Harbor Revenue Bonds	Additions by source of funds: Capitalized interest	Transfer out	Balance June 30, 2004
Subtotal brought forward	$ 42,763,294	$ 6,390,035	$ 15,000	$ 1,132,958	$ 29,214,483	$ 21,086,804
Kalaeloa Barbers Point Harbor (continued):						
Installation of Septic System	-	589	-	17	-	606
Replace bullrails at Piers 1, 5 & 6	2,250	(2,250)	-	-	-	-
Kahului Harbor:						
Cargo yard expansion	310,235	-	-	12,542	-	322,777
Drainage master plan	113,464	-	-	5,729	-	119,193
Pier 1 improvements	10,498,255	43,008	162,117	46,440	10,749,820	-
Navigation study	56,830	-	-	2,804	59,634	-
Pier 3 container yard reconstruction	708,380	2,399,071	-	69,544	3,176,995	-
Substructure Repairs at Pier 2	-	107	-	-	107	-
Environmental assessment master plan	52,985	52,000	-	4,264	-	109,249
Pier 2 substructure improvements	68,764	255,864	-	-	324,628	-
Kaumalapau Harbor Breakwater Repair	-	1,500,500	-	42,075	-	1,542,575
Substructure Repairs at Pier 2 extension- Phase 2	-	191	-	-	-	191
Pier 2 fender system	861	173,714	-	-	174,575	-
Replace air conditioning unit at Maui District Office	-	41	-	-	-	41
Pier 1c comfort station waterline and sewerline improvements	-	253,414	-	653	-	254,067
Upgrade perimeter fencing	7,724	65,744	-	2,168	-	75,636
Reconstruction of Puunene Container Yard	-	167,571	-	4,692	-	172,263
Construction of mooring dolphin at Pier 1c	-	3,464	-	87	-	3,551
Pavement repairs at Pier 1 Container Yard	-	41	-	-	-	41
Kaunakakai Harbor:						
Substructure improvement	6,574	81,116	-	6	87,696	-
Hilo Harbor:						
Demolition of sugar storage facility	-	47,226	-	-	47,226	-
Pier 1 fender system improvements	145,713	-	-	-	145,713	-
Pier 1 shed modifications	577,516	105,719	-	33,042	-	716,277
Pier 3 breasting dolphins and catwalks	315,016	71,876	-	18,436	-	405,328
Interisland Barge Terminal Facility	-	70,135	-	3,819	-	73,954
Subtotal carried forward	$ 55,627,861	$ 11,679,176	$ 177,117	$ 1,379,276	$ 43,980,877	$ 24,882,553

Schedule 2
(continued)

State of Hawaii
Department of Transportation
Harbors Division

CONSTRUCTION IN PROGRESS OF THE PUBLIC UNDERTAKING (continued)

Fiscal year ended June 30, 2004

Project	Balance at July 1, 2003	Additions by source of funds: Harbor Special Fund	Additions by source of funds: Harbor Revenue Bonds	Capitalized interest	Transfer out	Balance June 30, 2004
Subtotal brought forward	$ 55,627,861	$ 11,679,176	$ 177,117	$ 1,379,276	$ 43,980,877	$ 24,882,553
Hilo Harbor (continued):						
Bullrail installation	82,941	214,459	-	10,301	-	307,701
Pier 3 pile improvements	100,312	-	-	-	100,312	-
Substructure repairs at Piers 2 & 3	-	1,863	-	-	-	1,863
Pier 1 shed waterline improvements	185	2,284	-	-	-	2,469
Upgrade perimeter fencing	14,126	11,730	-	1,027	-	26,883
Removal of architectural barriers at overseas terminal	-	53	-	-	-	53
Construction of Inter-island cargo terminal	-	4,277	-	120	-	4,397
Kawaihae Harbor:						
Repair cut-off wall	-	1,000	-	-	-	1,000
Pile improvements	86,337	-	-	-	86,337	-
Modifications project	-	240,000	-	6,732	-	246,732
Nawiliwili Harbor:						
Pier 3	-	164	-	-	164	-
Environmental risk assessment	37,788	-	-	1,875	-	39,663
Pier 3 shed roof improvements	22,899	-	-	-	22,899	-
Pier 2 extension	365,045	269,876	-	26,414	-	661,335
Bullrail installation	321,310	143	-	1,452	322,905	-
Relamp floodlights	145,172	13,578	-	5	158,755	-
Commercial Harbors 2020 Master Plan	-	61,800	-	1,733	-	63,533
Pavement Repairs at Pier 2	-	20,739	-	-	-	20,739
Replacement of Pier 3 fendering system	-	89,916	-	2,298	-	92,214
Upgrade perimeter fencing	8,134	194,684	-	5,710	-	208,528
Pier 3 improvements	2,407	(2,407)	-	-	-	-
Port Allen:						
Replace siding	18,510	147,933	-	-	-	166,443
Replace fireline	-	137,099	-	-	-	137,099
Installation of lift station and force main	-	2,881	-	81	-	2,962
	$ 56,833,027	$ 13,091,248	$ 177,117	$ 1,437,024	$ 44,672,249	$ 26,866,167

Schedule 3

State of Hawaii
Department of Transportation
Harbors Division

GENERAL OBLIGATION BONDS OF THE PUBLIC UNDERTAKING

June 30, 2004

State of Hawaii General Obligation Bonds	Date of Bonds	Last installment due date	Interest rate	Original amount of issue	Amount repaid	Balance at June 30, 2004		
						Current	Noncurrent	Total
Series BW	March 1, 1992	March 1, 2012	5.15 - 6.40%	$ 12,870	$ 7,866	$ -	$ 5,004	$ 5,004
Series CI	November 1, 1993	November 1, 2010	4.00 - 5.00%	160,901	85,824	10,725	64,352	75,077
Series CS	April 1, 1998	April 1, 2009	5.00 - 5.25%	64,631	16,187	8,737	39,707	48,444
Series CW	August 1, 2001	August 1, 2015	3.40 - 5.50%	737	-	-	737	737
Series CY	February 1, 2002	February 1, 2015	3.60 - 5.75%	1,481	-	-	1,481	1,481
				$ 240,620	$ 109,877	$ 19,462	$ 111,281	$ 130,743

State of Hawaii
Department of Transportation
Harbors Division

REVENUE BONDS OF THE PUBLIC UNDERTAKING

June 30, 2004

	Final redemption date	Interest rate	Original amount of issue	Balance at June 30, 2004		
				Current	Noncurrent	Total
Issue of 1997	July 1, 2027	3.95 - 5.75%	$ 56,290,000	$ 955,000	$ 52,915,000	$ 53,870,000
Issue of 2000	July 1, 2029	4.50 - 6.00%	79,405,000	4,175,000	66,145,000	70,320,000
Issue of 2002	July 1, 2019	3.00 - 5.50%	24,420,000	3,930,000	18,290,000	22,220,000
Issue of 2004	January 1, 2024	2.50 - 6.00%	52,030,000	6,320,000	45,710,000	52,030,000
			$ 212,145,000	$ 15,380,000	$ 183,060,000	$ 198,440,000

Schedule 5

State of Hawaii
Department of Transportation
Harbors Division

INCOME FROM OPERATIONS BEFORE DEPRECIATION

Fiscal year ended June 30, 2004

		District										
		Oahu			Hawaii		Maui			Kauai		
	Statewide	Honolulu	Kalaeloa	Kewalo	Hilo	Kawaihae	Kahului	Kaunakakai	Kaumalapau	Nawiliwili	Port Allen	Total
Operating revenues:												
Services:												
Wharfage	$ -	$ 26,928,765	$ 1,073,264	$ -	$ 1,721,535	$ 1,842,087	$ 3,593,305	$ 138,388	$ -	$ 1,638,096	$ (10,394)	$ 36,925,046
Passenger debark/embark	-	696,088	-	-	981,738	-	598,005	-	-	1,031,970	-	3,307,801
Dockage	-	3,376,196	420,105	-	262,996	46,182	278,341	52,460	-	189,730	15,374	4,641,384
Demurrage	-	317,523	-	-	248,572	219,918	178,005	-	-	34,060	-	998,078
Port entry	-	709,377	102,975	2,312	79,921	40,044	90,338	13,175	-	61,069	2,775	1,101,986
Mooring charges	-	34,498	-	796,041	33,986	53	258	18,234	-	1,596	388,574	1,273,240
Cleaning wharves	-	122,487	2,149	297	-	548	369	-	-	10,575	1,222	137,647
Other	-	214,786	38,425	3,030	379	10,990	312	589	-	1,005	3,070	272,586
Total services	-	32,399,720	1,636,918	801,680	3,329,127	2,159,822	4,738,933	222,846	-	2,968,101	400,621	48,657,768
Rentals:												
Wharf space and land	-	15,921,180	583,376	613,134	101,189	171,576	233,390	13,147	300	389,559	169,791	18,196,642
Storage	-	2,852,813	40,222	-	96,997	85,265	255,832	2,117	-	326,495	8,051	3,667,792
Automobile parking	-	833,840	1,100	41,731	85,302	5,302	68,510	-	-	66,145	14,768	1,116,698
Pipelines	-	220,372	743,024	89	401,815	35,742	500,086	23,350	-	83,036	136,624	2,144,138
Total rentals	-	19,828,205	1,367,722	654,954	685,303	297,885	1,057,818	38,614	300	865,235	329,234	25,125,270
Others:												
Sale of utilities	-	506,375	54,837	29,691	17,928	3,736	45,805	-	-	12,037	5,940	676,349
Miscellaneous	-	90,802	1,735	172,359	12,300	3,812	16,236	8,840	-	1,284	1,418	308,786
Total others	-	597,177	56,572	202,050	30,228	7,548	62,041	8,840	-	13,321	7,358	985,135
Total operating revenues	-	52,825,102	3,061,212	1,658,684	4,044,658	2,465,255	5,858,792	270,300	300	3,846,657	737,213	74,768,173
Operating expenses before depreciation:												
Personal services	3,730,534	4,837,785	109,825	95,980	620,916	37,372	611,853	50,791	-	607,836	53,660	10,756,552
Harbor operations	6,651,885	1,645,869	96,028	307,886	111,400	42,200	197,917	9,718	-	197,117	17,316	9,277,336
Maintenance	238,031	1,511,986	68,841	224,980	275,158	23,932	283,638	79,252	38,642	158,943	11,971	2,915,374
State of Hawaii, surcharge for central service expenses	2,766,405	-	-	-	-	-	-	-	-	-	-	2,766,405
Fireboat operations	-	1,704,790	-	-	-	-	-	-	-	-	-	1,704,790
General administration	1,239,218	111,899	193	6,161	21,892	4,614	12,185	1,811	-	21,186	1,832	1,420,991
Department of Transportation, general administration expenses	733,531	-	-	-	-	-	-	-	-	-	-	733,531
Operating expenses	15,359,604	9,812,329	274,887	635,007	1,029,366	108,118	1,105,593	141,572	38,642	985,082	84,779	29,574,979
Allocation of statewide expenses (Note 1)	(15,359,604)	10,602,147	297,013	686,120	1,112,222	116,821	1,194,585	152,967	41,752	1,064,374	91,603	-
Total operating expenses	-	20,414,476	571,900	1,321,127	2,141,588	224,939	2,300,178	294,539	80,394	2,049,456	176,382	29,574,979
Income from operations before depreciation	$ -	$ 32,410,626	$ 2,489,312	$ 337,557	$ 1,903,070	$ 2,240,316	$ 3,558,614	$ (24,239)	$ (80,094)	$ 1,797,201	$ 560,831	$ 45,193,194

NOTES:
(1) Statewide expenses are allocated to the harbors based upon their respective current-year operating expenses to total current-year operating expenses for all harbors.

State of Hawaii
Department of Transportation
Harbors Division

HARBOR REVENUE BONDS 1997 CERTIFICATE - MINIMUM NET REVENUE REQUIREMENT OF THE PUBLIC UNDERTAKING

Fiscal year ended June 30, 2004

Net revenues, as defined by the 1997 Certificate:		
Income from operations before depreciation		$ 45,193,194
Add:		
Interest income, exclusive of investment in direct financing lease	$ 3,664,514	
State of Hawaii, surcharge for central service expenses	2,766,405	
Cash available in the harbor reserve and contingency account	-	6,430,919
		$ 51,624,113
Harbor revenue bond debt service requirements under the 1997 Certificate, including minimum sinking fund payments for the immediately ensuing 12 months		$ 21,316,613
Ratio of net revenues to harbor revenue bond debt service requirements		2.42