The Honorable Linda Lingle
Governor of Hawaii
Hawaii State Capitol
Executive Chambers
Honolulu, Hawaii 96813

Dear Governor Lingle:

It is with sincere appreciation for your tremendous support 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 have continued to improve our financial management and accounting systems throughout the year. Although in FY 1997 the Corporation received a qualified audit with many material weaknesses, we have now received our sixth consecutive “clean” unqualified audit with no material weaknesses for FY 2003, FY 2002, FY 2001, FY 2000, FY 1999 and FY 1998. The FY 2003 and FY 2002 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 are a listing of Functional Accomplishments and a listing of HHSC Cost Savings and Enhanced Revenues.

We have continued to develop and improve our clinical and non-clinical quality programs consistently putting into practice our mantra that “Quality is Job One.” The quality of our clinical operations was recognized by HMSA recently with $1,195,922 in checks to six HHSC facilities for our excellent results from participating in the HMSA Quality and Service Recognition Program.
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. In recognition of the tremendous value of our energy services performance contracting (initiative) with Noresco, LLC, the Energy User News recently recognized HHSC’s multi-million dollar energy conservation project as the “Best Healthcare Facility Project” at World Energy Engineering Congress in Atlanta, Georgia, as explained in the attached article from the January 2004 issue.

For FYs 1998 through 2002, HHSC’s operating losses have fluctuated between a loss of $18.5 million to $29.9 million. For this same period, the operating results for other hospitals in Hawaii have plummeted from aggregate net operating profit of $46.5 million in 1998 to a loss of $27 million in FY 2001 and an even greater loss of $60 million in FY 2002, exclusive of HHSC operational results. HSSC is fortunate to have been able to maintain relative stability in financial results, considering the Statewide trends in the hospital industry. In FY 2003, HHSC’s aggregate loss was $45 million. The increase in HHSC loss from FY 2002 to FY 2003 attributed to an increase of $14 million in HHSC contributions mandated by the State for the Employee’s Retirement System (ERS) and health benefit plan. Although the combined income/loss for all other Hawaii hospitals has not been calculated for FY 2003, we anticipate the loss in FY 2003 will be far more than in FY 2002.

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### HHSC Compared to Hawaii Hospitals*

**Operating Income/(Loss)**

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<tr>
<td>HHSC</td>
<td>$16,526,653</td>
<td>$28,027,357</td>
<td>$19,423,391</td>
<td>$25,935,447</td>
<td>$29,883,322</td>
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<td>Hospitals</td>
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<td>Operating</td>
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<tr>
<td>Income</td>
<td>$46,526,653</td>
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<td>$11,423,391</td>
<td>$27,064,553</td>
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<td>$-29,000,000</td>
<td>$-9,000,000</td>
<td>$-2,400,000</td>
<td>$-4,132,106</td>
<td>$-30,232,356</td>
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*Note: HHSC’s operating totals have been subtracted from the study by Ernst and Young.

Source: Healthcare Association of Hawaii; Financial Impact on Hawaii's Hospitals and Nursing Facilities as compiled by Ernst & Young, LLP -- November 2003
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 period when the healthcare industry is in crisis nation-wide, we understand the urgent 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. However, until such time as either the declining trend in reimbursements is reversed or 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, and restraints on managing levels of service), then HHSC must keep returning to the Legislature to request a level of funding adequate 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 for HHSC are separate collective bargaining, major wage/benefit modification pilot program, Paid Time Off (PTO) Plan, simplification of work rules/bonus pay rules/scheduling plan and closer partnership affiliations with other organizations. We will continue to dialogue with both the Administration and the Legislature on future directions for HHSC.

In order to provide full perspective on challenges and outcomes in FY 2003, copies of HHSC testimonies for both the Senate Committee on Ways and Means and the House Committee on Finance hearings on January 8, 2004, are attached.

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. Functional Accomplishments
5. HHSC Cost Savings and Enhanced Revenues
6. HMSA Quality and Service Recognition Program Report
9. Executive Summary, January 8, 2004 Budget Hearing Presented to the Senate Committee on Ways and Means and the House Finance Committee
10. Testimony, January 8, 2004 Budget Hearing, Presented to the Senate Committee on Ways and Means and the House Finance Committee
FISCAL YEAR 2003
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
  - 100 active volunteers
    - Nearly 24,300 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 - $25,000
    - Grants twenty (20) $500 nursing scholarship annually to nursing students at both UHH and HCC - $10,000
  - Hilo Medical Center Foundation
    - Since inception, raised approximately $970,400 via community contributions and grants. Raised over $750,000 in gifts and pledges this year.

- Hale Ho’ola Hamakua
  - 29 active volunteers
    - Nearly 9096 volunteered service hours each year
Auxiliary has raised more than $2000, in addition to providing two (3) $250 scholarships

- **Ka’u Hospital**
  - 3 active volunteers
    - Nearly 1620 volunteered service hours each year
  - Hospital Auxiliary provided two (2) $250.00 scholarships and raised over $500.00 (jointly with HMC and HH-H Auxiliaries in the operation of a food booth at an event in Hilo)

**WEST HAWAII REGION**

- **Kona Community Hospital**
  - 71 active volunteers and still growing
    - Nearly 10,000 volunteered service hours
  - Auxiliary has donated $600 each to Kalani Ola and Long-Term Care for patient use as well as $1,800 to support the physicians’ workroom.
  - Auxiliary has donated six nursing scholarships totaling $9,000
  - Auxiliary has donated support for patient Lifeline emergency response system - $665
  - Auxiliary has donated $2,500 for continuing education for nurses
  - Auxiliary donated baby caps for the newborns
  - Auxiliary White Elephant Sale proceeds totaled nearly $6,000
  - Auxiliary booths at the Holiday Craft Fair on King Kamehameha Hotel made $3,400
  - Auxiliary produces and coordinates Vital Signs, hospital’s monthly newsletter
  - Auxiliary donated labor and over $1,000 for renovation of OB waiting room
Gift Shop was renovated and reopened in August under new management with new stock.

Carts with Heart was initiated by the Foundation and the Auxiliary helped keep it stocked with comfort items for patients. Volunteers made rounds to distribute free items and good cheer to patients.

Auxiliary's weekly bake sale netted almost $3,000 in support of the nursing scholarship program.

Auxiliary donated about $14,000 to the Foundation for the Radiation Therapy Unit.


Project for 2004—chapel for Kona Community Hospital.

Kohala Hospital

- 21 active volunteers
  - Nearly 1,700 volunteered service hours each year

- Annual Hospital Auxiliary Spaghetti Fundraiser Dinner raised $8,000.

- Annual cable television service provided by the Kamehameha Cable Vision ($385)

KAUAI REGION

Kauai Veterans Memorial Hospital

- 40 active volunteers
  - Nearly 3,200 volunteered service hours each year
  - Auxiliary raised more than $25,000
    - $18,000 in the Gift Shop
$3,500 in commission sales (vending machines)
$3,500 Gross profit from the Annual Christmas Craft Fair

- $500 donated to the Hospital from the West Kauai Hongwanji Women's Association to use toward the purchase of a "large" wheelchair

- Auxiliary purchases included ($15,000):
  - Donated $100 toward the Doctor's Day Activities
  - Purchased the food catering services for the Grand Opening of the Family Birth Center ($2,000)
  - Purchased two computer desks for the Respiratory Department ($2,000)
  - Purchased facsimile, copy, scanner, printer machine for the Health Information Management Department ($500)
  - Purchased wheelchair for the Emergency Department ($500)
  - Donated $2,000 for the "Ten Times Healthier Baby" Video
  - Purchased wheelchair for the Medical/Surgical Department ($800)
  - Purchased craft/activity items for the Long Term Care/Activities Department ($500)
  - Purchased privacy curtains and TV's for the Family Birth Center (OB Department) ($3,000)
  - Purchased an electric wok for the Long Term Care Department ($75)
  - Donated purchases for Hospital Week Festivities
  - Registration fees for Educational Training for staff (off-site)
    *Slint Workshop for the Occupational Therapy Department ($600)
  - Health Awareness Pamphlets
  - Recognition Awards Program (gift certificate awards, balloons, leis)

- KVMH Charitable Foundation
  
  - Secured grant funds from the Wilcox Trust and the Vidinha Trust focused toward the Obstetrical Wing renovation
  
  - Donated $60,000 toward the Renovation of the KVMH Family Birth Center (Obstetrical Wing)
- Raised over $4,000 through the Red Hat Luncheon fundraiser held
- Raised approximately $2,000 through the mini-mail fund drive
- Approximately $1,500 in personal donations

Samuel Mahelona Memorial Medical Center

- 58 active volunteers
- Nearly 7,500 volunteered service hours each year
- Auxiliary raised more than $5,800 (Thrift Shop)
- $2,000 donated from Hawaii Hotel Industry Association
- $1,000 raised from Rummage/Country Store Sale
- $50 donated from the Kapaa Hongwanji Women Association.
- $50 donated from the Kapaa Jodo Mission
- $50 donated from the Kapaa Meisho Fujinkai
- $100 donated from the Kapaa Lions Club
- $100 donated from the Dogs Fanciers of Kauai
- $4,000 in monetary donations
- Personal Items donated to residents from At Your PACE Gym
- Auxiliary purchases included:
  - Aquarium
  - Tables for Wards
  - Office Supplies
  - Computer Supplies
  - Christmas gifts for Residents
  - Kapaa High School Student Health Field
    Scholarship & Award Luncheon.
  - Decorations for XMAS float
MAUI REGION

Maui Memorial Medical Center
- 60 active volunteers
  - Nearly 12,500 volunteered service hours each year
  - Donated $5,577 towards scholarships/workshops/continuing education
  - Approximately $31,899 for hospital equipment including three birthing beds for OB
  - Made $6,781 at the annual Harvest Sale in November

MMMC Charitable Foundation
- Donated $43,000 for a Sentinel Node Probe
- Raised $200,000 for the Angiography Suite
- Received a gift of property valued at $174,000
- Donated $45,000 for cancer patient and continuing medical education programs.

Kula Hospital
- 88 Active Volunteers
  - Nearly 4108 volunteer hours last year
  - Auxiliary purchases totaled more than $17,600.00
  - Physical Therapy Department
  - 1 Complete Rehab Exercise Kit
  - 1 Geriatric Exercise & Rehab Kit
  - 1BCi Pulse Oximeter
  - 1 Core Balance Video
  - 2 fitness Circles
  - 1 Spine Supporter
  - 1 Hydrocollator Heating Unit
  - 1 Midland Electronic Treatment Table
  - 1 Set of four 3” Casters for Treatment Table
• 1 Professional Reformer
• 1 Reformer Box (use with Reformer)
• 1 Small Barrel (use with Reformer)
• 2 Foam Rollers 36” X 36”
• 1 Pilates On a Roll Video (use with Roller)
• 1 BOSU Pro Pack
• 1 BOSU for Sports Training Video
• 1 Kitchen Aid Mixer
• 1 Kenmore White Range
• 1 Magni-Focuser Magnifier
• 1 High Frequency Desiccator
• 1 Genie Lift
• 2 Sofas
• 10 Barrel Chairs
• 1 Toshiba 27” TV
• 1 Sony Digital Camcorder
• 1 Panasonic 4 head Stereo VCR
• 1 Camera Tripod

Lanai Community Hospital
• 26 active volunteers
  • Nearly 1,750 volunteered service hours each year
  • $500 student scholarship from the Auxiliary

OAHU REGION

Leahi Hospital
• 60 active volunteers
  • Nearly 8,640 volunteered service hours each year
  • Thrift Shop raised a net of more than $15,000
  • In kind donations totaled $3,833
  • Monetary donations totaled $1,715
Maluhia

- 102 active volunteers
  - Nearly 16,000 volunteered service hours each year
  - Gift Shop raises more than $21,000 per year
  - Monetary donations totaled $14,700
  - Auxiliary covered the costs of the following items: new tables and chairs, activity rooms and nursing stations; new equipment for Nursing; new supplies for Recreational Department; gift packages for residents; and renovation of several office spaces
  - Equipment donated:
    - Large Screen TV sets for resident activity rooms
    - Puzzles, games, and activity equipment
    - Artwork for resident rooms and facility hallways
    - Wheel chairs and beds
    - Computers for resident internet access
    - Truck for use by Maintenance department
East Hawaii Region Management Advisory Report
HHSC Annual Report
December 2003

What a great year for the East Hawaii Region. Hilo Medical Center, Kau Hospital, and Hale Ho'o'ola Hamakua are operating at near full capacity with the continued need for additional beds along our coast. All three facilities continue to serve their communities with care, compassion and professionalism.

In Hilo, the U.S. Department of Veterans Affairs just released $18.4 million dollars in construction funds for the new State Veterans Home. In August, Governor Lingle approved $10 million in state funds to match the federal money. The 95 bed State Veterans Home is the first for the state of Hawaii, and is capable of being expanded if the need arises. The State Veterans Home is to be built on the grounds of the old Hilo Hospital and is expected to be completed in 2006. It was through the tremendous combined efforts that this is becoming a reality and we wish to thank everyone for their support and help.

Kau Hospital's new Rural Health Clinic has been a great success with the addition of three new doctors in the community. In November, the hospital hosted a Rural Health Fair that brought over 250 visitors to the event of which approximately 163 were screened with having high blood pressure, glucose, and cholesterol. The benefit to this sprawling rural community is hard to describe, but the sense of appreciation has been loud and clear. The census at Kau hospital is now at near capacity year round as a Critical Access Hospital.

Hale Ho'o'ola Hamakua's partnership with the University of Hawaii at Hilo for a branch campus in the old Honokaa Hospital has happened. Classes have already begun to assist community members with educational opportunities without the long commute to Hilo. Funding for upgrading the old hospital for classroom use is being sought through the legislature and seems very promising. The proposal to extend Hale Ho'o'ola Hamakua is still on track – as the waitlist rises every year. The hospital is at full capacity, and as we prepare for baby boomer's growing medical demands, it is becoming increasingly important that we look ahead and be prepared for our changing needs. The challenge will be to find the balance to care for our parents as well as nourish our children.

Respectfully Submitted,

[Signature]

Jerry Broughton, Chair

East Hawaii Region Management Advisory Committee
On behalf of the Maui MAC, I would like to thank you again for an opportunity to submit this report as an attachment to HHSC Annual Report. 2003 was filled with opportunities and challenges.

For the former, we are pleased to welcome aboard Wesley Lo, HHSC Maui region, chief financial officer. Mr. Lo brings to us a wealth of financial experience, in addition to a wide range of administrative/managerial skills. He also is extremely familiar with the functions of both the public and private sectors.

With the help of Mr. Low and the Maui Memorial Medical Center leadership team, the long awaited $38 million renovation project is proceeding forward. At this point, the architectural firm has been selected. The first phase includes a new parking lot, enlarged intensive care unit, new outpatient surgery center, new medicine ward, new recovery unit, new lobby, and new driveway.

For the latter, the Maui region’s loss before appropriation totaled $8,816,027: MMMC - $5,415,573; Kula Hospital - $2,184,843; and Lanai Community Hospital - $1,235,611. The significant loss was primarily due to bad debt, over budgeted expenses, and long-term care expenses.

Thanks to the revenue collection efforts of the other HHSC regions (i.e., Oahu and Kauai), Maui was able to offset the greater than expected losses for 2003. The Maui region is grateful to all of the regions for their continued commitment to exceed budget expectations. At the same time, the Maui region is aggressively moving ahead to do the same.

As a result, the system works! 2003 was a dynamic year that clearly reflects how a top, revenue-generating region can fall behind and how other traditionally subsidized regions can come to the rescue.

HHSC, the community hospital system, needs your continued support in 2004. The Maui MAC greatly appreciates your commitment to uphold quality healthcare in Hawaii.

Respectfully submitted,

[Signature]

Herbert Sakakihara
Chairman
Maui Region Management Advisory Committee
WEST HAWAII MANAGEMENT ADVISORY COMMITTEE
OF THE HAWAII HEALTH SYSTEMS CORPORATION

Annual Report for 2003

The year 2003 has been a busy 12 months for the Hawaii Health Systems Corporation's West Hawaii Region and its West Hawaii Management Advisory Committee (WHMAC). Reggie Morimoto assumed the Chairmanship from Ken Clewett who continues as a most valuable member. Frank Jung reluctantly resigned to become a member of the Public Housing Board and was succeeded by Ron Aronson. The WHMAC much appreciates the interest and active service which both have demonstrated during their WHMAC membership.

The West Hawaii Region's issues remain largely economic in nature, and reflect national and State trends of rapid advances in costs of healthcare without comparable increases in revenue, and wide negative balances between patient expenses and patient/insurance payments. In addition, by providing the required and much-needed healthcare "safety net" for rural communities, this Region cares for and treats a large population of uninsured or underinsured people without recompense; and is faced with spiraling employee compensation/benefits for which it has no voice in negotiating.

During the year a competent team of physicians, employees, and administrators at HHSC's two facilities in West Hawaii made significant improvements in the quality and quantity of healthcare services being provided to residents and visitors of that area, with the advice/support of the WHMAC.

At Kohala Hospital, with the help of the Kohala Hospital Foundation, two (2) additional long-term care beds were added. This increases the licensed beds from 26 to 28. Additionally, the $1.7 million dollar capital improvement project (i.e., new roof, new sprinkler system, new nurse call system, upgrade of electrical system and new interior ceilings and lights) was completed in August 2003. The rehabilitation outpatient services (i.e., physical and occupational therapies and speech pathology) contracted with Hawaiian Rehabilitation; expanded from two days to five day a week to meet the ever increasing demands for rehabilitation services in the North Kohala community.

Kona Community Hospital’s co-generation plant became operational in January. This project improved the energy efficiency by over 20% and will pay for itself in savings. Nuclear Medicine and digital echocardiograms were added to our growing capacity of clinic diagnostic services. Physician recruiting efforts were successful in adding a urologist, general surgeon and anesthesiologist to the clinical staff.

The Kona Hospital Foundation continues to provide valuable support and brings the hospital and community closer together. They have reached 75% of the goal to collect $1.5 million to help fund the Radiation Therapy Clinic. With this success the contracts were signed in December, to begin construction. The WHMAC is also participating in the planning committee that is completing the plans for a medical center for West Hawaii called PMC 21. The goal of this group is to have the new facility opened in 2010. The Kona Community Hospital Auxiliary also had a very good year doubling the number of active volunteers to 71.
Despite the progress being made throughout the Region it is apparent that State support will continue to be required to fund the revenue gap between expenses rising at a faster rate than revenues. HHSC will need legislative support on the following issues:

1. Provide required funding of HHSC in FY05.

2. Grant sufficient autonomy to HHSC and its facilities as to permit streamlined recruiting/placement of staff and HHSC negotiation of their salaries/benefits, with higher regard for the interests of the community and its tax-paying citizens.

3. Assure an equal level of care/treatment service 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 a greater portion of actual costs of treatment/care to be reimbursed by the patients and/or their insurance companies.

5. Consider further partnering with other governmental agencies and the private sector to provide greater quality and efficiency in easily accessible care/treatment at a minimal expense. Consider joint private-government operation of some facilities.

6. Consider introducing health wellness programs in the hospitals to provide a service to the public, while acquainting the community with the facilities when they are well, and increasing revenue through utilizing facilities during "down-times".

Mahalo for your attention and continued support.

WEST HAWAII MANAGEMENT ADVISORY COMMITTEE
Reggie Morimoto, Chair    Louise Chun-Ling, RN
Ron Aronson               Roy Nagle, MD
Donna Brown               Frank Sayre, DDS
Ken Clewett               Keli'i Sine, RN, Ph.D.
Robyn Cook, MD


December 30, 2003

Kauai Region Public Health Facilities Management Advisory Committee
Annual Report 2003
(CY January 1, 2003 to December 31, 2003)

Season’s Greetings!

Aloha and thank you for the opportunity to, once again, share with you the events and activities that have taken place in the Kauai Region, for the calendar year 2003. The Kauai Region Senior Management Team is continuing to positively move forward to lead the various hospital departments in providing quality healthcare for our Island community. Through the continued support of the Board of Directors of the Hawaii Health Systems Corporation and the leadership of Mr. Thomas Driskill, Jr., President and CEO, and the Executive Management Team of the Hawaii Health Systems Corporation, the Kauai Region continues in its mission and vision to providing quality healthcare to our island community.

The accomplishments for the Calendar-Year 2003 are as follows:

- The Kauai Region was truly focused on improving its financial situation. The Business Office reviewed its current condition and took steps to implement initiatives necessary to improve its Cash Collections. The region began the calendar year with A/R days of 71 at KVMH and 100 at SMMH. Through the dedication of the staff and management of the business office, services rendered were promptly billed for and consistently tracked until payment from the insurance carriers was received. As of December 19, 2003, A/R days at KVMH were at 59 and 74 at SMMH respectively. This accomplishment has been a positive step forward for the Region and will continue to be an ongoing goal for the Business Office.
The Kauai Region Senior Management Team has consistently focused on effectively managing expenses. Labor costs have continued to be reduced at both hospitals and regionalization has been a solid factor for Kauai as it has made it possible for us to improve our services and contributed to a considerable reduction in managerial and staff positions through attrition, thus reducing our salary budget.

The Kauai Region Senior Management Team was truly dedicated in controlling our deficit projected at ($5,092,300.00). The control over expenses in labor and supplies brought our deficit down to ($4,627,000.00 – before state appropriations and corporate overhead).

**Achievements as of FYE 6/30/03**

**Kauai Region REVENUE**

Target:  $22.0M  
Achieved: $20.4M

**Kauai Region CASH COLLECTION**

Target:  $19.8M  
Achieved: $18.9M

**Achievements year to date as of November 30, 2003**

**Kauai Region REVENUE**

Target:  $9.5M  
Achieved: $8.1M

**Kauai Region CASH COLLECTION**

Target:  $8.4M  
Achieved: $8.7M

The Critical Access Hospital (CAH) Program plays an important factor in the financial picture for the Kauai Region. Since the inception of the Critical Access Hospital designation in April 2001, the Kauai Region has seen a positive benefit of approximately $2M in cash, (from Medicare reimbursement) allowing us to achieve our financial targets.

Capital Improvement Project funds along with $60,000 in grant monies presented by the KVMH Charitable Foundation, Inc. (through grants from the Wilcox Trust and the Vidinha Trust), made the renovation of the Obstetrics Wing at the West Kauai Medical Center a reality. A Grand Opening celebration was held in April 2003 to mark the “birth” of the KVMH Family Birth Center. Also, through this celebration, KVMH marked its 45th year in service to our community.

In 2003 we entered into a new partnership with the Kapiolani Medical Center for Women and Children (KMCWC) in Honolulu. Through this partnership, we now have services available for high-risk fetal diagnostic monitoring (ultrasound) through tele-ultrasound capability connection to the KMCWC enabling us to enhance the Obstetrical services that we provide.

We have installed new ultrasound equipment enabling us to provide cardiac ultrasound services to our community. This is in addition to the current fetal
ultrasound services, CT, x-ray, and mammography services that we provide 24 hours a day, 7 days a week.

- A new physician, Mitchell Jenkins, M.D., Internist, joined the West Kauai Clinics in October 2003. He is currently practicing at the West Kauai Clinic located at the Eleele Shopping Center in Elelele.
- The behavioral health contract with the Hawaii State Hospital remains in effect to house and care for “forensic” psychiatric patients. Samuel Mahelona Memorial Hospital’s psychiatric unit prior to 2002 saw an average daily census of 3 patients. Since the contract with the Department of Mental Health began, we have seen a rise in utilization that increased the average daily census to 7 patients within the unit. This program allows for a positive working relationship between the two entities in ensuring that quality “forensic” psychiatric care is provided to Kauai Island patients who would otherwise have to be cared for on Oahu under this program.
- Kauai Region Hospitals maintained their State Licensures and Medicare/Medicaid certifications.
- Through the dedication of both the KVMH and SMMH Auxiliaries we have seen an increase in volunteerism in our hospitals, gift/thrift shops community and fundraising events. Both Auxiliaries have also played important roles in financially purchasing small equipment, obtaining activities supplies (residents), and catering services (special events) for our hospitals and clinics.
- The KVMH Charitable Foundation, Inc. has sponsored several events this year in their efforts to raise funds in support of the hospital.

* KVMH First Annual Golf Tournament – Proceeds of about $5,000 were donated to the Occupational Therapy Department to use for needed department renovations.
* First Annual Na Wahine Hanohano (Signature Event for the KVMH Charitable Foundation) – Proceeds of about $3,000 was generated from this event.
* Red Hat Luncheon (third year) – Proceeds of about $4,000 was generated from this event.

The Kauai Region Senior Management Team continues to move forward in great strides through strengthening relationships within our community and sharing ideas to enhance our system as we service our Kauai island communities and visitors alike. All of these accomplishments could not have been achieved without the leadership and guidance of Ms. Orianna Skomoroch, Kauai Regional CEO.

Respectfully submitted,

[Signature]

M. Jean Odo
Kauai Region PHFMAC Chair
In a year of profound uncertainty, the HHSC Oahu region (i.e., Maluhia and Leahi Hospital) employees and administrative leadership demonstrated extraordinary resilience and spirit. They continue to effectively respond to unprecedented circumstance by assisting families of aged loved ones, carrying out sound business practices and serving our residents (long-term care patients) with professional excellence. They take pride in the way care, compassion, and dedication is extended to our Oahu communities.

In spite of generally difficult business conditions, the Oahu region performed well in 2003. Revenues and expenses exceeded budget goals. Cash collections exceeded its goal by $1.2 million. The region was below its budget by $1.7 million. These efforts helped to offset the unanticipated budget shortfalls of the Maui region and set a standard for other regions in terms of age of accounts receivable and cash collections.

The Oahu region strengthened its leadership in 2003. Nathan Yim, chief financial officer, is now concentrating on enhancing ownership among department heads by allowing them to manage their own budgets. Ken Takeuchi was appointed director of clinical operations. Mr. Takeuchi is developing systems that will enable our functions to become more efficient and effective. Nathan and Ken lead an outstanding team of health professionals who performed superbly in a trying year.

Other highlights in 2003 included a 60th wedding anniversary celebration of Mr. and Mrs. Benny Marquez in May 12. The nursing unit, during National Nursing Home Week, honored Mrs. Marquez, an 87-year old Leahi Hospital resident and her healthy and independent 99-year old husband Benny. The heartwarming story was covered by all of the print, television, and radio media.

In response to our nursing shortage, both Maluhia and Leahi Hospital were able to take advantage of a $1 million Federal Rural Development Grant, which enabled existing employees an opportunity to upgrade their skills through the Patient Care Technician Program. A total of 23 certified nurses aides from the HHSC Oahu region completed 48 hours of classroom instruction on their own time in advanced skill areas such as gastrostomy tube feeding, oral suctioning, non-sterile dressing changes, tracheostomy care, fingerstick blood glucose checks, and colostomy and ileostomy care.

Compassionate Caring training for managers began in October. The effort is intended to enhance understanding and appreciation of long-term care issues.

Then on December 10, as part of Maluhia’s 80th Anniversary Celebration, the resident families recognized the facility’s long-term physicians, in addition to the nursing and
support staff. Over 200 guests attended this touching evening event. It clearly reflected the compassionate and quality healthcare being provided by the Alewa Heights facility.

These results have been realized thanks to the continued support of the Legislature and the Administration. Your assistance will help the Oahu region pursue more cost efficiencies and help to preserve the excellence we have achieved as we move towards the challenges of our New Year 2004.

Aloha and Mahalo,

D. William Wood, Chair
Oahu Region Management Advisory Committee
The Hawaii Health Systems Corporation Physicians Advisory Group, consisting of over 800 physicians, recognizes the important role the community hospitals play in the treatment of patients and the contribution they make in our Neighbor Island communities throughout the State of Hawaii.

In today's complex and ever-changing health environment, particularly with our steadily declining insurance reimbursements, in addition to federal and state mandates, HHSC is forced to seek financial support from the state to ensure that every member of the community, regardless of economic background, will continue to receive quality medical care.

The Hawaii State Legislature and the Administration play a vital role in helping HHSC fulfill its mission to provide a superior medical staff, nursing and support staff, and technology to our patients. Through this support, we are making a crucial difference in the quality of our patients' lives. HHSC provides quality, hometown healthcare to the residents of our island communities, in addition to thousands of Neighbor Island visitors and tourists every day of the year.

The PAG urges you to work with your colleagues to pass legislation that provides HHSC a means to continue achieving maximum quality of care and cost efficiencies. Your support is a positive step forward for healthcare in Hawaii.

Sincerely,

[Signature]

Anthony Manoukian, M.D.
Pathologist, Maui Memorial Medical Center
Chairman, HHSC Physicians Advisory Group
Maui Memorial Medical Center
221 Mahalani Street
Wailuku, Hawaii 96793
FUNCTIONAL ACCOMPLISHMENTS

- **HHSC System-Wide**
  - Achieved an Absolute Standard of Quality Care Across All 12 Facilities By Establishing a Quality System Managed by the HHSC Board of Directors
  - Achieved System JCAHO Qualit Accreditation for 4 hospitals & State / Federal accreditation for all 12 hospitals
  - Automated Personnel System
  - Consolidated Accounting Systems for Accounts Payable and General Ledger
  - Energy Conservation through Co-Generation
  - Established Customer Satisfaction Benchmarks and Training
  - Established Four Critical Access Hospitals (CAH)
  - Established Laboratory Joint Venture
  - Established Material/Equipment Standardization Teams
  - Established Patient Accounting Teams for Process Improvement and Standardization Across the Enterprise
  - Established Infrastructure Structure for Supporting Over 100 Application Servers
  - Established System for Enterprise-Wide Electronic Mail
  - Established Two Subsidiary Corp: 1) Ass. Living Facility; 2) Sys. Foundation
  - Established Joint Labor-Management Committee
  - Established Veterans Administration Partnership
  - Completed Fire/Safety Upgrade per NFPA 101
  - Developed most Comprehensive & Functional Teleradiology Program in the State
  - Video Teleconference
  - Completed HIPPA Compliance
  - Established Award Winning Healthy Workplace Program

- **Maui Memorial Medical Center**
  - Magnetic Resonance Imaging Replacement
  - New Computerized Tomography Scanner
  - New Monitoring Systems
  - New Neurosurgery Service
  - Started $38M Hospital refurbishment

- **Lanai Community Hospital**
  - New Renal Dialysis Service
  - Nurse Call System Replacement

- **Kula Hospital**
  - Increased Admissions from 25/year to 185/year
  - Increased Skilled Nursing Days from 900 patient days/year to 6,500+ patient days/year

- **Hilo Medical Center**
  - New Angiography Suite
  - New Nurse Call-System Replacement
  - New Cancer Center Service with Linear Accelerator
  - Opened Clinical Learning Center in Collaboration with UH-Hilo & Hawaii Community College
  - Increased Long Term Care Capacity by 28 Beds
  - Added Second Nuclear Medicine Camera
  - New Lithotripter Service (shared with Kona and North Hawaii)
  - Implementing KRONOS Time & Attendance
  - Initiated Radiology Technologist School

- **Ka'ū Hospital**
  - Attained Critical Access Hospital (CAH) Status in July 2000
  - Increased LTC/acute Beds from 15-21 total beds
$190K Savings with Rural Health Clinic Implementation

- **Hale Ho'ola Hamakua**
  - Collaborate with UH for College level Nurse Aide Training

- **Kona Community Hospital**
  - Established Hospitalist Program
  - Increased Total Licensed Beds from 75 to 94
  - New Magnetic Resonance Imaging
  - New Behavioral Health Unit
  - New Chemotherapy Clinic
  - New Computerized Tomography Scanner
  - New Lithotripsy (HMC too)
  - New Nuclear Medicine Service
  - Added 4 New Labor & Delivery Beds

- **Kohala Hospital**
  - Implemented Teleradiology Service
  - Increased Licensed LTC Beds from 22 to 24
  - Completed Replacement of Facility Roof
  - Upgrade of Electrical System
  - Installation of Sprinkler System throughout Hospital
  - Expansion of Outpatient Rehabilitation Service
  - Established Hospital Foundation

- **Kauai Veterans Memorial Hospital**
  - Added New 24-Hour Ultrasound Service
  - Initiated Kauai Teleradiology Center
  - Established First Critical Access Hospital in Hawaii
  - Helped Facilitate Establishment of Kauai's First Federally-Qualified Health Center (via Collaborative Work with Hale Ho'ola and Hawaii Primary Care Association)
  - Established Two New Community Clinics

  - Expanded Outpatient Dialysis Service on West Kauai via Partnership with St. Francis Establishing Two Sites
  - Expanded Obstetrics Service

- **Samuel Mahelona Memorial Hospital**
  - Established Collaborative Relationship with State Adult Mental Health Program to Allow Admission of Forensic Patients to SMMH Psych Unit
  - Teleradiology Spoke

- **Maluhia**
  - Basement Expansion & Interior Improvements

- **Leahi Hospital**
  - Adult Day Care Health Service Expansion
  - Developed IV Therapy Program
Hawaii Health Systems Corporation
Cost Savings &
Enhanced Revenues

1. Overall savings to Hawaii of $150 million in past five years compared to FY97
2. NORESCO (Energy co-generation) savings of $23 million beginning in FY99
3. Laboratory contract re-negotiation with ClinLab - $5 million savings per year since FY97
4. Insurance re-negotiation - $1 million per year from FY97 – FY02
5. Workers Compensation claims per 100 employees consistently reduced from 21.5 in FY97 to less than 8 per year each year since then.
6. Achieved Critical Access Hospital (CAH) status for four HHSC hospitals and thereby enhanced HHSC revenue by $2.2 million per year starting in FY02
7. Increased HHSC revenues thru enhanced cash collections from $247 million in FY02 to $277 million in FY03. In the last 4 years, HHSC increased cash collections by $74 million from $203 million in FY99 to $277 million in FY03. The goal for FY04 has been set at $298 million.
8. Medical Supply consolidation savings of $4 million per year since FY97
9. Re-negotiation of third-party payer contracts - ($$ savings amount is proprietary information) since FY97.
10. 340B pharmaceutical program (federal discount program for safety-net patients) - $200,000 per year
11. Foundation expansion - from only 3 Foundations in FY97 to 10 Foundations. In 2003 supporting HHSC facilities
12. Consolidate equipment maintenance support, savings of $500,000 per year since FY01
13. Reestablish hospital radiology services at four HHSC facilities = $2 million dollars in new revenue per year since FY02
14. Established Rural Development Fund Nurse Training and Development Program HHSC-wide with $1 million grant in FY03
15. Implement restructuring plans under Volunteer Separation Incentive Program (VSIP) in FY03 and FY04
January 13, 2004

Mr. Kelley Roberson  
Chief Operating Officer & Chief Financial Officer  
Hawaii Health Systems Corporation  
3675 Kilauea Ave  
Honolulu, Hawaii  96816

SUJECT: HMSA Quality and Service Recognition Program Report

Dear Mr. Roberson:

It is with great pleasure to report to you that the Hawaii Health System Corporation (HHSC) has received recognition in its efforts to improve the quality of Healthcare in Hawaii and was awarded $1,195,922 from the Hawaii Medical Service Association (HMSA) in recognition of its efforts to improve the quality of hospital care over the past year.

Now in its third year, HMSA's Hospital Quality and Service Recognition Program (HQSR) recognizes delivery of high-quality and cost-effective patient care in hospitals providing general, medical, surgical and maternity services. The program is part of HMSA's overall Patient Safety Initiatives to improve the quality of care for its more than 600,000 members.

Individual facility performance awards were given to six hospitals in the health system. They include Hilo Medical Center, Kauai Veterans Memorial Hospital, Kona Community Hospital, Maui Memorial Hospital, Lanai Community Hospital, and Samuel Mahelona Memorial Hospital.

This is the second consecutive year that participating HHSC facilities have received recognition for quality improvements. Last year, five of the above facilities received financial awards totaling $503,557.

Methodology

The HQSR program was created in response to the Institute of Medicine's recommendation that financial incentives be given to hospitals for implementing best practices and achieving better patient outcomes. In the end, the goal is to encourage the delivery of safe, high-quality care.
Kelley Roberson  
Chief Operating Officer & Chief Financial Officer  
January 14, 2003  
Page 2

HMSA's HQSR program is the result of a collaborative effort between Hawaii's hospitals, HMSA, and Health Benchmarks, Inc., a national health care research company. The program develops medical performance standards that reflect high standards of patient care and service.

Hospitals volunteering to be part of HQSR are evaluated and compared to one another and receive points based on achieving these standards. HHSC and other hospitals are involved in developing the reporting tools used to support their quality improvement efforts. The tools include a software application with patient-level information on complications and length of stay, a detailed report and an executive summary with actionable information for improvement.

Clinical improvement indicators are monitored through hospital-generated information or claims data analysis. Surveys are used to evaluate service satisfaction including (1) patient satisfaction with emergency room and inpatient care; and (2) physician satisfaction with hospital facilities, operations and staff.

The Hawaii Medical Service Association (HMSA) recently received national honors from the Blue Cross and Blue Shield Association (BCBSA) for the program. HMSA received a 2003 "Best of Blue" award for innovations in quality improvement. The national awards program has been in place for six years. In 2003, BCBSA received 116 entries for medical and pharmacy management programs.

HMSA is nonprofit, mutual benefit association founded in Hawaii in 1938. It is governed by a community board of directors that serves without compensation and includes representatives from health care, business, labor, government, education, clergy, and the community at large. HMSA is a member of the Blue Cross and Blue Shield Association, an association of independent Blue Cross and Blue Shield plans. Nationally, HMSA and 41 other Blue Cross and Blue Shield plans provide coverage to more than 85 million members.

If you have any questions, please do not hesitate to call me at 733-7913.

Sincerely,

[Signature]

STEPHEN CHONG  
Corporate Compliance Officer  
Hawaii Health Systems Corporation
Heithold Earns EUN Energy Manager of the Year Award

Toyota project earns praise, too

ATLANTA, GA-Rick Heithold, strategic sourcing manager-Energy & Maintenance, Food Lion LLC earned recognition as Energy User News Energy Manager of the Year at an awards breakfast held November 13th in Atlanta, GA. Toyota received project of the year honors for a project at its Torrance, CA, south campus. Food Lion was also recognized for a retrofit of its freezer case lighting in all its stores. In all, 14 projects were recognized for their approach to energy management. The awards were presented during the World Energy Engineering Congress, hosted by the Association of Energy Engineers at the Georgia World Congress Center.

Kevin Heslin, editor of Energy User News, said during the awards presentation, "We want these projects to be models for the wise use of energy nationwide. Too often, this nation gives lip service to energy management, but no one is talking about it today, who have shown themselves to be leaders." Heslin said I gratified by the diversity of the projects and solutions, and was especially heartened by the recognition of a spec office building.

Heithold was described during the breakfast as "the consummate corporate energy professional." He is involved in a variety of successful projects to reduce energy and operational expenses across the company. The lighting project he submitted this year appears to be one of many such projects that could have chosen.

Heithold, as Food Lion's Corporate Energy/R&D manager assisted Amtech Lighting in identifying the need for a sub-zero T8 lighting solution for freezer cases. He helped initiate and implement an energy efficiency strategy that is paying off in terms of energy conservation. The project includes the implementation of energy conservation measures on Food Lion's P&L statements, thereby reducing their compliance with corporate goals.

Project of the Year
The Toyota South Campus project was recognized for its integration of clean/LEED sustainability and traditional energy conservation. Toyota wisely made use of California's 50% rebate for photovoltaics. Other measures include investment in building envelope, IAQ, and water utilities that enhance the considerable power savings. These energy conservation measures include daylighting, lighting controls, and gas-fired absorption chillers.
At 536 kW, Toyota’s South Campus solar electric system is one of the largest privately owned roof-top systems in the country and is expected to provide up to 20% of the electricity for the buildings. The campus is a sustainable building showcase; in addition to the solar electric system, the campus features recycled water for irrigation, thermally-insulated glazing, high-efficiency absorption chilling, and a host of other features that helped Toyota achieve a Gold L.E.E.D. Award for the project.

Participating manufacturers include Shell Solar, Falcon Water, Linear Lighting, Allen Bradley, and Allerton.

**Winning Entries**

**Best Retrofit Project**

Naval Station Great Lakes Energy Savings Project, Great Lakes, IL The Great Lakes Training Facility’s continuing dedication to energy-savings produced a nine-phase culminated in November 2002. The project included more than 150 buildings of which the project was well coordinated: the interactive effects of each energy conserving measure were accounted for to maximize the energy savings. The project included replace numerous lighting and HVAC systems, including air handlers, rooftop units, and centrifugal, and absorption chillers. Direct digital controls were also installed.

Participating manufacturers include Carrier, Trane, Siemens, Philips Lighting, Adve Transformer, and Magnetek

**Best New Construction Project**

Oscar J. Boldt Construction, Wisconsin River Valley Office, Stevens Point, WI.

Innovative in many ways, the Oscar J. Boldt Construction office was designed as a Silver L.E.E.D. project. Its sustainable characteristics include numerous water and energy measures. Most impressive, however, is the use of daylight dimming and occupant control to minimize electrical costs. In addition, the HVAC systems provide additional savings that post-occupancy commissioning assured the full realization of savings.

Participating manufacturers include Trane, Ledalite, Day-Brite, Precision Architectural, Gardco, Leviton, and Watt Stopper.

**Best Education Facility Project**

Ruben Salazar Hall Renovation (Sonoma State University), Rohnert Park, CA.

While photovoltaics are the most obvious of the energy conservation measures in the evaporative cooling application is a truly innovative measure. The two-stage application adds approximately $350,000 to the project, but Sonoma State believe the design reduces peak load by almost 400 tons on the hottest days. Because of its energy efficiency and renewable energy technologies, the remodeled building uses less energy than required by California’s 1998 Title 24 Building Standard. The solar generated by Sonoma State University’s system will cover 7.3% of the facility’s to-

Participating manufacturers include Matrix, Photowatt, Watt-Stopper, and Allerton

**Best Warehouse Project**
United States Cold Storage, Tulare, CA.

The United States Cold Storage facility is a public refrigerated warehouse that in large amounts of electricity. The retrofit features innovative applications of refrigeration controls to save energy. The project required only a small capital investment, a high return, even without the utility rebate. Specific technologies employed in the include freezer bi-level lighting controls, freezer door motion sensors, VFD control on volume ratio.

Participating manufacturers include Square D, Baldor, M&M Refrigeration, and Co Lighting

Best Government Project

San Mateo County Forensics Laboratory, San Mateo, CA.

San Mateo County's Forensic Laboratory has earned recognition from other organs largely due to its efforts to achieve Silver L.E.E.D. certification. San Mateo estimated that operating costs will be 30% less for this facility than similar labs. The project includes a peak photovoltaic system, a number of building envelope features, and an energy lighting system with daylighting controls. Participating manufacturers include Sylvania.

Best Office Facility

Hamilton Landing, Building 5, Novato, CA.

The Hamilton Landing project represents an innovation of the fifth of several aircraft hangars to office space. During the design phase, a detailed computer model was created using DOE-2 simulation software. The model showed that the design exceeded California Energy Commission requirements by 29.6%. Utilizing equipment raised the nominal efficiency of the air conditioners from about 1.1 kW/KW/ton. The mechanical system features an underfloor air system for heating and in a spec office building in the U.S.

Participating manufacturers include GE and Prudential.

Best Public Space Facility

Adler Planetarium Stellar Energy Efficiency Retrofits, Chicago, IL.

Originally constructed in 1930, the Adler Planetarium and Astronomy Museum is a planetarium built in the western hemisphere. The original structure earned the designation from the Chicago Chapter of the AIA.

The three phases of construction all included new lighting mechanical equipment for energy improvements. Improved lighting levels, and light controls system improvements control and sequence major equipment. The boiler upgrade increased combustion efficiency leading to natural gas savings. In addition, the Adler and a number of vendors installed new control equipment in the facility integrating it with an existing DDC system. This upgrade saved Adler money but on the basis for building system commissioning. Participating manufacturers include Controls and Osram Sylvania.

Best Retail Project
Case Lighting Retrofit, Salisbury, NC.

Energy is the second largest operating cost in Food Lion stores, and tight industry margins make every dollar saved valuable. For energy savings in the frozen food section, Food Lion needed a lighting solution for operation below zero degrees. Amtech Lighting Lighting together designed a solution for Food Lion that made use of five and six-lamps. The Food Lion project features very creative and intensive application of high efficiency lighting not normally experienced in these kinds of facilities. Energy savings coupled with utility rebates achieved in some locations. Participating manufacturers include Osram Sylvania, GE Lighting.

Best Healthcare Facility Project

Hawaii Health Systems Corporation, Waimea, HI.

A combination of measures in a variety of health care facilities, well researched, applied. The three-phase Hawaii Health Systems Corporation projects represent an example of how to develop and implement multiple energy conservation measures. This project included the complete renovation of a chilled water plant, with a new chilled water and variable speed drive system in one facility, a new 160-ton screw chiller and cooling tower in a second facility, and an entire central plant renovation in a third. New cogeneration facilities improved reliability.

Participating manufacturers include Carrier, Trane, York, Caterpillar, GE Sensor and ABB.

Honorable Mention

Office Facility

Neutrogena Headquarters Campus, Los Angeles, CA.

Neutrogena's Headquarters retrofit includes an increase in the capacity of its photovoltaic system to 546 kW, making it one of the largest in the world. At the same time, Neutrogena entered into a partnership with the Green Lights project, which led to the replacement of fluorescent lamps in the seven campus buildings with T8 lamps and energy-efficient ballasts. Participating manufacturers include Shell Solar and Xantrex.

Public Space Facility

Reliant Park (Astrodome) Central Plant, Houston, TX.

Reliant Park's central plant maximizes energy efficiency and comfort for visitors to the stadium and exhibit hall. Reliant Park attains these goals through a design that utilizes a series-parallel arrangement, utilizes 20 F cooled water delta to minimize pumping energy. The AHU features cooling towers with variable speed fans. Participating manufacturers include Siemens, and Johnson Controls.

Special Recognition

Pneumatic to DDC AHU Retrofits-Multiple Buildings

The University of Michigan completed a number of direct digital control projects in meeting the university's simple payback requirements. The addition of DDC to existing handling units allowed for increased comfort, air quality, and control. Participating manufacturers include Siemens.
Highest Efficiency Dust Collecting for Karges Furniture

The classic design for collecting dust in a hand-carved furniture operation wastes percentage of the energy required to operate the machines, which are in use only time. Karges successfully designed and installed on-demand dust collecting with auto-stop, and high-efficiency motors. Participating manufacturers include Koger.

Posted on: 12/20/2003

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Hawaii Health Systems Corporation

Consolidated Financial Statements for the Years
Ended June 30, 2003 and 2002, Supplemental
Information for the Year Ended June 30, 2003
and Independent Auditors' Reports
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HAWAII HEALTH SYSTEMS CORPORATION

INTRODUCTION

PURPOSE OF THE REPORT

The purpose of this report is to present the consolidated financial statements of Hawaii Health Systems Corporation (HHSC) as of and for the years ended June 30, 2003 and 2002 and the independent auditors' reports thereon.

SCOPE OF THE AUDIT

The audit was 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 consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation.

ORGANIZATION OF THE REPORT

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

- The first section presents this introduction.

- The second section presents the consolidated financial statements of HHSC as of and for the years ended June 30, 2003 and 2002 and the independent auditors' report thereon. This section also presents management's discussion and analysis and 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 consolidated statements of net assets of Hawaii Health Systems Corporation (HHSC), a component unit of the State of Hawaii, as of June 30, 2003 and 2002, and the related consolidated statements of revenues, expenses, and changes in net assets and of cash flows for the years then ended. These financial statements are the responsibility of HHSC’s management. Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements present fairly, in all material respects, the financial position of HHSC at June 30, 2003 and 2002 and the results of its operations and its cash flows 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 year 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, 2003, negotiations between the State and HHSC relating to the transfer of assets and liabilities (including amounts due to the State) still had not been finalized. Accordingly, the assets, liabilities, and net assets reflected in the accompanying consolidated statements of net assets at June 30, 2003 and 2002 may be significantly different from those eventually included in the final settlement.

The management’s discussion and analysis information on pages 4 through 11 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental schedule on pages 29 and 30 is presented for the purpose of additional analysis and is not a required part of the basic financial statements. The supplemental combining and consolidating schedules on pages 31 through 33 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 audit 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 14, 2003 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 14, 2003
Overview of the Financial Statements

This discussion and analysis are intended to serve as an introduction to Hawaii Health Systems Corporation's (HHSC's) basic financial statements. In accordance with Statement No. 34 of the Governmental Accounting Standards Board, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments (GASB No. 34), a government entity's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements.

Government-wide financial statements are designed to provide readers with a broad overview of a government entity's finances, in a manner similar to a private-sector business. The Statement of Net Assets presents information on all of a government entity's assets and liabilities, with the differences between the two reported as net assets. The Statement of Revenues, Expenses, and Changes in Net Assets presents information showing how the government entity's net assets changed during the most recent fiscal year. The Statement of Net Assets and the Statement of Revenues, Expenses, and Changes in Net Assets are prepared using the economic resources measurement focus and the accrual basis of accounting.

Fund financial statements are used to ensure and demonstrate compliance with finance-related legal requirements. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. All funds of a government entity can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds. HHSC's funds are categorized as proprietary funds. Proprietary fund reporting focuses on the determination of operating income, changes in net assets, financial position, and cash flows. Proprietary fund financial statements are similar to that of the government-wide financial statements in that they are also prepared using the economic resources measurement focus and the accrual basis of accounting.

Under the provisions of GASB No. 34, HHSC is considered to be a Special Purpose government entity. And, as a Special Purpose government entity engaged only in business-type activities, the only financial statements required to be presented are those for proprietary funds. Accordingly, HHSC's basic financial statements consist of a Consolidated Statement of Net Assets, a Consolidated Statement of Revenues, Expenses, and Changes in Net Assets, a Consolidated Statement of Cash Flows, and Notes to Consolidated Financial Statements.
Financial Analysis

Consolidated Statements of Net Assets

Summarized financial information of HHSC's Consolidated Statements of Net Assets as of June 30, 2003 and 2002 is as follows:

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<thead>
<tr>
<th>ASSETS</th>
<th>2003</th>
<th>2002</th>
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<tbody>
<tr>
<td>Current assets</td>
<td>$ 74,377,026</td>
<td>$ 67,312,163</td>
</tr>
<tr>
<td>Capital assets - net</td>
<td>186,775,282</td>
<td>176,168,634</td>
</tr>
<tr>
<td>Other assets</td>
<td>3,284,853</td>
<td>921,797</td>
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<tr>
<td><strong>Total assets</strong></td>
<td><strong>$264,437,161</strong></td>
<td><strong>$244,402,594</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>LIABILITIES</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Current liabilities</td>
<td>$ 88,000,939</td>
<td>$ 68,915,916</td>
</tr>
<tr>
<td>Accrued vacation - less current portion</td>
<td>20,884,868</td>
<td>18,273,984</td>
</tr>
<tr>
<td>Capital lease obligations - less current portion</td>
<td>-24,367,818</td>
<td>17,049,951</td>
</tr>
<tr>
<td>Long-term debt - less current portion</td>
<td>12,594,445</td>
<td>11,423,465</td>
</tr>
<tr>
<td>Due to the State of Hawaii</td>
<td>20,122,507</td>
<td>20,122,507</td>
</tr>
<tr>
<td>Other liabilities</td>
<td>763,491</td>
<td>914,765</td>
</tr>
<tr>
<td><strong>Total liabilities</strong></td>
<td><strong>166,734,068</strong></td>
<td><strong>136,700,588</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>NET ASSETS</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Invested in capital assets - net of related debt</td>
<td>141,502,484</td>
<td>140,464,914</td>
</tr>
<tr>
<td>Unrestricted</td>
<td>(45,929,897)</td>
<td>(33,244,379)</td>
</tr>
<tr>
<td>Restricted</td>
<td>2,130,506</td>
<td>481,471</td>
</tr>
<tr>
<td><strong>Total net assets</strong></td>
<td><strong>97,703,093</strong></td>
<td><strong>107,702,006</strong></td>
</tr>
</tbody>
</table>

| Total liabilities and net assets | **$264,437,161** | **$244,402,594** |

At June 30, 2003 and 2002, HHSC's capital assets, net of accumulated depreciation, comprised approximately 71% and 72%, respectively, of its total assets. These assets consist mainly of land, hospital buildings and equipment that are used in HHSC's operations. The fiscal year 2003 increase of approximately $10.6 million is due to capital asset additions of approximately $26.2 million, offset by depreciation expense of approximately $15.5 million. The primary reason for the increase is due to the acquisition of medical equipment and energy saving equipment of $14.4 million funded through HHSC's municipal leasing lines of credit and State-funded capital improvement projects of $6.2 million. The State-funded capital improvement projects consisted primarily of life-safety code improvements at HHSC's critical access hospitals (Kauai Veterans Memorial Hospital, Kohala Hospital, Lanai Community Hospital, and Ka'u Hospital) and a nurse call system installation and electrical upgrades at Maui Memorial Medical Center. The fiscal year 2002 increase of approximately $7.7 million is due to capital asset additions of approximately $21.6 million, offset by depreciation expense of approximately $13.8 million. The primary reason for the increase is the acquisition of medical equipment (primarily the MRI, monitors, and imaging equipment for Maui Memorial Medical Center) and application systems (primarily the Lawson Human Resources application and Laser Arc data storage). The vast majority of these purchases were financed through HHSC's municipal leasing.
lines of credit (see further explanation below). A summary of HHSC's capital assets as of June 30, 2003 and 2002 is as follows:

<table>
<thead>
<tr>
<th></th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land and land improvements</td>
<td>$5,083,354</td>
<td>$4,809,354</td>
</tr>
<tr>
<td>Buildings and improvements</td>
<td>205,427,870</td>
<td>193,742,748</td>
</tr>
<tr>
<td>Equipment</td>
<td>110,505,091</td>
<td>105,435,204</td>
</tr>
<tr>
<td>Construction in progress</td>
<td>22,835,068</td>
<td>14,986,281</td>
</tr>
<tr>
<td><strong>Less accumulated depreciation and amortization</strong></td>
<td>343,851,383</td>
<td>318,973,587</td>
</tr>
<tr>
<td></td>
<td>(157,076,101)</td>
<td>(142,804,953)</td>
</tr>
<tr>
<td><strong>Capital assets - net</strong></td>
<td>$186,775,282</td>
<td>$176,168,634</td>
</tr>
</tbody>
</table>

At June 30, 2003, HHSC's current assets approximated 28% of total assets. Current assets increased by approximately $7.1 million from the fiscal year 2002 balance due to the increases in cash and cash equivalents of approximately $8.3 million and in supplies and other current assets of approximately $1.2 million, offset by a decrease in net patient accounts receivable of approximately $2.4 million. The increase in cash and cash equivalents is primarily due to the need to repay $5 million out of operating funds at the end of fiscal year 2002 to the State of Hawaii for an advance given to HHSC to fund its operating deficit for fiscal year 2002. The other reason for the increase in cash and cash equivalents is the increase in cash collections for fiscal year 2003 as compared to the prior year. HHSC collected $277 million in fiscal year 2003 as compared to $247 million in fiscal year 2002 due to an increase in patient services as a result of HHSC's investment in imaging equipment at its three major acute facilities.

At June 30, 2002, HHSC's current assets approximated 28% of total assets. Current assets decreased by approximately $1.2 million from the fiscal year 2001 balance due to three primary factors: increase in net patient accounts receivable of approximately $9 million, decrease in prepaid pension costs of approximately $6.2 million, and decrease in cash and cash equivalents of approximately $4.9 million. The increase in net patient accounts receivable represents an increase of 21% from fiscal year 2001, primarily due to an increase in net patient service revenues of $25.3 million (see further explanation below), offset by an increase of $12.1 million in cash collections. The decrease in prepaid pension costs is due to the amortization of the pension costs into salaries and benefits expense, resulting from HHSC's overpayment into the Employees' Retirement System of the State of Hawaii (ERS) in fiscal year 2000. The decrease in cash and cash equivalents is primarily due to reduced cash flow, as the demands to meet payroll, municipal lease and loan payments, and accounts payable were far greater than the amount of cash collected.

At June 30, 2003, HHSC's other noncurrent assets increased approximately $2.4 million from fiscal year 2002. The primary reasons for the increase are the restricted contribution of $1.5 million received from the Harry & Jeanette Weinberg Foundation to fund the Hawaii Prescription Care Association program, and an increase of approximately $709,000 in HHSC's investment in the Clinical Laboratories of Hawaii LLP joint venture.

At June 30, 2003 and 2002, HHSC's current liabilities approximated 53% and 50%, respectively, of total liabilities. The fiscal year 2003 increase in current liabilities is primarily due to the $14 million advance from the State of Hawaii (see explanation under general fund appropriations below) which is to be repaid in fiscal year 2004. Increases in accounts payable and accrued expenses over fiscal years 2002 and 2001 were caused by a general delay in paying creditors, caused by operating cash flow.
shortages, resulting in an increase of approximately $4.7 million and $7.3 million as of June 30, 2003 and 2002, respectively. Increases in the current portion of the capital lease obligation over fiscal years 2002 and 2001 of approximately $896,000 and $3.8 million, respectively, are due to the increase in the financing of the majority of HHSC's equipment purchases through municipal leasing lines (see further explanation below).

At June 30, 2003 and 2002, HHSC's total capital lease obligation balance increased approximately $8.2 million and $11.6 million from fiscal years 2002 and 2001, respectively. The primary reason for the increases is the acquisition of fixed equipment, medical equipment, and application systems (see explanation under capital assets above). HHSC has municipal leasing lines of credit with Academic Capital Group, Inc. and Salem Capital Group, which allow HHSC to finance equipment purchases at interest rates below market rates.

At June 30, 2003, HHSC's long-term debt balances represented notes and term loans payable on land, building, and medical equipment previously owned by Hilo Residency Training Program of approximately $11.4 million and a mortgage note payable relating to the acquisition of the nursing cottages on the Maui Memorial Medical Center campus with a remaining balance of approximately $1.6 million. At June 30, 2002, HHSC's long-term debt balances represented notes and term loans payable on land, building, and medical equipment previously owned by Hilo Residency Training Program of approximately $11.6 million and a term loan payable relating to the financing of the balance owing under HHSC's guarantee of an $800,000 loan made by a local bank to West Kauai Community Development Corporation of $375,000.

At June 30, 2003 and 2002, the portion of HHSC's net assets that is reflected as its investment in capital assets, net of related debt, of approximately $142 million and $140 million, respectively, is larger than the total net assets of approximately $98 million and $108 million, respectively. This means that HHSC's net operations since inception have resulted in losses of over $46 million and $33 million, respectively.
Consolidated Statements of Revenues, Expenses, and Changes in Net Assets

Summarized financial information of HHSC's Consolidated Statements of Revenues, Expenses, and Changes in Net Assets for the years ended June 30, 2003 and 2002 is as follows:

<table>
<thead>
<tr>
<th></th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating expenses:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salaries and benefits</td>
<td>$190,429,748</td>
<td>$170,747,415</td>
</tr>
<tr>
<td>Purchased services and professional fees</td>
<td>39,153,782</td>
<td>34,237,579</td>
</tr>
<tr>
<td>Supplies and drugs</td>
<td>45,110,748</td>
<td>42,657,736</td>
</tr>
<tr>
<td>Provision for doubtful accounts</td>
<td>16,736,879</td>
<td>12,265,438</td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td>15,493,133</td>
<td>13,835,128</td>
</tr>
<tr>
<td>Other</td>
<td>26,518,413</td>
<td>23,900,147</td>
</tr>
<tr>
<td>Total operating expenses</td>
<td>333,442,703</td>
<td>297,643,443</td>
</tr>
<tr>
<td>Operating revenues</td>
<td>288,410,439</td>
<td>267,296,489</td>
</tr>
<tr>
<td>Loss from operations</td>
<td>(45,032,264)</td>
<td>(30,346,954)</td>
</tr>
<tr>
<td>Nonoperating revenues:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>General appropriations from State of Hawaii</td>
<td>13,300,000</td>
<td>7,000,000</td>
</tr>
<tr>
<td>Collective bargaining pay raise appropriation from State of Hawaii</td>
<td>12,394,468</td>
<td>6,213,838</td>
</tr>
<tr>
<td>Restricted contributions</td>
<td>2,447,524</td>
<td>947,032</td>
</tr>
<tr>
<td>Other nonoperating revenues - net</td>
<td>662,957</td>
<td>1,381,247</td>
</tr>
<tr>
<td>Nonoperating revenues - net</td>
<td>28,804,949</td>
<td>15,542,117</td>
</tr>
<tr>
<td>Loss before capital contributions</td>
<td>(16,227,315)</td>
<td>(14,804,837)</td>
</tr>
<tr>
<td>Capital assets contributed by State of Hawaii</td>
<td>6,228,402</td>
<td>2,287,258</td>
</tr>
<tr>
<td>Decrease in net assets</td>
<td>$ (9,998,913)</td>
<td>$ (12,517,579)</td>
</tr>
</tbody>
</table>

For the years ended June 30, 2003 and 2002, HHSC's operating expenses exceeded its operating revenues by approximately $45 million and $30.3 million, respectively. The collective bargaining pay raise appropriation from the State of Hawaii of approximately $12.4 million and $6.2 million, general fund appropriations from the State of Hawaii of $13.3 million and $7 million, other nonoperating revenues of approximately $3.1 million and $2.3 million, and capital assets contributed by the State of Hawaii of approximately $6.2 million and $2.3 million reduced the decrease in net assets to approximately $10 million and $12.5 million, respectively.

Operating expenses in fiscal year 2003 were approximately 12% higher than fiscal year 2002. The increase was mainly in the categories of salaries and benefits expense, purchased services and professional fees, and the provision for doubtful accounts. Salaries and benefits expense increased 12% from fiscal year 2002, due primarily to an increase in the fringe benefit rate charged to all State agencies from 21.19% to 32.22%. The increase in the fringe benefit rate was due primarily to an increase in the required contribution to the Employee Retirement System (ERS) from 0% to 8.87%. The impact of the fringe benefit increases for the ERS, Retiree Health Insurance, and Employee Health Fund was an additional $14 million in salaries and benefits expense to HHSC in fiscal year 2003.

Further, HHSC's union employees received pay raises from the unions' collective bargaining.
agreements with the State of Hawaii, ranging from 2-5%. These pay raises represented an additional $6.2 million in salaries and benefits expense over fiscal year 2002. Purchased services and professional fees increased 14.4% from fiscal year 2002, primarily due to increased use of registry nurses and clinical laboratory services at Maui Memorial Medical Center, driven by larger than expected patient volume throughout the year. Provision for doubtful accounts increased by approximately $4.5 million from fiscal year 2002, primarily due to an increase of $5.4 million in provision for doubtful accounts at Maui Memorial Medical Center. While the facility's business office was fairly successful in keeping up with billing and collecting the fiscal year 2003 patient accounts, it was unable to maintain its collection efforts on fiscal year 2002 and older patient accounts. As a result, the facility's accounts receivable aging deteriorated substantially in fiscal year 2003. The facility's accounts receivable aged current to 60 days past due decreased 13% from June 30, 2002 to June 30, 2003; while the accounts receivable aged 151 days and older increased 12% from June 30, 2002 to June 30, 2003. Therefore, a substantially higher provision for doubtful accounts was necessary to account for the diminished likelihood of collection on the older patient accounts receivable.

Operating expenses in fiscal year 2002 were approximately 11.4% higher than fiscal year 2001. The increase was primarily in the categories of salaries and supplies and drugs. Salaries and benefits expense increased approximately 20% from fiscal year 2001, due primarily to an increase in full-time equivalent employees (FTEs). The increase in FTEs was primarily due to added personnel for imaging departments at Hilo Medical Center, Maui Memorial Medical Center, and Kona Community Hospital, accounting for approximately 47 FTEs, as well as the conversion of nurses who were previously on contract to full-time employees, accounting for approximately 78 FTEs. In addition, HHSC's union employees received pay raises ranging from 2% to 4% from the unions' collective bargaining agreements with the State of Hawaii. Further, HHSC amortized approximately $6.2 million in prepaid pension costs into salaries and benefits expense during fiscal year 2002, as the amount overpaid by HHSC in fiscal year 2000 was used for the fiscal year 2002 contribution to the ERS. Supplies and drugs expense in fiscal year 2002 increased approximately 19% from fiscal year 2001, primarily due to an increase in patient volume and an average 17% increase in the price of prescription drugs.

Operating revenue in fiscal year 2003 increased by approximately 7.9%, as a result of a 1.3% increase in patient days, a 5% rate increase effective July 1, 2002, and continued revenue enhancements as a result of HHSC's imaging initiatives that began in fiscal year 2002. The increase in revenues primarily came in the areas of major surgery, emergency room, imaging (including MRI, diagnostic radiology services, and CT Scan), clinical laboratory testing, and drugs sold to patients. The primary increase in operating revenues occurred at Maui Memorial Medical Center, primarily due to a 5.3% increase in emergency room visits, a 4.7% increase in newborn patient days, and a 2.3% increase in acute patient days.

The 2002 increase in net patient service revenues was driven by a 6% increase in patient days and a 5% increase in outpatient visits, driven by initiatives such as the purchases of imaging equipment at Hilo Medical Center, Maui Memorial Medical Center, and Kona Community Hospital, as well as the increase in the clinic revenues at Kauai Veterans Memorial Hospital. The increase in patient days is reflected in increases in the long-term care occupancy percentage, from 92% in fiscal year 2001 to 97% in fiscal year 2002, and the acute care occupancy percentage, from 66% in fiscal year 2001 to 70% in fiscal year 2002.

For the year ended June 30, 2003, General Fund Appropriations from the State of Hawaii is comprised of $14 million approved for HHSC's operating purposes by the 2002 Legislature, which was reduced by $700,000 due to a budget restriction imposed by the Governor of the State of Hawaii. During fiscal year 2003, HHSC communicated to the State Department of Budget and Finance and the Governor of the State of Hawaii that due to unanticipated increases in the amounts assessed to HHSC for employee
retirement system contributions and other health benefit costs, the level of general fund appropriations HHSC was to receive for fiscal year 2003 would be insufficient to support its operations. The Governor agreed to loan HHSC $14 million, with the understanding that HHSC would seek an emergency appropriation from the 2003 Legislature to repay the loan. The 2003 Legislature did not support HHSC's emergency appropriation request; accordingly, the balance of the $14 million loan from the Governor is reflected as "Advance from the State of Hawaii" on the Statement of Net Assets.

The significant excess of operating expenses over operating revenues in both fiscal years 2003 and 2002, as well as the cumulative net losses, is due to several factors. First, HHSC's payor mix is made up of predominantly government-type payors. For fiscal years 2003 and 2002, 56% and 58%, respectively, of HHSC's total gross revenues were from government-type payors (approximately 21% and 23% from Medicare and approximately 19% and 26% from Medicaid and Med-Quest). In fact, Medicare, Medicaid, and Med-Quest account for over 88% and 80% of HHSC's revenues for its long-term care facilities in 2003 and 2002, respectively. Reimbursements from government-type payors has not kept up with the increasing costs of health care providers since the Balanced Budget Act of 1997 was passed, which dramatically reduced the level of reimbursements from government-type payors.

Second, HHSC's facilities on the neighbor islands suffer from an insufficient supply of long-term care beds. As noted above, HHSC's beds in its long-term care facilities are virtually fully occupied and there are very few other freestanding long-term care facilities on the neighbor islands. As a result, HHSC's acute care facilities, especially Hilo Medical Center and Maui Memorial Medical Center, have numerous patients initially admitted as acute patients, but who continue to occupy acute care beds while awaiting long-term care beds to become available. Such patients are called "wait-list" patients. HHSC receives little to no reimbursement from insurers for such patients, as insurers will not reimburse providers for patients whose required level of care does not coincide with the type of bed the patient is occupying. Hilo Medical Center and Maui Memorial Medical Center both have an average census of approximately 20-40 wait-list patients per day in fiscal year 2003 and 30-50 wait-list patients per day in fiscal year 2002. Management expects the wait-list problem to worsen as Hawaii's population continues to age and the State of Hawaii lags behind on a credible plan to address the long-term care crisis.

Third, HHSC is bound by the collective bargaining agreements negotiated by the State of Hawaii and the public employee unions (Hawaii Government Employees Association and United Public Workers). The collective bargaining agreements not only bind HHSC to the negotiated pay raises, but also to the union work regulations and benefit packages. Management believes that such arrangements do not allow HHSC to manage its resources as effectively as other health-care systems.

Fourth, HHSC inherited aging facilities upon the formation of the Corporation in 1996. These aging facilities require substantial improvements and maintenance before they can be brought up to par with other health care facilities in the State of Hawaii. While the State of Hawaii has provided annual funding for capital improvement projects, that funding has been primarily used to correct life-safety code concerns. Funding for medical equipment, application systems, and routine repair and maintenance is funded from HHSC's operational cash flow. Given HHSC's payor mix and cost burdens, HHSC's operational cash flows are inadequate to fully fund the capital acquisitions that are necessary to keep up with the advances in health care technology that allow hospitals to improve the quality of care for their patients.

Finally, HHSC serves as the "safety-net" provider of health care in the State of Hawaii. HHSC is the sole source of health care for several isolated neighbor island communities (e.g., Ka'u, Kohala, Lanai, etc.). Further, Maui Memorial Medical Center is the primary acute care facility on the island of Maui, and Hilo Medical Center and Kona Community Hospital are the only acute care facilities with more
than 50 acute beds on the island of Hawaii. In addition, Leahi Hospital functions as the primary tuberculosis hospital for the State of Hawaii. Also, HHSC's long-term care facilities provide the primary source of long-term care services for elderly people who cannot afford private care or nursing homes and do not have family that can care for them. Given all of the above, management believes that HHSC has a vital role in ensuring that the people of the State of Hawaii have access to quality health care.

Further, management believes that there are two Medicaid reimbursement issues that will have a significant negative impact on the financial performance of HHSC: the implementation of Act 294 and the lack of Medicaid Disproportionate Share Hospital (DSH) provider reimbursements in the State of Hawaii. Act 294 was passed by the State Legislature in 1998, and requires that no later than June 30, 2003, there be no distinction in reimbursement rates between hospital-based and non-hospital based long-term care facilities under the Medicaid program. Prior to the passage of Act 294, hospital-based long-term care facilities received a higher reimbursement than freestanding long-term care facilities under the Medicaid program, primarily due to the recognition that hospital-based long-term care facilities subject to the compliance with EMTALA (Emergency Medical Treatment and Labor Act) requirements, which requires hospitals to accept all patients who come through an emergency room, regardless of the patient's ability to pay. Freestanding long-term care facilities are not subject to EMTALA requirements. Compliance with EMTALA requirements imposes additional costs on hospital-based long-term care facilities, primarily in staffing requirements and in bad debt expense. Six HHSC facilities would be negatively impacted by the implementation of Act 294, while one facility (Maluhia Hospital) would be positively impacted. Understanding the dramatic impact that implementation of Act 294 would have on HHSC, the Department of Human Services has authorized a phased implementation of Act 294 over six years. However, management estimates that even with a phased implementation, the cost to HHSC will be approximately $38 million over the six-year phase-in period. Once Act 294 is fully implemented, management estimates that the cost to HHSC will be approximately $13 million per year. Management believes that such large annual costs will simply serve to increase the amount of general fund appropriations that HHSC will be seeking from the State of Hawaii each year as the amount of cost reductions and revenue enhancements that can be reasonably explored will not be enough to absorb such costs.

When the State of Hawaii implemented the Med-QUEST (QUEST) program in 1994, the federal funds provided to the State of Hawaii for Medicaid DSH payments to hospitals were eliminated. DSH payments are additional reimbursements that attempt to reflect additional costs incurred by providers who serve a significantly disproportionate number of low-income patients and/or significant number of Medicaid patients. HHSC's patient mix is such that it would have qualified for Medicaid DSH payments had the State of Hawaii not eliminated such payments. Such additional reimbursements would have reduced the amount of State subsidies needed to finance the operations of HHSC. Management estimates that if the State of Hawaii had maintained Medicaid DSH payments, HHSC would be receiving approximately $7 million more in reimbursements than it currently does. To illustrate the importance of Medicaid DSH payments to public hospital systems, the National Association of Public Hospitals' report on "America's Safety Net Hospitals and Health Systems, 2001" states that in 2001, "Medicaid DSH once again proved to be a critical funding source, financing 25 percent of unreimbursed costs." The 2003 Legislature passed a resolution requesting the State Department of Human Services to work with Hawaii's congressional delegation to aggressively advocate for the restoration of DSH payments from the Centers for Medicare and Medicaid Services to compensate Hawaii hospitals for care provided to the uninsured.
HAWAII HEALTH SYSTEMS CORPORATION

CONSOLIDATED STATEMENTS OF NET ASSETS
JUNE 30, 2003 AND 2002

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CURRENT ASSETS:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and cash equivalents:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>On deposit with the State of Hawaii</td>
<td>$8,158,638</td>
<td>$514,684</td>
</tr>
<tr>
<td>On deposit with banks and on hand (Note 3)</td>
<td>7,112,264</td>
<td>6,454,896</td>
</tr>
<tr>
<td>Patient accounts receivable - less allowances of $108,887,907 and</td>
<td></td>
<td></td>
</tr>
<tr>
<td>$95,553,804 for contractual adjustments and doubtful accounts</td>
<td>50,479,290</td>
<td>52,914,430</td>
</tr>
<tr>
<td>Supplies and other current assets</td>
<td>8,626,834</td>
<td>7,428,153</td>
</tr>
<tr>
<td><strong>Total current assets</strong></td>
<td>74,377,026</td>
<td>67,312,163</td>
</tr>
<tr>
<td><strong>CAPITAL ASSETS - Net (Notes 4, 6 and 7)</strong></td>
<td>186,775,282</td>
<td>176,168,634</td>
</tr>
<tr>
<td><strong>ASSETS LIMITED AS TO USE</strong></td>
<td>2,517,281</td>
<td>862,830</td>
</tr>
<tr>
<td><strong>OTHER ASSETS (Note 11)</strong></td>
<td>767,572</td>
<td>58,967</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>$264,437,161</td>
<td>$244,402,594</td>
</tr>
<tr>
<td>LIABILITIES AND NET ASSETS</td>
<td>2003</td>
<td>2002</td>
</tr>
<tr>
<td>---------------------------</td>
<td>---------------</td>
<td>---------------</td>
</tr>
<tr>
<td>CURRENT LIABILITIES</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts payable and accrued expenses (Note 11)</td>
<td>$44,160,581</td>
<td>$39,436,774</td>
</tr>
<tr>
<td>Accrued workers' compensation liability (Note 10)</td>
<td>18,500,000</td>
<td>18,500,000</td>
</tr>
<tr>
<td>Advance from the State of Hawaii (Note 5)</td>
<td>14,000,000</td>
<td></td>
</tr>
<tr>
<td>Current portion of capital lease obligations (Note 6)</td>
<td>7,933,202</td>
<td>7,036,881</td>
</tr>
<tr>
<td>Estimated third-party payor settlements</td>
<td>1,565,986</td>
<td>1,978,549</td>
</tr>
<tr>
<td>Current portion of accrued vacation (Note 6)</td>
<td>840,270</td>
<td>719,154</td>
</tr>
<tr>
<td>Current portion of long-term debt (Note 7)</td>
<td>377,333</td>
<td>568,423</td>
</tr>
<tr>
<td>Other current liabilities</td>
<td>623,567</td>
<td>676,135</td>
</tr>
<tr>
<td><strong>Total current liabilities</strong></td>
<td><strong>88,000,939</strong></td>
<td><strong>68,915,916</strong></td>
</tr>
<tr>
<td>CAPITAL LEASE OBLIGATIONS - Less current portion (Note 6)</td>
<td>24,367,818</td>
<td>17,049,951</td>
</tr>
<tr>
<td>LONG-TERM DEBT - Less current portion (Note 7)</td>
<td>12,594,445</td>
<td>11,423,465</td>
</tr>
<tr>
<td>ACCRUED VACATION - Less current portion (Note 6)</td>
<td>20,884,868</td>
<td>18,273,984</td>
</tr>
<tr>
<td>DUE TO THE STATE OF HAWAII</td>
<td>20,122,507</td>
<td>20,122,507</td>
</tr>
<tr>
<td>PATIENTS' SAFEKEEPING DEPOSITS</td>
<td>386,775</td>
<td>381,359</td>
</tr>
<tr>
<td>OTHER LIABILITIES</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total liabilities</strong></td>
<td><strong>166,734,068</strong></td>
<td><strong>136,700,588</strong></td>
</tr>
<tr>
<td>NET ASSETS:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Invested in capital assets - net of related debt</td>
<td>141,502,484</td>
<td>140,464,914</td>
</tr>
<tr>
<td>Unrestricted (Note 3)</td>
<td>(45,929,897)</td>
<td>(33,244,379)</td>
</tr>
<tr>
<td>Restricted</td>
<td>2,130,506</td>
<td>481,471</td>
</tr>
<tr>
<td><strong>Total net assets</strong></td>
<td><strong>97,703,093</strong></td>
<td><strong>107,702,006</strong></td>
</tr>
<tr>
<td>TOTAL</td>
<td><strong>$264,437,161</strong></td>
<td><strong>$244,402,594</strong></td>
</tr>
</tbody>
</table>

See notes to consolidated financial statements.
### HAWAII HEALTH SYSTEMS CORPORATION

**CONSOLIDATED STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS**

**YEARS ENDED JUNE 30, 2003 AND 2002**

<table>
<thead>
<tr>
<th></th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>OPERATING REVENUES:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net patient service revenues (Note 8)</td>
<td>$283,900,653</td>
<td>$263,466,300</td>
</tr>
<tr>
<td>Other operating revenues (Notes 8 and 11)</td>
<td>4,509,776</td>
<td>3,830,189</td>
</tr>
<tr>
<td><strong>Total operating revenues</strong></td>
<td>288,410,439</td>
<td>267,296,489</td>
</tr>
</tbody>
</table>

| **OPERATING EXPENSES:** |               |               |
| Salaries and benefits (Notes 8 and 9) | 190,429,748   | 170,747,415   |
| Medical supplies and drugs | 32,525,872    | 31,628,897    |
| Professional fees (Notes 8 and 11) | 20,459,213    | 16,912,677    |
| Purchased services (Notes 8 and 11) | 18,694,569    | 17,324,902    |
| Provision for doubtful accounts | 16,736,879    | 12,265,438    |
| Depreciation and amortization | 15,493,133    | 13,835,128    |
| Other supplies | 12,584,876    | 11,028,839    |
| Utilities | 7,302,695     | 7,168,591     |
| Repairs and maintenance | 3,453,900     | 5,122,963     |
| Rent and lease | 3,505,118     | 2,874,317     |
| Insurance | 3,328,280     | 1,909,978     |
| Interest (net of capitalized interest) (Note 6) | 2,373,961     | 1,910,873     |
| Other | 4,554,459     | 4,913,425     |
| **Total operating expenses** | 333,442,703   | 297,643,443   |

| **LOSS FROM OPERATIONS** | (45,032,264) | (30,346,954) |

| **NONOPERATING REVENUES:** |               |               |
| General appropriations from State of Hawaii | 13,300,000    | 7,000,000     |
| Collective bargaining pay raise appropriation from State of Hawaii | 12,394,468    | 6,213,838     |
| Restricted contributions | 2,447,524     | 947,032       |
| Interest and dividend income | 221,292       | 235,836       |
| Other nonoperating revenues - net | 441,665       | 1,145,411     |
| **Nonoperating revenues - net** | 28,804,949    | 15,542,117    |

| **LOSS BEFORE CAPITAL CONTRIBUTIONS** | (16,227,315) | (14,804,837) |

| **CAPITAL ASSETS CONTRIBUTED BY STATE OF HAWAII** (Note 4) | 6,228,402     | 2,287,258     |

| **DECREASE IN NET ASSETS** | (9,998,913) | (12,517,579) |

| **NET ASSETS, BEGINNING OF YEAR** | 107,702,006  | 120,219,585   |

| **NET ASSETS, END OF YEAR** | $ 97,703,093 | $107,702,006 |

See notes to consolidated financial statements.
# Hawaii Health Systems Corporation

## Consolidated Statements of Cash Flows

**Years Ended June 30, 2003 and 2002**

<table>
<thead>
<tr>
<th></th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Operating Activities:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payments from government,</td>
<td>$269,186,361</td>
<td>$240,123,598</td>
</tr>
<tr>
<td>insurance and patients</td>
<td>(185,974,391)</td>
<td>(163,340,414)</td>
</tr>
<tr>
<td>Payments to employees</td>
<td>(109,274,264)</td>
<td>(92,848,049)</td>
</tr>
<tr>
<td>Other receipts - net</td>
<td>3,400,979</td>
<td>3,453,886</td>
</tr>
<tr>
<td><strong>Net cash used in operating</strong></td>
<td>(22,661,315)</td>
<td>(12,610,979)</td>
</tr>
<tr>
<td><strong>Activities:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Appropriations from State of</td>
<td>25,694,468</td>
<td>13,213,838</td>
</tr>
<tr>
<td>Hawaii</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Advances from the State of</td>
<td>14,000,000</td>
<td></td>
</tr>
<tr>
<td>Hawaii</td>
<td>371,234</td>
<td>757,421</td>
</tr>
<tr>
<td><strong>Net cash provided by</strong></td>
<td>40,065,702</td>
<td>13,971,259</td>
</tr>
<tr>
<td><strong>Noncapital Financing</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Activities:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Repayments on capital</td>
<td>(6,288,048)</td>
<td>(3,879,484)</td>
</tr>
<tr>
<td>lease obligations</td>
<td>(2,106,622)</td>
<td>(1,900,616)</td>
</tr>
<tr>
<td>Payments on long-term debt</td>
<td>(711,010)</td>
<td>(523,176)</td>
</tr>
<tr>
<td>Proceeds from sale of capital</td>
<td>2,615</td>
<td>227</td>
</tr>
<tr>
<td>assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>**Net cash used in capital and</td>
<td>(9,103,065)</td>
<td>(6,303,049)</td>
</tr>
<tr>
<td>related financing activities</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Net Increase (Decrease) in</strong></td>
<td>8,301,322</td>
<td>(4,942,769)</td>
</tr>
<tr>
<td>Cash and Cash Equivalents</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Cash and Cash Equivalents,</strong></td>
<td>6,969,580</td>
<td>11,912,349</td>
</tr>
<tr>
<td><strong>Beginning of Year</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Cash and Cash Equivalents,</strong></td>
<td>$15,270,902</td>
<td>$6,969,580</td>
</tr>
<tr>
<td><strong>End of Year</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
RECONCILIATION OF LOSS FROM OPERATIONS TO NET CASH USED IN OPERATING ACTIVITIES:

<table>
<thead>
<tr>
<th>Description</th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loss from operations</td>
<td>$(45,032,264)</td>
<td>$(30,346,954)</td>
</tr>
<tr>
<td>Adjustments to reconcile loss from operations to net cash used in operating activities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Provision for doubtful accounts</td>
<td>16,736,879</td>
<td>12,265,438</td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td>15,493,133</td>
<td>13,835,128</td>
</tr>
<tr>
<td>Amounts released from restrictions</td>
<td>798,489</td>
<td>1,413,001</td>
</tr>
<tr>
<td>Amortization of prepaid pension costs</td>
<td></td>
<td>6,206,461</td>
</tr>
<tr>
<td>Change in operating assets and liabilities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Receivables</td>
<td>(14,301,739)</td>
<td>(21,276,875)</td>
</tr>
<tr>
<td>Supplies and other assets</td>
<td>(1,907,286)</td>
<td>(1,620,328)</td>
</tr>
<tr>
<td>Accounts payable, accrued expenses, and other liabilities</td>
<td>3,232,036</td>
<td>6,687,948</td>
</tr>
<tr>
<td>Accrued workers’ compensation liability</td>
<td></td>
<td>1,516,063</td>
</tr>
<tr>
<td>Estimated third-party payor settlements</td>
<td>(412,563)</td>
<td>(2,065,327)</td>
</tr>
<tr>
<td>Accrued vacation</td>
<td>2,732,000</td>
<td>774,966</td>
</tr>
</tbody>
</table>

Net cash used in operating activities: $22,661,315  $12,610,979

SUPPLEMENTAL CASH FLOW INFORMATION:

<table>
<thead>
<tr>
<th>Description</th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest paid, primarily on capital lease obligations</td>
<td>$3,077,856</td>
<td>$2,312,522</td>
</tr>
</tbody>
</table>

Non-cash financing and investing activities:

- Capital assets acquired under capital leases | 14,502,236 | 15,445,269 |
- Capital assets contributed by State of Hawaii | 6,228,402 | 2,287,258 |
- Capital asset purchases included in accounts payable | 1,838,295 | 555,782 |
- Capital assets acquired through long-term debt financing | 1,690,900 | 585,084 |
- Capital assets acquired through grants | 423,238 | 750,000 |
- Reclassification of deposits to capital assets |          |          |
- Contribution of capital assets |          | 59,000 |

See notes to consolidated financial statements.
HAWAII HEALTH SYSTEMS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2003 AND 2002

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, which became effective in fiscal year 1997, 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

Mano County:
- Maui Memorial Medical Center
- Kula Hospital
- Lanai Community Hospital

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

City and County of Honolulu:
- Leahi Hospital
- Maluhia

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 consolidated financial statements relate only to HHSC and the facilities and are not intended to present the financial position, results of operations, or cash flows of the Department of Health.

Negotiations between HHSC and the State relating to the transfer of assets and assumption of liabilities pursuant to Act 262 had not been finalized as of June 30, 2003. Accordingly, the assets, liabilities and net assets of HHSC reflected in the accompanying consolidated statements of net assets may be significantly different from those eventually included in the final settlement.

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting - HHSC prepares its financial statements using the economic resources measurement focus and the accrual basis of accounting.
HHSC's financial statements are presented in accordance with the pronouncements of the Governmental 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 consolidated 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 consolidated 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, 2003 and 2002 is indicated in the accompanying consolidated statements of net assets as "Cash and cash equivalents on deposit with the State of Hawaii." The Hawaii Revised Statutes authorize the Director of Finance to invest in obligations of, or guaranteed by, the U.S. Government, obligations of the State, federally-insured savings and checking accounts, time certificates of deposit, and repurchase agreements with federally-insured financial institutions. Cash and deposits with financial institutions are collateralized in accordance with State Statutes. All securities pledged as collateral are held either by the State Treasury or by the State's fiscal agents in the name of the State.

HHSC has cash in financial institutions that is in excess of available depository insurance coverage.

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

Capital Assets - Capital assets assumed from the State at inception are recorded at cost less accumulated depreciation. Other capital assets are recorded at cost or estimated fair market value at the date of donation. Donated buildings, equipment and land are recognized as revenue when all eligibility requirements have been met, generally at the date of donation. Equipment under capital leases is recorded at the present value of future payments. Buildings, equipment and improvements are depreciated by the straight-line method over their estimated useful lives. Gains or losses on the sale of capital assets are reflected in other nonoperating revenues. Normal repairs and maintenance expenses are charged to operations as incurred.

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

Assets Limited as to Use - Assets limited as to use are restricted net assets and patients' safekeeping deposits. Such restrictions have been externally imposed by contributors. Restricted resources are applied before unrestricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available. Patients' safekeeping deposits represent funds received or property belonging to the patients that are held by HHSC in a fiduciary capacity as custodian. Receipts and disbursements of these funds are not reflected in HHSC's operations.
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. For employees first employed on or before July 1, 2001, vacation is earned at a rate of one and three-quarters working days for each month of service. For employees first employed on or after July 2, 2001, vacation is earned at a rate of one working day for each month of service. Vacation days may be accumulated to a maximum of 90 days.

Operating Revenues and Expenses - HHSC has defined its operating revenues and expenses as those relating to the provision of health care services. Those revenues and expenses relating to capital and related financing activities, noncapital financing activities, and investing activities are excluded from that definition.

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, 2003 and 2002.

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 approximately $1,566,000 and $1,979,000, as of June 30, 2003 and 2002, 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 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 2000.

- **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 (HMSCA) - 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.

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. For the years ended June 30, 2003 and 2002, the amount of bond interest allocated to HHSC was $2,443,000 and $2,381,000, respectively.

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 10.

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, 2003 and 2002 was as follows:

<table>
<thead>
<tr>
<th></th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medicare</td>
<td>14%</td>
<td>13%</td>
</tr>
<tr>
<td>Medicaid</td>
<td>24</td>
<td>24</td>
</tr>
<tr>
<td>HMSA</td>
<td>12</td>
<td>15</td>
</tr>
<tr>
<td>Other third-party payors</td>
<td>22</td>
<td>22</td>
</tr>
<tr>
<td>Patients and other</td>
<td>28</td>
<td>26</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100%</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

Reclassifications - Certain amounts in the 2002 financial statements have been reclassified to conform to the 2003 presentation.
3. BOARD-DESIGNATED FUNDS

As of June 30, 2002, 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 500

Total $5,500

During the years ended June 30, 2003 and 2002, HHSC's Board of Directors did not release any of the designated cash reserves for use in operations.

The designated funds are included in cash on deposit with banks and the unrestricted net assets balance.

4. CAPITAL ASSETS

Transactions in the capital assets accounts for the years ended June 30, 2003 and 2002 were as follows:

<table>
<thead>
<tr>
<th>2003</th>
<th>Beginning of Year</th>
<th>Additions</th>
<th>Retirements</th>
<th>Transfers</th>
<th>End of Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets Not Subject to Depreciation:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land and land improvements</td>
<td>$ 4,809,354</td>
<td></td>
<td>$274,000</td>
<td></td>
<td>$ 5,083,354</td>
</tr>
<tr>
<td>Construction in progress</td>
<td>14,986,281</td>
<td>$16,541,247</td>
<td>(8,692,460)</td>
<td></td>
<td>22,835,068</td>
</tr>
<tr>
<td>Assets Subject to Depreciation:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Buildings and improvements</td>
<td>193,742,748</td>
<td>4,156,964</td>
<td>$ (63,668)</td>
<td>7,591,826</td>
<td>205,427,870</td>
</tr>
<tr>
<td>Major moveable equipment</td>
<td>69,150,419</td>
<td>4,833,773</td>
<td>(1,030,996)</td>
<td>370,627</td>
<td>73,323,823</td>
</tr>
<tr>
<td>Fixed equipment</td>
<td>36,284,785</td>
<td>699,312</td>
<td>(243,706)</td>
<td>440,877</td>
<td>37,181,268</td>
</tr>
<tr>
<td>Less accumulated depreciation and amortization</td>
<td>(142,804,953)</td>
<td>(15,493,133)</td>
<td>1,206,855</td>
<td>15,130</td>
<td>(157,076,101)</td>
</tr>
<tr>
<td>Capital assets - net</td>
<td>$ 176,168,634</td>
<td>$ 10,738,163</td>
<td>(131,515)</td>
<td></td>
<td>$ 186,775,282</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>2002</th>
<th>Beginning of Year</th>
<th>Additions</th>
<th>Retirements</th>
<th>Transfers</th>
<th>End of Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets Not Subject to Depreciation:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land and land improvements</td>
<td>$ 4,744,929</td>
<td>$ 64,425</td>
<td></td>
<td></td>
<td>$ 4,809,354</td>
</tr>
<tr>
<td>Construction in progress</td>
<td>13,798,590</td>
<td>10,081,311</td>
<td>$(8,893,620)</td>
<td></td>
<td>14,986,281</td>
</tr>
<tr>
<td>Assets Subject to Depreciation:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Buildings and improvements</td>
<td>192,495,936</td>
<td>190,273</td>
<td>1,056,539</td>
<td></td>
<td>193,742,748</td>
</tr>
<tr>
<td>Major moveable equipment</td>
<td>61,127,964</td>
<td>9,088,953</td>
<td>$(1,071,556)</td>
<td>5,058</td>
<td>69,150,419</td>
</tr>
<tr>
<td>Fixed equipment</td>
<td>26,365,598</td>
<td>2,158,047</td>
<td>(70,883)</td>
<td>7,832,023</td>
<td>36,284,785</td>
</tr>
<tr>
<td>Less accumulated depreciation and amortization</td>
<td>(130,092,006)</td>
<td>(13,835,128)</td>
<td>1,122,181</td>
<td></td>
<td>(142,804,953)</td>
</tr>
<tr>
<td>Capital assets - net</td>
<td>$ 168,441,011</td>
<td>$ 7,747,881</td>
<td>(20,258)</td>
<td></td>
<td>$ 176,168,634</td>
</tr>
</tbody>
</table>
In 2003 and 2002, the State Department of Accounting and General Services transferred capital assets, including construction in progress, aggregating $6,228,402 and $2,287,258, respectively, to HHSC as a contribution of capital.

5. ADVANCE FROM THE STATE OF HAWAII

In fiscal year 2003, HHSC received a $14,000,000 advance from the State of Hawaii to relieve its cash flow shortfall. The advance is to be repaid in fiscal year 2004.

6. LONG-TERM LIABILITIES

Among HHSC’s long-term liabilities are accrued vacation and capital lease obligations. Transactions in these accounts during the years ended June 30, 2003 and 2002 were as follows:

<table>
<thead>
<tr>
<th>2003</th>
<th>Beginning of Year</th>
<th>Additions</th>
<th>Reductions</th>
<th>End of Year</th>
<th>Current Portion</th>
<th>Noncurrent Portion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accrued vacation</td>
<td>$18,993,138</td>
<td>$3,572,270</td>
<td>$(840,270)</td>
<td>$21,725,138</td>
<td>$840,270</td>
<td>$20,884,868</td>
</tr>
<tr>
<td>Capital lease obligations</td>
<td>24,086,832</td>
<td>14,502,236</td>
<td>(6,288,048)</td>
<td>32,301,020</td>
<td>7,933,202</td>
<td>24,367,818</td>
</tr>
<tr>
<td>Long-term liabilities</td>
<td>$43,079,970</td>
<td>$18,074,506</td>
<td>$(7,128,318)</td>
<td>$54,026,158</td>
<td>$8,773,472</td>
<td>$45,252,686</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>2002</th>
<th>Beginning of Year</th>
<th>Additions</th>
<th>Reductions</th>
<th>End of Year</th>
<th>Current Portion</th>
<th>Noncurrent Portion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accrued vacation</td>
<td>$18,229,714</td>
<td>$1,482,578</td>
<td>$(719,154)</td>
<td>$18,993,138</td>
<td>$719,154</td>
<td>$18,273,984</td>
</tr>
<tr>
<td>Capital lease obligations</td>
<td>12,521,047</td>
<td>15,445,269</td>
<td>(3,879,484)</td>
<td>24,086,832</td>
<td>7,036,881</td>
<td>17,049,951</td>
</tr>
<tr>
<td>Long-term liabilities</td>
<td>$30,750,761</td>
<td>$16,927,847</td>
<td>$(4,598,638)</td>
<td>$43,079,970</td>
<td>$7,756,035</td>
<td>$35,323,935</td>
</tr>
</tbody>
</table>

Future capital lease payments were as follows:

<table>
<thead>
<tr>
<th>Year ended June 30:</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>$10,414,130</td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td>9,129,782</td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td>7,286,328</td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td>4,443,941</td>
<td></td>
</tr>
<tr>
<td>2008</td>
<td>2,727,820</td>
<td></td>
</tr>
<tr>
<td>Thereafter</td>
<td>9,064,189</td>
<td></td>
</tr>
</tbody>
</table>

Total future minimum payments: 43,066,190
Less amount representing interest: (10,765,170)

Total capital lease obligations: 32,301,020
Current portion: (7,933,202)
Noncurrent portion: $24,367,818
HHSC has an arrangement with lessors whereby HHSC enters into capital leases 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 the financial statements of either Corporate or the facilities. Corporate makes the capital lease payments and incurs the interest expense, while the facilities record depreciation on the capital asset. Corporate also computes capitalized interest on construction in progress and transfers the capitalized interest asset to the facilities. The facilities reimburse Corporate through the due from affiliates account for the capital lease payments, interest expense, and capitalized interest. For the year ended June 30, 2003, interest capitalized for Corporate and all facilities was approximately $779,000.

7. **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. (HRTP) to ensure the uninterrupted operation of the Hilo Medical Center Cancer Treatment Center and its radiation and medical oncology services. As part of the acquisition, HHSC assumed HRTP's outstanding balances on the loans and notes payable of $11,893,162. (The assets and related liabilities have been recorded in the Facility's accounting records.) The loans and notes payable are collateralized by a security interest in the capital assets acquired from HRTP, as well as any rights, interest, and other tangible assets relating to such property.

**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 (WKCD). WKCD 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. WKCD'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, WKCD executed a promissory note to HHSC for $800,000, representing the outstanding balance WKCD 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. In December 2002, HHSC repaid the loan.

**Maui Memorial Medical Center Nurses' Cottages** - During fiscal year 2003, HHSC acquired buildings for $1,670,000 on behalf of Maui Memorial Medical Center (MMMC) for use in its operations. During fiscal year 2003, Corporate transferred the buildings to MMMC, but retained the loan payable in its accounting records. The note payable is collateralized by the buildings.
Long-term debt as of June 30, 2003 and 2002 consisted of the following:

Loan payable to Central Pacific Bank; $9,500,000; interest at 7.1% at June 30, 2003, thereafter, interest at weekly average of 5-year U.S. Treasury Securities rate plus 250 basis points; monthly principal and interest payments of $64,975; due December 1, 2027: $9,103,432 $9,243,754

Loan payable to Central Pacific Bank; $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: 237,000 256,859

Loan payable to Academic Capital; $1,690,900; interest at 6.3%; monthly principal and interest payments of $19,028; due November 4, 2012 1,608,131

Note payable to United States Department of Agriculture (USDA); $1,250,000; interest at 4.75%; monthly principal and interest payments of $6,188; due June 24, 2034 1,188,111 1,217,480

Note payable to USDA; $1,000,000; interest at 4.75%; monthly principal and interest payments of $8,170; due August 13, 2014 835,104 898,795

Term loan agreement payable to bank (WKCCDC); $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; paid December 17, 2002 375,000

Total 12,971,778 11,991,888

Less current portion 377,333 568,423

Noncurrent portion $12,594,445 $11,423,465

Transactions in long-term debt during the years ended June 30, 2003 and 2002 were as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Beginning of Year</th>
<th>Additions</th>
<th>Reductions</th>
<th>End of Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>Long-term debt</td>
<td>$11,991,888</td>
<td>$1,690,900</td>
<td>$(711,010)</td>
</tr>
<tr>
<td>2002</td>
<td>Long-term debt</td>
<td>$12,515,064</td>
<td>$ -</td>
<td>$(523,176)</td>
</tr>
</tbody>
</table>
Maturities of long-term debt are as follows:

<table>
<thead>
<tr>
<th>Year ending June 30</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>$377,333</td>
</tr>
<tr>
<td>2005</td>
<td>444,247</td>
</tr>
<tr>
<td>2006</td>
<td>474,797</td>
</tr>
<tr>
<td>2007</td>
<td>567,271</td>
</tr>
<tr>
<td>2008</td>
<td>436,800</td>
</tr>
<tr>
<td>Thereafter</td>
<td>10,711,330</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$12,971,778</strong></td>
</tr>
</tbody>
</table>

8. **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 $10,782,000 (excluding Clinical Laboratories of Hawaii Joint Venture fees of $11,884,000 as disclosed in Note 11) and $16,619,000 during fiscal years 2003 and 2002, 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 the use of the premises, supplies and laundry. These amounts are included in other operating revenues and aggregated approximately $871,000 and $790,000 during fiscal years 2003 and 2002, respectively. In addition, HHSC charges the contractors for the use of clinical personnel employed in the facilities. These amounts are netted against salaries and benefits expense and totaled $946,000 and $910,000 during fiscal years 2003 and 2002, respectively.

9. **EMPLOYER 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.

In July 2001, the State notified HHSC that the amounts overpaid by HHSC during the fiscal years ended June 30, 2000 would be applied toward HHSC's required contribution to the ERS in fiscal year 2002. Accordingly, the $6,206,461 of prepaid pension costs at June 30, 2001 was charged to salaries and benefits expense during the year ended June 30, 2002. HHSC's contribution to the ERS for the year ended June 30, 2003 was $11,431,000, equal to the required contribution.

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 Employees' 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.

For employees first employed prior to June 30, 1996, 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.

For employees first employed after June 30, 1996, HHSC pays for 100% of these benefits for employees who have at least 25 years of service. HHSC's share of the cost of these benefits is pro-rated for employees with between 10 and 25 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 $9,715,000 and $10,216,000 for the years ended June 30, 2003 and 2002, respectively.

Sick Leave

Accumulated sick leave as of June 30, 2003 and 2002 was approximately $39,107,000 and $36,244,000, respectively. For employees first employed on or before July 1, 2001, sick leave accumulates at the rate of 14 hours for each month of service, as defined, without limit. For employees first employed on or after July 1, 2001, sick leave accumulates at the rate of 10 hours for each month of service until the completion of ten years of work, and at the rate of 14 hours for each month of service thereafter. 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 consolidated financial statements.
10. COMMITMENTS AND CONTINGENCIES

Professional Liability

HHSC maintains professional and general liability insurance with a private insurance carrier with a $20 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 accrued a liability of $18,500,000 for unpaid claims as of June 30, 2003 and 2002.

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, 2003, the outcome of the lawsuit had not been finalized.

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. During fiscal year 2003, the Legislature of the State appropriated $16 million (to be funded by State general obligation bonds) for the construction of a 200-bed State Veteran's Home on the site of the old hospital building. The remaining construction costs of the State Veteran's Home will be funded by the Department of Veterans Affairs State Home Construction Program. The total construction costs include the demolition of the old hospital building and remediation of the asbestos contamination. In July 2003, management performed a feasibility study and determined that a 95-bed facility with the capacity for expansion would better serve the State. Management is performing an engineering analysis to obtain a better estimate of the total construction costs of the Veteran's Home. As the amount of any asbestos remediation is still uncertain, a liability for the cost of the remediation has not been recorded in HHSC's financial statements.
11. CLINICAL LABORATORIES OF HAWAII JOINT VENTURE

On May 1, 2002, HHSC entered into a Partnership Agreement with Clinical Laboratories of Hawaii, Inc., St. Francis Healthcare Enterprises, Inc., and Kapiolani Service Corporation to form Clinical Laboratories of Hawaii, LLP ("Partnership"). The primary purpose of the Partnership is to provide clinical laboratory services within the State of Hawaii. On June 1, 2002, HHSC contributed the use of the laboratory space and related ancillary services in seven of its facilities (Hilo Medical Center, Kona Community Hospital, Maui Memorial Medical Center, Hale Ho'ola Hamakua, Ka'u Hospital, Kohala Hospital, and Kula Hospital) in exchange for a minority equity interest in the Partnership. Ordinary distributions from the Partnership are to be made at least annually from the Partnership's "Available Cash" (as defined in the Partnership Agreement). There were no partnership distributions made to HHSC during fiscal year 2003.

HHSC's investment in the Partnership and related contribution of laboratory space and ancillary services are being recorded over the life of the Partnership Agreement. The contributed space and services recognized in fiscal year 2003 amount to $709,000, and the investment balance as of June 30, 2003 was $768,000.

In addition, HHSC charges the Partnership for the use of clinical personnel employed in the facilities, and certain routine tests referred to a facility's laboratory by the Partnership. Amounts billed to the Partnership totaled $1,770,000 during fiscal year 2003. Amounts due from the Partnership for such charges aggregated $1,610,000 as of June 30, 2003.

HHSC contracts with the Partnership to provide clinical laboratory and pathology services at its facilities. Amounts charged by the Partnership aggregated approximately $11,414,000 during fiscal year 2003. Amounts due to the Partnership aggregated $7,244,000 as of June 30, 2003.

Kauai Veterans Memorial Hospital (KVMH) and Samuel Mahelona Memorial Hospital contract with the Partnership to provide various services, but did not contribute the use of laboratory space and ancillary services to the Partnership. Amounts charged by the Partnership were approximately $470,000 during fiscal year 2003. Amounts due to the Partnership for such charges were $10,000 as of June 30, 2003. In addition, the Partnership contracts with KVMH to perform certain routine tests referred to the KVMH laboratory by the Partnership. Amounts billed to the Partnership were $104,000 during fiscal year 2003. Amounts due from the Partnership for such charges were $30,000 as of June 30, 2003.

* * * * * *
<table>
<thead>
<tr>
<th>Appropriation Symbol</th>
<th>Amount</th>
</tr>
</thead>
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<td>$485</td>
</tr>
<tr>
<td>S-93-312-H</td>
<td>544</td>
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<td>S-95-396-H</td>
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<td>S-96-359-H</td>
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<td>S-03-358-H</td>
<td>11,304</td>
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<td>S-03-359-H</td>
<td>21,718</td>
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<td>S-03-365-H</td>
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<td>18,625</td>
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<td>S-03-373-H</td>
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</table>

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<thead>
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<td>T-03-914-H</td>
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<td>T-03-918-H</td>
<td>1,272</td>
</tr>
<tr>
<td>T-03-921-H</td>
<td>6,679</td>
</tr>
</tbody>
</table>

**TOTAL PER STATE** 8,194,247
### HAWAI HEALTH SYSTEMS CORPORATION

**SUPPLEMENTAL SCHEDULE OF RECONCILIATION OF CASH ON DEPOSIT**  
WITH THE STATE OF HAWAII (Continued)  
**JUNE 30, 2003**

<table>
<thead>
<tr>
<th>Appropriation Symbol</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>RECONCILING ITEMS:</strong></td>
<td></td>
</tr>
<tr>
<td>Outstanding checks</td>
<td>$ 469</td>
</tr>
<tr>
<td>Reconciling items</td>
<td>(1,277)</td>
</tr>
<tr>
<td>Other</td>
<td>(34,801)</td>
</tr>
<tr>
<td></td>
<td>(35,609)</td>
</tr>
<tr>
<td><strong>TOTAL PER HHSC</strong></td>
<td>$ 8,158,638</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>ASSETS LIMITED AS TO USE:</strong></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>PATIENT TRUST FUNDS:</strong></td>
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<td>T-02-926-H</td>
<td>$ 18</td>
</tr>
<tr>
<td>T-03-911-H</td>
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<tr>
<td>T-03-926-H</td>
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<td><strong>TOTAL PER STATE</strong></td>
<td>157,062</td>
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<tr>
<td><strong>RECONCILING ITEMS:</strong></td>
<td></td>
</tr>
<tr>
<td>Patients' safekeeping deposits held by financial institutions</td>
<td>242,850</td>
</tr>
<tr>
<td>Restricted accounts receivable</td>
<td>100,000</td>
</tr>
<tr>
<td>Restricted net assets held by financial institutions</td>
<td>2,017,369</td>
</tr>
<tr>
<td><strong>TOTAL PER HHSC</strong></td>
<td>$ 2,517,281</td>
</tr>
</tbody>
</table>
### RECLASSIFICATIONS AND ELLIMINATIONS

<table>
<thead>
<tr>
<th>Hawaii Health Systems Foundation</th>
<th>Consoli-dated</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reclassifi-cations and Eliminat-ions</td>
<td>$8,752,900</td>
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<tr>
<td>Hawaii Health Systems Commu-nity and Eliminat-ions</td>
<td>$50,179,200</td>
</tr>
<tr>
<td>HHSIC</td>
<td>$6,213,552</td>
</tr>
<tr>
<td>$120,177,545</td>
<td>$15,818,838</td>
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</table>

### TOTAL ASSETS

<table>
<thead>
<tr>
<th>Hilo Medical Center</th>
<th>Hilo Community Hospital</th>
<th>Kona Medical Center</th>
<th>Kona Hospital</th>
<th>Kea'au Medical Center</th>
<th>Kea'au Hospital</th>
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<th>Lihue Medical Center</th>
<th>Lihue Hospital</th>
<th>Total Facilities</th>
<th>Corporate</th>
</tr>
</thead>
<tbody>
<tr>
<td>$15,982</td>
<td>$58,638</td>
<td>$154,149</td>
<td>$22,194</td>
<td>$89,825</td>
<td>$24,299</td>
<td>$14,677</td>
<td>$17,895</td>
<td>$8,489</td>
<td>$11,264</td>
<td>$409,877</td>
<td>$7,552,781</td>
<td>$8,752,900</td>
</tr>
<tr>
<td>On deposit with banks and on hand</td>
<td>$30,000</td>
<td>$23,714</td>
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<td>$1,533</td>
<td>(2,733)</td>
<td>55,104</td>
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<td>91,561</td>
<td>449,237</td>
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### FACILITIES

<table>
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<tr>
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<th>Kea'au Medical Center</th>
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</thead>
<tbody>
<tr>
<td>$12,462,993</td>
<td>$5,779,519</td>
<td>$21,359,948</td>
<td>$376,600</td>
<td>$1,894,277</td>
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<td>$376,600</td>
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<td>Supplies and other current assets</td>
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<td>$1,799,079</td>
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### TOTAL CURRENT ASSETS

<table>
<thead>
<tr>
<th>Hilo Medical Center</th>
<th>Hilo Community Hospital</th>
<th>Kona Medical Center</th>
<th>Kona Hospital</th>
<th>Kea'au Medical Center</th>
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<tr>
<td>$15,982</td>
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<td>$11,264</td>
<td>$409,877</td>
<td>$7,552,781</td>
<td>$8,752,900</td>
</tr>
</tbody>
</table>

### DUE FROM AFFILIATES - Net

<table>
<thead>
<tr>
<th>Hilo Medical Center</th>
<th>Hilo Community Hospital</th>
<th>Kona Medical Center</th>
<th>Kona Hospital</th>
<th>Kea'au Medical Center</th>
<th>Kea'au Hospital</th>
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<tr>
<td>$43,618,771</td>
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### CAPITAL ASSETS - Net

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<th>Hilo Community Hospital</th>
<th>Kona Medical Center</th>
<th>Kona Hospital</th>
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<th>Kea'au Hospital</th>
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<th>Lihue Medical Center</th>
<th>Lihue Hospital</th>
<th>Total Facilities</th>
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</tr>
</thead>
<tbody>
<tr>
<td>$41,810</td>
<td>$55,259</td>
<td>$200,000</td>
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<td>$32,394</td>
<td>$27,082</td>
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<td>$111,819</td>
<td>$62,592</td>
<td>$2,817,281</td>
<td>$2,817,281</td>
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### ASSETS LIMITED AS TO USE

<table>
<thead>
<tr>
<th>Hilo Medical Center</th>
<th>Hilo Community Hospital</th>
<th>Kona Medical Center</th>
<th>Kona Hospital</th>
<th>Kea'au Medical Center</th>
<th>Kea'au Hospital</th>
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<th>Lihue Medical Center</th>
<th>Lihue Hospital</th>
<th>Total Facilities</th>
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<tbody>
<tr>
<td>$292,914</td>
<td>$12,509</td>
<td>$200,000</td>
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### TOTAL

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<tr>
<th>Hilo Medical Center</th>
<th>Hilo Community Hospital</th>
<th>Kona Medical Center</th>
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<th>Lihue Medical Center</th>
<th>Lihue Hospital</th>
<th>Total Facilities</th>
<th>Corporate</th>
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<tbody>
<tr>
<td>$20,358,615</td>
<td>$37,213,932</td>
<td>$83,195,418</td>
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<td>$241,231,982</td>
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- 31 -
## HAWAII HEALTH SYSTEMS CORPORATION

### SUPPLEMENTAL COMBINED AND CONSOLIDATING STATEMENT OF NET ASSETS INFORMATION (Continued)

**JUNE 30, 2023**

<table>
<thead>
<tr>
<th>LIABILITIES AND NET ASSETS</th>
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<td>Mauna Kea Memorial Hospital</td>
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<td>Kahuku Hospital</td>
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<td>Kahuku Memorial Hospital</td>
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<td>Lili'uokalani Hospital</td>
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<td>Malamalama Hospital</td>
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<td>Total Facilities</td>
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<td>Total Corporate</td>
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<tr>
<td>Total Reconsolidated</td>
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</tr>
</tbody>
</table>

**CURRENT LIABILITIES:***

- Accounts payable and accrued expenses $11,335,626
- Accrued workers' compensation liability 5,431,474
- Advance from the State of Hawaii 16,000
- Current portion of capital lease obligations 358,255
- Current portion of accrued vacation 310,149
- Current portion of long term debt 216,377
- Other current liabilities 53,083

**Total current liabilities**

$18,415,857

**CAPITAL LEASE OBLIGATIONS - Long current portion**

421,077

**LONG-TERM DEBT - Long current portion**

11,012,170

**ACCRUED VACATION - Long current portion**

4,611,606

**DUE TO AFFILIATES - Net**

20,700,091

**DUE TO THE STATE OF HAWAII**

7,605,205

**PATIENTS' SAVINGS DEPOSITS**

47,810

**TOTAL LIABILITIES**

55,344,912

**NET ASSETS**

27,996,995

**TOTAL**

56,341,907

---

*Note: The table continues on the next page.*
## Operating Revenues:

<table>
<thead>
<tr>
<th>Service Type</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total patient service revenues</td>
<td>$7,330,584.43</td>
</tr>
<tr>
<td>Other operating revenues</td>
<td>$1,834,522.45</td>
</tr>
<tr>
<td>Total operating revenues</td>
<td>$9,165,106.88</td>
</tr>
</tbody>
</table>

## Operating Expenses:

<table>
<thead>
<tr>
<th>Expense Type</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total expenses</td>
<td>$8,637,603.83</td>
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</table>

## Income (Loss) from Operations:

<table>
<thead>
<tr>
<th>Income (Loss)</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total income</td>
<td>$6,333,933.98</td>
</tr>
</tbody>
</table>

## Nonoperating Revenues and Expenses:

<table>
<thead>
<tr>
<th>Revenue Source</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total nonoperating revenues</td>
<td>$2,333,933.98</td>
</tr>
</tbody>
</table>

## Income Before Capital Contributions:

<table>
<thead>
<tr>
<th>Income Before Capital Contributions</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total income before capital</td>
<td>$2,333,933.98</td>
</tr>
</tbody>
</table>

## Capital Assets Contributed by State of Hawaii:

<table>
<thead>
<tr>
<th>Capital Assets</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total capital</td>
<td>$2,333,933.98</td>
</tr>
</tbody>
</table>

## Increase (Decrease) in Net Assets:

<table>
<thead>
<tr>
<th>Increase (Decrease)</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total increase</td>
<td>$2,333,933.98</td>
</tr>
</tbody>
</table>
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 consolidated financial statements of Hawaii Health Systems Corporation (HHSC)
as of and for the years ended June 30, 2003 and 2002, and have issued our report thereon dated
November 14, 2003. We conducted our audit in accordance with auditing standards generally accepted
in the United States of America and the standards applicable to financial audits contained in
Government Auditing Standards, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether HHSC's consolidated 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 consolidated financial statement amounts. However, providing an opinion on
compliance with those provisions was not an objective of our audit and accordingly, we do not express
such an opinion. The results of our tests disclosed no instances of noncompliance that are required to
be reported under Government Auditing Standards.

Internal Control over Financial Reporting

In planning and performing our audit, we considered HHSC's internal control over financial reporting
in order to determine our auditing procedures for the purpose of expressing our opinion on the
consolidated financial statements and not to provide assurance on the internal control over financial
reporting. However, we noted a 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 consolidated
financial statements. The reportable condition is described in a separate letter to management of
HHSC dated November 14, 2003 and is summarized as follows:

- Billing of accounts receivable was 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 consolidated 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 conditions described above are material weaknesses.

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 14, 2003
Hawaii Health Systems Corporation, HHSC
Informational Budget Briefing on
Requests for Biennium Budget 2003-2005

Presented Before
Senate Ways & Means Committee
9:00 AM January 8, 2004
Hawaii State Capitol, Room # 211

EXECUTIVE SUMMARY
Program ID. and Title: HTH 210 – Community Hospitals

The Fiscal Year 2005 supplemental requests supported by the Administration for the Hawaii Health Systems Corporation (HHSC) consist of:

- Request in General Fund Appropriation of $31,220,000
- Increase in Special Fund Ceiling of $42,200,000 to bring the ceiling up to $302,837,937
- Capital Improvement Projects (G.O. Bonds) of $6,000,000

HHSC, through its twelve community hospitals, constitutes the primary acute and long-term care / rural health care “Safety Net” system on the Neighbor Islands. On Oahu, HHSC is the substantial provider of long-term care. Even as a safety net healthcare system, HHSC has the highest standards of quality care. All twelve HHSC hospitals are fully accredited by state and/or national institutions whose charter is to evaluate and certify the delivery of quality healthcare.

Since its establishment, HHSC has made significant improvements in the operations of the system formerly operated under the Division of Community Hospitals within DOH. HHSC manages and operates, for the State of Hawaii, the largest community hospital system in the State, and the 4th largest public health system in the nation. As one of the largest employers in the State with over 3,400 full time employees, HHSC is the single largest provider of emergency services in the State. In most Neighbor Island rural and remote communities, HHSC provides the only source of hospital level care acute and long term care services. HHSC’s twelve Community Hospitals are organized into five regions located on five different islands. Thus, HHSC is a statewide community hospital system caring for Hawaii’s communities from one end of the State to the other.

In FY 2003, HHSC achieved total cash collections of over $277 million, a 12 percent increase over the $247 million collected in FY 2002, and a 36 percent increase over the
$203 million collected in FY 1999. These increases can be attributed to HHSC facilities earning greater operating revenues than ever before and continued improvement in billing and collections processes.

However, for the year ended June 30, 2003, HHSC's operating expenses still exceeded its operating revenues by approximately $45 million. Operating expenses in fiscal year 2003 were approximately 12 percent higher than fiscal year 2002. The increase was mainly in the categories of salaries and benefits expense, purchased services and professional fees, and the provision for doubtful accounts (bad debt). Salaries and benefits expense increased 11.4 percent from fiscal year 2002, due primarily to an increase in the fringe benefit rate charged to all State agencies from 21.19 percent to 32.22 percent, and collective bargaining pay raises for HHSC's union employees.

The increase in the fringe benefit rate was due primarily to an increase in the required contribution to the Employee Retirement System (ERS) from 0 to 8.87 percent. The impact of the unanticipated, unbudgeted increases in the contributions to the ERS, Retiree Health Insurance, and Employee Health Fund was an additional $14 million in expenses for HHSC in fiscal year 2003. This $14 million increase in ERS and Health Fund costs in FY 03 is anticipated to grow to approximately $20 million in FY 04. Further HHSC's union employees received pay raises from the collective bargaining agreements with the State of Hawaii, ranging from 2 to 5 percent in FY 03. These pay raises represented an additional $6.2 million in salaries and benefits expense over fiscal year 2002 expenses.

Despite its tremendously improved collections, HHSC's operating expenses continue to exceed operating revenues. This difference is due primarily to:

- The failure of government-type payors (Medicaid, Medicare, and Quest) to keep up with the increasing cost of healthcare providers. In fiscal year 2002, the losses from government payors amounted to $46 million, an increase of $11 million from the previous year. The increase is primarily due to an increase in patient's covered by the government-type payors and reimbursement amounts not keeping up with increasing costs. The $46 million loss is comprised of $34 million in providing acute and outpatient services and $12 million in long-term care services.

- HHSC also provides a huge amount of care to indigent and uninsured patients. In fiscal year 2003, HHSC's bad debt/charity care increased to $16,736,879 compared to $12,265,438 in fiscal year 2002.

- An insufficient supply of long-term care beds, particularly on the neighbor islands. At Hilo Medical Center and Maui Memorial Medical Center, for example, many patients initially admitted as acute patients continue to occupy acute care beds while awaiting long-term care beds to become available. These patients are called "wait-list" patients, for whom HHSC receives little to no reimbursements because insurers will not reimburse providers for patients whose required level of care does not coincide with the type of bed being occupied. Depending upon how cost and lost
$203 million collected in FY 1999. These increases can be attributed to HHSC facilities earning greater operating revenues than ever before and continued improvement in billing and collections processes.

However, for the year ended June 30, 2003, HHSC’s operating expenses still exceeded its operating revenues by approximately $45 million. Operating expenses in fiscal year 2003 were approximately 12 percent higher than fiscal year 2002. The increase was mainly in the categories of salaries and benefits expense, purchased services and professional fees, and the provision for doubtful accounts (bad debt). Salaries and benefits expense increased 11.4 percent from fiscal year 2002, due primarily to an increase in the fringe benefit rate charged to all State agencies from 21.19 percent to 32.22 percent, and collective bargaining pay raises for HHSC’s union employees.

The increase in the fringe benefit rate was due primarily to an increase in the required contribution to the Employee Retirement System (ERS) from 0 to 8.87 percent. The impact of the unanticipated, unbudgeted increases in the contributions to the ERS, Retiree Health Insurance, and Employee Health Fund was an additional $14 million in expenses for HHSC in fiscal year 2003. This $14 million increase in ERS and Health Fund costs in FY 03 is anticipated to grow to approximately $20 million in FY 04. Further HHSC’s union employees received pay raises from the collective bargaining agreements with the State of Hawaii, ranging from 2 to 5 percent in FY 03. These pay raises represented an additional $6.2 million in salaries and benefits expense over fiscal year 2002 expenses.

Despite its tremendously improved collections, HHSC’s operating expenses continue to exceed operating revenues. This difference is due primarily to:

- The failure of government-type payors (Medicaid, Medicare, and Quest) to keep up with the increasing cost of healthcare providers. In fiscal year 2002, the losses from government payors amounted to $46 million, an increase of $11 million from the previous year. The increase is primarily due to an increase in patient’s covered by the government-type payors and reimbursement amounts not keeping up with increasing costs. The $46 million loss is comprised of $34 million in providing acute and outpatient services and $12 million in long-term care services.

- HHSC also provides a huge amount of care to indigent and uninsured patients. In fiscal year 2003, HHSC’s bad debt/charity care increased to $16,736,879 compared to $12,265,438 in fiscal year 2002.

- An insufficient supply of long-term care beds, particularly on the neighbor islands. At Hilo Medical Center and Maui Memorial Medical Center, for example, many patients initially admitted as acute patients continue to occupy acute care beds while awaiting long-term care beds to become available. These patients are called “wait-list” patients, for whom HHSC receives little to no reimbursements because insurers will not reimburse providers for patients whose required level of care does not coincide with the type of bed being occupied. Depending upon how cost and lost
revenues are calculated, these wait-list patients cost HHSC between $5 million to $30 million per year.

- As an agency of the State, HHSC incurs major costs associated with the civil service system; collective bargaining increases; and Employee Retirement System (ERS). These are considerable costs of doing business as a State agency.

- HHSC is the only public hospital system in the USA not eligible for consideration for Medicaid Disproportionate Share Hospital (DSH) payments. Although Tennessee hospitals are not eligible for Medicaid DSH either, they are eligible for DSH type payments by TENNCARE (Tennessee’s Medicaid waiver program). This absence of Medicaid DSH eligibility is a key reason why HHSC must seek additional operational funding support from the Legislature. When the State of Hawaii implemented the Med-QUEST (QUEST) program in 1994, the DSH program payments to hospitals were eliminated from the State of Hawaii’s Medicaid program. DSH payments are additional reimbursements that attempt to account for additional costs incurred by providers who serve a significantly disproportionate number of low-income patients and/or significant number of Medicaid patients. HHSC’s patient mix is such that it would have qualified for large Medicaid DSH payments had the State of Hawaii not eliminated such payments. Such additional reimbursements would have tremendously reduced the amount of State subsidies needed to finance the operation of HHSC facilities.

- HHSC’s malpractice insurer for the past fifteen years recently pulled out of the malpractice market. Huge increases in insurance premiums resulting in considerable additional expense may force HHSC to initiate legislation to set up a “captive” insurance company. No matter what HHSC does, malpractice insurance in the future will be much more expensive than in the past. In the long run, the “captive” will cost less and provide much more flexibility for both HHSC and other State agencies.

A recent study by Ernst & Young, commissioned by the Healthcare Association of Hawaii, documented that the dramatic financial losses of healthcare systems in Hawaii, including HHSC, are the result of the efforts of government programs to constrain payments from programs such as Medicare, Medicaid, and Quest. Over one-half of HHSC’s services are provided to beneficiaries of government programs. These losses are expected to increase as Medicare and Medicaid reimbursements continue to be constrained.

For the fiscal years 1998 through 2002, HHSC’s operating losses after appropriation have fluctuated between a loss of $18.5 million to $29.9 million for fiscal year 2002. For this same period, the operating results for other hospitals in Hawaii has plummeted from a net operating profit of $46.5 million in fiscal year 1998 to a loss of $27 million in fiscal year 2001 and an even greater loss of $60 million in fiscal year 2002. HHSC is fortunate to have been able to maintain relative stability in financial results, considering the statewide trends in the hospital industry; however, the additional requirement to reimburse the ERS

Executive Summary
2004 Budget Testimony of the Hawaii Health Systems Corporation
Page 3
for approximately $14 million in FY 03 drove HHSC losses to approximately $45 million before appropriation (after appropriation, the HHSC loss for FY 03 is approximately $10 million).

HHSC Compared to Hawaii Hospitals*
Operating Income/(Loss)

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</thead>
<tbody>
<tr>
<td>HHSC Operating Income (Loss)</td>
<td>(18,526,063)</td>
<td>(28,027,357)</td>
<td>(19,423,391)</td>
<td>(25,935,447)</td>
<td>(29,883,322)</td>
</tr>
<tr>
<td>Hawaii Hospitals Operating Income (Loss)*</td>
<td>46,526,063</td>
<td>39,027,357</td>
<td>11,423,391</td>
<td>(27,064,553)</td>
<td>(60,116,678)</td>
</tr>
</tbody>
</table>

*Note: HHSC’s operating totals have been subtracted from the study by Ernst and Young
Source: Healthcare Association of Hawaii: Financial Impact on Hawaii’s Hospitals and Nursing Facilities as compiled by Ernst & Young, LLP – November 2003

The budget requests supported by the Administration for the Hawaii Health Systems Corporation will enable us to address the revenue shortfall of the Corporation for the next fiscal year. HHSC will continue to make improvements in its operational efficiency and financial performance. However, until such time as either the decline in government reimbursements is reversed, and/or HHSC is afforded major autonomy, the Corporation’s expenses will continue to exceed its ability to generate sufficient revenues. Your commitment in funding our requests of $31,220,000 in general funds, a special fund ceiling increase of $42,200,000 and $6,000,000 in capital improvement projects is greatly appreciated.

Executive Summary
2004 Budget Testimony of the Hawaii Health Systems Corporation
Page 4
Hawaii Health Systems Corporation, HHSC
Informational Budget Briefing on
Requests for Biennium Budget 2003-2005

Presented to the
Senate Ways & Means Committee
9:00 AM January 8, 2004
Hawaii State Capitol, Room # 211

Program I.D., and Title: HTH 210 – Community Hospitals

I. Introduction:

A. Summary of Corporation Objectives. To maintain and enhance the levels of service and quality of care for the communities we serve in the most effective and cost-efficient fashion thus providing better health for the people of Hawaii, with emphasis on support for our rural acute and rural Long Term Care (LTC) facilities.

Hawaii Health Systems Corporation (HHSC) facilities include: Hilo Medical Center, Hale Ho’ola Hamakua, and Ka’u Hospital (East Hawaii Region); Kona Community Hospital and Kohala Hospital (West Hawaii Region); Maui Memorial Medical Center, Lanai Community Hospital and Kula Hospital (Maui Region); Leahi Hospital and Maluhia (Oahu Region); Kauai Veterans Memorial Hospital and Samuel Mahelona Memorial Hospital (Kauai Region).

B. Description of Corporation Objectives.

Corporation. The major activities carried out by the HHSC President/CEO and staff include strategic direction, policy formulation, hospital system operation, business development, quality assurance, corporate compliance, planning and coordination, financial management, legal counsel, public affairs, personnel management, materials management, information systems operation and technical services support for regions and their respective community hospitals, as well as interaction with the State administrative government agencies, the Hawaii Legislature, Hawaii’s Congressional Delegation, community advisors, labor leaders, employees, medical staff and all other key stakeholders.

Regions and Facilities. HHSC manages and operates, for the State of Hawaii, the largest community hospital system in the State, and the 4th largest public health system in the nation. HHSC’s twelve Community Hospitals are organized into five regions, and those 12 facilities are located on five different islands. The major activities and services provided by the five regions and twelve community facilities constitute the primary hospital acute, long term care and rural health care on the Neighbor Islands.
Essentially, HHSC provides the "safety-net" for acute and long term care services on the neighbor islands. Collectively, HHSC hospitals are the largest provider of emergency services in the State, even surpassing the annual number of ER visits logged by Queen's Medical Center. Collectively, HHSC hospitals are the single largest provider of long-term care (LTC) services in the State. HHSC is also the substantial provider of long term care on Oahu. In this regard, HHSC essentially also serves as the LTC "safety net" for the State of Hawaii. Inpatient services include surgical, medical, critical care, obstetrics, pediatrics, and psychiatric care. Outpatient care services include ambulatory surgery, home health, and emergency room services. Clinical services include nursing, anesthesiology, central supply, radiology, oncology, pathology, respiratory therapy, physical and occupational therapy, social services, pharmacy, and dietary. Support services include administration, admitting, business, personnel, data processing, medical records, logistics, housekeeping, and maintenance.

Identification of important program relationships. 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, and many hundreds of thousands of dollars to our nine hospital foundations.

HHSC has also benefited greatly by the five statutorily created, regional Public Health Facility Management Advisory Committees (MACs) that give valuable input to the President and CEO on the needs of the communities in monthly meetings. The MACs also are very active and involved in the daily operations of our HHSC facilities. The chairs of the MACs sit on the Executive MAC, which meets monthly with the President and CEO, as well as playing a vital role in policy decisions at the facility and regional level. The Executive MAC Chair serves as a member of the HHSC Board of Directors.

The Physicians Advisory Group (PAG) constitutes a group of physicians throughout the islands who volunteer their time and talents to come together on a monthly basis with the President and CEO to discuss the clinical and medical staff issues facing our hospitals. The PAG represents the 850 HHSC physician staff members who are essential to operations and success of HHSC. The continuing guidance and support of the MACs, Executive MAC and the PAG are tremendously important to both the successful functioning of the system and establishment of strategic direction for the system.

HHSC management has worked to obtain donations and grants to both enhance services provided and to offset the cost of operating our system under the provisions of State civil service collective bargaining in predominately rural areas. In this regard, HHSC has promoted the development of foundations at out hospitals and incorporated the Hawaii Health Systems Foundation (HHSF) as a wholly owned subsidiary 501(c)(3). The HHSF is working in coordination with eight other foundations associated with HHSC facilities to maximize donations and grants for the system and for respective facilities. Five years ago, there were three foundations supporting HHSC facilities of which only two were active. Today there are nine separate foundations and multiple hospital auxiliaries supporting one or more HHSC hospitals.
Finally, a wholly owned subsidiary 501(c)(3) (not-for-profit) corporation, Ali’i Community care was created in order to develop, lease and operate assisted living facilities. The ground breaking for the first facility, Roselani Place, with 114 beds in 98 units, took place on Maui on October 24, 2000, and the facility was dedicated on November 22, 2002. Although the facility cost $15.5M, there was no CIP cost to the State of Hawaii because the entire project was entrepreneurially structured with a “turn-key” developer, long term lease and is operated under a separate management contract. This action furthers the goal of HHSC to provide a full continuum of care for our communities.

C. Explain how your Program intends to meet its objectives within the current year.

HHSC will meet FY 04 and FY 05 program and budget objectives by collecting patient revenues to meet approximately 90 percent of expense requirements resulting in minimized general fund requirements. Also see:

b. Exhibit B: Tri-fold Document; HHSC Cost Savings & Enhanced Revenues
II. Program Performance Results:

Several HHSC accomplishments for this period are listed in Exhibit B.

A. Performance Results Achieved:


The following statistics are a sampling of the services provided by our facilities over the past two years.

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</tr>
</thead>
<tbody>
<tr>
<td>Hilo Medical Center</td>
<td>7,116</td>
<td>7,055</td>
<td>81,301</td>
<td>82,217</td>
<td>1,016</td>
<td>1,017</td>
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<td>17</td>
<td>32</td>
<td>6,040</td>
<td>6,088</td>
<td>63</td>
<td>63</td>
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<tr>
<td>Kauai Veterans Memorial Hospital</td>
<td>638</td>
<td>682</td>
<td>9,742</td>
<td>9,158</td>
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<td>63</td>
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<td>3,665</td>
<td>3,537</td>
<td>25,425</td>
<td>26,171</td>
<td>483</td>
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<tr>
<td>Kula Hospital</td>
<td>106</td>
<td>211</td>
<td>40,237</td>
<td>38,849</td>
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<tr>
<td>Lanai Community Hospital</td>
<td>52</td>
<td>49</td>
<td>3,710</td>
<td>3,651</td>
<td></td>
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<td>Leahi Hospital</td>
<td>142</td>
<td>116</td>
<td>64,335</td>
<td>65,061</td>
<td></td>
<td></td>
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<tr>
<td>Maui Memorial Medical Center</td>
<td>225</td>
<td>227</td>
<td>56,080</td>
<td>56,612</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Samuel Mahelona Memorial Hospital</td>
<td>10,450</td>
<td>10,791</td>
<td>56,846</td>
<td>58,500</td>
<td>1,552</td>
<td>1,663</td>
</tr>
<tr>
<td>Total</td>
<td>22,965</td>
<td>23,010</td>
<td>391,921</td>
<td>396,909</td>
<td>3,114</td>
<td>3,206</td>
</tr>
</tbody>
</table>


a. Introduction. Financial management efforts continue to be focused on improving fiscal performance of the Corporation and individual facilities and integrating financial management with the operational and quality goals. The integrity of accounting and financial management processes continues to be enhanced.


(1) Because HHSC facilities provided greater access to care than ever before, earned greater operating revenues than ever before and continued to improve processes for billing and collections, HHSC achieved total cash collections for FY 2003 of over $277 million, a twelve percent increase over FY 2002, and a 36% increase over FY99.

For the year ended June 30, 2003, HHSC's operating expenses exceeded its operating revenues by approximately $45 million. The collective
bargaining pay raise appropriation from the State of Hawaii of approximately $12.4 million, general fund appropriations from the State of Hawaii of $13.3 million, other non-operating revenues of approximately $3.1 million, and capital assets contributed by the State of Hawaii of approximately $6.2 million reduced the decrease in net assets to approximately $10 million.

(2) Operating expenses in fiscal 2003 were approximately 12% higher than fiscal 2002. The increase was mainly in the categories of salaries and benefits expense, purchased services and professional fees, and the provision for doubtful accounts. Salaries and benefits expense increased 11.4% from fiscal year 2002, due primarily to an increase in the fringe benefit rate charged to all State agencies from 21.19% to 32.22%, and collective bargaining pay raises for HHSC’s union employees.

The increase in the fringe benefit rate was due primarily to an increase in the required contribution to the Employee Retirement System (ERS) from 0 to 8.87%. The impact of the unanticipated, unbudgeted increases in the contributions to the ERS, Retiree Health Insurance, and Employee Health Fund was an additional $14 million to HHSC in fiscal year 2003. This $14 million increase in ERS and Health Fund costs in FY03 is anticipated to increase to approximately $20 million in FY04.

Further, HHSC’s union employees received pay raises from the unions’ collective bargaining agreements with the State of Hawaii, ranging from 2-5%. These pay raises represented an additional $6.2 million in salaries and benefits expense over fiscal year 2002 expenses. Purchased services and professional fees increased 14.3% from fiscal year 2002, primarily due to increased use of registry nurses and clinical laboratory services at Maui Memorial Medical Center, driven by larger than expected patient volume throughout the year.

Provision for doubtful accounts at Maui Memorial Medical Center increased $4.5 million from fiscal year 2002, primarily due to an increase of $5.4 million in provision for doubtful accounts. While the facility’s business office was fairly successful in keeping up with billing and collecting the fiscal year 2003 patient accounts, it was unable to maintain its collection efforts on fiscal year 2002 accounts. As a result, the facility’s accounts receivable aged substantially in fiscal year 2003. The facility’s accounts receivable that were zero to 60 days old decreased 13% from June 30, 2002 to June 30, 2003; while the accounts receivable aged 151 days and older increased 12% from June 30, 2002 to June 30, 2003. A substantially higher provision for doubtful accounts was necessary to account for the diminished likelihood of collection on the older accounts receivable.
(3) For all 12 HHSC facilities, operating revenues increased by approximately 7.9%, as a result of increases in patient days of 1.3%, a rate increase effective July 1, 2002 of 5%, and continued revenue enhancements as a result of HHSC's imaging initiatives which began in fiscal year 2002. The increase in revenues primarily came in the areas of major surgery, emergency room, imaging (including MRI, diagnostic radiology services, and CT Scan), clinical laboratory testing, and drugs sold to patients. The primary increase in operating revenues occurred at Maui Memorial Medical Center, primarily due to an increase in emergency room visits of 5.3%, an increase in newborn patient days of 4.7%, and an increase in acute patient days of 2.3%.

(4) The excess of operating expenses over operating revenues in fiscal year 2003, and cumulative net losses, are due to several factors.

(a) First, HHSC's payor mix is made up of predominantly government-type payors. For fiscal year 2003, almost 60% of HHSC's total gross revenues were from government-type payors. In fact, Medicare, Medicaid, and Med-Quest account for over 85% of HHSC's revenues for its long-term care facilities. Reimbursements from government-type payors has not kept up with the increasing costs of healthcare providers since the Balanced Budget Act of 1997 was passed, which dramatically reduced the level of reimbursements from government-type payors.

(b) Second, HHSC's facilities on the neighbor islands suffer from an insufficient supply of long-term care beds. As noted above, HHSC's beds in its long-term care facilities are virtually fully occupied, and there are few other freestanding long-term care facilities on the neighbor islands. As a result, HHSC's acute care facilities, especially Hilo Medical Center and Maui Memorial Medical Center, have numerous patients initially admitted as acute patients, but who continue to occupy acute care beds while awaiting long-term care beds to become available. Such patients are called "wait-list" patients. HHSC receives little to no reimbursement from insurers for such patients, as insurers will not reimburse providers for patients whose required level of care does not coincide with the type of bed the patient is occupying. Both Hilo Medical Center and Maui Memorial Medical Center each have an average census of approximately 20-40 wait-list patients per day. Management expects the wait-list problem to worsen as Hawai'i's population continues to age and a Statewide shortage of

Long Term Care alternatives continues. Not only are these wait-list patients placed in the wrong level of care, but they are costing HHSC millions of dollars per year from both lost revenues and unreimbursed expenses.
(c) Third, HHSC is bound by the collective bargaining agreements negotiated by the State of Hawaii and the public employee unions (Hawaii Government Employees Association and United Public Workers). The collective bargaining agreements not only bind HHSC to the negotiated pay raises, but also to the union work regulations and benefit packages. Management believes that such arrangements do not allow HHSC to manage its resources as effectively as other health-care systems who negotiate directly with their union counterparts.

(d) Fourth, HHSC inherited aging facilities upon the formation of the Corporation in 1996. These aging facilities required substantial improvements and maintenance before they could be brought up to par with other health care facilities in the State of Hawaii. While the State of Hawaii has provided annual funding for capital improvement projects, that funding has been primarily used to correct life-safety code concerns.

Funding for medical equipment, application systems, and routine repair and maintenance is funded from HHSC's operational cash flow. Given HHSC's payor mix and cost burdens, HHSC's operational cash flows are inadequate to fully fund the capital acquisitions that are necessary to keep up with the advances in health care technology that allow hospitals to improve the quality of care for their patients.

(e) Finally, although HHSC considers itself as the State's Community Hospital System, HHSC is essentially the State's "safety-net" provider of neighbor island acute and long term health care for the State of Hawaii. HHSC is the sole source of these health care services for several isolated neighbor island communities (e.g., Ka'u, Kohala, Lanai, etc.). Further, Maui Memorial Medical Center is the primary acute care facility on the island of Maui, and Hilo Medical Center and Kona Community Hospital are the only acute care facilities with more than 50 acute beds on the island of Hawaii. In addition, Leahi Hospital functions as the primary tuberculosis hospital for the State of Hawaii as well as a preeminent long term care facility on Oahu. Also, HHSC's long-term care facilities provide the primary source of long-term care services for elderly people who cannot afford private care or nursing homes and do not have family that can care for them.

Given all of the above, management states that HHSC has an irreplaceable and critically vital role in ensuring that the people of the State of Hawaii have adequate and appropriate access to quality acute and long term health care services, 24 hours a day, seven days a week (24-7).
Management believes that there are two Medicaid reimbursement issues that will have a significant negative impact on the financial performance of HHSC: the implementation of Act 294 and the lack of Medicaid Disproportionate Share Hospital (DSH) provider reimbursements in the State of Hawaii.

(a) **ACT 294 Medicaid Equity Reimbursement:** Act 294 was passed by the State Legislature in 1998, and requires that no later than June 30, 2003, there be no distinction in reimbursement provisions between hospital-based and non-hospital based long-term care facilities under the Medicaid program. Prior to the passage of Act 294, hospital-based long-term care facilities received a higher reimbursement than freestanding long-term care facilities under the Medicaid program, primarily due to the recognition that hospital-based long-term care facilities are subject to the compliance with EMTALA (Emergency Medical Treatment and Labor Act) requirements, which requires hospitals to accept all patients who come through an emergency room, regardless of the patient’s ability to pay.

Freestanding long-term care facilities are not subject to EMTALA requirements. Compliance with EMTALA requirements imposes additional costs on hospital-based long-term care facilities, primarily in staffing requirements and in bad debt expense. Six HHSC facilities will be tremendously negatively impacted by the implementation of Act 294, while one facility (Maluhia) would be positively impacted.

Understanding the dramatic impact that implementation of Act 294 will have on HHSC, the Department of Human Services has facilitated a phased implementation of Act 294 over six years. However, management estimates that even with a phased implementation, the cost to HHSC will be approximately $38 million over the six-year phase-in period, unless some significant financial offsets are identified. Once Act 294 is fully implemented, management estimates that the cost to HHSC will be approximately $13 million per year.

Med-Quest Division has submitted a Medicaid State Plan Amendment to the Center for Medicare and Medicaid Services to be effective July 1, 2003, to seek additional federal dollars to provide relief for healthcare providers negatively impacted by Act 294. If approved, this should minimize the negative impact of Act 294 to HHSC; however, additional State support may still be required after implementation unless other cost offset and or further autonomy is authorized for HHSC.

(b) **Medicaid Disproportionate Share Hospital (DSH) Provider:** When the State of Hawaii implemented the Med-QUEST (QUEST) program
in 1994, the Disproportionate Share Hospital (DSH) program payments to hospitals were eliminated from the State of Hawaii’s Medicaid program. DSH payments are additional reimbursements that attempt to account for additional costs incurred by providers who serve a significantly disproportionate number of low-income patients and/or significant number of Medicaid patients. HHSC’s patient mix is such that it would have qualified for Medicaid DSH payments had the State of Hawaii not eliminated such payments. Such additional reimbursements would have reduced the amount of State subsidies needed to finance the operations of HHSC.

To illustrate the importance of Medicaid DSH payments to public hospital systems, the National Association of Public Hospitals’ report on “America’s Safety Net Hospitals and Health Systems, 2001” states that in 2001, “Medicaid DSH once again proved to be a critical funding source, financing 25 percent of unreimbursed costs.” In effect HHSC is the only public hospital system in the USA not eligible for Medicaid DSH payments.

Only the States of Hawaii and Tennessee do not make Medicaid payments to hospitals. Working with the federal government, the State of Tennessee has implemented a program of supplemental hospital payments to compensate for the absence of DSH payments.

The 2003 Legislature passed a resolution requesting the State Department of Human Services to work with Hawaii’s congressional delegation to aggressively advocate for the restoration of DSH payments from the Centers for Medicare and Medicaid Services to compensate Hawaii hospitals for care provided to the uninsured.

c. **Accomplishments.** HHSC has achieved continuing improvements in financial performance over the past five years and continuing improvements in the integrity and meaning of financial information. These accomplishments have enabled the Corporation to maintain a high level of credibility with the business and financial communities. In this regard HHSC was listed in the December 2002 issue of Hawaii Business Magazine, as the 21st largest business in Hawaii.

(1) **Integrity of Accounting Process.** The HHSC financial team and executive leadership have continued to demonstrate excellence in management of their accounting processes.

Fiscal Year 2003 Audit: For the sixth consecutive year, HHSC received an Unqualified “Clean” Audit from external auditors, Deloitte & Touche, LLP, who conducted audits of all twelve HHSC facilities, the corporate office, and the overall system. This is a significant accomplishment, in that for years prior to 1998, the individual audits of the numerous community hospitals were
characterized by findings of numerous material weaknesses and qualifications in the audits. External business partners and the financial community (bankers and potential investors) do not look favorably on an organization for which external auditors must qualify their opinions because of significant accounting or financial discrepancies. So, these financial audits have been an important aid to achieving HHSC’s acceptance into the Hawaii Business Community as a full partner. Audit Results by year are summarized below.

Chronological History of External Financial Audit Results Pertaining to Hawaii Health Systems Corporation

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Number of Audit Firms</th>
<th>Was Opinion Unqualified?</th>
<th>Were Material Weaknesses Reported?</th>
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</thead>
<tbody>
<tr>
<td>FY 97</td>
<td>8</td>
<td>NO</td>
<td>YES</td>
</tr>
<tr>
<td>FY 98</td>
<td>1</td>
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<tr>
<td>FY 02</td>
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</tr>
<tr>
<td>FY 03</td>
<td>1</td>
<td>YES</td>
<td>NO</td>
</tr>
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</table>

(2) Continuing Improvement in Fiscal Performance. The Corporation has been able to increase revenues significantly over the past four years while constraining increases in non-payroll costs in order to partially offset the impact of collective bargaining raises to the maximum extent possible.

- As documented in the recent study by Ernst & Young commissioned by the Healthcare Association of Hawaii, the efforts of the government programs over the past several years to constrain payments to healthcare providers for services rendered to Medicare and Medicaid beneficiaries,
- Including the State of Hawaii's Med-Quest program beneficiaries, have caused dramatic financial losses for healthcare systems, including HHSC. The harm to HHSC has been profound because HHSC is the safety net healthcare system for communities where over one-half of services we provided were to beneficiaries of government programs. As indicated in the bar chart below HHSC lost approximately $46 million in Fiscal Year 2002 by participating in these government programs. These losses are $11 million more in Fiscal Year 2002 than in Fiscal Year 2001, and are forecast to worsen as Medicare and Medicaid reimbursements continue to be constrained. The increase in Medicaid losses are from increased patients covered by the Medicaid program and reimbursement not keeping pace with the increases in costs.

"HHSC Subsidized Government Program $46M in FY 02"

- In addition to subsidy provided by HHSC to Government reimbursement programs, there is also substantial bad debt/charity care provided for the communities served by HHSC. Although a little of this bad debt/charity care can be attributed to Government payer programs, almost $17M in FY 03 is additive to the Government payer losses as indicated in the next chart.
"HEISC Has Provided $79 Million in Free Care From FY'98 - FY'03"
As depicted below, FY 2003 cash collections of $277 million were $74 million higher than FY 1999. FY 2003 collections exceeded the annual system-wide target of $269 million by eight million dollars.

Hawaii Health Systems Corporation
Cash Collected from FY99 thru FY03

HHSC Collected $277 Million in Fiscal Year 2003
Compared to $203 Million in Fiscal Year 1999
For the fiscal years 1998 through 2002, HHSC's operating losses have fluctuated between a loss of $18.5M to $29.9M for FY2002. For this same period, the operating results for other hospitals in Hawaii has plummeted from a net operating profit of $46.5M in 1998 to a loss of $27M in FY 2001 and an even greater loss of $60M in FY2002. HHSC is fortunate to have been able to maintain relative stability in financial results, considering the statewide trends in the hospital industry.

**HHSC Compared to Hawaii Hospitals* Operating Income/(Loss)**

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<tbody>
<tr>
<td>HHSC Operating Income (Loss)</td>
<td>(18,526,053)</td>
<td>(28,027,357)</td>
<td>(19,423,391)</td>
<td>(25,935,447)</td>
<td>(29,883,322)</td>
</tr>
<tr>
<td>Hawaii Hospitals Operating Income (Loss)*</td>
<td>46,526,053</td>
<td>39,027,357</td>
<td>11,423,391</td>
<td>(27,064,553)</td>
<td>(60,116,678)</td>
</tr>
</tbody>
</table>

*Note: HHSC's operating totals have been subtracted from the study by Ernst and Young Source: Healthcare Association of Hawaii: Financial Impact on Hawaii's Hospitals and Nursing Facilities as compiled by Ernst & Young, LLP – November 2003*

B. Explain how these results relate to the Program’s Objectives and Department’s mission. See entries in “A” above from pages 4 - 14.

C. Explain how the effectiveness of the Program is measured (i.e.: outcome, measures of effectiveness, benchmarks, etc.) and discuss the performance results achieved during the past two years. See entries in “A” above from pages 4 - 14.

D. Discuss actions taken by each Program to improve its performance results. HHSC has established system and individual accountability by organizing, within and across regions, setting objectives, and targeting resources to improve processes and outcomes and has introduced new systems to achieve noteworthy performance improvements in both finance and quality. (See Exhibit B for a list of accomplishments.) (Also See written individual testimonies supporting the HHSC biennium budget proposal and
delineating actions taken by HHSC to improve its performance results. Written individual testimony will be submitted to the WAM and Finance Committees prior to the 8 January 2004 Budget Information hearings. Individual testimonies will be submitted from members of the HHSC Governing Body, Regional CEO’s, Physician Medical Executive Staff from all 5 HHSC Regions, and from a former President of Hawaii Medical Association, HMA).

III. Problems and Issues:

A. Discussion of Problems and Issues Encountered.

1. Civil Service and Collective Bargaining Provisions. The most significant challenge facing HHSC continues to be labor costs resulting from the fact that HHSC must manage employees under the provisions of State civil service and the State collective bargaining agreements.

With the passage of Act 253, SLH 2000, HHSC became a public employer in 2002 along with the State, Judiciary, the Board of Regents (UH), the Board of Education (DOE), the City and County of Honolulu, and the Counties of Hawaii, Maui and Kauai. Although public employer status enabled HHSC to negotiate separate provisions within master collective bargaining agreements, it is exceptionally difficult to achieve substantive changes in compensation and benefits through this process. The ability to structure compensation and benefits that match HHSC’s ability to pay with terms attractive to workers is vitally important to HHSC’s ability to attract, recruit and retain qualified workers in an ever-tightening healthcare labor market.

The current collective bargaining process greatly inhibits efforts to appropriately structure the compensation and benefits packages for HHSC employees. A more feasible alternative would be a system that allows HHSC to negotiate directly with the exclusive representatives on separate collective bargaining agreements and alleviates HHSC of the requirements to operate under current collective bargaining constraints.

2. Cost of Mandated Services/Rural Healthcare. Due to the fact that HHSC facilities were part of the former DCH, the community hospitals traditionally provided many “free” or under-reimbursed services to the public. Elimination of these services would offer virtually no options for the poor, needy, and court directed cases. Additionally, other feasible options are not available for the rural communities that HHSC serves.

HHSC operates facilities in rural locations in order to meet the needs of those communities. The combined actual inpatient volume for HHSC’s rural or remote facilities is well below the volume necessary to financially break even or make positive net income. These facilities will continue to operate at unprofitable levels because the population in these rural or remote locations served is not large enough to generate patient revenue sufficient to cover the costs of these facilities.

-15-
Even if HHSC was able to capture 100 percent of the market share in each of these markets, the current population sizes of these communities would be unable to generate or sustain the patient volume necessary to break even based upon HHSC's current labor costs under civil service with State collective bargaining rules. Nonetheless, services provided by these rural facilities are both essential and vital for the communities served by HHSC. Also, these services are integrally linked to the economy of the respective rural areas served by providing sorely needed jobs and to the economy of Hawaii by providing a safety net for Hawaii’s number one revenue generating industry – tourism.

3. **Prior Liabilities Inherited by HHSC from the Former DCH.** In order to determine exactly what liabilities and assets were transferred to HHSC, the Corporation contracted with Price Waterhouse Coopers, LLP, in 1996 to perform a “due diligence study.” This study indicated liabilities of approximately $59 million were inherited by HHSC in 1996 when it was created. However, this study was marginally complete and since that time, HHSC management has identified additional liabilities that existed in 1996 and estimates that total liabilities passed to HHSC in November 1996 were approximately $150 million.

The most significant liabilities remaining are approximately $18 million in workers’ compensation liabilities, over $50 million in capital improvement requirements for deferred maintenance, life and safety deficiencies, and deficiencies for JCAHO accreditation and MEDICARE/MEDICAID certification. The lack of cash reserves for these significant liabilities requires HHSC to occasionally divert revenue from current operations to pay for these important liabilities of the State of Hawaii and an unknown sum that can be attributed to finalization of ceded lands issue.

The 2000 Legislature required HHSC, by budget proviso, to spend no less than $500,000 in FY 2001 on workers compensation but did not provide additional funds for this purpose. The shortage of working capital for these important, prior liabilities leaves management less able to pursue opportunities to improve the system, reduce operating costs, or respond to revenue opportunities. The 2001 Legislature recognized some of these needs and appropriated $6,934,000 million in FY 2002 and $5,577,000 million in FY 2003 for CIP to help offset life safety code concerns that remain in the system from years of neglect. Most of these FY 2002 and FY 2003 CIP projects have been completed, and are within budget and on schedule.

Lack of cash reserves or alternative funding for these issues forces further delay, resulting in higher eventual renovation and construction costs, suffering of higher operating costs by HHSC, and exposure of HHSC and the State to accreditation/certification complications and/or resulting loss of operational revenue. However, HHSC has embarked on a major energy conservation initiative that will cover over $20M of these costs without State CIP support and no liability / cost to HHSC.
4. **Flat/Decreasing Revenues.** A leveling of reimbursements from private third-party payors, as well as Medicare and Medicaid payment reductions resulting from implementation of the Balanced Budget Act of 1997, have tremendously hampered the ability of HHSC to increase revenues. In addition, the elimination of the previous Disproportionate Share Hospital (DSH) payment system and the inability of the MedQuest program to effectively pass DSH funds through the health plans to HHSC facilities has further reduced revenue for HHSC resulting in HHSC actually subsidizing the MedQuest Program, Medicare Program and Medicaid Program by providing “under-compensated” care with an average subsidy for all three programs (Quest, Medicare and Medicaid) of approximately $35 million in FY 01, increasing to $45 million in FY 2002.

5. **Increased Costs of Supplies, Equipment, and Infrastructure.** Increased costs in supplies, equipment, and infrastructure maintenance, which grow at a rate greater than the Consumer Price Index, have had a negative financial impact. This impact is being significantly diffused as HHSC continually re-negotiates system contracts at preferred prices.

6. **Reduction of Working Capital and Restrictions on the Use of the Land and Facilities.** The ability to utilize the broad powers provided by Act 262 to enter into partnerships with private industry and expand into more lucrative markets requires working capital and the ability to give leases to other entities. High losses and low funding by the State in the three FYs ‘95, ‘96, and ‘97, caused a reduction in working capital so that HHSC nearly ran out of cash in FY ‘98 and did run out of cash in FY ‘99, requiring a significant loan from the State that was eventually paid back by State General Fund Appropriation. The lack of cash reserves for prior liabilities will continue to hinder these efforts. Ceced land issues continue to hinder development of other services at three sites.

7. **External Healthcare Issues.** In addition to specific issues listed above, significant external healthcare trends having impact on HHSC include, but are not limited to:

   a. The evolution of managed care and the constant changes in the Federal and State Medicare and Medicaid/QUEST programs have resulted in low operating margins for healthcare organizations.

   b. Increasing competition in acute care and outpatient services in many service areas. Competition is heightened by limited reimbursement dollars, demand for qualified health care professionals, and the encroachment of national organizations into the State, including the Neighbor Islands.

   c. Health care costs are increasing in general, and particularly in rural areas, at a time when we are experiencing an increase in the reliance on high-cost technology and complex information systems.
d. The ever increasing need for enhanced automation and technology advancement places a continuous burden on HHSC to keep pace and maintain the latest capabilities where appropriate. Physicians and other healthcare providers are demanding electronic medical record (EMR) and computer-based physician order-entry (CPOE) capability to reduce medication errors and enhance patient safety.

e. Increased cost of insurance is a growing concern for malpractice coverage. HHSC’s insurer for the past fifteen years has recently pulled out of the malpractice market forcing HHSC to consider asking the Legislature for funding to start a “captive” insurance company. A bill will be introduced to this effect. Although the initial start up cost for a HHSC “captive” would be approximately $8 million, in the long run, the “captive” will cost less and provide much more flexibility for both HHSC and other State agencies.

A. Program Change Recommendations to Remedy Problems. The HHSC Board of Directors and management are committed to continuing the transformation of HHSC into a self-sustaining healthcare system that provides access to quality healthcare for our communities. In order to become the self-sustaining quality system that our communities deserve, HHSC must be afforded much more autonomy. If autonomy is not forthcoming, there will continue to be an ever increasing cost to the State to maintain the HHSC Community Hospital system.

Although HHSC will do it’s best to find further efficiencies, it will have to continue to submit requests for additional financial support from the Legislature. In that regard, HHSC continues to seek input from stakeholders and to explore alternatives for both incremental and significant restructure of our system. Some examples of alternatives under discussion include: Separate Collective Bargaining Units; Designation of Levels of Services Control to the HHSC Board of Directors; Employee Stock Option Plan ("ESOP") reorganization into a not-for-profit corporation; paid time off option for employees, increased pay / reduced benefits "pilot program" and further partnership affiliation with other systems.

IV. Expenditures for Fiscal Year 2003-2004

<table>
<thead>
<tr>
<th></th>
<th>Act 210/2003</th>
<th>Net Allocation</th>
<th>Est. Total Expenditures</th>
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<td>FY 2004 C/B</td>
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<td>(2836.25)</td>
<td>(2836.25)</td>
</tr>
<tr>
<td>Personal Svcs</td>
<td>194,013,000</td>
<td>2,309,638</td>
<td>195,322,638</td>
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<tr>
<td>Current Exp.</td>
<td>97,844,937</td>
<td>-</td>
<td>97,844,937</td>
</tr>
<tr>
<td>Equipment</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Motor Vehicles</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>TOTAL</td>
<td>291,857,937</td>
<td>2,309,638</td>
<td>294,167,575</td>
</tr>
</tbody>
</table>

<p>|                      | (2836.25)    | (2836.25)      | (2836.25)               |
| Special              | 260,637,937  | 260,637,937    | 297,629,000             |
| General              | 31,220,000   | 2,309,638      | 33,529,638              |</p>
<table>
<thead>
<tr>
<th>Other</th>
<th>291,857,937</th>
<th>2,309,638</th>
<th>294,167,575</th>
<th>335,531,000</th>
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</thead>
</table>

-19-
V. Supplemental Budget Requests for Fiscal Year 2004-2005:

<table>
<thead>
<tr>
<th></th>
<th>Act 210/2003 FY 2005</th>
<th>Supplemental Request</th>
<th>Est. Total Expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td>posn count</td>
<td>(2836.25)</td>
<td>(2836.25)</td>
<td></td>
</tr>
<tr>
<td>Personal Svcs</td>
<td>201,774,000</td>
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<td>Current Exp.</td>
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<td>73,420,000</td>
<td>132,283,937</td>
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<td>Equipment</td>
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<tr>
<td>Motor Vehicles</td>
<td>-</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>TOTAL</td>
<td>260,637,937</td>
<td>73,420,000</td>
<td>334,057,937</td>
</tr>
</tbody>
</table>

|                      | (2836.25)            | (2836.25)            |                         |
| Special              | 260,637,937          | 42,200,000           | 302,837,937             |
| General              | 31,220,000           | 31,220,000           |                         |
|                      | 260,637,937          | 73,420,000           | 334,057,937             |

Workload or Program Request:

For each Program package or item being requested with the Program I.D., provide the following:

A. A brief description of the request, the reasons for the request, and the desired outcomes or the objectives to be accomplished by the proposed program.

1. Increase in Special Fund Ceiling of $42,200,000

Reason for Request

The purpose of the special fund ceiling increase is to allow HHSC the ability to spend up to the projected FY 05 budget based on availability of funds.

The values of HHSC are Integrity, Collaboration, Caring, Commitment, Innovation and Community. With these values, HHSC’s mission is to provide and enhance accessible, comprehensive health care services that are quality-driven, customer-focused, and cost-effective. For HHSC to carry out these values and mission, HHSC special fund ceiling needs to increase to accommodate new and existing ventures.

A listing/description of positions requested, funding requirements by cost category and source of funding.

Other Current Expenses $42,200,000 B

2. Increase in General Fund Appropriation of $31,220,000
Reason for Request

At the closing of the 2003 Legislature, the Legislature did not appropriate general funds to HHSC in fiscal year 2005 operating budget. General funds are needed to supplement the revenues of HHSC and are essential to ensure continued provisions of healthcare to the communities we serve. This general fund appropriation is an essential part of the overall HHSC funding necessary to help the Corporation remain solvent by offsetting the cost of providing mandated services in rural areas and offsetting the additional cost of labor resulting from HHSC being required to participate in the State collective bargaining agreements.

General funds are needed to supplement the revenues of HHSC and are essential to ensure continued provisions of healthcare to the communities we serve. This general fund appropriation is an essential part of the overall HHSC funding necessary to help the Corporation remain solvent by offsetting the cost of providing mandated services in rural areas and offsetting the additional cost of labor resulting from HHSC being required to participate in State collective bargaining agreements.

The impact of this request on the public is that potential critical safety problem may arise for our patients and staff if every effort is not made to ensure that HHSC is solvent. These funds are necessary to ensure solvency and continue provision of healthcare services both as the “Neighbor Island Safety Net” and to provide care for other communities served by HHSC.

Even with implementation of cost reductions, the impact on HHSC is that we cannot fund the projected cash-flow shortfall from its special funds. If the State does not provide a general fund appropriation, HHSC will not be able to meet payroll and pay its vendors. For FY 03, HHSC met with the State and received a loan to pay for employer contributions of HHSC to the employees’ retirement system and the health fund.

HHSC has demonstrated tremendous savings by instituting cost reduction measures to partially defray increased costs in operation. However, Act 262, SLH 1996, continues to restrict many efforts and modifications to scope of services that could save many additional dollars.

A listing/description of positions requested, funding requirements by cost category and source of funding.

Other Current Expenses $31,220,000 A

VI. Program Restrictions
Identify restrictions carried over from FY 2003-2004 as well as additional reductions due to Department of Budget and Finance ceilings for FY 2004-2005. If no reduction is being proposed, indicate “none”.

None.
VII. Capital Improvement Requests for Fiscal Year 2004-2005

1. HILO MEDICAL CENTER, EMERGENCY ROOM RENOVATION, HAWAII

PLANS, DESIGN, CONSTRUCTION, AND EQUIPMENT TO RENOVATE THE EXISTING EMERGENCY ROOM FOR EXPANSION

| Plans     | 192 C |
| Design    | 385 C |
| Construction | 2509 C |
| Equipment | 1 C   |

Explanation and Scope of Project

The scope of the Emergency Department renovations shall increase security, privacy, improve patient traffic flow patterns, reduce noise in patient rooms, provide for the upgrade of rooms, as well as the redesign of the nursing station and physician/staff work areas to improve overall efficiency. The renovation shall also include the build-out of additional emergency room bays to service the Hawaii Island community. It will also provide for the expansion of the patient waiting area.

Justification for the Project

Hilo Medical Center has the third busiest Emergency Department in the State of Hawaii and is currently working in a 7,000± square foot space with a total of 14 trauma rooms. Most of those trauma rooms are filled to capacity during peak periods. By expanding the Emergency Department, it is Hilo Medical Center’s intent to better serve its community while increasing the Department’s efficiency with regard to patient care.

| Senate District | 01 | House District | 02 |

2. LEAHI HOSPITAL, BUILDING REPAIR — ROOF REPLACEMENT, FIRE ESCAPE, ETC., OAHU

DESIGN AND CONSTRUCTION TO REPLACE THE SINCLAIR ROOF AND REPAIR THE ATHERTON FIRE ESCAPE STAIRWELL

| Design    | 92 C |
| Construction | 361 C |

Explanation and Scope of Project

The scope of the project is to prepare design and specifications for the construction of the Sinclair roof replacement and the repair of the Atherton fire escape stairwell.
Justification for the Project

The roof is badly damaged and is leaking in several areas. The stairwells have been exposed to the elements and have become corroded and rusty.

Senate District    10    House District    19

3.   KULA HOSPITAL, FIRE SPRINKLER SYSTEM, MAUI

DESIGN AND CONSTRUCTION FOR A FIRE SPRINKLER SYSTEM AT KULA HOSPITAL

Design    43 C
Construction    390 C

Explanation and Scope of Project

The scope of the project includes plumbing, fire lines, booster pumps, installation, monitors, ties to the emergency power, ties to alarms and life safety systems, interiors, ceilings, and testing.

Justification for the Project

The current fire protection system does not have enough capacity to serve this expanding facility and it does not meet the fire and life safety codes.

Senate District    06    House District    11

4.   KULA HOSPITAL, CORRECTION OF ADA DEFICIENCIES, MAUI

DESIGN AND CONSTRUCTION TO CORRECT ADA DEFICIENCIES TO INCLUDE RAMPS, BATHROOMS, ACCESS, RAILS, SIGNAGE, STAIRS, ETC.

Design    16 C
Construction    264 C

Explanation and Scope of Project

The scope of the project includes additions, repairs, ramps, bathroom modifications, signage, lighting, call/signal systems, and access and egress issues.

Justification for the Project

This project will renovate the facility to meet current needs per ADA and life safety related codes.
5. LEAHI HOSPITAL, LIFE SAFETY AND ADA RENOVATIONS, RAMPS, ACCESS, ETC., OAHU

DESIGN AND CONSTRUCTION TO BRING LEAHI HOSPITAL UP TO CODE ON LIFE SAFETY AND ADA REQUIREMENT

Design 41 C
Construction 468 C

Explanation and Scope of Project

The scope of the project includes signage, wall penetrations, smoke and fire dampers, egress issues, access issues, doors, alarms/call/signal/security systems, interiors, lighting, electrical, AC (including supply and exhaust and equipment), medical gases, plumbing, ceiling work, railings, ramps, bathrooms and fixtures.

Justification for the Project

Life safety and ADA compliance will assure visitors and patients a safe environment and proper ease of access. New codes and NFPA requirements dictate that the existing life safety and ADA compliance levels require improvements.

Senate District 10 House District 19

6. MALUHIA, KITCHEN EQUIPMENT, UPGRADE PLUMBING, ELECTRICAL, ETC., OAHU

PLANS, DESIGN, CONSTRUCTION, AND EQUIPMENT TO INSTALL NEW KITCHEN APPLIANCES TO REDUCE THE RISK OF INFECTIN THROUGH FOOD SERVICES/PROCESSING

Plans 3 C
Design 9 C
Construction 50 C
Equipment 75 C

Explanation and Scope of Project

The scope of the project will include the purchase and installation of equipment and appliances, plumbing, electrical, flooring replacement, signage, lighting, AC supply and exhaust, fire protection and interior repairs.

Justification for the Project
Some of the industrial kitchen appliances are nearing their life expectancy and require replacement. Existing equipment is starting to be inefficient, leaking, not heating to capacity, etc.; thereby, creating possible health risks. Some items that need to be replace includes, stoves, boiler pots, refrigerators, broilers, hoods, plumbing and the exhaust system requires updating.

Senate District 14 House District 27

7. SAMUEL MAHELONA MEMORIAL HOSPITAL, RENOVATE BATHROOMS IN LONG-TERM CARE, KAUAI

DESIGN AND CONSTRUCTION TO REMODEL AND UPDATE THE BATHROOMS IN THE LONG TERM CARE AREA

Design 23 C Construction 315 C

Explanation and Scope of Project

To design, remove, and renovate the bathrooms that are located in the long-term care area of the facility. Specifics of the scope of work are as follows, not limited to the following: 1. Removal of existing walls, ceilings, dividers, windows, flooring, plumbing fixtures, drains, vents, electrical fixtures, and etc. 2. Installation of new equipment, walls, plumbing, electrical, and other apparatus. Renovation to conform to life safety codes, uniform building codes, ADA requirements, and any other Federal or State agencies that have jurisdiction.

Justification for the Project

Existing bathrooms are old and in need of updating both for convenience and for functional application and quality care. Samuel Mahelona Memorial Hospital is approximately 52 years old. The bathrooms in the long-term care area are the originals since they were never upgraded. The tile floor is discolored, cracked, and slippery. Walls are cracked and need to be repaired by maintenance on a continual basis. Piping in the walls is deteriorating and needs to be repaired by maintenance due to age. Drains are consistently getting blocked and therefore, maintenance has to unblock them. All of these problems present itself to safety issues for the staff, patients and family members. Also, ADA compliance in the bathrooms is at a minimum or not at all.

Senate District 07 House District 13

8. LEAHI HOSPITAL, ELECTRICAL SYSTEM, NEW TRANSFORMERS, SWITCHES, ETC., OAHU

PLANS, DESIGN, AND CONSTRUCTION TO ADD AND UPDATE ELECTRICAL INFRASTRUCTURE
Plans  
Design  
Construction  

Explanation and Scope of Project

The scope work will include new transformer(s), conduit, switch-gear, testing, updating of system plans, signage, panels, circuit work, AC, space remodeling to accommodate changes, and structural anchorage.

Justification for the Project

Existing power sources and equipment are inadequate for the amount of level of care occupants that the facility currently has. At this time, the hospital is new maximum capacity on its existing electrical system and the risk of fire and power outages is rising. Electrical capacity demand grows at approximately two to three percent per year and this system has not been modified for over 20 years and approaching a disastrously high level of demand that can and eventually will result in a negative situation.

Senate District 10
House District 19

VIII. Proposed Lapses of Capital Improvement Program Projects:

HHSC is proposing to lapse $6,000,000 from the Construction phase from Act 200, SLH 2003, Item E-4 of the Hilo Long-term Care Veterans Home. The project has been downsized from the original approved funding.

List of Exhibits


Exhibit B: Tri-fold Document; HHSC Cost Savings & Enhanced Revenues

List of Attachments

Attachment 1: Totals for Proposed Department Budget Adjustments (by Method of Funding)
Attachment 2: Fiscal Year 04 Proposed Budget Adjustments
Attachment 3: Fiscal Year 05 Proposed Budget Adjustments
Attachment 4: FY 05 Capital Improvements Program Summary
Attachment 5: Supplemental Request Decisions
"FULLY FUND the
HHSC COMMUNITY HOSPITAL SYSTEM
for QUALITY HOMETOWN HEALTHCARE"

Here is how HHSC fared in the "2003" Legislature:

<table>
<thead>
<tr>
<th></th>
<th>FY03 Requested</th>
<th>FY03 Authorized</th>
<th>FY04 Requested</th>
<th>FY04 Authorized</th>
<th>FY05 Requested</th>
<th>FY05 Authorized</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operations</td>
<td>$0</td>
<td>$0</td>
<td>$19M</td>
<td>$31.2M</td>
<td>$24M</td>
<td>$0</td>
</tr>
<tr>
<td>Employee Retirement</td>
<td>$14M</td>
<td>$0</td>
<td>$20M</td>
<td>$0</td>
<td>$20M</td>
<td>$0</td>
</tr>
<tr>
<td><strong>Legislature Authorized</strong></td>
<td><strong>$0</strong></td>
<td><strong>$0</strong></td>
<td><strong>$31.2M</strong></td>
<td><strong>$0</strong></td>
<td><strong>$0</strong></td>
<td><strong>$0</strong></td>
</tr>
</tbody>
</table>

*(Does not include FY03 Operations, CIP and Collective Bargaining support authorized by 2002 Legislature)
**(Does not include FY04 CIP and Collective Bargaining support authorized by 2003 Legislature)

1. Health should be a top priority for the State. Here's why:
   - On the Neighbor Islands, HHSC is the State's acute care Community Hospital System, and HHSC is the long term care safety-net for the State of Hawaii.
     - HHSC's rural hospitals are often the last and only source for acute, emergency and long-term hospital care
     - There is limited air ambulance service in most areas on the Neighbor Islands
   - Even as the Community Hospital System, HHSC has the highest standards of care and quality. All 12 hospitals are accredited or certified by national and/or State institutions.
2. Can you guess the amount the State is paying to provide “Community Hospital System” healthcare services to residents of our Neighbor Islands? You’ll be very surprised.

- Based on the amount of money the 2003 Legislature appropriated for HHSC in our FY04 budget request for our Neighbor Island facilities, the State is spending less than 25 cents per day for each Neighbor Island resident to have access to a full range of acute and long term care services that HHSC provides.

- Yes, that’s right, less than 25 cents per Neighbor Island resident per day for Neighbor Island healthcare services. HHSC generates all of the rest of the money needed to provide quality healthcare to citizens and visitors throughout the State. See paragraph # 5 & # 13 for more details on why the State should pay more (not less) for healthcare services on the neighbor islands.

3. Act 294 may make the deficit worse:

In an attempt to establish equity for reimbursements between hospital based LTC facilities and free-standing facilities, a law (ACT 294) was passed in FY98 and is being implemented in FY04. This law will reduce the amount of reimbursement that most HHSC hospitals receive from State Medicaid programs for long term care patients. Estimated impact on HHSC is $13 million loss per year once the program is fully implemented. This change in reimbursement is being phased in over six years with a cumulative cost to HHSC over that six-year period of $38 million. At this point, HHSC is still not able to fully comply with the implementation process unless there is some identified financial offset.

4. Doesn’t health insurance cover the costs of providing health care?

Unfortunately, NO. In fact, HHSC loses money on most of its patients:

- Medicare, Medicaid, and other government programs pay for over 60% of HHSC patients. The difference between what these programs pay and what they cost HHSC results in a loss to HHSC of nearly $35 million per year.

- HHSC also loses $12-14 million each year in charity and bad debt care (patients who are not able to pay their bills).

- There is a severe shortage of long term care beds, throughout Hawaii, especially on the Neighbor Islands. In HHSC, approximately 90 acute care beds per day are occupied by patients waiting for transfers to long term care. Sometimes, acute care beds are not available to those who need them. HHSC loses revenues at the rate of about $1,800 per day for each patient in an acute care bed waiting to move to a long-term care bed. For example, Maui Memorial Medical Center estimates it loses as much as $10 million or more in revenue annually from the shortage of long term care beds.

5. Why don’t other hospitals have the same problems?

Almost all hospitals in Hawaii are losing money because of low reimbursements by both private and government payors. HHSC gets hit harder because the ratio of uninsured and government program participants is higher on the Neighbor Islands, which is its primary service area. See below for the comparison by Island.

<table>
<thead>
<tr>
<th>Island</th>
<th>Not Making a Livable Wage (%)</th>
<th>No Health Insurance (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oahu</td>
<td>27.7%</td>
<td>7.0%</td>
</tr>
<tr>
<td>Big Island</td>
<td>42.0%</td>
<td>10.7%</td>
</tr>
<tr>
<td>Maui</td>
<td>33.2%</td>
<td>10.1%</td>
</tr>
<tr>
<td>Kauai</td>
<td>36.0%</td>
<td>15.1%</td>
</tr>
</tbody>
</table>
6. Would HHSC be better off privatized?

By turning HHSC over to a private operator, the State could avoid further financial responsibility, but would abandon its Constitutional responsibility for maintaining the State's important Community Hospital System, especially for the Neighbor Islands. Faced with hard economic times, a private operator could eliminate unprofitable services or facilities, leaving some communities without adequate healthcare services.

7. Should HHSC be run by the Department of Health (DOH)?

DOH struggled to run the hospital system until HHSC was created in 1996. Under DOH there were huge budget deficits, even though reimbursement rates were far more in line with costs than they are today. Over the past seven years, costs under HHSC are $150 million less than they were projected to be under DOH. HHSC has made big improvements in operations and quality (it now has national recognition). As a separate corporation using standard business practices, HHSC can respond more quickly, and more successfully, to community needs than a government agency. Because of the positive changes, community leaders have been vocal in their dedicated support of HHSC efforts and have strongly opposed proposals to dismantle the system or return it to DOH.

8. HHSC was saddled with $150 Million in debt and no "start-up" funds when it was created in 1996.

Legislation creating HHSC also passed along more than $150 million in debt, which included $18 million in unpaid worker compensation claims and over $30 million in "deferred" maintenance on the 12 hospitals. Although the maintenance was "deferred," much of it was necessary to meet mandatory fire & safety code requirements, as well as State and Federal standards required by JCAHO and Medicare / Medicaid certification.

9. Things may get worse before they get better.

The problems will get worse. The population of persons over 65 years will increase dramatically as baby boomers age, intensifying the demand for long term care and other care for age-related illness. To further compound the problem, over 85% of HHSC long-term care patients are under Medicare, Medicaid, or other government programs which are pegged at low reimbursement rates that fall well below what it costs to provide that necessary care.

10. Hawaii Health Systems Corporation is Comprised of these Hospitals:

- Hilo Medical Center
- Kohala Hospital
- Maui Memorial Medical Center
- Hilo Ho'ola Hamakua
- Kauai Veterans Memorial Hospital
- Kula Hospital
- Ka'u Hospital
- Samuel Mahelona Memorial Hospital
- Leahi Hospital
- Kona Community Hospital
- Lanai Community Hospital
- Maluhia

11. HHSC is the Largest health system in Hawaii

- 12 hospitals on 5 Islands; 4th largest public healthcare system in U.S.
- 3,400 full time employees
- 1,275 acute and long-term care beds
- Collectively, largest provider of emergency services in the State
- Single largest provider of long-term care (LTC) services in the State

12. HHSC is the Community Hospital System for Hawaii – the rural communities depend on HHSC to provide:

- Emergency Care
- Acute and Long-Term Care
- Care for TB patients
- Care for patients with severe psychiatric disorders
Mri and other imaging service
Cancer treatment, including chemotherapy and radiation
Angiography to diagnose heart conditions
Obstetric care to deliver a baby in rural areas

13. Rural populations have different health demands.

With Hawaii's numerous rural population, which are oftentimes located in remote areas, HHSC does not have the patient volume to financially support the staffing and services mandated by Federal and State requirements. Other factors in the Neighbor Island health picture also impact the amount of care required and high cost of care that HHSC must absorb. For example:

Costly Health Indicators:
Diabetes Prevalence (per 1,000)
Oahu 50
Big Island 63
Maui 59
Kauai 51

No Prenatal Care (%)
Oahu 13.5
Big Island 24.1
Maui 26.4
Kauai 25.2

Coronary Heart Disease (100,000 aa)
Oahu 118.4
Big Island 144.9
Maui 125.1
Kauai 138.8

Lung Cancer Deaths (per 100,000 aa)
Oahu 34.7
Big Island 43.6
Maui 29.1
Kauai 40.7

aa = age adjusted

Statistics above from: Toward a Healthy Hawaii 2010 published by Hawaii State Department of Health

14. Show your support. Here's how:

Please share information with community leaders, elected officials, the press, friends, neighbors, and co-workers about HHSC and how vital your HHSC hospital is to your community. Write letters to the editor, speak to your Lions or Rotary Clubs, conduct tours of the hospital, and strengthen both your auxiliaries and your foundations. Let people know that their community hospital needs their support, especially with the Legislature. Let people know that your community hospital is just like the fire department or police department — it is an essential element of the quality of life for your community.

This pamphlet updated as of December 10, 2003
Hawaii Health Systems Corporation
Cost Savings &
Enhanced Revenues

1. Overall savings to Hawaii of $150 million in past five years compared to FY97
2. NORESCO (Energy co-generation) savings of $23 million beginning in FY99
3. Laboratory contract re-negotiation with ClinLab - $5 million savings per year since FY97
4. Insurance re-negotiation - $1 million per year from FY97 – FY02
5. Workers Compensation claims per 100 employees consistently reduced from 21.5 in FY97 to less than 8 per year each year since then.
6. Achieved Critical Access Hospital (CAH) status for four HHSC hospitals and thereby enhanced HHSC revenue by $2.2 million per year starting in FY02
7. Increased HHSC revenues thru enhanced cash collections from $247 million in FY02 to $277 million in FY03. In the last 4 years, HHSC increased cash collections by $74 million from $203 million in FY99 to $277 million in FY03. The goal for FY04 has been set at $298 million.
8. Medical Supply consolidation savings of $4 million per year since FY97
9. Re-negotiation of third-party payer contracts - ($$ savings amount is proprietary information) since FY97.
10. 340B pharmaceutical program (federal discount program for safety-net patients) - $200,000 per year
11. Foundation expansion - from only 3 Foundations in FY97 to 10 Foundations in 2003 supporting HHSC facilities
12. Consolidate equipment maintenance support, savings of $500,000 per year since FY01
13. Reestablish hospital radiology services at four HHSC facilities = $2 million dollars in new revenue per year since FY02
14. Established Rural Development Fund Nurse Training and Development Program HHSC-wide with $1 million grant in FY03
15. Implement restructuring plans under Volunteer Separation Incentive Program (VSIP) in FY03 and FY04
FUNCTIONAL ACCOMPLISHMENTS

• HHSC System-Wide
  ► Achieved an Absolute Standard of Quality Care Across All 12 Facilities By Establishing a Quality System
  Managed by the HHSC Board of Directors
  ► Achieved System JCAHO Quality Accreditation for 4 hospitals & State / Federal accreditation for all 12 hospitals
  ► Automated Personnel System
  ► Consolidated Accounting Systems for Accounts Payable and General Ledger
  ► Energy Conservation through Co-Generation
  ► Established Customer Satisfaction Benchmarks and Training
  ► Established Four Critical Access Hospitals (CAH)
  ► Established Laboratory Joint Venture
  ► Established Material/Equipment Standardization Teams
  ► Established Patient Accounting Teams for Process Improvement and Standardization Across the Enterprise
  ► Established Infra-Structure for Supporting Over 100 Application Servers
  ► Established System for Enterprise-Wide Electronic Mail
  ► Established Two Subsidiary Corp: 1) Asst. Living Facility; 2) Sys. Foundation
  ► Established Joint Labor-Management Committee
  ► Established Veterans Administration Partnership
  ► Completed Fire/Safety Upgrade per NFPA 101
  ► Developed most Comprehensive & Functional Teleradiology Program in the State
  ► Video Teleconference
  ► Completed HIPPA Compliance
  ► Established Award Winning Healthy Workplace Program

• Maui Memorial Medical Center
  ► Magnetic Resonance Imaging Replacement
  ► New Computerized Tomography Scanner
  ► New Monitoring Systems
  ► New Neurosurgery Service
  ► Started $38M Hospital refurbishment

• Lanai Community Hospital
  ► New Renal Dialysis Service
  ► Nurse Call System Replacement

• Kula Hospital
  ► Increased Admissions from 25/year to 185/year
  ► Increased Skilled Nursing Days from 800 patient days/year to 6,500+ patient days/year

• Hilo Medical Center
  ► New Angiography Suite
  ► New Nurse Call-System Replacement
  ► New Cancer Center Service with Linear Accelerator
  ► Opened Clinical Learning Center in Collaboration with UH-Hilo & Hawaii Community College
  ► Increased Long Term Care Capacity by 26 Beds
  ► Added Second Nuclear Medicine Camera
  ► New Lithotripter Service (shared with Kona and North Hawaii)
  ► Implementing KRONOS Time & Attendance
  ► Initiated Radiology Technologist School

• Ka‘u Hospital
  ► Attained Critical Access Hospital (CAH) Status in July 2000
  ► Increased LTC/acute Beds from 15-21 total beds
$190K Savings with Rural Health Clinic Implementation

- **Hale Ho'ola Hamakua**
  - Collaborate with UH for College level Nurse Aide Training

- **Kona Community Hospital**
  - Established Hospitalist Program
  - Increased Total Licensed Beds from 75 to 94
  - New Magnetic Resonance Imaging
  - New Behavioral Health Unit
  - New Chemotherapy Clinic
  - New Computerized Tomography Scanner
  - New Lithotripsy (HMC too)
  - New Nuclear Medicine Service
  - Added 4 New Labor & Delivery Beds

- **Kohala Hospital**
  - Implemented Teleradiology Service
  - Increased Licensed LTC Beds from 22 to 24
  - Completed Replacement of Facility Roof
  - Upgrade of Electrical System
  - Installation of Sprinkler System throughout Hospital
  - Expansion of Outpatient Rehabilitation Service
  - Established Hospital Foundation

- **Kauai Veterans Memorial Hospital**
  - Added New 24-Hour Ultrasound Service
  - Initiated Kauai Teleradiology Center
  - Established First Critical Access Hospital in Hawaii
  - Helped Facilitate Establishment of Kauai's First Federally-Qualified Health Center (via Collaborative Work with Hale Ho'ola and Hawaii Primary Care Association)
  - Established Two New Community Clinics

  - Expanded Outpatient Dialysis Service on West Kauai via Partnership with St. Francis Establishing Two Sites
  - Expanded Obstetrics Service

- **Samuel Mahelona Memorial Hospital**
  - Established Collaborative Relationship with State Adult Mental Health Program to Allow Admission of Forensic Patients to SMMH Psych Unit
  - Teleradiology Spoke

- **Maluhia**
  - Basement Expansion & Interior Improvements

- **Leahil Hospital**
  - Adult Day Care Health Service Expansion
  - Developed IV Therapy Program
A. Totals for Proposed Department Budget Adjustments (by Method of Funding)

<table>
<thead>
<tr>
<th>MOF</th>
<th>FY 04 Act 200/03 Appropriation (a)</th>
<th>FY 04 Emergency Request (c)</th>
<th>FY 04 Allocation (a) + (b) + (c)</th>
<th>FY 05 Act 200/03 Appropriation (d)</th>
<th>FY 05 Restriction (e)</th>
<th>FY 05 Addition (f)</th>
<th>Total (d) + (e) + (f)</th>
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<tr>
<td>B</td>
<td>260,637,937</td>
<td>260,637,937</td>
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<td>31,220,000</td>
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Totals by MOF:

<table>
<thead>
<tr>
<th>MOF</th>
<th>FY 04 Act 200/03 Appropriation (a)</th>
<th>FY 04 Emergency Request (c)</th>
<th>Total (a) + (b) + (c)</th>
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<td>291,857,937</td>
<td>260,637,937 + 31,220,000</td>
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<td>260,637,937 + 31,220,000</td>
<td>73,420,000</td>
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Attachment 2

B. Fiscal Year 04 Proposed Budget Adjustments

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<tr>
<th>Program ID</th>
<th>MOF</th>
<th>Program Title</th>
<th>FTE</th>
<th>$ Amount</th>
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<tbody>
<tr>
<td>HTH 210</td>
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<td>Hawaii Health Systems Corporation</td>
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<td>$14,000,000</td>
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<td></td>
<td></td>
<td>-emergency appropriation</td>
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Dept. Totals by MOF

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<th>Program Title</th>
<th>FTE</th>
<th>$ Amount</th>
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<tr>
<td>HTH 210</td>
<td>A</td>
<td>Hawaii Health Systems Corporation</td>
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<td>$14,000,000</td>
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Attachment 3
Summary Information
C. Fiscal Year 05 Proposed Budget Adjustments

<table>
<thead>
<tr>
<th>MOF</th>
<th>Title of Addition/Reduction</th>
<th>FTE</th>
<th>$ Amount</th>
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<tr>
<td>A</td>
<td>Continuing Funding in FY 05 - CB and operating</td>
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<td>$31,220,000</td>
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<tr>
<td>B</td>
<td>Increase in Special Fund Ceiling</td>
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<td>$42,200,000</td>
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<tr>
<td></td>
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<td>$73,420,000</td>
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Attachment 4
D. FY 05 Capital Improvements Program Summary

<table>
<thead>
<tr>
<th>Priority</th>
<th>Project Title</th>
<th>Additional FY 05 Funding</th>
<th>MOF</th>
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<tbody>
<tr>
<td>1</td>
<td>Hilo Medical Center - Emergency Room Renovation, expansion, new ramp</td>
<td>3,087,000</td>
<td>C</td>
</tr>
<tr>
<td>2</td>
<td>Leahi Hospital - Building Repair, roof replacement, fire escape repair, etc.</td>
<td>453,000</td>
<td>C</td>
</tr>
<tr>
<td>3</td>
<td>Kula Hospital - Fire Sprinkler System</td>
<td>433,000</td>
<td>C</td>
</tr>
<tr>
<td>4</td>
<td>Kula Hospital - ADA Renovations, ramps, bathroom modifications, etc.</td>
<td>280,000</td>
<td>C</td>
</tr>
<tr>
<td>5</td>
<td>Leahi Hospital - Life Safety and ADA Renovations, ramps, access, egress</td>
<td>509,000</td>
<td>C</td>
</tr>
<tr>
<td>6</td>
<td>Maluhia - New Kitchen Equipment, upgrade plumbing, electrical, etc.</td>
<td>137,000</td>
<td>C</td>
</tr>
<tr>
<td>7</td>
<td>SMMH - Renovate Bathrooms, total upgrade of title walls, plumbing, etc.</td>
<td>338,000</td>
<td>C</td>
</tr>
<tr>
<td>8</td>
<td>Leahi Hospital - Upgrade Electrical System, new transformers, switches, etc.</td>
<td>763,000</td>
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</table>

Attachment 5
E. Supplemental Request Decisions

<table>
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<tr>
<th>Departmental Priority</th>
<th>Program ID</th>
<th>Description</th>
<th>MOF</th>
<th>Department Temp. Perm. FTE</th>
<th>FTE</th>
<th>Amount</th>
<th>Governor's Final Decision Perm. FTE</th>
<th>FTE</th>
<th>Amount</th>
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</thead>
<tbody>
<tr>
<td>1</td>
<td>HTH 210</td>
<td>Continuing funding in FY 05 for HHSC that includes collective bargaining and operating general fund subsidy</td>
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<td></td>
<td>46,220,000</td>
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</tr>
<tr>
<td>2</td>
<td>HTH 210</td>
<td>Increase in Special Fund Ceiling</td>
<td>B</td>
<td></td>
<td></td>
<td>42,200,000</td>
<td>42,200,000</td>
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