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

"Touching Lives Everyday"

February 15, 2005

COO/CFO-04-005

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 support that we submit the Annual Report of the Hawaii Health Systems Corporation (HHSC) to you 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 seventh consecutive "clean" unqualified audit with no material weaknesses for FY 2004, FY 2003, FY 2002, FY 2001, FY 2000, FY 1999 and FY 1998. The FY 2004 and FY 2003 comparative Audit Report is enclosed in accordance with H.R.S. Section 323F-22 (Attachment 1).

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 nearly 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 (Attachment 2).

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 (Attachment 3). Our Physicians Advisory Group (PAG) has also submitted an optional Annual Report (Attachment 4). 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 HHSC Successes and a listing of HHSC Cost Savings and Enhanced Revenues (Attachments 5 & 6).

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 $1,198,334.00 in checks to six HHSC facilities for our excellent results from participating in the HMSA Quality and Service Recognition Program (Attachment 7).

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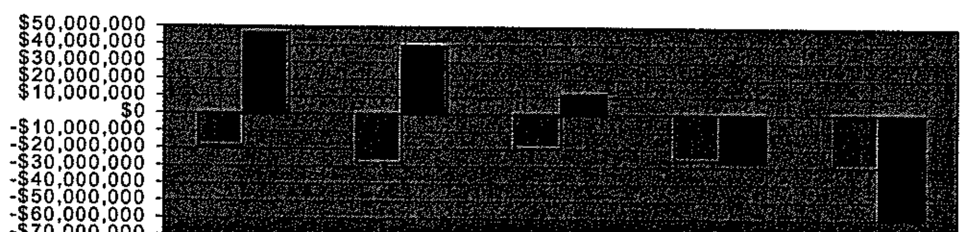
HILO • HONOKAA • KAU • KONA • KOHALA • WAIMEA • KAPAA • WAILUKU • KULA • LANAI • HONOLULU

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.

We are pleased to report that demolition has begun to make way for the construction of the State Veterans Home in Hilo and construction has begun in earnest on the major renovation and expansion of Maui Memorial Medical Center (MMMC). Our many stakeholders are most grateful to the state for the Capital Improvement Project (CIP) funding from the State of Hawaii for these important projects. Newspaper story on the groundbreaking for the State Veterans home is attached for reference (Attachment 8). Through self-funding, Kona Community Hospital was able to open a nuclear medicine unit in February 2003 and was able to install a new Computed Tomography (CT) system in April 2004. News release on the groundbreaking for major renovation and expansion at MMMC is attached for reference. (Attachment 9).

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 $60 million in FY 2002, exclusive of HHSC operational results. HSSC is fortunate to have been able to maintain stability in financial results, considering the statewide trends in the hospital industry.

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



	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002
HHSC Operating Income (Loss)	(18,526,053)	(28,027,357)	(19,423,391)	(25,935,447)	(29,883,322)
Hawaii Hospitals Operating Income (Loss)*	46,526,053	39,027,357	11,423,391	(27,064,553)	(60,116,678)

*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 Ad Hoc Committee was created in response to the Committee Report from HB 1800, HD1, SD1, CD1, which requested that HHSC present its vision for its future. The vision was expected to lead HHSC to incrementally reduce its dependence on a state general fund subsidy and achieve greater autonomy. The HHSC executives were requested to provide the Legislature, prior to the 2005 Legislative Session, with a draft blueprint outlining its plan, including measurable outcomes. The Conference Committee indicated that HHSC's recommendation to create an Ad Hoc Committee could assist in the process of creating its plan. Over the course of our six formal meetings of the committee, I believe we established new and beneficial levels of communication, and understanding between the Legislature, Staffers, HHSC, Community Leaders and Safety-Net stakeholders. Dr. Wayne Fukino convened the Ad Hoc Committee. The Committee consisted of representatives from the Legislature (including staff representatives), communities, unions, Executive Branch, HHSC Board of Directors, and HHSC staff. A "detailed strategic action plan outlining HHSC's vision for its future" has been submitted under separate cover to the legislature and to the administration.

HHSC management is working in concert with our Board of Directors, MACs, PAG, and many other external constituencies to find creative and effective solutions to financial and operating issues in order to move toward greater financial self-sufficiency. During this time of national challenge, more than ever we all understand the need to find new, "out of the box" solutions to providing services to the communities that we serve while reducing the demands on the State to provide support. Until such time as the Legislature is willing to grant HHSC more autonomy to implement the changes necessary to move to financial and operating self-sufficiency (such as moving away from operation under State Civil Service, State Collective Bargaining, restraints on managing our levels of service) then HHSC must keep returning to the Legislature to request a minimal level of funding to support the mandated "safety net" services that we provide. We are soliciting input from all of our stakeholders as to potentially new and innovative structural changes that could further improve HHSC's efficiency in the way we provide care to the communities we serve. 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 2004, copy of HHSC budget presentations for FY 2006 and FY 2007 to both the House Committee on Finance (Executive Summary) and the Senate Committee on Ways and Means are attached (Attachment 10).

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

Mahalo Nui Loa,

Tom Driskill

THOMAS M. DRISKILL, JR.
President and Chief Executive Officer
Hawaii Health Systems Corporation

Attachments:

1. Annual Audit Report: Consolidated Financial Statements for the Years Ended June 30, 2004 and 2003, Supplemental Information for the Year Ended June 30, 2004 and Independent Auditors' Reports

2. HHSC Volunteer Community Support

3. MAC Reports for East Hawaii, West Hawaii, Maui, Kauai, and Oahu

4. PAG Report

5. HHSC Successes

6. HHSC Cost Savings and Enhanced Revenues

7. HMSA Quality and Service Recognition Program Report

8. Newspaper Story – Ground Breaking for State Veterans Home at Hilo

9. News Release – Ground Breaking for Expansion and Renovation of Maui Memorial Medical Center

10. Executive Summary, January 7, 2005 Presentation to the House Committee on Finance and the Senate Committee on Ways and Means on the FY 2006-2007 HHSC Budget

Attachment 1

Hawaii Health Systems Corporation

Consolidated Financial Statements for the Years Ended June 30, 2004 and 2003, Supplemental Information for the Year Ended June 30, 2004 and Independent Auditors' Reports

HAWAII HEALTH SYSTEMS CORPORATION

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HAWAII HEALTH SYSTEMS CORPORATION

INTRODUCTION

PURPOSE OF THE REPORT

The purpose of this report is to present the consolidated financial statements of Hawaii Health Systems Corporation (HHSC) as of and for the years ended June 30, 2004 and 2003 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, 2004 and 2003 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.

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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, 2004 and 2003, 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, 2004 and 2003 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, 2004, 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, 2004 and 2003 may be significantly different from those eventually included in the final settlement.

The management's discussion and analysis information on pages 4 through 13 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 31 and 32 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 33 through 35 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 our report dated December 13, 2004 on our consideration of HHSC's internal control over financial reporting and our tests of its compliance and other matters. The purpose of that report is to describe the scope of our testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

As discussed in Note 2, effective in fiscal year 2004, the provision for doubtful accounts has been offset against patient service revenue and interest expense has been reclassified from an operating expense to a nonoperating expense. The fiscal year 2003 financial statements have been reclassified to reflect these changes.

Deloitte & Touche LLP

December 13, 2004

HAWAII HEALTH SYSTEMS CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS
YEARS ENDED JUNE 30, 2004 AND 2003

Overview of the Financial Statements

This discussion and analysis information is 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. 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, 2004 and 2003 is as follows:

	2004	2003
ASSETS		
Current assets	$ 76,242,228	$ 74,377,026
Capital assets–net	189,288,485	186,775,282
Other assets	2,750,321	3,284,853
Total assets	$268,281,034	$264,437,161
LIABILITIES		
Current liabilities	$ 90,667,690	$ 87,994,090
Capital lease obligations–less current portion	25,787,410	24,367,818
Long-term debt–less current portion	11,904,730	12,594,445
Accrued vacation–less current portion	20,862,000	20,884,868
Due to the State of Hawaii	20,122,507	20,122,507
Other liabilities	702,190	770,340
Total liabilities	170,046,527	166,734,068
NET ASSETS		
Invested in capital assets–net of related debt	143,124,046	141,502,484
Temporarily restricted	949,595	2,130,506
Unrestricted	(45,839,134)	(45,929,897)
Total net assets	98,234,507	97,703,093
Total liabilities and net assets	$268,281,034	$264,437,161

At June 30, 2004 and 2003, HHSC's capital assets, net of accumulated depreciation, comprised approximately 71% of its total assets. These assets consist mainly of land, hospital buildings and equipment that are used in HHSC's operations. The fiscal year 2004 increase of $2.5 million is due to capital asset additions of $19.0 million, offset by depreciation expense of approximately $16.2 million. The primary reasons for the increase are the acquisition of medical equipment and energy savings equipment of $9.6 million funded through HHSC's municipal leasing lines of credit and State-funded capital improvement projects of $5.4 million. The State-funded capital improvement projects consisted primarily of a nurse call system installation and electrical upgrades at Hilo Medical Center and design costs for the $38 million expansion of Maui Memorial Medical Center (MMMC).

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 the acquisition of medical equipment and energy saving equipment of $14.5 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 MMMC.

A summary of HHSC's capital assets as of June 30, 2004 and 2003 is as follows:

	2004	2003
Land and land improvements	$ 5,083,354	$ 5,083,354
Buildings and improvements	214,386,005	205,427,870
Equipment	116,430,470	110,505,091
Construction in progress	22,810,939	22,835,068
	358,710,768	343,851,383
Less accumulated depreciation and amortization	(169,422,283)	(157,076,101)
Capital assets–net	$ 189,288,485	$ 186,775,282

At June 30, 2004, HHSC's current assets approximated 28% of total assets. Current assets increased $1.9 million from the fiscal year 2003 balance primarily due to an increase in cash and cash equivalents. The increase in cash and cash equivalents is primarily due to the transfer of $1.5 million from the State of Hawaii general fund to HHSC's cash accounts with the State Treasury to pay for the retroactive pay raises for UPW bargaining unit 10. The other reason for the increase in cash and cash equivalents is the increase in cash collections for fiscal year 2004 as compared to the prior year. HHSC collected $291 million in fiscal year 2004 as compared to $277 million in fiscal year 2003 due to an increase in patient service revenues as a result of HHSC's investment in medical equipment at its three major acute facilities as well as HHSC's success in negotiating increases in reimbursement rates with third-party payors.

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, 2004, HHSC's other noncurrent assets were comparable to fiscal year 2003. 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, 2004 and 2003, HHSC's current liabilities approximated 53% of total liabilities. The primary reason for the increase over fiscal year 2003 is an increase in the accrued workers' compensation liability of approximately $3.3 million. Although HHSC has been successful in reducing the amount of workers' compensation incidents from historical levels, HHSC has not been able to settle its outstanding claims as quickly due to its cash flow shortfall. Therefore, the claims are outstanding longer, and additional medical and legal costs are being incurred for each claim. As a result, the estimate of incurred but not reported claims has increased accordingly. The fiscal year 2003 increase in current liabilities of $19.1 million 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 2005. Increases in accounts payable and accrued expenses over fiscal year 2002 were caused by a general delay in paying creditors, caused by operating cash flow shortages, resulting in an increase of approximately $4.7 million as of June 30, 2003. Increases in the current portion of the capital lease obligation over fiscal year 2002 of approximately $896,000 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, 2004 and 2003, HHSC's total capital lease obligation balance increased approximately $1.4 million and $8.2 million from fiscal years 2003 and 2002, 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, 2004 and 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 $10.9 million and $11.4 million, respectively, and a mortgage note payable relating to the acquisition of the nursing cottages on the MMMC campus with a remaining balance at June 30, 2004 and 2003 of approximately $1.5 million and $1.6 million, respectively.

At June 30, 2004 and 2003, the portion of HHSC's net assets that is reflected as its investment in capital assets, net of related debt, of approximately $143 million and $142 million, respectively, is larger than the total net assets of approximately $98 million. This means that HHSC's net operations since inception have resulted in losses of over $45.8 million.

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, 2004 and 2003 is as follows:

	2004	2003
Operating expenses:		
Salaries and benefits	$203,064,758	$190,634,252
Purchased services and professional fees	37,488,569	39,626,721
Supplies and drugs	47,660,220	45,121,947
Depreciation and amortization	16,243,898	15,493,133
Other	22,335,182	23,358,616
Total operating expenses	326,792,627	314,234,669
Operating revenues	288,238,743	270,403,980
Loss from operations	(38,553,884)	(43,830,689)
Nonoperating revenues (expenses):		
General appropriations from State of Hawaii	31,220,000	13,300,000
Collective bargaining pay raise appropriation from State of Hawaii	3,831,469	12,394,468
Restricted contributions	2,329,565	2,447,524
Other nonoperating expenses–net	(3,721,800)	(538,618)
Nonoperating revenues–net	33,659,234	27,603,374
Loss before capital contributions	(4,894,650)	(16,227,315)
Capital assets contributed by State of Hawaii	5,426,064	6,228,402
Increase (decrease) in net assets	$ 531,414	$ (9,998,913)

For the year ended June 30, 2004, HHSC's operating expenses exceeded its operating revenues by $38.6 million. The appropriations from the State of Hawaii for collective bargaining pay raises of $3.8 million, general fund appropriations from the State of Hawaii of $31.2 million, restricted contributions of $2.3 million, other nonoperating expenses of $3.7 million, and capital assets contributed by the State of Hawaii of $5.4 million resulted in an increase in net assets of $531,000.

For the year ended June 30, 2003, HHSC's operating expenses exceeded its operating revenues by approximately $43.8 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, restricted contributions of $2.4 million, other nonoperating expenses of $0.5 million, and capital assets contributed by the State of Hawaii of $6.2 million resulted in a decrease in net assets to $10 million.

Operating expenses in fiscal year 2004 were approximately 4.0% higher than fiscal year 2003. The increase was mainly in the category of salaries and benefits expense. Salaries and benefits expense increased 6.5% from fiscal year 2003, due primarily to collective bargaining pay raises for HHSC's union employees and an increase in FTEs at MMMC. HHSC's union employees in Hawaii Government Employees Association (HGEA) bargaining unit 9 (consisting of registered nurses) and United Public

Workers (UPW) bargaining unit 10 (consisting of licensed practical nurses) received pay raises from the union's collective bargaining agreements with the State of Hawaii of 5%. These pay raises represented an additional $3.8 million in salaries and benefits expense over fiscal year 2003. Further, as part of an effort to reduce MMMC's dependence on high-priced contract nurses and imaging techs to provide clinical services to the community, FTEs at MMMC increased from an average of 942 in fiscal year 2003 to an average of 1,014 in fiscal year 2004.

Operating expenses in fiscal year 2003 were approximately 12% higher than fiscal year 2002 (before netting the provision for doubtful accounts against patient service revenues and reclassification of interest expense). 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 21.2% to 32.2%. 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 8.9%. 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 MMMC, 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 MMMC. 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.

Fiscal year 2004 operating revenues increased by approximately 8.2% over fiscal year 2003 (before netting the provision for doubtful accounts against patient service revenues), as a result of increased sole community hospital reimbursements received by MMMC, a rate increase effective July 1, 2003 of 10%, and increases in negotiated reimbursement rates from third-party payors. The increase in revenues primarily came in the areas of emergency room, CT Scan, radiation therapy, respiratory therapy, acute psychiatry, clinical laboratory testing, and drugs sold to patients. The primary increase in operating revenues occurred at MMMC, partially due to an increase in emergency room visits of 7.3% and an increase in newborn patient days of 5%. The increase in sole community hospital reimbursements amounted to approximately $4 million in additional reimbursements to MMMC. Sole community hospitals are hospitals that, because of factors such as isolated location, weather conditions, travel conditions, or absence of other hospitals, are the sole source of inpatient services reasonably available in a geographic area, or are located more than 35 road miles from another hospital. Sole community hospitals receive either hospital-specific prospective rates based on base year costs updated to the present or the federal PPS rate, whichever is higher. The increase in negotiated reimbursement rates from third-party payors primarily represented inflationary increases of varying percentages.

After netting the provision for doubtful accounts against patient service revenues, fiscal year 2004 operating revenues increased by 6.6% over fiscal year 2003. Provision for doubtful accounts increased $5.7 million from fiscal year 2003, due to an increase of $3.7 million in provision for doubtful accounts at MMMC. In fiscal year 2004, management at MMMC made a concerted effort to focus the efforts of its business office staff on collecting on current bills and engaged several third-party collection agencies to focus on collecting the older outstanding receivables. As a result of this effort, numerous accounts over 151 days past due were written-off in an effort to focus efforts on the more collectible accounts.

Operating revenue in fiscal year 2003 increased by approximately 7.9% over fiscal year 2002 (before netting the provision for doubtful accounts against patient service revenues), 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 MMMC, 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.

For the year ended June 30, 2004, General Fund Appropriations from the State of Hawaii consisted of $31.2 million approved for HHSC's operating purposes by the 2003 Legislature.

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.

HHSC's management believes that the significant loss from operations in both 2004 and 2003, 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 year 2004, 60% of HHSC's total gross revenues were from government-type payors (approximately 23% from Medicare and approximately 26% from Medicaid and Med-Quest). In fact, government-type payors account for 84% of HHSC's long-term care revenues. Reimbursements from government-type payors have 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.

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 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 would be 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 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/revenue enhancements that can be reasonably explored will not be enough to absorb such costs. Management is working with the State Department of Human Services to explore alternative reimbursement solutions that would ease the burden of Act 294 on HHSC's long-term care facilities.

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.

Second, HHSC's facilities on the neighbor islands suffer from an insufficient supply of long-term care beds. 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 MMMC, have numerous patients initially admitted as acute patients, but who continue to occupy acute care beds while awaiting long-term care beds to become available. Such patients are called "wait-list" patients. HHSC receives little to no reimbursement from insurers for such patients, as insurers will not reimburse providers for patients whose required level of care does not coincide with the type of bed the patient is occupying. Hilo Medical Center and MMMC both have an average census of approximately 20-40 wait list patients per day. Management expects the wait-list problem to worsen as Hawaii's population continues to age and the State of Hawaii lags behind on a credible plan to address the long-term care crisis.

Third, HHSC's salaries and benefits expenses represent approximately 62% of its total operating expenses, and management continues to face several challenging issues regarding management of personnel and personnel costs. HHSC is bound by the collective bargaining agreements negotiated by the State of Hawaii and the public employee unions (HGEA and UPW). The collective bargaining agreements not only bind HHSC to the negotiated pay raises, but also to the union work regulations and benefit packages. Management believes that such arrangements do not allow HHSC to manage its resources as effectively as other health-care systems.

Also, since the majority of HHSC's facilities are in rural locations, management faces many recruitment and retention issues of key clinical personnel. Areas of acute shortage include RNs and LPNs, anesthetists, imaging technicians, physicians, surgery technicians, pharmacists and pharmacy technicians, and health information management specialists. These shortage areas are caused by several factors: 1) a nation-wide shortage of healthcare workers, 2) the inability of local colleges and universities to provide sufficient classes and teachers that can educate students in these areas, 3) competition for these same types of positions with private hospitals, which can pay significantly higher wage rates than HHSC. In particular, the shortage of RNs and LPNs results in HHSC having to expend significant amounts for agency nurses, who are paid at significantly higher rates. For example, an HHSC nurse earns approximately $29 per hour, while an agency nurse can earn between $48 and $96 per hour depending on the specialty. Another issue compounding HHSC's nursing situation is the fact that all of HHSC's nurses are full-time salaried employees, while the nurses at private hospitals are hourly employees. This allows the private hospitals to increase or decrease their nurse staffing based on census; by contrast, HHSC facilities cannot decrease their nurse staffing if census is lower than budgeted.

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 must be funded from HHSC's operational cash flow. Given HHSC's payor mix and cost burdens, HHSC's operational cash flows are inadequate to fully fund the capital acquisitions that are necessary to keep up with the advances in health care technology that allow hospitals to improve the quality of care for their patients.

Fifth, in the 2004 State of Hawaii Legislative Session, the Legislature passed, and the Governor signed into law, HB 2136, which effectively removed exemptions from HRS 103(d) (the State procurement code) for many state agencies (including HHSC) effective January 1, 2005. The State procurement code requires that for purchases greater than $25,000, competitive sealed bids must be solicited, with the award of the contract made to the lowest responsive and responsible offeror. For purchases less than $25,000, the State procurement code requires that the State agency obtain no less than three price quotes, with the award of the contract made to the most advantageous quotation. Any exceptions to these regulations must be approved by the Chief Procurement Officer for that agency. Under Act 262, HHSC was granted the ability to develop its own internal policies and procedures for the procurement of goods and services, consistent with the goals of public accountability and public procurement practices, but was not subject to HRS 103(d).

Management believes that the State procurement code is effective in doing what it was designed to do, which is to prevent graft and abuse of public funds. However, management does not believe that the State procurement code is effective in addressing the needs of commercial enterprises like HHSC that operate in today's rapidly changing business environment. The State procurement code is much more stringent and onerous than HHSC's current procurement policies. Today's business environment is moving more toward e-commerce, where more and more transactions and procurement are being done through the internet, and the State procurement code has not kept up with the advances in technology, which are changing the way commercial enterprises are doing business. Further, management believes that the removal of HHSC's exemption from 103(d) will result in significant additional cost to the State in terms of additional contracting personnel needed to comply with the provisions of the procurement code and in terms of discounts lost as a result of the extended period of time necessary to complete a contract under chapter 103(d). When HHSC's procurement exemption was removed, the law did not provide for any official of HHSC to be named its Chief Procurement Officer. Therefore, any exceptions to HRS 103(d) must be approved by the State of Hawaii Procurement Office. Given the volume of purchases that HHSC makes in a fiscal year and the small size of the State Procurement Office staff, management believes that procurement of many unique medical goods and services may be inordinately delayed. Management does not believe that the State procurement code is adequate to address the needs of a dynamic healthcare organization like HHSC, where the ability to quickly procure medical goods and services to handle emergency medical situations is critical to ensure the public health of the communities that HHSC serves.

Finally, HHSC serves as the "safety-net" provider of health care for 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, MMMC 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.

HAWAII HEALTH SYSTEMS CORPORATION

CONSOLIDATED STATEMENTS OF NET ASSETS
JUNE 30, 2004 AND 2003

ASSETS	2004	2003
CURRENT ASSETS:		
Cash and cash equivalents:		
On deposit with the State of Hawaii	$ 9,864,299	$ 8,158,638
On deposit with banks and on hand (Note 3)	8,764,360	7,112,264
Patient accounts receivable–less allowances of $93,591,425 and $108,974,531 for contractual adjustments and doubtful accounts	49,537,926	50,479,262
Supplies and other current assets	8,075,643	8,626,862
Total current assets	76,242,228	74,377,026
CAPITAL ASSETS—Net (Notes 4, 6 and 7)	189,288,485	186,775,282
ASSETS LIMITED AS TO USE	1,312,093	2,517,281
OTHER ASSETS (Note 11)	1,438,228	767,572
TOTAL	$268,281,034	$264,437,161

(Continued)

HAWAII HEALTH SYSTEMS CORPORATION

CONSOLIDATED STATEMENTS OF NET ASSETS
JUNE 30, 2004 AND 2003

LIABILITIES AND NET ASSETS	2004	2003
CURRENT LIABILITIES:		
Accounts payable and accrued expenses (Note 11)	$ 42,823,960	$ 44,324,301
Accrued workers' compensation liability (Note 10)	21,854,000	18,500,000
Advance from the State of Hawaii (Note 5)	14,000,000	14,000,000
Current portion of capital lease obligations (Note 6)	7,958,701	7,933,202
Estimated third-party payor settlements	1,393,620	1,565,986
Current portion of accrued vacation (Note 6)	1,365,261	840,270
Current portion of long-term debt (Note 7)	513,598	377,333
Other current liabilities	758,550	452,998
Total current liabilities	90,667,690	87,994,090
CAPITAL LEASE OBLIGATIONS—Less current portion (Note 6)	25,787,410	24,367,818
LONG-TERM DEBT—Less current portion (Note 7)	11,904,730	12,594,445
ACCRUED VACATION—Less current portion (Note 6)	20,862,000	20,884,868
DUE TO THE STATE OF HAWAII	20,122,507	20,122,507
PATIENTS' SAFEKEEPING DEPOSITS	362,498	386,775
OTHER LIABILITIES	339,692	383,565
Total liabilities	170,046,527	166,734,068
NET ASSETS:		
Invested in capital assets–net of related debt	143,124,046	141,502,484
Temporarily restricted (Note 12)	949,595	2,130,506
Unrestricted (Note 3)	(45,839,134)	(45,929,897)
Total net assets	98,234,507	97,703,093
TOTAL	$268,281,034	$264,437,161

See notes to consolidated financial statements.

(Concluded)

HAWAII HEALTH SYSTEMS CORPORATION

CONSOLIDATED STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS YEARS ENDED JUNE 30, 2004 AND 2003

	2004	2003
OPERATING REVENUES:		
Net patient service revenues (Note 8)	$283,296,884	$267,007,883
Other operating revenues (Notes 8 and 11)	4,941,859	3,396,097
Total operating revenues	288,238,743	270,403,980
OPERATING EXPENSES:		
Salaries and benefits (Notes 8 and 9)	203,064,758	190,634,252
Medical supplies and drugs	36,927,252	32,868,916
Purchased services (Notes 8 and 11)	34,508,122	36,251,437
Depreciation and amortization	16,243,898	15,493,133
Other supplies	10,732,968	12,253,031
Utilities	7,161,330	7,314,622
Repairs and maintenance	5,335,109	5,349,702
Rent and lease	3,840,882	3,502,585
Professional fees (Notes 8 and 11)	2,980,447	3,375,284
Insurance	2,333,601	3,327,248
Other	3,664,260	3,864,459
Total operating expenses	326,792,627	314,234,669
LOSS FROM OPERATIONS	(38,553,884)	(43,830,689)
NONOPERATING REVENUES (EXPENSES):		
General appropriations from State of Hawaii	31,220,000	13,300,000
Collective bargaining pay raise appropriation from State of Hawaii	3,831,469	12,394,468
Restricted contributions	2,329,565	2,447,524
Interest and dividend income	118,223	221,396
Interest expense (net of capitalized interest) (Note 6)	(2,871,484)	(2,374,538)
Other nonoperating revenues (expenses)–net	(968,539)	1,614,524
Nonoperating revenues–net	33,659,234	27,603,374
LOSS BEFORE CAPITAL CONTRIBUTIONS	(4,894,650)	(16,227,315)
CAPITAL ASSETS CONTRIBUTED BY STATE OF HAWAII (Note 4)	5,426,064	6,228,402
INCREASE (DECREASE) IN NET ASSETS	531,414	(9,998,913)
NET ASSETS, BEGINNING OF YEAR	97,703,093	107,702,006
NET ASSETS, END OF YEAR	$ 98,234,507	$ 97,703,093

See notes to consolidated financial statements.

HAWAII HEALTH SYSTEMS CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2004 AND 2003

	2004	2003
OPERATING ACTIVITIES:		
Payments from government, insurance and patients	$ 284,065,854	$ 269,030,488
Payments to employees	(197,019,766)	(186,178,895)
Payments to suppliers and others	(110,261,774)	(105,800,116)
Other receipts–net	5,493,078	1,488,783
Net cash used in operating activities	(17,722,608)	(21,459,740)
NONCAPITAL FINANCING ACTIVITIES:		
Appropriations from State of Hawaii	35,051,469	25,694,468
Advances from the State of Hawaii		14,000,000
Other nonoperating revenues–net	1,330,709	1,544,197
Net cash provided by noncapital financing activities	36,382,178	41,238,665
CAPITAL AND RELATED FINANCING ACTIVITIES:		
Repayments on capital lease obligations	(8,204,207)	(6,288,048)
Capital expenditures	(3,723,404)	(2,106,622)
Payments on long-term debt	(553,450)	(711,010)
Interest on capital lease obligations and long-term debt	(2,871,484)	(2,374,538)
Proceeds from sale of capital assets	1,772	2,615
Net cash used in capital and related financing activities	(15,350,773)	(11,477,603)
INVESTING ACTIVITIES—Distributions received from the Clinical Laboratories of Hawaii joint venture	48,960	
NET INCREASE IN CASH AND CASH EQUIVALENTS	3,357,757	8,301,322
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	15,270,902	6,969,580
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 18,628,659	$ 15,270,902

(Continued)

HAWAII HEALTH SYSTEMS CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2004 AND 2003

	2004	2003
RECONCILIATION OF LOSS FROM OPERATIONS TO NET CASH USED IN OPERATING ACTIVITIES:		
Loss from operations	$ (38,553,884)	$ (43,830,689)
Adjustments to reconcile loss from operations to net cash used in operating activities:		
Provision for doubtful accounts	22,397,079	16,728,285
Depreciation and amortization	16,243,898	15,493,133
Amounts released from restrictions	474,064	798,489
Change in operating assets and liabilities:		
Patient accounts receivable	(21,455,743)	(14,293,117)
Supplies and other assets	551,219	(1,907,314)
Accounts payable, accrued expenses, and other liabilities	(1,062,998)	3,232,036
Accrued workers' compensation liability	3,354,000	
Estimated third-party payor settlements	(172,366)	(412,563)
Accrued vacation	502,123	2,732,000
Net cash used in operating activities	$ (17,722,608)	$ (21,459,740)
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid, primarily on capital lease obligations	$ 3,123,893	$ 3,077,856
Non-cash financing and investing activities:		
• Capital assets acquired under capital leases	8,284,428	14,502,236
• Prior year capital assets in accounts payable funded through capital lease	1,364,870	
• Capital assets contributed by State of Hawaii	5,426,064	6,228,402
• Capital asset purchases included in accounts payable	1,452,737	1,838,295
• Capital asset purchases included in other liabilities	209,894	
• Contribution of capital assets	255,937	
• Capital assets acquired with restricted assets	138,461	
• Capital assets acquired through long-term debt financing		1,690,900
• Capital assets acquired through grants		423,238
• Rental income contributed to Clinical Laboratories of Hawaii joint venture	719,616	

See notes to consolidated financial statements. (Concluded)

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

City and County of Honolulu:
- Leahi Hospital
- Maluhia

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

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

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, 2004. 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, 2004 and 2003 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. The amount of uninsured and uncollateralized deposits totaled $10,663,000 at June 30, 2004.

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 and provision for doubtful accounts. 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, 2004 and 2003.

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 adjustments to the final settlements did not have a significant impact on the fiscal year 2004 and 2003 financial statements.

The estimated third-party payor settlement accrual of approximately $1,394,000 and $1,566,000, as of June 30, 2004 and 2003, 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 are paid based upon 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 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 2001.

- *Medicaid*—Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology. HHSC is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports and audits thereof by the Medicaid fiscal intermediary.

- *Hawaii Medical Service Association (HMSA)*—Inpatient services rendered to HMSA subscribers are reimbursed at prospectively determined case rates for hospitalization or procedures performed. The prospectively determined case rates are not subject to retroactive adjustment. In addition, outpatient services and certain contracts are reimbursed on a discounted charges method basis.

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

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, 2004 and 2003, the amount of bond interest allocated to HHSC was $2,608,000 and $2,443,000, 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, 2004 and 2003 was as follows:

	2004	2003
Medicare	12%	10%
Medicaid	17	17
HMSA	12	10
Other third-party payors	21	18
Patients and other	38	45
	100%	100%

Reclassifications—Effective in 2004, in accordance with GASB standards, the provision for doubtful accounts has been offset against patient service revenues and interest expense has been reclassified from an operating expense to a nonoperating expense. The 2003 financial statements have been reclassified to reflect these changes. The provision for doubtful accounts totaled $22,397,000 and $16,728,000 for the year ended June 30, 2004 and 2003, respectively. In addition, certain other amounts in the 2003 financial statements have been reclassified to conform to the 2004 presentation.

3. BOARD-DESIGNATED FUNDS

As of June 30, 2004, 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, 2004 and 2003, 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, 2004 and 2003 were as follows:

2004	Beginning of Year	Additions	Retirements	Transfers	End of Year
Assets Not Subject to Depreciation:					
Land and land improvements	$ 5,083,354	$ -	$ -	$ -	$ 5,083,354
Construction in progress	22,835,068	12,798,140	(18,191)	(12,804,078)	22,810,939
Assets Subject to Depreciation:					
Buildings and improvements	205,427,870	1,406,844	(95,339)	7,646,630	214,386,005
Major moveable equipment	73,323,823	4,005,473	(3,778,719)	1,432,465	74,983,042
Fixed equipment	37,181,268	807,043	(265,866)	3,724,983	41,447,428
	343,851,383	19,017,500	(4,158,115)	-	358,710,768
Less accumulated depreciation and amortization	(157,076,101)	(16,243,898)	3,897,716		(169,422,283)
Capital assets–net	$ 186,775,282	$ 2,773,602	$ (260,399)	$ -	$ 189,288,485

2003	Beginning of Year	Additions	Retirements	Transfers	End of Year
Assets Not Subject to Depreciation:					
Land and land improvements	$ 4,809,354	$ -	$ -	$ 274,000	$ 5,083,354
Construction in progress	14,986,281	16,541,247		(8,692,460)	22,835,068
Assets Subject to Depreciation:					
Buildings and improvements	193,742,748	4,156,964	(63,668)	7,591,826	205,427,870
Major moveable equipment	69,150,419	4,833,773	(1,030,996)	370,627	73,323,823
Fixed equipment	36,284,785	699,312	(243,706)	440,877	37,181,268
	318,973,587	26,231,296	(1,338,370)	(15,130)	343,851,383
Less accumulated depreciation and amortization	(142,804,953)	(15,493,133)	1,206,855	15,130	(157,076,101)
Capital assets–net	$ 176,168,634	$ 10,738,163	$ (131,515)	$ -	$ 186,775,282

In 2004 and 2003, the State Department of Accounting and General Services transferred capital assets, including construction in progress, aggregating $5,426,064 and $6,228,402, respectively, to HHSC as a contribution of capital.

During fiscal year 2004, $138,461 of capital assets were purchased with funds contributed by an affiliated foundation.

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 intended to be repaid in fiscal year 2005.

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, 2004 and 2003 were as follows:

2004	Beginning of Year	Additions	Reductions	End of Year	Current Portion	Noncurrent Portion
Accrued vacation	$ 21,725,138	$ 1,867,384	$(1,365,261)	$ 22,227,261	$ 1,365,261	$ 20,862,000
Capital lease obligations	32,301,020	9,649,298	(8,204,207)	33,746,111	7,958,701	25,787,410
2003						
Accrued vacation	$ 18,993,138	$ 3,572,270	$ (840,270)	$ 21,725,138	$ 840,270	$ 20,884,868
Capital lease obligations	24,086,832	14,502,236	(6,288,048)	32,301,020	7,933,202	24,367,818

Future capital lease payments were as follows:

Year ended June 30:	
2005	$ 10,316,969
2006	9,006,377
2007	6,968,106
2008	4,334,132
2009	3,479,576
2010-2014	8,589,996
2015-2019	864,233
Total future minimum payments	43,559,389
Less amount representing interest	(9,813,278)
Total capital lease obligations	33,746,111
Current portion	(7,958,701)
Noncurrent portion	$ 25,787,410

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 years ended June 30, 2004 and 2003, interest capitalized for Corporate and all facilities was approximately $826,000 and $779,000, respectively.

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.

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 loan payable is collateralized by a security interest in the capital assets acquired.

Long-term debt as of June 30, 2004 and 2003 consisted of the following:

	2004	2003
Loan payable to Central Pacific Bank; $9,500,000; interest at 5.75% at June 30, 2004, 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	$ 8,780,726	$ 9,103,432
Loan payable to Central Pacific Bank; $319,000; interest at 5.875% at June 30, 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	215,614	237,000
Loan payable to Academic Capital; $1,690,900; interest at 6.3%; monthly principal and interest payments of $19,028; due November 4, 2012	1,477,429	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	1,161,383	1,188,111
Note payable to USDA; $1,000,000; interest at 4.75%; monthly principal and interest payments of $8,170; due August 13, 2014	783,176	835,104
Total	12,418,328	12,971,778
Less current portion	(513,598)	(377,333)
Noncurrent portion	$11,904,730	$12,594,445

Transactions in long-term debt during the years ended June 30, 2004 and 2003 were as follows:

2004	Beginning of Year	Additions	Reductions	End of Year
Long-term debt	$ 12,971,778	$ -	$ (553,450)	$ 12,418,328
2003				
Long-term debt	$ 11,991,888	$ 1,690,900	$ (711,010)	$ 12,971,778

Maturities of long-term debt are as follows:

	Principal	Interest	Total
Year ending June 30:			
2005	$ 513,598	$ 644,234	$ 1,157,832
2006	497,357	660,475	1,157,832
2007	526,777	631,054	1,157,831
2008	477,525	602,024	1,079,549
2009	505,705	573,843	1,079,548
2010-2014	2,617,006	2,403,681	5,020,687
2015-2019	1,981,114	1,981,114	3,962,228
2020-2024	2,627,993	1,137,853	3,765,846
2025-2029	2,425,826	321,650	2,747,476
2030-2034	245,427	22,078	267,505
Total	$12,418,328	$ 8,978,006	$21,396,334

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 aggregated approximately $11,113,000 and $10,857,000 (excluding Clinical Laboratories of Hawaii joint venture fees of $11,010,000 and $11,414,000 as disclosed in Note 11) during fiscal years 2004 and 2003, respectively.

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

HHSC charges the contractors for use of the premises, supplies, and laundry. These amounts are included in other nonoperating revenues and aggregated approximately $976,000 and $881,000 during fiscal years 2004 and 2003, 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 $848,000 and $946,000 during fiscal years 2004 and 2003, respectively.

9. EMPLOYEE BENEFITS

Defined Benefit Pension Plans

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

The ERS is composed of a contributory retirement plan and a noncontributory retirement plan. Eligible employees who were in service and a member of the existing contributory plan on June 30, 1984, were given an option to remain in the existing plan or join the noncontributory plan, effective January 1, 1985. All new eligible employees hired after June 30, 1984, automatically become members of the noncontributory plan. Both plans provide death and disability benefits and cost of living increases. Benefits are established by State statute. In the contributory plan, employees may elect normal retirement at age 55 with 5 years of credited service or elect early retirement at any age with 25 years of credited service. These 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.

HHSC's contribution to the ERS for the years ended June 30, 2004 and 2003 was $12,386,000 and $11,500,000, respectively, 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 $10,195,000 and $9,748,000 for the years ended June 30, 2004 and 2003, respectively.

Sick Leave

Accumulated sick leave as of June 30, 2004 and 2003 was approximately $41,147,000 and $38,991,000, 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 2, 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 $21,854,000 and $18,500,000 for unpaid claims as of June 30, 2004 and 2003, respectively.

Ceded Lands

The Office of Hawaiian Affairs (OHA) and the State of Hawaii are presently in negotiation 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, 2004, the outcome of the negotiation 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 various 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. In fiscal year 2003, the State appropriated funds for the construction of a State Veteran's Home on the site of the old hospital building. Funding for the construction will also come from the Department of Veterans Affairs State Home Construction Program. The total construction costs to be funded will include the demolition of the old hospital building and remediation of the asbestos contamination. Because an allocation of the asbestos remediation costs to HHSC, if any, presently cannot be determined, a liability for the cost of remediation has not been recorded in HHSC's financial statements.

Construction Commitment

In fiscal year 2002, the State Legislature approved the issuance of $38 million of State of Hawaii general obligation bonds, the proceeds of which are to be used for the renovation and expansion of the MMMC campus. At June 30, 2004, MMMC was in the process of negotiating contracts for the design and construction of the facilities. MMMC expects to break ground in 2005 and complete the project in 2007.

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, MMMC, Hale Ho'ola Hamakua, Ka'u Hospital, Kohala Hospital, and Kula Hospital) in exchange for a less than controlling 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). In fiscal year 2004, HHSC received a partnership distribution of $49,000. Such partnership distribution is accounted for as a reduction of the investment balance.

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 2004 and 2003 amounted to $720,000 and $709,000, respectively, and the investment balance as of June 30, 2004 and 2003 was $1,439,000 and $768,000, respectively. The contributed space and services are included in other nonoperating revenues in the consolidated statements of revenues, expenses and changes in net assets, and the investment balance is included in other assets in the consolidated statements of net assets.

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 $1,158,000 and $1,723,000 during fiscal years 2004 and 2003, respectively. Amounts due from the Partnership for such charges aggregated $506,000 and $1,604,000 as of June 30, 2004 and 2003, respectively.

HHSC contracts with the Partnership to provide clinical laboratory and pathology services at its facilities. Amounts charged by the Partnership aggregated approximately $11,010,000 and $11,414,000 during fiscal years 2004 and 2003, respectively. Amounts due to the Partnership aggregated $5,866,000 and $7,244,000 as of June 30, 2004 and 2003, respectively.

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 $41,000 and $470,000 during fiscal years 2004 and 2003, respectively. 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 $105,000 and $104,000 during fiscal years 2004 and 2003, respectively. Amounts due from the Partnership for such charges were $30,000 as of June 30, 2003. There were no amounts due from or due to the Partnership as of June 30, 2004.

12. TEMPORARILY RESTRICTED NET ASSETS

Changes in temporarily restricted net assets for the years ended June 30, 2004 and 2003 were as follows:

	2004	2003
Balance, beginning of year	$ 2,130,506	$ 481,471
Restricted contributions received	2,329,565	2,447,524
Expenditures for restricted purposes	(474,064)	(798,489)
Transfers of restricted net assets	(2,897,951)	
Capital assets purchased	(138,461)	
Balance, end of year	$ 949,595	$2,130,506

In fiscal years 2004 and 2003, HHSF received $3,000,000 in grants from a not-for-profit organization to administer a patient assistance and drug assistance program, which would provide prescription drugs and nutritional supplements to indigent families. HHSF partnered with HHSC, the State of Hawaii, and two health care associations to operate the program. In fiscal year 2004, all of the partners formed a separate not-for-profit organization to take over the administration of the program. Accordingly, HHSF transferred the remaining net assets of the program to the not-for-profit organization. The $2,897,951 of net assets transferred is included in other nonoperating expenses in the consolidated statements of revenues, expenses, and changes in net assets.

13. SUBSEQUENT EVENT

The Kona Hospital Foundation is an independent not-for-profit organization with a separate board of directors and management from HHSC. The Foundation receives donations from individuals in the community, and at December 31, 2003 had approximately $1.6 million in total assets. Subject to certain conditions relating to the building of a new radiation therapy unit, a pledge from the Foundation for $1.5 million is expected to be received in fiscal year 2005, and the related contribution revenue will be recorded as temporarily restricted until the funds are used for the construction of the radiation therapy unit at Kona Community Hospital.

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HAWAI HEALTH SYSTEMS CORPORATION

SUPPLEMENTAL SCHEDULE OF RECONCILIATION OF CASH ON DEPOSIT WITH THE STATE OF HAWAII
JUNE 30, 2004

	Appropriation Symbol	
CASH ON DEPOSIT WITH THE STATE OF HAWAII:		
SPECIAL FUNDS:		
	S-93-359-H	$ 2,818
	S-94-359-M	33,400
	S-94-396-H	8,673
	S-95-396-H	19,636
	S-96-359-H	2,007
	S-96-396-H	9,040
	S-97-359-H	3,556
	S-97-396-H	180
	S-98-396-H	1,687
	S-04-303-H	178
	S-04-312-H	202,641
	S-04-320-H	8,000,000
	S-04-350-H	345,362
	S-04-351-H	64,698
	S-04-352-H	22,207
	S-04-353-H	46,738
	S-04-354-H	152,740
	S-04-355-H	415,356
	S-04-358-H	14,276
	S-04-359-H	73,414
	S-04-365-H	161,259
	S-04-371-H	132,819
	S-04-373-H	82,909
TRUST FUNDS:		
	T-04-906-H	2,512
	T-03-909-H	680
	T-04-909-H	48,562
	T-03-918-H	1,273
	T-03-921-H	6,679
	T-04-907-H	200
	T-04-923-H	4,129
TOTAL PER STATE		9,859,629
RECONCILING ITEMS		4,670
TOTAL PER HHSC		$9,864,299

(Continued)

HAWAI HEALTH SYSTEMS CORPORATION

SUPPLEMENTAL SCHEDULE OF RECONCILIATION OF CASH ON DEPOSIT WITH THE STATE OF HAWAII
JUNE 30, 2004

	Appropriation Symbol	
ASSETS LIMITED AS TO USE:		
PATIENT TRUST FUNDS:	T-02-926-H	$ 18
	T-03-926-H	75
	T-04-911-H	22,912
	T-04-915-H	12,763
	T-04-919-H	1,044
	T-04-925-H	110,810
	T-04-926-H	11,296
TOTAL PER STATE		158,918
RECONCILING ITEMS:		
Patients' safekeeping deposits held by financial institutions		266,506
Restricted net assets held by financial institutions		888,312
Other		(1,643)
TOTAL PER HHSC		$ 1,312,093

(Concluded)

HAWAII HEALTH SYSTEMS CORPORATION

SUPPLEMENTAL COMBINING AND CONSOLIDATING STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS INFORMATION
YEAR ENDED JUNE 30, 2004

	Facilities																			
	Hilo Medical Center	Kona Community Hospital	Maui Memorial Medical Center	Ka'u Hospital	Kula Hospital	Kauai Veterans Memorial Hospital	Samuel Mahelona Memorial Hospital	Hale Ho'ola Hamakua	Kohala Hospital	Leahi Hospital	Maluhia	Lanai Community Hospital	Total Facilities	Corporate	Reclassifi-cations and Elimi-nations	HHSC Combined	Hawaii Health Systems Founda-tion	Alii Com-munity Care	Reclassifi-cations and Elimi-nations	HHSC Consolidated
OPERATING REVENUES:																				
Net patient service revenues	$ 72,749,297	$35,073,721	$104,578,262	$2,580,616	$10,353,361	$12,130,026	$ 7,322,893	$ 5,027,342	$ 2,681,306	$17,049,083	$12,374,589	$ 1,376,388	$283,296,884	$ -	$ -	$283,296,884	$ -	$ -	$ -	$283,296,884
Other operating revenues	1,103,004	295,334	954,304	5,878	71,837	641,532	157,289	18,854	25,626	399,694	29,637	8,550	3,711,539		(244,379)	3,467,160		1,474,699		4,941,859
Total operating revenues	73,852,301	35,369,055	105,532,566	2,586,494	10,425,198	12,771,558	7,480,182	5,046,196	2,706,932	17,448,777	12,404,226	1,384,938	287,008,423		(244,379)	286,764,044		1,474,699		288,238,743
OPERATING EXPENSES:																				
Salaries and benefits	51,250,584	24,238,568	57,523,282	2,501,892	10,709,631	9,404,752	6,924,078	4,527,018	2,764,647	14,420,028	11,106,703	1,547,864	196,919,039	4,748,123		201,667,162	244,794	1,152,802		203,064,758
Medical supplies and drugs	11,064,383	5,266,258	16,675,134	91,219	809,977	858,059	344,546	141,156	65,776	792,156	684,224	134,364	36,927,252			36,927,252				36,927,252
Purchased services	7,551,472	4,893,932	16,215,140	99,848	633,309	2,304,820	482,704	166,904	442,672	781,378	882,471	344,052	34,798,702	187,259	(490,291)	34,495,670		12,452		34,508,122
Depreciation and amortization	3,266,901	2,524,031	4,304,747	99,961	330,130	593,533	326,175	533,385	219,920	913,216	327,046	92,886	13,531,931	2,709,847		16,241,778	2,120			16,243,898
Other supplies	2,508,588	850,813	3,822,358	80,421	655,731	380,872	281,857	223,758	136,801	853,240	544,159	82,269	10,420,867	76,159		10,497,026	57,833	178,109		10,732,9(
Utilities	1,642,082	735,309	1,930,832	88,064	172,823	601,815	256,533	361,873	83,899	590,604	368,244	72,845	6,904,123	77,729		6,981,852	1,348	178,130		7,161,33.
Repairs and maintenance	1,798,642	1,007,368	1,517,488	14,358	60,999	322,736	144,059	82,340	20,109	134,411	137,745	23,243	5,263,498	44,575		5,308,073	130	26,906		5,335,109
Rent and lease	578,487	298,603	1,007,809	11,185	18,123	143,070	7,333	17,645	21,389	17,944	4,231	3,391	2,129,210	48,447		2,177,657	9,398	1,653,827		3,840,882
Professional fees	860,108	601,686	250,918	85,044	78,568	165,681	156,961	100,304	94,468	41,404	25,762	154,822	2,555,726	166,687		2,722,413	10,236	247,798		2,980,447
Insurance	584,054	253,337	837,293	39,394	52,453	165,354	43,711	21,527	17,661	103,629	80,638	17,718	2,216,769	21,275		2,238,044	68	95,489		2,331,601
Other	864,478	474,989	984,289	45,202	80,453	256,626	68,329	34,584	47,142	86,825	126,478	40,851	3,110,246	205,284		3,315,530	215,751	132,979		3,664,260
Total operating expenses	81,909,779	41,144,894	105,068,490	3,156,588	13,602,197	15,197,318	9,036,286	6,210,486	3,914,484	18,734,835	14,287,701	2,514,305	314,777,363	8,285,385	(490,291)	322,572,457	541,678	3,678,492		326,792,627
INCOME (LOSS) FROM OPERATIONS	(8,057,478)	(5,775,839)	464,076	(570,094)	(3,176,999)	(2,425,760)	(1,556,104)	(1,164,290)	(1,207,552)	(1,286,058)	(1,883,475)	(1,129,367)	(27,768,940)	(8,285,385)	245,912	(35,808,413)	(541,678)	(2,203,793)		(38,553,884)
NONOPERATING REVENUES (EXPENSES):																				
General appropriations from State of Hawaii													-	31,220,000		31,220,000				31,220,000
Collective bargaining pay raise appropriation from State of Hawaii	988,561	484,102	1,222,035	33,825	195,596	124,661	115,742	96,220	48,044	263,462	219,204	40,817	3,831,469			3,831,469				3,831,469
Restricted contributions		253,819	100,000			14,000	22,584	9,242	9,242				408,887			408,887	1,920,678			2,329,565
Interest and dividend income	3,104	2,419	39,702	607		2,179	225	1,345	303	5,309	28	14	55,235	65,886		121,121	8,564	51	(11,513)	118,223
Interest expense (net of capitalized interest)	(672,210)	(39,496)	(25,499)		(7,031)		(674)	(348)	(1,418)	(1,987)	(364)		(749,927)	(2,122,457)		(2,871,484)	(11,513)		11,513	(2,871,484)
Corporate allocation expense	(2,887,926)	(1,408,686)	(3,659,735)	(109,907)	(485,075)	(542,026)	(297,309)	(198,946)	(127,424)	(649,390)	(503,238)	(90,169)	(10,959,831)	10,959,831		-				-
Other nonoperating revenues (expenses)-net	723,703	407,354	346,928	(15,713)	85,904	99,001	178,554	133,365	(12,914)	86,538	1,888	37,884	2,072,492	(198,218)	(245,912)	1,628,362	(2,596,901)			(968,539)
Nonoperating revenues (expenses)-net	(1,844,768)	(300,488)	(1,976,569)	(91,188)	(210,606)	(302,185)	19,122	40,878	(84,167)	(296,068)	(282,482)	(12,254)	(5,340,775)	39,925,042	(245,912)	34,338,355	(679,172)	51		33,659,234
INCOME (LOSS) BEFORE CAPITAL CONTRIBUTIONS	(9,902,246)	(6,076,327)	(1,512,493)	(661,282)	(3,387,605)	(2,727,945)	(1,536,982)	(1,123,412)	(1,291,719)	(1,582,126)	(2,165,957)	(1,141,621)	(33,109,715)	31,639,657	-	(1,470,058)	(1,220,850)	(2,203,742)	-	(4,894,650)
CAPITAL ASSETS CONTRIBUTED BY STATE OF HAWAII	928,421		2,926,492		345,081	619,053	229,271	82,253	282,181			13,312	5,426,064			5,426,064				5,426,064
INCREASE (DECREASE) IN NET ASSETS	$ (8,973,825)	$ (6,076,327)	$ 1,413,999	$ (661,282)	$ (3,042,524)	$ (2,108,892)	$ (1,307,711)	$ (1,041,159)	$ (1,009,538)	$ (1,582,126)	$ (2,165,957)	$ (1,128,309)	$ (27,683,651)	$ 31,639,657	$ -	$ 3,956,006	$ (1,220,850)	$ (2,203,742)	$ -	$ 531,414

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INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND COMPLIANCE AND OTHER MATTERS 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, 2004 and 2003, and have issued our report thereon dated December 13, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered 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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether 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*.

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

Deloitte & Touche LLP

December 13, 2004

.WAII HEALTH SYSTEMS CORPORATION

'PLEMENTAL COMBINING AND CONSOLIDATING STATEMENT OF NET ASSETS INFORMATION
IE 30, 2004

IETS	Facilities: Hilo Medical Center	Kona Community Hospital	Maui Memorial Medical Center	Ka'u Hospital	Kula Hospital	Kauai Veterans Memorial Hospital	Samuel Mahelona Memorial Hospital	Hale Ho'ola Hamakua	Kohala Hospital
:RENT ASSETS:									
h and cash equivalents:									
1 deposit with the State of Hawaii	$ 352,877	$ 152,740	$ 415,356	$ 28,886	$ 132,819	$ 87,605	$ 78,727	$ 68,482	$ 46,738
1 deposit with banks and on hand	111,086		108,659	9,720	12,411	116,679	60,654	500	17,803
ient accounts receivable–less owances for contractual justments and doubtful accounts	10,418,304	5,807,672	22,229,055	587,565	1,426,285	1,751,447	1,195,569	463,913	564,155
plies and other current assets	2,171,737	1,522,782	2,496,692	44,911	198,790	339,044	78,206	93,805	39,102
Total current assets	13,054,004	7,483,194	25,249,762	671,082	1,770,305	2,234,775	1,413,156	626,700	667,798
: FROM AFFILIATES—Net			3,169,424						
ITAL ASSETS—Net	41,856,593	28,768,925	56,479,756	1,344,311	4,841,948	12,644,020	3,715,789	13,807,010	2,249,041
ETS LIMITED AS TO USE	30,796	144,814	300,000	4,335	50,376	41,306	47,872	20,315	8,894
IER ASSETS	745,470	260,958	378,545	12,745	10,629	-		15,249	14,632
'AL	$ 55,616,863	$ 36,657,891	$ 85,577,487	$ 2,032,473	$ 6,673,258	$ 14,980,101	$ 5,176,817	$ 14,469,274	$ 2,940,365

IETS	Facilities: Leahi Hospital	Maluhia	Lanai Community Hospital	Total Facilities	Corporate	Reclassifications and Eliminations	HHSC Combined	Hawaii Health Systems Foundation	Alii Community Care	Reclassifications and Eliminations	HHSC Consolidated
:RENT ASSETS:											
h and cash equivalents:											
1 deposit with the State of Hawaii	$ 285,140	$ 161,259	$ 14,276	$ 1,824,905	$ 8,039,394	$ -	$ 9,864,299	$ -	$ -	$ -	$ 9,864,299
1 deposit with banks and on hand	445,077	68,218	40,332	991,139	7,547,130		8,538,269	123,741	102,350		8,764,360
ient accounts receivable–less owances for contractual justments and doubtful accounts	2,494,291	2,363,375	236,295	49,537,926			49,537,926				[illegible]
plies and other current assets	508,442	108,616	76,353	7,678,480	166,542		7,845,022		230,621		[illegible]
Total current assets	3,732,950	2,701,468	367,256	60,032,450	15,753,066		75,785,516	123,741	332,971		76,242,228
: FROM AFFILIATES—Net				3,169,424	150,870,503	(149,840,522)	4,199,405			(4,199,405)	-
ITAL ASSETS—Net	6,463,321	3,571,414	983,032	176,725,160	12,182,721		188,907,881	651	379,953		189,288,485
ETS LIMITED AS TO USE	161,599	81,713	3,664	895,684	5,000		900,684	411,409			1,312,093
IER ASSETS				1,438,228	97,822		1,536,050			(97,822)	1,438,228
'AL	$ 10,357,870	$ 6,354,595	$ 1,353,952	$ 242,260,946	$ 178,909,112	$(149,840,522)	$ 271,329,536	$ 535,801	$ 712,924	$ (4,297,227)	$ 268,211,034

(Continued)

WAII HEALTH SYSTEMS CORPORATION

PLEMENTAL COMBINING AND CONSOLIDATING STATEMENT OF NET ASSETS INFORMATION
E 30, 2004

LITIES AND ASSETS	Facilities: Hilo Medical Center	Kona Community Hospital	Maui Memorial Medical Center	Ka'u Hospital	Kula Hospital	Kauai Veterans Memorial Hospital	Samuel Mahelona Memorial Hospital	Hale Ho'ola Hamakua	Kohala Hospital	Leahi Hospital	Maluhia	Lanai Community Hospital	Total Facilities	Corporate	Reclassifications and Eliminations	HHSC Combined	Hawaii Health Systems Foundation	Alii Community Care	Reclassifications and Eliminations	HHSC Consolidated
RENT LIABILITIES:																				
ounts payable and accrued expenses	$ 9,545,370	$ 5,515,832	$ 17,632,795	$ 310,946	$ 1,331,810	$ 1,079,821	$ 618,173	$ 503,246	$ 407,181	$ 1,567,194	$ 1,142,996	$ 258,512	$ 39,913,876	$ 2,623,626	$ -	$ 42,537,502	$ 29,968	$ 256,490	$ -	42,823,960
ued workers' compensation liability	7,877,474	2,411,024	4,319,298	165,490	1,977,407	858,785	960,572	719,175	293,388	1,620,373	1,134,220	135,450	21,702,656	151,344		21,854,000				21,854,000
ance from the State of Hawaii													-	14,000,000		14,000,000				14,000,000
ent portion of capital lease obligations	305,632						1,604						307,236	7,651,465		7,958,701				7,958,701
ated third-party payor settlements	117,230	16,623	390,066	79,048	9,940	752,094	30,805	52,359	44,972	56,695	9,308	(165,520)	1,393,620			1,393,620				1,393,620
ent portion of accrued vacation	191,999	84,412	240,379	35,203	329,866	34,854	67,562	26,771	88,812	75,590	74,743	90,542	1,340,733	24,528		1,365,261				1,365,261
ent portion of long-term debt	374,363												374,363	139,235		513,598				513,[illegible]
r current liabilities	315,020	3,983				205,509		3,016					527,528			527,528	103,496	127,526		[illegible]7
Total current liabilities	17,927,088	8,031,874	22,582,538	590,687	3,649,023	2,961,063	1,678,716	1,304,567	834,353	3,319,852	2,361,267	318,984	65,560,012	24,590,198		90,150,210	133,464	384,016		90,667,[illegible]
TAL LEASE OBLIGATIONS—current portion	89,269												89,269	25,698,141		25,787,410				25,787,410
G-TERM DEBT—Less current portion	10,566,536												10,566,536	1,338,194		11,904,730				11,904,730
UED VACATION—Less current on	5,096,931	2,680,608	5,531,723	153,952	732,442	1,122,733	958,273	468,934	195,580	1,735,462	1,355,534	111,259	20,143,431	718,569		20,862,000				20,862,000
TO AFFILIATES—Net	29,907,233	19,988,107		6,854,471	9,800,619	33,662,236	10,658,190	104,600	6,491,623	6,999,409	17,087,387	8,294,647	149,840,522		(149,840,522)	-	357,674	3,841,731	(4,199,405)	-
TO THE STATE OF HAWAII		7,605,205			1,114,264	1,843,345	2,417,150	506,153	528,149	6,416,791	491,450		20,122,507			20,122,507				20,122,507
ENTS' SAFEKEEPING DEPOSITS	30,796	7,570		4,335	50,376	7,065	22,244	11,073	6,598	161,599	57,178	3,664	362,498			362,498				362,498
R LIABILITIES	10,862		4,369	10,932		3,808	18,620	15,478	9,942	45,005	13,296		122,312	217,380		339,692				339,692
Total liabilities	63,628,715	38,305,364	28,118,630	7,614,377	15,346,724	38,800,250	15,745,193	2,408,805	8,066,245	18,678,118	21,366,112	8,728,554	266,807,087	52,562,482	(149,840,522)	169,529,047	491,138	4,225,747	(4,199,405)	170,046,527
ASSETS:																				
ted in capital assets-net of related t	30,520,793	28,768,925	56,479,756	1,344,311	4,841,948	12,644,020	3,714,185	-13,807,010	2,249,041	6,463,321	3,571,414	983,032	165,387,756	(22,644,314)		142,743,442	651	379,953		143,124,046
porarily restricted		137,244	300,000			34,241	25,628	9,242	2,296		24,535		533,186	5,000		538,186	411,409			949,595
stricted	(38,462,645)	(30,553,642)	679,101	(6,926,215)	(13,515,414)	(36,498,410)	(14,308,189)	(1,755,783)	(7,377,217)	(14,783,569)	(18,607,466)	(8,357,634)	(190,467,083)	148,985,944		(41,481,139)	(367,397)	(3,892,776)	(97,822)	(45,839,134)
Total net assets	(7,941,852)	(1,647,473)	57,458,857	(5,581,904)	(8,673,466)	(23,820,149)	(10,568,376)	12,060,469	(5,125,880)	(8,320,248)	(15,011,517)	(7,374,602)	(24,546,141)	126,346,630		101,800,489	44,663	(3,512,823)	(97,822)	98,234,507
L	$ 55,686,863	$ 36,657,891	$ 85,577,487	$ 2,032,473	$ 6,673,258	$ 14,980,101	$ 5,176,817	$ 14,469,274	$ 2,940,365	$ 10,357,870	$ 6,354,595	$ 1,353,952	$ 242,260,946	$ 178,909,112	$(149,840,522)	$ 271,329,536	$ 535,801	$ 712,924	$ (4,297,227)	$ 268,281,034

(Concl

Attachment 2

December 31, 2004

FISCAL YEAR 2004
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 27,200 volunteered service hours each year
  - Auxiliary raises between $15,000-$30,000 annually
    - Commission from Baby Photos - $3,500
    - Palm Tree Gift Shop - $25,000
    - Grants twenty (20) $500 nursing scholarship annually to nursing students at both UHH and HCC - $10,000
  - Hilo Medical Center Foundation
    - In FY 2003-04, the HMCF netted $317,438.87. As of June 30, 2004, a total of $1,038,243.79 was raised for the Emergency Department (pledges and gifts).
- **Hale Ho'ola Hamakua**
  - 29 active volunteers
    - Nearly 9983 volunteered service hours each year

- Auxiliary has raised more than $2000, in addition to providing two (3) $250 scholarships

- **Ka'u Hospital**
  - 17 active volunteers
    - Nearly 1500 volunteered service hours each year
  - Hospital Auxiliary donations included:
    - Seca over-sized wheelchair scale, $2,424
    - Fetal vascular probe, $700
    - Electric patient life, $3,500
    - Education scholarship, $200
    - Volunteer Appreciation Program sponsor, $50
    - Hospital Activity Program sponsor, $200
  - Ka'u Hospital Charitable Foundation
    - Obtained close to $12,500 in grants to furnish Ka'u Hospital Rural Health Clinic – i.e., furniture, office equipment, carpet, paint, wall paper, carpentry, and other labor costs

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
- Auxiliary members participated in the Emergency Ham Radio Network, Coffee Festival Parade, Second Hospital Foundation Golf Classic and Christmas at Kona Village silent auction
- Project for 2004—chapel for Kona Community Hospital

Kohala Hospital

- 5-22 active volunteers monthly
    - Nearly 1,900 volunteered service hours each year
- Kohala Hospital Auxiliary raised $31,971 with fundraisers, grants, & dues.
- The Auxiliary donated $22,628 for a complete Activity Dayroom renovation, including new furniture, nursing station renovations, outdoor pavilion renovation, funding for Open House event, hospital

newsletter, a steam table for the kitchen, new wheel chair Christmas party and gifts for the residents, a printer, nursing reference and medical books, a subscription to West Hawaii Today, and monthly funding for the Activity Fund.

- Auxiliary participated in the Mauna Lani Charity Christmas Tree display, had a booth at the Kohala County Fair, assisted with the LTC Customer Satisfaction Survey, and coordinates the PAVE student volunteer program.

- 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 ($800)
- 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 Scholarships & Award Luncheon.
  - Decorations for XMAS float

- Mahelona Medical Center Charitable Foundation
  - Supplies for CPR Classes, Friends & Family ($172)
  - Mahelona Holiday Sing Along ($10,115) event generated $18,225 in receipts
  - CPR Manikins – through a grant from Young Brothers ($2,000)
  - Crisis Prevention Training, 3 certified staff trained – through a grant from Young Brothers ($1,000)
  - 15 passenger van – grant through Antone & Edene Vidinha Charitable Trust ($52,350), Lions Club – freight for van ($300), Alexander and Baldwin Foundation ($1,000 toward shipping), Matson – ($1,000 toward shipping), and First Hawaiian Bank Foundation ($2,500)

MAUI REGION

- **Maui Memorial Medical Center**
  - 60 active volunteers
    - Nearly 12,000 volunteered service hours each year
    - Donated over $8,000 towards scholarships/workshops/continuing education
    - Made $8,333 at the annual Harvest Sale in November
    - Donated $1,140 to Radiology Department for continuing education.
  - 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**
  - 27 Active Volunteers
    - Nearly 6,100 volunteer hours last year
    - Auxiliary purchases totaled more than $16,000
      - 6 square-back chairs
      - 1 27-inch television, wall mount/VCR
      - 6 table tops
      - 1 wingchair with cut-out vinyl
      - 1 loveseat with cutout vinyl
      - 3 sofas with cutout vinyl
      - 3 fans
      - 1 Panasonic DVD/VHS player
      - 2 televisions with DVD/VHS attachment

- 1 Whirlpool 14.4 cubic foot, no-frost refrigerator
- 1 Magicphone
- 1 Wareing one-gallon blender
- 1 Brother sewing machinge
- 1 karaoke machine
- Thread galvanized pipe equipment
- 1 Shindaiwa weed wacker

- The Kula Hospital Auxiliary sponsored nine continuing education seminars for facility staff totaling close to $5,000.

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

OAHU REGION

- **Leahi Hospital**
  - 78 active volunteers
    - Nearly 9,169 volunteered service hours each year
    - Thrift Shop raised a net of more than $17,000
    - Thrift Shop covered nearly $29,000 in needed equipment
      - Security system for nursing units Young 3 and 5
      - Dishes for Dietary Department
      - Ice machine for North Trotter nursing unit
    - In kind donations totaled $2,220
    - Monetary donations totaled $900

- **Maluhia**

  - 102active 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 bed
      - Computers for resident internet access
      - Truck for use by Maintenance department

Attachment 3

East Regional Management Advisory Report
HHSC Annual Report
December 2004

The East Hawaii Region had a dynamic and interesting fiscal year. All three facilities show diverse growth and continued progress with projects that give outreach in community healthcare. Ka`u Hospital, Hilo Medical Center, and Hale Ho`ola Hamakua, are very excited about new partnerships and projects that will ensure better health care in the eastern region of Hawaii.

Ka`u Hospital has successfully showed progress within its first year as a combined CAH Rural Clinic and Hospital. The hospital has successfully hired three physicians; two doctors for clinic primary care and one ER specialist, providing 24/7 in ER coverage and doubling the coverage that was available in the past. Swing bed days have advanced exponentially with parallel growth in observation hours and acute care days. During this year's growth, cost effectiveness has been maintained to ensure continuation of affordable health care.

Hale Ho`ola Hamakua continues to operate in full capacity, with a waiting list, showing the need for additional beds in the coastal community. The request for capital improvement funds (CIP) has become a reality for the expansion of 50 more beds. The partnership with University of Hawaii at Hilo for a branch campus in the old state hospital has come to fruition and classes have already begun, enabling the community to take advantage of educational opportunities.

Hilo Medical Center has been busy securing federal funds for the first veteran's State Home on the hospital campus with the support of the Honorable Senator Daniel K. Inouye. State matching funds were also secured. Additional state funds were also secured for the improvement of the 2nd busiest ER in the State. The Hilo Medical Foundation has worked hard securing additional funds through community support for both projects.

The East Hawaii Region continues to be challenged by the Medicare/Medicaid/Quest coverage for a majority of its patients. Together with the assistance of the corporate staff and the support of the Board, the Regional facilities continue to build and grow with its services for our communities, meeting challenges face to face and finding solutions together as a team.

Respectfully Submitted,

Marge Elwell

Marge Elwell
Hawaii Region Management Advisory Committee Chairperson

WEST HAWAII MANAGEMENT ADVISORY COMMITTEE OF THE HAWAII HEALTH SYSTEMS CORPORATION

Annual Report for 2004

The West Hawaii Management Advisory Committee completed another dynamic year as positive changes continue at both Kohala Critical Access Hospital and Kona Community Hospital. For the purposes of clarity this report is divided into 4 sections: Management Advisory Committee (MAC), Kona Community Hospital (KCH), Kohala Critical Access Hospital (KCAH), and Recommendations.

Management Advisory Committee -

Generally service and patient satisfaction have improved throughout the region. Finances have improved at Kohala with the addition of 2 beds while Kona did not make budget due to a reduction in available physicians. The participation of the MAC Chairman, Reggie Morimoto, in the HB1800 required Ad Hoc Committee between HHSC staff and legislative representatives was mostly educational for all involved. The committee met between June and November with the results being very positive for HHSC.

Board members Ron Aronson, Louise Chun-Ling, RN and Dr. Robyn Cook, completed their much-appreciated service to the MAC. Heidi Stromberg, Ph.D. Daryl Kurozawa, MD, Bill Mielcke and Henry AhSam have joined as new members this year.

Kohala Critical Access Hospital –

Herb Yim, the hospital administrator for the last 5 years retired in September. Management, with the approval of the MAC, is restructured to make the Kona Community Hospital's CEO the administrator of both hospitals. The goal is to reduce costs and facilitate more regionalization of programs. Construction has started on the long awaited Kohala ambulance carport renovation to allow the new taller ambulances the ability to back up closer to the building and be covered in the rain. A new Emergency Room physician contract was let in July creating regional coverage and oversight.

The hospital Auxiliary renovated the day room to include new tile floor, new window dressings and new furniture. The hospital Foundation donated 20 new beds.

Kona Community Hospital –

The hospital growth slowed during the last year due to the retirement and relocation of several physicians from the medical staff. In September 2003 there were 5 obstetricians and 2 gynecologists on staff. By January 2004 the department was reduced to 4 obstetricians. In July the department was further reduced to 3 obstetricians and 1 gynecologist. Kona Community Hospital recruited 2 new OB/GYN's so that by January 2005 the medical staff will have 4 obstetricians and 2 gynecologists. In addition, 2 anesthesiologists were recruited and a full service contract was signed with the newly formed company, Kona Anesthesia, LLC, thereby significantly improving services to the hospital.

With the support of the Hospital Foundation the hospital completed construction of a helicopter-landing pad. The Foundation contributed more than 60% of the $70,000 project. In addition, a new parking lot is being constructed to replace and add additional spaces for the area set aside for the construction of the Radiation Therapy Clinic.

On February 1, 2004, Dr. Christopher Trauth opened the first full-time medical oncology service in West Hawaii. In August construction began on the $4 million dollar Radiation Therapy Clinic with a projected opening date of April 1, 2005. Both the Hospital Foundation and the Hospital Auxiliary have experienced very good years by significantly contributing to increasingly improved services offered by Kona Community Hospital.

Perhaps the best indicators of the state of Kona Community Hospital was being recognized by HMSA in its state wide program honoring the facility with the highest overall quality. Plus, the readers of the West Hawaii Today (local newspaper) voted KCH the best hospital in West Hawaii for the first time ever!

MAC Recommendations –

As noted last year it remains apparent that State support will continue to be required to fund the revenue gap between expenses rising at a faster rate than revenues. Accordingly, HHSC will need legislative support on the following issues:

1. Provide required funding for HHSC for FY06 and FY07.
2. Reinstate HHSC's exemption from the state procurement program.
3. Reduce the economic pressure on the medical staff to stop the physician flight from medical practice by addressing tort reform and ER coverage.

The ability to find receiving physicians to accept patients that need services not available on Hawaii or temporarily not available because the local physicians are off island or not on call is becoming increasingly difficult. The medical centers in Oahu are experiencing similar problems finding physicians who are willing to cover the emergency rooms, even for pay. This situation of not having physicians available throughout the state will be a disastrous problem if not promptly addressed.

WEST HAWAII MANAGEMENT ADVISORY COMMITTEE

Reggie Morimoto, Chair	Bill Mielcke
Henry AhSam	Roy Nagle, MD
Donna Brown	Frank Sayre, DDS
Ken Clewett	Keli'i Sine, RN, Ph.D.
Daryl Kurozawa, MD	Heidi Stromberg, Ph.D.

Respectfully Submitted,

Reginald Morimoto
Chairman
West Hawaii Management Advisory Committee

Maui Region Public Health Facility Management Advisory Committee
Hawaii Health Systems Corporation
Annual Report to the Hawaii State Legislature
December 2004

On behalf of the Maui MAC, I would like to thank you again for us an opportunity to submit this report as an attachment to HHSC Annual Report.

In the best of all worlds, health care facilities devoted to strengthening island communities work together for greater results. During fiscal year 2004, Maui Memorial Medical Center managed to report a small operating profit, but did not meet its operating performance target by over $2 million. While MMMC's revenues exceeded budget by over $6.6 million, expenses also exceeded budget by over $8.7 million, primarily in the area of salaries and benefits expense. Management continues to make improvements in its operations, particularly in the area of revenue cycle management

The Hawaii Health Systems Corporation plays an important role in helping its Maui region (i.e., MMMC, Kula Hospital, and Lanai Community Hospital) fulfill its mission to provide a superior medical staff, services, and technology to our patients. The continued support of the HHSC system is making a crucial difference in the quality of our patients' lives.

A major part of this assistance is the $42 million expansion and renovation of MMMC. This effort will serve an absolutely vital community need for decades. The project is part of a strategic, long-range plan to address future growth and healthcare trends. Construction is expected to be complete in 2007. Additionally, MMMC, through its leadership team and physicians, is proactively pursuing to expand its present specialized services that would provide services to patients from other islands.

At the same time, in light of steadily declining insurance reimbursements and an increase in our uninsured population, in addition collective bargaining wage increases, we continue to seek financial support from the State of Hawaii to ensure that every member of the community, regardless of economic background, will continue to receive quality medical care. Your continued assistance is a direct investment in the health and well being of your island communities. As you are aware, each HHSC facility plays an important role in effectively responding the healthcare needs of its communities.

Please support the Hawaii Health Systems Corporation so we can continue to fulfill our safety-net, community hospital mission in 2005. The Maui MAC greatly appreciates your commitment to uphold quality healthcare in Hawaii.

Respectfully submitted,

Herbert Sakakihara
Chairman

KAUAI REGION
Public Health Facilities Management Advisory Committee
P.O. Box 337
Waimea, HI 96796
Phone (808) 338-9431 Fax (808) 338-9420

Annual Report 2004

(CY January 1, 2004 to December 31, 2004)

Seasons Greetings!

On behalf of the Kauai Region Public Health Facilities Management Advisory Committee, I would like to thank you for the opportunity to share with you the events and activities that have taken place in the Kauai Region for the year 2004. The Kauai Region Senior Management Team has continued to effectively manage operational costs and revenue resources while working attentively to continually lead the various hospital departments and clinics of the Kauai Region (West Kauai Medical Center/KVMH, West Kauai Clinics – Waimea, Eleele, and the Mahelona Medical Center/SMMH) in providing quality healthcare to our island community.

The Kauai Region facilities, through the guidance of the Hawaii Health Systems Corporation, play an integral role in carrying out the mission of HHSC – to provide and enhance accessible, comprehensive healthcare services that are quality-driven, customer focused, and cost-effective.

This past year as been an exciting one with several blessings and events marking new beginnings for healthcare services/equipment for the communities we serve as well as an opportunity for KVMH to generate partial-electrical power (through positive networking with the Kauai Island Utility Cooperative and Noresco) for daily operations, thus minimizing monthly electrical costs.

Kauai Region Milestones:

- The Kauai Region Hospitals maintained their State Licensures and Medicare/Medicaid certifications.
- Kauai Co-Generation Project Blessing and Dedication was held on Tuesday, March 16, 2004. Key leaders from the Kauai Island Utility Cooperative, Noresco, Hawaii Health Systems Corporation and the Kauai Region came together to witness a new, positive beginning for KVMH. The Kauai Co-Generation project was put into place to allow KVMH to generate "partial" power for its use thus minimizing their monthly electrical power cost.

- The Obstetrics and Gynecology program at KVMH is blossoming beautifully. This year, we've witnessed 135 deliveries in comparison to 81 deliveries last year. The number of deliveries has significantly increased and it is all due to Dr. Surachat Chatkupt. He has been busy delivering babies as well as tending to women's health needs. The island community has taken a positive liking to Dr. Chatkupt.
- Over the past two years we've created a strong relationship with the Ho'ola Lahui Hawaii organization. The WKMC/KVMH currently lease space to HLH for their Federally Qualified Health Clinic and Dental office located in the Kawaiola Medical Building on the West Kauai Medical Center campus. This year, they moved forward in their quest, entering into a lease agreement with us to open a Federally Qualified Health Clinic and Dental office over on the east side on the Mahelona Campus to serve the east Kauai community. A blessing and dedication was held on Tuesday, April 13, 2004.
- Richard Goding, M.D, Orthopaedic Surgeon joined the West Kauai Clinics in September 2004. With his arrival, we have witnessed an increase in surgeries as well as in his patient volume. His practice has grown tremendously in a short period of time, a plus for the Kauai Region.
- Labor costs have continued to be reduced at both hospitals. Regionalization still plays in important role in the Kauai Region's quest to improve services and has contributed to a considerable reduction in managerial and staff positions through attrition, thus reducing our salary budget.
- The Kauai Region continues in its mission to carry out initiatives implemented to improve its cash collections. The region began the year with A/R days of 69 (budgeted 80) at KVMH and 78 (budgeted 80) days at SMMH. The year ended with a positive improvement of 52 A/R days at KVMH and 68 at SMMH respectively.
- The Emergency Department has been significantly busy this year. The total number of visits this year were at 2328 in comparison to that of 1864 last year.
- The Americans with Disabilities Act improvements to the public restrooms at KVMH and SMMH were completed making public restrooms more accessible and keeping in compliance with the ADA law.
- KVMH continues to benefit financially from the Critical Access Hospital (CAH) Program. Research on the possibility of converting SMMH into a Critical Access Hospital has begun.
- The Imaging Department of the West Kauai Medical Center/KVMH received a brand new Diagnostic Imaging System that was recently installed in the newly renovated room. This new machine replaced an "old dinosaur" that was first installed in 1978. The new machine was generously donated by Mr. & Mrs. Alfred and Elizabeth (Betsy) Knudsen Toulon. Mrs. Toulon is one of the founding members of the KVMH Charitable Foundation. We were able to celebrate this tremendous gift with a blessing and dedication ceremony on December 21, 2004. The Imaging Department of the West Kauai Medical Center/KVMH, along with the physicians, management and staff were truly grateful to receive a tremendous gift like this.

We are the Safety-Net healthcare provider for the communities we serve and are determined to continue caring for our island community. Your continued support of the Hawaii Health Systems Corporation allows us to carry on in our mission in 2005 and beyond.

Mahalo nui loa for your continued support.

Sincerely,

M. Jean Odo

M. Jean Odo
Chair, Kauai Region PHFMAC

Oahu Region Management Advisory Report

HHSC Annual Report

December 2004

In spite of an uncertain healthcare environment and a challenging year, the HHSC Oahu region (i.e., Maluhia and Leahi Hospital) continues to operate as effective public health care facilities committed to providing quality care. As a diverse group of individuals who work together as a team, the employees and administrative leadership continue to proactively respond to the long-term health needs of the Oahu communities through the implementation of sound business practices and services. And they continuously strive to maintain the highest standards.

The HHSC Oahu region performed well in 2004. The patient mix was on target and was consistent with the previous year. Likewise, the occupancy rate was right on target. Revenues and expenses exceeded budgeted goals. Cash collections exceeded its goal by $600,000. Total operating revenue exceeded its goals by $220,000. The region was also below its budgeted loss by $1.2 million, as of November 30, 2004.

2004 was another exciting year for the HHSC Oahu region. Maluhia opened its Employee Health Office in January. In March, the Oahu region enhanced its long-term care services by establishing the Leahi Hospital Outpatient Geriatric Clinic. It is one of only four such clinics in the nation operating in affiliation with the John A. Burns School of Medicine. Additionally, it is the only one in the United States offering elderly law consultation to its residents and their respective families.

Other highlights in 2004 included the100th birthday celebrations of two Leahi Hospital residents, Fujii Hasegawa and Sadako Kawamoto. Unfortunately, the former passed away shortly after the event. The HHSC Oahu region was also able to provide an educational opportunity, Compassionate Caring and Continuous Quality Improvement Program, for its section heads who learned how to help with other by learning from their mistakes and successes, and equally important, their enhance understanding and appreciation for long-term care issues.

The Leahi/Maluhia Foundation was greatly honored to be the recipient of a number of major grants totaling $67,200 from the Kosasa Foundation, J. Watamull Fund, Teruya Foundation, and the Thomas J. Long Foundation. The contributions are earmarked for the Leahi Hospital Walking Path and Garden Project.

These milestones have been realized thanks to the continued support of the Legislature and the Administration. Your continued 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 2005.

Aloha and Mahalo,

D. William Wood, Chair
Oahu Region Management Advisory Committee

PHYSICIANS ADVISORY GROUP
HAWAII HEALTH SYSTEMS CORPORATION
ANNUAL REPORT ATTACHMENT
2004

The Physicians Advisory Group, representing over 800 physicians throughout the State of Hawaii, recognizes the important role that the Hawaii Health Systems Corporation plays in maintaining the safety-net health care mission throughout our islands. The twelve HHSC facilities provide acute and long-term health care for all patients who come through our doors, regardless of ability to pay.

Of the major challenges for 2004, the most pressing is the specialty-care physician shortage on the neighbor islands. Thanks to initiatives by the HHSC leadership, this issue is being aggressively addressed through ongoing inter-agency discussion, involving representatives from the state's major acute care hospitals, the John A. Burns School of Medicine, the Department of Health, and the Emergency Air Ambulance Service. The PAG remains extremely optimistic, that through this collaborative effort, this critical issue will be resolved. We feel the ideal solution is for HHSC to continue providing appropriate, specialty care at the hometown level.

The PAG urges you to continue working with your colleagues to please consider legislation that will enable HHSC to continue its mission. Your support will provide this dynamic community hospital system with the resources needed to meet the varied and growing health care needs of the island communities that we all serve.

Sincerely,

T. Manoukian

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

- **HHSC Needs Increased Autonomy to Continue Reducing Operational Losses:** In spite of the constraints placed upon HHSC, we have reduced our Community Hospital System operational losses tremendously from the $46M loss in FY97. But, without further autonomy for HHSC, further reductions in the State financial support for mandated services are not feasible.

- **HHSC Has Limited Collective Bargaining Authority:** Collective bargaining pay increases are negotiated primarily by the State with input / involvement from HHSC, and then legislated for HHSC. By law, HHSC is provided with only one of the twelve employer votes. In essence, collective bargaining decisions still rest with the Governor along with at least one county mayor. HHSC (and the Judiciary) does not have any taxing authority of its own and accordingly, funding for collective bargaining is dependent solely on the State legislature. Therefore, HHSC's payroll and operating costs will be forever increasing under the current collective bargaining process resulting in requests to the legislature for higher and higher general fund appropriations. The most logical alternative for future payroll increases would be to empower HHSC to negotiate these issues independently from the other public employers.

- **HHSC Cares for Higher Acuity Patients = Higher Costs of Care:** HHSC hospitals are providing more definitive care for sicker patients now than in the past, however, reimbursement continues to decrease particularly in Long Term Care (LTC).

- **HHSC Inherited a Huge Debt from the State:** Approximately $150M dollars in deferred liabilities were passed to HHSC when it was created in 1996. Of that amount, approximately $100M dollars is related to liability for deferred maintenance, fire/safety certification deficiencies, and expansion requirements. Although HHSC is now implementing major facility energy conservation initiatives and the State has greatly assisted HHSC with CIP support, there is much more work that remains to be completed.

- **Nationally the rate of inflation for labor costs in healthcare continues to rise at an alarming rate.**
  - **Healthcare Employee Salaries & Wages**
    - 3.7% Increase in FY04
    - 4.0% in FY05
  - **Healthcare Employee Benefits**
    - 5.1% Increase in FY04
    - 4.6% Increase in FY05
  - **Total Salary & Benefits As % of Total Expenses Benefits**
    - 51.1 % National
    - 60 to 65% for HHSC

- **Hawaii's Hospitals, Including HHSC Facilities, Are Facing a Severe Malpractice Insurance Crisis.**
  - Dramatic Nationwide Increases in Costs for Hospital & Physician Malpractice Insurance
  - Farmers Insurance Has Departed the Malpractice Market after providing insurance to HHSC hospitals for 15 years
  - HHSC Malpractice Costs to Increase from $1.5M in FY04 to over $4M in FY05

- **Hawaii's Hospitals (to Include HHSC's 12 Hospitals) Have on Average a Negative Operating Margin for Medicaid and Medicare Patients that is Drastically Worse than Mainland Hospitals.**
  - **Hospital Margins - Medicaid**
    - ☐ US Mainland: -4% to –9%
    - ☐ Hawaii: -25%
  - **Hospital Margins - Medicare**
    - ☐ US Mainland -2% to –6%
    - ☐ Hawaii: -21%

- **Even with Private Pay Patients, Hawaii Hospitals to Include HHSC, Have a Much Less Positive Average Operating Margin Than Hospitals on the Mainland.**
  - **Hospital Margins - Private Payers**
    - ☐ US Mainland +14% to 18%
    - ☐ Hawaii +6%

Please visit us on the web @
www.hhsc.org or at:
www.hawaiihealthfoundation.org
Hawaii Health Systems Corporation
3675 Kilauea Avenue
Honolulu, HI 96816
Phone: (808) 733-4662 FAX: 808-733-4664

Updated As of: December 2004

"Touching Lives Everyday"
HAWAII HEALTH SYSTEMS
CORPORATION

Hawaii Health Systems Corporation

Successes

as of December 2004

- **HHSC Has Enhanced Quality:** Quality of care, access to care, and levels of service throughout the system have dramatically improved as a result of HHSC's management decisions and operational leadership

- **Increased Utilization of HHSC Facilities & Services:** The most poignant evidence of improved quality of care at HHSC facilities is in the steady annual increase in the percentage of Neighbor Islanders opting for acute care services on their Island – that is, they prefer to go to HHSC community hospitals versus traveling to Oahu for care. Over the past five years, our Neighbor Island facility patient volume has increased by approximately 10% while Oahu's volume of Neighbor Island patients decreased by a commensurate amount

- **Very Small State Support Required:** Because of the successful and efficient operation of the 12 community hospitals by HHSC, the amount of funding support that the State has provided HHSC each year, for the past seven years, is small, relative to the value of the $350 million in "safety-net" healthcare provided to the State of Hawaii. For example, based on the amount of money the 2004 Legislature appropriated for HHSC community hospitals in FY05, the State is spending less than **25 cents per day for each Neighbor Island resident** in order to have access to a full range of acute and long term care services available at HHSC facilities.

- **Generating Increased Revenues:** HHSC has earned 90% to 95% of its annual operating costs with approximately 5% to 10% support coming from

Attachment 5

the State of Hawaii for mandated services over the past seven years

- **Increased Revenue and Reduced Expenses**: Between FY97 and FY04, HHSC has constrained total expenses and increased total revenue by more than $150M.

- **Enhanced Return on Investment (ROI) for Hawaii**: In terms of return on investment (ROI) for the State, HHSC has proven to be a tremendously successful investment for Hawaii because the national average funding support that other states give to their community hospitals for external operations averages approximately 20% per year, compared to HHSC which is approximately 10% operational support from the State.

- **Successful Accreditation and Certification**: Over the past seven years, each of our twelve HHSC facilities have successfully passed every State / Federal accreditation and certification survey as well as every survey by the Joint Commission on the Accreditation of Healthcare Organizations (JCAHO). HHSC certification and survey scores have been markedly higher compared to scores received prior to HHSC taking full responsibility for the system in 1997.

- **Increased Efficiency in Corporate Operations**: HHSC has reduced Corporate Office operating expenses in FY04 to under 2% of the overall system operating expenses, compared to 2.5% in FY02 and compared to an average of 6% of operating costs for similar systems throughout the USA.

- **Telemedicine & Telehealth**: HHSC in partnership with University of Hawaii has established the State of Hawaii Telehealth Access Network (STAN) enabling HHSC facilities to take the leading edge in Telemedicine technology and initiatives in Hawaii.

- **HHSC-Union Partnership**: Over the last several years, HHSC and the Unions representing HHSC employees and patients have established very collegial and collaborative working relationships. HHSC considers our professional relations with HGEA, UPW, ILWU and other local unions, to be a "partnership to success".

- **Four HHSC Hospitals Achieve Critical Access Hospital (CAH) Designation**: In order to capitalize on enhanced reimbursement for rural hospitals in the Federal CAH program, four HHSC hospitals applied for and then been re-designated as CAH's. This re-designation has resulted in more than $3 million per year in additional Federal reimbursement to HHSC for services provided at our CAH's.

Continuing Challenges

- **We Have a Long Term Care (LTC) Crisis in Hawaii**: In Hawaii, the severe crisis that the State is facing in terms of access and availability of LTC services has been well documented. Unfortunately there has not been sufficient action taken to alleviate this crisis and the situation continues to worsen. HHSC is the single largest provider of LTC services in Hawaii with 808 LTC beds on five islands. HHSC is continually exploring and pursuing initiatives to expand LTC capacity and capabilities in Hawaii, but it is a complicated, costly process. Sufficient LTC beds are not available to serve our communities, resulting in large numbers of "wait-list" patients in major HHSC acute facilities. These wait-listed LTC patients generate millions of dollars of increased costs to the care HHSC provides, and these patients are receiving the wrong level of service. HHSC must continue to evolve to meet these LTC needs of the communities we serve by adding / facilitating both more home and community-based care capability, as well as increasing LTC beds. Although two new facilities, and one expanded facility now have appropriate funding, and the Department of Human Services is working closely with HHSC on several home and community based care initiatives, more needs to be done.

- **No Medicaid "DSH" Payments for HHSC:** HHSC is the only community hospital system in the United States that is not eligible to be considered for Medicaid DSH (Disproportionate Share Hospital) payments to help off-set the high costs and low reimbursements for providing quality care in our "Community Hospital System".

- **Impediments to Continued Success**: Ironically, the ability of HHSC to gain further efficiency in the operation of our "Community Hospital System" is tremendously impeded by the same law that created the Corporation in 1996. Act 262 basically requires HHSC to:

  - ✓ remain under the State civil service system;
  - ✓ to have the State conduct collective bargaining with measured input by HHSC; and
  - ✓ to have the Legislature control substantial changes to levels of service.

  In fact, requests for State support will increase proportionate to Collective Bargaining Pay Increases, Employee Retirement System (ERS) mandated costs, and employee/retiree health premium increases. HHSC is now being charged $20M more for ERS contribution in FY05 than it was charged in FY02 (the ERS increase in FY03 and FY04 was $14M more than FY02).

- **HHSC Has Significant Operational Constraints Imposed Upon It**: It is these three areas (shown above) plus constraints on potential outsourcing and managed competition that drive up the costs that the State shares for operating the "Community Hospital System".

- **Ka'u Hospital**
  - Attained Critical Access Hospital (CAH) Status in July 2001
  - Increased LTC/acute Beds from 15-21 total beds
  - $300K annual savings with Rural Health Clinic Implementation
- **Hale Ho'ola Hamakua**
  - Collaborate with UH for College level Nurse Aide Training
  - New U of H Regional Learning Center
- **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**
  - Attained Critical Access Hospital status in July 2001
  - 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
- **Kauai Veterans Memorial Hospital**
  - Established First Critical Access Hospital in Hawaii
  - Added New 24-Hour Ultrasound Service
  - Initiated Kauai Teleradiology Center
  - 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.
  - Expanded Obstetrics Service with over 100 babies born in FY04.
- **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
  - Helped Facilitate Establishment of Kauai's Second Federally Qualified Health Center
- **Maluhia**
  - Basement Expansion & Interior Improvements
  - Expansion of PACE
- **Leahi Hospital**
  - Adult Day Care Health Service Expansion
  - Developed IV Therapy Program

  - New Nurse Assistant Training Program

Please visit us on the web @
www.hhsc.org or at:
www.hawaiihealthfoundation.org

Hawaii Health Systems Corporation
3675 Kilauea Avenue
Honolulu, HI 96816

Updated As of: December 2004

"Touching Lives Everyday"
HAWAII HEALTH SYSTEMS
CORPORATION

Phone: (808) 733-4662
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Hawaii Health Systems Corporation
Cost Savings & Enhanced Revenues

1. **Overall savings to Hawaii of more than $150 million in past seven years compared to FY97**
2. **NORESCO (Energy co-generation) savings of more than $20 million beginning in FY99**
3. **Reestablish hospital radiology services at four HHSC facilities = $19 million dollars in new revenue per year since FY02**
4. **Laboratory contract re-negotiation with ClinLab - $5 million savings per year since FY97**
5. **Insurance re-negotiation - $1 million per year from FY97 – FY02**
6. **Workers Compensation claims per 100 employees consistently reduced from 21.5 in FY97 to less than 8 per year each year since then.**
7. **Achieved Critical Access Hospital (CAH) status for four HHSC hospitals and thereby**

Attachment 6

enhanced HHSC revenue by more than $3 million per year starting in FY02

8. Increased HHSC revenues thru enhanced cash collections from $203 million in FY99 to $291 million in FY04.

9. Medical Supply consolidation savings of $4 million per year since FY97

10. Re-negotiation of third-party payer contracts - ($$ savings amount is proprietary information) since FY97.

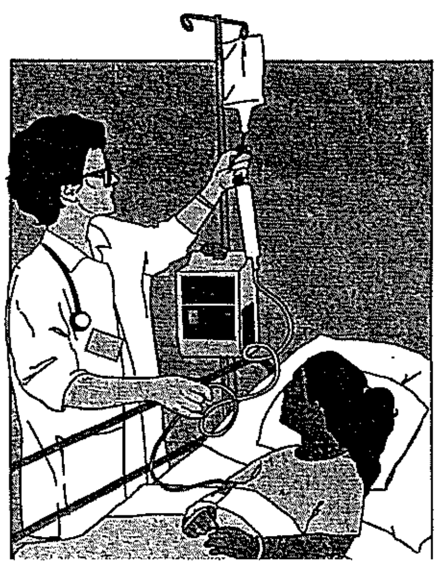
11. 340B pharmaceutical program (federal discount program for safety-net patients) - $300,000 per year since FY03.

12. Consolidate equipment maintenance support, savings of $500,000 per year since FY01

13. Established Rural Development Fund Nurse Training and Development Program HHSC-wide with $1 million grant in FY03 / FY04

14. Implement restructuring plans under Volunteer Separation Incentive Program (VSIP) in FY03 and FY04 with annual savings of $1.1 million

15. Foundation expansion- from only 3 Foundations in FY97 to 9 Foundations in 2004 supporting HHSC facilities.



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 Big Island Radiology 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 115 automated 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 for all 12 hospitals
  - Developed most Comprehensive & Functional Teleradiology Program in the State
  - Video Teleconference
  - Completed Year 2K Compliance
  - Completed HIPAA Compliance

Updated As of: December 2004

  - Established Award Winning Healthy Workplace Program
- **Maui Memorial Medical Center**
  - Magnetic Resonance Imaging Replacement
  - New Computerized Tomography Scanner
  - New Monitoring Systems
  - New Neurosurgery Service
  - New Cardio-Vascular Center
  - Started $38M Hospital refurbishment
- **Lanai Community Hospital**
  - New Renal Dialysis Service
  - Nurse Call System Replacement
  - Attained Critical Access Hospital (CAH) status in July 2001.
- **Kula Hospital**
  - Increased Admissions from 25/year to 150/year
  - Increased Skilled Nursing Days from 900 patient days/year to 6,000+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

Attachment 7

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

"Touching Lives Everyday"

February 11, 2005

COO/CFO-05-007

TO: Thomas Driskill, Jr.
President & Chief Executive Officer

FROM: Kelley Roberson
Chief Operating Officer & Chief Financial Officer

SUBJECT: HHSC Receives Recognition in its Efforts to Improve Quality of Care

Hawaii Health System Corporation was awarded $1.2 million out of the $7.5 million awarded from the 2004 Hawaii Medical Service Association (HMSA) Hospital Quality and Service Recognition Program (HQSR) in recognition of its efforts to improve the quality of hospital care over the past year.

Now in its fourth year, HMSA's 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 fourth consecutive year that participating HHSC facilities have received recognition for quality improvements. Last year, six of the above facilities received financial awards totaling $1.2 million out of $8.0 million in awards.

3675 KILAUEA AVENUE • HONOLULU, HAWAII 96816 • PHONE: (808) 733-4020 • FAX: (808) 733-4028

HILO • HONOKAA • KAU • KONA • KOHALA • WAIMEA • KAPAA • WAILUKU • KULA • LANAI • HONOLULU

Posted on: Friday, September 3, 2004

Work to begin on Hilo veterans center

Associated Press

HILO, Hawai'i - Hawai'i's first military veterans home will be a $28 million facility on the site of the old Hilo Hospital, built in 1951 to care for tuberculosis patients.

The old hospital will be razed to make way for a 95-bed care home, which is slated to open in late 2006 or early 2007.

At a ceremony Wednesday, U.S. Sen. Dan Inouye, D-Hawai'i, who arranged for the U.S. Veterans Administration to kick in 65 percent of the construction costs, said the project shows veterans that their service still is valued.

"With our actions today, we say to them duty, honor and country are not a one-way proposition," he said before joining Big Island Mayor Harry Kim and U.S. Rep. Ed Case, D-Hawai'i, in knocking a rock from the entry way to get the demolition started. "We will remember your sacrifice and we will remember your service."

Inouye also noted the dedication of such community organizations as the Hilo Medical Center Foundation, which helped raise money, and the more than 1,000 residents who signed a petition backing the care center.

Although originally envisioned as a 300-bed home, the project was scaled back because of the state's budget constraints.

The state has contributed $10 million, but plans call for expansion in the future.

Kim said the care center is not just for veterans who live in the Hilo area, but for all the veterans of Hawai'i. He pledged the center will not feel like an institution to its patients, as they should feel they are coming home.

Hawai'i is one of three states that does not have a long-term care facility for veterans.

This project is a step in the right direction, said Dale Wilson of Mountain View, a Vietnam veteran and member of the Military Order of the Purple Heart.

Wilson said with veterans making up as much as 10 percent of Hawai'i's population, the demand for services will only grow.

Delbert Nishimoto, Big Island vice-chairman of the Veterans Advisory State Board, said veterans across the state appreciate the efforts of the community and county, state and federal officials.

"At this place," Nishimoto said, "we vets feel very comfortable."

FOR IMMEDIATE RELEASE

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Maui Memorial Medical Center Hosts Groundbreaking for $42 Million Expansion

WAILUKU, MAUI, HAWAII – (January 6, 2005) – In its ongoing campus redevelopment, Maui Memorial Medical Center today held the groundbreaking for the $42 million expansion project that will provide a new 80,000 sq. ft. wing and improved patient services. The wing will become the new face for the hospital by and will house the new reception and admitting areas, as well as new occupational and physical therapy areas. The groundbreaking was attended by more than 100 of Maui officials and citizens.

"This is a very exciting moment for us," said Wesley Lo, Maui Memorial Medical Center CEO. "We have been building up to this day for many years and it is the result of many people working long hours to create the master plan and then work to secure the funding necessary to complete construction," according to Wesley Lo, Chief Executive Officer at Maui Memorial Medical Center. "It hasn't been an easy process, but we are thankful for the tenacity of the people who have long believed that improving healthcare on Maui begins with growing and strengthening Maui Memorial."

The construction project is scheduled for completion in 2007 and when finished will add the following:

- New lobby
- Additional ICU/CCU Beds & Med/Surg Beds
- Expansion of SurgiCenter
- Expansion of Surgical Support
- Upgrades and expansion of community/family support areas
- Expanded PT/OT Department

The existing circle in the front of the hospital will become a garden and reflecting area for patients and visitors.

(more)

The $42 million project was funded by $38 million appropriated as a general obligation bond by the state Legislature and another $4 million was a municipal loan.

Later in the year, construction will also begin on a new medical office building and parking structure at Maui Memorial. That $60 million project is being privately financed and will be developed by Maui Health Care Buildings, LLC.

About Maui Memorial Medical Center

Founded in 1952, Maui Memorial Medical Center is Maui's only full-service, acute-care hospital. The 196-bed hospital has more than 200 attending physicians and 1000 employees and its mission is to provide quality health services for all. It is part of the Hawaii Health Care Systems Corporation, Hawaii's safety-net healthcare system and can be found on the Web at www.hhsc.org

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(more)

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Attachment 10

"Touching Lives Everyday"

HAWAII HEALTH SYSTEMS

CORPORATION

Hawaii Health Systems Corporation, HHSC

Informational Budget Briefing on

Requests for Biennium Budget 2006-2007

Presented to the

House Finance Committee

And the

Senate Ways & Means Committee

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

I. Introduction:

A. Summary of program 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 healthcare for the people of Hawaii, with emphasis on support for our rural acute and rural Long Term Care (LTC) facilities.

In accordance with HB1800, HD1, SD1, CD1, a proposal being finalized for FY06-07 and beyond is a proposal for "Reducing the State's Payment for Services Provided by HHSC" in future years. This effort is in concert with the Ad Hoc Committee process in accordance with HB1800, CD1.

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 program objectives.

System. 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, the 22nd largest business in Hawaii, 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 system 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.

C. Explain how your system intends to meet its objectives within the upcoming fiscal biennium.

HHSC will meet FY 06 and FY 07 program and budget objectives by collecting patient revenues to meet approximately 90 percent of expense requirements resulting in minimized general fund requirements. HHSC will execute its operations in the most efficient manner possible to ensure continued success in providing safety-net services to all the communities served by HHSC hospitals.

II. Program Performance Results:

A. Discuss the performance results achieved by each program in FY03 and FY04

Quality, accessible and affordable healthcare efficiently provided by HHSC facilities to all communities served. Details available upon request.

B. Explain how these results relate to the program's objectives and department's mission.

Mission accomplished. Successfully fulfilled HHSC Safety-Net mission within budget and with quality outcomes.

C. Explain how the effectiveness of the program is measured and discuss the performance results achieved during the past two years.

All 12 HHSC hospitals are fully certified and licensed by both State & National standards assuring the highest quality of care for Hawaii's patients. All HHSC facilities are certified annually by Medicare / Medicaid and all have successfully passed those surveys.

In 2002, HHSC completed 1st Hospital System survey by JCAHO and first Critical Access Hospital (CAH) survey by Joint Commission on Accreditation of Healthcare Organizations (JCAHO) in the State of Hawaii. All hospitals surveyed, passed with some of the highest scores in the U.S. HHSC will receive its next JCAHO surveys in late 2005.

In addition, HHSC annually has a detailed independent third party financial audit conducted for the entire system. HHSC has just received its <u>seventh</u> consecutive "clean" unqualified audit with no material weaknesses and no reportable conditions. Furthermore, HHSC has a myriad of internal reporting / performance measures that are utilized by management and the board of Directors to insure compliance, quality and financial efficiency in all system work. Details available upon request.

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.

E. Please identify all modifications to your system's performance measures and discuss the rationale for these modifications.

As necessary, HHSC internal reporting / performance measures are continually adjusted and revamped to meet the ever-changing needs of today's fluid healthcare environment. Some examples are in annual reporting measures on workers compensation; new revenue enhancing measures; and additional quality measures involving patient safety. Details available upon request.

III. Problems and Issues:

A. Discussion of problems and issues encountered if any.

1. Increasing Charity Care / Bad Debt
2. Under Reimbursement by Medicare / Medicaid / Quest
3. Hawaii is the Only State with NO Medicaid Disproportionate Share Hospital (DSH)
4. Skilled Healthcare Labor Shortage is Exacerbated by the Civil Service and Collective Bargaining Provisions
5. Pressures on Physicians --- Increasing Demands and Needs for Hospitals Payments to Physicians
6. Increasing Cost of Professional & Hospital Liability Insurance
7. Insufficient Capacity for Long-Term Care (LTC) Patients, Resulting in Acute Care Hospital Wait-List
8. Niche Providers Skimming Profitable Services
9. Legislative Constraints on HHSC Operations
    a. ACT 262 basically requires HHSC to:
        i. Remain under the State Civil Service System
        ii. Have the State Conduct collective bargaining with only measured input by HHSC
        iii. Have the Legislature control substantial changes to levels of service
        iv. No Outsourcing
    b. ACT 294 Medicaid Equity Reimbursement
        i. ACT 294 will cost HHSC (and ultimately the State) over $13 million per year in lost reimbursements.
10. HHSC Inherited a Huge Debt for the State

Hawaii Healthcare Challenges (contd.)

Hawaii Lags Far Behind the Nation in Payer Margins

- Hospital Margins – Medicaid
  - Nation: - 4% to -9%
  - Hawaii: - 25%
- Hospital Margins – Medicare
  - Nation: - 2% to -6%
  - Hawaii: - 21%
- Hospital Margins – Private Payers
  - Nation: + 14% to + 18%
  - Hawaii: + 6%

* AHA Report – March 2003 (Reporting from 3,154 Hospitals)

Hawaii Healthcare Challenges

Hawaii Hospitals Have Moved From Profit to Loss for 1998 to 2002

	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002
HHSC Operating Income (Loss)	-18526053	-28027357	-19423391	-25835447	-29883322
Hawaii Hospitals Operating Income (Loss)*	46526053	38027357	11423391	-27064553	-40116678

*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. **Program change recommendations to remedy problems.**

The HHSC Board of Directors and management are committed to continuing the transformation of HHSC into a healthcare system that provides access to quality healthcare for all patients in our communities regardless of their ability to pay. In order to continue being the quality system that our communities deserve, and reduce State's payments for services provided by HHSC, HHSC must be afforded much more autonomy, with support to address concerns beyond HHSC control.

C. **Identify any program issues or problems that have affected or will affect the implementation of the program, and the corrective measures or remedies established or planned.**

- Delivery of Continuous Quality Healthcare
- Most Cost Efficient Delivery of Care Possible
- Reducing the State's Payments for Service Provided by HHSC

IV. Expenditures for Fiscal Year 2004-2005:

	Act 41/04 FY 2005	Add'ns/(Red'ns) C/B, Transfers, (Restrictions)	Net Allocation	Est. Total Expenditures
(posn count)	(2836.25)		(2836.25)	(2836.25)
Personal Svcs	215,000,000	9,819,002	224,819,002	215,000,000
Current Exp.	138,486,406	(278,485)	138,207,921	120,771,986
Equipment			-	-
Motor Vehicles			-	-
	353,486,406	9,540,517	363,026,923	335,771,986
(posn count)	(2836.25)		(2836.25)	(2836.25)
Special Fund	325,637,937		325,637,937	298,383,000
General Fund	27,848,469	9,540,517	37,388,986	37,388,986
	353,486,406	9,540,517	363,026,923	335,771,986

The $9,819,002 represents funds received for collective bargaining. The $278,485 represents a one-percent efficiency reduction imposed by the Governor. Impact to the system is minimal.

V. **Biennium Budget Requests for Fiscal Year 2005-2006 and Fiscal Year 2006-2007:**

	FY 2006	FY 2007	Total FB Requirements
(posn count)	(2836.25)	(2836.25)	(2836.25)
Personal Svcs	220,071,000	220,747,000	440,818,000
Current Exp.	146,652,978	145,976,978	292,629,956
Equipment			-
Motor Vehicles			-
	366,723,978	366,723,978	733,447,956
(posn count)	(2836.25)	(2836.25)	(2836.25)
Special Fund	325,637,937	325,637,937	651,275,874
General Fund	41,086,041	41,086,041	82,172,082
	366,723,978	366,723,978	733,447,956

Workload or Program Request.

None

VI. **Program Restrictions:**

The only restriction is the carried over from Fiscal Year 2004-2005 one percent efficiency savings.

VII. **Capital Improvement Program (CIP) Request for Fiscal Biennium 2005-2007:**

A. HAWAII HEALTH SYSTEMS FOUNDATION, HILO MEDICAL CENTER, STATE VETERANS HOME, HILO, HAWAII

CONSTRUCTION TO BUILD A LONG-TERM CARE FACILITY ON THE CAMPUS OF HILO MEDICAL CENTER IN HILO, HAWAII. THE OLD HOSPITAL STRUCTURE WILL BE DEMOLISHED AND REMOVED IN ORDER TO BUILD THIS NEW STRUCTURE.

	FY 2006	FY 2007
Construction	18,228 N	

Explanation and Scope of Project

This is a joint endeavor (Federal / State partnership) between the VA and HHSC to build and equip a long-term care facility on the grounds of Hilo Medical Center (HMC). The old Hilo Hospital that has not been used for direct patient care for 15 years will be demolished. The new State Veterans Home will be available for use by veterans in need of extended health care.

Justification for the Project

The State of the Hawaii is the only state in the nation without a State Veterans Home for our veterans. The Federal government has conditionally approved our application for Federal assistance in the cost of construction for a new 95-bed facility and has set aside the funds for this project.

Senate District 06 **House District** 11

B. MALUHIA, INSTALL FIRE SPRINKLER SYSTEM, OAHU

DESIGN AND CONSTRUCTION TO INSTALL A FIRE SPRINKLER SYSTEM

	FY 2006		FY 2007
Design	50	C	
Construction	450	C	

Explanation and Scope of Project

Design and construction to install a fire sprinkler system throughout the facility to be in compliance with the fire requirement for Medicare/Medicaid.

Justification for the Project

The facility has been cited by Medicare/Medicaid for being non-compliance and will be subject to fines should we not correct this situation.

Senate District 14 **House District** 27

C. KAU HOSPITAL, SEWER/SEPTIC (CESSPOOL) TANK, HAWAII

CONSTRUCTION FOR A SEPTIC OR WASTEWATER TREATMENT FACILITY

	FY 2006		FY 2007
Construction	400	C	

Explanation and Scope of Project

Installation of a septic or wastewater treatment facility to replace existing gang cesspools. There is an U.S. EPA ban on gang cesspools and a waiver needs to be obtained to request for extension beyond the deadline of April 2005.

Justification for the Project

This is a regulatory EPA requirement that will be in effect April 2005. Failure to receive approval of an extension and have a plan to replace existing cesspool could result in EPA fines and sanctions.

Senate District 03 **House District** 04

D. MAUI MEMORIAL MEDICAL CENTER, ROOFING REPAIR / REPLACEMENT, MAUI

DESIGN AND CONSTRUCTION TO REPLACE LEAKY ROOFS THROUGHOUT THE CAMPUS

	FY 2006		FY 2007	
Design	50	C		
Construction	200	C	250	C

Explanation and Scope of Project

Design and construction to replace aging and wind damaged roofs. Some of the roofs are old and leaking in key areas like the MRI building.

Justification for the Project

Presently, leaky roofs affect key areas – Nuclear storage, MRI, pathway from dietary to maintenance, business office, cottages, lanai walkway, and ER. During the rainy season or heavy storms, leakage will occur and may cause damage to computers and medical equipment. Also, it is a hazard as slippery conditions will occur and staff, patients, or visitors may slip and fall.

Senate District 05 **House District** 09

E. KONA COMMUNITY HOSPITAL, REPAIR AND REPLACE EXISTING ROOF, HAWAII

CONSTRUCTION TO REPAIR AND REPLACE ROOF ON THREE BUILDINGS

	FY 2006		FY 2007
Construction	300	C	

Explanation and Scope of Project

Construction to repair and replace the roof on the Special Services, Main Hospital, and Nursing Cottage buildings. Work will include removing and replacing existing metal roof on the Nursing Cottage and removing and replacing existing roofing materials used on the Main Hospital. Cost to include disposal of all old materials. Work will also include repairing the leaking roof on the Special Services building.

Justification for the Project

The roof on the Special Services building leaks during moderate to heavy rains. The roof on the Nurses Cottage is very old and leaks and cannot be repaired. It needs to be replaced. The roof on the Main Hospital is covered with membrane that is weather cracked and has multiple patches. It leaks during moderate to heavy rains and ceiling tiles are frequently changed because of the damages.

Senate District 03 **House District** 05

F. KAUAI VETERANS MEMORIAL HOSPITAL, ELECTRICAL UPGRADES, KAUAI

DESIGN AND CONSTRUCTION TO CORRECT VARIOUS CODE VIOLATIONS OF THE NATIONAL ELECTRICAL CODE

	FY 2006		FY 2007
Design	70	C	
Construction	880	C	

Explanation and Scope of Project

Design and construction to rectify various codes violations at Kauai Veterans Memorial Hospital including, but not limited to the following: 1) Relocating the air handler unit and associated ductwork located in the electrical room of the 1957 wing of the hospital The unit currently encroaches into the workspace clearance of the electrical apparatus. 2) Relocation of existing distribution panels because of inadequate workspace clearance fronting panel boards, disconnect switches, and enclosed circuit breakers throughout the facility. 3) Upgrade the electrical distribution system for the 1957 wing and other areas of the hospital. Remove existing apparatus devices, and branch circuit wiring and replace with new. 4) Remove and replace breakers / distribution panels in the 1978 wing that is defective. Check and upgrade all isolation monitor circuits. 5) Remove / dispose and replace of interior and exterior luminaries as necessary. 6) To verify and identify all circuits in all distribution panels throughout the hospital to include the labeling of all outlets and lights. To also replace or add additional circuits if the present circuits do not meet the requirements as set forth by the National Electrical Code.

Justification for the Project

The present distribution panels and wiring in the 1957 wing are old. Insulation of the wire is deteriorating and could cause a fire and endanger patients, staff, and visitors. Accessibility to disconnect is limited in space and does not meet code. Breakers for these distribution panels can no longer be acquired and because of this, some circuits are doubled up on another breaker. The testing of the breakers, as required by code, is not done on an annual basis because of the chance the breakers will not work once it is tested.

Senate District 07 **House District** 14

G. MALUHIA, UPGRADE ELEVATOR RECALL SYSTEM, OAHU

DESIGN AND CONSTRUCTION TO UPGRADE THE ELEVATOR RECALL SYSTEM

	FY 2006		FY 2007
Design	20	C	
Construction	80	C	

Explanation and Scope of Project

Design and construction to upgrade the elevator recall system to bring Maluhia's elevators in compliance with Firefighters Service Requirement Safety Code for existing elevators.

Justification for the Project

In event of a fire, Maluhia's elevators will not automatically go the lowest floors and will cause problems for firefighters. Also, Maluhia will be subject to monetary fines by Medicare/Medicaid, licensing agency.

Senate District 14 **House District** 27

H. KONA COMMUNITY HOSPITAL, EMERGENCY POWERS, HAWAII

DESIGN, CONSTRUCTION, AND EQUIPMENT TO ADD / INCREASE EMERGENCY POWER TO PATIENT ROOMS

	FY 2006		FY 2007
Design	50	C	
Construction	150	C	
Equipment	50	C	

Explanation and Scope of Project

Design, construction, and equipment to install / add control panels, circuit breakers and outlets to support patient care equipment during power outages. Work will include increasing number of electrical panels, pulling additional wires and increasing the number of circuit breakers. Each patient room shall have at least one emergency power outlet.

Justification for the Project

The existing patient care rooms in the long-term care and medical / surgical units do not have emergency power outlets. Extension cords are plugged in at the nurses station and pulled to the rooms were electrical equipment supporting patient care is being used. This is a safety hazard and staff tends to overload the extension cords by adding additional lines to each extension cord. This overloads the circuit breaker.

Senate District 03 **House District** 05

I. MALUHIA, REPLACE NURSE CALL SYSTEM, OAHU

DESIGN AND CONSTRUCTION TO REPLACE THE NURSE CALL SYSTEM

	FY 2006		FY 2007
Design	20	C	
Construction	80	C	

Explanation and Scope of Project

Design and construction to replace the nurse call system to meet the Medicare/Medicaid requirements.

Justification for the Project

Presently, the system does not work properly. Lots of callbacks and overtime occurs when the system malfunctions. Nursing staff gets irritated and we are not in compliance with Medicare/Medicaid.

Senate District 14 **House District** 27

J. SAMUEL MAHELONA MEMORIAL HOSPITAL, ELECTRICAL POWER UPGRADE, KAUAI

DESIGN AND CONSTRUCTION TO REPLACE ALL ELECTRICAL APPARATUS, BOXES, RACEWAYS AND CONDUCTORS IN THE CRAWL SPACE UNDER THE BUILDING AND EXTERIOR WALKWAYS. ALSO TO RECTIFY VARIOUS CODES VIOLATIONS.

	FY 2006		FY 2007
Design	50	C	

Construction	580	C

Explanation and Scope of Project

Design and construction to replace all electrical apparatus, boxes, raceways, and conductors in the crawl space under the building and exterior walkway. Also to rectify various codes violations including but not limited to the following: 1) Inadequate workspace clearance fronting the disconnect switch for the A/C unit in Radiology. 2) Inadequate workspace clearance fronting Panel K and K1 in the kitchen. 3) Inadequate workspace clearances fronting the panel board and disconnect switches in the Boiler Room. 4). Inadequate workspace clearance fronting the panel board in the Laundry room. 5) To verify and identify all circuits in all distribution panels throughout the hospital to include the labeling of all outlets and lights. To also replace or add additional circuits if the present circuits do not meet the requirements as set forth by the National Electrical Code. 6). The replacement of all interior and exterior luminaries.

Justification for the Project

The present electrical conduit, raceways, and boxes that are on the outside of the building are rusted and in some places have deteriorated to where the wire is exposed. Presently, a lot of the circuits in the hospital are overloaded and breakers keep tripping. New circuits need to be added to handle the load. Also the wiring is from the original construction of the hospital and in a variety of areas, maintenance has noticed that the insulation of the wiring is cracking and falling apart. Also, in majority of the circuits, the ground for outlet are achieved by grounding the ground pin to the outlet box and not taking it back to the distribution panel. Outlets are in the bathrooms, close to sinks, and on the exterior of the building are not GFI.

Senate District 07 **House District** 13

K. MAUI MEMORIAL MEDICAL CENTER, FIRE DAMPER UPGRADE, MAUI

DESIGN AND CONSTRUCTION TO REPAIR AND / OR REPLACE FIRE DAMPERS THROQUGHTHOUT THE HOSPITAL TO MEET JCAHO AND LIFE SAFETY CODES

	FY 2006		FY 2007
Design	20	C	
Construction	80	C	

Explanation and Scope of Project

Design and construction to replace or repair fire dampers hospital-wide.

Justification for the Project

Presently, the existing fire dampers need to be repaired or replaced. Construction modification will be needed to access the dampers. If this is not done, the hospital will not meet JCAHO and Life Safety codes.

Senate District 05 **House District** 09

L. LEAHI HOSPITAL, UPGRADE ELECTRICAL SYSTEM, OAHU

DESIGN AND CONSTRUCTION TO UPGRADE THE ELECTRICAL SYSTEM

	FY 2006		FY 2007
Design	85	C	
Construction	840	C	

Explanation and Scope of Project

Design and construction to upgrade electrical wiring on clinical side of Young Building. Existing wiring about 54 years old. Insulation of wiring is already brittle. Replace two 600 KW emergency generators, one 112 KVA transformer and load shedding circuits.

Justification for the Project

Wiring in Young building is old and brittle and may cause possible short circuit. Existing generators are 400 KW, last cost to repair was $50,000. Existing transformer unit leaks oil. Load shedding circuits need replacement to prevent emergency generator from overloading.

Senate District 10 **House District** 19

M. LEAHI HOSPITAL, REPLACE ELEVATORS IN YOUNG BUILDING, OAHU

DESIGN AND CONSTRUCTION TO REPLACE THE ELEVATORS IN THE YOUNG BUILDING

	FY 2006		FY 2007
Design	45	C	
Construction	375	C	

Explanation and Scope of Project

Design and construction to replace elevators with communication system in case of emergencies. Button panel for handicap.

Justification for the Project

Elevators are old. Call backs due to cab floor not even with existing floors.

Senate District	10	**House District**	19

N. LANAI COMMUNITY HOSPITAL, ELEVATOR PRE-ACTION SYSTEM, LANAI

DESIGN AND CONSTRUCTION TO UPGRADE THE ELEVATOR TO MEET CODES FOR PRE-ACTION SYSTEM

	FY 2006		FY 2007	
Design	12	C		
Construction	68	C		

Explanation and Scope of Project

Design and construction to upgrade existing elevator to meet code for the pre-action system.

Justification for the Project

Presently, the elevator has a sprinkler system in the elevator shaft, but the elevator has no electrical shutdown system to prevent electrical short. This is a potential fire hazard. Removing the sprinkler system will leave the elevator shaft with no fire protection, but this would be unacceptable.

Senate District	04	**House District**	07

O. KAUAI VETERANS MEMORIAL HOSPITAL, EMERGENCY GENERATOR, KAUAI

DESIGN AND CONSTRUCTION TO INSTALL A 455 KW EMERGENCY GENERATOR AND ASSOCAITED EQUIPMENT AND REPLACE EXISTING TRANSFER SWITCH

	FY 2006		FY 2007	
Design			50	C
Construction			600	C

Explanation and Scope of Project

Design and construction to install a 455 KW emergency generator and associated equipment and to replace the existing transfer switch with a manual switch for downtime or failure of the 455 KW.

Justification for the Project

There is only one generator supplying emergency power to the acute facility. Should this generator fail to operate during an emergency, there will be no emergency electrical power available. In the past, Kauai has experienced devastating hurricane encounters which the last one being Hurricane Iniki that left Kauai without electricity for approximately three months. Medicare/Medicaid, NFPA, Joint Commission and other regulatory agencies require that emergency power be available, maintained, and reliable for the hospital. Presently, Kauai Veterans Memorial Hospital has no emergency power to run any of its chillers, air handlers chillwater and condenser pumps, and some of its radiology equipment. Failure to have uninterrupted air conditioning, can result in the operating room not being able to function, medical equipment failure due to the rise in the temperature within the building and isolation rooms will no longer be able to isolate patients safely on the units. The potential of infection will become a problem.

Senate District 07 **House District** 14

P. KULA HOSPITAL, ROOFING REPAIR / REPLACEMENT, MAUI

CONSTRUCTION TO REPAIR LEAKY AND DAMAGED ROOFS DUE TO THE HIGH WIND

	FY 2006		FY 2007	
Construction	30	C	75	C

Explanation and Scope of Project

Construction to repair / replace the roofs on one small building, two house roof and repair the main hospital roof.

Justification for the Project

Due to high wind and old age, the three small building and the main hospital sustained damages to its roof. If we do not repair the roof soon, the weather will do more damage and possibly cause mold.

Senate District 06 **House District** 11

Q. KULA HOSPITAL, ELECTRICAL SYSTEM REPAIR / IMPROVEMENT , MAUI

DESIGN AND CONSTRUCTION FOR THE UPGRADE OF THE ELECTRICAL SYSTEM

	FY 2006		FY 2007	
Design	75	C	25	C
Construction	125	C	275	C

Explanation and Scope of Project

Design and construction to upgrade the emergency generator / power to patient areas and upgrade lower gage wires, fixtures, etc.

Justification for the Project

Most of the major electrical wiring to the hospital has been upgraded. Now the lower gage wires, fixtures, outlets, etc., needs to be replaced in the clinic. Emergency power to other patient areas is needed, as well, as upgrading the emergency generators and its fuel tank.

Senate District 06 **House District** 11

R. MALUHIA, REPLACE AIR CONDITIONING DUCTS, OAHU

DESIGN AND CONSTRUCTION TO REPLACE AIR CONDITIONING DUCTWORK CONTAINING MOLD

	FY 2006		FY 2007
Design	35	C	
Construction	215	C	

Explanation and Scope of Project

Design and construction to replace the air conditioning duct work.

Justification for the Project

Mold has been identified.

Senate District 14 **House District** 27

S. KOHALA HOSPITAL, RENOVATE BATHROOM DOORS, HAWAII

CONSTRUCTION TO RENOVATE 10 PATIENT BATHROOM DOORS TO ALLOW ACCESS. PROJECT WILL INCLUDE REMOVING EXISTING

DOORS AND DOOR FRAMES WITH ADA COMPLIANT DOORS AND HARDWARES

	FY 2006		FY 2007
Construction	75	C	

A. Explanation and Scope of Project

Construction to renovate the patient bathrooms to meet ADA requirements. This includes doors, doorframes, and hardware.

Justification for the Project

The current facility bathrooms that are in the patient rooms do not allow patients to access the facilities. The doors are 30-inches wide and this does not allow patients with disabilities to access bathrooms. The patient must use a common bathroom that is located in the common corridor. Kohala Hospital is primarily a long-term care facility and the majority of the patients have disabilities that require walkers, wheelchairs or need assistance to ambulate.

Senate District 01 **House District** 01

VIII. Proposed Lapses of CIP projects:

None