



HAWAII HEALTH SYSTEMS
C O R P O R A T I O N

"Touching Lives Everyday"

January 22, 2002

COO/CFO-02-017

The Honorable Benjamin J. Cayetano
Governor of Hawaii
Hawaii State Capitol
Executive Chambers
Honolulu, Hawaii 96813

Dear Governor Cayetano:

It is with sincere appreciation that we submit the annual report of the Hawaii Health Systems Corporation (HHSC) to the Governor and the Legislature of the State of Hawaii. The continued dedication and hard work of our employees, medical staff, community advisors, Board of Directors, union partners, and many other stakeholders, coupled with support from our legislators and the Administration have resulted in many successes this past year.

We continue to improve our financial management and accounting systems throughout the Corporation. While the Corporation received a qualified audit with many material weaknesses in FY 97, we have now received our fourth consecutive "clean" unqualified audit with no material weaknesses for FY 01, FY 00, FY 99 and FY 98. The FY 01 and FY 00 comparative audit report is enclosed in accordance with H.R.S. Section 323F-22.

As a public hospital system, HHSC depends heavily on input and support from our local communities. Over this past year, hundreds of community volunteers Statewide donated over 100,000 service hours to our facilities. The attached report details the donations of time and money from our communities in support of our facilities.

In accordance with H.R.S. Section 323F-22, we are pleased to enclose the optional annual reports as submitted by our five Management Advisory Committees (MACs): East Hawaii, West Hawaii, Maui, Kauai, and Oahu. Our Physicians Advisory Group (PAG) has also submitted an optional annual report. The continuing guidance and support of the MACs and PAG are tremendously important to the successful functioning of our system. Enclosed for your additional reference is a summary of specific accomplishments by HHSC over the past fiscal year and a general summary of our accomplishments over the past four years.

We have continued to develop and improve our clinical and non-clinical quality programs continually putting into practice our mantra that "Quality is job one." The quality of our clinical operations was recognized by HMSA recently in \$445,291.34 in checks to four HHSC facilities for our excellent results from participating in the HMSA Quality Service Recognition Program. In recognition of the quality of our personnel management programs, the American

Psychological Association has recognized HHSC as 2001 Healthy Workplace, in the Government Agency Category, as explained on page 2 of the attached HHSC newsletter, *Ike Ola Kino*. HHSC quality initiatives, which have provided the system with measurable solutions for improving quality of care, were accomplished through the dedicated efforts and cooperation of our staff, community physicians and other healthcare professionals. Depending upon the facility type, all HHSC facilities have either received Joint Commission on Accreditation of Healthcare Organizations (JCAHO) accreditation and/or passed their State licensure survey with full certification in all instances. Through enhanced quality care, HHSC is achieving additional financial efficiency.

HHSC management is working in concert with our Board of Directors, MACs, PAG, and many other external constituencies to find creative and effective solutions to financial and operating issues in order to move toward greater financial self-sufficiency. During this time of national challenge, more than ever we all understand the need to find new, "out of the box" solutions to providing services to the communities that we serve while reducing the demands on the State to provide support. Until such time as the Legislature is willing to grant HHSC more autonomy to implement the changes necessary to move to financial and operating self-sufficiency (such as moving away from operation under State Civil Service, State Collective Bargaining, restraints on managing our levels of service) then HHSC must keep returning to the Legislature to request a minimal level of funding to support the mandated "safety net" services that we provide. We are soliciting input from all of our stakeholders as to potentially new and innovative structural changes that could further improve HHSC's efficiency in the way we provide care to the communities we serve. Some of the alternatives currently under evaluation are an Employee Stock Option Plan (ESOP), Not-For-Profit Organization, and closer partnership affiliations with other organizations. We will continue to dialogue with both the Administration and the Legislature on future directions for HHSC.

If you have any questions, please call me personally at 733-4151.

Mahalo Nui Loa,


THOMAS M. DRISKILL, JR.
President and Chief Executive Officer

Enclosures:

1. HHSC Volunteer Community Support
2. MAC Reports for East Hawaii, West Hawaii, Maui, Kauai, and Oahu
3. PAG Report
4. Summary of Accomplishments
5. Hawaii Psychological Association Award
6. HMSA Quality and Service Recognition Program Report
7. *Ike Ola Kino*, 4th Quarter 2001 Edition
8. Annual Audit Report: Financial Statements and Supplemental Information for the Year Ended June 30, 2001 and 2000 and Independent Auditors' Reports

December 31, 2001

FISCAL YEAR 2001 HAWAII HEALTH SYSTEMS CORPORATION (HHSC) VOLUNTEER COMMUNITY SUPPORT

Community support has played an integral role in enhancing the mission of the Hawaii Health Systems Corporation (HHSC) over the past year. Each community has diligently worked together with HHSC to ensure the continuance of quality healthcare provided by its respective facility. Numerous community groups and individuals have generously contributed their time and expertise to assist in serving the health needs of their respective communities. There are close to 1,000 active volunteers who contribute nearly 100,000 volunteer service hours each year for the combined facilities. Community improvement projects include:

EAST HAWAII REGION

■ Hilo Medical Center

- 93 active volunteers
 - Nearly 18,500 volunteered service hours each year
- Auxiliary raises between \$15,000-\$30,000 annually
 - Commission from Baby Photos - \$3,500
 - Palm Tree Gift Shop & Auxiliary Workshop - \$20,000
 - Commission from Pay Telephones - \$400
 - Grants ten (10) \$500 nursing scholarship annually to nursing students at UHH and HCC.
 - \$128,600 Rural Development Project Grant to develop learning centers for nursing staff.
- Hilo Medical Center Foundation
 - Since inception, raised more than \$70,000 via community contributions and grants. Raised over \$15,000 this fiscal year.

■ Hale Ho'ola Hamakua

- 25 active volunteers
 - Nearly 9,250 volunteered service hours each year
- Auxiliary has raised more than \$1500, in addition to providing two (2) \$250 scholarships

■ Ka'u Hospital

- 3 active volunteers
 - Nearly 1620 volunteered service hours each year

WEST HAWAII REGION

■ Kona Community Hospital

- 61 active volunteers
 - Nearly 7,570 volunteered service hours each year
- Auxiliary has donated \$5,000 to the Kalani Ola Behavioral Health Unit
- Auxiliary has donated \$1,000 for painting of the building
- Auxiliary has donated four scholarships - \$1,500 each
- A \$10,000 donation was received from Dr. Clarence Hodges for the Auxiliary Kona Community Hospital Nursing Scholarship Fund
- Auxiliary donated baby caps for the newborns
- Healing Garden was blessed on January 11, 2001. Many volunteers and businesses contributed generously of their time and resources
- Kailua-Kona Lions Club donated a computer for the long-term care unit patients
- Kona Rotary Club contributed \$30,000 towards the purchase of a mobile lithotripsy, in addition to \$6,900 for the set up of a chemotherapy unit

- The Kona Hospital Foundation purchased a building valued at \$200,000
- The Kona Hospital Foundation hired a development coordinator who initiated a \$5 million, three-year capital campaign, to support the facility's primary projects — exterior painting, nuclear medicine purchase, and radiation therapy vault construction

■ **Kohala Hospital**

- 21 active volunteers
 - Nearly 1,700 volunteered service hours each year
- Scholarships (\$1,000) provided by Hospital Auxiliary
- Annual cable television service provided by the Kamehameha Cable Vision (\$385)
- Portable water fountain and installation donated by family of long-term care resident (\$400)
- Critical Access Hospital designation is achieved, which will enable facility to receive total cost reimbursement.
- Capital improvement funds totaled \$1.75 million:
 - Facility reroofing
 - Sprinkler system installation
 - Fire alarm system upgrade
 - Electrical system upgrade

KAUAI REGION

■ **Kauai Veterans Memorial Hospital**

- 14 active volunteers
 - Nearly 1380 volunteered service hours each year
 - Auxiliary raised more than \$20,000
 - Auxiliary purchases included:
 - Rice cooker
 - SNF activity equipment
 - SNF Address-o-graph
 - Shelving

- Refrigerator
- Office supplies and equipment
- Computer equipment
- Various furniture
- Awareness pamphlets
- Compressor
- Training material & supplies

- \$1350 donated from the Dr. Wade's Memorial Fund

Samuel Mahelona Memorial Medical Center

- 43 active volunteers
 - Nearly 7,000 volunteered service hours each year
 - Auxiliary raised more than \$6,200 (Thrift Shop)
 - \$5,000 donated from Hawaii Hotel Industry Association
 - \$335 raised from Rummage Sale
 - \$200 donated from the Kauai Orchid Society

MAUI REGION

Maui Memorial Medical Center

- 66 active volunteers
 - Nearly 16,200 volunteered service hours each year
 - Auxiliary raises more than \$50,000 annually
 - Equipment donated:
 - Lateral Transfer
 - Hysteroscopy Setup
 - Electric Breast Pump (2)
 - IV Warmers
 - Infusion Pumps
 - VCR TV and Tapes for Pediatrics
 - Scholarship grants to MMMC Employees:
 - (3) \$1500 RN at Maui Community College
 - (2) \$800 Masters degree in Nursing
 - \$525 to sponsor 10 OB nurses to attend upcoming seminar

- \$600 (\$50 a month) to Adult and Adolescent Psychiatric Unit for miscellaneous items

● **MMMC Charitable Foundation**

- Provided a \$37,000 grant for the Observation Unit
- Provided a \$19,000 grant for defibrillator equipment
- Donated \$7,250 to cancer patients
- Donated \$16,000 for video teleconferencing equipment
- Sponsored four seminars on Planned Giving
- Donated 800 Beanie Babies to hospital units
- Received \$15,000 for volunteer participation in the Mercedes Championship
- Raised \$35,000 at its Annual Banquet ceremony

■ **Kula Hospital**

● **38 active volunteers**

- Nearly 6,850 volunteered service hours each year
- Auxiliary purchases totaled more than \$16,500
 - Shampoo bowl & tray
 - Shower commode
 - Artificial ficus trees
 - Sewing machine & table
 - Projector & accessories
 - Beam scale
 - Men's electric shaver
 - Linen carts
 - Trauma manikin
 - ECG machine
 - Floral decorations
 - Lamps & microwave over
 - Quilt & cable for Hale Makamae
 - Two wheelchairs
- Employee education subsidy totaled more than \$1,970
- Auxiliary disbursements totaled more than \$3,000
 - Subsidize three staff members to attend off-island

- conferences
- Resident excursions

Lanai Community Hospital

- 54 active volunteers
 - Nearly 1,250 volunteered service hours each year
 - \$500 student scholarship from the Auxiliary
 - VCR equipment donated - \$150 value

OAHU REGION

Leahi Hospital

- 146 active volunteers
 - Nearly 14,680 volunteered service hours each year
 - Thrift Shop raised a net of more than \$12,000
 - In kind donations totaled \$3,310
 - Monetary donations totaled \$1,080

Maluhia

- 53 active volunteers
 - Nearly 13,180 volunteered service hours each year
 - Gift Shop raises more than \$15,000 per year
 - Monetary donations totaled \$2,500
 - Auxiliary purchased a new tent for the hospital lanai valued at \$2,000
 - Equipment donated:
 - Computer with Japanese language games for resident usage
 - Puzzles, games, and activity equipment
 - Artwork for resident rooms and facility hallways



December 31, 2001

East Hawaii Region Management Advisory Report HHSC Annual Report

This past fiscal year has been full of challenges and opportunities for the East Hawaii Region. The senior leadership of the region's facilities has stabilized, though Hilo Medical Center is currently recruiting for its vacant Assistant Administrator and Director of Patient and Nursing Services position (Director of Nursing).

Ka'u Hospital accomplished a major goal of being developed into a Critical Access Hospital (CAH). This designation will assist Ka'u Hospital financially, during this very difficult fiscal environment. Ka'u Hospital continues to look into the feasibility of a rural health clinic in an effort to meet the growing needs of such a large (in terms of acreage) community.

Hale Ho'ola Hamakua (HHH) continues to operate at almost full capacity for most of the fiscal year. The possibility of bed expansion is being explored due to the full capacity situation. A partnership with the University of Hawaii at Hilo for a branch campus in the old Honokaa Hospital is in the works, and Hale Ho'ola Hamakua continues to work with its community, including the neighboring North Hawaii Community Hospital, for possible partnerships which would benefit the Hamakua community and both facilities.

Hilo Medical Center worked for months towards the successful integration of all outpatient imaging services into the medical center's operations and management. It also successfully incorporated the cancer center's operations into the medical center. After two very successful Town Meetings last fall, and recognizing the value of community input, Hilo Medical Center acted on several initiatives raised by the community. A patient call bell system was installed in the Spring to assist patients and nursing staff with response time; the painting of the exterior of the acute hospital commenced; and the medical center, along with HHSC, began exploring the possibility of partnering to provide geriatric care for the aged and the aging Veteran population. The federal funds for a feasibility study to develop a *Center of Aging* on the Hilo Medical Center campus is making its way through Congress currently.

A Patient Care Committee was established to look into improving staff competencies and the overall relationship between physicians and nursing staff. The committee is represented by physicians, line staff, managers, and the union.

Hilo Medical Center jump-started the nurse mentorship program, whereby newly graduated nursing students were mentored at the hospital for clinical and didactic learning, to better prepare the students for their nursing exams. The medical center also received grant monies from the Rural Development Project. The grant was a joint project between the Hilo Medical Center, Kona Community Hospital, Hawaii Community College, North Hawaii Community Hospital, and the Department of Health, to address the impending nursing shortage by developing learning centers so that nurses can build competencies and remain at our island hospitals. The grant totaled \$128,586 of which \$24,135 was allocated to Hilo Medical Center.

WEST HAWAII MANAGEMENT ADVISORY COMMITTEE
HAWAII HEALTH SYSTEMS CORPORATION

ANNUAL REPORT -- 2001

The West Hawaii Management Advisory Committee (WHMAC) appreciates very much the opportunity to have worked closely this year with some very competent members of the Hawaii Health Systems Corporation -- its President Tom Driskill Jr., the West Hawaii Region's CEO Lynn Walton (who also serves as CEO for Kona Community Hospital), Kohala Hospital's Administrator Herb Yim, and their staffs.

Through the cooperation and hard work of those people (and with advice/support of the WHMAC), the year 2001 was a very dynamic one for the West Hawaii Region. The most significant events were Kona Community Hospital (KCH) opening its new Behavior Health Unit on April 1, Kohala Hospital (KH) achieving Critical Access Hospital status on July 1, and KCH increasing its authorized beds from 75 to 95. During the year Donna Brown and Reggie Morimoto joined the Committee to succeed Richard Boyd and Virginia Isbell, whose service was much appreciated.

It appears that the year 2002 will be another productive one for the Region. KH is scheduled to complete its CIP projects of a new roof, electrical/mechanical upgrading and installation of a fire alarm/sprinkler system. KCH is expected to increase clinical services by initiation of mobile lithotripsy service (to be shared among three hospitals Island-wide) in the first quarter and opening of the Imaging Center (with MRI, Nuclear Medicine, CT Scan and Ultrasound) in the second quarter. KCH also plans to expand its cancer chemotherapy program, fully implement its new energy savings project which includes co-generation of electricity and heated water, and undergo repainting of the entire exterior of its main hospital building.

With encouragement and assistance of the WHMAC, both hospitals have initiated programs for further involvement with their communities. This includes establishing speakers bureaus, big increase in news releases and feature stories, more open house programs, open forums on hospital activities, making facilities available for community meetings, and greater participation in community activities. This initiative is well demonstrated by the Kona Hospital Foundation's newly-launched \$5 million, three-year, capital campaign for private donations and the planned establishment of KH's first-ever Foundation early in 2002.

WHMAC Annual Report for 2001

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At the same time, there are several needs which the WHMAC believes require prompt attention by the Legislature and/or other decision-making levels, in the interest of delivery of effective quality health care to residents and guests of this State at reasonable costs. They include the following:

1. Reduce burdensome bureaucratic procedures; streamline (and minimize the costly red-tape) of administration in such areas as personnel and fiscal. In many cases the huge expense in time and dollars doesn't seem justified, and creates significant extra costs and delays which jeopardize recruiting/retention of top-quality staff, of promptly obtaining some supplies, and of providing timely service at reasonable costs.
2. Make HHSC facilities more user-friendly through. Increasing the Aloha hospitality and decreasing the institutionalization look and attitude. This involves the physical appearance, layout, and parking, as well as personal relations with patients/visitors.
3. Provide an equal level of care/treatment for people throughout the State, regardless of whether they reside in an urban area such as Honolulu or in rural neighbor island regions.
4. Arrange for insurance companies to be responsible for a greater, more reasonable percentage of the actual treatment/care costs for their clients
5. Encourage further partnering with private business and other governmental entities in providing greater quality and efficiency in care/treatment at a minimal expense.

Thank you for your kind attention and continuing support.

WEST HAWAII MANAGEMENT ADVISORY COMMITTEE

Donna Brown
Robyn Cook, MD
Frank Jung, Vice-Chair
Roy Nagle, MD

Ken Clewett, Chair
Louise Hector
Reggie Morimoto
Laura Power, Secretary

Frank Sayre, DDS

Maui Region Public Health Facility Management Advisory Committee
Hawaii Health Systems Corporation
Annual Report to the Hawaii State Legislature
December, 2001

Thank you for the opportunity to provide this report. On behalf of the Maui Region Public Health Facility Management Advisory Committee, I would like to report that managerial concerns at Maui Memorial Medical Center were identified and have been corrected. The search has begun to fill the following vacant positions, Chief Executive Officer, Chief Administrative Officer, and Chief Medical Officer. Hospital staff has pulled together and morale has greatly improved. Despite organizational changes and communication breakdowns the Medical Center has experienced, patient care continues to be the top priority.

I would ask for your continued assistance with the Bond issue for the Maui Memorial Medical Center Master Plan. This project is imperative to ensure improvement of patient care areas that are most critical to the Medical Center's growth and quality of care. The project was to have taken place two years ago, in order to be current with the needs of the community and to be able to meet our financial goals in the future, it is vital that we move forward with this project.

The Management Advisory Committee is grateful for the assistance of the Hawaii Health Systems Corporation. The Corporate structure has provided the benefits that a system offers (corporate support, legal counsel, human resources, and information technology assistance). They have also assisted the Medical Center with covering payroll during a period where there was a cash shortfall.

As I mentioned in previous reports submitted to you, there will always be a need for legislative support to ensure the continuation of our safety net hospital system. Thank you for your commitment to healthcare in Hawaii. I am hopeful that the Legislators will come and visit the Maui Region facilities in the near future. Thank you.

Respectfully submitted,



Herbert Sakakihara
Maui Region Management
Advisory Committee Chairman



West Kauai Medical Center/KVMH
Mahelona Medical Center/SMMH
Hawaii Health Systems Corporation
P.O. Box 337
Waimea, HI 96796

December 31, 2001

**Kauai Region Public Health Facilities Management Advisory Committee
Annual Report 2001
(July 1, 2000 to June 30, 2001)**

Aloha, and thank you for the opportunity to share, with you, the events that took place relating to the Kauai Region, for the year 2001. The Kauai Region Senior Management Team has been, for the first time in recent years, at full compliment.

The accomplishments for FY 2001 are as follows:

- Labor costs for the Kauai Region have been reduced by a total of 10.7% (3.3% for KVMH and 7.4% for SMMH).
- Financial Impact of CAH on KVMH has increased net revenue by approximately 10%.
- After demise of Ohana Physicians Group, acquired the three clinics: East Kauai Walk-in clinic, West Kauai Clinic at Waimea and Eleele - now under the management of the Kauai Region CEO.
- Improvement in Accounts Receivable Days for the Kauai Region and significant decrease by 21 days at KVMH whereby bringing it closer to the required regional targets.
- The KVMH and SMMH Auxiliaries collected a total of \$41,091.29 for the year 2001. A total of \$21,632.38 was expended on equipment and other items for both KVMH and SMMH.
- Established Foundations of both KVMH and SMMH (KVMH Charitable Foundation and Mahelona Medical Center Charitable Foundation). Fundraising activities and grants were made possible with the assistance of a fundraising consultant bringing in approximately \$800,000 of which \$500,000 is specified for the new Niihau Project.
- Kauai Region Hospitals maintained their State Licensures and Medicare/Medicaid certifications.
- KVMH is preparing for the upcoming JCAHO survey, tentatively scheduled for September 2002, which will be under the new JCAHO/CAH Standards.

Kauai Region MAC Annual Report
July 1, 2000 to June 30, 2001

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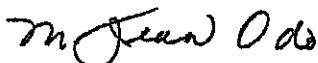
Future Goals and Challenges:

- Create Kauai Medical System through collaborative partnership with Wilcox, KVMH and SMMH.
- Obtain Rural Health Clinic designation for KVMH's Waimea and Eleele clinics. Through continued partnership with Ho'ola, obtain FQHC designation for clinic at SMMH.
- Formalize and finalize Behavioral Health system and financial partnership with Division of Mental Health (DOH).
- Commence operational and financial analysis for SMMH and its conversion to a free standing "Geriatric Center of Excellence."

The leadership has moved forward in great strides and have taken on many tasks to bring the Kauai Region to where it is at today. The Region would not have been able to come thus far without the leadership of its Regional CEO - Ms. Orianna Skomoroch and her Regional Senior Team.

I would like to thank the Hawaii Health Systems Corporation Board of Directors and Thomas Driskill, Jr. the President and CEO of HHSC for their continued support of the Kauai Region.

Respectfully submitted,



M. Jean Odo
Kauai Region MAC Chair

OAHU REGION MANAGEMENT ADVISORY COUNCIL REPORT 2001

Fiscal year 2001 was a time of change and accomplishments for Oahu Region. The challenge was planning and initiating improvement toward the regionalization of operational functions such as fiscal, human resources, and purchasing and etc.

The accomplishments for fiscal year 2001 are as follows:

- Sharing of management, staff and other resources among Leahi and Maluhia Hospitals were initiated.
- Regional directors of Finance, Human Resources, Purchasing and Rehab Therapies are in place.
- Business Office integration initiated.
- A computerized information system was installed in the Oahu Region for both clinical and billing operations. The computerized information system provided fiscal section control over the accounts receivables and it has improved receivable collections dramatically.
- Leahi Hospital improved its account receivable days from 100 days at June 30, 2000 to 72 days at June 30, 2001.
- Maluhia Hospital average long term care occupancy percentage increased from 95% for FY 2000 to 97.4% for FY 2001. This resulted in an increased net revenue of \$880,000 over the previous fiscal year.
- Expansion of PACE Program to Leahi with the first participants enrolled at Leahi in June, 2001.
- Nursing Quality Improvement project at Leahi Hospital decreased the usage of restraints from 3% to 1.9%. The QI project on Inter Disciplinary Team improved the documentation process for the MDS & RAI.
- The "Leadership 2000", a twelve module training module for supervisors, was completed.
- Leahi prevailed in 2 Leahi UPW grievances.
- Preliminary discussions for a One-Work Unit at Leahi Hospital with HGEA and UPW were started.

- Leahi Hospital developed a Pain Assessment and Management program too which all Nursing Service personnel were trained and implemented.
- Oahu Regional Hospitals maintained their State Licensures and Medicare/Medicaid certifications.
- Maluhia exceeded all financial targets this year.
- Maluhia Volunteer was nominated for the Mayor's award.

The challenges the Oahu Region face are:

- To continue the clinical and non-clinical staff skill & competencies with our limited resources.
- Continue to improve the level of services in an environment of shrinking reimbursement and increase regulations.
- Being identified as the placement of last resort for the most serious and costly health care of long term care patients.
- To challenge our personnel to think and operate as an integrated Oahu Region.

There was leadership and administrative changes in the end of fiscal year 2001 with the retirement of Dr. Jerry Walker. We are grateful and appreciative of the contribution and commitment that he has made to Leahi and Maluhia Hospitals and to the Oahu Region.

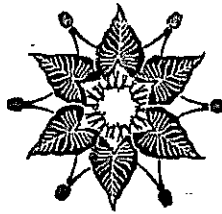
The Oahu Region was fortunate to have Mr. Dennis Sato serve as an interim Regional CEO until Mr. Vincent Lee was selected as the permanent Oahu Regional CEO. We thank Mr. Sato for the contributions and leadership that he provided during his tenure.

We want to thank the Hawaii Health System Corporation board of directors and the HHSC President and CEO for their continued support to the Oahu Region.

Respectfully submitted,



CLIFF CISCO, Chair
Oahu Region Public Health Facilities
Management Advisory Committee



Maui Memorial MEDICAL CENTER

Hawaii Health Systems Corporation — Maui Region

Hawaii Health Systems Corporation Physician's Advisory Group Annual Report to Hawaii State Legislature 2001 In Review

It is a pleasure to write this review on behalf of the HHSC Physician's Advisory Group. The Physician's Advisory Group consists of elected Physician leaders who represent an HHSC Medical Staff which is now over 800 strong. We would like to thank CEO Tom Driskill, his Executive Management Team, the HHSC Board of Directors, the Regional CEOs and their administrative staffs, and the Regional Management Advisory Committees for their collaboration and support in 2001.

Over the past five years, we have seen HHSC develop its structure and organization, and develop financial accountability such that the corporation actually earns an excess of 95% of its \$260,000,000 operating expense. These successes have been achieved, in large part by our ability to reduce audited losses over the past five years by nearly 67%.

HHSC has continued to support its Medical Staff in providing quality medical care to the residents and visitors of Hawaii. Our physicians have been invited to participate in:

1. Corporate Strategic Planning
2. Development of a Radiology Information System.
3. Development of Decision Support Systems based on clinical and financial criteria.
4. Development of Telemedicine System for specialty consultations, i.e.: Dermatology.
5. Development of Video Teleconferencing for meetings and continuing medical education.
6. Medical Staff Bylaws revision.
7. Transition to Critical Access Hospitals for selected Regional Facilities.
8. Development of Programs to empower our Physicians through Leadership Training.

In particular, HHSC has allowed physicians to provide input on key decisions affecting health care at the executive management level.

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We truly hope that there is an improved understanding by the Legislature of the critical role that HHSC plays in providing quality health care to our residents throughout the state, and in particular, on the neighbor islands. With your continued support, we will, as a team, be successful in achieving this goal.

Sincerely,



T. Manoukian, M.D., Chairman
HHSC Physician's Advisory Group
Maui Memorial Medical Center
221 Mahalani Street
Wailuku, HI 96793

January 14, 2002



Hawaii Health Systems Corporation Past Successes, Current Accomplishments, Continuing Challenges

Continuing Challenges:

- ☐ Obtaining sufficient autonomy of action to meet the strategic and operationally necessary goals to further reduce and ultimately eliminate any dependence upon the State.
- ☐ Ironically, the ability of HHSC to further reduce financial losses within the system is tremendously impeded by the same law that created the Corporation in 1996. Act 262 basically requires HHSC
 - to remain under the State civil service system
 - to have the State conduct all collective bargaining for HHSC
 - to have the Legislature control substantial changes to levels of service
 It's in these three areas (shown above) that additional autonomy is essential for HHSC to make further progress in becoming 100% independent of State support.
- ☐ HHSC has reduced our Community Hospital System operational losses tremendously from the \$46 million loss in FY1997. But, without the autonomy that HHSC needs and has continually sought, further reductions in the State financial support for mandated services may not be feasible. In fact, request for State support will increase proportionate to collective bargaining pay increases.
- ☐ Collective bargaining pay increases are currently negotiated by the State, and then legislated for HHSC. This places an impossibly large financial hardship on HHSC because the system is essentially unable to alter commercial or government healthcare payer contracts to cover the higher payroll costs. This results in HHSC's growing request to the Legislature for collective bargaining pay increase support. The most logical, cost efficient alternative for future increases, would be to empower HHSC to negotiate these issues separately from the State so that pay increases could be negotiated along with associated offsetting cost reductions.
- ☐ More than \$40 million dollars in deferred maintenance liabilities and fire and safety certification deficiencies on the twelve campuses were passed to HHSC when it was created in 1996. Although HHSC is now implementing major facility energy conservation initiatives and the State has assisted HHSC with CIP support, much more work remains.
- ☐ Hospitals are providing more definitive care for sicker patients now than in the past, however, reimbursement continues to decrease particularly in Long Term Care. Over 750 of our 1250 staffed beds are Long Term Care beds.

Past Successes:

- ☐ Between FY 97 and FY 01 HHSC has constrained total expenses and increased total revenue by \$130M.
- ☐ HHSC has earned approximately 95% of its annual operating costs with approximately 5% support from the State of Hawaii for mandated services over the past five years. In terms of return on investment (ROI) for the State, this is a tremendous investment because the national average for public hospitals' external operational support is 15% per year.
- ☐ HHSC has constrained Corporate Office operating expenses to just 3% of the overall system operating expenses, compared to the average of 6% of operating costs for comparable systems.
- ☐ Quality of care, access to care, and levels of service throughout the system have dramatically improved as a result of HHSC's management decisions and operational leadership.
- ☐ The most poignant evidence of improved quality of care at HHSC facilities is in the steady annual increase in the percentage of neighbor islanders opting for acute care services at neighbor island (primarily HHSC) facilities vs. traveling to Oahu for care. Neighbor island facility patient volume has increased by 10% while Oahu volume of neighbor island patients decreased by 11% over the past 5 years.
- ☐ In the past four years, each of the twelve HHSC facilities have successfully passed every accreditation and certification survey or inspection either by the Joint Commission on the Accreditation of Hospitals or by the Healthcare Financing Administration and/or Department of Health inspectors for Medicare and Medicaid certification. HHSC certification and survey scores have been markedly higher compared to scores received prior to HHSC taking control of the system.
- ☐ HHSC in partnership with UofH has established the State of Hawaii Telehealth Access Network (STAN) with HHSC facilities taking the leading edge in telemedicine technology and initiatives in Hawaii.

Current Accomplishments:

- ☐ Initial implementation of an energy conservation project on ten of the neighbor island HHSC campuses that will result in significant savings in the cost of energy to the Corporation, which will pay for over \$20M worth of facility improvements.

Current Accomplishments: (continued)

- ❑ Designation and full certification/licensure of four HHSC hospitals (KVMH, Lanai, Kohala, Ka'u) as Critical Access Hospitals, which authorizes them to bill Medicare and Medicaid on a cost-reimbursement basis, thereby allowing HHSC to further reduce losses at those facilities.
- ❑ Embarking on a comprehensive and diverse partnering and collaborative relationship between the Hawaii VA and HHSC to develop new healthcare initiatives on neighbor islands which will further improve quality of care and access to care and will bring in additional (new) federal funding of that care.
- ❑ Reduced Annual Worker's Compensation claims from 21.5 per hundred in FY97 to 7.8 per hundred in FY01 (HHSC is now below both National and State averages for Worker's Compensation claims).
- ❑ Established subsidiary not-for-profit corporation that will build and operate a system of assisted living facilities, with the first facility scheduled to open on Maui in 2002.
- ❑ Established subsidiary not-for-profit corporation to serve as a Foundation for HHSC to facilitate Foundation support as a new way of generating resources for HHSC facilities.

HHSC Regional Accomplishments

- ❑ **West Hawaii Region:**
 - New Computer Aided Tomography (CAT) Scan service added.
 - New services in Ultra Sound, Lactation Clinic, Chemotherapy and Infusion.
 - Four new labor and delivery rooms provided from a major remodeling effort.
 - New 11 bed psychiatric ward opened in April 2001.
 - New state-of-the-art MRI (Magnetic Resonance Imaging) now under construction.
 - Eight additional SNF beds opened in March 2001.
 - In coordination with Hilo Medical Center and NHCH has purchased a mobile lithotripter
- ❑ **Maui Region:**
 - New state-of-the-art MRI service recognized as the best in Hawaii has been established.
 - Opening of a four bed Sleep Disorders Lab.
 - Two additional ICU/CCU beds have been opened.
 - Neurosurgeon added to the MMMC staff for services previously only available on Oahu.
 - Initial development of a Center of Excellence for Diabetes Prevention and Research.
 - Continued development of a 45,000 SF Medical Office Building on campus.
 - Lanai Community Hospital established a renal dialysis center - never before available on Lanai.
- ❑ **Kauai Region:**
 - Certification as a Critical Access Hospital CAH, has increased net revenue by 10%
 - Kauai Region has acquired and manages three new outpatient clinics: E. Kauai, W. Kauai & Eleele
 - Awarded \$500,000 grant for healthcare services on Niihau
 - Inpatient obstetrics (OB) has been reopened.
 - Significantly increased out/inpatient surgical options: hip replacement, eye surgery & plastic surg.
 - New state-of-the-art diagnostic services to include: CT, Mammography, and Ultrasound.
 - Renal dialysis services being provided for both inpatients and outpatients.
 - New outpatient clinic established at Samuel Mahelona Memorial Hospital and at Eleele.
 - New Federal Qualified Health Center (FQHC) opened at KVMH in November 2001.
- ❑ **East Hawaii Region:**
 - Two New Hospice Residential Units opened on the Med/Surg Unit
 - Expansion of Pulmonary Function Testing capability---previously it was referred off-island
 - Operation & management of all imaging services by the HMC Radiology Department
 - New advanced surgical services have been started that are available only at HMC.
 - New state-of-the-art less invasive system for breast biopsies - only hospital in Hawaii to offer this.
 - New HMC Oncology Center includes state-of-the-art linear accelerator & women's imaging center.
 - Opening and dedication of the new VA Clinic at Hilo Medical Center.
 - Development of a Pacific Island Healthcare program for patient referrals from the Pacific.
 - Expansion of Obstetrics community education programs to include breast feeding classes
- ❑ **Oahu Region:**
 - Expand Program for All-Inclusive Care to the Elderly (PACE) at both Maluhia and Leahi.
 - Relocation of Hawaii Department of Health TB Outpatient Clinic to Leahi Hospital
- ❑ **At All 12 HHSC Hospitals**

Levels of Service and Quality of Care have been preserved and/or measurably enhanced, resulting in an improved capability to provide care for the Hawaii communities we serve.



HAWAII HEALTH SYSTEMS

C O R P O R A T I O N

"Touching Lives Everyday"

HMSA Quality and Service Recognition Program

HMSA, in association with Health Benchmarks, Inc, a health care research company, created the Hospital Quality and Service Recognition (HQSR) Program to encourage the delivery of high-quality and cost-effective patient care and to identify opportunities for quality improvement at the hospital level. The program is intended for acute general-medical-surgical-maternity hospitals.

HMSA worked with Health Benchmarks, Inc. and six HMSA participating hospitals in 2000-01 to develop a method to evaluate hospital performance. Hawaii hospital executives and HMSA staff collaborated on the design and development of the program with Health Benchmarks, Inc.'s multidisciplinary team of physicians, researchers, and statisticians based in Woodland Hills, California.

The HQSR Program recognizes and rewards excellence in the areas of patient service quality, service satisfaction, business operations, and resource use. In general, points are awarded in each category based on the hospital's performance relative to HMSA peer hospitals, with large and small volume hospitals evaluated separately. A total score is then determined, and an HQSR award is calculated based on that score.

The methodology used in the 2001 HQSR Program was tested during an initial pilot program and subsequently refined. The pilot program included Kapiolani Medical Center for Women and Children, Kapiolani Medical Center at Pali Momi, Kuakini Medical Center, Maui Memorial Medical Center, Straub Clinic and Hospital, and Wahiawa General Hospital.

The 4 major components of the HQSR program are:

Patient Service Quality – Maximum 35 points

- Clinical Complications (25 points)
- Process of Care : CMS (Proportion of Medicare beneficiaries that receive a specific intervention during treatment, i.e., proportion of Medicare patients diagnosed with congestive heart failure for whom ACE inhibitors were used appropriately) (4 points)
- JCAHO measures (2 points)
- Internal Quality Initiatives (4 points)

Service Satisfaction – Maximum 35 points

- Patient Satisfaction (20 points)
- Physician Satisfaction (15 points)

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Business Operations – Maximum 10 points

- Joint Commission Grid Chapter Scores (5 points)
- HMSA Business Activities (5 points)

Resource Use – Maximum 20 points

- Length of Stay (20 points)
- Readmissions (for informational purposes only, not scored)

The maximum award available to the hospital is computed in a multi-step process. Large and small volume hospitals were ranked independently (large volume hospitals are defined as hospitals treating 300 or more patients that underwent HMSA select surgery and maternity procedures and small volume were fewer than 300 patients). To recognize and reward excellence, hospitals scoring 95 percent and above receive 100 per cent of their potential award and hospitals scoring 94 per cent and below receive the corresponding percentage of their maximum award. No facility in Hawaii received 100 per cent of their maximum potential award.

As a condition of enrollment in the HQSR program, the hospitals had to submit the following data to Health Benchmarks, Inc.:

- Data from the most current JCAHO report, specifically the JCAHO accreditation grid ;
- Data relating to all Centers for Medicare and Medicaid Services (CMS) Peer Review Organization Sixth Scope of Work inpatient indicators for the disease conditions of congestive heart failure, acute myocardial infarction, pneumonia and transient ischemic attack; and
- Completed a Quality Initiatives Questionnaire listing internal quality initiatives and supporting documentation

The ranking and approximate monetary amount for our facilities is as follows:

A total of 9 hospitals participated in the large volume hospital HQSR Award and a total of 5 participated in the small volume hospital HQSR Award

- Maui Memorial Medical Center – Third place in the large volume hospital ranking with a total point score of 85.44 out of 100. Maui Memorial Medical Center will receive approximately \$261,000. The first place hospital had 92.40 points out of 100.
- Kona Community Hospital - Sixth place in the large volume hospital ranking with a total point score of 82.38 and will receive approximately \$55,800.
- Hilo Medical Center- Seventh place in the large volume hospital ranking with a total point score of 81.74 and will receive approximately \$146,000.
- Kauai Veterans Memorial Hospital – Second place in the small volume hospital ranking with a total point score of 75.87. Kauai Veterans Memorial Hospital will receive approximately \$8,800. The first place hospital received 87.09 points.

The Regional CEOs have been provided a copy of the full report and a copy of a CD-ROM, which contains the patient's names and claims data . A discussion session for the 2001 HQSR

Program will be held in HMSA's Multi-Purpose Room on January 17, 2002 from 2:00 p.m.- 4:00 p.m. Hospital administrators and the hospital's quality management physicians and staff are invited to attend. Representatives from Health Benchmarks, Inc. and HMSA's executive staff will be present to discuss details about the methodology and answer questions. Each facility will decide how to use the monies from this award.

**Deloitte
& Touche**

***Hawaii Health Systems
Corporation***

*Financial Statements for the Years Ended
June 30, 2001 and 2000, Supplemental
Information for the Year Ended June 30, 2001
and Independent Auditors' Reports*

HAWAII HEALTH SYSTEMS CORPORATION

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HAWAII HEALTH SYSTEMS CORPORATION

INTRODUCTION

PURPOSE OF THE REPORT

The purpose of this report is to present the financial statements of Hawaii Health Systems Corporation (HHSC) as of and for the years ended June 30, 2001 and 2000 and the independent auditors' reports thereon.

SCOPE OF THE AUDITS

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

ORGANIZATION OF THE REPORT

This report on the financial statements is divided into three sections:

- The first section presents this introduction.
- The second section presents the financial statements of HHSC as of and for the years ended June 30, 2001 and 2000 and the independent auditors' report thereon. This section also presents supplemental financial information.
- The third section presents the independent auditors' report in accordance with *Government Auditing Standards* on HHSC's internal control and compliance with laws and regulations.



INDEPENDENT AUDITORS' REPORT

Board of Directors of Hawaii Health Systems Corporation:

We have audited the accompanying statements of financial position of Hawaii Health Systems Corporation (HHSC), a component unit of the State of Hawaii, as of June 30, 2001 and 2000, and the related statements of operations - unrestricted funds, changes in fund balances, and cash flows - unrestricted funds for the years then ended. These financial statements are the responsibility of HHSC's management. 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of HHSC at June 30, 2001 and 2000 and the results of its operations and the cash flows of its unrestricted funds for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1, in fiscal 1997, the administration of the facilities that comprise HHSC was transferred from the State Department of Health - Division of Community Hospitals (State) to HHSC. As of June 30, 2001, negotiations between the State and HHSC relating to the transfer of assets and liabilities (including amounts due to the State) were on-going. Accordingly, the assets, liabilities and fund balances reflected in the accompanying statements of financial position at June 30, 2001 and 2000 may be significantly different from those eventually included in the final settlement.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental information on pages 20 and 21 is presented for the purposes of additional analysis and is not a required part of the basic financial statements. The supplemental combining and consolidating schedules on pages 22 through 24 are presented for the purpose of additional analysis of the basic financial statements rather than to present the financial position and results of operations of individual facilities, and are not a required part of the basic financial

statements. This supplemental information and the supplemental combining and consolidating schedules are the responsibility of HHSC's management. Such information has been subjected to the auditing procedures applied in our audits of the basic financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 8, 2001 on our consideration of HHSC's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Deloitte & Touche LLP

November 8, 2001

HAWAII HEALTH SYSTEMS CORPORATION

STATEMENTS OF FINANCIAL POSITION JUNE 30, 2001 AND 2000

ASSETS	2001	2000
CURRENT ASSETS:		
Cash and cash equivalents:		
On deposit with the State of Hawaii	\$ 384,286	\$ 978,270
On deposit with banks and on hand	<u>11,528,063</u>	<u>8,449,512</u>
Total cash and cash equivalents	11,912,349	9,427,782
Patient accounts receivable - less allowances of \$89,260,755 and \$91,825,787 for contractual adjustments and doubtful accounts	43,902,993	45,117,748
Prepaid pension costs (Note 8)	6,206,461	
Supplies and other current assets	<u>6,518,970</u>	<u>5,766,655</u>
Total current assets	68,540,773	60,312,185
PROPERTY, PLANT AND EQUIPMENT - Net (Notes 4, 5 and 6)	168,441,011	150,802,526
RECEIVABLE FROM THE STATE OF HAWAII - Pension funding (Note 8)		6,206,461
ASSETS LIMITED AS TO USE (Note 3)	1,399,922	1,892,669
OTHER ASSETS	<u>97,822</u>	<u>111,266</u>
TOTAL	<u>\$238,479,528</u>	<u>\$219,325,107</u>

HAWAII HEALTH SYSTEMS CORPORATION

STATEMENTS OF FINANCIAL POSITION (Continued) JUNE 30, 2001 AND 2000

LIABILITIES AND FUND BALANCES	2001	2000
CURRENT LIABILITIES:		
Accounts payable and accrued expenses	\$ 32,117,381	\$ 23,301,541
Accrued vacation	18,229,714	17,853,866
Accrued workers' compensation liability (Note 9)	16,983,937	17,000,000
Estimated third-party payor settlements	4,044,376	4,500,928
Current portion of capital lease obligations (Note 6)	3,204,408	1,567,982
Current portion of long-term debt (Note 5)	496,385	
Patients' safekeeping deposits	446,982	349,228
Other current liabilities	582,822	1,038,087
Total current liabilities	76,106,005	65,611,632
CAPITAL LEASE OBLIGATIONS - Less current portion (Note 6)	9,316,639	4,404,168
LONG-TERM DEBT - Less current portion (Note 5)	12,018,679	
DUE TO THE STATE OF HAWAII	20,122,507	20,122,506
OTHER LIABILITIES	696,113	461,363
Total liabilities	118,259,943	90,599,669
FUND BALANCES:		
Unrestricted:		
Board-designated (Note 3)	5,500	5,500
Other	119,266,645	127,181,997
Total unrestricted	119,272,145	127,187,497
Restricted	947,440	1,537,941
Total fund balances	120,219,585	128,725,438
TOTAL	\$238,479,528	\$219,325,107

See notes to financial statements.

HAWAII HEALTH SYSTEMS CORPORATION

STATEMENTS OF OPERATIONS - UNRESTRICTED FUNDS YEARS ENDED JUNE 30, 2001 AND 2000

	2001	2000
OPERATING REVENUES:		
Net patient service revenues (Note 7)	\$238,192,152	\$ 235,420,763
Other (Note 7)	<u>3,045,396</u>	<u>2,315,524</u>
Total operating revenues	241,237,548	237,736,287
OPERATING EXPENSES:		
Salaries and benefits	142,269,185	138,359,409
Medical supplies and drugs	25,517,513	26,054,661
Professional fees (Note 7)	23,477,964	20,993,690
Purchased services (Note 7)	18,096,770	18,102,412
Provision for doubtful accounts	14,002,665	12,653,146
Depreciation and amortization	11,457,171	12,378,048
Other supplies	10,463,653	9,557,906
Interest	652,758	485,050
Other	21,339,580	17,979,814
Year 2000 compliance		<u>581,222</u>
Total operating expenses	<u>267,277,259</u>	<u>257,145,358</u>
LOSS FROM OPERATIONS	(26,039,711)	(19,409,071)
NONOPERATING REVENUES - Net:		
Appropriations from the State of Hawaii	13,000,649	28,252,267
Other - net	<u>2,050,791</u>	<u>2,179,693</u>
Nonoperating revenues - net	<u>15,051,440</u>	<u>30,431,960</u>
EXCESS OF REVENUES OVER EXPENSES (EXPENSES OVER REVENUES)	<u>\$ (10,988,271)</u>	<u>\$ 11,022,889</u>

See notes to financial statements.

HAWAII HEALTH SYSTEMS CORPORATION

STATEMENTS OF CHANGES IN FUND BALANCES YEARS ENDED JUNE 30, 2001 AND 2000

	2001	2000
UNRESTRICTED FUNDS:		
Balance, beginning of year	\$ 127,187,497	\$ 111,687,674
Excess of revenues over expenses (expenses over revenues)	(10,988,271)	11,022,889
Amounts released from restrictions	1,350,624	541,694
Property, plant and equipment contributed by the State of Hawaii (Note 4)	<u>1,722,295</u>	<u>3,935,240</u>
Balance, end of year	<u>\$ 119,272,145</u>	<u>\$ 127,187,497</u>
RESTRICTED FUNDS:		
Balance, beginning of year	\$ 1,537,941	\$ 1,789,775
Restricted contributions	760,123	289,860
Amounts released from restrictions	<u>(1,350,624)</u>	<u>(541,694)</u>
Balance, end of year	<u>\$ 947,440</u>	<u>\$ 1,537,941</u>

See notes to financial statements.

HAWAII HEALTH SYSTEMS CORPORATION

STATEMENTS OF CASH FLOWS - UNRESTRICTED FUNDS YEARS ENDED JUNE 30, 2001 AND 2000

	2001	2000
OPERATING ACTIVITIES:		
Loss from operations	\$(26,039,711)	\$(19,409,071)
Adjustments to reconcile loss from operations to net cash used in operating activities:		
Provision for doubtful accounts	14,002,665	12,653,146
Depreciation and amortization	11,457,171	12,378,048
Amounts released from Board designations		2,994,500
Amounts released from restrictions	1,350,624	541,694
Change in operating assets and liabilities:		
Receivables	(11,987,910)	(7,827,634)
Supplies and other current assets	(758,015)	205,000
Other assets	111,266	(111,266)
Accounts payable, accrued expenses, and other liabilities	8,127,142	5,736,454
Accrued vacation	375,848	1,113,254
Accrued workers' compensation liability	(16,063)	(1,500,000)
Estimated third-party payor settlements	(456,552)	(550,635)
Accrued retroactive compensation		(13,279,298)
Net cash used in operating activities	(3,833,535)	(7,055,808)
INVESTING ACTIVITIES:		
Purchase of investment	(97,822)	
Pension funding paid in advance		(6,206,461)
Net cash used in investing activities	(97,822)	(6,206,461)
NONCAPITAL FINANCING ACTIVITIES:		
Appropriations from the State of Hawaii	13,000,649	28,252,267
Other nonoperating revenues - net	1,947,889	1,846,955
Payments on long-term debt	(335,402)	
Receipts from the State of Hawaii		7,042
Net cash provided by noncapital financing activities	14,613,136	30,106,264
CAPITAL AND RELATED FINANCING ACTIVITIES:		
Capital expenditures	(5,580,675)	(5,657,564)
Repayments on capital lease obligations	(2,631,162)	(2,124,868)
Proceeds from sale of property, plant and equipment	14,625	20,250
Net cash used in capital and related financing activities	(8,197,212)	(7,762,182)
NET INCREASE IN CASH AND CASH EQUIVALENTS (Forward)	2,484,567	9,081,813

HAWAII HEALTH SYSTEMS CORPORATION

STATEMENTS OF CASH FLOWS - UNRESTRICTED FUNDS (Continued) YEARS ENDED JUNE 30, 2001 AND 2000

	2001	2000
NET INCREASE IN CASH AND CASH EQUIVALENTS (Forward)	\$ 2,484,567	\$9,081,813
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>9,427,782</u>	<u>345,969</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 11,912,349</u>	<u>\$9,427,782</u>
 SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid, primarily on capital lease obligations	\$ 867,094	\$ 425,607
Non-cash financing and investing activities:		
• Property, plant and equipment contributed by the State of Hawaii	1,722,295	3,935,240
• Interest capitalized on construction projects	359,273	362,162
• Equipment acquired under capital leases	9,180,059	3,336,924
• Equipment purchases included in accounts payable	468,183	899,712
• Property, plant and equipment contributed by third parties	46,988	120,000
• Equipment acquired under debt	11,893,162	
• Assumption of long-term debt and accounts receivable	800,000	
• Reclassification of other current assets to property	5,700	

See notes to financial statements.

HAWAII HEALTH SYSTEMS CORPORATION

NOTES TO FINANCIAL STATEMENTS YEARS ENDED JUNE 30, 2001 AND 2000

1. ORGANIZATION

Hawaii Health Systems Corporation (HHSC) is a public body corporate and politic and an instrumentality and agency of the State of Hawaii (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 transferred all facilities under the administration of the Department of Health - Division of Community Hospitals to HHSC. The facilities are as follows:

Hawaii County:

Hilo Medical Center
Hale Ho'ola Hamakua
Ka'u Hospital
Kohala Hospital
Kona Community Hospital

City and County of Honolulu:

Leahi Hospital
Maluhia

Maui County:

Maui Memorial Medical Center
Kula Hospital
Lanai Community Hospital

Kauai County:

Kauai Veterans Memorial Hospital
Samuel Mahelona Memorial Hospital

The Act became effective in fiscal year 1997. 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 of Hawaii, and is a component unit of the State of Hawaii. 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 (including amounts due to the State) pursuant to Act 262 were continuing as of June 30, 2001. Accordingly, the assets, liabilities and fund balances of HHSC reflected in the accompanying statements of financial position may be significantly different from those eventually included in the final settlement.

Beginning in fiscal year 2001, consolidated financial statements are being presented for HHSC and Hawaii Health Systems Foundation (HHSF), a non-profit organization of which HHSC is the sole member. The purpose of HHSF is to raise funds and obtain gifts and grants on behalf of HHSC. In fiscal year 2001, the operations of HHSF were not significant.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting - HHSC uses the proprietary fund method of accounting, which recognizes revenues and expenses on the accrual basis.

Financial Statement Presentation - The accompanying financial statements are presented in accordance with the pronouncements of the Government Accounting Standards Board (GASB) and the American Institute of Certified Public Accountants audit guide for health care organizations. Pursuant to GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, HHSC has elected not to apply the provisions of relevant pronouncements of the Financial Accounting Standards Board issued after November 30, 1989.

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

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 moneys paid into the State Treasury (cash pool). HHSC's portion of this cash pool at June 30, 2001 and 2000 is indicated in the accompanying statements of financial position as "Cash 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.

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

Property, Plant and Equipment - Property, plant and equipment assumed from the State at inception are recorded at cost less accumulated depreciation. Other property, plant and equipment are recorded at cost, or estimated fair market value at the date of donation. Donated buildings, equipment and land are considered additions to the permanent capital of HHSC and, therefore, are credited directly to the unrestricted fund balance. Equipment under capital leases is recorded at the present value of future payments. Buildings, equipment and improvements are depreciated by the straight-line method over their estimated useful lives. Gains or losses on the sale of property, plant and equipment are reflected in other nonoperating revenues. Normal repairs and maintenance expenses are charged to operations as incurred.

Depreciation and amortization are provided using the straight-line method over the estimated useful lives of the assets.

HHSC's capital improvement projects are managed by the State Department of Accounting and General Services. The related costs are transferred to HHSC's property, plant and equipment accounts as a contribution of capital as costs are incurred.

Assets Limited as to Use - Assets limited as to use are restricted funds, board-designated funds, and patients' safekeeping deposits. Patients' safekeeping deposits represent funds received, or property belonging to the facilities' 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. In addition, such assets also include restricted contributions.

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

Net Patient Service Revenues - Net patient service revenues are recorded on an accrual basis in the period in which the related services are provided at established rates, less contractual adjustments. HHSC, as a safety net provider, provides charity care to certain patients; the specific cost of such care is not determinable for the years ended June 30, 2001 and 2000.

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 revenues are 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 estimated third-party payor settlement accrual of \$4,044,376 and \$4,500,928 as of June 30, 2001 and 2000, respectively, is 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 efforts, judgment, and certain methodologies to estimate the anticipated final outcome.

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

- **Medicare** - Inpatient acute services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. Effective August 1, 2000, certain inpatient services and all hospital outpatient services rendered to Medicare beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Inpatient non-acute services, outpatient services and defined capital and medical education costs related to Medicare beneficiaries were paid based upon a cost reimbursement methodology. HHSC was reimbursed at a tentative rate with final settlement determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediary. The appropriateness of admissions is subject to an independent review by peer review organizations under contract with HHSC. HHSC's Medicare cost reports have been audited by the Medicare fiscal intermediary through fiscal year 1999.

- **Medicaid** - Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology. HHSC is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports and audits thereof by the Medicaid fiscal intermediary.
- **Hawaii Medical Service Association (HMSA)** - Inpatient services rendered to HMSA subscribers are reimbursed at prospectively determined case rates for hospitalization or procedures performed. The prospectively determined case rates are not subject to retroactive adjustment. In addition, outpatient services and certain contracts are reimbursed on a discounted charges method basis.

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.

Donations - Restricted donations are recorded as additions to restricted funds. Resources restricted for specific operating purposes are transferred to the unrestricted fund and reflected as other operating revenues to the extent expended by the unrestricted fund during the year. Funds that are restricted for property expenditures are transferred from the restricted fund to the unrestricted fund to the extent expended within the year.

Unrestricted donations are recorded as nonoperating revenues.

Contributed Services - Volunteers have made contributions of their time in furtherance of HHSC's mission. The value of such contributed services is not reflected in the accompanying financial statements since it is not susceptible to objective measurement or valuation.

Bond Interest - HHSC reports as nonoperating expense the interest paid by the State for general obligation bonds whose proceeds were used for hospital construction. A corresponding contribution from the State is reported as nonoperating revenues. The bonds are obligations of the State, to be paid by the State's general fund, and are not reported as liabilities of HHSC.

Bond interest costs incurred on construction projects funded with State general obligation bonds are capitalized during the construction period.

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.

Concentration of Credit Risk - Patient accounts receivable consists of amounts due from insurance companies and patients for services rendered by 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 at June 30, 2001 and 2000 was as follows:

	2001	2000
Medicare	19%	20%
Medicaid	21	18
HMSA	16	18
Other third-party payors	26	29
Patients and other	<u>18</u>	<u>15</u>
	<u>100%</u>	<u>100%</u>

New Accounting Pronouncement - In June 1999, the Governmental Accounting Standards Board issued Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments* (GASB 34). GASB 34 establishes financial reporting standards for state and local governments. Among its requirements, GASB 34 requires governmental entities to report certain supplementary information, including management's discussion and analysis of the entity's financial performance. HHSC will adopt GASB 34 effective July 1, 2001. Management does not expect the adoption of GASB 34 to have a significant impact on the financial statements.

Reclassifications - Certain amounts in the 2000 financial statements have been reclassified to conform to the 2001 presentation.

3. BOARD-DESIGNATED FUNDS

As of June 30, 2001 and 2000, HHSC's Board of Directors had designated cash reserves as follows:

For capital equipment acquisitions and/or equity investments for growth initiatives	\$5,000
For settlement and extinguishment of residual workers' compensation claims	<u>500</u>
Total	<u>\$5,500</u>

During the year ended June 30, 2000, HHSC's Board of Directors released \$2,994,500 of the designated cash reserves for use in operations.

The designated funds are included in assets limited as to use and in the board-designated fund balance.

4. PROPERTY, PLANT AND EQUIPMENT

At June 30, 2001 and 2000, property, plant and equipment consisted of the following:

	2001	2000
Land and land improvements	\$ 4,744,929	\$ 3,357,465
Buildings and improvements	192,495,936	175,344,737
Major moveable equipment	61,127,964	57,446,739
Fixed equipment	26,365,598	23,083,353
Construction in progress	<u>13,798,590</u>	<u>15,306,022</u>
	298,533,017	274,538,316
Less accumulated depreciation and amortization	<u>(130,092,006)</u>	<u>(123,735,790)</u>
Property, plant and equipment - net	<u>\$ 168,441,011</u>	<u>\$ 150,802,526</u>

In fiscal years 2001 and 2000, the State Department of Accounting and General Services transferred property, plant and equipment, including construction in progress, aggregating \$1,722,295 and \$3,935,240, respectively, to HHSC as a contribution of capital.

5. LONG-TERM DEBT

Hilo Residency Training Program - In June 2001, HHSC acquired land, building, and medical equipment of \$11,893,162 from Hilo Residency Training Program, Inc. (H RTP) 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 H RTP's outstanding balances on the loans and notes payable of \$11,893,162. The loans and notes payable are collateralized by a security interest in the property, plant, and equipment acquired from H RTP, as well as any rights, interest, and other tangible assets relating to such property.

West Kauai Community Development Corporation - In June 2001, HHSC entered into a \$700,000 Term Loan Agreement (Loan Agreement) with a local bank to finance the balance of the amount owing under HHSC's guarantee of an \$800,000 loan made by the local bank to West Kauai Community Development Corporation (WK CDC). WK CDC had obtained the loan to fund Ohana Physicians Group's (Ohana) operating deficits during the time that Ohana provided physician services to Kauai Veterans Memorial Hospital. WK CDC's loan was collateralized by certain real property and improvements located in Waimea, Kauai. Under the terms of the Loan Agreement, HHSC does not stand to receive any interest in such property nor any rights to the proceeds from the sale of the property. In June 2001, WK CDC executed a promissory note to HHSC for \$800,000, representing the outstanding balance WK CDC owed the local bank on its loan. Due to uncertainty as to the realization of any proceeds from the promissory note, HHSC has recorded an allowance for doubtful notes receivable of \$800,000 against the note receivable balance.

Long-term debt as of June 30, 2001 consisted of the following:

Loan payable to bank (H RTP); \$9,500,000; interest at 8% until December 1, 2002, thereafter, interest at weekly average of 5-year U.S. Treasury Securities rate plus 250 basis points; monthly principal and interest payments of \$71,000; due December 1, 2027	\$ 9,346,853
Loan payable to bank (H RTP); \$319,000; interest at 9% until June 8, 2004, thereafter, interest at weekly average of 3-year U.S. Treasury Securities rate plus 275 basis points; monthly principal and interest payments of \$3,500; due June 8, 2007	275,000
Note payable to United States Department of Agriculture (USDA) (H RTP); \$1,250,000; interest at 4.75%; monthly principal and interest payments of \$6,188; due June 24, 2034	1,236,086
Note payable to USDA (H RTP); \$1,000,000; interest at 4.75%; monthly principal and interest payments of \$8,170; due August 13, 2014	957,125
Term loan agreement payable to bank (WKCDC); \$700,000; interest at the bank's prime rate; interest payments monthly with additional payments of principal commencing on January 15, 2002 of \$200,000, followed by equal quarterly payments of \$125,000 commencing on April 15, 2002; due December 17, 2002	<u>700,000</u>
Total	12,515,064
Less current portion	<u>(496,385)</u>
Noncurrent portion	<u>\$12,018,679</u>

Maturities of long-term debt are as follows:

Year ending June 30:	
2002	\$ 496,385
2003	582,735
2004	222,672
2005	238,747
2006	256,050
Thereafter	<u>10,718,475</u>
Total	<u>\$12,515,064</u>

6. CAPITAL LEASE OBLIGATIONS

HHSC has an arrangement with Academic Capital LLC (Academic Capital) whereby HHSC enters into capital leases with Academic Capital on behalf of the facilities. The capital lease obligation is recorded on HHSC-Corporate's (Corporate) financial statements. While the assets are being constructed, the amounts are recorded as construction in progress on Corporate's financial statements. Upon completion, the asset is transferred to the facility's financial statements. Corporate makes the capital lease payments, while the facility records depreciation on the capital asset. The facilities reimburse Corporate through the due from affiliates account.

Future lease payments as of June 30, 2001 for capital leases, which expire on various dates through fiscal year 2022, were as follows:

Year ended June 30:	
2002	\$ 4,114,094
2003	3,937,763
2004	3,264,596
2005	2,273,715
2006	927,664
Thereafter	<u>241,327</u>
Total future minimum payments	14,759,159
Less amount representing interest	<u>(2,238,112)</u>
Total capital lease obligations	12,521,047
Current portion	<u>(3,204,408)</u>
Noncurrent portion	<u>\$ 9,316,639</u>

7. FACILITY-BASED TECHNICAL SERVICE AGREEMENTS

HHSC has facility-based technical service agreements relating to certain ancillary services. These arrangements are generally related to administrative services, clinical personnel, space rental, and clinical services. Reimbursement arrangements vary by contractor and range from fixed amounts per month to 100% reimbursements of charges. Amounts charged by the contractors are included in operating expenses in purchased services and professional fees, and aggregated approximately \$20 million and \$21 million during fiscal years 2001 and 2000, respectively.

In compliance with Medicare and Medicaid regulations, HHSC bills third-party payors for the services provided to patients by the contractors. These billings are included in net patient service revenues.

HHSC charges the contractors for use of the premises, supplies and laundry. These amounts are included in other operating revenues and aggregated approximately \$1,859,000 and \$2,008,000 during fiscal years 2001 and 2000, respectively.

8. 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 5 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% 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% 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 at age 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% of their average final salary, as defined, for each year of credited service. Benefits fully vest on reaching ten 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.

During the year ended June 30, 2000, HHSC's contribution to the ERS was \$6,206,461. In July 2000, the State of Hawaii Department of Budget and Finance notified HHSC that, due to the late approval of fringe benefit rates for fiscal year 2000, assessments of fringe benefits for all State entities during fiscal year 2000 were based on the fiscal year 1999 rates. However, as the approved fiscal year 2000 ERS contribution rate was zero, the contributions made by HHSC entities during fiscal year 2000 resulted in an overcollection of such amounts. Accordingly, the HHSC has recorded a receivable for the amount it contributed to the ERS during the year ended June 30, 2000 (shown as receivable from the State of Hawaii - pension funding in the fiscal year 2000 statement of financial position). In July 2001, the State notified HHSC that the amounts overpaid by HHSC during the fiscal year ended June 30, 2000 will be applied toward HHSC's required contribution toward the ERS in fiscal year 2002. As such, the State will not be refunding any portion of the overpayments made during fiscal year 2000. Accordingly, the amount previously reported as receivable from the State of Hawaii-pension funding has been reclassified to prepaid pension costs in the statement of financial position at June 30, 2001.

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

Post-Retirement Health Care and Life Insurance Benefits

In addition to providing pension benefits, the State of Hawaii Public Employees Health Fund provides certain health care (medical, prescription drug, vision, and dental) and life insurance benefits for retired employees. Contributions are based upon negotiated collective bargaining agreements and are limited by State statute to the actual cost of benefit coverage. HHSC pays for 100% of these benefits for employees who have at least 10 years of service. HHSC's share of the cost of these benefits is pro-rated for employees with less than 10 years of service. HHSC also reimburses Medicare expenses of retirees and qualified spouses (through the State of Hawaii) who are at least 62 years of age and have at least 10 years of service. HHSC's post-retirement benefits expense approximated \$5,751,000 and \$6,570,000 for the years ended June 30, 2001 and 2000, respectively.

Sick Leave

Accumulated sick leave as of June 30, 2001 was approximately \$33 million. 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.

9. COMMITMENTS AND CONTINGENCIES

Professional Liability

HHSC maintains professional and general liability insurance with a private insurance carrier with a \$40 million limit per claim. 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.

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's facilities also directly provide 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 \$16,983,937 and \$17,000,000 for unpaid claims as of June 30, 2001 and 2000, respectively.

Ceded Lands

The Office of Hawaiian Affairs (OHA) and the State of Hawaii 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. As of June 30, 2001, the outcome of the lawsuit had not been decided.

At the present time, HHSC is not able to estimate the magnitude of a potential adverse ruling (or that portion of the exposure which may ultimately be allocated to claims relating to HHSC and certain of its facilities). HHSC does not believe that it will suffer any material adverse impact from an adverse ruling against the State because the claim is against the State and not HHSC. In addition, should any payments be required to be made to OHA, management believes that the Legislature would appropriate funds to cover any amounts allocated to HHSC.

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.

Asbestos Contamination

There is known asbestos contamination of the old hospital building located next to the Hilo Medical Center facility. Present estimates by management to demolish the building and remediate the asbestos contamination approach \$2 million or more. No decision has yet been made by HHSC on how to proceed on this issue. The ultimate ownership of the old building is still in negotiation between the State of Hawaii and HHSC, since Act 262 did not specify which assets and liabilities would transfer to HHSC. As such, a liability for the cost of the remediation has not been recorded in HHSC's financial statements.

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HAWAI HEALTH SYSTEMS CORPORATION

SUPPLEMENTAL SCHEDULE OF RECONCILIATION OF CASH ON DEPOSIT WITH THE STATE OF HAWAII JUNE 30, 2001

	Appropriation Symbol	
CASH ON DEPOSIT WITH THE STATE OF HAWAII:		
SPECIAL FUNDS:		
	S-85-364-M	\$ 1,597
	S-92-312-H	485
	S-93-312-H	544
	S-93-353-H	6,563
	S-93-359-H	5,681
	S-94-359-M	46,305
	S-94-396-H	8,673
	S-95-396-H	19,636
	S-96-312-H	469
	S-96-359-H	23,019
	S-96-396-H	9,040
	S-97-359-H	5,878
	S-97-396-H	182
	S-98-396-H	1,687
	S-99-355-H	2,615
	S-00-350-H	69,233
	S-00-352-H	5,894
	S-00-353-H	9,822
	S-01-354-H	19,843
	S-01-365-H	1
	S-00-373-H	1
	S-01-355-H	46,299
	S-01-351-H	21,243
	S-01-371-H	54,779
	S-01-358-H	3,983
TRUST FUNDS:		
	T-01-909-H	31,446
	T-01-914-H	19,538
	T-01-918-H	<u>1,273</u>
TOTAL PER STATE		415,729
RECONCILING ITEMS:		
Outstanding checks		(1,895)
Other		<u>(29,548)</u>
TOTAL PER HHSC		<u>\$ 384,286</u>

HAWAI HEALTH SYSTEMS CORPORATION

SUPPLEMENTAL SCHEDULE OF RECONCILIATION OF CASH ON DEPOSIT WITH THE STATE OF HAWAII (Continued) JUNE 30, 2001

	Appropriation Symbol	
ASSETS LIMITED AS TO USE:		
GIFT FUNDS:		
	T-01-910-H	\$ 63,106
	T-01-915-H	12,437
	T-01-919-H	1,044
	T-01-911-H	22,912
PATIENT TRUST FUNDS:		
	T-01-920-H	4,292
	T-01-921-H	6,679
	T-01-925-H	103,411
	T-01-926-H	<u>13,380</u>
TOTAL PER STATE		227,261
RECONCILING ITEMS:		
Board-designated fund balance		5,500
Restricted fund balance		53,074
Restricted contributions receivable		
Cash held by financial institutions		1,100,194
Patients' safekeeping deposits		36,784
Other		<u>(22,891)</u>
TOTAL PER HHSC		<u>\$1,399,922</u>

HAWAII HEALTH SYSTEMS CORPORATION

SUPPLEMENTAL COMBINING STATEMENT OF FINANCIAL POSITION INFORMATION JUNE 30, 2001

ASSETS	Facilities										HHSC Combined	Reclassifi- cations and Elim- inations	Hawaii Health Systems Founda- tion	Reclassifi- cations and Elim- inations	HHSC Consolidated
	Hilo Medical Center	Hale Ho'ola Hamakua	Ka'u Hospital	Kohala Hospital	Kona Community Hospital	Mau Memorial Medical Center	Kula Hospital	Lanai Community Hospital	Kauai Veterans Memorial Hospital	Samuel Mehelona Memorial Hospital	Leahi Hospital	Total Facilities	Corporate		
CURRENT ASSETS:															
Cash and cash equivalents:															
On deposit with the State of Hawaii	\$ 87,448	\$ 25,028	\$ 5,894	\$ 16,385	\$ 19,843	\$ 45,918	\$ 54,779	\$ 3,943	\$ 22,234	\$ 22,141	\$ 65,429	\$ 333,209	\$ 37,323	\$ 42,717	\$ 384,286
On deposit with banks and on hand	209,558	500	5,137	24,448	301,432	99,079	8,508	19,290	42,539	22,141	38,825	1,094,666	10,390,660		11,485,236
Total cash and cash equivalents	297,006	25,528	11,031	40,833	321,275	145,017	63,287	23,273	64,773	22,142	104,254	333,210	10,427,983	42,737	11,869,612
Patient accounts receivable - less allowances for contractual adjustments and doubtful accounts	10,913,495	791,691	353,536	502,536	5,411,385	16,030,131	2,197,325	229,367	2,610,953	1,041,840	2,205,145	1,595,589	43,902,993		43,902,993
Prepaid pension costs	1,620,000	135,000	79,000	90,000	686,000	1,521,000	296,000	68,632	302,147	248,000	570,000	410,052	180,630		6,206,461
Supplies and other current assets	2,224,805	103,645	41,943	25,125	1,450,247	1,523,169	143,107	51,920	334,539	44,234	201,532	111,034	395,566	8,000	6,518,970
Total current assets	15,055,306	1,055,864	485,510	658,494	7,868,907	19,219,317	2,699,719	373,192	3,332,412	1,356,216	3,080,931	2,439,885	11,004,179	68,229,932	68,540,773
DUE FROM AFFILIATES - Net						9,710,001						9,710,001	64,109,406	4,000	(4,000)
PROPERTY, PLANT AND EQUIPMENT - Net	36,645,793	15,157,369	893,057	664,433	24,994,753	45,958,644	5,392,469	529,480	9,317,066	4,091,090	8,230,761	4,115,923	12,445,456	4,717	168,441,011
ASSETS LIMITED AS TO USE	33,639	18,367	10,804	7,538	75,344	44,507	55,831	1,646	54,963	29,104	153,575	101,382	813,222		1,399,922
OTHER ASSETS													97,872		97,872
TOTAL	\$51,734,718	\$16,231,600	\$1,389,371	\$1,330,465	\$32,939,004	\$74,952,469	\$8,148,019	\$94,318	\$12,704,441	\$5,476,410	\$11,465,267	\$6,657,190	\$88,470,085	\$5,454	\$218,479,518

SUPPLEMENTAL COMBINING STATEMENT OF FINANCIAL POSITION INFORMATION (Continued)
JUNE 30, 2001

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SUPPLEMENTAL COMBINING STATEMENT OF OPERATIONS - UNRESTRICTED FUNDS INFORMATION

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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Board of Directors of Hawaii Health Systems Corporation:

We have audited the financial statements of Hawaii Health Systems Corporation (HHSC) as of and for the years ended June 30, 2001 and 2000, and have issued our report thereon dated November 8, 2001. 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.

Compliance

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

Internal Control over Financial Reporting

In planning and performing our audits, we considered HHSC's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted a certain matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect HHSC's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. The reportable condition is described in a separate letter to management of HHSC dated November 8, 2001 and is summarized as follows:

- Reconciliations of certain general ledger accounts are not performed on a timely basis.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned

functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we do not believe the reportable condition described above is a material weakness.

This report is intended solely for the information and use of the Board of Directors and management of Hawaii Health Systems Corporation and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche LLP

November 8, 2001