Hawaii Health Systems Corporation

Financial Report
with Other Supplemental Information
June 30, 2013

Hawaii Health Systems Corporation

Contents

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Independent Auditor's Report

To the Board of Directors
Hawaii Health Systems Corporation

Report on the Financial Statements

We have audited the accompanying financial statements of Hawaii Health System Corporation (HHSC), a component unit of the State of Hawaii, as of and for the years ended June 30, 2013 and 2012 and the related notes to the financial statements, which collectively comprise HHSC's financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits 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 audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of HHSC as of June 30, 2013 and 2012 and the respective changes in its financial position and cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

To the Board of Directors
Hawaii Health Systems Corporation

Emphasis of Matter

As discussed in Note 1, the financial statements present only HHSC (a component unit of the State of Hawaii) and do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2013 and 2012 or the changes in its financial position or its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified in respect to this matter.

As described in Note 2 to the financial statements, HHSC has adopted the provisions of GASB No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* and GASB No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, as of June 30, 2013. Our opinion is not modified with respect to these matters.

Other Matters

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise Hawaii Health Systems Corporation's financial statements. The accompanying other supplemental information, as identified in the table of contents, is presented for the purpose of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Required Supplemental Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, as identified in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplemental information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

To the Board of Directors
Hawaii Health Systems Corporation

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated January 9, 2014 on our consideration of HHSC'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* in considering HHSC's internal control over financial reporting and compliance.

Plante & Moran, PLLC

January 9, 2014

This discussion and analysis of Hawaii Health Systems Corporation's (HHSC or the "Corporation") financial performance provides an overview of the Corporation's financial activities for the fiscal years ended June 30, 2013, 2012, and 2011. Please read it in conjunction with the Corporation's financial statements, which begin on page 16.

Using this Annual Report

The Corporation's financial statements consist of three statements: (a) a statement of position, (b) a statement of revenue, expenses, and changes in net position, and (c) a statement of cash flows. These financial statements and related notes provide information about the activities of the Corporation, including resources held by the Corporation but restricted for specific purposes.

The Balance Sheet and Statement of Revenue, Expenses, and Changes in Net Position

- The analysis of the Corporation's finances begins on page 5. One of the most important questions asked about the Corporation's finances is, "Is the Corporation as a whole better or worse off as a result of the year's activities?" The statement of net position and the statement of revenue, expenses, and changes in net position report information about the Corporation's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. All of the current year's revenue and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Corporation's net position and changes in them. You can think of the Corporation's net position - the difference between assets and liabilities - as one way to measure the Corporation's financial health or financial position. Over time, increases or decreases in the Corporation's net position are one indicator of whether its financial health is improving or deteriorating. You will need to consider other nonfinancial factors, however, such as changes in the Corporation's patient base and measures of the quality of service it provides to the community, as well as local economic factors, to assess the overall health of the Corporation.

The Statement of Cash Flows

The final required statement is the statement of cash flows. The statement reports cash receipts, cash payments, and net changes in cash resulting from operating, investing, and financing activities. It provides answers to such questions as, "Where did cash come from?," "What was cash used for?," and "What was the change in cash balance during the reporting period?"

The Corporation's Net Position

The Corporation's net position is the difference between its assets and liabilities reported in the statement of net position. The Corporation's net position decreased by $45,311,432 (51 percent) in 2013, decreased by $40,719,703 (32 percent) in 2012, and increased by $207,829 (0.16 percent) in 2011, as you can see from the following table.

Assets, Liabilities, and Net Position

Summarized financial information of HHSC's statement of net position as of June 30, 2013, 2012, and 2011 is as follows:

	2013	2012	2011
Assets			
Current assets	$ 239,227,989	$ 226,346,844	$ 216,565,876
Capital assets - Net	340,290,684	309,561,477	291,103,090
Other assets	4,673,601	12,011,753	4,579,301
Total assets	**$ 584,192,274**	**$ 547,920,074**	**$ 512,248,267**
Liabilities			
Current liabilities	$ 149,032,679	$ 127,641,898	$ 112,587,993
Other postemployment liability	267,115,426	196,718,378	143,024,739
Due to the State of Hawaii	36,622,507	42,122,507	41,622,507
Other liabilities	88,389,500	93,093,697	85,949,731
Total liabilities	541,160,112	459,576,480	383,184,970
Net Position (Deficit)			
Invested in capital assets - Net of related debt	287,829,340	250,810,573	238,189,336
Restricted	349,241	663,192	902,579
Unrestricted	(245,146,419)	(163,130,171)	(110,028,618)
Total net position	43,032,162	88,343,594	129,063,297
Total liabilities and net position	**$ 584,192,274**	**$ 547,920,074**	**$ 512,248,267**

At June 30, 2013, 2012, and 2011, HHSC's current assets approximated 41 percent, 41 percent, and 42 percent of total assets, respectively. Current assets increased approximately $12.8 million in 2013 due to increases in estimated third-party payor settlements from Medicare and Medicaid of $19.3 million, which were partially offset by the decrease in cash and cash equivalents of $3.3 million and accounts receivable of $3.7 million. The increase in settlements expected from Medicare and Medicaid of $19.3 million is primarily due to the timing of the Medicaid uncompensated care payment. The decrease in cash and cash equivalents of $3.3 million is primarily due to various factors, as reflected in the statement of cash flows. The decrease in patient accounts receivable was due to recovering from the increase in 2012 related to implementation of an electronic medical records (EMR) system whereby billing and collection staff were reallocated to the EMR project. The reasons for this change are discussed in the operating results and changes in net position section below.

The primary reason for the increase in current assets in 2012 was due to increases in patient accounts receivable of $19.1 million and estimated third-party payor settlements from Medicare and Medicaid of $5.1 million, which were partially offset by the decrease in cash and cash equivalents of $18.4 million. The increase in patient accounts receivable was due to the efforts related to implementation of an electronic medical records (EMR) system whereby billing and collection staff were reallocated to the EMR project. The increase in settlements expected from Medicare and Medicaid of $5.1 million is primarily due to the timing of the Medicaid uncompensated care payment. The decrease in cash and cash equivalents of $18.4 million is primarily due to various factors, as reflected in the statement of cash flows.

At June 30, 2013, 2012, and 2011, HHSC's current liabilities were approximately 28 percent, 28 percent, and 29 percent of total liabilities, respectively. The primary reason for the increase in current liabilities in 2013 of $21.4 million is due to the increase in accounts payable and accrued expenses of $26.8 million, which were partially offset by the decrease in current portion of long-term debt of $7.6 million. The increase in accounts payable and accrued expenses continues to be a result of the efforts related to the EMR. The primary reason for the increase in current liabilities in 2012 of $15.1 million is due to the increase in accounts payable and accrued expenses $16.9 million, which was the result of the efforts related to the EMR implementation, and the decrease in funding from the State of Hawaii. Billing and collection staff were reallocated to the EMR project, which negatively affected cash collections of patient accounts receivable, thereby causing HHSC to stretch the payment time to vendors for accounts payable and accrued expenses.

At June 30, 2013, 2012, and 2011, HHSC's net position is reflected as its investment in capital assets, net of related debt, of approximately $288 million, $251 million, and $238 million, respectively. Total net position was $43 million in 2013, $88 million in 2012, and $129 million in 2011.

Capital Assets

At June 30, 2013, 2012, and 2011, HHSC's capital assets, net of accumulated depreciation, comprised approximately 58 percent, 56 percent, and 57 percent of its total assets, respectively. These assets consist mainly of land, hospital buildings, and equipment that are used in HHSC's operations. The increase of approximately $30.7 million in 2013, $18.5 million in 2012, and $5.5 million in 2011, respectively, is due primarily to ongoing construction projects, particularly the EMR project in 2013 and 2012.

A summary of HHSC's capital assets as of June 30, 2013, 2012, and 2011 is as follows:

	2013	2012	2011
Land and land improvements	$ 6,534,782	$ 6,456,524	$ 6,483,834
Building and improvements	410,515,944	392,899,001	376,906,867
Equipment	182,756,658	174,780,856	160,299,322
Construction in progress	56,417,845	31,402,877	21,485,947
Total capital assets	656,225,229	605,539,258	565,175,970
Less accumulated depreciation and amortization	(315,934,545)	(295,977,781)	(274,072,880)
Capital assets - Net	**$ 340,290,684**	**$ 309,561,477**	**$ 291,103,090**

Long-term Debt and Capital Lease Obligations

At June 30, 2013 and 2012, HHSC had long-term debt and capital lease obligations totaling approximately $61.5 million and $66.8 million, respectively. The decrease of $5.3 million in 2013 was primarily due to repayments of both long-term debt and capital leases. The increase of $5.8 million in 2012 was primarily due to HHSC entering into capital lease obligations of $16.1 million that were mainly related to the EMR project. The increase was partially offset by repayments of both long-term debt and capital lease obligations of $10.3 million in 2012. More detailed information about HHSC's long-term debt and capital lease obligations is presented in the notes to the financial statements.

Operating Results and Changes in Net Position

Summarized financial information of HHSC's statement of revenue, expenses, and changes in net position for the years ended June 30, 2013, 2012, and 2011 is as follows:

	2013	2012	2011
Operating revenue	$ 550,004,762	$ 524,674,715	$ 488,382,320
Operating expenses:			
Salaries and benefits	458,914,797	419,534,023	377,762,380
Purchased services and professional fees	84,251,648	81,190,116	69,056,744
Medical supplies and drugs	73,513,302	70,171,139	64,202,837
Depreciation and amortization	27,960,208	27,261,446	24,118,505
Insurance	5,401,503	5,465,887	6,316,661
Other	63,881,780	64,514,649	58,734,535
Total operating expenses	713,923,238	668,137,260	600,191,662
Operating loss	(163,918,476)	(143,462,545)	(111,809,342)
Nonoperating revenue:			
General appropriations from the State of Hawaii	79,999,224	73,375,585	81,967,200
Other nonoperating income - Net	7,109,677	1,183,211	421,319
Total nonoperating revenue	87,108,901	74,558,796	82,388,519
Excess of expenses over revenue before capital contributions	(76,809,575)	(68,903,749)	(29,420,823)
Capital contributions	31,498,143	28,184,046	29,628,652
(Decrease) increase in net position	**$ (45,311,432)**	**$ (40,719,703)**	**$ 207,829**

For the years ended June 30, 2013, 2012, and 2011, HHSC's operating expenses exceeded its operating revenues by $163.9 million, $143.5 million, and $111.8 million, respectively. General appropriations from the State of Hawaii totaled $80.0 million, $73.4 million, and $82.0 million, respectively. In addition, the appropriations from the State of Hawaii for capital contributions totaled $31.5 million, $28.2 million, and $29.6 million, respectively. These items, along with the other nonoperating revenue, contributed to a decrease in net position of $45.3 million in 2013, a decrease in net position of $40.7 million in 2012, and an increase in net position in of $208,000 in 2011.

Operating expenses for the fiscal year ended June 30, 2013 were approximately 6.9 percent higher than 2012. Operating expenses for the fiscal year ended June 30, 2013 increased $45.8 million from fiscal year 2012, which was primarily due to increases in payroll expenses of $40.0 million and nonpayroll expenses of $6.4 million. The increase in payroll expenses is the result of the increase of $70.4 million in the postemployment health care and life insurance benefit liability as well as the reinstatement of the wage concessions made under bargaining unit contracts. The increase in nonpayroll expenses is due primarily to increases at Hilo Medical Center (HMC) of $1.6 million, Maui Memorial Medical Center (MMMC) of $2.8 million, and Kona Community Hospital (KCH) of $2.8 million. At HMC, the increase was due to increases of $1.3 million in purchased services and professional fees due to the increased usage of registry nurses to fill vacant positions and for on-call pay to physicians. At MMMC, the increase was primarily due to an increase of $2.4 million in medical supplies and drugs which is consistent with the increased admissions, patient days, and ER visits of 5.5 percent, 3.5 percent, and 9.1 percent respectively, resulting in increased medical supplies and drugs dispensed. Additionally, an increase in purchased services at MMMC of $300K is attributed to costs for EMR backfill in 2013 which did not occur in 2012. At KCH, the increase of $2.8 million is primarily attributed to increased purchased services of $1.3 million for additional physician on-call, increased repairs and maintenance of $924K for additional renovation projects in the hospital, and an increase in medical supplies and drugs of $508K attributed to much higher patient revenues and volume in 2013 compared to 2012.

Operating expenses for the fiscal year ended June 30, 2012 were approximately 11.3 percent higher than 2011. Operating expenses for the fiscal year ended June 30, 2012 increased $67.9 million from fiscal year 2011, which was primarily due to increases in payroll expenses of $41.8 million and nonpayroll expenses of $26.2 million. The increase in payroll expenses is the result of the increase of $14.1 million in the postemployment health care and life insurance benefit liability as well as the reinstatement of the wage concessions made under bargaining unit contracts. The increase in nonpayroll expenses is due primarily to increases at Hilo Medical Center (HMC) of $11.3 million and at Maui Memorial Medical Center (MMMC) of $7.7 million. At HMC, the increase was due to increases of $4.0 million in purchased services and professional fees due to the increased usage of registry nurses to fill vacant positions and for on-call pay to physicians and $3.0 million in medical supplies and drugs due to the increase in volume. At MMMC, the increase was primarily due to other operating expenses of $2.9 million and the increase of $2.8 million in medical supplies and drugs and was mainly the result of the cardiovascular program commencing in 2012.

Operating expenses for the fiscal year ended June 30, 2011 were approximately 4.9 percent higher than 2010. Operating expenses for the fiscal year ended June 30, 2011 increased $27.9 million from fiscal year 2010 due primarily to increases in nonpayroll expenses of $19.4 million and to salaries and benefits of $8.5 million. The increase in operating expenses was due primarily to the increases of $14.7 million at MMMC and $10.9 million at HMC. At MMMC, nonpayroll and payroll expenses increased by $7.8 million and $6.9 million, respectively, and were primarily due to the continued expansion of its cardiovascular program services. At HMC, nonpayroll and payroll expenses increased by $7.1 million and $3.8 million, respectively, and were due primarily to the increase in volume in all areas, most notably the increase in emergency room visits of 3.9 percent.

HHSC's management believes that the significant excess of operating expenses over operating revenues in both fiscal years 2013 and 2012, as well as the cumulative net losses, are due to several factors which are outlined below.

When the State of Hawaii implemented the QUEST program in 1994, the federal funds provided to the State of Hawaii for Medicaid disproportionate share hospital (DSH) payments to hospitals were used to partially fund the QUEST program in order to expand health insurance coverage to more residents of the state. DSH payments are additional reimbursements that attempt to reflect additional costs incurred by providers who serve a significantly disproportionate number of low-income patients and/or a significant number of Medicaid patients. HHSC's patient mix is such that it would have qualified for Medicaid DSH payments had the State of Hawaii not eliminated such payments. Such additional reimbursements would have reduced the amount of State subsidies needed to finance the operations of HHSC. Management estimates that if the State of Hawaii had maintained Medicaid DSH payments, the amount of federal funds received by the State of Hawaii for the Medicaid program would be significantly more than what is currently being provided. To illustrate the importance of Medicaid DSH payments to public hospital systems, the National Association of Public Hospitals' *America's Safety Net Hospitals and Health Systems, 2010* published in June 2012 states that "Medicaid disproportionate share hospital (DSH) funding represented 8 percent of total revenue and financed 24 percent of the unreimbursed care provided by NAPH members in 2010. Additional federal, state, and local payments financed 30 percent of unreimbursed care." During the 2012 legislative session, management worked with the State Department of Human Services (DHS), the Healthcare Association of Hawaii (HAH), the Hawaii Long-term Care Association, and certain key legislators to pass a nursing home and a hospital sustainability fee bill, which was effective on July 1, 2012. The bills allow the State to impose a fee on hospital and nursing home revenues in order to draw down federal funds from the federal Medicaid program to provide additional funding to private hospitals and nursing homes. The bills established that HHSC would be able to utilize more of its compensated care losses to draw down federal funds for its own use. Management estimates that HHSC would receive approximately $34.7 million in supplemental uncompensated care payments starting in fiscal year 2013, which was approximately $16 million more than what HHSC received in uncompensated care payments in fiscal year 2012. Management will continue to work with DHS, the State of Hawaii Legislature, and HAH to explore other long-term reimbursement enhancements that could reduce HHSC's reliance on General Fund appropriations.

Many of HHSC's facilities suffer from an insufficient supply of long-term care beds. For fiscal year 2013, HHSC's long-term care occupancy percentage was 86 percent, and there are very few other freestanding long-term care facilities on the neighbor islands. As a result, HHSC's acute care facilities, especially HMC and MMMC, have numerous patients initially admitted as acute patients, but who continue to occupy acute-care beds while awaiting long-term care beds to become available. Such patients are called "wait-list" patients. HHSC receives little to no reimbursement from insurers for such patients, as insurers will not reimburse providers for patients whose required level of care does not coincide with the type of bed the patient is occupying. Medicare does not pay any additional money to hospitals for the additional days spent by the patient in the hospital while the patient waits for a long-term care placement. Medicaid pays approximately 20-30 percent of the cost of those additional wait-listed days to Hawaii hospitals. A 2013 Hawaii Health Information Corporation report titled *Acute Care Wait-listed Patients in Hawaii: Hospital Level Data* reported that MMMC lost $15.5 million on wait-listed patients in 2011, which represents a loss of $13,918 per patient. The report indicated that MMMC had the second highest amount of wait-listed patients in Hawaii next to Queen's Medical Center. In addition, Hilo Medical Center lost $4.0 million on wait-listed patients in 2011 and Kona Community Hospital lost $869,000 on wait-listed patients in 2011. Combined, HMC and MMMC have an average census of approximately 45-55 wait-list patients per day. Management expects the wait-list problem to worsen as Hawaii's population continues to age and the State of Hawaii lags behind on a credible plan to address the long-term care crisis.

HHSC's salaries and benefits expenses represent approximately 64 percent of its total operating revenues, whereas the industry median for nonprofit hospitals and health systems is approximately 50 percent, and management continues to face several challenging issues regarding management of personnel and personnel costs. HHSC is bound by the collective bargaining agreements negotiated by the State of Hawaii and the public employee unions (HGEA and UPW). The collective bargaining agreements not only bind HHSC to the negotiated pay raises, but also to the union work regulations and benefit packages. Management believes that such arrangements do not allow HHSC to manage its resources as effectively as other healthcare systems.

Also, since the majority of HHSC's facilities are in rural locations, management faces many recruitment and retention issues of key clinical personnel. Areas of acute shortage include anesthetists, imaging technicians, physicians, surgery technicians, pharmacists and pharmacy technicians, and health information management specialists. These shortage areas are caused by several factors: (1) a nationwide shortage of healthcare workers, (2) the inability of local colleges and universities to provide sufficient classes and teachers that can educate students in these areas, and (3) competition for these same types of positions with private hospitals, which can pay significantly higher wage rates than HHSC. Another issue compounding HHSC's staffing costs situation is the fact that the vast majority of HHSC's nurses are full-time salaried employees, while the nurses at the other private hospitals are hourly employees. This allows the private hospitals to increase or decrease their nurse staffing based on census; by contrast, HHSC facilities have great difficulty in decreasing their nurse staffing if census is lower than budgeted.

The shortage of physicians on the neighbor islands has been of particular concern to management. In past years, HHSC's facilities had very little contractual or employment relationships with physicians. The medical staff of HHSC's facilities consisted of those physicians with their own practices who had admitting privileges at the facilities. Within the past several years, many of the physicians who had practices on the neighbor islands have left their communities because of a confluence of factors including low physician reimbursements from third-party payors, high malpractice insurance costs, Hawaii's high cost of living, and the lack of tort reform that would limit the amounts that parties could sue medical care providers. As a result, residents of the neighbor islands were at times not able to receive specialty physician services in the event of an emergency, and had to be transported to Oahu to receive the necessary care. As an example, according to Hawaii Health Information Corporation data, approximately 75 percent of Hawaii County residents were discharged for either orthopedic surgeries or cardiovascular surgeries from Oahu hospitals. In keeping with HHSC's mission of providing and enhancing accessible, comprehensive healthcare services that are quality-driven, customer-focused, and cost-effective, management began to contract or employ physicians to ensure that neighbor island residents would be able to receive quality health care in a timely manner in the community in which they reside. HHSC's costs of contracting with or employing physicians increased from $7.8 million in fiscal year 2006 to $27.0 million in fiscal year 2013. These costs not only include the salary or contract payments to the physicians, but also the cost of establishing the clinics and physician offices for those physicians. Management believes that without significant medical tort reform and an increase in physician reimbursement rates, there will be continuing pressure put on HHSC's facilities to recruit and employ the physician specialists that are needed to ensure that neighbor island residents receive the quality healthcare that they deserve. Related to the physician shortage issue is the issue of on-call coverage. In the past, physicians provided on-call coverage for hospital emergency rooms as part of their duties as a medical staff member. However, due to the financial pressures listed in the paragraph above, physicians have started to demand payment for providing on-call coverage for hospital emergency rooms in order to make up for the financial shortfalls they experience from their private practices. Management has attempted to mitigate the need to pay physicians for on-call coverage by contracting with or employing hospitalists. Hospitalists are doctors whose primary professional focus is the practice of hospital medicine. They help manage patients throughout the continuum of hospital care, often seeing patients in the emergency room, and admitting them to inpatient wards. However, the lack of specialty physician availability on the neighbor islands described above has caused HHSC to pay certain of its physicians to provide on-call coverage for the emergency room. HHSC's cost for hospitalist/on-call coverage was $12.6 million in fiscal year 2012 and $15.1 million in fiscal year 2013.

HHSC inherited aging facilities upon the formation of the Corporation in 1996. These aging facilities require substantial improvements and maintenance before they can be brought up to par with other healthcare facilities in the State of Hawaii. While the State of Hawaii has provided annual funding for capital improvement projects, that funding has been primarily used to correct life-safety code concerns. Funding for medical equipment, application systems, and routine repair and maintenance must be funded from HHSC's operational cash flow. Given HHSC's payor mix and cost burdens, HHSC's operational cash flows are inadequate to fully fund the capital acquisitions that are necessary to keep up with the advances in healthcare technology that allow hospitals to improve the quality of care for their patients. As a result, HHSC's average age of plant in fiscal year 2013 and 2012 was 11.3 years and 10.9 years, respectively, whereas the median average age of plant for all U.S. non-profit hospitals and health systems is approximately 10 years. Management has identified almost $1 billion in capital improvement projects that need to be funded in the next 10 years in order to have HHSC's facilities continue to deliver quality care to its patients.

Finally, HHSC is a significant provider of health care for the State of Hawaii. HHSC's facilities account for approximately 19 percent of all acute care discharges and approximately 27 percent of all emergency room visits in the State of Hawaii. HHSC's facilities discharged more acute care patients during that time period than most of the acute care hospitals on Oahu. Also, HHSC is the sole source of hospital services for several isolated neighbor island communities (e.g., Ka'u, Kohala, Lanai, etc.). Furthermore, MMMC is the primary acute care facility on the island of Maui, and HMC and Kona Community Hospital are the only acute care facilities with more than 50 acute beds on the island of Hawaii. In large part because of HHSC's facilities in Maui, approximately 80 percent of Maui County residents received their care in Maui instead of having to fly to Oahu to receive care. The same can be said for residents of the County of Hawaii, as approximately 66 percent of all residents in the County of Hawaii received medical services from HHSC's five facilities on the island of Hawaii. Also, HHSC's long-term care facilities provide the primary source of long-term care services for elderly people who cannot afford private care or nursing homes and do not have family that can care for them. Given all of the above, management believes that HHSC has a vital role in ensuring that the people of the State of Hawaii have access to quality health care.

HHSC believes that there are four significant challenges facing HHSC in the near future: (1) the impact of federal healthcare reform on HHSC's facilities, (2) the implementation of an electronic medical record/health information system, (3) the federal mandate to implement the ICD-10 coding standard, and (4) federal deficit reduction legislation. The Patient Protection and Affordable Health Care Act (PPACA) was signed into law on March 23, 2010. On March 30, 2010, the president enacted the Health Care and Education Reconciliation Act, which made a number of changes to the PPACA.

Management estimates that the total impact of the provisions of the PPACA on HHSC's facilities will be a $56,002,000 decrease in reimbursements over a 10-year period (federal fiscal years 2010-2019).

This calculation does not include the impact of potential adjustments for low-volume hospitals, value-based purchasing, healthcare acquired conditions payment penalties, and a cap on outlier payments for home health services. It also does not include the impact on cost-based Medicare plans, such as HMSA 65C+. The largest impact will be on HHSC's acute care facilities (Hilo, Maui, and Kona), primarily due to the PPACA marketbasket reductions, which are reductions in Medicare reimbursement rates. HHSC's acute care facilities are not affected by the Medicare DSH reductions because they receive a higher facility-specific Medicare reimbursement rate due to their designation as sole community hospitals. HHSC's critical access hospitals are not significantly affected by the PPACA because those facilities' Medicare reimbursements are cost-based. Management is in the process of evaluating what impact the Centers for Medicare and Medicaid Services' rule on accountable care organizations or the formation of state health insurance exchanges will have on HHSC.

In July 2011, HHSC entered into a contract with Siemens Healthcare to implement its Soarian Electronic Medical Records (EMR) and Health Information Systems. The system has been implemented at Kona Community Hospital and Kohala Hospital, with the remainder of the facilities to be implemented in a phased approach through calendar year 2014. Management believes that the installation of an EMR system is a key step in the creation of an integrated health network with real-time access to patient information across the system. Unleashing new efficiencies and capturing quality improvement are examples of the many opportunities that will be enabled through the utilization of contemporary information technology. Driving out manual intervention, modernizing workflow across the HHSC continuum of care, hard-wiring change, and proactively monitoring performance through near real-time analytics are just a few of the essential elements sought by HHSC in pursuit of meaningful use as designated by the Centers for Medicare and Medicaid Services.

The U.S. Department of Health and Human Services and the Centers for Medicare and Medicaid Services (CMS) mandated that HIPAA-covered hospitals transition from ICD-9 to ICD-10 diagnosis codes by October 1, 2014. This mandate includes all Hawaii Health Systems Corporation (HHSC) facilities. The extent of this transition is far reaching with the potential to impact not only IT systems but also business and clinical processes. The transition to ICD-10 represents a desire to better communicate patient conditions and the nature of services delivered, thus improving the ability to monitor quality of care. ICD-10-CM will be used to define all inpatient and outpatient diagnoses and ICD-10-PCS will be used to define inpatient procedures. CPT coding will remain in place to define procedures in the outpatient and physician practice settings. There are several impacts of this federal mandate to HHSC:

- HHSC, like hospitals across the country, will require additional coder resources to successfully transition to ICD-10 while minimizing impact to accurate, timely coding. In addition to the current workforce, it is estimated that an additional 11.2 coder FTEs will be needed in total across HHSC across year-1 post ICD-10 transition in order to support timely and accurate coding, maintain low DNFC, and prevent decelerated cash flow.

- There is inherent revenue risk as a result from the transition to ICD-10 as it relates to denials and payment errors. It is anticipated that medical necessity/authorization denials may increase by as much as 10-25 percent upon the transition. In addition, Medicaid payment error rates are expected to increase by 3 percent. While this is not necessarily lost revenue, it is a risk for delayed revenue, requiring additional resources to rework and recover at-risk dollars. Management estimates that this will result in a year-1 post ICD-10 transition revenue risk of $2.8 million on the low end to $5.7 million on the high end for HHSC.

- Given the brand new coding system and what will be a steep learning curve for even experienced coders, it is anticipated that an organization's unbilled receivables may increase by as much 50-100 percent across the first year of the transition, with the largest impact felt across the first six months post-transition.

- Across the country, it is anticipated that payors will adjudicate claims more slowly upon the transition to ICD-10. The increase in denials will also increase A/R. As such, it is anticipated that billed accounts receivables may increase by as much as 25-50 percent upon the first year of the transition.

Management will work with the state administration and the third-party payors to ensure that plans are in place to address the potential negative cash flow and revenue impacts to HHSC of this issue.

Federal deficit reduction legislation has already had a significant impact on HHSC. In 2012, Congress passed federal deficit reduction legislation that imposed a reduction in Medicare reimbursements for MS-DRG coding adjustments (among other spending cuts) to prevent the "fiscal cliff." It is anticipated that the impact of this adjustment will be an annual loss of Medicare reimbursements of $2.6 million beginning October 1, 2013. The breakdown of the loss by facility is $939,000 for Hilo Medical Center, $1,376,000 for Maui Memorial Medical Center, and $242,000 for Kona Community Hospital. In addition, in February 2013, the sequestration provisions of the Budget Control Act of 2011 were triggered, which resulted in automatic 2 percent cuts to all federal programs, including the Medicare program. Such costs will result in a loss of approximately $2 million in Medicare reimbursements. As Congress and the president continue to struggle to deal with the federal budget deficit, management anticipates that further action could be taken to reduce reimbursements to healthcare providers in future years.

Contacting the Corporation's Financial Management

This financial report is designed to provide our patients, suppliers, taxpayers, and creditors with a general overview of the Corporation's finances and to show the Corporation's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Corporation's corporate office at Hawaii Health Systems Corporation, 3675 Kilauea Avenue, Honolulu, HI 96816.

Hawaii Health Systems Corporation

Statement of Net Position

		June 30, 2013		June 30, 2012
Assets				
Current Assets				
Cash and cash equivalents - State of Hawaii (Note 2)	$	10,324,365	$	8,484,953
Cash and cash equivalents		23,984,217		29,139,752
Patient accounts receivable - Less allowances for doubtful accounts of $37,660,961 and $40,128,953 for the years ended June 30, 2013 and 2012, respectively (Note 2)		84,029,495		90,019,123
Investments (Note 3)		7,071,193		7,212,156
Supplies and other current assets		18,676,965		19,017,528
Due from the State of Hawaii (Note 5)		63,479,395		60,129,055
Estimated third-party payor settlements		31,662,359		12,344,277
Total current assets		239,227,989		226,346,844
Capital Assets - Net (Note 4)		340,290,684		309,561,477
Assets Limited as to Use (Note 2)		3,190,852		10,335,254
Other Assets		1,482,749		1,676,499
Total assets	**$**	**584,192,274**	**$**	**547,920,074**
Liabilities and Net Position (Deficit)				
Current Liabilities				
Current portion of long-term debt (Note 8)	$	1,589,257	$	9,212,308
Current portion of capital lease obligations (Note 8)		8,512,172		7,257,210
Accounts payable and accrued expenses		115,723,498		88,925,727
Current portion of accrued workers' compensation (Note 9)		3,315,000		3,058,000
Current portion of accrued vacation (Note 6)		16,142,893		16,036,158
Current portion due to the State of Hawaii (Note 5)		2,000,000		2,000,000
Other current liabilities		1,749,859		1,152,495
Total current liabilities		149,032,679		127,641,898
Long-term Debt - Less current portion (Note 8)		33,347,606		25,352,367
Capital Lease Obligation - Less current portion (Note 8)		18,013,309		24,929,020
Other Liabilities				
Accrued vacation - Less current portion (Note 6)		24,198,774		28,779,340
Accrued workers' compensation - Less current portion (Note 9)		10,424,000		11,836,000
Other postemployment benefit liability (Note 7)		267,115,426		196,718,378
Due to the State of Hawaii - Less current portion (Note 5)		36,622,507		42,122,507
Patients' safekeeping deposits		319,932		278,511
Other liabilities		2,085,879		1,918,459
Total liabilities		541,160,112		459,576,480
Net Position (Deficit)				
Invested in capital assets - Net of related debt		287,829,340		250,810,573
Restricted for capital purchases (Note 2)		349,241		663,192
Unrestricted		(245,146,419)		(163,130,171)
Total net position		43,032,162		88,343,594
Total liabilities and net position	**$**	**584,192,274**	**$**	**547,920,074**

See Notes to Financial Statements.

Hawaii Health Systems Corporation

Statement of Revenue, Expenses, and Changes in Net Position

	Year Ended June 30, 2013	Year Ended June 30, 2012
Operating Revenue		
Net patient service revenue (net of provision for doubtful accounts of $38,374,547 and $30,038,943 for the years ended June 30, 2013 and 2012, respectively)	$ 541,629,368	$ 513,267,301
Other revenue	8,375,394	11,407,414
Total operating revenue	550,004,762	524,674,715
Operating Expenses		
Salaries and benefits	458,914,797	419,534,023
Purchased services	69,850,438	66,478,625
Medical supplies and drugs	73,513,302	70,171,139
Depreciation and amortization	27,960,208	27,261,446
Utilities	17,338,634	16,809,996
Repairs and maintenance	12,261,640	12,866,757
Other supplies	19,026,868	18,394,512
Professional fees	14,401,210	14,711,491
Insurance	5,401,503	5,465,887
Rent and lease	7,886,572	7,737,477
Other	7,368,066	8,705,907
Total operating expenses	713,923,238	668,137,260
Operating Loss	(163,918,476)	(143,462,545)
Nonoperating Revenue (Expenses)		
General appropriations from the State of Hawaii	79,999,224	73,375,585
Collective bargaining pay raise appropriation from the State of Hawaii	6,028,192	-
Loss on disposal of capital assets	(450,070)	(535,955)
Restricted contributions	3,055,335	1,614,031
Interest expense	(3,793,882)	(3,693,432)
Interest and dividend income	309,239	310,390
Other nonoperating revenue - Net	1,960,863	3,488,177
Total nonoperating revenue	87,108,901	74,558,796
Excess of Expenses Over Revenue Before Capital Contributions	(76,809,575)	(68,903,749)
Capital Contributions	31,498,143	28,184,046
Decrease in Net Position	(45,311,432)	(40,719,703)
Net Position - Beginning of year	88,343,594	129,063,297
Net Position - End of year	**$ 43,032,162**	**$ 88,343,594**

Hawaii Health Systems Corporation

Statement of Cash Flows

	Year Ended June 30, 2013	Year Ended June 30, 2012
Cash Flows from Operating Activities		
Cash received from government, patients, and third-party payors	$ 528,300,914	$ 489,053,308
Cash payments to employees for services	(386,900,020)	(359,818,579)
Cash payments to suppliers for services and goods	(206,184,415)	(210,568,326)
Other receipts from operations	8,375,394	11,407,414
Net cash used in operating activities	(56,408,127)	(69,926,183)
Cash Flows from Noncapital Financing Activities		
Appropriations from the State of Hawaii	79,999,224	73,375,585
Collective bargaining funding from the State of Hawaii	6,028,192	-
Other nonoperating revenue - Net	5,016,198	5,102,208
Repayment of advance from the State of Hawaii	(5,500,000)	-
Net cash provided by noncapital financing activities	85,543,614	78,477,793
Cash Flows from Capital and Related Financing Activities		
Purchase of capital assets	(29,338,437)	(4,819,807)
Interest paid	(3,793,882)	(3,693,432)
Repayments on long-term debt	(9,161,670)	(1,204,629)
Repayments on capital lease obligations	(7,286,082)	(9,135,902)
Proceeds from sale of assets	-	267,020
Proceeds from issuance of long-term debt	9,533,857	-
Net cash used in capital and related financing activities	(40,046,214)	(18,586,750)
Cash Flows from Investing Activities		
Interest income	309,239	310,390
Decrease (increase) in short-term investments and assets limited as to use	7,285,365	(8,640,441)
Net cash provided by (used in) investing activities	7,594,604	(8,330,051)
Net Decrease in Cash and Cash Equivalents	(3,316,123)	(18,365,191)
Cash and Cash Equivalents - Beginning of year	37,624,705	55,989,896
Cash and Cash Equivalents - End of year	**$ 34,308,582**	**$ 37,624,705**
Balance Sheet Classification of Cash and Cash Equivalents		
Cash and cash equivalents - State of Hawaii	$ 10,324,365	$ 8,484,953
Cash and cash equivalents	23,984,217	29,139,752
Total cash and cash equivalents	**$ 34,308,582**	**$ 37,624,705**

See Notes to Financial Statements.

Statement of Cash Flows (Continued)

A reconciliation of operating loss to net cash used in operating activities is as follows:

	Year Ended June 30, 2013	Year Ended June 30, 2012
Cash Flows from Operating Activities		
Operating loss	$ (163,918,476)	$ (143,462,545)
Adjustments to reconcile operating loss to net cash from operating activities:		
Provision for doubtful accounts	38,374,547	30,038,943
Depreciation and amortization	27,960,208	27,261,446
Changes in assets and liabilities:		
Patient accounts receivable	(32,384,919)	(49,164,136)
Supplies and other assets	506,402	(165,450)
Accounts payable, accrued expenses, and other liabilities	27,603,976	14,588,396
Accrued workers' compensation liability	(1,155,000)	(315,000)
Postemployment benefit liability	70,397,048	53,693,639
Estimated third-party payor settlements	(19,318,082)	(5,088,799)
Accrued vacation	(4,473,831)	2,687,323
Net cash used in operating activities	**$ (56,408,127)**	**$ (69,926,183)**
Noncash Financing and Investing Activities		
Assets acquired under capital leases and debt	$ 1,625,333	$ 16,077,682
Capital assets contributed by the State of Hawaii and others	28,147,803	25,596,991
Loss on disposal of capital assets	450,070	535,955
Change in due from the State of Hawaii	3,350,340	2,587,055

Note 1 - Organization

Structure - Hawaii Health Systems Corporation (HHSC or the "Corporation") is a public body corporate and politic and an instrumentality and agency of the State of Hawaii (the "State"). HHSC is managed by a chief executive officer under the control of a 13-member board of directors.

In June 1996, the legislature of the State passed Act 262, S.B. 2522. The act, which became effective in fiscal year 1997, transferred all facilities under the administration of the Department of Health - Division of Community Hospitals to HHSC. HHSC currently operates the following facilities:

East Hawaii Region:
- Hilo Medical Center
- Hale Ho'ola Hamakua
- Ka'u Hospital
- Yukio Okutsu Veterans Care Home (Yukio is not included in the East Hawaii Region audited financial statements)

West Hawaii Region:
- Kona Community Hospital
- Kohala Hospital

Maui Region:
- Maui Memorial Medical Center
- Kula Hospital
- Lanai Community Hospital

Kauai Region:
- Kauai Veterans Memorial Hospital
- Samuel Mahelona Memorial Hospital

Oahu Region:
- Leahi Hospital
- Maluhia

Kahuku Medical Center

Act 262 also amended a previous act to exempt all facilities from the obligation to pay previously allocated central service and departmental administration expenses by the State.

HHSC is considered to be administratively attached to the Department of Health of the State and is a component unit of the State. The accompanying financial statements relate only to HHSC and the facilities, and are not intended to present the financial position, results of operations, or cash flows of the Department of Health.

Negotiations between HHSC and the State relating to the transfer of assets and assumption of liabilities pursuant to Act 262 had not been finalized as of June 30, 2012. Accordingly, the assets, liabilities, and net assets of HHSC reflected in the accompanying statement of revenue, expenses, and changes in net assets may be significantly different from those eventually included in the final settlement.

Note 1 - Organization (Continued)

The financial statements are being presented for HHSC, Hawaii Health Systems Foundation (HHSF), and Alii Community Care, Inc. (Alii). HHSF and Alii are nonprofit organizations of which HHSC is the sole member. The purpose of HHSF is to raise funds and to obtain gifts and grants on behalf of HHSC. The purpose of Alii is to own, manage, and operate assisted-living and other healthcare facilities in the state.

In June 2007, the State Legislature passed Act 290, S.B. 1792. This act, which became effective July 1, 2007, required the establishment of a 7- to 15-member regional system board of directors for each of the five regions of the HHSC system. Each regional board was given custodial control and responsibility for management of the facilities and other assets in their respective regions. This act also restructured the 13-member HHSC board of directors to 15 members, comprised of 10 members appointed by the governor from nominees submitted by legislative leadership, two at-large members at the governor's discretion, two physician members selected by the HHSC board, and the State Director of Health.

Act 290 also exempted the regions from the requirements of the State procurement code and other exemptions from State agency laws, such as tax clearance certificate requirements, the concession law, and the sunshine law.

In 2009, the Legislature passed Act 182, S.B. 1673, effective July 1, 2009, which allowed the individual facilities or regions of HHSC to transition into a new legal entity in any form recognized under the laws of the State of Hawaii, including but not limited to a nonprofit corporation, a for-profit corporation, a municipal facility, a public benefit corporation, or a combination of the above. The act also amended the requirement for maintenance of services to outline a process that must be followed in order for a facility to substantially reduce or eliminate a direct patient care service. Furthermore, the act reconstituted the HHSC board of directors to a 12-member board of directors which includes the five regional chief executive officers, one representative each appointed by the East Hawaii, West Hawaii, Kauai, and Oahu regional boards, two members appointed by the Maui regional board, and the Director of the Department of Health as an ex-officio nonvoting member.

In June 2011, the Legislature passed Act 126, S.B. 1300, effective July 1, 2011, which reconstituted the HHSC board of directors to a 13-member board of directors by adding an at-large voting member appointed by the governor of the State of Hawaii and changing the voting status of the Director of the Department of Health from a nonvoting to voting member.

In June 2013, the Legislature passed Act 278, H.B. 1130, effective July 2013, which reconstituted the HHSC board of directors by adding five regional members appointed by the governor and making the five regional chief executive officers ex-officio, nonvoting members.

Note 1 - Organization (Continued)

Kahuku Medical Center - In June 2007, the State Legislature passed Act 113, H.B. 843. This act amended Hawaii Revised Statutes 323F to allow for the assimilation of Kahuku Hospital into HHSC in a manner and to an extent that was to be negotiated between Kahuku Hospital and HHSC. The act also specified that none of the liabilities of Kahuku Hospital were to become the liabilities of HHSC, that HHSC could adjust the levels of services provided by Kahuku Hospital, and that the employees of Kahuku Hospital were not to be considered employees of the State. This act appropriated $3,900,000, which was disbursed through the Department of Health of the State, to pay for the cost of acquiring the assets of Kahuku Hospital and to operate the facility. On March 14, 2008, the asset purchase was completed for a purchase price of approximately $2,652,000 in cash, including transaction costs of $197,000 in cash, and the facility is now operating as Kahuku Medical Center. The purchase price was allocated to assets based on their respective estimated fair values at the acquisition date.

Liquidity - During the year ended June 30, 2013, HHSC incurred losses from operations of approximately $164 million and had negative cash flows from operations of $56.4 million. Overall, days in accounts payable have increased as compared to June 30, 2012 because the delay in receipt of uncompensated care funds caused facilities to extend vendor payables. Days in accounts receivable have decreased as compared to June 30, 2012 due to improvements in revenue cycle processes. Downward pressure on reimbursements were due to federal healthcare reform and federal deficit reduction legislation. Although improvements continue to be seen by HHSC, management believes maintaining the current levels of service provided by HHSC will require continued funding by the State of Hawaii.

Note 2 - Summary of Significant Accounting Policies

Basis of Accounting - HHSC prepares its financial statements using the economic resources measurement focus and the accrual basis of accounting.

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

Note 2 - Summary of Significant Accounting Policies (Continued)

Cash and Cash Equivalents - Cash and cash equivalents include short-term investments with original maturities of three months or less. It also includes amounts held in the State Treasury. The State Director of Finance is responsible for the safekeeping of all monies paid into the State Treasury (cash pool). HHSC's portion of this cash pool at June 30, 2013 and 2012 is indicated in the accompanying statement of net position as "cash and cash equivalents on deposit with the State of Hawaii." The Hawaii Revised Statutes authorize the Director of Finance to invest in obligations of, or guaranteed by, the U.S. government, obligations of the State, federally insured savings and checking accounts, time certificates of deposit, and repurchase agreements with federally insured financial institutions. Cash and deposits with financial institutions are collateralized in accordance with State statutes. 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.

HHSC has cash in financial institutions that is in excess of available depository insurance coverage. The amount of uninsured and uncollateralized deposits totaled approximately $30,046,000 and $34,796,000 at June 30, 2013 and 2012, respectively. Accordingly, these deposits were exposed to custodial credit risk. Custodial credit risk is the risk that in the event of a financial institution failure, HHSC's deposits might not be returned to it. HHSC believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all deposits. As a result, HHSC evaluates each financial institution with which it deposits funds; only those institutions with an acceptable estimated risk level are used as depositories.

Accounts Receivable - Patient accounts receivable are stated at net realizable value amounts. An allowance for uncollectible accounts is established on an aggregate basis by using historical write-off factors applied to unpaid accounts based on aging. Loss rate factors are based on historical loss experience and adjusted for economic conditions and other trends affecting HHSC's ability to collect outstanding amounts. Uncollectible amounts are written off against the allowance for doubtful accounts in the period they are determined to be uncollectible. An allowance for contractual adjustments is based on expected payment rates from payors based on current reimbursement methodologies.

Supplies - Supplies consist principally of medical and other supplies and are recorded at the lower of first-in, first-out cost, or market.

Capital Assets - Capital assets assumed from the State at inception are recorded at cost less accumulated depreciation. Other capital assets are recorded at cost or estimated fair market value at the date of donation. Donated buildings, equipment, and land are recognized as revenue when all eligibility requirements have been met, generally at the date of donation. Equipment under capital leases is recorded at the present value of future payments. Buildings, equipment, and improvements are depreciated by the straight-line method using these asset lives:

Note 2 - Summary of Significant Accounting Policies (Continued)

Building and improvements	5-40 years
Equipment	3-20 years

Gains or losses on the sale of capital assets are reflected in other nonoperating revenue. Normal repairs and maintenance expenses are charged to operations as incurred.

Certain of HHSC's capital improvement projects are managed by the State Department of Accounting and General Services. The related costs for these projects are transferred to HHSC's capital asset accounts and are reflected as revenue below the nonoperating revenue category in the statement of revenue, expenses, and changes in net position.

Assets Limited as to Use - Assets limited as to use are restricted net position, patients' safekeeping deposits, restricted deferred contributions, restricted cash, and cash in escrow accounts related to future lease draws. Such restrictions have been externally imposed by contributors or by collateral agreements. Restricted resources are applied before unrestricted resources when an expense is incurred for purposes for which both restricted and unrestricted net position is available. Patients' safekeeping deposits represent funds received or property belonging to the patients that are held by HHSC in a fiduciary capacity as custodian. Receipts and disbursements of these funds are not reflected in HHSC's operations.

At June 30, 2013 and 2012, assets limited as to use consisted of restricted cash of $3,190,852 and $10,335,254, respectively.

Accrued Vacation and Compensatory Pay - HHSC 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 a rate of one and three-quarters working days for each month of service. Vacation days may be accumulated to a maximum of 90 days.

Postemployment Benefits - HHSC records an expense for postemployment benefits expense, such as retiree medical and dental costs, over the years of service on an accrual basis based on an allocation from the State of Hawaii primarily based on payroll.

Net Position - Net position is classified in three components. Net position invested in capital assets - net of related debt consist of capital assets net of accumulated depreciation and are reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. Restricted expendable net position is noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Corporation. Unrestricted net position is the remaining net assets that do not meet the definition of invested in capital assets - net of related debt or restricted.

Note 2 - Summary of Significant Accounting Policies (Continued)

Operating Revenue and Expenses - HHSC has defined its operating revenue and expenses as those relating to the provision of healthcare services. The revenue and expenses relating to capital and related financing activities, noncapital financing activities, and investing activities are excluded from that definition.

Net Patient Service Revenue - Net patient service revenue is recorded on an accrual basis in the period in which the related services are provided at established rates, less contractual adjustments and provision for doubtful accounts. HHSC, as a safety net provider, provides charity care to certain patients; the specific cost of such care for the years ended June 30, 2013 and 2012 was approximately $5,046,000 and $4,350,000, respectively.

HHSC has agreements with third-party payors that provide for payments at amounts different from their established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per-diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are recorded on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. The adjustments to the final settlements did not have a significant impact on the fiscal year 2013 and 2012 financial statements.

The estimated third-party payor settlements are based on estimates because complete information is not currently available to determine the final settlement amounts for certain cost report years. Management has used its best effort, judgment, and certain methodologies to estimate the anticipated final outcome.

A summary of the payment arrangements with major third-party payors is as follows:

- *Medicare* - Inpatient acute services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge referred to as the inpatient prospective payment system (IPPS). Under the IPPS, each case is categorized into a diagnosis-related group (DRG). Each DRG has a payment weight assigned to it based on the average resources used to treat Medicare patients in that DRG.

  Outpatient services rendered to Medicare beneficiaries are paid under a prospective payment system called ambulatory payment classifications (APC). Services in each APC are similar clinically and in terms of the resources they require. A payment rate is established for each APC and, depending on the services provided, hospitals may be paid for more than one APC for an encounter.

Note 2 - Summary of Significant Accounting Policies (Continued)

Skilled nursing services provided to Medicare beneficiaries are paid on a per-diem prospective payment system covering all costs (routine, ancillary, and capital) related to the services furnished. The per-diem payments for each admission are case-mix adjusted using a resident classification system (resource utilization groups) based on data from resident assessments and relative weights developed from staff time data.

All Medicare-certified hospitals and skilled nursing facilities are required to file annual Medicare cost reports. HHSC facilities required to file Medicare cost reports have been audited by the Medicare fiscal intermediary through fiscal year 2007.

- *Medicaid* - Inpatient acute services rendered to Medicaid program beneficiaries are reimbursed under a prospectively determined rate per day and per discharge with a cost settlement for capital costs. Medicaid long-term care services are reimbursed based on a price-based case mix reimbursement system. The case mix reimbursement system uses the resource utilization groups classification system calculated from the minimum data set assessment. The case mix reimbursement payment method takes into account a patient's clinical condition and the resources needed to provide care for the patient. Medicaid outpatient services are reimbursed based on a fee schedule using current procedure terminology (CPT) codes established for the State.
- *Critical Access Hospital (CAH)* - HHSC has eight facilities (Hale Ho'ola Hamakua, Kauai Veterans Memorial Hospital, Kahuku Medical Center, Ka'u Hospital, Kohala Hospital, Kula Hospital, Lanai Community Hospital, and Samuel Mahelona Memorial Hospital) that are designated as critical access hospitals (CAHs) by the Centers for Medicare and Medicaid Services (CMS). CAHs are limited-service hospitals located in rural areas that receive cost-based reimbursement. To be designated a CAH, a facility must, among other requirements: (1) be located in a county or equivalent unit of a local government in a rural area, (2) be located more than a 35-mile drive from a hospital or another healthcare facility, or (3) be certified by the State as being a necessary provider of healthcare services to residents in the area. These facilities are paid an interim reimbursement rate throughout the year based on each facility's expected costs per inpatient day or the allowable outpatient cost-to-charge. After the close of each fiscal year, the facility would receive retrospective settlements for the difference between interim payments received and the total allowable cost as documented in the Medicare cost reports.

Note 2 - Summary of Significant Accounting Policies (Continued)

- *Sole Community Hospital* - HHSC has three facilities (Hilo Medical Center, Kona Community Hospital, and Maui Memorial Medical Center) that are designated as sole community hospitals by the CMS. Inpatient case rates for services rendered to Medicare beneficiaries are finally determined upon the filing of the annual Medicare cost reports.

- *Hawaii Medical Service Association (HMSA)* - Inpatient services rendered to HMSA subscribers are reimbursed at prospectively determined case rates. The prospectively determined case rates are not subject to retroactive adjustment. In addition, outpatient surgical procedures and emergency room visits are reimbursed at a negotiated case rate. All other outpatient services are reimbursed based on a fee schedule using standard CPT codes.

- *Other Commercial* - HHSC has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment under these agreements includes prospectively determined rates per discharge, discounts from established rates, and prospectively determined daily rates.

The Medicare program has initiated a recovery audit contractor (RAC) initiative, whereby claims subsequent to October 1, 2007 may be reviewed by contractors for validity, accuracy, and proper documentation. HHSC has been contacted by the RAC auditors and is currently unable to determine the extent of liability for overpayments, if any.

State Appropriations - HHSC recognizes general and capital appropriations at the time allotments are made available to the facility for expenditure.

Effective July 1, 2008, HHSC - Corporate (Corporate) permanently allocated general appropriations to each facility. General appropriations are reflected as nonoperating revenue and capital appropriations are included in capital grants and contributions after the nonoperating revenue (expenses) subtotal in the statement of revenue, expenses, and changes in net position. If restrictions are placed on such appropriations, the restrictions are given separate and discrete accounting recognition.

Bond Interest - HHSC is allocated an amount for interest paid by the State of general obligation bonds whose proceeds were used for hospital construction. A corresponding contribution from the State is also allocated to HHSC. The bonds are obligations for the State, to be paid by the State's General Fund, and are not reported as liabilities of HHSC. For the years ended June 30, 2013 and 2012, interest expense totaled approximately $6,760,000 and $6,150,000, respectively.

Note 2 - Summary of Significant Accounting Policies (Continued)

Risk Management - HHSC is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; and employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any of the three preceding years. The facilities are self-insured for workers' compensation and disability claims and judgments as discussed in Note 9.

Accounting Changes - In November 2010, the GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus*. This pronouncement, which is an amendment to Statement No. 14 and Statement No. 34, modifies certain requirements for inclusion of component units in the financial reporting entity. This statement also amends the criteria for reporting components units as if they were part of the primary government (that is, blending) in certain circumstances. Lastly, the statement also clarifies the reporting of equity interests in legally separate organizations. The Corporation has adopted this standard as of June 30, 2013.

In December 2010, the GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. This statement incorporates into GASB literature certain accounting and financial reporting guidance issued on or before November 30, 1989 that is included in FASB statements and interpretations, APB opinions, and accounting research bulletins of the AICPA Committee on Accounting Procedure. The Corporation has adopted this standard as of June 30, 2013.

In June 2011, the GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. The statement incorporates deferred outflows of resources and deferred inflows of resources, as defined by GASB Concepts Statement No. 4, into the definitions of the required components of the residual measure of net position, formerly net assets. This statement also provides a new statement of net position format to report all assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position. The Corporation has adopted this standard as of June 30, 2013.

Upcoming Accounting Changes - In March 2012, the GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*. Statement No. 65 establishes accounting and financial reporting standards that reclassify, as deferred outflows and inflows of resources, certain items that were previously reported as assets and liabilities. This statement also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources. The statement will be effective for the 2014 fiscal year.

Note 2 - Summary of Significant Accounting Policies (Continued)

In June 2012, the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions.* Statement No. 68 requires governments providing defined benefit pensions to recognize their unfunded pension benefit obligation as a liability for the first time and to more comprehensively and comparably measure the annual costs of pension benefits. This net pension liability will be computed differently than the current unfunded actuarial accrued liability, using specific parameters set forth by the GASB. The statement also enhances accountability and transparency through revised note disclosures and required supplemental information (RSI). The statement will be effective for the 2015 fiscal year.

HHSC is currently evaluating the impact these standards will have on the financial statements when adopted.

Concentration of Credit Risk - Patient accounts receivable consist of amounts due from insurance companies and patients for services rendered by the facilities. The facilities grant credit without collateral to their patients, most of whom are local residents and are insured under third-party payor arrangements. The mix of receivables from patients and third-party payors as of June 30, 2013 and 2012 was as follows:

	Percentage	
	2013	2012
Medicare	27 %	24 %
Medicaid	24	23
HMSA	11	13
Other third-party payors	24	24
Patient and other	14	16
Total	100 %	100 %

Note 3 - Investments

HHSC's investment options are limited to investments listed in the Hawaii Revised Statutes. At June 30, 2013, HHSC held investments in U.S. Treasury obligations, U.S. government agencies, and certificates of deposit. At June 30, 2013, the fair value of these investments was $3,355,206, $1,632,909, and $2,083,078, respectively. At June 30, 2012, HHSC held investments in U.S. Treasury obligations, U.S. government agencies, and certificates of deposit. At June 30, 2012, the fair value of these investments was $3,516,834, $1,618,401, and $2,076,921, respectively.

Note 3 - Investments (Continued)

HHSC's investments are subject to several types of risk, which are examined in more detail below:

Custodial Credit Risk of Investments

Custodial credit risk is the risk that, in the event of the failure of the counterparty, HHSC will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. All of HHSC's investments are held by financial institutions registered in HHSC's name.

Interest Rate Risk

As a means of limiting its exposure to fair value losses arising from interest rates, HHSC's investment policy generally limits maturities on investments to not more than five years from the date of investment. All of HHSC's investments at June 30, 2013 and 2012 have an original maturity date within five years from the date of investment.

Credit Risk

HHSC's investment policy limits investments in state and U.S. Treasury securities, time certificates of deposit, U.S. government or agency obligations, repurchase agreements, commercial paper, bankers' acceptances, and money market funds maintaining a Triple-A rating. As of June 30, 2013 and 2012, HHSC held investments in U.S. Treasury securities and U.S. government agencies.

Concentration of Credit Risk

HHSC's investment policy provides guidelines for portfolio diversification by placing limits on the amount that may be invested in any one issuer, types of investment instruments, and position limits per issue of an investment instrument. There were no investments that individually exceed 5 percent of HHSC's total investments at June 30, 2013 and 2012.

Note 4 - Capital Assets

Transactions in the capital asset accounts for the year ended June 30, 2013 were as follows:

	Beginning of Year	Additions	Retirements	Transfers and Adjustments	End of Year
Assets not subject to depreciation:					
Land and land improvements	$ 6,456,524	$ -	$ (10,907)	$ 89,165	$ 6,534,782
Construction in progress	31,402,877	47,469,566	-	(22,454,598)	56,417,845
Assets subject to depreciation:					
Buildings and improvements	392,899,001	723,662	(761,102)	17,654,383	410,515,944
Equipment	174,780,856	10,951,461	(7,686,709)	4,711,050	182,756,658
Total	605,539,258	59,144,689	(8,458,718)	-	656,225,229
Less accumulated depreciation:					
Buildings and improvements	(167,013,410)	(14,018,605)	388,325	(582,946)	(181,226,636)
Equipment	(128,964,371)	(13,913,423)	7,586,939	582,946	(134,707,909)
Total	(295,977,781)	(27,932,028)	7,975,264	-	(315,934,545)
Capital assets - Net	$ 309,561,477	$ 31,212,661	$ (483,454)	$ -	$ 340,290,684

Transactions in the capital asset accounts for the year ended June 30, 2012 were as follows:

	Beginning of Year	Additions	Retirements	Transfers and Adjustments	End of Year
Assets not subject to depreciation:					
Land and land improvements	$ 6,483,834	$ -	$ (27,310)	$ -	$ 6,456,524
Construction in progress	21,485,947	36,215,047	-	(26,298,117)	31,402,877
Assets subject to depreciation:					
Buildings and improvements	376,906,867	2,651,459	(1,976,440)	15,317,115	392,899,001
Equipment	160,299,322	7,627,974	(4,127,442)	10,981,002	174,780,856
Total	565,175,970	46,494,480	(6,131,192)	-	605,539,258
Less accumulated depreciation:					
Buildings and improvements	(154,203,980)	(13,902,785)	1,753,153	(659,798)	(167,013,410)
Equipment	(119,868,900)	(13,330,333)	3,575,064	659,798	(128,964,371)
Total	(274,072,880)	(27,233,118)	5,328,217	-	(295,977,781)
Capital assets - Net	$ 291,103,090	$ 19,261,362	$ (802,975)	$ -	$ 309,561,477

The State Department of Accounting and General Services and others transferred capital assets, including construction in progress, aggregating approximately $26,939,000 and $25,597,000 to HHSC as a contribution of capital for June 30, 2013 and 2012, respectively.

Note 4 - Capital Assets (Continued)

HHSC may enter into capital leases on behalf of the facilities. In that situation, the capital lease obligation is recorded in Corporate's accounting records. While the assets are being constructed, the amounts are recorded as construction in progress in the accounting records of either Corporate or the facilities. Corporate makes the capital lease payments and incurs the interest expense, while the facilities record depreciation on the capital asset. Corporate also computes capitalized interest on construction in progress and transfers the capitalized interest asset to the facilities. The facilities reimburse Corporate through the due from affiliates account.

The facilities may also enter into capital leases individually. In that situation, the capital lease obligation is recorded in the facility's accounting records. While the assets are being constructed, the amounts are recorded as construction in progress in the accounting records of the facility. The facility makes the capital lease payments and incurs the interest expense, as well as the depreciation on the capital asset.

In July 2011, HHSC entered into a $28.7 million contract with Siemens Healthcare to implement its Soarian Electronic Medical Records and Health Information Systems. West Hawaii Region and Corporate implemented the system in February 2013 and the other HHSC facilities will be implementing the system in a phased approach.

Note 5 - State of Hawaii Advances and Receivable

In fiscal year 2003, HHSC received a $14,000,000 advance from the State to relieve its cash flow shortfall. At June 30, 2013 and 2012, HHSC did not have the ability and thus does not intend to repay the advance. Furthermore, management does not expect the State to demand payment of the advance in fiscal year 2014. Accordingly, the advance is classified as a noncurrent liability at June 30, 2013 and 2012. The amount due to the State of $38,622,507 and $44,122,507 at June 30, 2013 and 2012, respectively, includes the $14,000,000 previously described plus $20,122,507 of cash advances to the Department of Health - Division of Community Hospitals, which was assumed by HHSC at the date of its formation, and $4.5 million in advances from the State. Of the $4.5 million in advances, a $2 million advance is due in fiscal year 2014.

At June 30, 2013 and 2012, $63,479,395 and $60,129,055 was due from the State for allotments made to HHSC before June 30, 2013 and 2012, respectively.

Note 6 - Accrued Vacation

Transactions in this account during the year ended June 30, 2013 were as follows:

	Beginning of Year	Additions	Reductions	End of Year	Current Portion	Noncurrent Portion
Accrued vacation	$ 44,815,498	$ 14,406,858	$ (18,880,689)	$ 40,341,667	$ 16,142,893	$ 24,198,774

Transactions in this account during the year ended June 30, 2012 were as follows:

	Beginning of Year	Additions	Reductions	End of Year	Current Portion	Noncurrent Portion
Accrued vacation	$ 42,128,175	$ 20,024,703	$ (17,337,380)	$ 44,815,498	$ 16,036,158	$ 28,779,340

Note 7 - Employee Benefits

Defined Benefit Pension Plans - All full-time employees of HHSC are eligible to participate in the Employees' Retirement System of the State of Hawaii (ERS), a cost-sharing, multiple-employer public employee retirement system covering eligible employees of the State and counties.

The ERS is composed of a contributory retirement plan and a noncontributory retirement plan. Eligible employees who were in service and a member of the existing contributory plan on June 30, 1984 were given an option to remain in the existing plan or join the noncontributory plan effective January 1, 1985. All new eligible employees hired after June 30, 1984 automatically become members of the noncontributory plan. Both plans provide death and disability benefits and cost of living increases. Benefits are established by State statute. In the contributory plan, employees may elect normal retirement at age 55 with five years of credited service or elect early retirement at any age with 25 years of credited service. Such employees are entitled to retirement benefits, payable monthly for life, of 2 percent of their average final salary, as defined, for each year of credited service. Benefits fully vest on reaching five years of service; retirement benefits are actuarially reduced for early retirement. Covered contributory plan employees are required by State statute to contribute 7.8 percent of their salary to the plan; HHSC is required by State statute to contribute the remaining amounts necessary to pay contributory plan benefits when due. In the noncontributory plan, employees may elect normal retirement age at 62 with 10 years of credited service or at age 55 with 30 years of credited service, or elect early retirement at age 55 with 20 years of credited service. Such employees are entitled to retirement benefits, payable monthly for life, of 1.25 percent of their average final salary, as defined, for each year of credited service. Benefits fully vest on reaching 10 years of service; retirement benefits are actuarially reduced for early retirement. HHSC is required by State statute to contribute all amounts necessary to pay noncontributory plan benefits when due.

Note 7 - Employee Benefits (Continued)

On July 1, 2006, a new hybrid contributory plan became effective pursuant to Act 179, Session Laws of Hawaii of 2004. Participants prior to July 1, 2006 could choose to participate in this hybrid plan or remain in the existing plans. New employees hired after July 1, 2006 are required to join the hybrid plan. Participants will contribute 6 percent of their salary to this plan. Furthermore, members in the hybrid plan are eligible for retirement at age 62 with five years of credited service or at age 55 and 30 years of credited service. Members will receive a multiplier of 2 percent for each year of credited service in the hybrid plan. The benefit payment options are similar to the current contributory plan.

HHSC's contribution to the ERS for the years ended June 30, 2013, 2012, and 2011 was approximately $39.5 million, $36.7 million, and $33.8 million, respectively, equal to the required contribution.

The ERS issues a publicly available financial report that includes financial statements and required supplemental information. That report may be obtained by writing to the Employees' Retirement System, 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813-2929 or by calling (808) 586-1660.

Postemployment Health Care and Life Insurance Benefits - In addition to providing pension benefits, the State provides certain postretirement healthcare benefits (medical, prescription drug, vision, and dental) to all qualified employees and their dependents. Pursuant to Act 88 SLH of 2001, the State contributes to the Hawaii employer-union health benefits trust fund, an agent multiple-employer defined benefit plan. This plan is sponsored by and administered by the State of Hawaii.

For employees hired before July 1, 1996, the State pays the entire monthly healthcare premium for employees retiring with 10 or more years of credited service, and 50 percent of the monthly premium for employees retiring with fewer than 10 years of credited service. Retirees in this category can elect a family plan to cover dependents.

For employees hired after June 30, 1996 but before July 1, 2001, and who retire with less than 10 years of service, the State makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the State pays 50 percent of the retired employees' monthly Medicare or non-Medicare premium. For those retiring with at least 15 years but fewer than 25 years of service, the State pays 75 percent of the base monthly contribution. For those employees retiring with at least 25 years of service, the State pays 100 percent of the base monthly contribution. Only single plan coverage is provided for retirees in this category. Retirees in this category can elect a family plan to cover dependents.

Note 7 - Employee Benefits (Continued)

For employees hired on or after July 1, 2001, and who retire with less than 10 years of service, the State makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the State pays 50 percent of the base monthly contribution. For those retiring with at least 15 years but fewer than 25 years of service, the State pays 75 percent of the base monthly contribution. For those employees retiring with at least 25 years of service, the State pays 100 percent of the base monthly contribution. Only single plan coverage is provided for retirees in this category. Retirees can elect family coverage but must pay the difference in plan costs.

Free life insurance coverage for retirees and free dental coverage for dependents under age 19 are also available. Retirees covered by the medical portion of Medicare are eligible to receive reimbursement of the basic medical coverage premium.

The State of Hawaii receives an annual actuarial valuation to compute the annual required contribution (ARC) necessary to fund the postretirement obligation for all state employees, including those employed by HHSC. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the current normal cost of benefits provided this year and to amortize any unfunded actuarial liabilities over a period not to exceed 30 years. Currently, the State contributes to the plan on a "pay-as-you-go basis," only contributing the amounts necessary to pay for current year benefits.

For cost allocation purposes, the State allocates the full accrual ARC expense among its component units, including HHSC, based on respective percentages of covered payroll. The State requires HHSC to contribute to the plan at a rate of covered payroll necessary to fund its share of the annual "pay-as-you-go contributions," which is significantly less than the actuarially determined contribution rate. HHSC then allocates its full accrual ARC expense among its various regions based on their respective percentages of covered payroll. The cumulative difference between the amounts the State requires HHSC to contribute and HHSC's allocation of the total plan ARC expense is recorded as other postretirement benefit liability on the balance sheet of each region. HHSC's actual cash contributions for postretirement benefits approximated $26.5 million, $19.8 million, and $16.3 million for the years ended June 30, 2013, 2012, and 2011, respectively.

	2013	2012
Beginning of year	$ 196,718,378	$ 143,024,739
Required contributions	96,885,417	73,515,244
Actual contributions	(26,488,369)	(19,821,605)
End of year	$ 267,115,426	$ 196,718,378

Note 7 - Employee Benefits (Continued)

Sick Leave - Accumulated sick leave as of June 30, 2013 and 2012 was approximately $78,534,000 and $75,796,000, respectively. Sick leave accumulates at the rate of 14 hours for each month of service, as defined, without limit. Sick pay can be taken only in the event of illness and is not convertible to pay upon termination of employment. Accordingly, no liability for sick pay is recorded in the accompanying financial statements.

Note 8 - Long-term Liabilities

Long-term liability activity for the year ended June 30, 2013 was as follows:

	2012	Current Year Additions	Current Year Reductions	2013	Amounts Due Within One Year
Long-term debt	$ 34,564,675	$ 9,533,857	$ (9,161,669)	$ 34,936,863	$ 1,589,257
Capital lease obligations	$ 32,186,230	$ 1,625,333	$ (7,286,082)	$ 26,525,481	$ 8,512,172

Long-term liability activity for the year ended June 30, 2012 was as follows:

	2011	Current Year Additions	Current Year Reductions	2012	Amounts Due Within One Year
Long-term debt	$ 35,769,304	$ -	$ (1,204,629)	$ 34,564,675	$ 9,212,308
Capital lease obligations	$ 25,244,450	$ 16,077,682	$ (9,135,902)	$ 32,186,230	$ 7,257,210

The long-term debt obligations are summarized as follows:

Roselani Place - In September 2007, Alii exercised its option to purchase its 113-unit assisted-living and Alzheimer facility and personal property from the developer/landlord for $16 million. In connection with the purchase, Alii also assumed the land lease on which the facility is situated, and a parking license covering real property adjacent to the facility.

In connection with the purchase agreement, Alii also reached an agreement with the developer/landlord concerning an arbitration award that was rendered in favor of the developer/landlord in January 2006 for $1.9 million. The arbitration decision was on appeal to the Intermediate Court of Appeals of the State of Hawaii. Alii and the developer/landlord agreed to settle the $1.9 million judgment for $500,000. This settlement payment is in addition to the $16 million purchase price.

The note payable requires monthly payments of $126,433 including interest at 5.9 percent, through October 2027. The note is collateralized by certain property and equipment. At June 30, 2013 and 2012, the balance payable was $14,654,668 and $15,211,810, respectively.

Note 8 - Long-term Liabilities (Continued)

MMMC Working Capital Financing - In April 2008, Maui Memorial Medical Center (MMMC) obtained an $11 million taxable revolving line of credit loan facility from JPMorgan Chase Bank, N.A. for working capital purposes. On May 20, 2010, MMMC signed a revised agreement on the $11 million taxable revolving line of credit, removing financial covenants and restructuring repayment. In January 2011, JPMorgan Chase Bank, N.A. assigned its interest in the taxable revolving line of credit loan facility to Bank of Montreal. Concurrently, MMMC and Bank of Montreal agreed to amend the terms and conditions of the loan to extend the maturity date to January 2012 and increase the draws under the revolving credit facility from $6.5 million to $8.0 million. At June 30, 2012, the balance payable was $8 million. During the current year, the Bank of Montreal loan was refinanced with USDA bonds issued.

In 2013, MMMC issued general obligation bonds. These bonds were executed in two parts, series 2012A and series 2012B. The series 2012A bonds were issued to refinance MMMC's existing $8 million loan which had been held with Bank of Montreal. Total borrowing under the first agreement was $8,100,000. These bonds carry an interest rate of 4.05 percent. The series 2012A bonds are secured by a loan note guarantee issued by the United States Department of Agriculture (USDA) through its Rural Development division. The series 2012B bonds will provide initial funding for the purposes of construction of a physician clinic adjacent to the hospital, partially funding a building renovation, and equipment associated with imaging services. Total borrowing costs under the second agreement were $901,000. These bonds carry a variable interest rate that starts at 5 percent until September 1, 2017, at which point, the rate shall reset on each September 1, occurring every five years thereafter at a rate equal to 3.75 percent over the prevailing five-year FHLB bulled rate (Seattle). In the event that such rate is no longer available or practicable, a similar index, as mutually agreed upon by the issuer and holders of the bonds, will be used. The series 2012B bonds are unsecured. The bonds are payable in annual installments ranging from $172,000 to $978,000. In connection with the series 2012A and series 2012B bond issuance, MMMC is subject to certain financial covenants.

In October 2013, MMMC closed on the final issuance under its agreement with the USDA. The final issuance consisted of an additional $12.6 million. The third and final agreement will provide the remaining funding for the construction of a physician clinic adjacent to the hospital and also funding for building renovation and equipment associated with imaging services. Total estimated cost of construction will be approximately $11.6 million.

Note 8 - Long-term Liabilities (Continued)

Hilo Residency Training Program - In June 2001, HHSC acquired land, building, and medical equipment of $11,893,162 from Hilo Residency Training Program, Inc. (HRTP) to ensure the uninterrupted operation of the Hilo Medical Center Cancer Treatment Center and its radiation and medical oncology services. As part of the acquisition, HHSC assumed HRTP's outstanding balances on the loans and notes payable of $11,893,162 from Central Pacific Bank and the United States Department of Agriculture (USDA). The assets and related liabilities have been recorded in the facility's accounting records. The loans and notes payable are collateralized by a security interest in the capital assets acquired from HRTP, as well as any rights, interest, and other tangible assets relating to such property. In October 2007, the loans and notes payable to Central Pacific Bank and the USDA were refinanced into a single note payable to Academic Capital.

The note payable requires monthly payments, including interest, totaling $64,069 through September 2032. The note payable is secured by certain assets of Hilo Medical Center (HMC). At June 30, 2013 and 2012, the balance payable was $8,834,012 and $9,073,898, respectively.

Yukio Okutsu Veterans' Home - In May 2008, the Yukio Okutsu Veterans' Home entered into a line of credit for $1.8 million, which calls for monthly interest-only payments at an interest rate of 5 percent. In December 2013, the Yukio Okutsu Veterans' Home signed an extension, which extended the balloon principal payment due date from December 2013 to December 2014. At June 30, 2013 and 2012, the balance payable was $1,303,831 and $1,139,141, respectively.

KVMH's Port Allen Clinic - In April 2008, HHSC - Corporate entered into a promissory note with a bank to finance the leasehold improvements for KVMH's Port Allen Clinic. The note requires monthly principal and interest payments of $16,207 through maturity at November 23, 2017. The note is secured by a security interest in the leasehold improvements of the clinic. At June 30, 2013 and 2012, the balance payable was $671,121 and $800,114, respectively.

Kahuku Medical Center - In July 2012, Kahuku Medical Center entered into a purchase and maintenance services agreement with Holden Hospital Supply, Inc. to finance the purchase and maintenance of an oxygen generator. The note requires monthly payments of $4,188 through maturity on June 30, 2019. The agreement also includes the financing of electrical and additional charges related to the oxygen generator. The note requires an additional monthly payment of $5,550 through September 2013. Interest is not a component of the agreement. At June 30, 2013, the balance of the loan was $267,964.

Note 8 - Long-term Liabilities (Continued)

The capital lease obligations are summarized as follows:

Corporate - HHSC entered into capital leases on behalf of the facilities. The capital lease obligation is recorded in HHSC - Corporate's accounting records. While the assets are being constructed, the amounts are recorded as construction in progress in the accounting records of either Corporate or the facilities. Corporate makes the capital lease payments and incurs the interest expense, while the facilities record depreciation on the capital assets. Corporate also computes capitalized interest on construction in progress and transfers the capitalized interest asset to the facilities. The facilities reimburse Corporate through the due from affiliates account. For the years ended June 30, 2013 and 2012, capitalized interest was not material. Capital lease obligations recorded on Corporate's accounting records at June 30, 2013 and 2012 were $25,739,557 and $30,776,781, respectively.

During 2012, Corporate entered into a capital lease with Siemens for the financing of an electronic medical records system that is currently being installed.

Maui Memorial Medical Center - In September 2009, MMMC entered into a capital lease for the acquisition of equipment for $780,000. The lease requires monthly payments over 48 months with a bargain purchase option at the end of the term. On November 30, 2009, MMMC entered into a capital lease for the acquisition of equipment for $830,000. The lease requires monthly payments over 60 months and is collateralized by the equipment. At June 30, 2013 and 2012, the balance payable on these leases was $277,165 and $564,418, respectively.

Kahuku Medical Center - Kahuku Medical Center has entered into various capital lease obligations. The leases require monthly payments and are collateralized by the equipment. At June 30, 2013 and 2012, the balance payable was $55,930 and $85,336, respectively.

Kauai Veterans Memorial Hospital - In August 2009, KVMH entered into a capital lease for the acquisition of a mammography machine. The lease term is 60 months, with a monthly payment of $12,748, including interest at a rate of 8.5 percent. The lease is collateralized by the equipment. In October 2009, KVMH entered into a capital lease for the acquisition of an MRI machine. The lease term is 60 months, with a monthly payment of $13,676, including interest at a rate of 8.5 percent. The lease is collateralized by the equipment. At June 30, 2013 and 2012, the balance payable on the leases was $353,998 and $638,064, respectively.

Alii Health Center - Kona - During the year, Alii - Kona entered into a capital lease for equipment for $125,921. The lease term is 60 months, with a monthly payment of $2,099, including interest. The lease is collateralized by the equipment. At June 30, 2013, the balance payable was $98,831.

Note 8 - Long-term Liabilities (Continued)

The following is a schedule by year of principal and interest as of June 30, 2013:

Years Ending June 30	Long-term Debt Principal	Long-term Debt Interest	Capital Lease Obligation Principal	Capital Lease Obligation Interest
2014	$ 1,589,257	$ 1,780,750	$ 8,512,172	$ 862,046
2015	2,601,186	1,771,249	6,640,625	456,820
2016	1,374,303	1,626,560	5,555,922	329,680
2017	1,456,593	1,541,988	2,398,570	239,659
2018	1,358,856	3,586,722	964,649	166,932
2019-2023	14,815,879	8,184,124	1,515,148	522,518
2024-2028	8,856,969	1,263,479	938,395	106,824
2029-2033	2,883,820	383,700	-	-
Total payments	$ 34,936,863	$ 20,138,572	$ 26,525,481	$ 2,684,479

Note 9 - Commitments and Contingencies

Professional Liability - HHSC maintains professional and general liability insurance with a private insurance carrier with a $35 million limit per claim and a $39 million aggregate. HHSC has also purchased additional excess insurance with a $10 million per claim and aggregate limit. HHSC's general counsel advises that, in the unlikely event any judgments rendered against HHSC exceed HHSC's professional liability coverage, such amount would likely be paid from an appropriation from the State's General Fund. Settled claims have not exceeded the coverage provided by the insurance carrier in any of the past three fiscal years.

Workers' Compensation Liability - HHSC is self-insured for workers' compensation claims. HHSC pays a portion of wages for injured workers (as required by law), medical bills, judgments as stipulated by the State's Department of Labor, and other costs. HHSC also directly provides treatment for injured workers. The estimated liability is based on actuarial projections of costs using historical claims-paid data. Estimates are continually monitored and reviewed and, as settlements are made or estimates adjusted, differences are reflected in current operations. HHSC has accrued a liability of $13,739,000 and $14,894,000 for unpaid claims as of June 30, 2013 and 2012, respectively.

	2013	2012
Estimated liability - Beginning of year	$ 14,894,000	$ 15,209,000
Estimated claims incurred - Including changes in estimates	2,180,300	2,745,000
Claim payments	(3,335,300)	(3,060,000)
Estimated liability - End of year	$ 13,739,000	$ 14,894,000

Note 9 - Commitments and Contingencies (Continued)

Operating Leases - HMC, MMMC, and Kahuku entered into various operating leases and related sublease agreements. Future minimum lease payments and sublease receipts at June 30, 2013 are as follows:

Years Ending June 30	Lease Payments	Sublease Receipts
2014	$ 1,756,951	$ 106,294
2015	1,748,860	106,294
2016	1,777,724	106,294
2017	1,807,452	106,294
2018	1,061,188	-
Thereafter	5,948,012	-
Total	$ 14,100,187	$ 425,176

Ceded Lands - The Office of Hawaiian Affairs (OHA) and the State are presently in litigation involving the State's alleged failure to properly account for and pay to OHA monies due to OHA under the provisions of the Hawaii State Constitution and Chapter 10 of the Hawaii Revised Statutes for use by the State of certain ceded lands.

During the 2006 legislative session, the State of Hawaii Legislature enacted Act 178, which provided interim measures to ensure that a certain amount of proceeds was made available to OHA from the pro-rata portion of the public land trust for the betterment of the conditions of native Hawaiians. The act provided that the State agencies that collect receipts from the use of lands within the public land trust transfer a total of $3,775,000 to OHA within 30 days of the close of each fiscal quarter (or $15,100,000 per fiscal year), beginning with the 2006 fiscal year. In addition, the act appropriated $17,500,000 out of the State's general revenue to pay OHA for underpayments of the State's use of lands in the public land trust for the period from July 1, 2001 to June 30, 2005.

Note 9 - Commitments and Contingencies (Continued)

On September 20, 2006, the governor of the State of Hawaii issued Executive Order No. 06-06, which established procedures for the State agencies to follow in order to carry out the requirements of Act 178. Each State agency that collects receipts from the use of ceded or public land trust land is to determine OHA's share of such receipts by calculating the ceded/nonceded fraction of the parcel that generated the receipt, multiplying the receipt by the ceded/nonceded fraction, and multiplying that result by 20 percent. The resulting amounts are to be deposited into a trust holding account established for such purpose, and within 10 days of the close of each fiscal quarter, the amounts are to be transferred to OHA. Within a specified period after the close of each quarter, the director of finance is to reconcile the actual amounts transferred to OHA with the required amount of $3,775,000 and adjust each specific agency's payments accordingly.

For the years ended June 30, 2013 and 2012, there were no payments made to OHA.

Litigation - HHSC is a party to certain litigation arising in the normal course of business. In management's opinion, the outcome of such litigation will not have a material impact on HHSC's financial statements.

Note 10 - Clinical Laboratories of Hawaii Partnership

On May 1, 2002, HHSC entered into a partnership agreement with Clinical Laboratories of Hawaii, Inc., St. Francis Healthcare Enterprises, Inc., and Kapiolani Service Corporation to form Clinical Laboratories of Hawaii, LLP (the "Partnership"). The primary purpose of the Partnership was to provide clinical laboratory services within the State of Hawaii. On June 1, 2002, HHSC contributed the use of the laboratory space and related ancillary services in seven of its facilities (Hilo Medical Center, Kona Community Hospital, MMMC, Hale Ho'ola Hamakua, Ka'u Hospital, Kohala Hospital, and Kula Hospital) in exchange for a less than controlling interest in the Partnership.

In September 2008, the partners sold their interest in the Partnership to Sonic Healthcare USA. According to the terms of the sale, the majority of the sales proceeds was distributed to each of the partners in the Partnership according to their ownership percentage in the Partnership, with a certain portion being held in escrow to cover unanticipated compliance claims, to be distributed to the partners at certain dates in the future. HHSC's share of the sales proceeds was $8,484,290, which was used to pay down HHSC's accounts payable to the Partnership as stated in the sale agreement. In addition, the terms of the agreement require HHSC to continue to provide laboratory space and certain ancillary services until May 2012. As a result, $4 million of the proceeds was deferred and has been amortized on a straight-line basis through May 2012 for the obligation to provide this space.

Other Supplemental Information

Hawaii Health Systems Corporation

Supplemental Schedule of Reconciliation of Cash on Deposit and Assets Limited as to Use with the State of Hawaii Year Ended June 30, 2013

	Appropriation Symbol	
Cash and cash equivalents - State of Hawaii		
Special funds:		
	S-13-303-H	$ 444,843
	S-13-350-H	17,776
	S-13-356-H	299,341
	S-93-359-H	2,818
	S-96-359-H	2,007
	S-97-359-H	3,556
	S-12-350-H	1,424,325
	S-12-351-H	166,555
	S-12-352-H	64,330
	S-12-353-H	80,690
	S-11-354-H	810,863
	S-10-355-H	5,412,415
	S-10-371-H	320,825
	S-10-358-H	149,394
	S-10-365-H	309,385
	S-13-312-H	390,394
	S-13-359-H	1
	S-13-373-H	335,117
Trust funds:	T-04-918-H	1,273
	T-04-921-H	6,679
Total per State		10,242,587
Reconciling items		81,778
Total per HHSC		**$ 10,324,365**
Assets limited as to use - Patient trust funds:		
	T-04-923-H	$ 4,129
	T-04-911-H	22,912
	T-11-909-H	9,234
	T-11-925-H	70,701
Total per State		106,976
Reconciling items:		
Patients' safekeeping deposits held by financial institutions		183,861
Restricted assets held by financial institutions		2,900,015
Total per HHSC		**$ 3,190,852**

Hawaii Health Systems Corporation

Statement of Net Position (Deficit) of Facilities
June 30, 2013

	Facilities													
	Hilo Medical Center	Hale Ho'ola Hamakua	Ka'u Hospital	Yukio Okutsu Veterans Care Home - Hilo	Kona Community Hospital	Kohala Hospital	Maui Memorial Medical Center	Kula Hospital	Lanai Community Hospital	Leahi Hospital	Maluhia	Kahuku Medical Center	Kauai Veterans Memorial Hospital	Samuel Mahelona Memorial Hospital
Assets														
Current Assets														
Cash and cash equivalents - State of Hawaii	$ 1,513,305	$ 167,828	$ 63,807	$ -	$ 810,863	$ 80,690	$ 5,412,415	$ 320,825	$ 149,394	$ 390,394	$ 309,385	$ -	$ 8,382	$ 335,117
Cash and cash equivalents	3,616,342	11,349	41,658	700	2,778,621	832,907	11,709,393	162,633	110,310	808,644	388,440	506,713	302,934	18,833
Patient accounts receivable - Less allowances for doubtful accounts	20,187,063	2,840,549	444,679	1,705,371	14,194,062	1,160,277	26,122,095	3,136,597	576,355	2,208,830	2,783,309	2,006,105	3,478,230	2,632,460
Investments	7,071,193	-	-	-	-	-	-	-	-	-	-	-	-	-
Supplies and other current assets	3,982,049	129,403	360,036	8,629	2,302,395	54,453	8,602,066	300,664	114,691	153,403	1,283,645	232,847	677,261	355,883
Due from the State of Hawaii	4,458,000	1,000	2,663,000	-	5,991,000	2,076,000	27,905,000	5,565,000	1,930,000	1,984,000	3,777,000	4,809,000	57,000	1,534,395
Estimated third-party payor settlements	9,026,633	470,573	532,140	-	4,484,046	395,167	9,021,364	342,694	42,996	2,788,211	1,825,209	-	2,123,939	609,387
Total current assets	49,854,585	3,620,702	4,105,320	1,714,700	30,560,987	4,599,494	88,772,333	9,828,413	2,923,746	8,333,482	10,366,988	7,554,665	6,647,746	5,486,075
Due from Affiliates - Net	-	-	-	-	-	-	11,654,019	-	-	-	-	-	-	-
Capital Assets - Net	47,328,026	19,622,099	4,885,305	24,412,787	26,604,700	1,258,134	118,815,499	11,505,111	2,592,162	7,454,678	6,319,294	2,881,782	12,702,133	6,895,588
Assets Limited as to Use	46,099	31,374	1,901	-	277,034	-	798,176	60,950	1,913	94,880	91,770	175	44,320	18,824
Other Assets	352,203	-	-	1,458	53,001	-	1,012,250	-	-	-	-	-	36,450	-
Total assets	**$ 97,580,913**	**$ 23,274,175**	**$ 8,992,526**	**$ 26,128,945**	**$ 57,495,722**	**$ 5,857,628**	**$ 221,052,277**	**$ 21,394,474**	**$ 5,517,821**	**$ 15,883,040**	**$ 16,778,052**	**$ 10,436,622**	**$ 19,430,649**	**$ 12,400,487**
Liabilities and Net Position (Deficit)														
Current Liabilities														
Current portion of long-term debt	$ 254,428	$ -	$ -	$ -	$ -	$ -	$ 259,833	$ -	$ -	$ -	$ -	$ 66,911	$ 145,628	$ -
Current portion of capital lease obligations	-	-	-	-	-	-	199,496	-	-	-	-	32,450	286,159	-
Accounts payable and accrued expenses	34,387,689	1,377,612	622,704	678,330	11,520,591	557,810	34,813,971	3,401,665	1,046,456	2,765,191	1,533,090	1,093,375	6,405,120	1,954,763
Current portion of accrued workers' compensation liability	627,000	89,000	7,000	-	541,000	139,000	823,000	176,000	1,000	464,000	156,000	-	122,000	170,000
Current portion of accrued vacation	4,482,888	314,685	228,632	2,000	1,863,570	174,613	4,176,745	767,082	78,770	984,237	799,000	212,239	1,096,364	483,234
Current portion of due to State of Hawaii	-	-	-	-	-	-	2,000,000	-	-	-	-	-	-	-
Other current liabilities	466,123	4,170	9,259	997	-	-	714,239	2,095	40,000	-	-	48,020	2,011,600	20,000
Total current liabilities	40,218,128	1,785,467	867,595	681,327	13,925,161	871,423	42,987,284	4,346,842	1,166,226	4,213,428	2,488,090	1,452,995	10,066,871	2,627,997
Long-term Debt - Less current portion	8,579,584	-	-	1,303,831	-	-	8,741,167	-	-	-	-	201,053	525,493	-
Capital Lease Obligations - Less current portion	-	-	-	-	-	-	77,669	-	-	-	-	23,480	67,839	-
Other Liabilities														
Accrued vacation - Less current portion	4,896,751	415,726	168,640	-	2,550,526	348,211	6,913,911	1,269,777	130,392	1,620,846	1,055,561	-	2,684,202	1,183,089
Accrued workers' compensation - Less current portion	2,762,000	196,000	176,000	-	1,191,000	159,000	3,106,000	629,000	68,000	516,000	435,000	-	750,000	279,000
Other postemployment benefit liability	64,896,491	6,050,152	3,395,996	-	28,423,801	3,015,599	89,432,144	11,466,974	1,669,368	12,084,196	10,034,799	-	21,803,314	7,556,555
Due to affiliates - Net	73,637,169	2,561,866	10,057,552	525,461	47,319,032	9,736,822	-	25,004,187	15,384,360	19,837,604	27,750,695	674,648	56,867,298	17,884,711
Due to the State of Hawaii - Less current portion	-	506,153	-	-	7,605,205	528,149	2,500,000	1,114,264	-	6,416,791	491,450	-	1,043,345	2,417,150
Patients' safekeeping deposits	46,099	31,374	1,901	-	-	-	-	60,950	1,913	85,647	67,235	175	6,858	17,780
Other liabilities	19,663	-	-	1,794,800	243,833	(3,960)	-	-	-	-	-	-	22,845	8,698
Total liabilities	195,055,885	11,546,738	14,667,684	4,305,419	101,258,558	14,655,244	153,758,175	43,891,994	18,420,259	44,774,512	42,322,830	2,352,351	93,838,065	31,974,980
Net Position (Deficit)														
Invested in capital assets - Net of related debt	38,494,014	19,622,099	4,885,305	23,108,956	26,604,700	1,258,134	118,538,335	11,505,111	2,592,162	7,454,678	6,319,294	2,557,888	11,677,014	6,895,588
Restricted for capital purchases	-	-	-	-	264,271	-	12,695	-	-	9,234	24,535	-	37,462	1,044
Unrestricted	(135,968,986)	(7,894,662)	(10,560,463)	(1,285,430)	(70,631,807)	(10,055,750)	(51,256,928)	(34,002,631)	(15,494,600)	(36,355,384)	(31,888,607)	5,526,383	(86,121,892)	(26,471,125)
Total net position (deficit)	(97,474,972)	11,727,437	(5,675,158)	21,823,526	(43,762,836)	(8,797,616)	67,294,102	(22,497,520)	(12,902,438)	(28,891,472)	(25,544,778)	8,084,271	(74,407,416)	(19,574,493)
Total liabilities and net position (deficit)	**$ 97,580,913**	**$ 23,274,175**	**$ 8,992,526**	**$ 26,128,945**	**$ 57,495,722**	**$ 5,857,628**	**$ 221,052,277**	**$ 21,394,474**	**$ 5,517,821**	**$ 15,883,040**	**$ 16,778,052**	**$ 10,436,622**	**$ 19,430,649**	**$ 12,400,487**

	Total Facilities	Corporate	Reclassifications and Eliminations	HHSC Combined	Hawaii Health Systems Foundation	Alii Community Care - Maui	Alii Community Care - Kona	Reclassifications and Eliminations	HHSC Consolidated
Assets									
Current Assets									
Cash and cash equivalents - State of Hawaii	$ 9,562,405	$ 761,960	$ -	$ 10,324,365	$ -	$ -	$ -	$ -	$ 10,324,365
Cash and cash equivalents	21,289,477	2,417,890	-	23,707,367	48,627	127,044	101,179	-	23,984,217
Patient accounts receivable - Less allowances for doubtful accounts	83,475,982	-	-	83,475,982	-	14,549	538,964	-	84,029,495
Investments	7,071,193	-	-	7,071,193	-	-	-	-	7,071,193
Supplies and other current assets	18,557,425	6,853	-	18,564,278	-	56,965	55,722	-	18,676,965
Due from the State of Hawaii	62,750,395	729,000	-	63,479,395	-	-	-	-	63,479,395
Estimated third-party payor settlements	31,662,359	-	-	31,662,359	-	-	-	-	31,662,359
Total current assets	234,369,236	3,915,703	-	238,284,939	48,627	198,558	695,865	-	239,227,989
Due from Affiliates - Net	11,654,019	312,660,202	(309,216,813)	15,097,408	-	-	-	(15,097,408)	-
Capital Assets - Net	293,277,298	35,016,244	-	328,293,542	-	11,695,801	301,341	-	340,290,684
Assets Limited as to Use	1,467,416	1,723,436	-	3,190,852	-	-	-	-	3,190,852
Other Assets	1,455,362	-	-	1,455,362	-	-	27,387	-	1,482,749
Total assets	**$ 542,223,331**	**$ 353,315,585**	**$ (309,216,813)**	**$ 586,322,103**	**$ 48,627**	**$ 11,894,359**	**$ 1,024,593**	**$ (15,097,408)**	**$ 584,192,274**
Liabilities and Net Position (Deficit)									
Current Liabilities									
Current portion of long-term debt	$ 726,800	$ -	$ -	$ 726,800	$ -	$ 670,634	$ 191,823	$ -	$ 1,589,257
Current portion of capital lease obligations	518,105	7,971,179	-	8,489,284	-	-	22,888	-	8,512,172
Accounts payable and accrued expenses	102,158,367	13,048,550	-	115,206,917	-	240,260	260,088	16,233	115,723,498
Current portion of accrued workers' compensation liability	3,315,000	-	-	3,315,000	-	-	-	-	3,315,000
Current portion of accrued vacation	15,664,059	478,834	-	16,142,893	-	-	-	-	16,142,893
Current portion of due to State of Hawaii	2,000,000	-	-	2,000,000	-	-	-	-	2,000,000
Other current liabilities	3,316,503	-	(1,975,408)	1,341,095	-	408,764	-	-	1,749,859
Total current liabilities	127,698,834	21,498,563	(1,975,408)	147,221,989	-	1,319,658	474,799	16,233	149,032,679
Long-term Debt - Less current portion	19,351,128	-	-	19,351,128	-	13,984,034	12,444	-	33,347,606
Capital Lease Obligations - Less current portion	168,988	17,768,378	-	17,937,366	-	-	75,943	-	18,013,309
Other Liabilities									
Accrued vacation - Less current portion	23,237,632	849,438	-	24,087,070	-	-	111,704	-	24,198,774
Accrued workers' compensation - Less current portion	10,267,000	157,000	-	10,424,000	-	-	-	-	10,424,000
Other postemployment benefit liability	259,829,389	7,286,037	-	267,115,426	-	-	-	-	267,115,426
Due to affiliates - Net	307,241,405	-	(307,241,405)	-	-	15,113,641	-	(15,113,641)	-
Due to the State of Hawaii - Less current portion	22,622,507	14,000,000	-	36,622,507	-	-	-	-	36,622,507
Patients' safekeeping deposits	319,932	-	-	319,932	-	-	-	-	319,932
Other liabilities	2,085,879	-	-	2,085,879	-	-	-	-	2,085,879
Total liabilities	772,822,694	61,559,416	(309,216,813)	525,165,297	-	30,417,333	674,890	(15,097,408)	541,160,112
Net Position (Deficit)									
Invested in capital assets - Net of related debt	281,513,278	1,477,445	-	282,990,723	-	(2,958,867)	(1,757)	7,799,241	287,829,340
Restricted for capital purchases	349,241	-	-	349,241	-	-	-	-	349,241
Unrestricted	(512,461,882)	290,278,724	-	(222,183,158)	48,627	(15,564,107)	351,460	(7,799,241)	(245,146,419)
Total net position (deficit)	(230,599,363)	291,756,169	-	61,156,806	48,627	(18,522,974)	349,703	-	43,032,162
Total liabilities and net position (deficit)	**$ 542,223,331**	**$ 353,315,585**	**$ (309,216,813)**	**$ 586,322,103**	**$ 48,627**	**$ 11,894,359**	**$ 1,024,593**	**$ (15,097,408)**	**$ 584,192,274**

Hawaii Health Systems Corporation

Statement of Revenue, Expenses, and Changes in Net Position (Deficit) of Facilities
Year Ended June 30, 2013

Facilities

	Hilo Medical Center	Hale Ho'ola Hamakua	Ka'u Hospital	Yukio Okutsu Veterans Care Home - Hilo	Kona Community Hospital	Kohala Hospital	Maui Memorial Medical Center	Kula Hospital	Lanai Community Hospital	Leahi Hospital	Maluhia
Operating Revenue											
Net patient service revenue - Net of provision for doubtful accounts	$ 135,323,321	$ 10,240,885	$ 5,326,528	$ 11,427,149	$ 62,250,183	$ 5,753,116	$ 204,096,687	$ 14,979,066	$ 3,126,490	$ 16,257,469	$ 16,801,099
Other revenue	1,224,586	15,620	41,492	-	301,280	4,727	1,434,937	90,682	26,617	226,785	51,116
Total operating revenue	136,547,907	10,256,505	5,368,020	11,427,149	62,551,463	5,757,843	205,531,624	15,069,748	3,153,107	16,484,254	16,852,215
Operating Expenses											
Salaries and benefits	110,207,125	10,840,767	5,416,903	5,538,610	49,515,344	5,343,041	147,524,398	18,565,846	2,991,757	19,338,959	16,866,701
Purchased services	21,006,400	1,754,967	1,022,233	1,447,318	10,739,686	1,104,350	22,355,067	1,249,563	1,699,058	839,918	617,645
Medical supplies and drugs	18,801,488	402,225	128,269	463,800	8,389,720	81,445	40,322,471	663,826	296,599	479,170	385,496
Depreciation and amortization	6,557,896	1,010,367	439,159	994,456	3,553,120	398,625	9,018,922	426,502	140,462	945,328	515,532
Utilities	3,105,569	657,826	211,914	1,000,403	1,699,335	165,367	5,034,076	402,717	160,318	1,286,406	769,437
Repairs and maintenance	3,585,060	261,400	127,915	74,767	2,764,157	295,382	2,887,273	218,702	77,844	245,618	247,089
Other supplies	4,826,214	554,529	176,194	453,409	1,522,536	377,724	6,230,843	841,847	131,115	738,516	773,656
Professional fees	6,986,081	16,100	27,863	68,891	176,396	102,574	2,462,077	67,401	1,382	34,772	106,682
Insurance	1,288,499	85,776	77,216	1,104,534	406,709	23,499	1,446,939	139,270	64,433	153,109	104,052
Rent and lease	2,470,368	20,601	26,665	52,243	708,243	41,697	3,148,463	60,509	3,020	34,961	3,490
Other	1,822,783	289,712	97,367	968,767	710,802	53,834	1,731,827	65,706	67,913	80,352	47,288
Total operating expenses	180,657,483	15,894,270	7,751,698	12,167,198	80,186,048	7,987,538	242,162,356	22,701,889	5,633,901	24,177,109	20,437,068
Operating Loss	(44,109,576)	(5,637,765)	(2,383,678)	(740,049)	(17,634,585)	(2,229,695)	(36,630,732)	(7,632,141)	(2,480,794)	(7,692,855)	(3,584,853)
Nonoperating Revenue (Expenses)											
General appropriations from the State of Hawaii	16,744,026	1,445,052	1,266,344	-	12,071,530	867,314	26,344,488	2,184,111	1,166,547	5,265,277	3,066,405
Collective bargaining pay raise appropriations	1,513,303	170,708	69,055	-	695,165	67,814	2,080,542	289,663	43,542	321,948	293,095
Loss on disposal of capital assets	(76,975)	-	-	-	(7,427)	-	(4,155)	-	(3,537)	-	-
Restricted contributions	1,287,720	-	85,623	-	-	30,158	1,226,110	-	-	-	-
Interest expense	(530,765)	(111)	(69)	(61,130)	(114,970)	(70)	(706,284)	(11,007)	(35)	(4,801)	(190)
Interest and dividend income	134,510	-	5,127	-	14,093	6,024	40,024	15,874	213	14,228	13,136
Corporate allocation expense	(1,973,746)	(160,707)	(85,949)	-	(880,252)	(84,037)	(2,690,090)	(255,788)	(64,712)	(266,521)	(230,749)
Other nonoperating revenue (expenses) - Net	317,295	305,144	(3,165)	309	(870,901)	4,538	332,752	104,526	75,543	23,197	-
Total nonoperating revenue (expenses)	17,415,368	1,760,086	1,336,966	(60,821)	10,907,238	891,741	26,623,387	2,327,379	1,217,561	5,353,328	3,141,697
Excess of Revenue (Under) Over Expenses	(26,694,208)	(3,877,679)	(1,046,712)	(800,870)	(6,727,347)	(1,337,954)	(10,007,345)	(5,304,762)	(1,263,233)	(2,339,527)	(443,156)
Capital Contributions	3,589,649	(17,000)	43,641	-	336,584	2,053,200	12,962,130	40,180	692,089	1,855,439	1,134,523
Transfer from (to) Affiliate	-	-	-	-	1,735,930	111,931	-	-	-	-	-
(Decrease) Increase in Net Position	**$ (23,104,559)**	**$ (3,894,679)**	**$ (1,003,071)**	**$ (800,870)**	**$ (4,654,833)**	**$ 827,177**	**$ 2,954,785**	**$ (5,264,582)**	**$ (571,144)**	**$ (484,088)**	**$ 691,367**

	Kahuku Medical Center	Kauai Veterans Memorial Hospital	Samuel Mahelona Memorial Hospital	Total Facilities	Corporate	Reclassifications and Eliminations	HHSC Combined	Hawaii Health Systems Foundation	Alii Community Care - Maui	Alii Community Care - Kona	Reclassifications and Eliminations	HHSC Consolidated
Operating Revenue												
Net patient service revenue - Net of provision for doubtful accounts	$ 8,417,829	$ 30,787,349	$ 13,498,642	$ 538,285,813	$ -	$ -	$ 538,285,813	$ -	$ (4,608)	$ 3,348,163	$ -	$ 541,629,368
Other revenue	214,092	282,740	24,342	3,939,016	-	(357,638)	3,581,378	-	3,734,763	1,059,253	-	8,375,394
Total operating revenue	8,631,921	31,070,089	13,522,984	542,224,829	-	(357,638)	541,867,191	-	3,730,155	4,407,416	-	550,004,762
Operating Expenses												
Salaries and benefits	5,475,173	33,580,260	14,861,075	446,065,959	8,614,343	-	454,680,302	-	-	4,234,495	-	458,914,797
Purchased services	790,961	3,580,349	1,501,577	69,709,092	181,657	(357,638)	69,533,111	-	17,926	299,401	-	69,850,438
Medical supplies and drugs	484,301	2,162,786	266,284	73,327,880	-	-	73,327,880	-	-	185,422	-	73,513,302
Depreciation and amortization	469,271	1,553,812	591,618	26,615,070	326,332	-	26,941,402	-	858,365	160,441	-	27,960,208
Utilities	375,763	1,297,064	607,892	16,774,087	172,153	-	16,946,240	-	386,326	6,068	-	17,338,634
Repairs and maintenance	289,950	803,500	127,608	12,006,265	103,006	-	12,109,271	-	56,114	96,255	-	12,261,640
Other supplies	246,662	1,042,872	538,113	18,454,230	180,503	-	18,634,733	-	369,313	22,822	-	19,026,868
Professional fees	1,005,127	783,219	245,180	12,083,745	91,952	-	12,175,697	-	2,225,513	-	-	14,401,210
Insurance	85,466	185,909	100,382	5,265,793	15,600	-	5,281,393	-	67,278	52,832	-	5,401,503
Rent and lease	169,983	483,946	60,029	7,284,218	51,468	-	7,335,686	-	97,869	453,017	-	7,886,572
Other	234,985	638,266	56,451	6,866,053	452,089	-	7,318,142	2,070	138,170	(90,316)	-	7,368,066
Total operating expenses	9,627,642	46,111,983	18,956,209	694,452,392	10,189,103	(357,638)	704,283,857	2,070	4,216,874	5,420,437	-	713,923,238
Operating Loss	(995,721)	(15,041,894)	(5,433,225)	(152,227,563)	(10,189,103)	-	(162,416,666)	(2,070)	(486,719)	(1,013,021)	-	(163,918,476)
Nonoperating Revenue (Expenses)												
General appropriations from the State of Hawaii	1,475,193	5,746,177	2,356,760	79,999,224	-	-	79,999,224	-	-	-	-	79,999,224
Collective bargaining pay raise appropriations	-	312,406	170,951	6,028,192	-	-	6,028,192	-	-	-	-	6,028,192
Loss on disposal of capital assets	(357,976)	-	-	(450,070)	-	-	(450,070)	-	-	-	-	(450,070)
Restricted contributions	-	-	-	2,629,611	-	-	2,629,611	-	-	425,724	-	3,055,335
Interest expense	(22,179)	(155,137)	-	(1,606,748)	(1,289,605)	-	(2,896,353)	-	(884,088)	(13,441)	-	(3,793,882)
Interest and dividend income	-	11,000	43,184	297,413	5,951	-	303,364	-	5,875	-	-	309,239
Corporate allocation expense	-	(495,113)	(209,055)	(7,396,719)	7,396,719	-	-	-	-	-	-	-
Other nonoperating revenue (expenses) - Net	-	356,536	190,505	836,279	149,693	-	985,972	-	-	974,891	-	1,960,863
Total nonoperating revenue (expenses)	1,095,038	5,775,869	2,552,345	80,337,182	6,262,758	-	86,599,940	-	(878,213)	1,387,174	-	87,108,901
Excess of Revenue (Under) Over Expenses	99,317	(9,266,025)	(2,880,880)	(71,890,381)	(3,926,345)	-	(75,816,726)	(2,070)	(1,364,932)	374,153	-	(76,809,575)
Capital Contributions	(82,233)	(62)	1,299,911	23,908,051	7,590,092	-	31,498,143	-	-	-	-	31,498,143
Transfer from (to) Affiliate	-	-	-	1,847,861	(1,847,861)	-	-	-	-	-	-	-
(Decrease) Increase in Net Position	**$ 17,084**	**$ (9,266,087)**	**$ (1,580,969)**	**$ (46,134,469)**	**$ 1,815,886**	**$ -**	**$ (44,318,583)**	**$ (2,070)**	**$ (1,364,932)**	**$ 374,153**	**$ -**	**$ (45,311,432)**

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

Independent Auditor's Report

To Management and the Board of Directors
Hawaii Health Systems Corporation

We have audited, 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, the financial statements of Hawaii Health Systems Corporation, which comprise the basic statement of net position as of June 30, 2013 and the related basic statements of revenue, expenses, and changes in net position and cash flows for the year then ended, and related notes to the financial statements and have issued our report thereon dated January 9, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Hawaii Health Systems Corporation's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we do not express an opinion on the effectiveness of the entity's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings as Findings 2013-1 through 2013-4 to be material weaknesses.

To Management and the Board of Directors
Hawaii Health Systems Corporation

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying schedule of findings as Findings 2013-05 through 2013-12 to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Hawaii Health Systems Corporation's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Hawaii Health Systems Corporation's Responses to Findings

Hawaii Health Systems Corporation's responses to the findings identified in our audit are described in the accompanying schedule of findings. Hawaii Health Systems Corporation's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Plante & Moran, PLLC

January 9, 2014

Finding - 2013-1

Organization - Alii Community Care, Inc.

Finding Type - Material weakness

Criteria - Property and equipment lapse schedules should be maintained. Reconciliation of the detailed lapse schedule to the general ledger is essential to ensure amounts presented in the financial statements are accurate.

Condition - A property and equipment lapse schedule is not being updated. Also, depreciation expense had not been recorded correctly in fiscal year 2013.

Context - Property and equipment amounts recorded in the general ledger did not have adequate supporting documentation.

Cause - An adjustment to depreciation expense of approximately $22,045 needed to be recorded in fiscal year 2013.

Effect - The balance sheet and statement of operations were misstated throughout the year. An adjusting journal entry was posted to correct this misstatement.

Recommendation - We recommend management perform formal reviews of property and equipment accounts to ensure what is being reported is properly supported by lapse schedules or other detailed records. Additionally, management should record depreciation expense on a monthly basis to ensure net property and equipment amounts presented in internal financial statements are reasonably stated.

Views of Responsible Officials and Planned Corrective Action Plan - The Roselani accountant will utilize QuickBooks or Excel to maintain capital asset balances and compute and then record depreciation expense on at least an annual basis. The HHSC liaison will ensure that the amount is recorded at year end.

Finding - 2013-2

Organization - Alii Community Care, Inc.

Finding Type - Material weakness

Criteria - Operating lease expenses should be recorded in a straight-line manner over the course of the lease.

Condition - A straight-line rent expense calculation does not exist. Also, rent expense had not been recorded properly in fiscal year 2013.

Context - We identified that rent expense was being recorded in accordance with the lease agreement, not in a straight-line manner.

Cause - Additional rent expense of approximately $24,219 needed to be recorded during the year.

Effect - The balance sheet and statement of operations were misstated throughout the year. An adjusting journal entry was posted to correct this misstatement.

Recommendation - We recommend management and the board review general ledger accounts related to debt to ensure outstanding obligations are properly reflected in the general ledger.

Views of Responsible Officials and Planned Corrective Action Plan - At year end, the Alii Health Center (AHC) director will ensure AHC's outside accountants record the journal entry for the straight-line adjustment related to operating leases under accounting principles generally accepted in the United States of America.

Finding - 2013-3

Organization - Alii Community Care, Inc.

Finding Type - Material weakness

Criteria - Financial statements should be reported on an accrual basis throughout the year.

Condition - Alii Community Care, Inc. reported financial results on a cash basis throughout 2013.

Context - Generally accepted accounting principles require the accrual basis of accounting.

Cause - Decision by management to report financial results on cash basis

Effect - Statement of operations was misstated throughout the year. Adjusting journal entries were posted to correct this misstatement.

Recommendation - We recommend that management review the decision to report financial results in accordance with generally accepted accounting principles on an interim basis.

Views of Responsible Officials and Planned Corrective Action Plan - HHSC management will revisit the issue of maintaining AHC on the cash basis of accounting for internal reporting purposes. For subsequent annual audits, AHC's financial statements will be drafted under the full accrual method of accounting.

Finding - 2013-4

Organization - East Hawaii Region

Finding Type - Material weakness

Criteria - Review of the contractual model and zero balance account reports is essential to ensure that amounts recorded for the contractual allowance in the financial statements are accurate and properly valued. A review of the information contained within the contractual model (contractual allowance/bad debt reserve percentages, credit balances, and zero balance reports) should be performed to ensure that the amounts used as inputs within the model are proper and represent accurate data as of the report date.

Condition - The zero balance reports used to generate the contractual allowance percentages for the contractual model varied from other quarters in fiscal year 2013 and were not challenged or adjusted at year end. In addition, these reports were not formally reviewed in all circumstances. The lack of controls resulted in an understatement of approximately $2,750,000 in the allowance for contractual accounts as compared to the contractual model.

Context - Support schedules for allowance calculations are not being reviewed.

Cause - Procedures are not in place to update the contractual model with the most recent percentages calculated from updated reports.

Effect - The allowance for contractual accounts was understated by approximately $2,750,000.

Recommendation - We recommend management implement a formal review process. An individual separate from the preparation process should review and sign-off on the various reports that support the allowance for contractual adjustments on a monthly/quarterly basis.

Views of Responsible Officials and Planned Corrective Action Plan - Management has implemented a new zero balance process per the recommendation from the auditing team. The zero balance process has been modified to allow a more recent look back regarding the contractual allowances. Further controls implemented will be an additional review to be completed by the finance analyst prior to final approval.

Finding - 2013-5

Organization - Corporate

Finding Type - Significant deficiency

Criteria - Accounts payable and expenditures should be reviewed for proper cutoff at year end.

Condition - Accounts payable and expenditures were not properly stated at June 30, 2013.

Context - Lack of proper review of 2013 expenditures posted subsequent to June 30, 2013

Cause - Management reviewed expenditures after year end, but did not properly record all expenditures at June 30, 2013.

Effect - At the HHSC - Corporate level, accounts payable, expenditures, and assets were understated by approximately $100,000, $50,000, and $50,000, respectively, at June 30, 2013. At the Hawaii Health System Corporation consolidated level, accounts payable, expenditures, assets, and net position were overstated by approximately $630,000, $815,000, $310,000, and $500,000, respectively, at June 30, 2013.

Recommendation - Management should review the detail of all expenditures subsequent to year end to determine proper cutoff at year end.

Views of Responsible Officials and Planned Corrective Action Plan - For the understatement of accounts payable, the corporate controller will communicate to management the importance of providing the accounting department with invoices in the period that goods are received or services rendered. Prior to year end, a follow-up communication will be sent by the corporate accountant to ensure that for all goods received and services rendered, an invoice is received. If an invoice is not received by a vendor, then an accrual estimate will be made by management.

For overstatement of accounts payable, the corporate accountant will keep a log of invoices over $10,000 that span across fiscal years such as licenses and maintenance contracts. At year end, management will determine whether the impact of such overstatement would warrant recording the transactions in the general ledger across facilities.

Finding - 2013-6

Organization - Corporate

Finding Type - Significant deficiency

Criteria - Accrued vacation calculation should be reviewed to verify the proper inputs are being used in the calculation.

Condition - Accrued vacation was not properly reviewed and recorded at June 30, 2013.

Context - Lack of proper review of calculation by someone in human resources (HR) before the calculation is provided to finance to record

Cause - The calculation formulas were reviewed; however, the inputs such as salary/wage rates and use/earnings of vacation were not reviewed.

Effect - The accrued vacation calculation was updated several times with the final version resulting in an insignificant misstatement at year end.

Recommendation - Management should involve human resources in the review of the accrued vacation calculation to verify the proper inputs are being used. In addition, another review of the calculation should be completed at least annually by an independent person.

Views of Responsible Officials and Planned Corrective Action Plan - All HR reports relating to leave records and relevant information (i.e., pay rates, FTE, earn and use accruals, etc.) will be reviewed for correctness on a monthly basis. HR will continue to remind managers and supervisors to provide all approved leave requests to HR in a timely manner.

Finding - 2013-7

Organization - Alii Community Care, Inc.

Finding Type - Significant deficiency

Criteria - General journal entries are not required to be reviewed before being posted.

Condition - It was noticed during year-end audit procedures that any individual that has access to the accounting system (QuickBooks) can post an entry into the system.

Context - Errors could be made when entries are made and their effect could go unnoticed and uncorrected.

Cause - A restriction on the posting of journal entries is not in place. The accounting system should be modified so that an individual that creates a journal entry cannot post the entry to the system or a formal policy should be adopted and followed whereby all manual entries are signed off on as being reviewed before being posted.

Effect - Unsupported or incorrect journal entries could be made to the system.

Recommendation - We recommend that a policy be put in place whereby all manual journal entries that are posted to the system be approved by the individual not posting the entry or the accounting system should be modified to not allow the creator of an entry to post that entry.

Views of Responsible Officials and Planned Corrective Action Plan - Although journal entries are not reviewed, monthly financial statements are reviewed by the HHSC liaison on a monthly basis. Material errors would be detected.

Finding - 2013-8

Organization - East Hawaii Region

Finding Type - Significant deficiency

Criteria - Obligations for goods and services should be reviewed each month-end close to verify they are recorded in the period when the goods are received or the services are performed.

Condition - Various invoices reviewed for both HMC and HHH were recorded in the improper period.

Context - For both HMC and HHH, the improper invoices noted were related to services performed. After full review of invoices relating to services which were recorded at June 30, 2013 and invoices entered into in July 2013, the amount improperly excluded totaled approximately $70,727.

Cause - Input into the system is being determined based on invoice date instead of the date the services were performed or the goods were received.

Effect - Accounts payable and total expenses were understated. The total amount was insignificant and no adjusting journal entry was required.

Recommendation - We recommend the East Hawaii Region implement procedures to enter accounts payable invoices based on date of service and date of goods received rather than invoice date.

Views of Responsible Officials and Planned Corrective Action Plan - Management is implementing new procedures to obtain the date of service and date of goods received from the respective departments at the time of invoice processing and approval.

Finding - 2013-9

Organization - Kauai Region

Finding Type - Significant deficiency

Criteria - The balance recorded in construction in progress should be reviewed on a regular basis to ensure projects are capitalized and depreciation begins timely.

Condition - Invoices related to construction projects for Samuel Mahelona Memorial Hospital (SMMH) were not capitalized in the appropriate amount. Additionally, payments from the State of Hawaii related to funding for construction projects were not recorded appropriately.

Context - Lack of review of construction throughout the year and lack of review of capital contributions and construction in progress additions schedule

Cause - Management was tracking the projects, but failed to properly record amounts included on invoices received after year end to construction in progress. In addition, amounts recorded for payments on the total capital contributions received from the State of Hawaii were improperly recorded.

Effect - Interim financial statements did not properly reflect depreciable assets throughout the year and funding received from the State of Hawaii was overstated.

Recommendation - On a regular basis, construction in progress accounts should be reviewed on a project basis. Management should review all invoices for construction in progress to determine that all amounts related to the current year are properly capitalized.

Views of Responsible Officials and Planned Corrective Action Plan - Management is going to transfer the processing of SMMH construction in progress back to SMMH. By this process, the construction in progress schedule and posting will be done on a timely basis and not a true-up at month end or year end. The accountant and management will review the additions and completion of all construction in progress at mid year and year end.

Finding - 2013-10

Organization - Kauai Region

Finding Type - Significant deficiency

Criteria - Accounts receivable should be reviewed for proper reconciliation at year end.

Condition - Gross accounts receivable balance was not properly stated at June 30, 2013 for Samuel Mahelona Memorial Hospital (SMMH).

Context - Lack of proper review of unapplied cash balances received subsequent to year end at SMMH.

Cause - Management at SMMH improperly posted the unapplied cash balances received subsequent to year end related to patient accounts receivable balances as of June 30, 2013.

Effect - Accounts receivable at June 30, 2013 in aggregate was fairly stated but the clearing account was overstated by approximately $429,000 and gross accounts receivable was understated by approximately $429,000.

Recommendation - Management should review all reconciliations and cash payments received subsequent to year end.

Views of Responsible Officials and Planned Corrective Action Plan - Management will review all closing entries to verify that the adjusting journal entry is consistent with subsequent events.

Finding - 2013-11

Organization - West Hawaii Region

Finding Type - Significant deficiency

Criteria - Obligations for goods and services should be reviewed each month-end close to verify they are recorded in the period when the goods are received or the services are performed.

Condition - Various invoices reviewed for both Kona and Kohala were recorded in the improper period. Additionally, Kohala did not have an accounts payable balance initially recorded as of June 30, 2013.

Context - For Kona, the improper invoices noted were related to services performed. After full review of invoices relating to services which were recorded at June 30, 2013 and invoices entered in July 2013, the amount improperly excluded totaled $371,394. For Kohala, a list of invoices related to fiscal year 2013 was maintained but not recorded. The amount of invoices related to fiscal year 2013 totaled $31,269.

Cause - Input into the system is being determined based on invoice date instead of the date the services were performed or the goods were received. In addition, cutoff procedures are not functioning properly due to issues encountered with obtaining reports in the new system.

Effect - Accounts payable and total expenses were understated and required the posting of audit adjusting journal entries. The errors determined at Kona resulted in a journal entry to increase accounts payable and expenses by $371,394 at June 30, 2013. The listing maintained by Kohala relating to fiscal year services resulted in a journal entry to increase accounts payable and expenses by $31,269 at June 30, 2013.

Recommendation - We recommend the West Hawaii Region implement procedures to enter accounts payable invoices based on date of service and date of goods received, rather than invoice date. In addition, we recommend finding appropriate reports within the new system that will aid in determining proper cutoff of invoices throughout the year and at year end.

Views of Responsible Officials and Planned Corrective Action Plan - Both Kona and Kohala went live with a new electronic medical record system and a new general ledger system on February 1, 2013. As a result, new procedures and processes have been set up, along with new reports, to properly record the monthly expense accruals for goods and services.

Finding - 2013-12

Organization - West Hawaii Region

Finding Type - Significant deficiency

Criteria - Based on HHSC's capital asset policy, all property purchased over $5,000 is to be considered capitalized property. The type of property includes land, building, improvement to land, vehicle, and equipment.

Condition - Kohala had various renovations occur during fiscal year 2013. Portions of those renovations included equipment and improvements that were over $5,000. The amounts should have been capitalized based on the capital asset policy; however, all items were directly expensed.

Context - Based on the listing of renovation invoices, it was determined that approximately $104,000 of renovation costs were expensed and should have been capitalized.

Cause - Kohala determined to classify all renovation costs as repairs and maintenance instead of following the HHSC capital asset policy.

Effect - The net capital assets were understated and the total expenses were overstated. The total amount was insignificant and no adjusting journal entry was required.

Recommendation - We recommend Kohala perform an analysis of all projects or renovations performed at the hospital to determine if any of the expenses meet the capitalization threshold of $5,000. If amounts meet the threshold, those renovations should be capitalized.

Views of Responsible Officials and Planned Corrective Action Plan - Kohala will review all projects and renovations at the hospital and for those expenses that meet the $5,000 threshold; those renovation costs will be appropriately capitalized or expensed.