HAWAII HEALTH SYSTEMS
CORPORATION
"Touching Lives Everyday"

April 27, 2007

CEO-07-037

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

Dear Governor Lingle:

It is with sincere appreciation for your tremendous support that we submit the Annual Report of the Hawaii Health Systems Corporation (HHSC) to 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 Legislators and the Administration have resulted in many successes this past year.

HHSC annually has a detailed independent third party financial audit conducted for the entire system and has received its ninth consecutive "clean" unqualified audit with no material weaknesses and no reportable conditions. Additionally, HHSC has a myriad of internal reporting/performance measures that are utilized by the board of Directors and management to insure compliance, quality and financial efficiency in all system work. We have continued to improve our financial management and accounting systems throughout the years. Although in FY 1997 the Corporation received a qualified audit with many material weaknesses, we have now received our ninth consecutive "clean" unqualified audit with no material weaknesses for FY2006, FY 2005, FY2004, FY 2003, FY 2002, FY 2001, FY 2000, FY 1999 and FY 1998. In accordance with HRS Section 323F-22 the attached report includes the FY 2006 and FY 2005 comparative audit report, projected facility revenue and capital improvement projects planned. Additional HHSC organization, budget and service information are also included in the report.

Hawaii Health System 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); and Kauai Veterans Memorial Hospital and Samuel Mahelona Memorial Hospital (Kauai Region).

Hawaii Health Systems Corporation recognizes the continuing guidance and support of the Management Advisory Committees and the Physician Advisory Group that are tremendously important to the successful functioning of our system.

The five statutorily created, regional Public Health Facility Management Advisory Committees (MACs) provide 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 five MACs sit on the Executive MAC, which meets monthly with the President and CEO, as well as play a vital role in policy decision 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 physicians throughout the islands who volunteer their time and talents to come together on a semi-monthly basis with the President and CEO to discuss the clinical and medical staff issues facing our hospitals. The PAG represents approximately 860 HHSC medical staff members who are essential to operations and success of HHSC.

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 92,000 service hours to our facilities. The attached report details the donations of time and money from our communities in support of our facilities, representing the regions of East Hawaii, West Hawaii, Maui, Kauai and Oahu.

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 predominantly rural areas. In this regard, HHSC has promoted the development of foundations at our hospitals and incorporated the Hawaii Health Systems Foundation (HHSF) as a wholly owned subsidiary 501(c) (3). HHSC is working in coordination with eight other foundations associated with HHSC facilities to maximize donations and grants for the system and for respective facilities. Eight 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.

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."

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.

All HHSC hospitals are fully certified and licensed by both State and National standards assuring the highest quality of care for Hawaii's patients. All HHSC facilities are Medicare/Medicaid certified and all have successfully passed those surveys. In 2005, HHSC completed its second Hospital System accreditation survey by the Joint Commission. All hospitals that were surveyed passed with scores that exceeded National Standards.

HHSC management works 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 solutions to providing services to the communities that we serve while reducing the demands on the State to provide support. HHSC continues to solicit 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 2006, copies of the HHSC budget presentations for Fiscal Biennium 2007-2009 to the House Committee on Finance and the Senate Committee on Ways and Means are attached.

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

Mahalo Nui Loa,

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

Enclosures:
1) Annual Report to the Legislature
2) Attachment 1 - HHSC Budget Briefing on the Executive Biennium Budget, Fiscal Biennium 2007-2009 to the Senate Ways and Means Committee and the House Finance Committee, January 11, 2007

EXECUTIVE CHAMBERS

HONOLULU

LINDA LINGLE
GOVERNOR

May 2, 2007

The Honorable Colleen Hanabusa, President
and Members of the Senate
Twenty-Fourth State Legislature
State Capitol, Room 003
Honolulu, Hawaii 96813

Dear Madame President and Members of the Senate:

For your information and consideration, I am transmitting two (2) copies of the Annual Report of Hawaii Health Systems Corporation, pursuant to HRS 323F-22. In accordance with Section 93-16, Hawaii Revised Statutes, I am also informing you that the report may be viewed electronically at www.state.hi.us/budget.

Sincerely,

LINDA LINGLE

Enclosures

EXECUTIVE CHAMBERS

HONOLULU

LINDA LINGLE
GOVERNOR

May 2, 2007

The Honorable Calvin S, Y. Say, Speaker
and Members of the House of Representatives
Twenty-Fourth State Legislature
State Capitol, Room 431
Honolulu, Hawaii 96813

Dear Mr. Speaker and Members of the House of Representatives:

For your information and consideration, I am transmitting two (2) copies of the Annual Report of Hawaii Health Systems Corporation, pursuant to HRS 323F-22. In accordance with Section 93-16, Hawaii Revised Statutes, I am also informing you that the report may be viewed electronically at www.state.hi.us/budget.

Sincerely,

LINDA LINGLE

Enclosures

HAWAII HEALTH SYSTEMS
CORPORATION

"Touching Lives Every Day"

Hawaii Health Systems Corporation (HHSC)

Report to the Legislature
FY 2006

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
www.hhsc.org <http://www.hhsc.org>

Hawaii Health Systems Corporation (HHSC)
Annual Report for FY 2006

Contents

Introduction

Annual audit and report for Hawaii Health Systems Corporation, in accordance with HRS Section 323F-22, contains a) Consolidated Financial Statements for Year Ended June 30, 2006 and 2005, Supplemental Information for the Year Ended June 30, 2006, and Independent Auditor's Reports, and b) information on projected facility revenue and capital improvement projects planned (for FY07). Additional organization and descriptive information is provided and HHSC Budget Briefings on the Executive Biennium Budget FB 2007-2009 presented to the Senate Ways and Means Committee and House Finance Committee are included to provide full perspective on challenges and outcomes in FY2006.

Deloitte

Part A

Hawaii Health Systems Corporation

Consolidated Financial Statements for the Years Ended June 30, 2006 and 2005, Supplemental Information for the Year Ended June 30, 2006, and Independent Auditors' Reports

HAWAII HEALTH SYSTEMS CORPORATION

TABLE OF CONTENTS

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, 2006 and 2005 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of HHSC's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, 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, 2006 and 2005 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.

Deloitte.

Deloitte & Touche LLP
Suite [illegible]
113[illegible] Bishop St.
Honolulu, [illegible]
USA

Tel: +1 [illegible]
Fax: +1 208 525 0225
www.deloitte.com

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, 2006 and 2005, 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of HHSC's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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, 2006 and 2005 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, 2006, 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, 2006 and 2005 may be significantly different from those eventually included in the final settlement.

The management's discussion and analysis information on pages 4 through 14 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 34 and 35 is presented for the purpose of additional analysis and is not a required part of the basic financial statements. The supplemental combining and consolidating information on pages 36 through 38 is 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 is not a required part of the basic financial statements. This supplemental schedule and the supplemental combining and consolidating information 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 8, 2006 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.

Deloitte & Touche LLP

December 8, 2006

HAWAII HEALTH SYSTEMS CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2006

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis are intended to serve as an introduction to Hawaii Health Systems Corporation's (HHSC's) basic financial statements. In accordance with Statement No. 34 of the Government 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 difference between the two reported as net assets. The statement of revenues, expenses, and changes in net assets presents information showing how the government entity's net assets changed during the most recent fiscal year. The statement of net assets and the statement of revenues, expenses, and changes in net assets are prepared using the economic resources measurement focus and the accrual basis of accounting.

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

Under the provisions of GASB No. 34, HHSC is considered to be a Special Purpose government entity. And, as a Special Purpose government entity engaged only in business-type activities, the only financial statements required to be presented are those for proprietary funds. Accordingly, HHSC's basic financial statements consist of a statement of net assets, a statement of revenues, expenses, and changes in net assets, a statement of cash flows, and notes to financial statements.

FINANCIAL ANALYSIS

Consolidated Statements of Net Assets

Summarized financial information of HHSC's consolidated statements of net assets as of June 30, 2006 and 2005 is as follows:

	2006	2005
ASSETS		
Current assets	$ 96,685,796	$ 83,779,878
Capital assets—net	221,454,648	195,793,055
Other assets	3,903,016	3,979,473
Total assets	$322,043,460	$283,552,406
LIABILITIES		
Current liabilities	$ 74,815,892	$ 68,092,311
Capital lease obligations—less current portion	32,254,903	27,351,486
Long-term debt—less current portion	10,880,541	11,536,119
Accrued vacation—less current portion	26,552,028	24,479,604
Due to the State of Hawaii	34,122,507	34,122,507
Other liabilities	657,524	731,072
Total liabilities	179,283,395	166,313,099
NET ASSETS		
Invested in capital assets—net of related debt	169,665,927	148,472,198
Restricted	493,445	1,302,537
Unrestricted	(27,399,307)	(32,535,428)
Total net assets	142,760,065	117,239,307
Total liabilities and net assets	$322,043,460	$283,552,406

At June 30, 2006, HHSC's capital assets, net of accumulated depreciation, comprised approximately 69% of its total assets. These assets consist mainly of land, hospital buildings, and equipment that are used in HHSC's operations. The increase of approximately $25.7 million is due to property additions of $44.7 million, offset by depreciation expense of $18.5 million and retirements of $0.6 million. The primary reason for the increase is due to the acquisition of medical equipment, information systems, and energy-saving equipment of $13.3 million funded through HHSC's municipal leasing lines of credit and State-funded capital improvement projects of $26.1 million. The State-funded capital improvement projects consisted primarily of construction costs for the $38 million expansion of Maui Memorial Medical Center (MMMC) and for the construction of the Yukio Okutsu Veterans Care Home.

At June 30, 2005, HHSC's capital assets, net of accumulated depreciation, comprised approximately 69% of its total assets. These assets consist mainly of land, hospital buildings and equipment that are used in HHSC's operations. The increase of approximately $6.5 million is due to property additions of $24.0 million, offset by depreciation expense of $16.9 million and retirements of $0.6 million. The primary reason for the increase is due to the acquisition of medical equipment, information systems, and energy-saving equipment of $9.3 million funded through HHSC's municipal leasing lines of credit and State-funded capital improvement projects of $10.1 million. The State-funded capital improvement projects consisted primarily of planning, design, and initial construction costs for the $38 million expansion of MMMC.

A summary of HHSC's capital assets as of June 30, 2006 and 2005 is as follows:

	2006	2005
Land and land improvements	$ 5,180,572	$ 5,180,572
Buildings and improvements	221,899,300	216,954,326
Equipment	121,057,483	122,668,591
Construction in progress	63,085,041	30,385,291
	411,222,396	375,188,780
Less accumulated depreciation and amortization	(189,767,748)	(179,395,725)
Capital assets—net	$ 221,454,648	$ 195,793,055

At June 30, 2006, HHSC's current assets approximated 30% of total assets. Current assets increased $12.9 million from the fiscal year 2005 balance due to an increase in cash and cash equivalents and an increase in patient accounts receivable. The increase in cash and cash equivalents of $6.9 million is primarily due to the need to save sufficient funds to fund the July 20 payroll payment and an increase in the cash on deposit with the State of Hawaii of $1.4 million (used to fund the July 5 payroll payment). The other reason for the increase in cash and cash equivalents is the increase in cash collections for fiscal year 2006 as compared to the prior year. HHSC collected $351 million in fiscal year 2006 as compared to $317 million in fiscal year 2005 due to $12.7 million in extraordinary third-party payor settlements received as a result of the status of several HHSC facilities being designated as sole community hospitals, $8.8 million in supplemental direct payments to hospitals from the State Department of Human Services (DHS), and HHSC's success in negotiating increases in reimbursement rates with third-party payors. Further, HHSC reduced its gross days in accounts receivable from 72.1 days at June 30, 2005 to 70.7 days at June 30, 2006. The reduction in gross days in accounts receivable was due to management's concerted effort to improve HHSC's revenue-cycle processes, focusing on regular monitoring of HHSC's revenue-cycle performance against industry key performance indicators, with corrective action being taken where necessary. The increase in patient accounts receivable of $8.5 million is primarily due to the accrual of $5.1 million in relief payments from DHS to mitigate the detrimental impact on reimbursements that Act 294 had on HHSC's long-term care facilities. This money was paid to HHSC in July 2006.

At June 30, 2005, HHSC's current assets approximated 30% of total assets. Current assets increased $7.5 million from the fiscal year 2004 balance due to an increase in cash and cash equivalents and the establishment of estimated third-party payor settlement receivables. The increase in cash and cash equivalents of $2.2 million is primarily due to the transfer of $1.0 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 United Public Workers (UPW) bargaining units 1 and 10. The other reason for the increase in cash and cash equivalents is the increase in cash collections for fiscal year 2005 as compared to the prior year. HHSC collected $317 million in fiscal year 2005 as compared to $291 million in fiscal year 2004 due to $10.6 million in third-party payor settlements received as a result of the status of several HHSC facilities being designated either as critical access hospitals or sole community hospitals as well as HHSC's success in negotiating increases in reimbursement rates with third-party payors.

At June 30, 2006, HHSC's current liabilities approximated 42% of total liabilities. The primary reason for the increase from fiscal year 2005 is due to increases in accounts payable, accrued payroll, and estimated third-party payor settlements. Accounts payable at June 30, 2006 increased by $2.9 million from June 30, 2005, primarily due to an increase of $19.3 million in non-payroll expenses from fiscal year 2005 to fiscal year 2006. As a result, days in accounts payable increased from 35.6 days at June 30, 2005 to 38.8 days at June 30, 2006.

Accrued payroll at June 30, 2006 increased by $1.7 million from June 30, 2005 as a result of a combination of collective bargaining pay raises and increases in full-time equivalents as a result of additional contracting personnel needed to comply with the requirements of the State Procurement Code and additional physician employees to ensure that sufficient medical coverage is available for patients needing care in HHSC's acute care facilities. The estimated third-party payor settlements increased from a receivable of $4 million at June 30, 2005 to a payable of $4.6 million at June 30, 2006. The increase is primarily due to open cost reports at the facilities and to the anticipated recoupment of Medicare coinsurance and deductibles by the Med-QUEST (QUEST) program.

At June 30, 2005, HHSC's current liabilities approximated 41% of total liabilities. The primary reason for the decrease from fiscal year 2004 is due to a decrease in accounts payable. Due to the increased cash collections described above, HHSC was able to reduce its accounts payable balance significantly, from $18.9 million at June 30, 2004 to $12.3 million at June 30, 2005. Days in accounts payable also decreased significantly, from 62.2 days at June 30, 2004 to 35.6 days at June 30, 2005. The other significant reason for the decrease in current liabilities is a reclassification of the advance from the State of Hawaii of $14 million from current liabilities to noncurrent liabilities. The reason for the reclassification is that HHSC does not have the ability to repay the advance, and HHSC management does not anticipate the State calling the loan within the next fiscal year. Discussions with the State of Hawaii to resolve this issue are ongoing.

At June 30, 2006 and 2005, HHSC's total capital lease obligation balance increased approximately $5.3 million and $1.3 million from fiscal years 2005 and 2004, 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 several municipal leasing companies, which allow HHSC to finance equipment purchases at interest rates below market rates.

At June 30, 2006, HHSC's long-term debt balances represented: 1) notes and term loans payable on the land, building, and medical equipment previously owned by Hilo Residency Training Program with a remaining balance of approximately $10.2 million, 2) a mortgage note payable relating to the acquisition of nursing cottages on the MMMC campus with a remaining balance of approximately $1.2 million, and 3) notes payable to two individuals relating to the acquisition of clinic assets with a remaining balance of approximately $0.2 million.

At June 30, 2006, the portion of HHSC's net assets that is reflected as its investment in capital assets, net of related debt, of approximately $169.7 million, is larger than the total net assets of approximately $142.8 million. This means that HHSC's net operations since inception have resulted in losses of over $27.4 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, 2006 and 2005 is as follows:

	2006	2005
Operating expenses:		
Salaries and benefits	$234,551,456	$218,702,702
Purchased services and professional fees	48,086,105	39,352,751
Supplies and drugs	56,680,517	51,691,249
Depreciation and amortization	18,483,895	16,905,894
Insurance	6,146,134	5,124,854
Other	27,200,524	21,991,832
Total operating expenses	391,148,631	353,769,282
Operating revenues	352,772,138	320,921,172
Loss from operations	(38,376,493)	(32,848,110)
Nonoperating revenues (expenses):		
General appropriations from State of Hawaii	32,280,041	27,569,984
Collective bargaining pay raise appropriation from State of Hawaii	5,474,356	10,837,961
Restricted contributions	260,421	2,695,069
Other nonoperating revenues (expenses)—net	(233,411)	(996,944)
Total nonoperating revenues (expenses)	37,781,407	40,106,070
Income before capital contributions, transfers, and special item	(595,086)	7,257,960
Contributed capital assets and transfers	26,115,844	15,273,967
Special item—demolition costs		(3,527,127)
Increase in net assets	$ 25,520,758	$ 19,004,800

For the year ended June 30, 2006, HHSC's operating expenses exceeded its operating revenues by $38.4 million. The appropriations from the State of Hawaii for collective bargaining pay raises of $5.5 million, general fund appropriations from the State of Hawaii of $32.3 million, restricted contributions of $0.3 million, other nonoperating expenses of $0.3 million, and capital assets contributed by the State of Hawaii of $26.1 million resulted in an increase in net assets of $25.5 million.

For the year ended June 30, 2005, HHSC's operating expenses exceeded its operating revenues by $32.8 million. The appropriations from the State of Hawaii for collective bargaining pay raises of $10.8 million, general fund appropriations from the State of Hawaii of $27.6 million, restricted contribution of $2.7 million, other nonoperating expenses of approximately $1.0 million, and contributed capital assets and transfers of $15.3 million, less special item expenditure of $3.5 million, resulted in an increase in net assets of $19 million.

Management believes that three factors impede the comparability of the fiscal year 2006 results with those of prior fiscal years: 1) property contributed by the State of Hawaii of $26.1 million, which represents payments made by the State of Hawaii for HHSC's construction projects, 2) extraordinary third-party payor settlements for sole community hospital designation of HHSC's three acute care hospitals of $9.2 million (see comment below), and 3) relief payments of $8.2 million for fiscal years 2004 and 2005 to HHSC's facilities with long-term care beds for the negative impact of Act 294. Management believes that these factors are neither controllable nor recurring, and may not reflect HHSC's true operating performance. The following chart shows the impact of these three factors on HHSC's financial performance.

Increase in net assets for the year ended June 30, 2006	$ 25,521,000
Adjustments to exclude noncontrollable or nonrecurring items:	
Contributed capital assets and transfers	(26,116,000)
Extraordinary cost report settlements received	(9,166,000)
Act 294 relief payments	(8,209,000)
Total adjustments	(43,491,000)
Adjusted decrease in net assets for the year ended June 30, 2006	$ (17,970,000)

Operating expenses in fiscal year 2006 were approximately 10.6% higher than fiscal year 2005. The increase was mainly in the category of salaries and benefits, supplies and drugs, professional fees, and purchased services expense. Salaries and benefits expense increased 7.2% from fiscal year 2005, due primarily to collective bargaining pay raises for HHSC's union employees and an increase in the fringe benefit rate assessed to HHSC by the State of Hawaii. During fiscal year 2006, HHSC's union employees in Hawaii Government Employees Association (HGEA) and UPW received pay raises from the unions' collective bargaining agreements with the State of Hawaii of varying percentages effective on various dates throughout the fiscal year. These pay raises represented an additional $5.5 million in salaries expense over fiscal year 2005. Further, the fringe benefit rate assessed to HHSC by the State of Hawaii increased from 34.66% for fiscal year 2005 to 39.39% for fiscal year 2006. The primary reason for the increase is the increase in the required contribution to fund the State Employee Retirement System. The impact of the increase in fringe benefit rate on HHSC was approximately $7.9 million for fiscal year 2006. The remaining increase is due to an increase in full-time equivalents as a result of additional contracting personnel needed to comply with the requirements of the State Procurement Code and additional physician employees to ensure that sufficient medical coverage is available for patients needing care in HHSC's acute care facilities. The increase in supplies and drugs expense was primarily due to a 7% increase in utilization of drugs sold to patients, as well as an increase in the use of chemotherapy drugs, which are much more expensive than other types of drugs. Chemotherapy procedures increased 41% from fiscal year 2005 to 2006. Professional fees and purchased services expenses increased $8.7 million from fiscal year 2005 primarily due to an increase of $4.8 million in registry nurse expense. The increase in registry nurse expense is primarily due to the need to maintain minimum nurse staffing ratios to keep up with patient volume. Increase is also due to the use of registry nurses to staff the emergency rooms that opened at Hale Ho'ola Hamakua, Kula Hospital, and Samuel Mahelona Memorial Hospital during fiscal year 2006. The remaining increase is primarily due to contracted payments to physicians to ensure the availability of specialty medical care and on-call coverage for neighbor island patients.

Operating expenses in fiscal 2005 were approximately 8% higher than fiscal 2004. The increase was mainly in the categories of salaries and benefits, supplies and drugs, professional fees and purchased services, and insurance expense. Salaries and benefits expense increased 7.7% from fiscal year 2004, due primarily to collective bargaining pay raises for HHSC's union employees and an increase in the fringe benefit rate assessed to HHSC by the State of Hawaii. HHSC's union employees in HGEA bargaining unit 9 (consisting of registered nurses) and UPW bargaining units 1 and 10 (consisting of blue collar nonsupervisory employees and licensed practical nurses) received pay raises from the union's collective bargaining agreements with the State of Hawaii of 5% effective July 1, 2004. HHSC's employees in HGEA bargaining units 2, 3, 4, and 13 received step pay increases effective July 1, 2004, with a 5% pay increase effective January 1, 2005. These pay raises represented an additional $7 million in salaries and benefits expense over fiscal year 2004. Further, the fringe benefit rate assessed to HHSC by the State of Hawaii increased from 32.2% for fiscal year 2004 to 34.7% for fiscal year 2005. The primary reason for the increase is the increase in the required contribution to fund the State Employee Retirement System. The impact of the increase in fringe benefit rate on HHSC was approximately $3.6 million for fiscal year 2005. In fiscal year 2005, HHSC recorded an adjustment of $3.7 million to increase its accrued workers' compensation liability based on an actuarial study. The reason for the increase was primarily due to rising medical costs for each workers' compensation claim and HHSC's inability to generate sufficient cash flow to settle its claims in an expedient manner. The increase in supplies and drugs expense was primarily due to a 6.3% increase in utilization of drugs sold to patients, as well as an increase in the use of chemotherapy drugs, which are much more expensive than other types of drugs. Chemotherapy procedures increased 37% from fiscal year 2004 to 2005. Professional fees and purchased services expenses increased by 4.9% primarily due to an increase in the amount of physician contracts entered into by HHSC due to the acquisition of a clinic by Kauai Veterans Memorial Hospital on December 31, 2004, as well as the need to ensure that certain specialty physician services are provided to Hawaii's rural communities, such as orthopedic and OB/GYN services. Insurance expenses increased due to the increase in malpractice insurance premiums. In fiscal year 2005, HHSC's malpractice insurance premium was $4.3 million, as compared to $1.475 million in fiscal year 2004. The reason for the increase is that the insurance carrier that provided coverage to HHSC in fiscal year 2004 decided to exit the Hawaii market and no longer provide such coverage.

Fiscal year 2006 operating revenues increased by approximately 9.9% over fiscal year 2005 as a result of extraordinary third-party payor settlements received for sole community hospital reimbursement (primarily at MMMC), payments received from the State Department of Human Services (DHS) for supplemental direct payments to hospitals, payments received from DHS for Act 294 relief provisions for fiscal years 2004 and 2005, and increases in negotiated reimbursement rates from private third-party payors. In fiscal year 2006, HHSC received $9.2 million in third-party payor settlements from government-type payors relating to the sole community hospital reimbursement for MMMC, Hilo Medical Center (HMC), and Kona Community Hospital, with $8.2 million of the total going to MMMC. The settlements covered the fiscal years 2002 through 2004. 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. In fiscal year 2006, HHSC received $8.8 million in supplemental direct payments to hospitals from DHS (see discussion on Medicaid reimbursement issues on page 12 for more information). In fiscal year 2006, HHSC also recorded $8.2 million in relief payments from DHS for the detrimental reimbursement impact on HHSC's long-term care reimbursements as a result of Act 294 (see discussion on Medicaid reimbursement issues on page 11 for more information). The increase in negotiated reimbursement rates from private third-party payors primarily represented inflationary increases of varying percentages.

Fiscal year 2005 operating revenues increased by approximately 11.3%, as a result of third-party payor settlements received for sole community hospital reimbursement (primarily at MMMC), increase in ER visits at HHSC's acute care hospitals, and increases in negotiated reimbursement rates from private third-party payors. In fiscal year 2005, HHSC received $11.6 million in cost report settlements from Medicare and HMSA 65C+ relating to the sole community hospital reimbursement for MMMC, HMC, and Kona Community Hospital, with $10.2 million of the total going to MMMC. The settlements covered the fiscal years 2002 through 2004. The sole community hospital status also resulted in an increase in Medicare and

HMSA 65C+ reimbursement rates during fiscal year 2005. The acute care reimbursement rates for MMMC, HMC, and Kona Community Hospital increased 27%, 11%, and 8%, respectively, in fiscal year 2005. Emergency Room visits for HHSC's three acute care hospitals increased 4.5% from fiscal year 2004 to fiscal year 2005. The largest increase occurred at MMMC, where Emergency Room visits increased 8.6% from fiscal year 2004 to fiscal year 2005. The increase in negotiated reimbursement rates from private third-party payors primarily represented inflationary increases of varying percentages.

For the year ended June 30, 2006, General Fund Appropriations from the State of Hawaii consisted of $32.3 million approved for HHSC's operating purposes by the 2005 Legislature. For the year ended June 30, 2005, General Fund Appropriations from the State of Hawaii consisted of $27.8 million approved for HHSC's operating purposes by the 2004 Legislature, reduced by approximately $278,000 by the Governor for efficiency savings.

HHSC's management believes that the significant excess of operating expenses over operating revenues in both 2006 and 2005, 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 2006, 60% of HHSC's total gross revenues were from government-type payors (approximately 23% from Medicare and approximately 25% from Medicaid and QUEST). For fiscal year 2005, 61% of HHSC's total gross revenues were from government-type payors (approximately 23% from Medicare and approximately 27% from Medicaid and QUEST). In fact, government-type payors account for 89% of HHSC's long-term care revenues. Reimbursements from government-type payors has not kept up with the increasing costs of health care providers since the Balanced Budget Act of 1997 was passed, which dramatically reduced the level of reimbursements from government-type payors.

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 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. In September 2003, the Center for Medicare and Medicaid Services approved Hawaii's Medicaid State Plan Amendment to provide relief payments to those nursing facilities negatively impacted by Act 294. In fiscal year 2006, DHS paid $3.1 million to HHSC in Act 294 relief payments for patient services rendered in fiscal year 2004. In July 2006, DHS paid $5.1 million to HHSC in Act 294 relief payments for patient services rendered in fiscal year 2005 reflected in patient accounts receivable at June 30, 2006. While this will provide short-term relief for HHSC's facilities that are negatively impacted by Act 294, management is continuing to work with the State Department of Human Services to explore long-term 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 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 Public Hospitals and Health Systems, 2004" states that "Medicaid DSH funding financed almost one-fifth of the unreimbursed care provided in 2004, while state and local subsidies financed 35 percent." In September 2005, the State Department of Human Services (DHS), in partnership with HHSC management, the Governor, the State of Hawaii Legislature, and the Healthcare Association of Hawaii (HAH), was able to use HHSC's fiscal years 2006 and 2007 projected losses from providing uncompensated care under the Medicaid fee-for-service program to draw down additional federal funding for all Hawaii hospitals. DHS has paid to HHSC $8.8 million for fiscal year 2006, and management expects DHS to pay HHSC $6.9 million in fiscal year 2007. Because of this innovative approach to drawing down additional federal funds, HHSC was able to reduce its request for State general fund appropriations by those amounts in fiscal years 2006 and 2007. Management will continue to work with DHS, the State of Hawaii Legislature, and HAH to explore long-term reimbursement enhancements that could reduce HHSC's reliance on general fund appropriations.

Second, HHSC's facilities on the neighbor islands suffer from an insufficient supply of long-term care beds. For fiscal year 2006, HHSC's long-term care occupancy percentage was 95.3%, and there are very few other freestanding long-term care facilities on the neighbor islands. As a result, HHSC's acute care facilities, especially HMC and MMMC, have numerous patients initially admitted as acute patients, but who continue to occupy acute-care beds while awaiting long-term care beds to become available. Such patients are called "wait-list" patients. HHSC receives little to no reimbursement from insurers for such patients, as insurers will not reimburse providers for patients whose required level of care does not coincide with the type of bed the patient is occupying. Combined, HMC and MMMC 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 60% 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 health care workers, 2) the inability of local colleges and universities to provide sufficient classes and teachers that can educate students in these areas, and 3) competition for these same types of positions with private hospitals, which can pay significantly higher wage rates than HHSC. In particular, the shortage of RNs and LPNs results in HHSC having to expend significant amounts for agency nurses, which are paid at significantly higher rates. Agency nurse expenses increased from $5,909,792 for fiscal year 2005 to $10,751,412 for fiscal year 2006. 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 the other private hospitals are hourly employees. This allows the private hospitals to increase or decrease their nurse staffing based on census; by contrast, HHSC facilities 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 required 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 required 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 not subject to HRS 103(d). In fact, prior to the formation of HHSC, the state hospitals under the Division of Community Hospitals were excluded from HRS 103(d) competitive procurement provisions, so that the hospitals could have the autonomy to procure goods and services in a setting where timeliness is crucial to the provision of quality health care to patients.

During the 2006 Legislative Session, the State of Hawaii Legislature passed S.B. 2898, S.D.2, H.D.2, C.D.1, designating the chief executive officer of HHSC as its chief procurement officer. This bill also amended HRS 103(d) by raising the small purchase threshold from $25,000 to $50,000. Even with the designation of chief procurement officer authority, HHSC has incurred significant costs in its attempt to comply with the provisions of HRS 103(d). The most troubling cost is in the area of delayed medical care due to the delay in obtaining needed medical equipment. This results in more pain for the patient and the likelihood of a detrimental outcome increases. Another cost is that the medical staffs at HHSC's hospitals are upset about the implementation of the code. These physicians are being forced to spend an inordinate amount of time justifying the purchase of a specific piece of essential medical equipment on a piece-by-piece basis, which is time that could better be spent providing care to their patients. Given the shortage of certain physician specialists on the neighbor islands, anything that would cause frustration to these physicians could result in a loss of certain specialty care in neighbor island communities should these physicians choose to leave. The medical staffs are also upset that preferences of a surgeon in using particular brands of medical equipment require extensive justification under HRS 103(d). Further, the State Procurement Office is having a difficult time providing answers to questions and training to HHSC personnel due to their limited staff and the difficulty in reconciling the provisions of HRS 323(f) (the statute that delineates the powers and governance of HHSC) and HRS 103(d). Finally, HHSC has incurred costs in increasing procurement/legal staff to handle the increased workload of complying with the requirements of HRS 103(d), as well as the cost of increased employee time to handle the increased paperwork and number of requests for proposal (RFPs) that are required under the code. Management estimates that HHSC will be required to perform 150 more RFPs/Invitation for Bid (IFBs) each year due to the requirements of HRS 103(d).

Management believes that exemption from HRS 103(d) is appropriate for HHSC in order for HHSC to provide timely medical services to the communities it serves in an efficient and effective manner. In the alternative, management believes that medical supplies, drugs, and medical purchased services should be exempt from the requirements of HRS 103(d) so that necessary medical services can be procured quickly to insure that patients are treated in a timely manner with equipment that is familiar to HHSC's medical staff.

Finally, HHSC is a significant provider of health care for the State of Hawaii. From fiscal year 2003 through fiscal year 2005, HHSC's facilities accounted for 19.19% of all acute care discharges in the State of Hawaii. HHSC's facilities discharged more acute care patients during that time period than most of the acute care hospitals on Oahu. Also, HHSC is the sole source of 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 HMC and Kona Community Hospital are the only acute care facilities with more than 50 acute beds on the island of Hawaii. In large part because of HHSC's facilities in Maui, 89.5% of Maui County residents were discharged for acute care services from Maui hospitals instead of having to fly to Oahu to receive care. The same can be said for residents of East and West Hawaii: 84.6% of East Hawaii residents and 82.5% of West Hawaii residents were discharged for acute care services from hospitals on the island of Hawaii instead of having to fly to Oahu to receive care. 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, 2006 AND 2005

ASSETS	2006	2005
CURRENT ASSETS:		
Cash and cash equivalents:		
On deposit with the State of Hawaii	$ 11,171,229	$ 9,805,315
On deposit with banks and on hand (Note 3)	16,317,741	10,748,445
Patient accounts receivable, less allowances of $75,777,177 and $82,083,403 for contractual adjustments and doubtful accounts	58,806,410	50,342,937
Supplies and other current assets	10,390,416	8,908,486
Estimated third-party payor settlements		3,974,695
Total current assets	96,685,796	83,779,878
CAPITAL ASSETS—Net (Notes 4, 6, 7, 12 and 14)	221,454,648	195,793,055
ASSETS LIMITED AS TO USE	872,233	1,706,212
OTHER ASSETS (Notes 11 and 13)	3,030,783	2,273,261
TOTAL	$322,043,460	$283,552,406

(Continued)

HAWAII HEALTH SYSTEMS CORPORATION

CONSOLIDATED STATEMENTS OF NET ASSETS
JUNE 30, 2006 AND 2005

LIABILITIES AND NET ASSETS	2006	2005
CURRENT LIABILITIES:		
Accounts payable and accrued expenses (Note 11)	$ 39,871,147	$ 33,001,707
Accrued workers' compensation liability (Note 10)	19,274,950	25,282,963
Current portion of capital lease obligations (Note 6)	8,105,845	7,738,765
Current portion of accrued vacation (Note 6)	1,671,353	829,121
Current portion of long-term debt (Note 7)	699,070	694,487
Other current liabilities	605,314	545,268
Estimated third-party payor settlements	4,588,213	
Total current liabilities	74,815,892	68,092,311
CAPITAL LEASE OBLIGATIONS—Less current portion (Note 6)	32,254,903	27,351,486
LONG-TERM DEBT—Less current portion (Note 7)	10,880,541	11,536,119
ACCRUED VACATION—Less current portion (Note 6)	26,552,028	24,479,604
DUE TO THE STATE OF HAWAII (Note 5)	34,122,507	34,122,507
PATIENTS' SAFEKEEPING DEPOSITS AND DEFERRED INCOME—Restricted contributions	378,788	403,675
OTHER LIABILITIES	278,736	327,397
Total liabilities	179,283,395	166,313,099
NET ASSETS:		
Invested in capital assets—net of related debt	169,665,927	148,472,198
Restricted (Note 12)	493,445	1,302,537
Unrestricted (Note 3)	(27,399,307)	(32,535,428)
Total net assets	142,760,065	117,239,307
TOTAL	$322,043,460	$283,552,406

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, 2006 AND 2005

	2006	2005
OPERATING REVENUES:		
Net patient service revenues (Note 8)	$347,877,556	$315,092,101
Other operating revenues (Note 8)	4,894,582	5,829,071
Total operating revenues	352,772,138	320,921,172
OPERATING EXPENSES:		
Salaries and benefits (Notes 8 and 9)	234,551,456	218,702,702
Purchased services (Notes 8 and 11)	43,926,743	34,765,839
Medical supplies and drugs	41,708,594	39,450,011
Depreciation and amortization	18,483,895	16,905,894
Other supplies	14,971,923	12,241,238
Utilities	8,733,781	7,556,158
Repairs and maintenance	7,085,095	6,426,572
Insurance	6,146,134	5,124,854
Rent and lease	4,520,138	3,915,669
Professional fees	4,159,362	4,586,912
Other	6,861,510	4,093,433
Total operating expenses	391,148,631	353,769,282
LOSS FROM OPERATIONS	(38,376,493)	(32,848,110)
NONOPERATING REVENUES (EXPENSES):		
General appropriations from State of Hawaii	32,280,041	27,569,984
Collective bargaining pay raise appropriation from State of Hawaii	5,474,356	10,837,961
Restricted contributions (Note 12)	260,421	2,695,069
Interest and dividend income	539,539	241,709
Interest expense (net of capitalized interest) (Notes 6 and 7)	(2,355,317)	(3,155,053)
Other nonoperating revenues—net (Note 8)	1,582,367	1,916,400
Total nonoperating revenues (expenses)	37,781,407	40,106,070
INCOME BEFORE CAPITAL CONTRIBUTIONS, TRANSFERS, AND SPECIAL ITEM	(595,086)	7,257,960
CONTRIBUTED CAPITAL ASSETS AND TRANSFERS (Notes 4 and 14)	26,115,844	15,273,967
SPECIAL ITEM—Demolition costs (Note 14)		(3,527,127)
INCREASE IN NET ASSETS	25,520,758	19,004,800
NET ASSETS—Beginning of year	117,239,307	98,234,507
NET ASSETS—End of year	$142,760,065	$117,239,307

See notes to consolidated financial statements.

HAWAII HEALTH SYSTEMS CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2006 AND 2005

	2006	2005
OPERATING ACTIVITIES:		
Receipts from government, insurance and patients	$ 347,976,991	$ 308,918,775
Payments to employees	(235,762,109)	(211,002,445)
Payments to suppliers and others	(133,378,977)	(128,403,163)
Other receipts—net	4,894,582	5,849,484
Net cash used in operating activities	(16,269,513)	(24,637,349)
NONCAPITAL FINANCING ACTIVITIES:		
Appropriations from State of Hawaii	37,754,397	38,407,945
Other nonoperating revenues—net	1,112,441	1,224,168
Net cash provided by noncapital financing activities	38,866,838	39,632,113
CAPITAL AND RELATED FINANCING ACTIVITIES:		
Repayments on capital lease obligations	(8,068,835)	(7,927,543)
Capital expenditures	(5,322,474)	(2,228,181)
Payments on long-term debt	(650,995)	(439,722)
Interest on capital lease obligations and long-term debt	(2,355,317)	(3,166,566)
Proceeds from sale of capital assets	150	47,730
Deposit on noncurrent asset		(25,000)
Loss on disposal of capital assets—net	551,756	565,459
Net cash used in capital and related financing activities	(15,845,715)	(13,173,823)
INVESTING ACTIVITIES:		
Distributions received from the Clinical Laboratories of Hawaii partnership	183,600	212,160
Purchase of clinic assets		(108,000)
Net cash provided by investing activities	183,600	104,160
NET INCREASE IN CASH AND CASH EQUIVALENTS	6,935,210	1,925,101
CASH AND CASH EQUIVALENTS—Beginning of year	20,553,760	18,628,659
CASH AND CASH EQUIVALENTS—End of year	$ 27,488,970	$ 20,553,760

(Continued)

HAWAII HEALTH SYSTEMS CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2006 AND 2005

	2006	2005
RECONCILIATION OF LOSS FROM OPERATIONS TO NET CASH USED IN OPERATING ACTIVITIES:		
Loss from operations	$ (38,376,493)	$ (32,848,110)
Adjustments to reconcile loss from operations to net cash used in operating activities:		
Provision for doubtful accounts	21,173,044	16,057,850
Depreciation and amortization	18,483,895	16,905,894
Amounts released from restrictions (Note 12)	860,292	824,486
Change in operating assets and liabilities:		
Patient accounts receivable	(29,636,517)	(16,862,861)
Supplies and other assets	(1,481,657)	(812,430)
Accounts payable, accrued expenses, and other liabilities	7,238,372	(9,044,290)
Accrued workers' compensation liability	(6,008,013)	3,428,963
Estimated third-party payor settlements	8,562,908	(5,368,315)
Accrued vacation	2,914,656	3,081,464
Net cash used in operating activities	$ (16,269,513)	$ (24,637,349)
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid, primarily on capital lease obligations	$ 2,355,317	$ 3,166,566
NONCASH FINANCING AND INVESTING ACTIVITIES:		
• Capital assets acquired under capital leases	13,339,332	9,271,683
• Capital assets contributed by State of Hawaii	26,115,844	11,746,840
• Capital assets transferred from other noncurrent assets	25,000	
• Capital asset purchases included in accounts payable	301,544	659,091
• Contribution of capital assets	24,736	212,848
• Capital assets acquired with restricted assets (Note 12)	209,221	1,517,641
• Rental income contributed to and equity in earnings of the Clinical Laboratories of Hawaii partnership	984,727	732,606
• Demolition costs funded by transfers from the State of Hawaii		3,527,127
• Acquisition of clinic assets:		
Goodwill		$ 243,000
Intangible asset		55,000
Inventory		12,000
Equipment		50,000
Less cash paid		(108,000)
Assets purchased through the issuance of long-term debt		$ 252,000

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. HHSC currently operates the following facilities:

Hawaii County:
- Hilo Medical Center
- Hale Ho'ola Hamakua
- Ka'u Hospital
- Kohala Hospital
- Kona Community Hospital
- Yukio Okutsu Veterans Care Home

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, 2006. 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.

In fiscal year 2005, HHSC created a new division, the Yukio Okutsu Veterans Care Home (Veterans Home), to develop and operate a long-term care facility for veterans in Hilo, Hawaii (see Note 14).

The consolidated financial statements are being presented for HHSC. Hawaii Health Systems Foundation (HHSF), and Alii Community Care, Inc. (Alii). HHSF and Alii are nonprofit organizations of which HHSC is the sole member. The purpose of HHSF is to raise funds and 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, 2006 and 2005 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 approximately $20,918,000 and $9,510,000 at June 30, 2006 and 2005, respectively.

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, patients' safekeeping deposits, and restricted deferred contributions. 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.

At June 30, 2006, the entire balance of assets limited as to use consisted of restricted cash. At June 30, 2005, assets limited as to use consisted of restricted cash of $1,346,771 and a receivable from the Kona Hospital Foundation of $359,441 (see Note 12).

Accrued Vacation and Compensatory Pay—HHSC accrues all vacation and compensatory pay at current salary rates, including additional amounts for certain salary-related expenses associated with the payment of compensated absences (such as employer payroll taxes and fringe benefits), in accordance with GASB Statement No. 16, *Accounting for Compensated Absences*. Vacation is earned at a rate of one and three-quarters working days for each month of service. Vacation days may be accumulated to a maximum of 90 days.

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 for the years ended June 30, 2006 and 2005 was $2,575,220 and $1,246,093, respectively.

HHSC has agreements with third-party payors that provide for payments at amounts different from their established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service 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 2006 and 2005 financial statements.

The estimated third-party payor settlement payable of $4,588,213 as of June 30, 2006 and the estimated third-party payor settlement receivable of $3,974,695 as of June 30, 2005 are based on estimates, because complete information is not currently available to determine the final settlement amounts for certain cost report years. Management has used its best effort, judgment, and certain methodologies to estimate the anticipated final outcome.

A summary of the payment arrangements with major third-party payors 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. Medicare cost reports for the various HHSC facilities have been audited by the Medicare fiscal intermediary through fiscal year 2004.

- ***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.

  Patient accounts receivable at June 30, 2006 and net patient service revenues for the year then ended include approximately $5,100,000 of adjustments to Medicaid payments made by the State of Hawaii to mitigate the impact of Act 294 on HHSC's long-term care facilities.

- ***Critical Access Hospitals***—HHSC has seven facilities (Hale Ho'ola Hamakua, Kauai Veterans Memorial Hospital, Ka'u Hospital, Kohala Hospital, Kula Hospital, Lanai Community Hospital, and Samuel Mahelona Memorial Hospital) that are designated as critical access hospitals (CAH) by the Center for Medicare and Medicaid Services. CAHs are limited-service hospitals located in rural areas that receive cost-based reimbursement. To be designated a CAH, a facility must, among other requirements: 1) be located in a county or equivalent unit of a local government in a rural area, 2) be located more than a 35-mile drive from a hospital or another health care facility, or 3) be certified by the State as being a necessary provider of health care services to residents in the area. These facilities are paid an interim reimbursement rate throughout the year based on each facility's expected costs per inpatient day or the allowable outpatient cost-to-charge. After the close of each fiscal year, the facility would receive retrospective settlements for the difference between interim payments received and the total allowable cost as documented in the Medicare cost reports.

- ***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, 2006 and 2005, the amount of bond interest allocated to HHSC was approximately $4,414,000 and $2,665,000, 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, 2006 and 2005 was as follows:

	2006	2005
Medicare	15%	13%
Medicaid	20	16
HMSA	14	11
Other third-party payors	25	28
Patients and other	26	32
	100%	100%

Reclassifications—Certain amounts in the 2005 financial statements have been reclassified to conform to the 2006 presentation.

3. BOARD-DESIGNATED FUNDS

As of June 30, 2006 and 2005, 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, 2006 and 2005, 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, 2006 and 2005 were as follows:

2006	Beginning of Year	Additions	Retirements	Transfers	End of Year
Assets Not Subject to Depreciation:					
Land and land improvements	$ 5,180,572	$ -	$ -	$ -	$ 5,180,572
Construction in progress	30,385,291	37,868,620		(5,168,870)	63,085,041
Assets Subject to Depreciation:					
Buildings and improvements	216,954,326	838,620	(383,809)	4,490,163	221,899,300
Major moveable equipment	79,429,038	5,755,287	(2,152,755)	1,223,907	84,255,477
Fixed equipment	43,239,553	216,533	(6,108,880)	(545,200)	36,802,006
	375,188,780	44,679,060	(8,645,444)	-	411,222,396
Less accumulated depreciation and amortization	(179,395,725)	(18,465,561)	8,093,538		(189,767,748)
Capital assets—net	$ 195,793,055	$ 26,213,499	$ (551,906)	$ -	$ 221,454,648

2005	Beginning of Year	Additions	Retirements	Transfers	End of Year
Assets Not Subject to Depreciation:					
Land and land improvements	$ 5,083,354	$ 16,875	$ (22,006)	$ 102,349	$ 5,180,572
Construction in progress	22,810,939	16,680,644	(209,894)	(8,896,398)	30,385,291
Assets Subject to Depreciation:					
Buildings and improvements	214,386,005	914,657	(4,430,315)	6,083,979	216,954,326
Major moveable equipment	74,983,042	6,277,197	(1,841,417)	10,216	79,429,038
Fixed equipment	41,447,428	134,280	(1,042,009)	2,699,854	43,239,553
	358,710,768	24,023,653	(7,545,641)	-	375,188,780
Less accumulated depreciation and amortization	(169,422,283)	(16,905,894)	6,932,452		(179,395,725)
Capital assets—net	$ 189,288,485	$ 7,117,759	$ (613,189)	$ -	$ 195,793,055

In 2006 and 2005, the State Department of Accounting and General Services transferred capital assets, including construction in progress, aggregating $26,115,844 and $11,746,840, respectively, to HHSC as a contribution of capital.

During fiscal years 2006 and 2005, $209,221 and $1,517,641, respectively, of capital assets were purchased with funds contributed by outside organizations.

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. At June 30, 2006, HHSC did not have the ability, and thus does not intend to repay the advance. Furthermore, management does not expect the State of Hawaii to demand payment of the advance in fiscal year 2007. Accordingly, the advance is classified as a noncurrent liability at June 30, 2006.

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, 2006 and 2005 were as follows:

	Beginning of Year	Additions	Reductions	End of Year	Current Portion	Noncurrent Portion
2006						
Accrued vacation	$25,308,725	$ 4,586,009	$(1,671,353)	$28,223,381	$ 1,671,353	$26,552,028
Capital lease obligations	35,090,251	13,339,332	(8,068,835)	40,360,748	8,105,845	32,254,903
2005						
Accrued vacation	$22,227,261	$ 6,024,307	$(2,942,843)	$25,308,725	$ 829,121	$24,479,604
Capital lease obligations	33,746,111	9,271,683	(7,927,543)	35,090,251	7,738,765	27,351,486

Future capital lease payments were as follows:

Years Ended June 30	
2007	$ 10,576,881
2008	8,139,759
2009	7,224,777
2010	6,153,438
2011	5,445,898
2012-2016	13,626,767
2017-2019	1,755,888
Total future minimum payments	52,923,408
Less amount representing interest	(12,562,660)
Total capital lease obligations	40,360,748
Current portion	(8,105,845)
Noncurrent portion	$ 32,254,903

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, 2006 and 2005, interest capitalized for Corporate and all facilities was approximately $1,279,000 and $685,000, 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 $1,690,900 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, 2006 and 2005 consisted of the following:

	2006	2005
Loan payable to Central Pacific Bank; $9,500,000; interest at 5.75% at June 30, 2006 (interest at weekly average of 5-year U.S. Treasury Securities rate plus 250 basis points); monthly principal and interest payments of $57,015; due December 1, 2027	$ 8,423,972	$ 8,598,940
Loan payable to Central Pacific Bank; $319,000; interest at 5.875% at June 30, 2006 (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	161,951	189,544
Loan payable to Academic Capital; $1,690,900; interest at 6.3%; monthly principal and interest payments of $19,028; due November 4, 2012	1,189,928	1,338,193
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	1,003,357	1,153,106
Note payable to USDA; $1,000,000; interest at 4.75%; monthly principal and interest payments of $8,170; due August 13, 2014	648,765	718,370
Notes payable to two individuals; $252,000; interest at 5% at June 30, 2006; monthly principal and interest payments of $22,745; due January 1, 2008 (see Note 13)	151,638	232,453
Total	11,579,611	12,230,606
Less current portion	(699,070)	(694,487)
Noncurrent portion	$10,880,541	$11,536,119

Transactions in long-term debt during the years ended June 30, 2006 and 2005 were as follows:

	Beginning of Year	Additions	Reductions	End of Year
2006				
Long-term debt	$12,230,606	$ -	$ (650,995)	$11,579,611
2005				
Long-term debt	$12,418,328	$ 252,000	$ (439,722)	$12,230,606

Maturities of long-term debt are as follows:

Years Ending June 30	Principal	Interest	Total
2007	$ 699,070	$ 633,001	$ 1,332,071
2008	541,147	601,130	1,142,277
2009	502,510	571,400	1,073,910
2010	532,229	541,680	1,073,909
2011	563,723	510,186	1,073,909
2012-2016	2,217,926	2,119,560	4,337,486
2017-2021	2,196,505	1,544,276	3,740,781
2022-2026	2,916,072	824,708	3,740,780
2027-2031	1,229,563	119,485	1,349,048
2032-2034	180,866	13,548	194,414
Total	$11,579,611	$7,478,974	$19,058,585

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 $13,114,000 and $9,616,000 (excluding Clinical Laboratories of Hawaii partnership fees of approximately $12,724,000 and $11,211,000 as disclosed in Note 11) during fiscal years 2006 and 2005, 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 $1,070,000 and $1,008,000 during fiscal years 2006 and 2005, 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 approximately $848,000 and $751,000 during fiscal years 2006 and 2005, 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, 2006 and 2005 was approximately $22,973,000 and $14,126,000, 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 provides certain health care (medical, prescription drug, vision, and dental) and life insurance benefits for retired employees.

For employees hired before July 1, 1996, the State pays the entire monthly health care premium for employees retiring with 10 or more years of credited service, and 50% of the monthly premium for employees retiring with fewer than 10 years of credited service.

For employees hired after June 30, 1996, and who retire with fewer than 10 years of service, the State makes no contributions. For those retiring with at least 10 years but fewer than 15 years of services, the State pays 50% of the retired employees' monthly Medicare or non-Medicare premium. For employees hired after June 30, 1996, and who retire with at least 15 years but fewer than 25 years of service, the State pays 75% of the retired employees' monthly Medicare or non-Medicare premium; for those retiring with over 25 years of service, the State pays the entire health care premium.

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, 2006 and 2005 was approximately $22,973,000 and $14,126,000, 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 provides certain health care (medical, prescription drug, vision, and dental) and life insurance benefits for retired employees.

For employees hired before July 1, 1996, the State pays the entire monthly health care premium for employees retiring with 10 or more years of credited service, and 50% of the monthly premium for employees retiring with fewer than 10 years of credited service.

For employees hired after June 30, 1996, and who retire with fewer than 10 years of service, the State makes no contributions. For those retiring with at least 10 years but fewer than 15 years of services, the State pays 50% of the retired employees' monthly Medicare or non-Medicare premium. For employees hired after June 30, 1996, and who retire with at least 15 years but fewer than 25 years of service, the State pays 75% of the retired employees' monthly Medicare or non-Medicare premium; for those retiring with over 25 years of service, the State pays the entire health care premium.

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

Contributions are financed on a pay-as-you-go basis, and are limited by State statute to the actual cost of benefit coverage. HHSC's post-retirement benefits expense approximated $11,179,000 and $10,835,000 for the years ended June 30, 2006 and 2005, respectively.

Sick Leave

Accumulated sick leave as of June 30, 2006 and 2005 was approximately $50,105,000 and $46,105,000, respectively. Sick leave accumulates at the rate of 14 hours for each month of service, as defined, without limit. Sick pay can be taken only in the event of illness and is not convertible to pay upon termination of employment. Accordingly, no liability for sick pay is recorded in the accompanying 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 $19,274,950 and $25,282,963 for unpaid claims as of June 30, 2006 and 2005, respectively.

Ceded Lands

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

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

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

For the quarter ended September 30, 2006, HHSC's share of public land trust payments to OHA approximated $57,000.

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 the Veterans Home on the site of the old hospital building (see Note 1). 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 (see Note 14).

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. The Facility began construction in fiscal year 2005 and expects to complete the project in fiscal year 2007.

11. CLINICAL LABORATORIES OF HAWAII PARTNERSHIP

On May 1, 2002, HHSC entered into a Partnership Agreement with Clinical Laboratories of Hawaii, Inc., St. Francis Healthcare Enterprises, Inc., and Kapiolani Service Corporation to form Clinical Laboratories of Hawaii, LLP (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 years 2006 and 2005, HHSC received partnership distributions of $183,600 and $212,160, respectively.

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 2006 and 2005 amounted to $984,727 and $732,606, respectively, and the investment balance as of June 30, 2006 and 2005 was $2,760,283 and $1,959,156, 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 approximately $1,706,000 and $1,522,000 during fiscal years 2006 and 2005, respectively. Amounts due from the Partnership for such charges aggregated approximately $522,000 and $605,000 as of June 30, 2006 and 2005, respectively.

HHSC contracts with the Partnership to provide clinical laboratory and pathology services at its facilities. Amounts charged by the Partnership aggregated approximately $12,724,000 and $11,211,000 during fiscal years 2006 and 2005, respectively. Amounts due to the Partnership aggregated approximately $3,388,000 and $1,314,000 as of June 30, 2006 and 2005, 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 $93,000 and $81,000 during fiscal years 2006 and 2005, respectively. 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 approximately $79,000 and $102,000 during fiscal years 2006 and 2005, respectively. There were no amounts due from or due to the Partnership as of June 30, 2006 and 2005.

12. TEMPORARILY RESTRICTED NET ASSETS

Changes in temporarily restricted net assets for the years ended June 30, 2006 and 2005 were as follows:

	2006	2005
Balance, beginning of year	$1,302,537	$ 949,595
Restricted contributions received	260,421	2,695,069
Expenditures for restricted purposes	(860,292)	(824,486)
Capital assets purchased	(209,221)	(1,517,641)
Balance, end of year	$ 493,445	$ 1,302,537

In fiscal year 2005, HHSC received a pledge from an affiliated foundation of $1,818,840 to build a new radiation therapy unit at Kona Community Hospital.

13. PURCHASE OF CLINIC ASSETS

In December 2004, the Facility purchased certain assets of a clinic operated by certain physicians for $360,000. The assets purchased included office equipment, supplies, a trademark/service mark, and non-compete agreements for two physicians. No existing liabilities of the clinic were assumed. Since the purchase price exceeded the estimated fair value of the purchased assets, goodwill of $243,000 was recorded. The non-compete agreements were valued at $55,000 and are being amortized over the three-year period of the agreements.

In connection with the purchase, the Facility paid cash of $108,000 and signed two promissory notes to the former clinic owners totaling $252,000. The cash was advanced from HHSC. The promissory notes require monthly payments of $22,745 through January 2008, including interest at 5%. At June 30, 2006 and 2005, the balance of the long-term debt totaled $151,638 and $232,453, respectively.

14. VETERANS HOME

In fiscal years 2006 and 2005, HHSC received $3,392,928 and $5,169,021, respectively, from the State of Hawaii for construction of the new veterans' long-term care facility. Of this amount, $5,034,822 was expended for planning, design, and construction costs, and is included in construction in progress in the consolidated statements of net assets. The remaining $3,527,127 was expended to demolish an old, existing building on the campus site, and is included as a special item in the consolidated statements of revenues, expenses, and changes in net assets, due to the infrequent nature of such expenditures by HHSC.

15. SUBSEQUENT EVENT

On October 15, 2006, an earthquake with a magnitude of 6.7 occurred approximately 10 miles north-northwest of Kailua-Kona on the island of Hawaii. The earthquake and its subsequent aftershocks caused significant damage to the structure and fixtures at Kona Community Hospital, Hale Ho'ola Hamakua, and Kohala Hospital, forcing the temporary evacuation of some patients to other nearby facilities or hospitals. As of the date of this report, management cannot reasonably estimate the amount or the extent of the damage caused by the earthquake. Management expects that the majority of the costs of repairing the hospitals' facilities will be paid from a combination of proceeds from the State of Hawaii's property insurance policy and disaster relief assistance from the Federal Emergency Management Agency.

* * * * * *

HAWAI HEALTH SYSTEMS CORPORATION

SUPPLEMENTAL SCHEDULE OF RECONCILIATION OF CASH ON DEPOSIT WITH THE STATE OF HAWAII
JUNE 30, 2006

	Appropriation Symbol	
CASH ON DEPOSIT WITH THE STATE OF HAWAII:		
SPECIAL FUNDS:		
	S-93-359-H	$ 2,818
	S-94-396-H	8,673
	S-95-396-H	19,636
	S-96-359-H	2,007
	S-96-396-H	9,039
	S-97-359-H	3,556
	S-97-396-H	182
	S-98-396-H	1,687
	S-04-353-H	168,185
	S-04-358-H	88,449
	S-05-345-H	1,556,866
	S-05-350-H	2,769,139
	S-05-355-H	62
	S-06-303-H	267,914
	S-06-320-H	16,126
	S-06-351-H	251,323
	S-06-352-H	185,243
	S-06-355-H	3,117,891
	S-06-359-H	549,593
	S-06-365-H	627,979
	S-06-371-H	534,573
	S-06-373-H	1,074,562
TRUST FUNDS:		
	T-04-918-H	1,272
	T-04-921-H	6,678
	T-04-923-H	4,129
	T-05-906-H	50
	T-06-907-H	183
	T-06-915-H	1,640
TOTAL PER STATE		11,269,455
RECONCILING ITEMS		(98,226)
TOTAL PER HHSC		$ 11,171,229

(Continued)

HAWAI HEALTH SYSTEMS CORPORATION

SUPPLEMENTAL SCHEDULE OF RECONCILIATION OF CASH ON DEPOSIT WITH THE STATE OF HAWAII
JUNE 30, 2006

	Appropriation Symbol	
ASSETS LIMITED AS TO USE:		
PATIENT TRUST FUNDS:		
	T-04-911-H	$ 22,912
	T-04-919-H	1,044
	T-06-915-H	12,763
	T-06-925-H	109,269
	T-06-926-H	9,396
TOTAL PER STATE		155,384
RECONCILING ITEMS:		
Patients' safekeeping deposits held by financial institutions		224,673
Restricted net assets held by financial institutions		430,602
Other		61,574
TOTAL PER HHSC		$ 872,233

(Concluded)

HAWAII HEALTH SYSTEMS CORPORATION

SUPPLEMENTAL COMBINING AND CONSOLIDATING STATEMENT OF NET ASSETS INFORMATION
JUNE 30, 2006

ASSETS	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	Yukio Okutsu Veterans Care Home	Total Facilities	Corporate	Reclassifications and Eliminations	HHSC Combined	Hawaii Health Systems Foundation	Alii Community Care	Reclassifications and Eliminations	HHSC Consolidated
	Facilities																				
CURRENT ASSETS:																					
Cash and cash equivalents:																					
On deposit with the State of Hawaii	$ 2,769,139	$ 1,556,066	$ 3,117,953	$ 191,921	$ 534,573	$ 536,638	$ 314,221	$ 252,645	$ 164,185	$ 767,932	$ 627,979	$ 48,449	$ -	$ 10,866,501	$ 304,728	$ -	$ 11,171,229	$	$ -	$ -	$ 11,171,229
On deposit with banks and on hand	131,545	104,258	144,470	40,950	37,791	351,366	40,922	10,442	44,399	355,175	216,674	28,835		1,574,671	13,931,490		15,506,161	660,667	124,913		16,[illegible]741
Patient accounts receivable - less allowances for contractual adjustments and doubtful accounts	11,041,612	8,263,190	23,351,298	566,040	3,083,162	3,474,965	2,181,655	1,125,832	477,392	2,906,059	1,941,502	262,946		58,806,410			58,806,410				58,806,410
Supplies and other current assets	2,064,447	2,153,820	3,483,060	67,392	240,081	335,553	112,131	100,053	32,526	189,001	401,144	63,724		10,349,322	32,070		10,381,392		9,024		10,390,416
Total current assets	16,006,743	12,254,134	30,110,371	874,949	3,895,409	4,698,544	2,648,929	1,489,012	722,502	4,712,938	3,207,299	403,054		81,597,104	14,268,048		95,865,152	660,667	133,937		96,[illegible]
DUE FROM AFFILIATES - Net			7,390,645											7,390,645	222,403,935	(220,492,447)	9,255,133			(9,255,133)	-
CAPITAL ASSETS - Net	34,541,615	28,019,224	87,561,065	1,174,536	4,379,946	14,804,216	5,043,203	13,025,643	1,976,527	5,406,313	4,410,104	676,449	5,042,444	210,583,989	10,580,703		221,164,692		289,956		221,454,648
ASSETS LIMITED AS TO USE	92,099	30,152	194,684	14,251	63,814	42,543	14,200	14,473	26,766	136,924	72,902	453		694,126			694,126	178,097			872,223
OTHER ASSETS	1,430,732	366,031	726,567	24,159	26,410	278,900		29,257	20,087					3,030,703	97,822		3,126,003			(97,822)	3,030,783
TOTAL	$ 56,061,739	$ 41,606,541	$ 125,434,282	$ 2,088,195	$ 8,356,079	$ 20,217,804	$ 7,756,452	$ 14,558,385	$ 2,742,816	$ 10,254,195	$ 7,750,310	$ 1,539,956	$ 5,042,444	$ 303,296,457	$ 247,350,548	$ (220,492,447)	$ 330,[illegible]	$ 804,764	$ 423,893	$ (9,352,955)	$ 32[illegible]

(Continued)

HAWAII HEALTH SYSTEMS CORPORATION

SUPPLEMENTAL COMBINING AND CONSOLIDATING STATEMENT OF NET ASSETS INFORMATION
JUNE 30, 2006

LIABILITIES AND NET ASSETS (DEFICIT)	Facilities: Hilo Medical Center	Facilities: Kona Community Hospital	Facilities: Maui Memorial Medical Center	Facilities: Ka'u Hospital	Facilities: Kula Hospital	Facilities: Kauai Veterans Memorial Hospital	Facilities: Samuel Mahelona Memorial Hospital	Facilities: Hale Ho'ola Hamakua	Facilities: Kohala Hospital
CURRENT LIABILITIES:									
Accounts payable and accrued expenses	$ 8,066,124	$ 5,651,134	$ 13,944,354	$ 400,028	$ 1,660,447	$ 1,063,069	$ 744,066	$ 451,739	$ 282,556
Accrued workers' compensation liability	5,054,000	2,307,000	4,692,000	112,000	1,785,000	1,001,745	540,372	600,000	253,000
Current portion of capital lease obligations									
Current portion of accrued vacation	210,711	227,418	534,411	4,033	16,221	20,366	20,844	25,854	14,196
Current portion of long-term debt	456,236					84,954			
Other current liabilities	87,511	3,833		354		73,178			
Estimated third-party payor settlements	1,316,137	329,105	1,673,808	85,902	13,764	958,625	(17,624)	46,557	(6,567)
Total current liabilities	15,031,019	8,518,441	20,844,573	650,917	3,889,432	3,242,177	1,287,656	1,220,150	543,243
CAPITAL LEASE OBLIGATIONS - Less current portion									
LONG-TERM DEBT - Less current portion	9,781,809					66,684			
ACCRUED VACATION - Less current portion	6,411,065	3,410,700	6,685,517	305,896	1,553,097	1,465,535	1,322,979	623,572	337,192
DUE TO AFFILIATES - Net	47,481,000	35,718,452		8,178,814	16,312,922	44,099,400	15,751,574	3,473,523	7,407,021
DUE TO THE STATE OF HAWAII		7,005,265			1,114,264	1,043,345	2,417,156	500,153	528,149
PATIENTS' SAFEKEEPING DEPOSITS AND DEFERRED INCOME - Restricted contributions	39,009	7,221		14,251	63,414	7,016	26,559	14,473	39,700
OTHER LIABILITIES	10,462		5,620			7,474	10,626	13,478	
Total liabilities	78,753,364	55,260,125	27,735,716	9,149,878	21,913,929	50,431,830	20,817,538	4,851,349	8,916,305
NET ASSETS (DEFICIT):									
Invested in capital assets - net of related debt	26,303,076	26,819,224	87,061,065	1,174,536	4,379,640	14,466,216	5,143,263	13,025,645	1,576,527
Restricted		22,931	194,654			35,527	32,701		
Unrestricted	(52,196,435)	(42,497,920)	10,442,407	(8,236,219)	(17,936,296)	(45,155,779)	(18,182,050)	(3,318,662)	(8,345,016)
Total net assets (deficit)	(25,893,565)	(13,655,764)	97,698,526	(7,061,683)	(13,557,256)	(30,214,036)	(13,061,086)	9,707,046	(6,768,489)
TOTAL	$ 52,860,799	$ 41,604,361	$ 125,434,242	$ 2,088,195	$ 8,356,673	$ 20,217,803	$ 7,756,452	$ 14,558,395	$ 2,147,816

LIABILITIES AND NET ASSETS (DEFICIT)	Facilities: Leahi Hospital	Facilities: Maluhia	Facilities: Lanai Community Hospital	Facilities: Yukio Okutsu Veterans Care Home	Facilities: Total Facilities	Corporate	Reclassifications and Eliminations	HHSC Combined	Hawaii Health Systems Foundation	Alii Community Care	Reclassifications and Eliminations	HHSC Consolidated
CURRENT LIABILITIES:												
Accounts payable and accrued expenses	$ 1,210,149	$ 444,451	$ 327,571	$ -	$ 35,166,079	$ 2,757,332	$ -	$ 37,923,411	$ -	$ 1,947,736	$ -	39,871,147
Accrued workers' compensation liability	1,253,375	981,220	129,000		18,854,950	420,000		19,274,950				19,274,950
Current portion of capital lease obligations						8,105,845		8,105,845				8,105,845
Current portion of accrued vacation	300,916	101,543	35,619		1,616,134	55,219		1,671,353				1,671,353
Current portion of long-term debt					541,190	157,480		698,670				698,670
Other current liabilities					164,876			164,876	303,306	137,132		605,314
Estimated third-party payor settlements	(109,780)	5,001	(24,334)		4,588,213	-		4,588,213				4,588,213
Total current liabilities	2,663,316	1,072,214	467,856		60,931,442	11,496,276		72,427,718	303,306	2,084,868		74,815,892
CAPITAL LEASE OBLIGATIONS - Less current portion					-	32,254,003		32,254,003				32,254,003
LONG-TERM DEBT - Less current portion					9,848,493	1,032,048		10,880,541				10,880,541
ACCRUED VACATION - Less current portion	1,636,338	1,625,175	158,771		25,726,837	825,191		26,552,028				26,552,028
DUE TO AFFILIATES - Net	11,454,177	21,399,333	9,700,571	27,662	220,499,447		(220,499,447)	-	357,674	8,897,459	(9,255,133)	-
DUE TO THE STATE OF HAWAII	6,416,791	401,456			20,122,507	14,000,000		34,122,507				34,122,507
PATIENTS' SAFEKEEPING DEPOSITS AND DEFERRED INCOME - Restricted contributions	130,924	48,304	433		378,786			378,786				378,786
OTHER LIABILITIES		13,296			61,356	217,380		278,736				278,736
Total liabilities	22,607,546	25,546,026	10,355,651	27,662	337,564,870	59,825,786	(220,499,447)	176,891,209	660,980	11,002,327	(9,255,133)	179,299,383
NET ASSETS (DEFICIT):												
Invested in capital assets - net of related debt	5,408,313	4,410,108	876,449	5,062,444	200,345,964	(30,663,977)		169,681,987		290,356		169,972,343
Restricted		34,535			315,348			315,348	178,097			493,445
Unrestricted	(17,757,669)	(22,290,359)	(9,872,144)	(27,662)	(234,973,505)	218,494,723		(16,478,782)	45,687	(10,868,790)	(97,822)	(27,399,707)
Total net assets (deficit)	(12,349,356)	(17,845,716)	(8,995,695)	5,034,782	(34,312,193)	187,830,746	-	153,518,553	223,784	(10,578,434)	(97,822)	143,066,081
TOTAL	$ 10,258,190	$ 7,700,310	$ 1,359,956	$ 5,062,444	$ 303,252,677	$ 247,656,532	$ (220,499,447)	$ 330,409,762	$ 884,764	$ 423,893	$ (9,352,955)	$ 322,365,464

(Concluded)

HAWAII HEALTH SYSTEMS CORPORATION

SUPPLEMENTAL COMBINING AND CONSOLIDATING STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS INFORMATION
YEAR ENDED JUNE 30, 2006

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	Yukio Okutsu Veterans Care Home
OPERATING REVENUES													
Net patient service revenues	$87,592,531	$43,367,116	$127,440,069	$3,035,774	$14,932,429	$17,271,623	$8,637,824	$6,715,170	$3,726,212	$18,013,334	$15,061,970	$1,639,509	$ -
Other operating revenues	831,298	534,892	913,322	12,333	62,126	852,642	156,224	17,634	20,956	329,682	31,527	22,655	
Total operating revenues	88,423,829	43,902,008	128,353,391	3,048,107	14,994,555	18,124,265	8,794,048	6,732,804	3,747,168	18,343,016	15,093,497	1,662,164	
OPERATING EXPENSES													
Salaries and benefits	57,206,252	29,724,164	68,412,400	3,100,447	11,565,772	12,475,442	7,780,012	5,217,151	3,014,544	15,553,454	12,301,418	1,962,161	
Purchased services	10,357,279	5,254,138	19,169,871	184,032	1,273,733	4,210,540	1,052,444	860,097	539,[illegible]	662,872	687,036	523,969	
Medical supplies and drugs	12,920,733	6,671,276	17,644,100	150,452	741,444	1,466,431	354,037	212,733	110,052	602,561	300,400	234,736	
Depreciation and amortization	5,946,513	3,028,164	5,493,232	95,342	323,753	1,084,267	302,788	546,118	237,666	651,626	200,489	79,359	
Other supplies	3,660,374	1,169,359	3,336,065	102,400	467,865	540,598	416,564	399,796	193,548	1,049,606	630,713	93,838	
Utilities	1,265,737	1,115,273	2,608,406	91,676	248,854	677,647	271,506	536,007	106,233	737,024	431,933	88,889	
Repairs and maintenance	2,044,202	1,413,644	1,971,507	22,469	166,137	388,387	149,539	124,265	41,056	324,285	216,160	45,034	
Insurance	1,515,032	785,126	1,827,748	64,337	262,231	521,504	181,806	119,052	67,922	334,977	279,832	44,454	
Rent and lease	832,530	299,867	1,281,003	9,342	19,529	294,251	13,665	14,167	21,435	24,329	23,047	6,022	
Professional fees	497,797	721,539	284,805	18,448	49,294	210,031	154,476	24,756	77,766	50,012	23,263	67,737	
Other	793,879	911,594	1,144,227	42,750	33,977	394,737	146,554	41,641	42,660	146,253	254,788	49,172	
Total operating expenses	95,122,982	50,994,112	125,280,180	3,933,275	15,615,674	22,261,177	10,924,431	7,850,905	4,454,032	20,423,991	15,423,509	3,221,172	
INCOME (LOSS) FROM OPERATIONS	(6,672,151)	(7,092,104)	3,073,211	(885,168)	(621,119)	(4,136,912)	(2,130,383)	(1,118,101)	(706,864)	(2,080,975)	(330,012)	(1,559,008)	
NONOPERATING REVENUES (EXPENSES)													
General appropriations from State of Hawaii													
Collective bargaining pay raise appropriations from State of Hawaii	1,379,435	648,344	1,610,067	35,160	271,811	250,144	177,291	124,573	71,421	499,638	324,789	47,625	
Restricted contributions		58,131	70,741	16,548		8,112	347	8,873					
Interest and dividend income	6,882	1,881	12,367	360		327	258			21,465	140		
Interest expense (net of capitalized interest)	(591,482)	(54,417)	(436)		(2,013)	(10,289)	(135)	(695)	(1,263)	(925)	(22)		
Corporate allocation expense	(3,138,994)	(1,584,877)	(4,961,350)	(127,984)	(512,089)	(604,350)	(352,570)	(248,957)	(141,864)	(648,914)	(521,908)	(102,916)	
Other nonoperating revenues (expenses) - net	763,212	273,791	625,160	14,811	48,136	93,652	299,201	156,934	46,178	59,061	(730)	24,540	
Total nonoperating revenues (expenses)	(1,562,887)	(617,103)	(1,765,313)	(41,069)	(154,203)	(356,404)	14,992	44,728	(25,654)	(210,403)	(197,631)	(30,751)	
INCOME (LOSS) BEFORE CAPITAL CONTRIBUTIONS AND TRANSFERS	(8,235,000)	(7,709,211)	1,307,906	(926,237)	(776,201)	(4,487,316)	(2,065,991)	(1,073,373)	(730,518)	(2,290,778)	(728,443)	(1,589,756)	
CONTRIBUTED CAPITAL ASSETS AND TRANSFERS	217,877		21,322,444	-	6,301	12,951	520,501	76,230	99,000	467,407			3,392,928
INCREASE (DECREASE) IN NET ASSETS	$ (8,017,163)	$(7,709,211)	$ 22,630,350	$ (926,237)	$ (769,780)	$(4,474,365)	$(1,545,490)	$ (997,143)	$ (631,518)	$(1,823,371)	$ (728,443)	$(1,589,756)	$ 3,392,928

	Total Facilities	Corporate	Reclassifications and Eliminations	HHSC Combined	Hawaii Health Systems Foundation	Ali'i Community Care	Reclassifications and Eliminations	HHSC Consolidated
OPERATING REVENUES								
Net patient service revenues	$347,477,556	$ -	$ -	$347,477,556	$	$ -	$ -	$347,477,556
Other operating revenues	3,612,269		(475,549)	3,136,720		1,557,462		4,694,182
Total operating revenues	351,089,825		(475,549)	350,614,276		1,557,462		352,171,738
OPERATING EXPENSES								
Salaries and benefits	228,862,551	5,679,164		234,541,715	9,741			234,551,456
Purchased services	44,476,662	277,491	(843,507)	43,910,646		11,897		43,922,743
Medical supplies and drugs	41,706,594			41,706,594				41,706,594
Depreciation and amortization	16,212,349	2,178,987		18,391,336	249	92,116		18,483,875
Other supplies	14,455,482	328,164		14,783,646	6,172	182,105		14,971,923
Utilities	8,411,687	79,676		8,491,763		242,014		8,733,781
Repairs and maintenance	6,905,609	151,035		7,056,644		20,451		7,085,095
Insurance	6,608,275	22,702		6,630,977		115,157		6,746,134
Rent and lease	2,844,117	49,221	(32,723)	2,860,615	550	1,658,903		4,520,178
Professional fees	2,201,268	191,859		2,393,127	3,917	1,762,318		4,159,362
Other	4,062,367	719,234		4,781,601	67,110	2,065,729		6,863,510
Total operating expenses	374,156,431	9,677,727	(876,230)	382,957,928	87,739	6,104,564		391,134,631
INCOME (LOSS) FROM OPERATIONS	(23,066,606)	(9,677,727)	400,681	(32,343,652)	(87,739)	(4,547,102)		(38,127,493)
NONOPERATING REVENUES (EXPENSES)								
General appropriations from State of Hawaii	-	32,280,041		32,280,041				32,280,041
Collective bargaining pay raise appropriations from State of Hawaii	5,411,356	62,998		5,474,356				5,474,356
Restricted contributions	156,752			158,752	101,669			260,421
Interest and dividend income	43,820	472,059		515,879	21,367	2,271		539,517
Interest expense (net of capitalized interest)	(661,769)	(1,693,548)		(2,355,317)				(2,355,317)
Corporate allocation expense	(12,157,341)	12,157,341		-				
Other nonoperating revenues (expenses) - net	2,365,948	1,242	(402,681)	1,962,509	(380,142)			1,582,767
Total nonoperating revenues (expenses)	(4,841,432)	43,280,334	(402,681)	38,036,220	(257,106)	2,271		37,781,407
INCOME (LOSS) BEFORE CAPITAL CONTRIBUTIONS AND TRANSFERS	(29,306,038)	33,602,606	-	4,296,568	(344,845)	(4,544,879)		(595,086)
CONTRIBUTED CAPITAL ASSETS AND TRANSFERS	26,115,844			26,115,844			-	26,115,844
INCREASE (DECREASE) IN NET ASSETS	$ (3,192,194)	$ 33,602,606	$ -	$ 30,410,412	$ (344,845)	$(4,544,879)	$	$ 25,520,756

Deloitte.

Deloitte & Touche LLP
Suite 1200
1132 Bishop St.
Honolulu, HI 96813-2870
USA

Tel: +1 808 543 0700
Fax: +1 808 526 0225
www.deloitte.com

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, 2006 and 2005, and have issued our report thereon dated December 8, 2006. 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.

Internal Control over Financial Reporting

In planning and performing our audits, we considered HHSC's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the 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 8, 2006

Hawaii Health Systems Corporation (HHSC)
Report for FY 2006

Wherever you are in Hawaii, You're never far away from quality healthcare

Established in 1996, HHSC is a public benefit corporation of the State of Hawaii. As the State's community hospital system, HHSC continues to fulfill the state's promise to provide quality, hometown health care, particularly in rural locations where private hospitals are unwilling or unable to service. HHSC is an essential part of our island communities, just like fire and police services.

The first Hawaii State hospital opened its doors well over a century ago. Today, HHSC is the fourth-largest hospital system in the U.S., the 26th largest business in Hawaii and the largest provider of healthcare for Hawaii's neighbor island residents and visitors with over 3,600 employees and 850 hospital-affiliated physicians.

Our Mission is: Providing and enhancing accessible, comprehensive healthcare services that are:

- Quality-Driven
- Customer-Focused
- Cost-Effective

Our Vision is: To be the Provider of Choice for the Pacific communities we serve; Employer of choice for staff; and System of choice for physicians

Our Values are:

- Integrity – We act openly and truthfully in everything we do
- Collaboration – We work together cooperatively, recognizing that our combined efforts exceed what we can accomplish individually
- Caring – We treat those we serve with concern, kindness, and respect
- Commitment – We are dedicated to providing excellence in every aspect of our work
- Innovation – We believe that new ideas and timely access to information will lead to better healthcare
- Community – We recognize and respect the importance of our local communities and their healthcare needs

Who we are:

- **Your family, neighbors, friends**--Three thousand six hundred employees and 850 hospital-associated physicians working in Hawaii's largest hospital system of more than 440 acute and 820 long-term care beds. The 26th largest business in Hawaii.

  Staff including, but not limited to: RPNs in ICU, ER, Obstetrics, LPNs, Nursing Aides, Orderlies and Attendants, Occupational Therapists and Assistants, Physical

Therapist and Assistants, Social Workers, Pharmacy Technicians and Surgical Technicians, Medical Assistants, Medical Records and Health Information Technicians, Computer and Information Systems Managers, Food Preparation and Serving Workers, Janitors and Cleaners, General Office Clerks, Maintenance and Repair Workers, Grounds-keeping Workers, Management, Business and Financial Workers, Legal and Contracts Specialists, Office and Administrative Support Workers; Physicians (including Emergency Medicine, Family Practice, Obstetric/Gynecology, Orthopedic surgery, Child and Adolescent Psychiatrist, General Surgeon, Invasive Cardiology, Neurology, Orthopedic Surgery, Urology, Regional Medical Director, Oncology, etc.)

- **Five Regions and twelve facilities** - East Hawaii – Hilo Medical Center, Hale Ho'ola Hamakua, Ka'u Hospital; West Hawaii – Kohala Hospital, Kona Community Hospital; Maui – Maui Memorial Medical Center, Kula Hospital, Lana'i Community Hospital; Kauai – Kauai Veterans Memorial Hospital, Samuel Mahelona Memorial Hospital; Oahu – Maluhia, Leahi; nine Foundations and multiple auxiliaries.
    - East Hawaii Region CEO Ronald Schurra, Hale Ho'ola Hamakua Administrator Romel Dela Cruz, Ka'u Hospital Adminstrator Merilyn Harris
    - West Hawaii Region CEO Donald Lewis, Kohala Hospital Administrator Gino Amar
    - Maui Region CEO Wesley Lo, Kula Hospital Administrator Lee Johnson, Lana'i Hospital Administrator John Schaumburg
    - Kauai Region CEO Orianna Skomoroch
    - Oahu Region CEO Vincent Lee, Maluhia Administrator Jay Duquette

- **Board of Directors** providing the system with highly qualified governance and leadership - Community volunteers, leaders who are knowledgeable of Hawaii's unique cultural diversity and health needs; represent the total community from medical statespersons to business leaders, physicians and public policy makers, and who generously contribute their time and broad expertise.

- Chair S. Dwight Lyons, M.D. (Maui)
- Vice Chair/Sec/Treasurer M. Jean Odo (Exec MAC Chair)
- Andrew Don, M.D. (At Large)
- Chiyome L. Fukino, M.D. (Ex Officio)
- Rosanne Harrigan, Ed.D. (At Large)
- James M. Lightner (West Hawaii)
- Carol Myrianthis, Psy. D. (East Hawaii)
- Brian K. Nakashima (Oahu)
- Russell T. Stodd, M.D. (At Large)
- Gerald S. Tomory, M.D. (Physician)
- Robert Valencia Sr. (Kauai)

- **Five Regional Management Advisory Committees and a Physician Advisory Group** – committed to the promotion and maintenance of quality care and treatment provided at each of the 12 HHSC hospitals throughout the State of Hawaii in each Region's communities.

East Hawaii Management Advisory Committee (MAC)
Marge Elwell, Chair
Jerry Broughton, Vice Chair
Mary Hinck
Katharyn Daub
Israel Gorali
Brenda Iokepa-Moses
Raymond Lee, M.D.
Albert Nishimura
Marcia Yardley
Aaron Ueno

West Hawaii Management Advisory Committee (MAC)
Reginald Morimoto, Chair
Ken Clewett, Vice Chair
Henry Ah Sam
Lisa Rickets, RN
Daryl Kurozawa, M.D.
Rick Vidgen
Heidi Stromerg, Ph.D.
Frank Sayre, D.D.S
Adam Gratz, M.D.

Maui Management Advisory Committee (MAC)
Herbert Sakakihara, Chair
Tony Takitani
Donna McCleary, M.D.
Tony Manoukian, M.D.
Thomas Rogers, M.D.
Thomas Mitsunaga
Wayne Lu
Mark Hyde, Esq.

Oahu Management Advisory Committee (MAC)
William Wood, Ph.D., Chair
Cliff Cisco, Vice Chair
Clarice Hashimoto
Roy Chikamoto, Esq.
James Lumeng, M.D.
Winifred Odo
Michael Abe
Carolee Kubo
Alma Takata

Kauai Management Advisory Committee (MAC)
M. Jean Odo, Chair
Henry Hashimoto, Vice Chair
Laverne Bessert
Roland Sagum III
Juan Francisco
Wayne R. Fukino, M.D.
Carol Nii
Scott Sagum
Richard Magyar

Physician Advisory Group (PAG)
Hilo Medical Center: Linda Dolan M.D., Carlos Abeyta M.D., Chris King M.D.
Kona Community Hospital: Lawrence Peebles M.D., Lora Lee Aller M.D., Deen Wong M.D.
Oahu Region: Albert Yazawa M.D., Linda Tom M.D.
Maui Memorial Medical Center: Pedro Giron M.D., Tony Manoukian M.D., Barry Shitamoto M.D., Benjamin Berry M.D.
Kauai Veterans Memorial Hospital: Gerald Tomory M.D., C. Mitchell Jenkins M.D., Wayne Fukino M.D., Natalie Relles M.D.

- **Volunteers in each community** numbering over 700 active individuals contributing nearly 92,000 service hours through the hospital auxiliaries and foundations. HHSC has promoted the development of foundations at hospitals and incorporated the HHSF as a wholly owned subsidiary 501 (c) 3 organization. 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. Eight 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.
    - Hilo Medical Center Foundation, HMC Auxiliary
    - Hale Ho'ola Hamakua Auxiliary
    - Ka'u Hospital Charitable Foundation, Ka'u Hospital Auxiliary
    - Kona Community Hospital Foundation, KCH Auxiliary
    - Kohala Hospital Foundation, Kohala Hospital Auxiliary
    - Maui Memorial Medical Center Foundation, Kula Hospital Auxiliary, Lanai Hospital Volunteers
    - Kauai Veterans Memorial Hospital Charitable Foundation, KVMH Auxiliary
    - Mahelona Medical Center Charitable Foundation, SMMH Auxaliary
    - Leahi-Maluhia Foundation, Leahi Hospital Auxiliary , Maluhia Volunteers
    - Hawaii Health Systems Foundation

- **Administrative Team of system-wide support** operating the business, providing advice and counsel, evaluation, recommendations and implementation of major policies and strategies that assure continuance of quality health care to the communities that are served.
    - Thomas Driskill Jr; President and CEO
    - Kelley Roberson, Chief Operating Officer and Chief Financial Officer
    - Barbara Kahana, VP & Chief Information Officer
    - Janice Wakatsuki VP & Director of Human Resources
    - Miles Takaaze, VP & Communication/Public Affairs Director
    - Rene McWade, VP & General Counsel
    - Alice Hall, Executive Director of Contract Management and Assistant General Counsel

Services

Emergency, acute care, long-term care and community based care.

HHSC provides the "safety net" for acute and long-term care services on the neighbor islands plus additional levels of specialty care in select locations.
The twelve Regional facilities had over 440 acute care beds and 820 long-term care beds in FY 06. Hospitals are accredited by Joint Commission and are Medicare/Medicaid certified by the State Department of Health Quality Assurance Division. By mid-FY06, seven HHSC facilities had received Critical Access Hospital (CAH) designation, which

assures increased access and higher reimbursements for services in rural communities. CAH facilities include: Kauai Veterans Memorial Hospital, Kohala Hospital, Ka'u Hospital, Lanai Community Hospital, Hale Ho'ola Hamakua, Kula Hospital, and Samuel Mahelona Hospital.

In the past fiscal year, services provided included over 22,800 in-patient admissions and 113,700 acute care patient days; 1,400 long-term care admission and over 286,200 long-term care patient days. Over 3,300 babies were born, over 186,100 x-rays were taken, and more than 722,400 lab procedures were done.

Budget

HHSC operating budget includes special funds and general funds. Special funds are revenues generated by services provided and general funds are additional "state funds" requested from the Legislature. In FY 06, State general funds that were requested were approximately 12% of the budget.

Total Budget Expenditures: FY 06 and FY 07

FY 06	FY 07 (estimated)
$385 million	$422 million

Total Biennium Budget Request: FB 07- 09

FY 08	FY 09
$433 million	$457 million

Projected Revenues by Each Health Care Facility: FY 07

April 2006, based upon FY 06 (Dec 2005 Y-T-D)

Hawaii Health Systems Corporation - Fiscal Year 2007 Budget (Amounts in $ 000s)

Hamakua	6,940
Hilo	90,030
Kau	3,337
Kauai	24,832
Kohala	3,324
Kona	47,202
Kula	15,560
Lanai	1,715
Leahi	16,925
Maluhia	14,667
Maui	123,696
SMMH	11,795
Total	360,023

Proposed Capital Improvement Projects Planned for Implementation during FY 07: FY 07 CIP Implementation Plan ($ thousands)

FORM C

FY 07 CIP IMPLEMENTATION PLAN ($ thousands)

Hawaii Health Systems Corporation

Contact Person/Phone No.: Nadine Asai, 733-4028

Priority	Act/Yr	Item	Project Title and Brief Project Description	E or L	M O F	Apprn	Prior Allotments	1st Half FY 07	2nd Half FY 07	Comments
1	178/2006	E-11.01	Maui Memorial Medical Center, Hospital Expansion Phase 1	E	C	5300	38000	5300		Request for the release of funds has been submitted to B&F
2	178/2006	E-11.03	Maui Memorial Medical Center, Emergency Room	E	C	2884	4154	2884		Request for the release of funds has been submitted to B&F
3	178/2006	E-11.02	Maui Memorial Medical Center, Air Conditioning	L	C	6600		6600		Request for the release of funds has been submitted to B&F
4	178/2006	E-11.04	Hilo Medical Center, Emergency Room	E	C	2500	3087	2500		
5	178/2006	E.007	Hawaii Health Systems Foundation - Hilo Medical Center, Veterans Home	E	C	3200	10000	3200		
6	178/2005	E-6	Lump Sum CIP, Kauai Veterans Mem Hospital, Electrical Upgrades	E	C	950		100	850	
6	178/2005	E-6	Lump Sum CIP, Kona Community Hospital, Add Emergency Power Outlets to Nursing Units	E	C	250		125	125	
6	178/2005	E-6	Lump Sum CIP, Samuel Mahelona Mem Hospital, Replace all Electrical Apparatus, boxes, etc	E	C	630		50	580	
			Subtotals, by MOF		B					
					C	22314	55241	20759	1555	0
					D					
					E					
					N					
					W					
			Grand Total			22314	55241	20759	1555	0

E = Executive Project, L = Legislative Project

HHSC Volunteer Community Support
Fiscal Year 2006

Community support has played an integral role in enhancing the mission of the Hawaii Health Systems Corporation (HHSC) over the past years. 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. In Fiscal year 2005-2006 over 700 active volunteers contributed nearly 92,000 volunteer service hours for the combined facilities. Community improvement projects included:

EAST HAWAII REGION

- **Hilo Medical Center**
  - 100 active volunteers
    Nearly 23,000 volunteered service hours each year
  - Auxiliary raises between $15,000-$30,000 annually
    - Commission from Baby Photos - $3,500
    - Palm Tree Gift Shop & Auxiliary Workshop - $25,000
    - Grants twenty (20) $500 nursing scholarship annually to nursing students at both UHH and HCC - $10,000
  - Hilo Medical Center Foundation
    - In FY 2005-2006, the HMCF netted $215,980. As of June 30, 2006, a total of $1,232,153 was raised for the Emergency Department (pledges and gifts) and $35,807 was raised for the State Veterans Home (pledges and gifts).
- **Hale Ho'ola Hamakua**
  - 29 active volunteers
    Nearly 10,000 volunteered service hours each year
  - Auxiliary donations included:
    - Auxiliary sponsored two (2) $250 scholarships - $500.00
    - Auxiliary bought pens for facility - $119.05
    - Volunteer Appreciation Luncheon - $147.76
    - Auxiliary sponsored programs - $1,121.00
    - Purchased Chaffing Dishes Dietary - $156.17

- Sponsored Nurses training - $120.00
- Advanced monies for 10 year celebration - $1,000.00
- Purchased sound system for Activities Dept. - $529.00

Ka'u Hospital

- 10 active volunteers
  Nearly 1810 volunteered service hours each year

- Hospital Auxiliary donations included:
  - College scholarship, $200
  - Thanksgiving dinner donation, $200
  - New curtains in patient rooms and emergency room, $2,600
  - Bake and craft sale, in collaboration with Red Hats, Ka Lae Quilters for emergency room equipment, $8,000
  - Industrial floor stripper, $1,300
  - Adopt-A-Room Project donation, $6,410

- The Ka'u Hospital Charitable Foundation received 501c3 designation and formed a Board of Directors in FY05-06.

  - The Foundation opened a new office at the Hospital with a scanner and computer for compiling old plantation medical records.
  - Raised $3,000 for the Hospital Monthly published Health Notes in the Ka'u Calendar News Paper
  - Helped local Red Hatter in raising funds at a two day event, collected $8,000 toward ER equipment
  - Collected $1,450 at Ka'u Interfaith Service that enabled KHCF to replace three water drinking fountains
  - Collected additional funds of $2,000 for building a cover for a sundeck for the LTC residents, and a local builder to do it without charge
  - KHCF made approximately $1,500 in Auxiliary "Cook Book" sales; and will also sell at the next Red Hatters function.
  - Raised $400 from an ad in the newspaper and retired employees.
  - Raised $4,000 for "adopt-a-room" project to renovated long term care resident rooms.

WEST HAWAII REGION

- **Kona Community Hospital**

  - 100 active volunteers and still growing
    Nearly 4,630 volunteered service hours

  - Kona Community Hospital Auxiliary provides the volunteer support base for service, fundraising and friend raising for the Kona Community Hospital. Membership in the Auxiliary is open to men and women eighteen years of age or older, of all backgrounds and abilities who are interested in providing services to patients which the staff would not normally provide.

    - Volunteers help the staff to perform technical assistance in Administration and data processing; are involved in patient interactions such as healing touch or assisting with long term care patients; provide patient services such as carts with heart or work in the Gift Shop and the weekly Bake Sale at the Cafeteria

    - Auxiliary volunteers assist the Foundation in fundraising activities like the By-Pass Road Race, the Hokulia Golf Tournament and participate in the many community parades and activities representing the Auxiliary and Kona Community Hospital.

    - The Auxiliary provides a number of Nursing Scholarships and Continuing Education funds for KCH Nurses. Other fundraising activities fund a monthly stipend for non-funded items to Long Term Care, Kalani Ola and the Physicians Workroom. The Auxiliary also works to fund special requests from various hospital departments for non-funded items.

    - The Auxiliary provides a communication link between the community and the Kona Community Hospital. Community inputs through the Auxiliary are welcomed and warmly received by Administration and staff. The Auxiliary's representative to the Hospital Advisory Committee (HAC) helps provide three-way communication between the Hospital Administration and staff, the HAC and MAC and the larger Kona Community represented by the Auxiliary.

  - The Kona Community Hospital Foundation sponsored many events and fundraisers to support the people and physical plant at

Kona Community Hospital. Some of the fundraising and community outreach events included:

- The 4th Annual Hokuli'a Bypass Road Race. This event drew over 150 participants and 25 volunteers for a 1 mile walk, 5k run and 10k run. As part of Hospital Week festivities, all employees of the hospital were invited to participate for free.
- The 5th Annual Hoku Concert Series. A joint project with North Hawaii Community Hospital, this series was designed to increase community awareness of the need for cooperative healthcare on the Big Island. It raised about $10,000 for each hospital.
- 5th Annual Gala and Golf Classic at Hokuli'a. The biggest fundraiser on the Big Island is a two day event that is sold out every year. Over $350,000 was raised for the Hospital Foundation in 2006 and over 80 volunteers provided their services to make the event happen.
- Christmas at Kona Village—the granddaddy of food and wine events on the Big Island. The Hospital Foundation has held the silent auction for the last 4 years. Twenty volunteers helped raise over $15,000 during the course of the evening.

- The Hospital Foundation participated in the 2006 Hawaii Island and Aloha United Way as a write-in charity and in the 2006 Give Aloha with Foodland Stores program that matches donations given to charities.

- The Kona Hospital Foundation exists to support Kona Community Hospital. Some of the ways the Foundation participated were:
  - Hosting a JCAHO Mahalo party for employees upon receiving terrific scores.
  - Facilitating the creation of the Delmer Buse/Florence Rangasan Nursing Scholarship to provide for the continuing education of Kona Community Hospital nurses.
  - Purchasing 600 Teddy Bears from the Build-A-Bear Foundation to make sure that every child in the Emergency Room is given a stuffed bear for comfort while receiving care.
  - Launching the "Adopt A Room" project. The Foundation and a committee of community members are cooperating to provide the design and funds for an aesthetic renovation of all patient rooms on the Long Term Care, Skilled Nursing and Medical Surgical units

- The Foundation provides support in others areas during the year. including:

- Funding of a Wound Care Program, development of the Grieving Program for families who lose loved ones at the hospital, assistance with Healing Touch massage program scholarships, funding Social Service Department needs, and purchase of equipment for the Radiology Department, Maternity Ward, Chemotherapy Department, and Long Term Care Unit.
- Sponsoring many Hospital Week and Nursing Week activities, including unit decoration contest with prizes and "Thank You" banners and pins for nurses and employees.
- Receiving grants from Bank of Hawaii Foundation, HHSC Foundation, Tokyu Foundation, Kukio Foundation and SalesForce.com Foundation, and completed work on a Federal RUS grant in cooperation with HHSC.

Kohala Hospital

- Up to 20 active volunteers monthly
  Nearly 3,500 volunteered service hours each year

- The Kohala Hospital Auxiliary raised over $8,900 with fundraisers, grants and dues.
  - The Auxiliary donated a new Med cart for Nursing, a Blitzer mixer for the kitchen, Gerrie-chairs, clocks for all resident rooms, a leaf blower, vacuum cleaner, camera, CPR manikins and supplies, Christmas party and gifts for the residents, subscription to West Hawaii Today, and monthly funding for the Activity Fund.
  - Auxiliary won the Mauna Lani Charity Christmas Tree display raising an additional $7,500, had a booth at the Kohala County Fair, assisted with the LTC Customer Satisfaction Survey, ran the Resident Council Meetings monthly, and coordinated the PAVE student volunteer program.
  - Annual cable television service provided by the Kamehameha Cable Vision.
  - Auxiliary donated $1,880 in scholarships.
  - Auxiliary provided 92 hours of continuous service to the Food Bank and donated 617# of food.
  - Over $2,600 in-kind donations from 22 individuals/groups.
  - Kohala Hospital Charitable Foundation (KHCF) raised over $60,000 with fundraisers and grants.
  - KHCF projects include: renovating Radiology area, upgrade of telephone system, purchase of hospital equipment (Sit-to-Stand lift and Electric Hospital bed), and replacement of kitchen stove. Estimated value above $25,000.

- The Kohala Hospital Foundation, with money received from its silent auction plus funds that were the result of its annual mailing donations, successful efforts to acquire grant money and other generous donations, provided the following:

    - Painted the exterior of Kohala Hospital
    - Funded a totally new phone system upgrade
    - Initiated an x-ray room upgrade which includes a better filling capability and new x-ray monitoring access
    - Provided the funds for a "stand lift" device that helps the hospital staff to care for the patients hygiene needs
    - Bought a new meal cart that is more than twice the size of the old one for better efficiency during meal times.

    - The Kohala Hospital Foundation committed approximately $52,000.00 to these tasks.

KAUAI REGION

Kauai Veterans Memorial Hospital

- 50 active volunteers
  Nearly 4,250 volunteered service hours each year

- Auxiliary raised more than $31,900

    - $22,000 in Gift Shop sales
    - $4,200 in commission sales (vending machines)
    - $5,700 gross profit from the Annual Christmas Craft Fair

- Auxiliary purchases included:
    - TV/VCR/DVD, Scanner, Chair, Videos, DVDs for in-service Department ($955.00)
    - Simulator, Lead Wires, Cabinet, Ankle/Leg Exerciser for the Physical Therapy Department ($1,270.00)
    - Staff Refrigerator for the Nursing/Long Term Care Department ($622.00)
    - Kodak Camera/Docking Station for Nursing ($361.00)
    - Billpad for OB Nursery ($3,290.00)
    - Humidifier, Head Gear Equipment for Respiratory Department ($1,825.00)
    - Wheelchairs, Shower Chair, Trapeze Bars for the Medical/Surgical Department ($1,184.00)

- Ergonomic Chairs for the Fiscal/Billing Department ($3,058.00)
- Crafts for the Long Term Care Activities Department ($1,768.00)
- Ergonomic Chair for the Quality Improvement/Infection Control Department ($437.00)
- Kitchen Shelving for the Dietary Department ($458.00)
- Educational Handbooks for OB/GYN, Virginia Beck, NP-Women's Health ($1,730.00)
- Mobile OT Cart for the Occupational Therapy Department ($1,810.00)
- Floor Cleaner for the Environmental Services Department ($1,925.00)
- Hair Dryers for the Long Term Care Department (residents) ($56.00)
- Fax Machine for the Human Resources Department ($580.00)
- Labels (special) for the Emergency Department ($158.00)
- Wheelchair for the Emergency Department ($370.00)

- KVMH Charitable Foundation

  Income:
  - $3,860 from Nick Castillo Concert Fundraiser
  - $375 from Yoga Class contributions
  - $325 from Letter Writing contributions
  - $1,000 from Virginia Beck, NP Scholarship
  - $3,480 from Red Hat Luncheon
  - $150 from Staff Appreciation contributions

  Expenditures:
  - Renovation of the Physical Therapy Department to expand the "working" area ($50,000 via grant monies funded by the McInerny Foundation
  - $703 for Motherhood Booklets for Virginia Beck, NP (Women's Health)
  - $295 for Childbirth Videos for Virginia Beck, NP (Women's Health)

- **Samuel Mahelona Memorial Medical Center**

  - 165 active volunteers
    Nearly 6,750 volunteered service hours for 2006

    - SMMH Auxiliary raised more than an estimated $8,525 (Thrift Shop) and an additional $1,800 (Annual Country Store).

- Auxiliary purchases included more than $9,000:
  $2,500 Staff Training
  $1,200 SMMH Recreational Therapy
  Functions/Events
  $2,000 Misc. Equipment/Supplies for Hospital Residents
  $1,975 Christmas Decorations/Gifts for Residents/Patients
  $875 High School Senior Scholarship program
  $ 450 New Washing Machine for Psychiatric Unit

- Mahelona Medical Center Charitable Foundation raised an estimated $5,000.

  - Charitable Foundation purchases estimate about $5,000.
    $250 Monthly Resident Bus Passes to Friendship House
    $2,500 Staff Training
    $2,250 Physician Office Furniture

  - Community donations:
    Petting Zoo – Orchid Society: $200.
    Petting Zoo – Kauai Electric: $150.

MAUI REGION

- **Maui Memorial Medical Center**

  - 59 active volunteers
    Nearly 12,000 volunteered service hours each year

    - Donated close to $1,300 for patient care
    - Raised close to $8,000 at the Annual Harvest Sale

  - The MMMC Foundation raised over $900,000
    - Challenge Grant Dowling Foundation, $125,000
    - Valley Isle Motors, $100,000
    - Clinical Labs, $100,000
    - Dorvin Leis, Co., $300,000
    - Yokouchi Foundation $10,000
    - Hawaii Community Foundation, $6,000
    - National Breast Cancer Foundation, $25,000
    - Grateful Patient Gifts Combined, $25,000
    - Maui Hotel Association Grant, $25,000
    - Special Grant – OR Waiting Room Renovation, $5,000
    - Special Grant – Patient Room Renovation, $15,000

- Alexander & Baldwin - Wall of Life, $5,000
- Cookbook Sales – Wall of Life, $25,000
- Entrak for the ENT Department – Equipment, $74,250
- Ultrasound for Emergency Department - Equipment, $15,755
- Patient Information Software – Equipment, $13,944
- Bariatric Life for Large Patients – Equipment, $6,785

Kula Hospital

- 32 Active Volunteers
  Over 7,500 volunteer hours last year

- Auxiliary purchases totaled more than $26,000
  - 3 Maui News subscriptions
  - Cable TV for 6 units, 1 sewing machine
  - Sofa and 2 arm chairs, coffee table and 2 end tables, plastic covers for the cushions
  - 2 Rocking chairs, 1 loveseat
  - Expenses like paint and carpet for the rededication of chapel.
  - Paint, mirrors and lights for beauty shop
  - Tickets for Ualena show for 30 residents to attend in Lahaina
  - Door prizes for monthly Bingo games, haircuts, and money for excursions into the community
  - Storage bins for Activities Department
  - Tagging guns for items at the Thrift Stores
  - Complete fencing of the area around the Thrift Store
  - 5 year TV warranty for HD TV
  - Donated over $2,500 towards scholarships/workshops/continuing education
  - Raised over $25,000 in donations and Kala Iki Thrift sales
  - Raised $46,838.25 in grants and private donations to purchase min-SUV van to transport 2 wheelchair residents or ambulatory residents at Hale Makamae. This is first time Kula Hospital Auxiliary submitted grant proposals to 4 Foundations.
  - Blanch & Bob Johnson Memorial garden was re-landscaped and walkways were made wide enough to accommodate wheelchair residents. Cost for the re-landscaping thus far $13,000. Plants and cuttings are being installed and will have maintenance upkeep.

- **Lanai Community Hospital**

  - 26 active volunteers
    Nearly 1,900 volunteered service hours each year

    - Castle and Cooke donated furniture, window coverings and miscellaneous items totaling close to $2,500
    - Miscellaneous community donations included: cash, wheelchairs, and miscellaneous items

OAHU REGION

- **Leahi Hospital**

  - 59 active volunteers
    Nearly 7,499 volunteered service hours for fiscal year 2005-2006

    - 343 active group volunteers (student & group organizations)
    - Nearly 1,221 volunteered service hours for group volunteers

  - Leahi Hospital Auxiliary (Thrift Shop) raised more than $24,000 for fiscal year 2005-2006

    - Donated $9,000 for resident recreational equipment and supplies. Includes bingo prizes, unit decorations, DVDs, CDs, arts and craft supplies, games, special treats, residents' parties, etc.
    - Donated $2,106 for 3-position recliners (for residents)
    - Donated $416 for new 27-inch VCR player/TV (for North Trotter residents)
    - Donated $5,421 for ten (10) glider chairs (for residents)
    - In kind donations totaled $4,556
    - Monetary donations totaled $235

- **Maluhia**

  - 55 active volunteers
    Nearly 8,900 volunteer service hours each year

  - Gift Shop raised $7,652.00 per year for fiscal year 2005-2006

    - Monetary donations totaled $1,407.00
    - Friends of Maluhia purchased the following items this past year:
      - Television for PACE
      - Monthly Bingo Prize supplies

- Special Menu items for Residents' Social Dining
- Admission to the "Wildest Show on Earth" at the Honolulu Zoo
- Subscription for Hawaii Hochi (Japanese newspaper)
- Subscription for Sing Tao Daily (Chinese newspaper)
- Subscription for Honolulu Advertiser (2nd and 3rd floors)

- The Leahi-Maluhia Foundation was able to raise over $17,350.00 in donations in CY 06.

HHSC Highlights
Achievements and commitment to the future©

Looking to a bright future for quality healthcare for all in Hawaii's communities with the legislature's support

Quality Driven – Cost Effective – Customer Focused

HHSC acute-care facilities awarded accreditation, high marks from Joint Commission
All four of the Hawaii Health Systems Corporation's primary acute-care hospitals—Hilo Medical Center, Kona Community Hospital, Maui Memorial Medical Center, and Kauai Veterans Memorial Hospital—received outstanding scores during the Joint Commission system-wide accreditation assessment.

Joint Commission survey preparedness and daily readiness at Maui Memorial Medical Center
Quality Survey Maui Memorial Medical Center Patient Safety Pilot Project – involving an approach to survey preparedness and daily readiness that traces the patient from admission to discharge; follows along with the patient to evaluate systems that move back to the patient in the chart, focuses on the patient and not only the documentation, humanizing the functions and emphasizing what you would want for yourself if you were the patient.

Electronic health record study on Kauai at West Kauai Medical Center, Samuel Mahelona Memorial Hospital and Clinics in Eleele, Kalaheo and Waimea.
An Electronic Health Record Study that is designed to implement open source electronic health records in two critical access hospitals and three rural clinics on the island of Kauai. This project is a partnership of a Department of Defense/Department of Veterans Affairs Joint Venture headquartered at Tripler Army Medical Center, HHSC, University of Hawaii Telecommunications and Information Policy Group, Pacific Research Institute, and MELE Health Information Systems. This technology brings information to the critical points of care and can significantly improve the quality of care these facilities provide patients and lower their operating cost by eliminating duplicate testing, errors and wasted resources.

Small communities are better served within the HHSC system rather than as individual hospitals that would not be able to support themselves.
HHSC has shown improvement in operating loss. Excluding the three large acute hospitals, the operating loss for HHSC facilities was $23 million in FY97 and $14 million in FY05. This represented an improvement of $9 million in operating loss for HHSC.

Critical Access Hospitals designation for HHSC facilities Seven HHSC facilities have achieved Critical Access Hospital (CAH) designation, which assures increased access and enhanced revenues to cover costs of care for services in rural

- Special Menu items for Residents' Social Dining
- Admission to the "Wildest Show on Earth" at the Honolulu Zoo
- Subscription for Hawaii Hochi (Japanese newspaper)
- Subscription for Sing Tao Daily (Chinese newspaper)
- Subscription for Honolulu Advertiser (2nd and 3rd floors)

- The Leahi-Maluhia Foundation was able to raise over $17,350.00 in donations in CY 06.

HHSC Highlights
Achievements and commitment to the future☺

Looking to a bright future for quality healthcare for all in Hawaii's communities with the legislature's support

Quality Driven – Cost Effective – Customer Focused

HHSC acute-care facilities awarded accreditation, high marks from Joint Commission
All four of the Hawaii Health Systems Corporation's primary acute-care hospitals—Hilo Medical Center, Kona Community Hospital, Maui Memorial Medical Center, and Kauai Veterans Memorial Hospital—received outstanding scores during the Joint Commission system-wide accreditation assessment.

Joint Commission survey preparedness and daily readiness at Maui Memorial Medical Center
Quality Survey Maui Memorial Medical Center Patient Safety Pilot Project – involving an approach to survey preparedness and daily readiness that traces the patient from admission to discharge; follows along with the patient to evaluate systems that move back to the patient in the chart, focuses on the patient and not only the documentation, humanizing the functions and emphasizing what you would want for yourself if you were the patient.

Electronic health record study on Kauai at West Kauai Medical Center, Samuel Mahelona Memorial Hospital and Clinics in Eleele, Kalaheo and Waimea.
An Electronic Health Record Study that is designed to implement open source electronic health records in two critical access hospitals and three rural clinics on the island of Kauai. This project is a partnership of a Department of Defense/Department of Veterans Affairs Joint Venture headquartered at Tripler Army Medical Center, HHSC, University of Hawaii Telecommunications and Information Policy Group, Pacific Research Institute, and MELE Health Information Systems. This technology brings information to the critical points of care and can significantly improve the quality of care these facilities provide patients and lower their operating cost by eliminating duplicate testing, errors and wasted resources.

Small communities are better served within the HHSC system rather than as individual hospitals that would not be able to support themselves.
HHSC has shown improvement in operating loss. Excluding the three large acute hospitals, the operating loss for HHSC facilities was $23 million in FY97 and $14 million in FY05. This represented an improvement of $9 million in operating loss for HHSC.

Critical Access Hospitals designation for HHSC facilities Seven HHSC facilities have achieved Critical Access Hospital (CAH) designation, which assures increased access and enhanced revenues to cover costs of care for services in rural communities. CAH facilities include: Kauai Veterans Memorial Hospital, Kohala Hospital, Ka'u Hospital, Lanai Community Hospital, Hale Ho'ola Hamakua, Kula Hospital, and Samuel Mahelona Hospital.

Workers compensation cost cuts by $1 million in FY06. The system surpassed goals resulting in a savings of more than $1 million. This was accomplished with the support, assistance and cooperation of concerned employees, supervisors, managers and executive officers.

Hawaii's communities are served with safety-net care by HHSC. HHSC will provide safety-net care to individuals statewide in five regions and twelve facilities with a total operating budget of $447 million in FY08 and $468 million in FY09. HHSC provides the "safety net" for acute and long-term care services on the neighbor islands plus additional levels of specialty care in select locations. In FY 05-06 approximately $23 million of services in under-reimbursed and charity care was provided by HHSC facilities.

Maui Memorial Medical Center New Wing dedicated. A $46 million dollar expansion project at Maui Memorial Medical Center includes a new lobby and admitting area, enlarged physical therapy/occupational therapy department with a gym, a new ambulatory surgery center with four procedure rooms and two fully equipped endoscope suites, a new ICU unit with larger rooms to accommodate families, and improved patient and public waiting areas.

Hilo State Veteran's Home

Hawaii's first State Veterans Home being constructed on the Hilo Medical Center campus is a $42 million federal and state project. The 95-bed VA State Home for long term nursing care on the campus of the Hilo Medical Center for VA beneficiaries throughout Hawaii is targeted for completion in 2007.

Master Planning Process – A Master Planning process to address uniform specialty medical care in all regions examines how HHSC can best respond to the healthcare needs of the island communities served and bringing appropriate levels of care. This major initiative is intended to provide the state with a new comprehensive integrated system master plan. It involves a bottom up planning process that asks for stakeholders' participation and support with input from the communities, physicians, nurses and management at the facility, region, and system levels in that order. Part of the concept anticipates establishing a referral center on Maui focused on quality outcomes serving as a disaster management center and Level II trauma center, with open heart surgery and other specialty services that will interact with robust HHSC Community hospitals, LTC facilities, Critical Access Hospitals and other partners throughout the State of Hawaii; level III trauma centers at Kona Community Hospital and Hilo Medical Center; regional initiatives such as a health science center at Hilo Medical Center, Chronic/facility in West Hawaii, enhanced surgical capabilities on Kauai, enhanced LTC capability throughout the system; and increased physician specialty emergency care capability throughout the system

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

"Touching Lives Everyday"

DRAFT

HHSC Master Planning for the Future
"Concept Business Plan"

June 26, 2006

"In response to the State-wide need for effective disaster management, as well as the need for Neighbor Island trauma management and patient referral requirements of the communities we serve, HHSC is evaluating the concept of building a new comprehensive System Referral Center on Maui, focused on quality outcomes and serving as a disaster management / Level II trauma center, with open heart surgery and other specialty services that will interact with robust HHSC Community Hospitals, LTC facilities, Critical Access Hospitals and other partners throughout the State of Hawaii."

- Build a new Comprehensive Acute-Care / Trauma Care Hospital of approximately 400 beds on Maui near current facility to serve as an HHSC referral center for Neighbor Islands.
- Provide the State with a Level II Trauma Center and open-heart surgery capability outside of Oahu.
- Provide the State with an additional Medical Disaster Management Center outside of Oahu.
- Provide all Neighbor Island communities with necessary access to most needed medical specialists and sub-specialists.
- Ensure that all provided health services meet and exceed the highest quality standards.
- Ensure current leading edge Information Technology is fully utilized for electronic medical records and related data systems.
- Conduct a system Master Plan (consultant selected – plan underway).
- Develop a Business Plan that will include:
    - Land on Maui close to current hospital
    - $400M in low interest investor financing
    - 24-7 air transport for patients between islands
    - Dedicated Disaster / Trauma funding sources through State and Federal programs such as Homeland Security
    - Integrated Foundation Support
    - Comprehensive analysis of physician referral patterns within and between Neighbor Islands
- Provide information briefings on this HHSC Master Planning for the Future to key stakeholders and continue collaboration conversations.

In order to accomplish this strategy, coordination collaboration and support from the Administration, Legislature, Neighbor Island Communities, Labor Organizations, Business Organizations, Physician Groups, and Senior Healthcare Leaders throughout the State, is essential.

POC: Thomas Driskill, President and CEO, HHSC, Tel: 808-733-4151

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

As we continue forward together advancing the health care system to serve communities throughout the state, a sincere thank you to all HHSC Employees, Board of Directors, Management Advisory Committees, Physicians Advisory Group, Auxiliaries, Foundations, Legislators, Administration, Labor unions and others whose support make the state system a great public hospital and safety-net system in Hawaii serving citizens, residents and visitors.

Attachment 1

"Touching Lives Everyday"
HAWAII HEALTH SYSTEMS
CORPORATION

Hawaii Health Systems Corporation, HHSC
Budget Briefing on the Executive Biennium Budget
Fiscal Biennium 2007-2009

Presented to the

Senate Ways & Means Committee

Thursday, January 11, 2007, 900AM
Conference Room #211
Hawaii State Capitol

Program I.D. and Title: HTH 210 – Hawaii Health Systems Corporation

I. Introduction:

A. Summary of program objectives.

To maintain and enhance the levels of accessible 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 Long Term Care (LTC) facilities.

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

B. Description of program objectives.

System. Following direction set by the HHSC Board of Directors, and with advice provided by both the Regional Public Health Facility Management Advisory Committees and the Physician Advisory Group, the HHSC President/CEO and staff coordinate and implement planning, policy formulation, hospital system operation, business development, quality assurance, corporate compliance, 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 that is the 26th largest business in Hawaii and the 4th largest public health system in the nation. HHSC's twelve Community Hospitals are organized into five regions across 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 (LTC) and rural health care on the Neighbor Islands with a large LTC presence on Oahu.

Essentially, HHSC provides the hospital "safety-net" for acute and long term care services on the neighbor islands plus additional levels of specialty service in select locations. Collectively, through operations of our ten emergency departments, HHSC hospitals are the largest provider of emergency services in the State, far surpassing the annual number of ER visits logged by Queen's Medical Center, the State's Trauma Center. Collectively, HHSC hospitals are the single largest provider of LTC services in the State. 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, cardiology, pediatrics, obstetrics, home health, 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. Generous benefactors donated many hundreds of thousands of dollars to our nine hospital foundations. This close collaboration between HHSC and community organizations is essential to the long-term success of HHSC.

During the aftermath of the Big Island earthquake disaster on October 15, maintenance, engineering, and other staff from non-affected HHSC facilities (i.e., Hilo Medical Center, Kauai Veterans Memorial, Leahi Hospital, and Samuel Mahelona Memorial Hospital) provided immediate and intermediary support in the recovery and assessment phases. Equally important, members of the respective, affected communities were immediately at hand to provide additional support. Collaborative efforts will continue with Home Land

Security, state and county civil defense, department of health, and the military in preparation for future disasters.

The five statutorily created, regional Public Health Facility Management Advisory Committees (MACs) provide 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 five 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 physicians throughout the islands who volunteer their time and talents to come together on a semi-monthly basis with the President and CEO to discuss the clinical and medical staff issues facing our hospitals. The PAG represents approximately 860 HHSC medical 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 our 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. Eight 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 08 and FY 09 program and budget objectives by collecting patient revenues to meet almost 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 access to quality 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 FY06 and FY07

Quality "patient safe", 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.

Program activities were accomplished in the past year, with over 22,800 in-patient admissions and 113,700 acute care patient days, 1,400 long term care admissions, over 286,200 long term care patient days, and over 3,300 babies born. There were over 186,100 x-rays taken, and more than 722,400 lab procedures were done.

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 2005, HHSC completed its second Hospital System accreditation survey by the Joint Commission on Accreditation of Healthcare Organizations, JCAHO. All hospitals that were surveyed passed with scores that exceeded National Standards.

In relation to JCAHO's newly implemented unannounced survey process, HHSC facilities have initiated activities to achieve constant survey readiness. A pilot project at Maui Memorial Medical Center involves an approach to JCAHO preparedness and daily readiness that traces the patient from admission to discharge. The tracer method follows along with the patient to evaluate systems that move back to the patient in the chart, focusing on the patient and not only the documentation; essentially humanizing the functions and emphasizing what you would want for yourself and your loved ones if you or one of them were the patient.

In addition, HHSC annually has a detailed independent third party financial audit conducted for the entire system. HHSC has just received its ninth 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 the board of Directors and management to insure compliance, quality and financial efficiency in all system work. Details available upon request. HHSC has hired a second internal auditor to further enhance and ensure our commitment to compliance and quality / financial efficiency throughout our system.

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.

A new performance measure established for reporting this fiscal year is percentage of patients with diagnosed pneumonia who receive antibiotics within four hours. Annually, HHSC focuses on new national patient safety goals most recently approved by JCAHO as it relates to hospitals and critical access hospitals. Details available upon request.

III. Problems and Issues:

A. Discussion of problems and issues encountered if any.

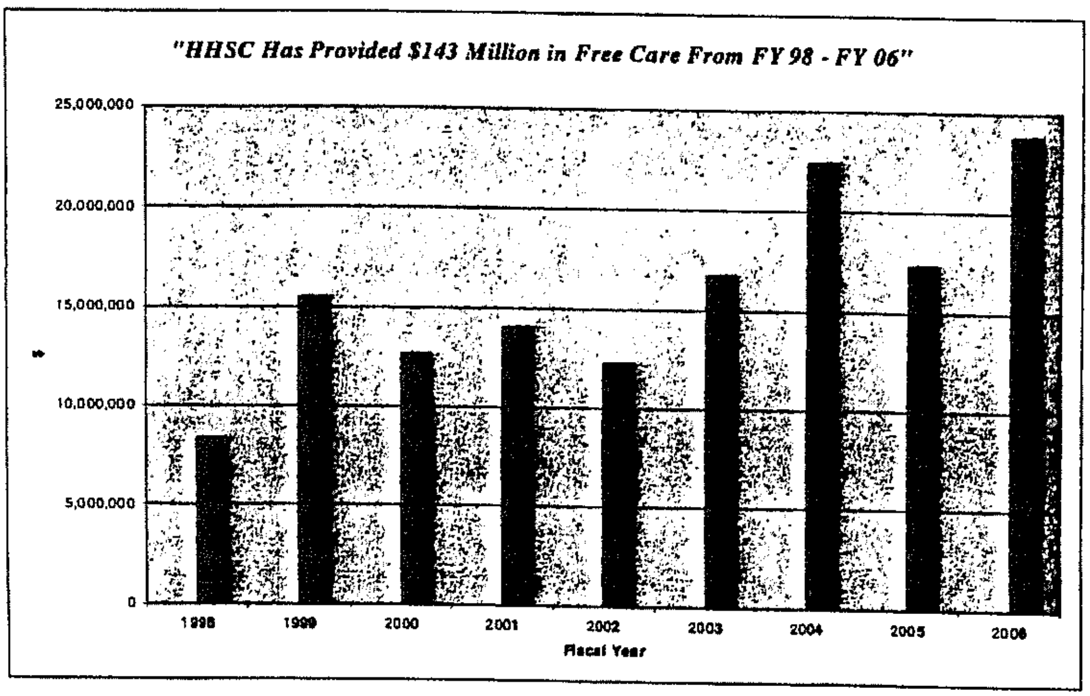
1. Significant Charity Care / Bad Debt (see graph below)
2. Continued Under Reimbursement by Medicare / Medicaid / Quest
3. For many years Hawaii has been one of only two States with no Medicaid Disproportionate Share Hospital (DSH) payment program (2006 action by the U.S. Senate would partially restore funding Medicaid DSH)

4. Skilled Healthcare Labor Shortage Causing Increased Overtime and Agency Costs
5. Pressures on Physicians --- Increasing Demands and Needs for Hospitals Payments to Physicians
6. Increasing Cost of Professional & Hospital Liability Insurance
7. Medical Complexity to Care for and Insufficient Capacity for Long-Term Care (LTC) Patients, Resulting in a Huge Number of Long-Term Care Hospital Wait-List Patients Tying up Acute Beds
8. Niche Providers Skimming Profitable Services in Acute and LTC Hospitals
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. Face Difficulty in Outsourcing
        v. Effective 1 January 2005, HHSC's procurement code exemption was withdrawn resulting in millions of dollars of additional expense and slowdown of key acquisitions affecting patient care, service, and material acquisition
    b. ACT 294 Medicaid Equity Reimbursement
        i. It has been computed that ACT 294 Will Cost HHSC (and Ultimately The State) Over $13 Million Per Year in Lost Reimbursements
10. Lack of Sufficient Automation. No Electronic Medical Record In Place
11. Substantial Liability From Historic Lack Of Reinvestment in HHSC Facilities and costs for infrastructure to support increasing

community needs/demand has resulted in a $909M Six-Year CIP Funding Need. Aging Facilities also result in operational inefficiencies and increased operational costs

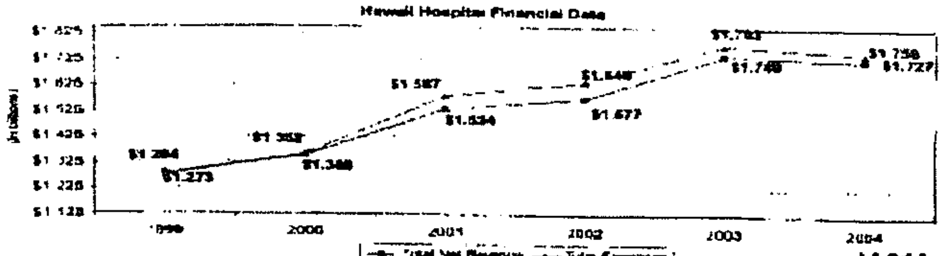
12. Federal Over-Regulation of Healthcare Resulting in Huge Compliance Cost

13. HHSC Inherited Substantial Liabilities from the State



Hawaii Hospital Financial Data

- Hawaii hospital financial data shows that expenses exceeded revenues beginning in 2000 with the losses continuing
- Hawaii hospitals in total experienced net losses since 2000
- Other operating (cafeteria, parking, etc.) and nonoperating revenues (interest and investment income, etc.) are needed in addition to net patient revenues to help cover expenses
- Personnel expenses comprise approximately 50% of hospital expenses and benefits are approximately 18% of payroll costs



Source: American Hospital Association, 2006 Hospital Statistics

Healthcare Association of Hawaii 5

(The updated chart will be released on Monday 1/8/07)

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 excellent access to highest-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.

In order to continue to provide the levels of services needed in rural communities and as a necessity for maintaining the essential, emergency room services in rural communities HHSC is seeking to have physicians relieved from liability for emergency care services at HHSC acute public health facilities.

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.

Please note that all problems mentioned in paragraph III A do have an impact on implementation of the HHSC program. However the following three points deserve special concern and comment.

- Operating under the State Procurement Code continues to add millions of dollars (approximately $5 million per year) to HHSC operating costs and continues to negatively affect our ability to procure goods and services in timely and appropriate manner. HHSC incurs other non-tangible costs from operating under the procurement code, such as lost opportunity for savings and new revenues because of the limitations imposed by the code and State Procurement Office requirements. While it is not a current HHSC legislative initiative to re-establish HHSC's exemption from the procurement code, it will be necessary, in the long term, to exempt HHSC from the procurement code to provide effective, efficient, cost-effective procurement services and to sustain timely, efficient access to healthcare for the communities we serve.

- Compensation for Physician On-Call coverage at the 12 HHSC hospitals will greatly increase overall operational costs by a projected amount of approximately $15 million in FY 08 and $16 million in FY 09. HHSC is compensating for the situation by recruiting, hiring and contracting with physician specialists to provide coverage for our Emergency Rooms. This situation has significantly worsened over the past year.

- Uniform provision of specialty medical care on the Neighbor Islands has been increasingly difficult to maintain. HHSC's engagement with NBBJ master planners is a major initiative that is intended to provide the State with a new comprehensive integrated system master plan. This plan will be developed from the bottom up with input from communities, physicians, nurses and management at the facility, region, and system levels in that order. Part of the concept involves establishing a referral center on Maui focused on quality outcomes serving as a disaster management center and Level II trauma center, with open heart surgery and other specialty services that will interact with robust HHSC Community Hospitals, LTC facilities, Critical Access Hospitals and other partners throughout the State of Hawaii. The master planning process also anticipates establishing level III trauma centers at Kona Community Hospital and Hilo Medical Center plus many other regional initiatives such as a health science center at Hilo Medical Center, some type of chronic/facility in West Hawaii, enhanced surgical capabilities on Kauai, enhanced long term care (LTC) capability on Oahu, and increased physician specialty emergency care capability throughout the system.

IV. Expenditures for Fiscal Year 2006-2007

	Act 160/06 FY 2007	Add'ns/(Red'ns) C/B, Transfers, (Restrictions)	Net Allocation	Est. Total Expenditures
(posn count)	(2836.25)		(2836.25)	(2836.25)
Personal Svcs	249,223,937	14,585,621	263,809,558	261,842,000
Current Exp.	117,500,041		117,500,041	160,467,599
Equipment			-	-
Motor Vehicles			-	-
	366,723,978	14,585,621	381,309,599	422,309,599
(posn count)	(2836.25)		(2836.25)	(2836.25)
Special Fund	332,569,937		332,569,937	373,569,937
General Fund	34,154,041	14,585,621	48,739,662	48,739,662
	366,723,978	14,585,621	381,309,599	422,309,599

V. Biennium Budget Requests for FY 08 and FY 09:

	FY 2008	FY 2009	Total FB Requirements
(posn count)	(2836.25)	(2836.25)	(2836.25)
Personal Svcs	268,150,000	272,534,000	540,684,000
Current Exp.	165,015,232	184,447,961	349,463,193
Equipment			-
Motor Vehicles			-
	433,165,232	456,981,961	890,147,193
(posn count)	(2836.25)	(2836.25)	(2836.25)
Special Fund	379,553,000	403,359,000	782,912,000
General Fund	53,612,232	53,622,961	107,235,193
	433,165,232	456,981,961	890,147,193

Workload or Program Request:

Special Fund Ceiling Increase

HHSC's biennium budget request is to increase the special fund ceiling by $46,983,063 in FY 08 and $70,789,063 in FY 09. This is needed due to expenditures incurred for the conversion of Kula, Hale Ho'ola Hamakua, and Samuel Mahelona Memorial hospitals to critical access hospital status; hospitalist programs at Hilo, Maui, and Kona; operating new med/surg wing at Maui Memorial; providing physicians for specialty coverage; and the rising costs to provide services to our communities compared to the less-rapidly rising reimbursements from government and from the private sector. Based on R-C Management Hospital Inflation index for 2008 and 2009, the inflations rates are ranging from a low 3.60% to a high 6.70% in certain categories, like pharmaceutical drugs; but overall reimbursement rates are not necessarily increasing at matching rates.

	FY 2008	FY 2009
Other Current Expenses	46,983,063 B	70,789,063 B

General Fund Subsidy

General Fund subsidy of $1,500,000 in FY 08 and $1,500,000 in FY 09 is being directed to HHSC for Kahuku Hospital. It is unknown at this time whether the $1.5 million per year in general fund subsidy would be sufficient to sustain operations of Kahuku Hospital. After due diligence on both operational deficits and required facility and other capital investments/liabilities and other potential liabilities, HHSC will provide updated information to the Administration and the Legislature so the appropriate decision can be made. At a minimum, this due diligence must include an external third party audit of finances, facilities and legal liabilities. Consideration must also be given to future levels of service, labor unions status and future application of the procurement code.

	FY 2008	FY 2009
Other Current Expenses	1,500,000 A	1,500,000 A

VI. Program Restrictions:

None

VII. Capital Improvement Requests for Fiscal Biennium 2007-2009

To correct health and life safety code deficiencies for all HHSC facilities, a lump sum CIP request of $10,000,000 in FY 08 and $10,000,000 in FY 09 is being requested. Although, these two amounts will be greatly appreciated, they fall woefully short of the minimum life safety code requirements originally submitted totaling $57,872,000. Failure to fully fund the minimum of HHSC's life safety code needs for FY 08 and FY 09 will potentially put patients, visitors and staff in jeopardy plus it will put some facilities in jeopardy of loss of accreditation and associated funding. A detailed list is available upon request delineating the potential concerns and impacts if full funding for the HHSC's life safety code requirements is not provided.

1. LUMP SUM CIP, CORRECT HEALTH AND SAFETY DEFICIENCIES, STATEWIDE

   PLANS, DESIGN, CONSTRUCTION, AND EQUIPMENT TO CORRECT HEALTH AND LIFE SAFETY CODE DEFICIENCIES FOR ALL HAWAII HEALTH SYSTEM CORPORATION FACILITIES, STATEWIDE

	FY 2008	FY 2009
Plans	1 C	
Design	2000 C	500 C

Construction	7998 C	9500 C
Equipment	1 C	

Explanation and Scope of Project

The scope of the work shall include correcting health and life safety code deficiencies at various Hawaii Health Systems Corporation facilities, statewide.

Justification for the Project

All of the Hawaii Health System Corporation facilities statewide have health and life safety code deficiencies that must be corrected to make a safe environment for staff, patients and the public.

Senate District (Statewide) **House District** (Statewide)

VIII. Proposed Lapses of Capital Improvement Program Projects:

None

"Touching Lives Everyday"
HAWAII HEALTH SYSTEMS
CORPORATION

Hawaii Health Systems Corporation, HHSC
Budget Briefing on the Executive Biennium Budget
Fiscal Biennium 2007-2009

Presented to the

House Finance Committee

Thursday, January 11, 2007, 1:00 PM.
Conference Room #308
Hawaii State Capitol

Program I.D. and Title: HTH 210 – Hawaii Health Systems Corporation

I. Introduction:

A. Summary of program objectives.

To maintain and enhance the levels of accessible 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 Long Term Care (LTC) facilities.

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

B. Description of program objectives.

System. Following direction set by the HHSC Board of Directors, and with advice provided by both the Regional Public Health Facility Management Advisory Committees and the Physician Advisory Group, the HHSC President/CEO and staff coordinate and implement planning, policy formulation, hospital system operation, business development, quality assurance, corporate compliance, 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 that is the 26th largest business in Hawaii and the 4th largest public health system in the nation. HHSC's twelve Community Hospitals are organized into five regions across 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 (LTC) and rural health care on the Neighbor Islands with a large LTC presence on Oahu.

Essentially, HHSC provides the hospital "safety-net" for acute and long term care services on the neighbor islands plus additional levels of specialty service in select locations. Collectively, through operations of our ten emergency departments, HHSC hospitals are the largest provider of emergency services in the State, far surpassing the annual number of ER visits logged by Queen's Medical Center, the State's Trauma Center. Collectively, HHSC hospitals are the single largest provider of LTC services in the State. 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, cardiology, pediatrics, obstetrics, home health, 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. Generous benefactors donated many hundreds of thousands of dollars to our nine hospital foundations. This close collaboration between HHSC and community organizations is essential to the long-term success of HHSC.

During the aftermath of the Big Island earthquake disaster on October 15, maintenance, engineering, and other staff from non-affected HHSC facilities (i.e., Hilo Medical Center, Kauai Veterans Memorial, Leahi Hospital, and Samuel Mahelona Memorial Hospital) provided immediate and intermediary support in the recovery and assessment phases. Equally important, members of the respective, affected communities were immediately at hand to provide additional support. Collaborative efforts will continue with Home Land

Security, state and county civil defense, department of health, and the military in preparation for future disasters.

The five statutorily created, regional Public Health Facility Management Advisory Committees (MACs) provide 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 five 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 physicians throughout the islands who volunteer their time and talents to come together on a semi-monthly basis with the President and CEO to discuss the clinical and medical staff issues facing our hospitals. The PAG represents approximately 860 HHSC medical 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 our 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. Eight 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 08 and FY 09 program and budget objectives by collecting patient revenues to meet almost 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 access to quality 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 FY06 and FY07

Quality "patient safe", 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.

Program activities were accomplished in the past year, with over 22,800 in-patient admissions and 113,700 acute care patient days, 1,400 long term care admissions, over 286,200 long term care patient days, and over 3,300 babies born. There were over 186,100 x-rays taken, and more than 722,400 lab procedures were done.

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 2005, HHSC completed its second Hospital System accreditation survey by the Joint Commission on Accreditation of Healthcare Organizations, JCAHO. All hospitals that were surveyed passed with scores that exceeded National Standards.

In relation to JCAHO's newly implemented unannounced survey process, HHSC facilities have initiated activities to achieve constant survey readiness. A pilot project at Maui Memorial Medical Center involves an approach to JCAHO preparedness and daily readiness that traces the patient from admission to discharge. The tracer method follows along with the patient to evaluate systems that move back to the patient in the chart, focusing on the patient and not only the documentation; essentially humanizing the functions and emphasizing what you would want for yourself and your loved ones if you or one of them were the patient.

In addition, HHSC annually has a detailed independent third party financial audit conducted for the entire system. HHSC has just received its ninth 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 the board of Directors and management to insure compliance, quality and financial efficiency in all system work. Details available upon request. HHSC has hired a second internal auditor to further enhance and ensure our commitment to compliance and quality / financial efficiency throughout our system.

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.

A new performance measure established for reporting this fiscal year is percentage of patients with diagnosed pneumonia who receive antibiotics within four hours. Annually, HHSC focuses on new national patient safety goals most recently approved by JCAHO as it relates to hospitals and critical access hospitals. Details available upon request.

III. Problems and Issues:

A. Discussion of problems and issues encountered if any.

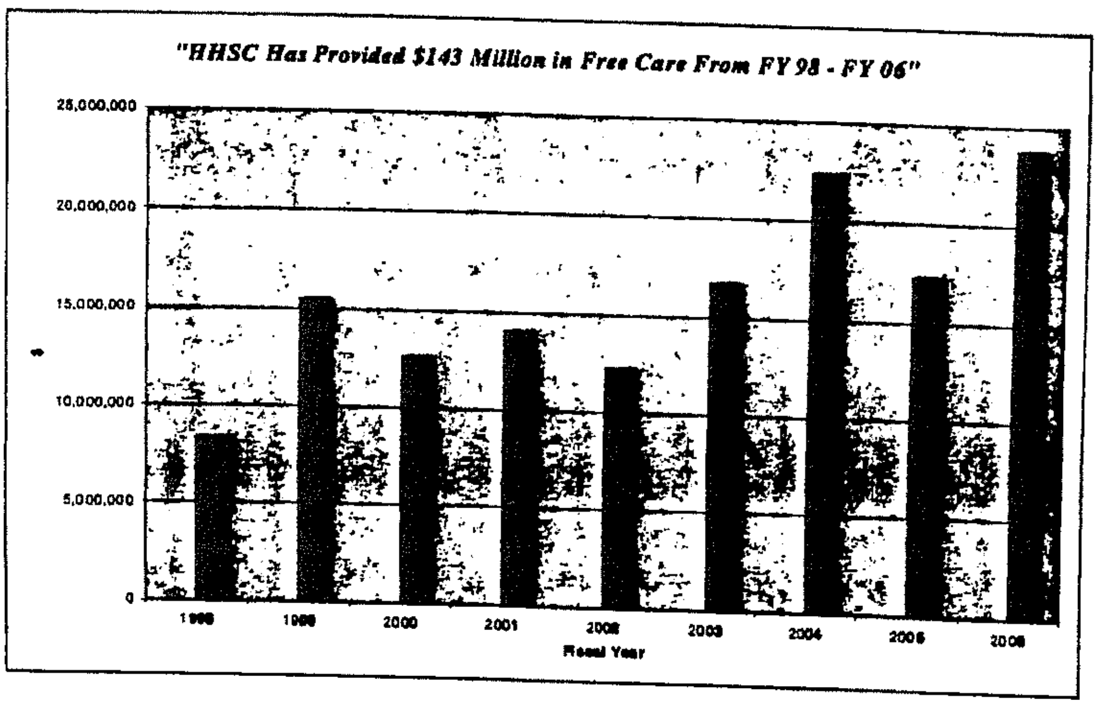
1. Significant Charity Care / Bad Debt (see graph below)
2. Continued Under Reimbursement by Medicare / Medicaid / Quest
3. For many years Hawaii has been one of only two States with no Medicaid Disproportionate Share Hospital (DSH) payment program (2006 action by the U.S. Senate would partially restore funding Medicaid DSH)

4. Skilled Healthcare Labor Shortage Causing Increased Overtime and Agency Costs
5. Pressures on Physicians --- Increasing Demands and Needs for Hospitals Payments to Physicians
6. Increasing Cost of Professional & Hospital Liability Insurance
7. Medical Complexity to Care for and Insufficient Capacity for Long-Term Care (LTC) Patients, Resulting in a Huge Number of Long-Term Care Hospital Wait-List Patients Tying up Acute Beds
8. Niche Providers Skimming Profitable Services in Acute and LTC Hospitals
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. Face Difficulty in Outsourcing
        v. Effective 1 January 2005, HHSC's procurement code exemption was withdrawn resulting in millions of dollars of additional expense and slowdown of key acquisitions affecting patient care, service, and material acquisition.
    b. ACT 294 Medicaid Equity Reimbursement
        i. It has been computed that ACT 294 Will Cost HHSC (and Ultimately The State) Over $13 Million Per Year in Lost Reimbursements
10. Lack of Sufficient Automation. No Electronic Medical Record In Place
11. Substantial Liability From Historic Lack Of Reinvestment in HHSC Facilities and costs for infrastructure to support increasing

community needs/demand has resulted in a $909M Six-Year CIP Funding Need. Aging Facilities also result in operational inefficiencies and increased operational costs

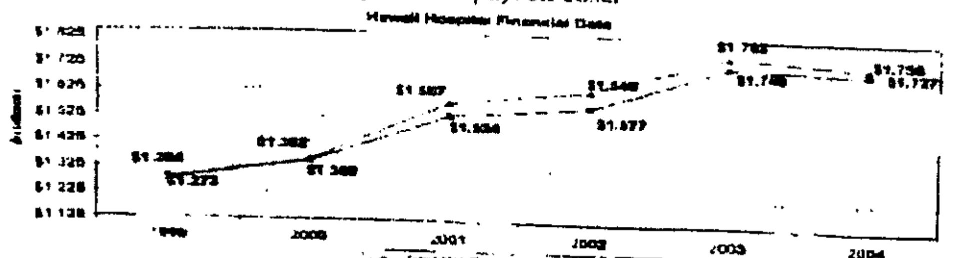
12. Federal Over-Regulation of Healthcare Resulting in Huge Compliance Cost

13. HHSC Inherited Substantial Liabilities from the State



Hawaii Hospital Financial Data

- Hawaii hospital financial data shows that expenses exceeded revenues beginning in 2000 with the losses continuing
- Hawaii hospitals in total experienced net losses since 2000
- Other operating (cafeteria, parking, etc.) and nonoperating revenues (interest and investment income, etc.) are needed in addition to net patient revenues to help cover expenses
- Personnel expenses comprise approximately 50% of hospital expenses and benefits are approximately 18% of payroll costs



Source: American Hospital Association, 2006 Hospital Statistics

5

(The updated chart will be released on Monday 1/8/07)

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 excellent access to highest-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.

In order to continue to provide the levels of services needed in rural communities and as a necessity for maintaining the essential, emergency room services in rural communities HHSC is seeking to have physicians relieved from liability for emergency care services at HHSC acute public health facilities.

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.

Please note that all problems mentioned in paragraph III A do have an impact on implementation of the HHSC program. However the following three points deserve special concern and comment.

- Operating under the State Procurement Code continues to add millions of dollars (approximately $5 million per year) to HHSC operating costs and continues to negatively affect our ability to procure goods and services in timely and appropriate manner. HHSC incurs other non-tangible costs from operating under the procurement code, such as lost opportunity for savings and new revenues because of the limitations imposed by the code and State Procurement Office requirements. While it is not a current HHSC legislative initiative to re-establish HHSC's exemption from the procurement code, it will be necessary, in the long term, to exempt HHSC from the procurement code to provide effective, efficient, cost-effective procurement services and to sustain timely, efficient access to healthcare for the communities we serve.

- Compensation for Physician On-Call coverage at the 12 HHSC hospitals will greatly increase overall operational costs by a projected amount of approximately $15 million in FY 08 and $16 million in FY 09. HHSC is compensating for the situation by recruiting, hiring and contracting with physician specialists to provide coverage for our Emergency Rooms. This situation has significantly worsened over the past year.

- Uniform provision of specialty medical care on the Neighbor Islands has been increasingly difficult to maintain. HHSC's engagement with NBBJ master planners is a major initiative that is intended to provide the State with a new comprehensive integrated system master plan. This plan will be developed from the bottom up with input from communities, physicians, nurses and management at the facility, region, and system levels in that order. Part of the concept involves establishing a referral center on Maui focused on quality outcomes serving as a disaster management center and Level II trauma center, with open heart surgery and other specialty services that will interact with robust HHSC Community Hospitals, LTC facilities, Critical Access Hospitals and other partners throughout the State of Hawaii. The master planning process also anticipates establishing level III trauma centers at Kona Community Hospital and Hilo Medical Center plus many other regional initiatives such as a health science center at Hilo Medical Center, some type of chronic/facility in West Hawaii, enhanced surgical capabilities on Kauai, enhanced long term care (LTC) capability on Oahu, and increased physician specialty emergency care capability throughout the system.

IV. Expenditures for Fiscal Year 2006-2007

	Act 160/06 FY 2007	Add'ns/(Red'ns) C/B, Transfers, (Restrictions)	Net Allocation	Est. Total Expenditures
(posn count)	(2836.25)		(2836.25)	(2836.25)
Personal Svcs	249,223,937	14,585,621	263,809,558	261,842,000
Current Exp.	117,500,041		117,500,041	160,467,599
Equipment				
Motor Vehicles			-	-
	366,723,978	14,585,621	381,309,599	422,309,599
(posn count)	(2836.25)		(2836.25)	(2836.25)
Special Fund	332,569,937		332,569,937	373,569,937
General Fund	34,154,041	14,585,621	48,739,662	48,739,662
	366,723,978	14,585,621	381,309,599	422,309,599

V. Biennium Budget Requests for FY 08 and FY 09:

	FY 2008	FY 2009	Total FB Requirements
(posn count)	(2836.25)	(2836.25)	(2836.25)
Personal Svcs	268,150,000	272,534,000	540,684,000
Current Exp.	165,015,232	184,447,961	349,463,193
Equipment			-
Motor Vehicles			-
	433,165,232	456,981,961	890,147,193
(posn count)	(2836.25)	(2836.25)	(2836.25)
Special Fund	379,553,000	403,359,000	782,912,000
General Fund	53,612,232	53,622,961	107,235,193
	433,165,232	456,981,961	890,147,193

Workload or Program Request:

Special Fund Ceiling Increase

HHSC's biennium budget request is to increase the special fund ceiling by $46,983,063 in FY 08 and $70,789,063 in FY 09. This is needed due to expenditures incurred for the conversion of Kula, Hale Ho'ola Hamakua, and Samuel Mahelona Memorial hospitals to critical access hospital status; hospitalist programs at Hilo, Maui, and Kona; operating new med/surg wing at Maui Memorial; providing physicians for specialty coverage; and the rising costs to provide services to our communities compared to the less-rapidly rising reimbursements from government and from the private sector. Based on R-C Management Hospital Inflation index for 2008 and 2009, the inflations rates are ranging from a low 3.60% to a high 6.70% in certain categories, like pharmaceutical drugs; but overall reimbursement rates are not necessarily increasing at matching rates.

	FY 2008	FY 2009
Other Current Expenses	46,983,063 B	70,789,063 B

General Fund Subsidy

General Fund subsidy of $1,500,000 in FY 08 and $1,500,000 in FY 09 is being directed to HHSC for Kahuku Hospital. It is unknown at this time whether the $1.5 million per year in general fund subsidy would be sufficient to sustain operations of Kahuku Hospital. After due diligence on both operational deficits and required facility and other capital investments/liabilities and other potential liabilities, HHSC will provide updated information to the Administration and the Legislature so the appropriate decision can be made. At a minimum, this due diligence must include an external third party audit of finances, facilities and legal liabilities. Consideration must also be given to future levels of service, labor unions status and future application of the procurement code.

	FY 2008	FY 2009
Other Current Expenses	1,500,000 A	1,500,000 A

VI. Program Restrictions:

None

VII. Capital Improvement Requests for Fiscal Biennium 2007-2009

To correct health and life safety code deficiencies for all HHSC facilities, a lump sum CIP request of $10,000,000 in FY 08 and $10,000,000 in FY 09 is being requested. Although, these two amounts will be greatly appreciated, they fall woefully short of the minimum life safety code requirements originally submitted totaling $57,872,000. Failure to fully fund the minimum of HHSC's life safety code needs for FY 08 and FY 09 will potentially put patients, visitors and staff in jeopardy plus it will put some facilities in jeopardy of loss of accreditation and associated funding. A detailed list is available upon request delineating the potential concerns and impacts if full funding for the HHSC's life safety code requirements is not provided.

1. LUMP SUM CIP, CORRECT HEALTH AND SAFETY DEFICIENCIES, STATEWIDE

   PLANS, DESIGN, CONSTRUCTION, AND EQUIPMENT TO CORRECT HEALTH AND LIFE SAFETY CODE DEFICIENCIES FOR ALL HAWAII HEALTH SYSTEM CORPORATION FACILITIES, STATEWIDE

	FY 2008	FY 2009
Plans	1 C	
Design	2000 C	500 C
Construction	7998 C	9500 C
Equipment	1 C	

Explanation and Scope of Project

The scope of the work shall include correcting health and life safety code deficiencies at various Hawaii Health Systems Corporation facilities, statewide.

Justification for the Project

All of the Hawaii Health System Corporation facilities statewide have health and life safety code deficiencies that must be corrected to make a safe environment for staff, patients and the public.

Senate District (Statewide) **House District** (Statewide)

VIII. Proposed Lapses of Capital Improvement Program Projects:

None