2004

Annual Report

The Research Corporation of the University of Hawaii

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The Research Corporation of the University of Hawaii

Its creation . . .

CUH is a State agency, established by the Legislature in 1965, and is attached to the University of Hawaii for administrative purposes. Its enabling legislation is codified as Chapter 307 of the Hawaii Revised Statutes.

Its mission . . .

he fundamental mission of RCUH is to support the research and training programs of the University of Hawaii and to enhance research, development, and training generally in Hawaii.

Its need . . .

... the rapid and extensive entry of the University of Hawaii into basic and applied research programs sponsored by the federal government, and into applied research programs which couple University capability with that of private industry, requires a much more flexible and streamlined method of operation than is permitted the usual operations of state agencies. In short, the University must be able to function in research activities more like a business . . . Standing Committee Report 809, House Committee on Higher Education, 1965

... Increasingly, research contracts accepted by the University require rapidity of action and flexibility in operational and financial activities more characteristic of business firms than of governmental agencies. State regulations of many types which control the University's normal functioning do not provide the expeditious managerial environment needed to function in the highly competitive area of science-related activities now involving universities, federal government and private industry. Standing Committee Report 836, Senate Committee on Ways & Means, 1965

Although penned almost forty years ago, these words still hold true today. In fact, these words are even more profound today. The University has made tremendous strides in the highly competitive world of externally-funded research, and today, it stands alongside the great research universities. We believe RCUH's role in facilitating research activities has contributed to this achievement.

Its function . . .

CUH is akin to a service bureau. Its services fall in the areas of accounting, human resources, and procurement. Because of its exemption from state statutes relating to special fund reimbursements to the state general fund, advertising for bids, purchases in Hawaii when public moneys are expended, civil service, compensation, public employment, and the retirement system. RCUH has the flexibility to function more like a business. Accordingly, RCUH has its own personnel, payroll, accounting, and disbursing systems, independent of the state and University systems. This makes it possible for RCUH to process transactions expeditiously, which in turn makes it possible for the researchers to focus more of their efforts on research rather than administrative activities

While most of the projects handled by RCUH are in the State of Hawaii, many transcend the boundaries of the state into different parts of the world. Because of the unique nature of research activities, RCUH must remain flexible to meet the needs of projects, while at the same time adhere to the rules and regulations attached to projects by sponsoring agencies.

Its relationship with the UH. . .

CUH is attached to the UH for administrative purposes. The Internal Agreement between the UH and RCUH defines the basic responsibilities of each party and the financial arrangement to pay for the cost of services rendered.

Its funding . . .

ike a business, RCUH must be self-supporting. It receives no state funds and operates entirely on fees charged for its services.

For University of Hawaii projects (referred to as 'service order' projects), the University currently pays RCUH a fee based on an agreed-upon amount.

'Direct' projects (typically non-University projects), such as those of other state agencies, federal agencies, and private organizations, are also charged

a fee to cover RCUH's administrative costs. These fees are individually negotiated and are based on the scope and volume of services provided.

Its governance . . .

he affairs of the Corporation are under the general management and control of a Board of Directors. The Board consists of ten members -- 5 appointed by the Governor and confirmed by the Senate and 5 members of the UH Board of Regents selected by the Board of Regents.

The President of the University of Hawaii also serves as President of RCUH.

The day-to-day affairs of the Corporation are managed by an Executive Director, who has the delegated authority to enforce and execute all policies, rules, regulations, etc., necessary to conduct the business of the Corporation.

Its employees . . .

he "core" staff of RCUH consists of approximately 30 employees, spread across the departments of accounting, disbursing, human resources, procurement, project management, and the executive director's office. The core staff is housed at Sakamaki Hall on the UH campus and at the Manoa Innovation Center on Woodlawn Drive in Manoa.

The RCUH Hilo Office has a staff of 4, and they are located in the Institute for Astronomy building in the UH Hilo Research Park.

At any given time, there are on average 2,200 project personnel on RCUH's payroll.

EEO/AA Policy

CUH is an equal employment opportunity/ affirmative action employer. It is the policy of RCUH to afford equal employment opportunity to all individuals without regard to race, color, religion, sex, national origin, age, arrest and court record, handicap, marital status, or status as a disabled veteran or veteran of the Vietnam era. RCUH's Affirmative Action Plan describes the programs/procedures developed to ensure employment opportunities for women, minorities, handicapped, disabled, and Vietnam era veterans. The Plan is available for inspection at the RCUH Human Resources Department.

The Year in Review

We experienced another banner year, with a volume of business of \$260.4 million. This represents a 22% increase over the previous year's volume. Although this was a substantial increase, it is worth noting that our operating expenses decreased by approximately 11% (from \$4.2 million to \$3.8 million).

We continued to invest in our electronic systems (financial and human resources) to refine our on-line processes. This has allowed us to handle the increased volume of business without adding staff.

The year can best be described as one of transition. The Executive Director responsibilities were carried out by Gilbert Oshima on an interim basis while the RCUH Board conducted its recruitment for a new Executive Director due to the retirement of Harold Masumoto at the end of the previous fiscal year. Our thanks to Gilbert for leading the charge during this transition period.

On June 1, 2004, we welcomed Michael Hamnett to the RCUH family as our new Executive Director. Mike was the Director of the Social Science Research Institute at UH Manoa prior to accepting the RCUH position. He was very familiar with RCUH since he was a "client" of ours for over ten years, and this provided for a smooth transition to the RCUH side of the house.

From the perspective of the Board of Directors, it was also a very busy year. The recruitment for the Executive Director took a great deal of time, and concurrently, the Board began work on a Strategic Plan for RCUH. Both of these major projects came to fruition as we approached the end of the fiscal year. The Strategic Plan for RCUH was adopted by the Board in June 2004, and this is the road map for our future directions. The general "charge" outlined in the Plan states:

"The 'ideal' RCUH is envisioned as an agile, efficient, responsive organization with highly motivated staff providing excellent support for research and training at the University of Hawaii and beyond ... RCUH would provide all required support for extramural research and training grants and contracts, from 'soup to nuts' "

RCUH will work closely with the University of Hawaii as it begins its journey toward this "ideal" but distant future. The Plan is meant to evolve and as circumstances may require, the Plan will be updated as necessary.

The RCUH Board extends its heartfelt thanks to Dr. Roger Lukas of the University of Hawaii Association of Research Investigators (UHARI) for his participation in both the RCUH Executive Director search and the development of the Strategic Plan for RCUH. He provided valuable input from our major client's perspective (the principal investigators) and that helped us tremendously in the successful completion of both endeavors.

Board Chairman Brian Tamamoto and Vice Chairman Lynn Kinney were at the leadership helm this past year, and we thank them and the rest of the Board for their tireless efforts in furthering the RCUH mission of supporting research, training, and economic development in the State.

Duane Kurisu left the Board in mid-year due to his resignation from the UH Board of Regents. As the year came to a close, we bid aloha to Charles Kawakami and Walter Nunokawa, whose terms came to an end. We extend our thanks and appreciation to these gentlemen for their contributions to RCUH over the years.

We look forward to the new year with continued enthusiasm as we focus our efforts on implementing our new Strategic Plan and furthering our mission of supporting the research and training activities of the State.

Board of Directors

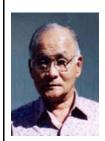
(as of 6/30/04)



Brian Tamamoto Director



Byron Bender Director



Shige Iwamoto Diretor



Joelle Kane Director



Lynn Kinney Director



Charles Kawakami Director



Kitty Lagareta Director



Walter Nunokawa Director



Eugene Tiwanak Director

[1 vacancy]

Project Review

We are pleased to highlight the following three projects:

A "UH Service Ordered" Project

Biocomplexity of Introduced Avian Diseases in Hawaii: Threats to Biodiversity of Native Forest Ecosystems

Historically, Hawaiian Honeycreepers were the dominant vertebrate component of native Hawaiian rainforests. However, since the arrival of Europeans half of the known species have become extinct and many of those remaining are faced with extinction and population declines. Today, introduced mosquitotransmitted diseases (avian pox and malaria) are thought to be the main factor driving these losses. An objective of this highly collaborative project is to develop a series of malarial models that might be applied to the more complex global issue of human malaria or serve as a model for emergent mosquitoborne diseases such as West Nile Virus. These collective efforts will result in a better understanding of avian disease in Hawaii and hopefully reveal weak links in the system that may be targeted for management strategies to protect native Hawaiian forest birds. The research team consists of geneticists, ornithologists, mathematical modelers, an entomologist, a parasitologist, an ecologist, and a climatologist/geographer from three federal and four academic institutions providing the expertise to explore this system from the molecular level to the broad landscape.

Team member Sue Jarvi, a geneticist at UH Hilo, is using a variety of molecular methods to investigate the role of genetics in disease resistance in avian hosts and is examining genetic diversity of malaria parasites in search of virulence genes. Genetic analyses of the genomes of individual avian hosts able to survive when infected with malaria might reveal particular genes or gene systems that provide resistance to this infectious disease. Alternatively, analyses of genes of those that succumb might disclose genetic regions influencing susceptibility. Population-level studies can reveal genes or gene frequencies in populations found in low elevation habitats that have high levels of mosquito-vectored disease transmission that are distinct from those in disease-free high elevation habitats. Genes found

uniquely in low elevation bird populations would then be considered as candidates for further study. Specific approaches include:

- Analyses of bird genomes by AFLP (amplified fragment length polymorphism).
- Analyses of immune system genes (major histocompatibility complex genes) by DNA sequence comparisons between individual surviving or non-surviving birds.
- Surveys of low and high elevation population genes and gene frequencies by micro (spotted) array hybridization.
- Comparison of malaria parasite gene sequences from individuals that have survived infection versus those who have succumbed.
- Geographic surveys of malaria parasite diversity by SNP (single nucleotide polymorphism) analyses.
- PCR-based malaria and poxvirus diagnostic development.
- Evaluation of poxvirus isolates by DNA sequence comparisons.
- Use of "ancient DNA" techniques on museum samples to establish a timeline for start of disease transmission.
- PCR-based approaches to determine feasibility of analyzing mosquito bloodmeals for disease transmission rates, bird sex and identification.

A "Direct" Project

Seafarers Training Center

Congressional authorization created funding to develop the Seafarers Training Center of the Paul Hall Institute of Human Development, located in Kalaeloa, Hawaii (the former Barber's Point Naval Air Station). The facility is located on Hawaii Army National Guard property licensed for use by the Paul Hall Institute for Human Development. The facility provides needed training to U.S. merchant mariners in Hawaii and the Pacific region to meet the specialized training requirements of civilian seafarers as required by the U.S. Coast Guard, the Department of Defense, and maritime employers. The Seafarers Training Center is also available to meet the continuing education needs of the Hawaii Army National Guard and the Fire Department of the City and County of Honolulu.

In consultation with the Seafarers International Union, the Hawaii National Guard, maritime employers (including contractors for the Department of Defense), the U.S. Coast Guard, and federal, state and local emergency response agencies, a planning process determined the types of courses and the infrastructure to support those courses that are needed by civilian seafarers operating on vessels throughout Hawaii and the greater Pacific region.

The process consists of development in three phases:

PHASE 1: Creation and operation of a temporary training facility. The facility operated as a "day school" only. No project funds were used for this phase of development.

PHASE 2: Creation and operation of an expanded permanent Seafarers Training Center. Administrative offices, classrooms and training props were located at Building 1874 in Kalaeloa. The curriculum and student base were significantly expanded. The emphasis in this phase of development concentrated on creating the infrastructure to support maritime fire fighting training.

PHASE 3: Expansion of required training infrastructure and full operation of the Seafarers Training Center. The emphasis in this phase of development is completing the infrastructure to support maritime fire fighting training and to create the facilities to support water survival training.

An initial phase of temporary operation was undertaken beginning in October 2000 to provide a practical training experience component. In four years of operation, the Seafarers Training Center has provided practical maritime education and safety training to more than 3,500 seafarers and local residents in Basic Safety Training, Basic Fire Fighting, First Aid, and CPR.

Phase 2 of the development process is almost complete. Building 1874 has been remodeled, furnished and equipped for maritime training. A 2-story confined space maze has been constructed and is in use. A ship mock-up fully piped for live flames has been constructed and is in use. Outdoor fire fighting props, including a helicopter mock-up have been constructed and are also being used for instruction. The fire fighting training area is equipped with a unique water recycling system to allow reuse of runoff water. With the development of this infrastructure, the Seafarers Training Center is now able to teach additional certified courses in Advanced Fire Fighting and Crowd & Crisis Management.

Phase 3 of this project concentrates on creating the infrastructure to support Water Survival Training, complete tasks unfinished from Phase 2, and to finalize student support facilities and services (i.e. housing and transportation). A water survival training pool has been completed to allow students to perform practical exercises in use of life jackets, life rafts and survival suits. Building 46 at Kalaeloa provides housing for offisland students. This dormitory has been renovated and includes bedrooms, recreational lounges and common areas, and separate rooms for visiting faculty and staff. Additional classrooms, to be located near Building 46, will be in use before the summer of 2005. And new support equipment (i.e. telephone system, audio-visual equipment and computers, SCBA fill system, and laundry) are in place.

Since its inception, instructors from the Seafarers Training Center have not only provided maritime training in Hawaii, they have traveled to the Republic of South Korea, Guam, and the Commonwealth of the Northern Marianas Islands to provide instruction to seafarers working aboard vessels in those locations.

As final development concludes, this project in on-track to complete the following initial objectives:

- Develop a maritime training setting that realistically presents the challenges of actual shipboard emergencies in a safe teaching environment.
- Implement a regular training schedule to be utilized by regional seafarers, maritime employers, and public entities such as the Hawaii Army National Guard and local fire departments.
- Develop a training regimen that can be consistently utilized by Pacific region maritime operators.
- Create appropriate infrastructure to support students participating in training programs.
- Develop and implement future training partnerships with maritime and non-maritime entities.

A "Revolving Fund" Project

Executive Education at the University of Hawaii at Manoa, College of Business Administration

Helping executives to increase their business knowledge or hone the skills they already possess is the *raison d'etre* for the College of Business Administration's Executive Education programs.

One area of focus for the College is degree programs.

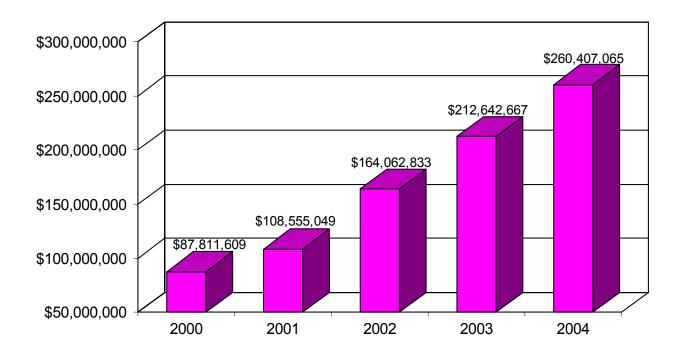
- The Executive MBA program allows students to continue their careers while acquiring the skills and network to move them to the next level of leadership.
- The Japan and China focused-MBA, offered in partnership with the Japan-America Institute for Management Science (JAIMS), offers students the opportunity to focus their studies on a particular region and also spend three months working in country.
- In 2003, the Master of Human Resources program was kicked off with 28 participants and continues to draw human resource professionals to the program. In 2004, the program was expanded to include 10 participants from Maui through a partnership with the University Center on Maui.
- Finally, the College has taken its MBA program to Vietnam. In partnership with the Hanoi School of Business, it offers senior executives the opportunity to study the MBA curriculum without leaving their careers or families. In all cases, students are able to take advantage of the College's internationally-focused faculty and earn the only AACSB accredited degree in Hawaii.

The other main focus of the College is training programs. These are programs specifically designed to meet the needs of the individual corporation. They range in length and focus, and can take place in Hawaii or in any location desired by the company. In recent years, the College has worked with a major telecom company headquartered in the US but with the majority of employees in China, major healthcare providers in the State of Hawaii, the Provincial Government of Taiwan, China Hewlett-Packard and many others. These programs are a major growth area for the College and they expect these opportunities to continue to grow as they allow the College to make the best use of its resources as a university and as an internationally focused state.

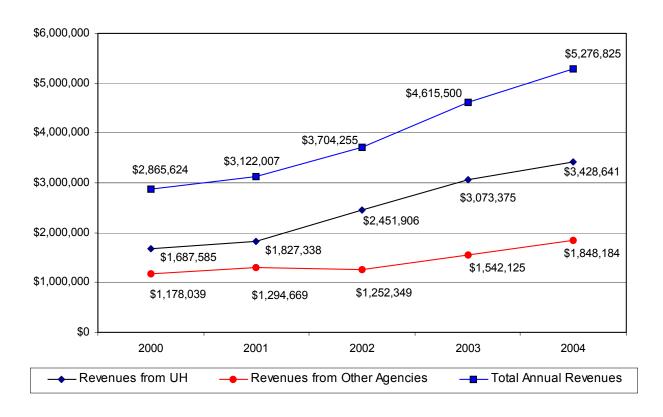
Programs such as these allow us to showcase the University of Hawaii, the College of Business Administration, and of course, the State of Hawaii. They bring in external dollars that go to support not only the Hawaii economy as a whole, but specifically, benefit the students of the College through equipment purchases, classroom upgrades, and many other programs and activities that enrich our students' education opportunities.

Statistical Data - Fiscal Years 2000-2004

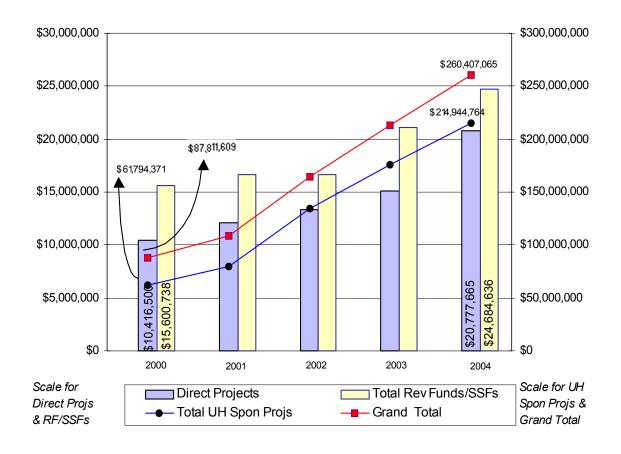
Dollar Volume of Project Administration



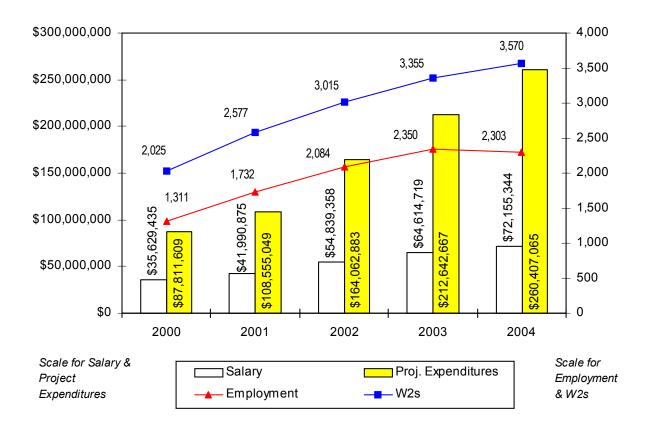
Operating Revenues Summary



Project Expenditures



Employment/W2s/Salaries/Project Expenditures



Distribution of Awards by Project Disciplines

	2000	2001	2002	2003	2004
Agriculture	\$5,864,154	\$5,765,112	\$6,874,096	\$5,435,998	\$5,854,099
Astronomy	\$10,991,189	\$16,489,668	\$21,389,807	\$21,348,650	\$26,364,139
Biomedicine	\$18,931,690	\$19,912,680	\$40,126,343	\$56,348,128	\$79,129,196
Fisheries & Aquaculture	\$1,517,608	\$3,128,072	\$3,173,514	\$4,277,010	\$6,690,703
Marine Programs	\$16,642,833	\$19,436,392	\$22,613,888	\$30,583,309	\$32,656,256
Natural Sciences	\$7,372,471	\$10,402,761	\$22,965,320	\$35,559,791	\$39,580,388
Publications/Educ Materials	\$2,092,514	\$4,196,119	\$11,821,206	\$17,373,216	\$18,826,363
Revolving Funds	\$15,718,255	\$16,605,734	\$16,626,924	\$21,101,406	\$24,684,636
Social Sciences	\$8,680,895	\$12,618,511	\$18,471,785	\$20,615,159	\$26,621,285
TOTAL	\$87,811,609	\$108,555,049	\$164,062,883	\$212,642,667	\$260,407,065

Volume of Business by Sponsoring Agency

UNIVERSITY PROJECTS	2000	%	2001	%	2002	%	2003	%	2004	%
FEDERAL Dept of Health & Human Services Dept of Commerce National Science Foundation Dept of Agriculture Dept of Interior Dept of Energy Dept of Defense Dept of Education Natl Aeronautics &Space Adminis Dept of State Other Miscellaneous Federal	10,362,196 5,506,494 4,834,609 3,904,449 4,928,886 595,160 2,350,763 1,231,692 2,004,425 3,323,168 1,622,099	11.80 6.27 5.51 4.45 5.61 0.68 2.68 1.40 2.28 3.78 1.85	12,956,111 6,607,200 6,981,894 4,637,651 5,620,943 692,347 5,250,187 4,251,257 3,867,868 2,922,028 2,265,350	11.94 6.09 6.43 4.27 5.18 0.64 4.84 3.92 3.56 2.69 2.09	21,867,899 9,610,271 8,882,914 5,526,550 6,058,590 772,915 16,630,419 10,229,809 6,042,056 2,980,994 3,614,791	13.31 5.86 5.41 3.37 3.69 0.47 10.14 6.24 3.68 1.82 2.20	29,751,403 11,716,908 12,798,076 5,228,131 6,909,207 779,864 31,728,095 10,781,062 5,884,155 2,280,616 6,251,654	13.99 5.51 6.02 2.46 3.25 0.37 14.92 5.07 2.77 1.07 2.94	30,640,504 15,200,894 5,930,906 4,440,861 8,356,279 878,729 27,767,432 10,636,720 9,858,790 3,117,950 7,765,837	11.77 5.84 6.12 1.71 3.21 0.34 10.66 4.08 3.79 1.20 2.98
TOTAL UH Federal Projects	40,663,941	46.31	56,052,836	51.65	92,217,208	56.19	124,109,171	58.37	134,594,902	51.69
NON-FEDERAL State & County Governments: University of Hawaii Sch of Ocean & Earth Sci & Techn Institute for Astronomy Ofc of Tech Transf & Econ Dev Cancer Research Center of HI School of Medicine UH Hilo UH Other Dept of Health Dept of Land & Natural Resrcs Dept of Education Dept of Defense County Government Other Sponsors TOTAL UH Non-Federal Projects TOTAL UH PROJECTS	1,729,385 1,429,883 1,599,402 1,056,259 - 7,183,701 134,840 991,366 74,043 730,307 482,182 5,719,062 21,130,430 61,794,371	1.97 1.63 1.82 1.20 - 8.18 0.15 1.13 0.09 0.83 0.55 6.51 24.06	1,499,125 2,902,380 1,422,423 804,064 - - 5,245,978 2,542,488 889,018 54,737 659,745 152,498 7,624,551 23,797,007 79,849,843	1.38 2.67 1.31 0.74 - 4.83 2.34 0.82 0.05 0.61 0.14 7.02 21.91 73.56	929,281 3,634,782 730,728 826,658 11,267,353 716,962 7,237,272 4,766,704 1,358,872 291,993 569,208 314,279 9,186,330 41,830,422 134,047,630	0.57 2.22 0.45 0.50 6.87 0.44 4.41 2.91 0.83 0.18 0.35 0.19 5.60 25.52 81.71	1,100,217 3,022,320 777,509 845,942 20,439,334 883,937 5,807,279 6,189,969 1,375,640 221,692 518,079 306,999 10,779,539 52,268,456 176,377,627	0.52 1.42 0.37 0.40 9.61 0.42 2.73 2.91 0.65 0.10 0.24 0.14 5.07 24.58	1,389,231 4,012,728 580,256 1,016,548 44,306,537 1,490,325 9,699,963 4,739,824 1,368,195 226,938 1,522,162 192,615 9,804,540 80,349,862 214,944,764	0.53 1.54 0.22 0.39 17.01 0.57 3.72 1.82 0.53 0.09 0.58 0.07 3.77 30.86
	2000	%	2001	%		%		%		%
FEDERAL	349,115	0.40	1,061,822	0.98	2002 947,249	0.58	2003 2,064,179	0.97	2004 5,181,583	1.99
NON-FEDERAL State & County Governments: Dept of Health Dept of Bus, Econ Dev & Tour Dept of Land & Natural Res Dept of Education Others: Joint Astronomy Centre Academia Sinica Instit of Astron Kuakini Medical Center Natl Astronomical Observ of Japan Other Sponsors	1,145,081 508,254 1,084,711 463,049 3,146,256 414,839 616,338 1,284,542 1,404,315	1.30 0.58 1.24 0.53 3.58 0.01 0.70 1.46 1.59	1,368,640 241,746 1,205,167 104,059 3,417,075 824,552 519,126 1,689,112 1,659,972	1.26 0.22 1.11 0.10 3.14 0.01 0.48 1.56 1.52	1,102,893 - 1,267,594 82,525 3,620,656 1,459,798 336,371 2,086,662 2,484,580	0.67 - 0.77 0.05 2.21 0.89 0.21 1.27 1.51	1,407,029 1,160,987 93,031 4,229,975 1,666,639 186,693 3,029,500 1,302,534	0.66 0.55 0.04 1.99 0.78 0.09 1.42 0.61	1,369,250 - 1,399,813 75,509 4,556,688 1,153,123 - 4,024,469 3,017,230	0.53 - 0.54 0.03 1.75 0.44 - 1.55 1.16
TOTAL Non-Federal Projects	10,067,385	11.46	11,029,449	10.16	12,441,079	7.58	13,076,388	6.14	15,596,082	5.99
TOTAL DIRECT PROJECTS	10,416,500	11.86	12,091,271	11.14	13,388,328	8.16	15,140,567	7.11	20,777,665	7.98
REVOLVING FUNDS & SSF's	2000	%	2001	%	2002	%	2003	%	2004	%
Specialized Service Fac/Ship Ops Revolving Funds & Other SSF's	3,460,507 12,140,231	3.94 13.83	3,849,913 12,764,022	3.54 11.76	3,235,248 13,391,677	1.97 8.16	7,674,420 13,450,053	3.61 6.33	8,920,660 15,763,976	3.43 6.05
TOTAL REVOL FUNDS & SSF's	15,600,738	17.77	16,613,935	15.30	16,626,925	10.13	21,124,473	9.94	24,684,636	9.48
TOTAL PROJECTS	87,811,609	100.0	108,555,049	100.0	164,062,883	100.0	212,642,667	100.0	260,407,065	100.0

Financial Statements for the Years Ended June 30, 2003 and 2004

Financial statements and report of independent certified public accountants

The Research Corporation of the University of Hawaii, State of Hawaii

June 30, 2004 and 2003

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SECTION I - FINANCIAL

Report of Independent Certified Public Accountants

The Board of Directors
The Research Corporation of the University of Hawaii

We have audited the accompanying balance sheets of The Research Corporation of the University of Hawaii, State of Hawaii, a component unit of the University of Hawaii, as of June 30, 2004 and 2003, and the related statements of revenues and expenses and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Research Corporation of the University of Hawaii, State of Hawaii, as of June 30, 2004 and 2003, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated August 6, 2004 on our consideration of the Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that 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 considered in assessing the results of our audits.

The Management's Discussion and Analysis on pages 6 and 7 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.

Is Grant Thornton LLP

Honolulu, Hawaii August 6, 2004

MANAGEMENT'S DISCUSSION AND ANALYSIS June 30, 2004 and 2003

The following discussion and analysis provides an overview of the financial position and results of operations for The Research Corporation of the University of Hawaii (RCUH) for the year ended June 30, 2004. It includes selected comparative information with the year ended June 30, 2003. This discussion and analysis should be read in conjunction with the financial statements and accompanying notes.

The financial reports of RCUH include three statements. The balance sheets, which summarize assets and liabilities and present an overall picture of the financial position of the Corporation, the statements of revenues, expenses and changes in net assets, which summarize the financial results of operations for the fiscal year, and the statements of cash flows, which identify the sources and uses of cash.

In fiscal year 2004, the Corporation attained a record volume of business (project expenditures) for the fourth consecutive year. Substantial growth was realized in business from the University of Hawaii (University) as well as other sponsors. The volume of business for fiscal years 2004 and 2003, was \$260,407,065 and \$212,642,667, respectively. The substantial increase in project expenditures had a significant impact on the Corporation's financial statements in terms of the cash, receivable and accounts payable balances presented on the balance sheet, revenues generated and levels of cash flows.

Total assets of the Corporation at June 30, 2004 and June 30, 2003, were \$32,239,064 and \$34,255,904, respectively. Cash balances decreased \$8,639,606 because of the higher level of monthly cash outflows attributable to the increase in project expenditures and the reclassification of time certificates of deposit (TCD's) from cash to investments. The Corporation classifies TCD's with maturity terms exceeding 90 days as investments. TCD's with maturity terms of 90 days or less are classified as cash. At June 30, 2003, the Corporation had no TCD's with maturity terms exceeding 90 days. At June 30, 2004, outstanding TCD's with maturity terms exceeding 90 days amounted to \$3,834,744. These TCD's were reclassified resulting in a reduction to cash balances and a corresponding increase to investments.

Receivables from "Other Sponsors" increased from \$2,153,782 at June 30, 2003 to \$3,274,978 at June 30, 2004. The net receivable balance due from the University at June 30, 2004 was \$1,089,185 compared to a net balance due to the University of \$10,703,815 at June 30, 2003. The higher receivable balances were primarily a result of the substantial increase in the volume of project expenditures handled by the Corporation in 2004. Amounts paid or owed to vendors by the Corporation on behalf of sponsored projects are recorded as receivables from the sponsors. The average monthly project expenditures in 2004 were approximately \$4,000,000 greater than in 2003 and vendor payables increased from \$7,892,975 at June 30, 2003 to \$12,619,932 at June 30, 2004, an increase of \$4,726,957.

The net value of fixed assets was \$940,111 and \$830,793 at June 30, 2004 and June 30, 2003, respectively. Fixed asset acquisitions amounted to \$371,725 for the year ended June 30, 2004 compared to \$72,093 for the year ended June 30, 2003. Depreciation expense for the years ended June 30, 2004 and June 30, 2003 amounted to \$262,407 and \$270,858, respectively.

Total liabilities were \$23,888,939 at June 30, 2004, and \$27,652,863 at June 30, 2003. The decrease was a result of the significant reduction in net receivable balance due to the University (advances) at June 30, 2004 compared to June 30, 2003. At June 30, 2004, the Corporation had no outstanding long-term debt.

For the year ended June 30, 2004, net assets increased \$1,747,084 as operating profit and net non-operating revenues were \$1,524,226 and \$222,858, respectively. Operating revenues of \$5,276,825 were attained on a record volume of business activity and was 14% higher than fiscal year 2003 operating revenues of \$4,615,500. Non-operating revenues included interest income of \$137,122 and a market value gain of \$85,736 in the quasi-endowment investments held at the University of Hawaii Foundation.

Operating expenses in fiscal year 2004 were \$3,752,599, a decrease of 11% from the previous year's expenses of \$4,209,434. Data processing costs of \$634,042 continued to be a major expense item although significantly below the fiscal year 2003 level of \$932,045. There were no major enhancements or modifications to existing computer systems and web applications and maintenance costs have stabilized as the online web systems have matured. Project development costs were significantly below prior years' levels as funding on a major research initiative was delayed to fiscal year 2005. Insurance costs increased from \$270,476 in fiscal year 2003 to \$346,966 in fiscal year 2004. Higher premiums continue to reflect the overall market conditions surrounding liability coverages.

At June 30, 2004 total net assets were \$8,350,125 compared to \$6,603,041 at June 30, 2003. Net assets invested in capital assets were \$940,111. There was no debt financing on capital assets and unrestricted net assets amounted to \$7,410,014.

The Research Corporation of the University of Hawaii State of Hawaii BALANCE SHEETS June 30,

ASSETS	2004	2003	LIABILITIES AND NET ASSETS		2003
CURRENT ASSETS: Cash & Cash Equivalents (note B) Investments (note C)	\$19,098,587 5,129,021	\$ 27,738,193 1,207,100	CURRENT LIABILITIES: Current installments of long-term debt (note H) Accounts payable Accrued salaries and other	\$ – 12,619,932 5,579,807	\$ 4,783 7,892,975 4,391,563
Receivables (note G): University of Hawaii (note D) Other sponsoring agencies (note D) Receivables under lease agreements,	1,089,185 3,274,978	2,153,782	Advances: University of Hawaii projects (note D) Other sponsoring agencies (note D) Workers' compensation and unemployment	3,521,736	10,703,815 2,670,297
excluding current portion of deferred credits (note E)		8,640	claims reserve (note O) Current portion of accrued supplemental retirement benefits (note K)	1,419,500 23,000	1,367,899 20,000
Total Receivables	4,364,163	2,162,422	Tourisms Soriems (rists 14)		
Prepaid expenses	276,600	358,894	Total current liabilities	23,163,975	27,051,332
Total Current Assets	28,868,371	31,466,609	NONCURRENT LIABILITIES: Accrued supplemental retirement benefits (notes I and K)	724,964	601,531
			Total Noncurrent Liabilities	724,964	601,531
			Total Liabilities	23,888,939	27,652,863
			COMMITMENTS AND CONTINGENCIES (notes G, I, K, L, M. N, O and P)	-	-
NONCURRENT ASSETS: Capital assets (note F) Restricted assets - cash (notes B and D)	940,111 2,430,582	830,793 1,958,502	NET ASSETS (note I): Investment in capital assets Unrestricted	940,111 7,410,014	830,793 <u>5,772,248</u>
Total Noncurrent Assets	3,370,693	2,789,295	Total Net Assets	8,350,125	6,603,041
TOTAL ASSETS	\$ 32,239,064	<u>\$ 34,255,904</u>	TOTAL LIABILITIES AND NET ASSETS	<u>\$ 32,239,064</u>	<u>\$ 34,255,904</u>

The accompanying notes are an integral part of these statements.

The Research Corporation of the University of Hawaii State of Hawaii STATEMENTS OF REVENUES AND EXPENSES AND CHANGES IN NET ASSETS Year ended June 30,

	2004	2003
	2004	2000
Operating revenues — administrative expense recoveries: University of Hawaii (note J)	\$ 3,428,641	\$ 3,073,375
Other sponsoring agencies	1,848,184	1,542,125
Total operating revenues	5,276,825	4,615,500
Operating expenses:		
Salaries and wages	1,590,263	1,604,381
Data processing services	634,042	932,045
Employee fringe benefits (note K)	409,767	404,613
Insurance Depreciation	346,966 262,407	270,476 270,858
Office supplies and services	192,465	198,730
Office and equipment rental (note N)	84,923	88,238
Professional and technical support	46,778	25,234
Project development	33,127	254,414
Tuition support Professional services	23,304	24,450
Communications	22,479 19,530	19,697 20,983
Staff development	17,219	17,319
Retiree medical benefits (note L)	16,517	12,958
UH Research awards	16,500	16,500
Board of Directors' meetings	13,785	5,244
Travel	9,859 7,470	23,433 7,521
Transportation Discretionary fund	5,164	12,060
Project overruns and disallowances	34	280
Total operating expenses	3,752,599	4,209,434
Operating profit	1,524,226	406,066
Operating profit	1,524,220	400,000
Nonoperating revenues (expenses):		
Interest income: Cash, certificates of deposit and investment	137,122	203,932
Lease (note E)	72	11,335
Interest expense — long-term debt (note H)	(72)	(11,335)
Intergovernmental (Federal Awards):	, ,	, ,
Revenue	4,470,580	1,577,038
Expense Quasi-endowment income (expenses):	(4,470,580)	(1,577,038)
Increase (decrease) in fair value of investments (note C)	85,736	(46,374)
Investment (note I)	32,084	28,164
Research assistantships expense (note I)	(32,084)	(22,108)
Total nonoperating revenues, net	222,858	163,614
INCREASE IN NET ASSETS	1,747,084	569,680
Net assets at beginning of year	6,603,041	6,033,361
Net assets at end of year	<u>\$ 8,350,125</u>	<u>\$ 6,603,041</u>

The accompanying notes are an integral part of these statements.

The Research Corporation of the University of Hawaii State of Hawaii STATEMENTS OF CASH FLOWS Year ended June 30,

	2004	2003
Cash flows from operating activities: Project cost reimbursements received from:		
University of Hawaii Other sponsors	\$208,655,012 36,353,019	\$180,108,671 36,981,299
Management fees received from: University of Hawaii Other sponsors	3,642,840 1,808,689	2,417,147 1,531,316
Payments to vendors Payments to employees	(180,860,067) (50,343,604)	(149,702,970) (44,643,259)
Payments of federal and state payroll taxes Project cost reimbursements to the University of HI Cash received under equipment lease agreements, including interest	(21,590,245) (2,019,515) 8,640	(19,142,514) (2,379,297) 1,354,474
Other receipts	<u>253,276</u>	570,633
Net cash provided by operating activities	(4,091,955)	7,095,500
Cash flows from noncapital financing activities: Principal and interest payments on debt	(4,783)	(1,477,712)
Net cash used in noncapital financing activities	(4,783)	(1,477,712)
Cash flows from capital and related financing activities: Purchase of capital assets	<u>371,725</u>	(72,093)
Net cash used in capital and related financing activities	(371,725)	(72,093)
Cash flows from investing activities: Proceeds from maturities of investments Purchase of investments Interest income received on cash deposits and investment income Contribution to University of Hawaii assistantships	- (3,836,185) 169,206 (32,084)	7,360,410 (1,435,317) 232,096 (22,108)
Net cash (used in) provided by investing activities	(3,699,063)	6,135,081
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(8,167,526)	11,680,776
Cash and cash equivalents at the beginning of the year	29,696,695	<u> 18,015,919</u>
Cash and cash equivalents at the end of the year	<u>\$ 21,529,169</u>	<u>\$ 29,696,695</u>
Cash and cash equivalents are presented in the accompanying balance sheets as follows:	\$ 19,098,587 2,430,582	\$ 27,738,193 1,958,502
Cash and cash equivalents Restricted assets - cash	\$ 21,529,169	\$ 29,696,695
Reconciliation of operating profit to net cash (used in) provided by operating activities: Operating profit Adjustments to reconcile operating profit to net cash provided by operating activities:	\$ 1,524,226	\$ 406,066
Depreciation expense Change in assets and liabilities:	262,407	270,858
Řeceivables Prepaid expenses	(2,201,741) 82,294	1,010,847 61,417
Accounts payable and accrued wages Advances from University of Hawaii and other sponsors Workers' compensation and unemployment claims reserve Accrued supplemental retirement benefits	5,915,201 (9,852,376) 51,601 126,433	3,740,026 1,340,455 147,997 117,834
Net cash (used in) provided by operating activities	\$ (4,091,95 <u>5</u>)	<u>\$ 7,095,500</u>

The accompanying notes are an integral part of these statements.

NOTES TO FINANCIAL STATEMENTS June 30, 2004 and 2003

NOTE A - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Legislature of the State of Hawaii (State) established The Research Corporation of the University of Hawaii (Corporation) in 1965 for the purpose of promoting, encouraging, initiating, developing and conducting scientific research and investigation in all branches of learning, and for disseminating and making available to the public the benefits of such research and investigation. The Corporation is exempt from any income taxes. The Corporation provides administrative support services to projects of the University of Hawaii (University), the State, and other organizations which have been assigned to it by those entities (Sponsors). For these services, the Corporation receives reimbursements for administrative expenses based on a negotiated fee or predetermined indirect cost rate. The projects normally remain under the general and technical supervision of personnel employed by the Sponsors.

The Corporation's Board of Directors consists of five members of the University Board of Regents and five members appointed by the Governor. Additionally, the President of the University serves as President of the Corporation.

1. Financial Statement Presentation and Financial Reporting Entity

The accompanying financial statements of the Corporation have been prepared in conformity with the accounting principles generally accepted in the United States of America prescribed by the Governmental Accounting Standards Board (GASB).

GASB Statement No. 14, *The Financial Reporting Entity* (Statement No. 14), as amended by GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, established standards for defining and reporting on the financial reporting entity. This statement requires that the financial statements of the University include the financial statements of organizations for which the University is financially accountable and other organizations for which the nature and significance of their relationship are such that exclusion would cause the financial statements of the University to be misleading.

The Corporation is fiscally dependent upon the University, and therefore the University is financially accountable for the Corporation as defined by Statement No. 14. Accordingly, the financial statements of the Corporation are blended with the University's financial statements.

2. Measurement Focus and Basis of Accounting

The accounting policies of the Corporation conforms to accounting principles generally accepted in the United States of America as applicable to enterprise activities of governmental units as promulgated by the GASB. In accordance with GASB standards, the Corporation has elected not to apply all applicable Financial Accounting Standards Board pronouncements on accounting and reporting that were issued after November 30, 1989.

An enterprise fund is used to account for the acquisition, operation and maintenance of government facilities and services that are entirely or predominantly supported by user charges. The Corporation's operations are accounted for on the flow of economic resources measurement focus and the accrual basis of accounting is utilized. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Enterprise funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services or goods in connection with a proprietary fund's principal ongoing operations. Revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses. The principal operating revenues of the Corporation are administrative expense recoveries.

Net assets are restricted when constraints placed on them are either externally imposed or imposed by constitutional provisions or enabling legislation. Internally imposed designations of resources are not presented as restricted net assets. When both restricted and unrestricted resources are available for use, generally, it is management's policy to use restricted resources first, then unrestricted resources as they are needed.

3. Cash Equivalents

For purposes of the statements of cash flows, the Corporation considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents. Cash equivalents amounted to \$3,500,000 and \$6,333,082 at June 30, 2004 and 2003, respectively.

NOTES TO FINANCIAL STATEMENTS June 30, 2004 and 2003

NOTE A - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Investments

The Corporation accounts for its investments in accordance with the provisions of GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and External Investment Pools* (Statement No. 31). Statement No. 31 establishes accounting and financial reporting standards for all investments held by governmental external investment pools and establishes fair value standards for other governmental entities. Accordingly, the Corporation has stated its investments at fair value. Changes in the fair value of investments are recognized in the statements of revenues and expenses.

5. Capital Assets

Capital assets, which include office furniture and equipment and computer software acquired for the administrative operations, are reported in the financial statements. Management capitalizes office furniture and equipment and computer software costs if the cost is in excess of \$5,000 and the useful life exceeds 1 year. Purchased capital assets are valued at cost.

Depreciation expense is recorded in the financial statements. The straight-line method is utilized over the assets' estimated useful life. Generally, the useful lives used for office furniture and equipment and computer software costs is 6 years.

Furniture and equipment acquired by the Corporation for projects are charged to project expenditures and are not capitalized for financial statement purposes. Title to fixed assets acquired for direct project contracts generally remains with the sponsoring agency. Title to fixed assets acquired for University projects which are assigned to the Corporation passes directly to the University.

6. Retirement Plan

The Corporation has a retirement plan for substantially all employees. The Corporation's policy is to contribute 10% of eligible employees' regular compensation to the plan. The required contributions are recognized as employee fringe benefits expense.

7. <u>Vacation</u>

Employees are credited with vacation at the rate of 168 hours per calendar year. The maximum accumulation of such vacation credits is limited to 360 hours at calendar year end and are convertible to pay upon termination of employment. Accumulated vacation for administrative personnel has been accrued and reflected in the accompanying balance sheets.

8. Accumulated Sick Leave

Sick leave accumulates at the rate of 14 hours per month of service without limit and is not convertible to pay upon termination of employment. However, an employee who retires in good standing and meets certain eligibility requirements may be entitled to supplemental retirement benefits (see note K). Accumulated sick leave at June 30, 2004 and 2003 aggregated approximately \$1,011,000 and \$1,062,000, respectively.

9. Risk Management

Liabilities related to certain types of losses (including torts, theft of, damage to, or destruction of assets, errors or omissions, natural disasters and injuries to employees) are reported when it is probable that the losses have occurred and the amount of those losses can be reasonably estimated.

10. <u>Use of Estimates</u>

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

NOTES TO FINANCIAL STATEMENTS June 30, 2004 and 2003

NOTE B - CASH AND CASH EQUIVALENTS

At June 30, 2004 and 2003, the carrying amount of total bank deposits was \$21,434,147 and \$29,614,274, respectively, while the corresponding bank balances which are represented were \$29,736,000 and \$33,352,000, respectively. The portion of such deposits not covered by federal depository insurance or invested in U.S. treasury notes are covered by collateral held in the name of the Corporation by third party custodians.

NOTE C - INVESTMENTS

The following schedule summarizes the fair value and cost of the Corporation's investments at June 30, 2004 and 2003:

	June 30,	June 30, 2004		2003
	Fair value	Cost	Fair value	Cost
Investments Certificates of deposit	\$1,294,277 3,834,744	\$1,408,594 3,834,744	\$1,207,100 -	\$1,407,153 -
	\$5,129,021	\$5,243,338	\$1,207,100	\$1,407,153

The Corporation has investments with the University of Hawaii Foundation (Foundation) and the Hawaii Strategic Development Corporation (HSDC), a state of Hawaii agency created in 1990 to promote economic development in conjunction with private enterprise.

Investments at the Foundation consist primarily of foreign and domestic equity and fixed income securities. At June 30, 2004 and 2003, the Corporation had 26,961 shares in the investment pool. The fair value of these investments are primarily based on quoted market prices reported to the Corporation by the Foundation. The investments at the Foundation amounted to \$885,683 and \$799,947 at June 30, 2004 and 2003, respectively. The increase (decrease) in fair value of investments (unrealized gains and losses) for the years ended June 30, 2004 and 2003 amounted to \$85,736 and \$(46,374), respectively.

In 2003, \$406,265 was transferred from the investment pool at the Foundation to HSDC. These funds are currently being held in an interest bearing demand deposit account for future investment in University of Hawaii developed technologies. At June 30, 2004, funds invested with HSDC amounted to \$408,594.

Investments are classified as to custodial risk by three categories as follows: Category 1 includes investments that are insured or registered or securities held by the Corporation or its agent in the Corporation's name; Category 2 includes uninsured and unregistered investments with the securities held by the counterparty's trust departments or agent in the Corporation's name; Category 3 includes uninsured and unregistered investments, with the securities held by the counterparty, or by its trust departments or agent but not in the Corporation's name. The investments held by the Foundation and HSDC are classified as Category 3, while the certificates of deposit are classified as a Category 1.

NOTE D - RECEIVABLES AND ADVANCES FROM OTHER SPONSORING AGENCIES

The Corporation's projects are divided into two groups: those administered under an agreement with the University, and those administered under direct agreements with other sponsors. Projects are either funded on a cost reimbursable basis or through advance fundings. Under cost reimbursable projects, expenditures are initially paid for by the Corporation and are later reimbursed by the sponsors. Under advance funded projects, the Corporation receives cash in advance of expenditures. Advances under direct agreements in excess of project expenditures totaled \$3,521,736 and \$2,670,297 at June 30, 2004 and 2003, respectively. Cash relating to a portion of the advances, amounting to \$2,430,582 and \$1,958,502 at June 30, 2004 and 2003, respectively, is restricted by the sponsors. Direct agreements allow for indirect cost recoveries based on a predetermined indirect cost rate. All claims are subject to audit and adjustments by the sponsoring agencies. Project expenditures less advances, and reimbursements from sponsors are accounted for within project accounts which are reflected on the Corporation's balance sheets. Except for direct federal awards, these transactions are not reflected on the Corporation's statements of revenues and expenses.

NOTES TO FINANCIAL STATEMENTS June 30, 2004 and 2003

NOTE E - RECEIVABLES UNDER LEASE AGREEMENTS

The Corporation borrowed funds and purchased certain equipment. It simultaneously entered into agreements to lease the equipment to the University for the amount of the debt repayment installments with an option to purchase the equipment for \$1 at the end of the lease term. There were no outstanding lease agreements or receivables under lease agreements at June 30, 2004.

NOTE F - CAPITAL ASSETS

Capital assets activity for the year ended June 30, 2004 is as follows:

	Beginning balance	Acquisitions	Dispositions	Ending Balance
Office equipment	\$ 518,623	\$ 15,029	\$(18,608)	\$ 515,044
Computer software	1,845,467	356,696		2,202,163
	2,364,090	371,725	(18,608)	2,717,207
Less accumulated depreciation				
Office equipment	204,738	13,297	(18,608)	199,427
Computer software	1,328,559	249,110		1,577,669
	1,533,297	262,407	(18,608)	1,777,096
	\$ 830,793	\$ 109,318	\$ -	\$ 940,111
Capital assets activity for the year ended June 30, 200	3 is as follows:			
	Beginning			Ending
	balance	Acquisitions	Dispositions	balance
Office equipment	\$ 532,365	\$ 5,916	\$(19,658)	\$ 518,623
Computer software	1,779,290	66,177	_	1,845,467
·	2,311,655	72,093	(19,658)	2,364,090
Less accumulated depreciation	, ,	•	(, ,	
Office equipment	205,189	19,207	(19,658)	204,738
Computer software	1,076,908	251,651		1,328,559
·	1,282,097	270,858	(19,658)	1,533,297
	\$1,029,558	\$(198,765)	<u> \$ </u>	\$ 830,793

Depreciation expense for the years ended June 30, 2004 and 2003 amounted to \$262,407 and \$270,858, respectively.

NOTE G - LINE OF CREDIT

The Corporation has a revolving line of credit with First Hawaiian Bank in the amount of \$2,000,000 for short-term working capital, expiring on December 1, 2004. The terms of the revolving line of credit require repayment as specified in the credit agreement. All borrowings are collateralized by a security agreement over accounts receivable. The rate of interest on borrowings outstanding is 75% of the bank's reference rate (4.25% at June 30, 2004). At June 30, 2004, there were no borrowings outstanding under this line.

NOTES TO FINANCIAL STATEMENTS June 30, 2004 and 2003

NOTE H - LONG-TERM DEBT

A summary of long-term debt at June 30, 2004 and 2003 is as follows:	2004	2003
6.57% note payable to Bank of Hawaii, secured by vehicles, monthly payments of \$980 including interest, due November 2003, by the Institute for Astronomy	\$ -	\$4,783
Less current installments of long-term debt		4,783
	\$ -	\$ -
The following is a summary of changes in long-term debt for the two years ended June 30, 2004:		
Balance as of July 1, 2002	\$1,479,563	
Additions	_	
Deductions	1,474,780	
Balance as of June 30, 2003	4,783	
Additions	_	
Deductions	4,783	
Balance as of June 30 2004	\$ -	

NOTE I - NET ASSETS

1. Working Capital

Many of the projects administered by the Corporation are cost reimbursable. The time lag in receiving reimbursements makes the creation of a reserve for working capital necessary. The Board of Directors authorized the establishment of designated net assets for this purpose. The Corporation transferred \$1,668,000 and \$606,735 from undesignated net assets to the designated net assets for working capital in 2004 and 2003, respectively.

In 2003, an additional \$406,265 was transferred from the quasi-endowment designated net assets to the designated net assets for working capital. The transfer was made to reflect the liquidation of investments in the quasi-endowment fund administered by the University of Hawaii Foundation and the re-investment of those funds in the Hawaii Strategic Development Corporation.

2. Quasi-Endowment

The quasi-endowment designated net assets was established by the Board of Directors to assist the Corporation in carrying out its legislative purpose to assist in establishing and maintaining scholarships, fellowships and professorships and other staff positions for the purpose of aiding in the acquisition and dissemination of knowledge.

For the years ended June 30, 2004 and 2003, investment income of \$32,084 and \$28,164, respectively, was earned from investments administered by the Foundation. Research assistantship expenditures deducted from the quasi-endowment reserve during 2004 and 2003 amounted to \$32,084 and \$22,108, respectively.

NOTES TO FINANCIAL STATEMENTS June 30, 2004 and 2003

NOTE I - NET ASSETS (continued)

2. Quasi-Endowment (continued)

In 2003, the quasi-endowment designated net assets were reduced by \$406,265 to reflect the liquidation of investments in the quasi-endowment fund administered by the University of Hawaii Foundation.

3. Supplemental Retirement Benefits

As described in note K, the Corporation offers supplemental retirement benefits. The liability as of June 30, 2004 and 2003 associated with the supplemental retirement benefits are accrued in the accompanying balance sheets. The supplemental retirement benefits designated net assets balance represents supplemental retirement benefits surcharge collected in excess of supplemental retirement benefits paid or accrued in the balance sheets as of June 30, 2004 and 2003.

4. Project Contingent Liabilities

The Corporation and the University enter into contracts and agreements with a multitude of organizations, both public and private, locally, nationally and internationally. These organizations often require terms and conditions in the contract or agreement, which if breached, may require reimbursement of expenses or payment of expenses. On March 13, 1998, the Board of Directors designated net assets to cover such reimbursements or expenses, which may include, but are not limited to project overruns and disallowances, litigation expenses, professional services and other project-related expenses. In 2004 and 2003, the amount of the designation was increased by \$8,015 and \$17,170, respectively. A separate interest-bearing account is maintained for this reserve.

Net assets at June 30, 2004 and 2003 are summarized as follows:

	2004	2003
Designated		
Working capital	\$6,479,000	\$4,811,000
Quasi-endowment	885,682	799,946
Supplemental retirement benefits	143,483	158,233
Project contingent liabilities	841,353	833,338
Undesignated	607	524
	\$8,350,125	\$6,603,041

NOTE J - OPERATING REVENUES - UNIVERSITY OF HAWAII

Operating revenues received from the University of Hawaii for the years ending June 30, 2004 and 2003 amounted to \$3,291,198 and \$2,932,769, respectively, for extramurally sponsored projects and \$137,443 and \$140,606, respectively, for internally funded projects.

NOTE K - PENSION INFORMATION

The Corporation participates with other institutions in the Teachers Insurance and Annuity Association and College Retirement Equities Fund, a noncontributory defined contribution retirement plan which covers substantially all qualified employees. Employees are eligible to participate in this plan upon completion of one year of service. Required contributions by the Corporation to the retirement plan are based on 10% of the gross salary of each employee. All contributions are fully vested and nonforefeitable when made. While it is expected that this retirement plan will continue indefinitely, the Board of Directors of the Corporation reserves the right to modify or discontinue the plan at any time. Total contributions to the retirement plan for the years ended June 30, 2004 and 2003 were \$138,379 and \$152,618, respectively.

The Corporation offers supplemental retirement benefits in addition to benefits available under the previously mentioned pension plan. To be eligible, a terminating employee must be at least age 45 years 4 months, have service of 10 years or more and have accumulated unused sick leave of 60 days or more. The supplemental retirement benefits amount to 10% of the value of the unused

NOTES TO FINANCIAL STATEMENTS June 30, 2004 and 2003

NOTE K - PENSION INFORMATION (continued)

sick leave reduced by 1/2% for each month below the age of 62. The terminating employee may elect to purchase an annuity or receive the benefit in cash. At June 30, 2004 and 2003, the Corporation accrued supplemental retirement benefits amounting to \$747,964 and \$621,531, respectively, in the accompanying balance sheets. The accrual represents the Corporation's best estimate of future supplemental retirement benefits based on available information. Supplemental retirement benefits paid during the years ended June 30, 2004 and 2003 were \$14,750 and \$13,895, respectively.

The following is a summary of changes in accrued supplemental retirement benefits for the years ended June 30, 2004 and 2003:

	2004	2003
Beginning balance	\$621,531	\$503,697
Additions Deductions	141,183 (14,750)	131,729 (13,895)
Ending balance	747,964	621,531
Less current portion of accrued supplemental retirement benefits	23,000	20,000
	\$724,964	\$601,531

NOTE L - POSTRETIREMENT HEALTH CARE AND LIFE INSURANCE BENEFITS

In addition to providing pension benefits, the Corporation also provides certain health care and life insurance benefits to all employees who retire in good standing with 10 years or more of continuous service, 10 years of participation in the Corporation's retirement and life insurance program and attain age 55. Contributions for health benefits are fixed at \$50 per month. The costs of retiree insurance benefits are recognized when the premiums are paid. The amounts paid for health care and life insurance for the years ended June 30, 2004 and 2003 aggregated to \$16,517 and \$12,958, respectively.

NOTE M - PROJECT EXPENDITURES AND COMMITMENTS

Project expenditures that are not reflected on the accompanying statements of revenues and expenses are as follows:

	University projects	Direct projects	Other projects	Total
2004: Salaries and wages Equipment Other	\$ 50,175,339 19,886,812 144,882,613	\$11,553,378 1,330,818 7,893,469	\$ 9,507,105 117,300 15,060,231	\$ 71,235,822 21,334,930 167,836,313
	\$214.944.764	\$20.777.665	\$24.684.636	\$260.407.065
2003: Salaries and wages Equipment Other	\$ 45,849,725 38,101,387 92.426.515	\$ 9,031,725 607,111 5,501,731	\$ 8,753,280 205,493 12.165.700	\$ 63,634,730 38,913,991 110.093.946
	\$176,377,627	\$15,140,567	\$21,124,473	\$212,642,667

NOTES TO FINANCIAL STATEMENTS June 30, 2004 and 2003

NOTE M - PROJECTEXPENDITURES AND COMMITMENTS (continued)

Other projects consist of the University's revolving funds and specialized service facilities.

Commitments in the form of outstanding project purchase orders that are not reflected on the accompanying balance sheets amounted to approximately \$133,818,000 and \$50,169,000 at June 30, 2004 and 2003, respectively.

NOTE N - OPERATING LEASE

The Corporation occupies office space under month-to-month operating leases. The leases contain escalation and renewal clauses and provide that the Corporation pay taxes, maintenance and certain other operating expenses applicable to the leased premise. Total office and equipment rental expense for the years ended June 30, 2004 and 2003 was \$84,923 and \$88,238,respectively, which includes \$64,655 and \$65,776, respectively, of office rental expense under the operating leases for the years ended June 30, 2004 and 2003.

NOTE O - RISK MANAGEMENT

1. Torts

The Corporation is involved in various actions, the outcome of which, in the opinion of management, will not have a material adverse effect on the Corporation's financial position.

2. Property and General Liability Insurance

The Corporation is covered under the statewide insurance program of the State of Hawaii. Under this program, the Corporation has property damage insurance of \$100 million per occurrence for losses that may occur from hurricane, and \$25 million for losses from earthquake, flood, fire, and windstorm and other occurrences of \$25 million per occurrence. Deductibles for windstorm losses are 3% of values at each location, subject to a minimum of \$250,000. Deductible for losses caused by earthquake, flood, tsunami and volcanic action is 3%, subject to a \$250,000 minimum. For other lines of coverage the deductible is \$250,000.

The Corporation has general liability insurance under the State with loss coverage of \$10 million for each occurrence. Exclusions include pollution, asbestos, airport and medical-professional losses. The deductible is \$4 million per occurrence. The State program includes crime insurance with loss coverage of \$10 million for criminal losses. Faithful performance of duties coverage is \$1 million. The deductible is \$250,000 per occurrence.

The Corporation has an additional general liability policy with loss coverage of \$1 million for each occurrence and \$4 million in the annual aggregate; coverage is \$100,000 for fire legal liability. Exclusions include professional liability, pollution, employment related practices, sexual abuse, fiduciary liability, securities and financial interest, and product completed operations. The deductible is \$25,000 per claim. In addition, the Corporation has a \$10 million umbrella liability policy in excess of the \$1 million coverage for general liability. The Corporation has a \$5 million insurance policy for directors' and officers' liability losses, with a deductible of \$15,000.

3. Workers' Compensation Policy

The Corporation is self-insured for workers' compensation losses incurred prior to July 1, 1997 and unpaid as of June 30, 1997, and is liable for all workers' compensation claims filed by its employees for that period. Liabilities for workers' compensation claims are established if information indicates that it is probable that liabilities have been incurred and the amount of those claims can be reasonably estimated. These liabilities include amounts for claims that have been incurred but not reported. At June 30, 2004 and 2003, the workers' compensation reserve amounted to \$646,537 and \$756,902, respectively, and is reported as a current liability in the accompanying balance sheets. The change in workers' compensation reserve resulted from the payments for workers' compensation claims of \$116,824 and \$66,046 during the year ended June 30, 2004 and 2003, respectively. This reserve represents the Corporation's best estimate of workers' compensation liabilities based on available information.

For workers' compensation losses incurred after June 30, 1997, including employer's liability losses, the Corporation has a retrospective rated insurance plan with coverage of \$1 million per injury and \$1 million per injury per employee. The insurance

NOTES TO FINANCIAL STATEMENTS June 30, 2004 and 2003

NOTE O - RISK MANAGEMENT (continued)

3. Workers' Compensation Policy (continued)

excludes bodily injury occurring outside of the United States or Canada unless during temporary travel, vessel operations, and damages from harassment, discrimination, termination and other matters as defined.

4. Unemployment Claims Reserve

The Corporation is self-insured for unemployment claims. Liabilities for unemployment claims are established if information indicates that it is probable that liabilities have been incurred and the amount for those claims can be reasonably estimated. At June 30, 2004 and 2003, the unemployment reserve amounted to \$772,963 and \$610,997, respectively, and is reported as a current liability in the accompanying balance sheets.

NOTE P - COMMITMENT

At June 30, 2004, the Corporation had an outstanding stand-by letter of credit commitment in the amount of \$287,500. The commitment is collateral for the deductible portion of a workers' compensation insurance policy obtained by the Corporation in relation to the administration of a University of Hawaii project to construct a new medical center. The commitment increases to \$575,000 in October 2004.

At June 30, 2004, the Corporation had an outstanding contract commitment through May 31, 2006 related to computer software and hardware maintenance of approximately \$129,000 and \$118,000 for fiscal years 2005 and 2006, respectively.

SUPPLEMENTARY INFORMATION

Report of Independent Certified Public Accountants on Supplementary information

The Board of Directors
The Research Corporation of the University of Hawaii

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole of The Research Corporation of the University of Hawaii, State of Hawaii, a component unit of the University of Hawaii, as of and for the years ended June 30, 2004 and 2003, which are presented in the preceding section of this report. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

Is Grant Thornton LLP

Honolulu, Hawaii August 6, 2004

The Research Corporation of the University of Hawaii State of Hawaii SCHEDULE OF EXPENDITURES AND FEDERAL AWARDS Year ended June 30, 2004

Federal Grantor/Pass-Through Grantor/Program Title	CFDA Number	Grant Number	Federal Program Award Amount	Federal Expenditure s
DEPARTMENT OF COMMERCE Economic Development Administration Stimulation, Telemedicine, Applied Technology and Incubator Center	11.300	07-01-05270	3,000,000	7,013
U.S. DEPARTMENT OF DEFENSE Office of Naval Research Maritime Fire Training at Barber's Point Seafarers Training Center Next Generation Optimized Radar Alternate Transmitter for Advanced Hawkeye (HEATX) Passed through DCS Corporation: Sensors C41 and Networking Technology Support	12.300 12.300 12.000 12.000	N00014-02-1-0999 N00014-03-1-0957 N00421-03-C-0013 N00421-03-C-0118 N00173-01-C-2016	1,931,000 2,363,850 1,163,028 7,462,180 616,181	1,134,670 345,521 449,727 2,033,097 79,294
U.S. DEPARTMENT OF INTERIOR Office of Insular Affairs U.S. Pacific Region Public Health Assistance Pacific Islands Health Officers Association	15.875 15.875	GEN-162 GEN-173	103,561 7,980	4,527 480
U.S. Geological Survey Hawaii GAP Analysis Project	15.808	01HQAG0195	779,551	187,771
Fish & Wildlife Service Malama Hawaii	15.000	122000G026	45,500	28,982
U.S. DEPARTMENT OF HEALTH & HUMAN SERVICES Maternal and Child Health Bureau Pacific Island Health Officers Association (PIHOA) Pacific Island Health Officers Association (PIHOA)	93.110 93.110	6 U93 MC00185-02 6 U93 MC00185-03	161,059 175,000	44,502 153,267
NATIONAL AERONAUTICS AND SPACE ADMINISTRATION Pass through Space Telescope Science Institute NICMOS Imaging Polarimetry of Compact Proto	43.00	HST-GO-09377.04A	6,365	<u>1,729</u> \$ 4,470,580

NOTE TO THE SCHEDULE OF EXPENDITURES AND FEDERAL AWARD Year ended June 30, 2004

NOTE 1 - BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards (schedule) includes the federal grant activity of the Corporation and is presented on the accrual basis of accounting, which is described in note A to the Corporation's financial statements. The information in this schedule is presented in accordance with the requirements of U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

SECTION II – INTERNAL CONTROL OVER FINANCIAL REPORTING AND COMPLIANCE

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

The Board of Directors
The Research Corporation of the University of Hawaii

We have audited the financial statements of The Research Corporation of the University of Hawaii, State of Hawaii (Corporation), as of and for the years ended June 30, 2004 and 2003, and have issued our report thereon dated August 6, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal control over financial reporting

In planning and performing our audit, we considered the Corporation's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in internal control that might be material weaknesses. A material weakness is a reportable 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 caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving 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 the Corporation's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Directors, management and federal awarding agencies and pass-through entities of the Corporation and is not intended to be and should not be used by anyone other than these specified parties.

Is Grant Thornton LLP

Honolulu, Hawaii August 6, 2004 SECTION III – COMPLIANCE AND INTERNAL CONTROL OVER FEDERAL AWARDS

Report on Compliance with Requirements Applicable to Each Major Program And on Internal Control Over Compliance in Accordance with OMB Circular A-133

To the Board of Directors
The Research Corporation of the University of Hawaii

Compliance

We have audited the compliance of The Research Corporation of the University of Hawaii, State of Hawaii (Corporation), with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2004. The Corporation's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Corporation's management. Our responsibility is to express an opinion on the Corporation's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Corporation's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Corporation's compliance with those requirements.

In our opinion, the Corporation complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2004.

Internal control over compliance

The management of the Corporation is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Corporation's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable 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 noncompliance with the applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program 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 compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Board of Directors, management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Is Grant Thornton LLP

Honolulu, Hawaii August 6, 2004

SCHEDULE OF FINDINGS AND QUESTIONED COSTS Year ended June 30, 2004

Section I - Summary of Auditor's Results Financial Statements Type of auditors' report issued: Unqualified opinion. Internal control over financial reporting: _√ no Material weakness(es) identified? yes • Reportable condition(s) identified that are not considered to be material weaknesses? √ none reported yes √_ no • Noncompliance material to financial statements noted? yes Federal Awards Internal control over major programs: √ no Material weakness(es) identified? yes Reportable condition(s) identified that are not considered to be material weakness(es)? √ none reported yes Type of auditor's report issued on compliance for major programs: Unqualified opinion. Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133? √ no yes Identification of major programs: CFDA Name of Federal Program Number(s) U.S. Department of Defense - Office of Naval Research Maritime Fire Training at Barbers Point 2.300 12.300 Seafarer's Training Center 12.000 Alternate Transmitter for Advanced Hawkeye (HEATX) Dollar threshold used to distinguish between type A and type B programs: \$300,000 √ yes Auditee qualified as a low-risk auditee under Section .530 of OMB Circular A-133? __ no Section II - Financial Statement Findings None noted. Section III - Federal Award Findings and Questioned Costs

None noted.