

























































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, 2005 and 2004 was as follows:

	<b>2005</b>	<b>2004</b>
Medicare	13%	12%
Medicaid	16	17
HMSA	11	12
Other third-party payors	28	21
Patients and other	<u>32</u>	<u>38</u>
	<u>100%</u>	<u>100%</u>

**Reclassifications**—Certain amounts in the 2004 financial statements have been reclassified to conform to the 2005 presentation.

### **3. BOARD-DESIGNATED FUNDS**

As of June 30, 2005 and 2004, HHSC's Board of Directors had designated cash reserves as follows:

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

During the years ended June 30, 2005 and 2004, 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, 2005 and 2004 were as follows:

	Beginning of Year	Additions	Retirements	Transfers	End of Year
<b>2005</b>					
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	<u>41,447,428</u>	<u>134,280</u>	<u>(1,042,009)</u>	<u>2,699,854</u>	<u>43,239,553</u>
	358,710,768	24,023,653	(7,545,641)	-	375,188,780
Less accumulated depreciation and amortization	<u>(169,422,283)</u>	<u>(16,905,894)</u>	<u>6,932,452</u>	<u>                    </u>	<u>(179,395,725)</u>
Capital assets—net	<u>\$ 189,288,485</u>	<u>\$ 7,117,759</u>	<u>\$ (613,189)</u>	<u>\$ -</u>	<u>\$ 195,793,055</u>
<b>2004</b>					
Assets Not Subject to Depreciation:					
Land and land improvements	\$ 5,083,354	\$ -	\$ -	\$ -	\$ 5,083,354
Construction in progress	22,835,068	12,798,140	(18,191)	(12,804,078)	22,810,939
Assets Subject to Depreciation:					
Buildings and improvements	205,427,870	1,406,844	(95,339)	7,646,630	214,386,005
Major moveable equipment	73,323,823	4,005,473	(3,778,719)	1,432,465	74,983,042
Fixed equipment	<u>37,181,268</u>	<u>807,043</u>	<u>(265,866)</u>	<u>3,724,983</u>	<u>41,447,428</u>
	343,851,383	19,017,500	(4,158,115)	-	358,710,768
Less accumulated depreciation and amortization	<u>(157,076,101)</u>	<u>(16,243,898)</u>	<u>3,897,716</u>	<u>                    </u>	<u>(169,422,283)</u>
Capital assets—net	<u>\$ 186,775,282</u>	<u>\$ 2,773,602</u>	<u>\$ (260,399)</u>	<u>\$ -</u>	<u>\$ 189,288,485</u>

In 2005 and 2004, the State Department of Accounting and General Services transferred capital assets, including construction in progress, aggregating \$11,746,840 and \$5,426,064, respectively, to HHSC as a contribution of capital.

During fiscal years 2005 and 2004, \$1,517,641 and \$138,461, 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, 2004, management had intended to repay the advance in fiscal year 2005 through either an emergency appropriation from the Legislature or an administrative procedure by the Governor of the State of Hawaii. At June 30, 2005, management 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 2006. Accordingly, the advance is classified as a noncurrent liability at June 30, 2005.

## 6. LONG-TERM LIABILITIES

Among HHSC's long-term liabilities are accrued vacation and capital lease obligations. Transactions in these accounts during the years ended June 30, 2005 and 2004 were as follows:

	<b>Beginning of Year</b>	<b>Additions</b>	<b>Reductions</b>	<b>End of Year</b>	<b>Current Portion</b>	<b>Noncurrent Portion</b>
<b>2005</b>						
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
<b>2004</b>						
Accrued vacation	\$ 21,725,138	\$ 1,867,384	\$(1,365,261)	\$ 22,227,261	\$ 1,365,261	\$ 20,862,000
Capital lease obligations	32,301,020	9,649,298	(8,204,207)	33,746,111	7,958,701	25,787,410

Future capital lease payments were as follows:

### **Years Ended June 30**

2006	\$ 10,404,400
2007	9,389,170
2008	6,719,881
2009	4,945,353
2010	3,727,825
2011-2015	11,711,677
2016-2019	<u>167,411</u>
Total future minimum payments	47,065,717
Less amount representing interest	<u>(11,975,466)</u>
Total capital lease obligations	35,090,251
Current portion	<u>(7,738,765)</u>
Noncurrent portion	<u>\$ 27,351,486</u>

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,

2005 and 2004, interest capitalized for Corporate and all facilities was \$685,290 and \$826,305, 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. (H RTP) to ensure the uninterrupted operation of the Hilo Medical Center Cancer Treatment Center and its radiation and medical oncology services. As part of the acquisition, HHSC assumed H RTP's outstanding balances on the loans and notes payable of \$11,893,162. The 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 H RTP, 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 \$1,690,000 on behalf of Maui Memorial Medical Center (MMMC) for use in its operations. During fiscal year 2003, Corporate transferred the buildings to MMMC, but retained the loan payable in its accounting records. The loan payable is collateralized by a security interest in the capital assets acquired.

Long-term debt as of June 30, 2005 and 2004 consisted of the following:

	2005	2004
Loan payable to Central Pacific Bank; \$9,500,000; interest at 5.75% at June 30, 2005 (interest at weekly average of 5-year U.S. Treasury Securities rate plus 250 basis points); monthly principal and interest payments of \$64,975; due December 1, 2027	\$ 8,598,940	\$ 8,780,726
Loan payable to Central Pacific Bank; \$319,000; interest at 5.875% at June 30, 2005 (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	189,544	215,614
Loan payable to Academic Capital; \$1,690,900; interest at 6.3%; monthly principal and interest payments of \$19,028; due November 4, 2012	1,338,193	1,477,429
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	1,153,106	1,161,383
Note payable to USDA; \$1,000,000; interest at 4.75%; monthly principal and interest payments of \$8,170; due August 13, 2014	718,370	783,176
Notes payable to two individuals; \$252,000; interest at 5% at June 30, 2005; monthly principal and interest payments of \$22,745; due January 1, 2008 (see Note 13)	232,453	
Total	12,230,606	12,418,328
Less current portion	(694,487)	(513,598)
Noncurrent portion	<u>\$11,536,119</u>	<u>\$11,904,730</u>

Transactions in long-term debt during the years ended June 30, 2005 and 2004 were as follows:

	Beginning of Year	Additions	Reductions	End of Year
<b>2005</b>				
Long-term debt	\$ 12,418,328	\$ 252,000	\$ (439,722)	\$ 12,230,606
<b>2004</b>				
Long-term debt	\$ 12,971,778	\$ -	\$ (553,450)	\$ 12,418,328

Maturities of long-term debt are as follows:

Years Ending June 30	Principal	Interest	Total
2006	\$ 694,487	\$ 662,120	\$ 1,356,607
2007	632,340	640,173	1,272,513
2008	543,435	606,150	1,149,585
2009	504,911	576,305	1,081,216
2010	534,737	546,475	1,081,212
2011-2015	2,425,947	2,273,197	4,699,144
2016-2020	2,089,898	1,684,345	3,774,243
2021-2025	2,773,269	1,000,974	3,774,243
2026-2030	1,852,886	217,365	2,070,251
2031-2034	178,696	30,212	208,908
Total	<u>\$12,230,606</u>	<u>\$8,237,316</u>	<u>\$20,467,922</u>

## 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 \$9,616,000 and \$11,215,000 (excluding Clinical Laboratories of Hawaii partnership fees of approximately \$11,211,000 and \$11,504,000 as disclosed in Note 11) during fiscal years 2005 and 2004, 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 \$1,008,000 and \$976,000 during fiscal years 2005 and 2004, 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 \$751,000 and \$848,000 during fiscal years 2005 and 2004, 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, 2005 and 2004 was approximately \$14,126,000 and \$12,457,000, respectively, equal to the required contribution.

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

### **Post-Retirement Health Care and Life Insurance Benefits**

In addition to providing pension benefits, the State of Hawaii Public Employees Health Fund provides certain health care (medical, prescription drug, vision, and dental) and life insurance benefits for retired employees. Contributions are based upon negotiated collective bargaining agreements and are limited by State statute to the actual cost of benefit coverage.

For employees first employed prior to June 30, 1996, HHSC pays for 100% of these benefits for employees who have at least 10 years of service. HHSC's share of the cost of these benefits is pro-rated for employees with less than 10 years of service.

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

HHSC also reimburses Medicare expenses of retirees and qualified spouses (through the State of Hawaii) who are at least 62 years of age and have at least 10 years of service.

HHSC's post-retirement benefits expense approximated \$10,835,000 and \$10,123,000 for the years ended June 30, 2005 and 2004, respectively.

### **Sick Leave**

Accumulated sick leave as of June 30, 2005 and 2004 was approximately \$46,105,000 and \$41,224,000, 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 \$25,282,963 and \$21,854,000 for unpaid claims as of June 30, 2005 and 2004, respectively.

### **Ceded Lands**

The Office of Hawaiian Affairs (OHA) and the State of Hawaii are presently in negotiation involving the State's alleged failure to properly account for and pay to OHA monies due to OHA under the provisions of the Hawaii State Constitution and Chapter 10 of the Hawaii Revised Statutes for use by the State of certain ceded lands. As of June 30, 2005, the outcome of the negotiation had not been finalized.

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

### **Litigation**

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



## **Asbestos Contamination**

There is known asbestos contamination of the old hospital building located next to the Hilo Medical Center facility. In fiscal year 2003, the State appropriated funds for the construction of 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 2005 and 2004, HHSC received partnership distributions of \$212,160 and \$48,960, 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 2005 and 2004 amounted to \$732,606 and \$719,616, respectively, and the investment balance as of June 30, 2005 and 2004 was \$1,959,156 and \$1,438,228, 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 \$1,522,000 and \$1,635,000 during fiscal years 2005 and 2004, respectively. Amounts due from the Partnership for such charges aggregated approximately \$605,000 and \$506,000 as of June 30, 2005 and 2004, respectively.

HHSC contracts with the Partnership to provide clinical laboratory and pathology services at its facilities. Amounts charged by the Partnership aggregated approximately \$11,211,000 and \$11,504,000 during fiscal years 2005 and 2004, respectively. Amounts due to the Partnership aggregated approximately \$1,314,000 and \$5,866,000 as of June 30, 2005 and 2004, 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 \$81,000 and \$41,000 during fiscal years 2005 and 2004, 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 \$102,000 and \$105,000 during fiscal years 2005 and 2004, respectively. There were no amounts due from or due to the Partnership as of June 30, 2005 and 2004.

## 12. TEMPORARILY RESTRICTED NET ASSETS

Changes in temporarily restricted net assets for the years ended June 30, 2005 and 2004 were as follows:

	2005	2004
Balance, beginning of year	\$ 949,595	\$2,130,506
Restricted contributions received	2,695,069	2,329,565
Expenditures for restricted purposes	(824,486)	(474,064)
Capital assets purchased	(1,517,641)	(138,461)
Transfers of restricted net assets	<u>                    </u>	<u>(2,897,951)</u>
Balance, end of year	<u>\$ 1,302,537</u>	<u>\$ 949,595</u>

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. At June 30, 2005, \$359,441 of the pledge still remained outstanding.

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

## 13. 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 noncompete agreements for two physicians. No existing liabilities of the clinic were assumed.

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, 2005, the balance of the long-term debt totaled \$232,453.

The noncompete agreements were valued at \$55,000 and are being amortized over the three-year period of the agreements. Since the purchase price exceeded the estimated fair value of the purchased assets, goodwill of \$243,000 was recorded. Both the noncompete agreements and goodwill are included in other assets in the consolidated statements of net assets.

#### **14. VETERANS HOME**

In fiscal year 2005, HHSC received \$5,169,021 from the State of Hawaii for construction of the new veterans' long-term care facility. Of this amount, \$1,641,894 was expended for planning and design 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.

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# HAWAI HEALTH SYSTEMS CORPORATION

## SUPPLEMENTAL SCHEDULE OF RECONCILIATION OF CASH ON DEPOSIT WITH THE STATE OF HAWAII AS OF JUNE 30, 2005

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	Appropriation Symbol	
<b>CASH ON DEPOSIT WITH THE STATE OF HAWAII:</b>		
SPECIAL FUNDS:		
	S-93-359-H	\$ 2,818
	S-94-356-M	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-05-303-H	7,792
	S-04-312-H	40,292
	S-05-320-H	9,000,000
	S-05-350-H	565
	S-04-351-H	12,182
	S-05-352-H	17,845
	S-04-353-H	23,561
	S-05-354-H	272,906
	S-05-355-H	279,623
	S-05-358-H	10,021
	S-05-359-H	31,827
	S-05-365-H	7,860
	S-03-371-H	66,305
	S-04-373-H	16,089
TRUST FUNDS:		
	T-05-906-H	50
	T-04-907-H	200
	T-05-907-H	1,500
	T-04-918-H	1,273
	T-04-921-H	6,679
	T-04-923-H	4,129
TOTAL PER STATE		9,848,297
RECONCILING ITEMS		<u>(42,982)</u>
TOTAL PER HHSC		<u><u>\$9,805,315</u></u>

(Continued)

# HAWAI HEALTH SYSTEMS CORPORATION

## SUPPLEMENTAL SCHEDULE OF RECONCILIATION OF CASH ON DEPOSIT WITH THE STATE OF HAWAII AS OF JUNE 30, 2005

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	<b>Appropriation Symbol</b>	
<b>ASSETS LIMITED AS TO USE:</b>		
PATIENT TRUST FUNDS:		
	T-05-909	\$ 23,973
	T-04-911-H	81,174
	T-05-915-H	12,763
	T-04-919-H	1,044
	T-05-925-H	112,842
	T-05-926-H	<u>10,604</u>
TOTAL PER STATE		242,400
RECONCILING ITEMS:		
Restricted accounts receivable		359,441
Patients' safekeeping deposits held by financial institutions		552,012
Restricted net assets held by financial institutions		554,001
Other		<u>(1,642)</u>
TOTAL PER HHSC		<u>\$ 1,706,212</u>

(Concluded)

**HAWAII HEALTH SYSTEMS CORPORATION**

**SUPPLEMENTAL COMBINING AND CONSOLIDATING STATEMENT OF NET ASSETS INFORMATION  
AS OF JUNE 30, 2005**

ASSETS	Facilities														Corporate	Reclassifications and Eliminations	HHSC Combined	Hawaii Health Systems Foundation	Aili Community Care	Reclassifications and Eliminations	HHSC Consolidated		
	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									
CURRENT ASSETS																							
Cash and cash equivalents																							
On deposit with the State of Hawaii	\$ 1,643	\$ 272,906	\$ 279,623	\$ 24,534	\$ 66,305	\$ 3,772	\$ 14,294	\$ 13,505	\$ 23,561	\$ 40,292	\$ 7,860	\$ 10,921	\$ -	\$ 758,306	\$ 9,047,009	\$ -	\$ 9,805,315	\$ -	\$ -	\$ -	\$ -	\$ 9,805,315	
On deposit with banks and on hand	264,056	49,314	168,663	6,815	6,337	52,216	84,148	10,364	19,713	447,391	468,036	23,064	-	1,600,117	8,458,690	-	10,058,807	665,540	24,098	-	10,748,445		
Patent accounts receivable less allowances for contractual adjustments and doubtful accounts	9,298,733	6,847,684	22,703,353	783,180	1,256,172	3,100,968	1,310,786	420,117	407,622	2,620,878	1,340,531	252,913	-	50,342,937	-	-	50,342,937	-	-	-	-	50,342,937	
Supplies and other current assets	2,079,048	2,052,551	2,694,307	70,152	227,644	467,714	96,854	93,051	37,353	658,019	86,786	71,277	-	8,634,756	61,579	-	8,696,335	-	212,151	-	-	8,908,486	
Estimated third-party payor settlements	834,120	485,979	3,257,036	38,587	(10,000)	(749,937)	68,931	(29,881)	188,050	(94,672)	(5,000)	(8,518)	-	3,974,695	-	-	3,974,695	-	-	-	-	3,974,695	
Total current assets	12,477,600	9,708,434	29,102,982	923,258	1,546,458	2,874,733	1,575,013	507,156	676,299	3,671,908	1,898,213	348,757	-	65,310,811	17,567,278	-	82,878,089	665,540	236,249	-	-	83,779,878	
DUE FROM AFFILIATES - Net			6,498,168											6,498,168	179,037,925	(178,750,441)	6,785,652			(6,785,652)		-	
CAPITAL ASSETS - Net	39,444,861	31,209,703	62,531,256	1,269,579	4,595,445	14,273,355	3,869,702	13,295,217	2,117,158	5,664,060	3,327,911	955,808	1,669,556	184,223,611	11,217,609		195,441,220	249	351,586			195,793,055	
ASSETS LIMITED AS TO USE	35,259	375,179	293,913	13,104	65,664	38,413	62,673	11,061	2,471	158,646	104,086	1,923		1,162,392			1,162,392	543,820				1,706,212	
OTHER ASSETS	1,015,235	355,394	515,531	17,350	40,233	288,833		20,763	19,922					2,273,261	97,822		2,371,083			(97,822)		2,273,261	
TOTAL	\$ 52,972,955	\$ 41,648,710	\$ 98,941,850	\$ 2,223,291	\$ 6,247,800	\$ 17,475,334	\$ 5,507,388	\$ 13,834,197	\$ 2,815,850	\$ 9,494,614	\$ 5,230,210	\$ 1,306,488	\$ 1,669,556	\$ 259,468,243	\$ 207,920,634	\$ (178,750,441)	\$ 288,638,436	\$ 1,209,609	\$ 587,835	\$ (6,883,474)	\$ 283,552,406		

(Continued)

**HAWAII HEALTH SYSTEMS CORPORATION**

**SUPPLEMENTAL COMBINING AND CONSOLIDATING STATEMENT OF NET ASSETS INFORMATION  
AS OF JUNE 30, 2005**

LIABILITIES AND NET ASSETS (DEFICIT)	Facilities													Corporate	Reclassifications and Eliminations	HHSC Combined	Hawaii Health Systems Foundation	Alii Community Care	Reclassifications and Eliminations	HHSC Consolidated	
	Hilo Medical Center	Kona Community Hospital	MauI Memorial Medical Center	Ka'u Hospital	Kula Hospital	Kauai Veterans Memorial Hospital	Samuel Mahalona Memorial Hospital	Hale Ho'ola Hamakua	Kohala Hospital	Leahi Hospital	Maluhia	Lanai Community Hospital	Yukio Okutsu Veterans Care Home								Total Facilities
<b>CURRENT LIABILITIES:</b>																					
Accounts payable and accrued expenses	\$ 7,318,575	\$ 4,999,458	\$ 11,170,791	\$ 368,138	\$ 1,025,203	\$ 1,788,170	\$ 649,637	\$ 443,250	\$ 366,296	\$ 1,449,611	\$ 1,034,161	\$ 295,035	\$ -	\$ 30,848,325	\$ 2,073,651	\$ -	\$ 32,921,976	\$ -	\$ 79,724	\$ 7	\$ 33,001,707
Accrued workers' compensation liability	7,152,000	2,984,000	6,103,000	217,000	2,276,000	1,118,785	792,572	779,175	353,388	1,627,373	1,229,220	174,450	-	24,806,963	476,000	-	25,282,963	-	-	-	25,282,963
Current portion of capital lease obligations	59,805	-	-	-	-	-	-	-	-	-	-	-	-	59,805	7,678,960	-	7,738,765	-	-	-	7,738,765
Current portion of accrued vacation	249,530	67,364	189,411	8,501	43,827	65,739	6,146	9,178	37,269	53,483	35,095	44,520	-	810,063	19,058	-	829,121	-	-	-	829,121
Current portion of long-term debt	465,402	-	-	-	-	80,820	-	-	-	-	-	-	-	546,222	148,265	-	694,487	-	-	-	694,487
Other current liabilities	59,287	3,983	-	-	-	81,925	-	3,016	-	-	-	-	-	148,211	-	-	148,211	283,306	113,751	-	545,268
Total current liabilities	15,304,599	8,054,805	17,463,202	593,639	3,345,030	3,135,439	1,448,355	1,234,619	696,953	3,130,467	2,298,476	514,005	-	57,219,589	10,395,934	-	67,615,523	283,306	193,475	7	68,092,311
<b>CAPITAL LEASE OBLIGATIONS</b>																					
Less current portion	-	-	-	-	-	-	-	-	-	-	-	-	-	-	27,351,486	-	27,351,486	-	-	-	27,351,486
<b>LONG-TERM DEBT - Less current portion</b>																					
	10,194,558	-	-	-	-	151,633	-	-	-	-	-	-	-	10,346,191	1,189,928	-	11,536,119	-	-	-	11,536,119
<b>ACCRUED VACATION - Less current portion</b>																					
	5,790,230	3,182,550	6,402,996	270,438	1,201,597	1,176,387	1,192,524	575,290	268,865	1,845,067	1,564,015	165,883	-	23,635,842	843,762	-	24,479,604	-	-	-	24,479,604
<b>DUE TO AFFILIATES - Net</b>																					
	37,513,789	28,749,044	-	7,481,556	13,308,715	37,693,928	11,929,016	789,417	6,856,383	8,419,620	17,950,695	8,030,616	27,662	178,750,441	-	(178,750,441)	-	357,674	6,427,985	(6,785,659)	-
<b>ADVANCE FROM THE STATE OF HAWAII</b>																					
	-	-	-	-	-	-	-	-	-	-	-	-	-	-	14,000,000	-	14,000,000	-	-	-	14,000,000
<b>DUE TO THE STATE OF HAWAII</b>																					
	-	7,605,205	-	-	1,114,264	1,943,345	2,417,150	506,153	528,149	6,416,791	491,450	-	-	20,122,507	-	-	20,122,507	-	-	-	20,122,507
<b>PATIENTS' SAFEKEEPING DEPOSITS AND DEFERRED INCOME - Restricted contributions</b>																					
	35,259	3,679	-	13,104	65,664	6,998	25,319	11,061	2,471	158,646	79,551	1,923	-	403,675	-	-	403,675	-	-	-	403,675
<b>OTHER LIABILITIES</b>																					
	10,862	-	9,476	-	-	7,278	10,620	13,478	-	45,007	13,296	-	-	110,017	217,380	-	327,397	-	-	-	327,397
Total liabilities	68,849,297	47,595,283	23,875,674	8,358,737	19,035,270	43,215,068	17,022,984	3,130,018	8,352,821	20,015,598	22,397,483	8,712,427	27,662	290,588,262	53,998,490	(178,750,441)	165,836,311	640,980	6,621,460	(6,785,652)	166,313,099
<b>NET ASSETS (DEFICIT):</b>																					
Invested in capital assets - net of related debt	28,725,096	31,209,703	62,531,256	1,269,579	4,595,445	14,040,902	3,869,702	13,295,217	2,117,158	5,664,060	3,327,911	955,808	1,669,556	173,271,293	(25,151,030)	-	148,120,363	249	351,586	-	148,472,198
Restricted	-	371,540	293,913	-	-	31,415	37,354	-	-	-	24,535	-	-	758,717	-	-	758,717	543,820	-	-	1,302,537
Unrestricted	(44,601,438)	(37,527,776)	(12,241,007)	(7,405,025)	(17,382,915)	(39,811,991)	(15,422,652)	(2,591,038)	(7,654,129)	(16,185,044)	(20,419,719)	(8,361,747)	(27,662)	(205,150,129)	179,073,174	-	(26,076,955)	24,560	(6,385,211)	(97,822)	(32,535,428)
Total net assets (deficit)	(15,876,342)	(5,946,573)	75,066,176	(6,135,446)	(12,787,470)	(25,739,674)	(11,515,596)	10,704,179	(5,536,971)	(10,520,984)	(17,067,273)	(7,405,939)	1,641,894	(31,120,019)	153,922,144	-	122,802,125	568,629	(6,033,625)	(97,822)	117,239,307
TOTAL	\$ 52,972,955	\$ 41,648,710	\$ 98,941,850	\$ 2,223,291	\$ 6,247,800	\$ 17,475,334	\$ 5,507,388	\$ 13,834,197	\$ 2,815,850	\$ 9,494,614	\$ 5,330,210	\$ 1,306,488	\$ 1,669,556	\$ 259,468,243	\$ 207,920,634	\$ (178,750,441)	\$ 288,638,436	\$ 1,209,609	\$ 587,835	\$ (6,883,474)	\$ 283,552,406

(Concluded)

**HAWAII HEALTH SYSTEMS CORPORATION**
**SUPPLEMENTAL COMBINING AND CONSOLIDATING STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS (DEFICIT) INFORMATION  
FOR THE YEAR ENDED JUNE 30, 2005**

	Facilities													Corporate	Reclassifications and Eliminations	HHSC Combined	Hawaii Health Systems Foundation	Alii Community Care	Reclassifications and Eliminations	HHSC Consolidated		
	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'oula Hamakua	Kohala Hospital	Leahi Hospital	Maluhia	Lanai Community Hospital	Yukio Okutsu Veterans Care Home								Total Facilities	
OPERATING REVENUES:																						
Net patient service revenues	\$ 80,279,175	\$ 38,685,304	\$ 119,113,134	\$ 2,976,575	\$ 10,261,163	\$ 15,231,402	\$ 7,450,774	\$ 4,924,993	\$ 3,603,342	\$ 16,703,924	\$ 12,969,710	\$ 2,892,605	\$ -	\$ 315,092,101	\$ -	\$ -	\$ 315,092,101	\$ -	\$ -	\$ -	\$ -	\$ 315,092,101
Other operating revenues	<u>1,173,330</u>	<u>733,814</u>	<u>1,321,794</u>	<u>11,548</u>	<u>76,660</u>	<u>822,046</u>	<u>154,803</u>	<u>15,797</u>	<u>29,471</u>	<u>372,029</u>	<u>23,653</u>	<u>24,480</u>		<u>4,759,425</u>			<u>(288,547)</u>	<u>4,470,878</u>			<u>1,358,193</u>	<u>5,829,071</u>
Total operating revenues	<u>81,452,505</u>	<u>39,419,118</u>	<u>120,434,928</u>	<u>2,988,123</u>	<u>10,337,823</u>	<u>16,053,448</u>	<u>7,605,577</u>	<u>4,940,790</u>	<u>3,632,813</u>	<u>17,075,953</u>	<u>12,993,363</u>	<u>2,917,085</u>		<u>319,851,526</u>			<u>(288,547)</u>	<u>319,562,979</u>			<u>1,358,193</u>	<u>320,921,172</u>
OPERATING EXPENSES:																						
Salaries and benefits	54,218,661	26,812,984	63,392,565	2,810,590	11,584,259	10,612,252	6,981,921	4,701,803	2,864,795	15,328,284	11,715,261	1,903,452		212,926,827	5,721,704		218,648,531	81,435				218,729,966
Medical supplies and drugs	12,741,732	6,193,628	16,003,899	99,402	778,497	1,231,600	383,536	180,220	97,351	858,901	746,178	135,067		39,450,011			39,450,011					39,450,011
Purchased services	8,174,250	4,515,858	15,167,248	210,113	706,056	3,254,925	550,578	161,562	489,666	547,405	924,254	384,698		35,086,613	193,240	(558,021)	34,721,832			16,737		34,738,569
Depreciation and amortization	3,803,116	2,608,769	4,618,039	97,290	323,543	749,143	309,123	508,431	230,419	855,127	293,719	75,649		14,472,368	2,334,008		16,806,376	402		99,116		16,905,894
Other supplies	3,179,322	940,389	4,051,541	86,493	734,185	466,134	320,960	235,763	159,968	924,008	645,545	118,768		11,863,076	197,257		12,060,333	15,156		165,750		12,241,239
Utilities	1,264,603	849,786	2,177,006	90,289	212,066	767,958	322,459	397,425	82,847	615,851	394,605	84,534		7,259,429	85,051		7,344,480			211,678		7,556,158
Repairs and maintenance	2,145,686	1,107,600	2,026,723	20,615	84,883	265,342	115,484	94,547	24,526	223,264	150,498	62,696		6,321,864	75,807		6,397,671			28,900		6,426,571
Insurance	1,542,167	908,725	1,732,997	18,382	100,535	245,491	72,135	45,018	41,342	143,134	99,530	31,942		4,981,398	20,068		5,001,466			123,388		5,124,854
Professional fees	720,228	677,476	418,638	43,597	26,043	416,705	160,746	115,209	94,927	101,085	25,354	144,544		2,944,552	180,500		3,125,052	12,600		1,449,260		4,586,912
Rent and lease	548,123	252,345	1,124,548	11,429	15,412	199,261	7,731	16,195	23,716	24,473	6,887	2,738		2,232,858	56,861	(33,810)	2,255,909			1,659,760		3,915,669
Other	967,271	683,137	933,217	52,855	98,647	290,427	67,611	32,776	64,318	90,241	197,610	37,381		3,515,491	211,011		3,726,502			238,884		4,093,439
Total operating expenses	<u>89,305,159</u>	<u>45,550,697</u>	<u>111,646,421</u>	<u>3,541,055</u>	<u>14,664,126</u>	<u>18,499,238</u>	<u>9,292,284</u>	<u>6,488,949</u>	<u>4,173,875</u>	<u>19,711,773</u>	<u>15,199,441</u>	<u>2,981,469</u>		<u>341,054,487</u>	<u>9,075,507</u>	<u>(591,831)</u>	<u>349,538,163</u>	<u>348,477</u>	<u>3,882,642</u>			<u>353,769,282</u>
INCOME (LOSS) FROM OPERATIONS	<u>(7,852,654)</u>	<u>(6,131,579)</u>	<u>8,788,507</u>	<u>(552,932)</u>	<u>(4,326,303)</u>	<u>(2,445,790)</u>	<u>(1,686,707)</u>	<u>(1,548,159)</u>	<u>(541,062)</u>	<u>(2,635,820)</u>	<u>(2,206,078)</u>	<u>(64,384)</u>		<u>(21,202,961)</u>	<u>(9,075,507)</u>	<u>303,284</u>	<u>(29,975,184)</u>	<u>(348,477)</u>	<u>(2,524,449)</u>			<u>(32,848,110)</u>
NONOPERATING REVENUES (EXPENSES)																						
General appropriations from State of Hawaii															27,569,984		27,569,984					27,569,984
Collective bargaining pay raise appropriation from State of Hawaii	2,694,749	1,361,871	3,158,533	109,272	618,743	465,469	360,285	260,216	147,165	819,932	665,569	96,833		10,758,637	79,324		10,837,961					10,837,961
Restricted contributions		1,818,840				9,500	1,729							1,830,069			1,830,069	865,000				2,695,069
Interest and dividend income	15,171	2,416	34,872	1,326		105	116			1,611	395	5		56,017	183,240		239,257	10,323	3,647			253,227
Interest expense (net of capitalized interest)	(631,378)	(65,178)	(23,706)		(3,503)	(3,215)	(767)	(1,871)	(3,007)	(4,703)	(267)			(737,595)	(2,428,971)		(3,166,566)					(3,166,566)
Corporate allocation expense	(2,986,120)	(1,476,968)	(3,666,405)	(117,134)	(487,874)	(609,417)	(316,623)	(207,884)	(132,490)	(655,179)	(513,715)	(96,438)		(11,266,247)	11,266,247		-					-
Other nonoperating revenues (expenses)—net	689,368	191,498	372,434	5,926	84,703	185,034	223,278	141,408	43,303	273,423	(1,660)	32,647		2,241,362	(18,803)	(303,284)	1,919,275	(2,880)				1,916,395
Total nonoperating revenues (expenses)	<u>(218,210)</u>	<u>1,832,479</u>	<u>(124,272)</u>	<u>(610)</u>	<u>212,069</u>	<u>47,476</u>	<u>268,018</u>	<u>191,869</u>	<u>54,971</u>	<u>435,084</u>	<u>150,322</u>	<u>33,047</u>		<u>2,882,243</u>	<u>36,651,021</u>	<u>(303,284)</u>	<u>39,229,980</u>	<u>872,443</u>	<u>3,647</u>			<u>40,106,070</u>
INCOME (LOSS) BEFORE CAPITAL CONTRIBUTIONS, TRANSFERS, AND SPECIAL ITEM	<u>(8,070,864)</u>	<u>(4,299,100)</u>	<u>8,664,235</u>	<u>(553,542)</u>	<u>(4,114,234)</u>	<u>(2,398,314)</u>	<u>(1,418,689)</u>	<u>(1,356,290)</u>	<u>(486,091)</u>	<u>(2,200,736)</u>	<u>(2,055,756)</u>	<u>(31,337)</u>		<u>(18,320,718)</u>	<u>27,575,514</u>	<u>-</u>	<u>9,254,796</u>	<u>523,966</u>	<u>(2,520,802)</u>			<u>7,257,960</u>
CONTRIBUTED CAPITAL ASSETS AND TRANSFERS	136,374		8,943,084		230	478,789	471,469		75,000				5,169,021	15,273,967			15,273,967					15,273,967
SPECIAL ITEM—Demolition costs													(3,527,127)	(3,527,127)			(3,527,127)					(3,527,127)
INCREASE (DECREASE) IN NET ASSETS	<u>\$ (7,934,490)</u>	<u>\$ (4,299,100)</u>	<u>\$ 17,607,319</u>	<u>\$ (553,542)</u>	<u>\$ (4,114,004)</u>	<u>\$ (1,919,525)</u>	<u>\$ (947,220)</u>	<u>\$ (1,356,290)</u>	<u>\$ (411,091)</u>	<u>\$ (2,200,736)</u>	<u>\$ (2,055,756)</u>	<u>\$ (31,337)</u>	<u>\$ 1,641,894</u>	<u>\$ (6,573,878)</u>	<u>\$ 27,575,514</u>	<u>\$ -</u>	<u>\$ 21,001,636</u>	<u>\$ 523,966</u>	<u>\$ (2,520,802)</u>	<u>\$ -</u>	<u>\$ 19,004,800</u>	



## **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, 2005 and 2004, and have issued our report thereon dated November 14, 2005. 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*

November 14, 2005