

A Review of the Definitions of Special, Revolving, and Trust Funds in Hawaii

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FOREWORD

This study was prepared in response to section 65 of Act 289, Session Laws of Hawaii 1993. That section directed the Legislative Reference Bureau to review and recommend definitions for the terms "special fund," "revolving fund," and "trust fund"; discuss the implications of the use of a trust as it applies to a trust fund; and define, evaluate, and recommend, if applicable, other types of funds that may be suitable for consideration by the State.

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Chapter 1

INTRODUCTION

Nature and Scope of the Study

The Seventeenth Legislature of the State of Hawaii, Regular Session of 1993, enacted House Bill No. 1152, the General Appropriations Act of 1993, which was signed into law as Act 289, Session Laws of Hawaii 1993. In section 65 of that Act (see Appendix A), the Legislature required the Auditor to perform a financial and management audit of the Department of Hawaiian Home Lands, and the Legislative Reference Bureau to review, on a statewide basis, the use of the terms "special fund", "revolving fund", and "trust fund".

Objective of the Study

Act 289 directed the Bureau to complete a study to:

- (1) Review and recommend more meaningful definitions of the terms special, revolving, and trust funds;
- (2) Include a discussion of the use of a trust as it applies to trust funds; and
- (3) Define, evaluate, and recommend, if applicable, other types of funds that might be suitable for consideration by the State.

While the Auditor's directive in section 65 applied only to the Department of Hawaiian Home Lands, the Bureau's study was specifically directed to be of general applicability to the State.

This study is organized into eight chapters. Chapter 1 discusses the nature and scope of the study. Chapter 2 discusses why the issue of properly defining funds is important and notes Hawaii's extensive use of these funds. Chapter 3 evaluates each current definition and discusses the effectiveness of each definition. Chapter 4 reviews the history of the Hawaiian Home Commission Act funds as a microcosm of the history of state funds in general. Chapter 5 reviews the definitions of these types of funds in other states. Chapter 6 looks at standard government accounting texts to ascertain how those texts define the funds that they use. Chapter 7 analyzes the information in the previous chapters and makes a variety of suggestions for improving Hawaii's definitions. Chapter 8 contains the findings and recommendations.

Chapter 2

THE ROLE OF FUNDS

Why is this study necessary? Why should it matter whether state funds have more meaningful definitions? Why should other types of funds be considered? The issues involved in this study are important because funds have a serious impact on the state budget.

If a state budget can be likened to the arteries of the body politic, pumping revenue to the state functions, funds are like units of blood syphoned off and available only for specified programs. The loss of this "blood" through the establishment of a few funds outside the normal flow of revenue is not generally harmful. When the number of funds rise, however, and more and more revenues are removed from the general flow and directed to the use of special programs, there is less available for the great number of projects that need to be funded through the general fund. A special or revolving fund may be running a surplus while other programs funded through the general fund wilt for lack of immediately available funds.

Hawaii has been noted for its extremely high use of funds. One 1958 report observed that in the 1957-59 operating budget, forty percent of the budget consisted of expenditures through special funds.¹ The report recommended that the fund structure be changed through abolition of most of the then-existing operating funds.² In 1959, the Territorial Legislature did abolish a number of its special funds.³ However, this did not fully address the multitude of special and revolving funds. A 1980 national study reviewed each state for its number of funds.⁴ The number of funds ranged between two and 4000. Hawaii was the state which had 4000.⁵ The next highest state had only 1209. The majority of the states, thirty-one, had less than one hundred.⁶

Why did Hawaii have so many funds? It appears that part of the reason was the multitude of special funds created at the school level.⁷ As Hawaii is the only state where education is run wholly at the state level, the other states do not have to consider their school funds when reporting on their total number of funds. But even subtracting approximately 3500 school funds, Hawaii in 1980 would have had about 500 funds, placing it in a tie for sixth highest number of funds.

Commentators on the general issue of state funds recommend a very limited number of funds:

[T]he practice [of using funds] can be carried to extremes. In the opinion of many, accounting and reporting are facilitated through the use of the minimum number of funds consistent with legal and operating requirements.⁸ (fn. omitted)

Too many funds, and particularly Special Revenue Funds, make for inflexibility and undue complexity in budgeting, accounting, and other phases of financial management and are best avoided in the interests of efficient and economical management.⁹

Recently Hawaii has again attempted to limit its surplusage of funds. In 1990, the Legislature directed the Auditor's office to subject special and revolving funds to an evaluation to determine whether their continued existence was justified.¹⁰ In the purpose section of that law, the Legislature found that:

[T]he future fiscal condition of the State is not immune to change. As the economy fluctuates, so will general fund revenues. Special and revolving funds provide guaranteed sources of revenue to particular programs without regard to the State's overall fiscal condition.

The Legislature found it "fiscally prudent" to evaluate existing special and revolving funds, and also to establish a review process for all new and proposed special and revolving funds.

The Auditor's office completed that request through a series of six studies that were published in 1991 and 1992.¹¹ The office recommended that 70, or 42 percent, of the 166 funds they studied be repealed. This does not mean they found that the purpose of the funds were without merit, but merely that the funding mechanism of a special or revolving fund was not appropriate. This is demonstrated by the fact that some of the funds were recommended to be repealed, while others were recommended to be repealed but funded through the general fund.

During the 1993 Regular Session, the Legislature acted upon these reports and repealed thirty-one of the special and revolving funds established by statute, and mandated the repeal of four special and revolving funds set up administratively.¹² In addition, the Legislature added certain provisos to existing funds to ensure they remain as lean as possible while still meeting their purpose. For example, the state disaster revolving loan fund was continued, but unencumbered moneys deemed by the director of finance not to be necessary to carry out the purposes of the section during the next fiscal year will lapse into the general fund.¹³ Although one might question whether the director of finance is in the best position to determine what funds will be needed in the ensuing fiscal year, as the fund is under the department of business, economic development, and tourism, the idea of adjusting this revolving fund is not inappropriate given its subject matter. The need for disaster relief fluctuates from year to year; repayments for loans made in one bad year may accumulate too much to be spent in a good one.

Another interesting proviso was inserted in two sections that requires the director of commerce and consumer affairs to monitor fees collected in two funds and to reduce the fees if necessary to ensure that the fees collected do not exceed the annual operating costs of the programs the fees are designed to fund.¹⁴ Creative mechanisms such as these should be welcomed as a way to make some revolving funds balance as near as possible between the extremes of overfunding a particular program and a lack of sufficient support.

Less concern has been expressed about the number of trust funds in Hawaii. This may be because there are fewer of them by far. A recent review of the *Hawaii Revised Statutes* revealed a little over one dozen trust funds established by statute.¹⁵ The original charge given the Auditor's office in 1990 was to monitor new special and revolving funds only.¹⁶ It has been mentioned that there appeared to be a tendency in ensuing years to try to create more trust funds, which would not fall under the Auditor's scrutiny. If there had been any truth to that in the past, it will be true no longer, for in 1993, Act 280 directed the Auditor's office to review the trust funds as well.

Summary

Funds are an important component of the state budget. Too many funds, however, decrease the ability of the State to budget wisely. As one authoritative commentator states:

Only the minimum number of funds consistent with legal and operating requirements should be established ... because unnecessary funds result in inflexibility, undue complexity, and inefficient financial administration.¹⁷

In the past, Hawaii has been ranked first in the nation in terms of having the largest number of funds. The Legislature has recognized the peril of too many funds in 1990 by directing the Auditor to review all of the State's special and revolving funds. The Auditor's office reviewed 166 funds and recommended repealing 70. The Legislature repealed 31 of the funds in 1993 and placed restrictions on others to try to ensure that the existing funds stay as lean as possible while still fulfilling their purposes.

The different types of state funds should be defined as accurately as possible, so that when a new fund is created it can be evaluated against this specific definition to ascertain the propriety of establishing a new fund, as opposed to finding other types of financing. It has been alleged that Hawaii has too many funds; this may be because the state's current definitions of special, revolving, and trust funds are overly broad and mislead legislators into creating funds where funds are not truly appropriate.

Endnotes

1. Public Administration Service, Special Funds and Budget Administration in the Territory of Hawaii (1958) at 7.
2. Id. at 31.
3. See Act 265, Session Laws of Hawaii 1959 (Regular Session of 1959).
4. Belmond Van Daniker, Inventory of Current State Government Accounting and Reporting Practices (Lexington, KY: The Council of State Governments, 1980).
5. Id. at 4.
6. Id.
7. Charles James, Special Funds in the State Government: Review of Selected Problems (Legislative Reference Bureau: 1960) at 12-13. The study estimates that there were approximately 1500 special funds to account for school fees and 2000 special funds to account for school funds.
8. Leon E. Hay and R.M. Mikesell, Governmental Accounting, 5th ed., (Homewood, Ill.: Richard D. Irwin, Inc., 1974) at 10.
9. National Committee on Governmental Accounting, Governmental Accounting, Auditing, and Financial Reporting (Chicago, Ill.: 1968) at 8.
10. Act 240, Session Laws of Hawaii 1990.
11. See, e.g., Auditor, Review of Special and Revolving Funds of the University of Hawaii, Report No. 92-9 (April 1992).
12. Act 280, Session Laws of Hawaii 1993.
13. See Section 22 pertaining to section 209-34, Hawaii Revised Statutes, of Act 280, Session Laws of Hawaii 1993.
14. See section 23 relating to sections 440G-15 and 26-9(o) Hawaii Revised Statutes, of Act 280, Session Laws of Hawaii 1993.
15. This number is approximate because two of the funds are labeled "special trust" funds, a term which is not defined in the statutes and which the researcher is assuming are intended to be trust funds rather than special funds.
16. See Hawaii Rev. Stat., sec. 23-11.
17. Government Finance Officers Association, Governmental Accounting, Auditing and Financial Reporting (Chicago, Ill.: 1988) at 11.

Chapter 3

CURRENT DEFINITIONS AND USES OF FUNDS IN THE STATE OF HAWAII

The law requiring this study directs the Bureau to review and recommend definitions of special, trust, and revolving funds. In the abstract, a good definition must describe the term defined so that it can be distinguished from other terms. In doing so, it must be both accurate and comprehensible. In a practical sense, a definition should also contribute to the statutory schema; it should be neither overly broad nor irrelevant. This study will review the three types of funds to determine whether their definitions fit these criteria.

Special Funds

The current definition of "special fund" is a fund that is "dedicated or set aside by law for a specified object or purpose, but excluding revolving funds and trust funds".¹ The scenario suggested by this definition is that the State has three types of funds other than special funds: revolving funds, trust funds, and, impliedly, a general fund, which is the only fund not set aside for a specified purpose. It is unclear whether the term "special funds" is meant to refer to a specific type of fund, like a trust fund, or is to be used as a catchall term that would embrace any other type of fund in the State, for virtually any other fund would meet the minimal requirements of being "set aside for a specified purpose".²

While this definition is readily comprehensible, and to a certain extent accurate, it begs the question as to what is the nature of a special fund. The definition reveals what it is not: it is not a revolving fund, a trust fund, or a general fund. But what are its specific, positive characteristics? The definition is silent. Merely stating that a special fund is for a specified purpose adds nothing besides distinguishing it from the general fund, for all other funds are established with a specified purpose in mind. That is the reason that revolving and trust funds have to be specifically excluded from the definition.

Abundant evidence exists that this term is viewed as vague and overly broad by legislators and others. One example of this vagueness are the references in the *Hawaii Revised Statutes* to "special trust funds"³ and "special revolving funds".⁴ These terms make no sense under the current definitions as a special fund means any fund **except** a revolving or trust fund. Adding the term "special" to them adds nothing. It appears that the term "special" is being used in the dictionary sense of "particularly valued", for there could be no reason in the statutes to create such a hybrid term.

An additional problem with the widespread use of special funds is that they do not come within the general fund ceiling. Their use is thus an easy way to subvert the constitutional limitations on state spending.

It is also interesting to note that the Department of Accounting and General Services (DAGS), in its comprehensive annual financial report,⁵ lists six fund types: general, special revenue, debt service, capital projects, enterprise, and trust and agency.⁶ Note that under the current definition, debt service, capital projects, and enterprise funds should be classified as special funds. This is another example of the overbroadness of the definition. DAGS places almost all⁷ of the special and revolving funds into the "special revenue fund" category as that is the least inappropriate classification. This does not mean that the category is an appropriate one, however, since neither of these two types of funds is required to meet the definitions of a special revenue fund, as will be discussed in detail in chapter 6. Perhaps the DAGS classification should be substituted for the current definition, as DAGS' definition is a standard governmental accounting classification.

Revolving Funds

Hawaii's current definition of "revolving fund" is a fund "from which is paid the cost of goods and services rendered or furnished to or by a state agency and which is replenished through charges made for goods or services or through transfers from other accounts or funds".⁸ There are two facets to this definition. One is the concept of the revolving fund as one in which money rotates in and out, expended for goods or services, which are paid for by the users, with those receipts going back to replenish the fund. Under this definition, once the fund is started up, it would be a closed-cycle, self-sustaining, zero-sum type of fund. This is the "revolving" part of the term.

However, the other facet of the definition permits the revolving fund to be replenished "through transfers from other accounts or funds". To the extent that some revolving funds are "fed" from other funds (which would include appropriations from the general fund) or accounts, there is little to distinguish them from special funds, which can also be replenished through appropriations.

At present, many revolving funds do fit the profile of funds that are replenished by user fees. Some, however, do not. Based on statutory language, ones that do not include:

- The surplus federal property revolving fund,⁹ which was created with a state appropriation and used to defray the cost of procuring and disposing of surplus property donated to the State by the federal government and which apparently is intended to be replenished with further state appropriations;¹⁰

- The rental assistance revolving fund,¹¹ which is funded by government programs or grants, private grant or contributions, bond proceeds, or legislative appropriations, and is to be invested and used to make payments under rental assistance contracts or to subsidize tenants' rents, as well as to provide interim construction financing for specified sponsors;
- The Hawaii community-based development revolving fund,¹² which is used for loans or grants, and fed by legislative appropriations and repayment of principal and interest;
- The highway beautification and disposal of abandoned vehicles fund,¹³ which is funded by a surcharge on each certificate of motor vehicle registration, and used by the counties to beautify their highways and defray the cost of disposing of abandoned vehicles; and
- The University of Hawaii housing assistance revolving fund,¹⁴ which is funded in an amount equal to 12 percent of the total indirect overhead funds generated by the university for research and training purposes in the prior fiscal year and used for implementing the University of Hawaii's housing assistance master plan and to account for all transactions of the university housing assistance program.

These funds do not truly provide services that are paid for by user fees.

Then there are other revolving funds that are not closely tied to one activity but are used to run an entire agency. It is difficult to tell from the statutory structure whether this is a zero-sum fund, with moneys coming in balancing moneys going out, or whether there will be disparate amounts either way. These funds include:

- The convention center development revolving fund,¹⁵ which is funded by "all receipts and revenues of the authority and all legislative appropriations", and which is to be used for "the purposes of this chapter"; and
- The Hawaii community development revolving fund, funded by "all receipts and revenues of the authority" and used "for the purposes of this chapter".¹⁶

This type of use of revolving funds is problematic for two reasons. First, when a whole agency's operations are funded by all of an agency's receipts, as opposed to having one program run off its individual revenues, chances are greater that either the revenue will exceed expenses or expenses exceed revenue, violating the traditional concept of the revolving fund. Second, this type of use of revolving funds is a problem in that it can virtually

remove an entire agency from legislative oversight, since the agencies have their own independent fiscal support.

The problems described above probably arose because the definition has the second facet discussed above -- the loophole permitting revolving funds to be funded with moneys from other funds or accounts. This broad language negates the implication of self-funding implied by the label "revolving". Allowing other sources to fuel the fund also makes these broader funds very close to the catchall special fund designation. In fact, this similarity may be the reason that, as discussed above, some funds are labeled "special revolving funds", since no notable features distinguish the two. This may also be the reason that the Legislature authorized the director of finance to establish a "special or revolving fund ... to be known as the university revenue-undertakings fund",¹⁷ rather than specifying one or the other. If the two funds were truly different, the choice of which one to create would be readily ascertainable from the function and description of the fund.

Trust Funds

The current definition of a trust fund is a fund "in which designated persons or classes of persons have a vested beneficial interest or equitable ownership, or which was created or established by a gift, grant, contribution, devise or bequest that limits the use of the fund to designated objects or purposes".¹⁸ In terms of distinguishing trust funds from other fund types, this two-fold definition meets the criteria of accuracy, clarity, and relevance to the statutory scheme. It is accurate in that it describes the legal relationship necessary to establish a trust, i.e., a class of beneficiaries or a transfer of funds with a specified limited purpose. It is neither too broad, too narrow, or too vague. It is clear in its language and in its distinction between trusts and any other types of funds. It is also relevant to the statutory scheme as trust funds are in fact a different type of fund that requires a separate label to adequately describe their function.

However, definition is only part of the process to ensure that a statutory scheme is effective. The trust fund definition has been criticized for its lack of administrative criteria and explicitly imposed trust responsibilities. While this lack is not a flaw in the definition per se, its absence can affect how trust funds are utilized. It would be appropriate to include a description of the State's trust duties to ensure the proper use of these funds, once established.

Act 289 requires the Bureau to discuss the implications of the use of a trust as it applies to trust funds. The general elements of a trust are an agreement by the owner of the property (the settlor or trustor) to give the property to another (the trustee) for the benefit of a third party (the beneficiary). The trustee's power and discretion must be limited.¹⁹ The trustee's duties, which may be explicitly described, as in an express trust, or implied, include

the duties of good faith, honesty, and undivided loyalty to the beneficiary,²⁰ and due care, diligence, and skill.²¹ A statutorily-created trust fund should explicitly impose these duties on the State as trustee.

Provision should also be made for an annual report on the trust, including a financial accounting and detailed description of expenditures and income. In addition, it would help in delimiting the scope of the trust if the State imposed a requirement similar to Florida's, in which each statute establishing a trust fund is required to list specifics about its functions. Florida's statute is discussed further in chapter 5.

At present, Hawaii has approximately a dozen statutorily-created funds described or labeled as trust funds. These trust funds are of two types, according to its definition. One type is a trust fund because it involves a class of people with a vested interest or equitable ownership in the fund. That type of trust fund includes:

- The Hawaii public employees health fund,²² which is composed of employee contributions, giving the employees equitable ownership of the moneys.

The second type is a trust fund because it is created or established by contributions that limit the use of the fund. Some examples of the other trust funds are:

- The public-private partners for literacy trust fund,²³ which was established by an instrument of gift and which may be increased by private contributions and income and capital gains; and
- The police officers, firefighters, and bandsmen pension system trust fund,²⁴ which consists of donations, contributions, gifts, or bequests.

While trust funds are the best defined of the three terms, some of the actual trust funds do not meet the qualifications. One of those is the rental housing trust fund.²⁵ The purpose of the fund is to provide loans or grants for the development, pre-development, construction, acquisition, preservation, and substantial rehabilitation of rental housing units.²⁶ It was started by a \$15,000,000 transfer from the rental assistance revolving fund,²⁷ and it may continue to be funded by appropriations, private contributions, repayments of loans, interest, other returns, and other sources of money. It was not established by gift, bequest or devise, and no class of persons have an equitable interest in it, or even a vested interest. The name was taken from the many rental housing trust funds that arose throughout the country since 1985.²⁸ Perhaps the definition of trust fund is different in the state in which these funds originated, and thus was appropriately named there, but not here. While one might argue that persons needing rental assistance have an interest in the fund, in reality they no more have a vested interest in that fund than any other group in the state seeking benefits

from a government fund. There is no special relationship that would bring it under the definition of trust fund in Hawaii.

Another fund whose identity is confusing is the Captain Cook memorial fund.²⁹ Its method of establishment is not mentioned in the statute, and its source of funds is merely stated as "proceeds of sales or ... gift or otherwise". As its purpose is the collection of memorabilia related to Captain Cook and the history of the Hawaiian Islands, it does not appear that its purpose is to benefit a class of beneficiaries, but as its act of creation is not named, it is difficult to classify the fund as a trust fund, except for the concluding language of the section that provides for sales proceeds to be deposited into the "trust fund".

However, these problems do not arise from the definition of trust fund, but rather from the improper use of the term.

Funds as Described by Other State Agencies

The effectiveness of the definitions can be gauged by how the terms are used, not only by the Legislature but by commentators and analysts on the budget process. As discussed above, the legislative use of these terms has not been consistent (such as the creation of hybrid terms like 'special revolving fund') and that in itself is one indicia of a definition that is not fulfilling its purpose. The next section will discuss some of these terms as used by the Auditor and the Department of Accounting and General Services.

In 1990, the Legislature directed the Auditor through Act 240 to evaluate specified special and revolving funds to determine whether their continued existence was justified.³⁰ The criteria that the Auditor's office used in analyzing the appropriateness of each fund are interesting. The three criteria are the extent to which each fund:

- (1) Continues to serve the purpose for which it was originally created;
- (2) Reflects a clear link between the benefit sought and charges made upon the users or beneficiaries of the program, as opposed to serving primarily as a means to provide the program or users with an automatic means of support which is removed from the normal budget and appropriations process; and
- (3) Demonstrates the capacity to be financially self-sustaining.³¹

The first two criteria were supplied by Act 240. The first criterion, that the fund continues to serve its purpose, is clearly a valid one for both types of funds. The second, the clear link between benefit and charges, has merit to the extent the fund is set up to establish that kind of cycle. Some funds, however, are not, such as funds fed in whole or in part by

federal grants.³² In these situations, the linkage does not exist or is weakened but that does not necessarily invalidate the worth or purpose of the fund.

The third criteria, the requirement that the fund be self-sustaining, was added by the Auditor's office. The current statutory definition of revolving fund requires this quality. That is how it earns the title "revolving" fund. But special funds are not required by the statute to have this quality. In fact, special funds are defined as all funds that are not trust or revolving funds, thus by implication establishing that they do not have that self-sustaining quality that is the only distinguishing characteristic of revolving funds. Even special revenue funds, which are required by definition to be funded from specified revenue sources, "generally require annual appropriations to ensure sound financial management".³³ It would appear that the Auditor sees no difference in the two types of funds since both special and revolving funds are judged by the same three criteria.³⁴

Another interesting view of special and revolving funds is found in the Department of Accounting and General Services' annual fiscal report. That report, inter alia, tracks all state funds, but it does not use the term "special fund" in the report. Instead, the funds are broken down by "governmental fund types" and "fiduciary fund types".³⁵ The governmental fund types are general, special revenue, debt service, and capital projects. Special revenue funds are described as funds "used to account for the proceeds of specific revenue sources other than expendable trusts or major capital projects that are legally restricted for specified purposes."³⁶ Debt services funds are described as funds used to account for the accumulation of resources for, and the payment of, long-term debt principal and interest of general obligation bonds services by the general fund and special revenue funds. Capital projects are defined as funds used to account for financial resources to be used for the acquisition or construction of major capital facilities, other than those financed by enterprise or university fund.³⁷ The only type of fiduciary fund was the expendable trust fund.³⁸ The report also lists "proprietary fund types" which are enterprise funds run by the Department of Transportations' airports and harbors divisions, the housing funds run by the Hawaii Housing Authority and the Hawaii Finance Development Corporation, and the state hospital funds,³⁹ and the university funds.⁴⁰ Enterprise funds are defined as funds used to account for operations financed and operated in a manner similar to private business enterprises, where the costs of providing goods or services to the general public on a continuing basis are financed or recovered primarily through user charges.⁴¹ While this sounds like the definition of revolving fund, as tracked by DAGS the only enterprise funds are those for the airports, the harbors, public housing, and state hospitals.

It is interesting to note that the report mentions neither special nor revolving funds (Special revenue funds have a specified accounting meaning that is not the equivalent of Hawaii's special fund definition.). It may well be that adopting the use of terms that track the DAGS usage may provide greater clarification in establishing and classifying funds.⁴²

Summary

The current definition of the term "special fund" is very broad and provides little guidance to legislators in determining the parameters of this type of fund. The Department of Accounting and General Services, which prepares the State's annual financial report, using standard governmental accounting principles, is forced to place special and revolving funds into the "special revenue fund" category, which is technically not appropriate but which is the closest approximation. It may be that substituting the more narrow and defined term "special revenue fund" would help the Legislature in setting up new funds in the future as the more detailed definitions would provide a statutory framework by which to judge whether a new fund is appropriate or not.

The current definition of the term "revolving fund" includes both funds that are basically self-sufficient -- providing users with goods or services for which the users are charged a fee, as well as funds that are replenished from sources other than user fees. This latter type of revolving fund comes very close to the catchall definition of special fund. It would be clearer and more helpful if the definition of revolving fund were reduced to the component that required the funds to be self-sustaining.

The current definition of trust fund is a good one in that it specifies the relationship that distinguishes a trust fund from any other type of fund. While a few funds are labeled "trust fund" that do not meet these qualifications, this is a flaw in the creation of these funds and not in the definition itself.

Endnotes

1. Hawaii Rev. Stat. sec. 37-62.
2. In addition, a review of chapter 36, Hawaii Revised Statutes, entitled "state funds" shows that several sections of that chapter (sections 36-27, 36-30, and 36-31, Hawaii Revised Statutes) refer to actions that can be performed on all special funds, such as taking a certain percentage of the funds to cover central service expenses. But this still does not answer the question as to the nature of special funds.
3. See Hawaii Rev. Stat., secs. 46-144, 88-157, and 237-44.
4. Hawaii Rev. Stat., secs. 304-91 (creates a special fund which "shall be a revolving fund"), 326-27 (entitled "revolving fund" with money appropriated "as a special fund")(repealed in 1993), and 353-31 ("special revolving fund").
5. Department of Accounting and General Services, State of Hawaii Comprehensive Annual Financial Report For the Fiscal Year Ended June 30, 1992.
6. Id. at 24. Both the authors and the auditors of the report state that they believe the report conforms to generally acceptable auditing standards. Id. at 17 and 23.

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7. The larger special CIP funds are placed into the capital projects classification.
8. Hawaii Rev. Stat., sec. 37-62.
9. Hawaii Rev. Stat., sec. 29-22.
10. Hawaii Rev. Stat., sec. 29-23.
11. Hawaii Rev. Stat., sec. 201E-132.
12. Hawaii Rev. Stat., sec. 210D-4.
13. Hawaii Rev. Stat., sec. 286-51.
14. Hawaii Rev. Stat., sec. 304-8.96.
15. Hawaii Rev. Stat., sec. 206X-10.
16. Hawaii Rev. Stat., sec. 206E-16.
17. Hawaii Rev. Stat., sec. 306-10.
18. Hawaii Rev. Stat., sec. 37-62.
19. 76 American Jurisprudence 2d Trusts section 58.
20. Id. at section 379.
21. Id. at section 390.
22. Hawaii Rev. Stat., sec. 87-2.
23. Previously at section 581-5, Hawaii Revised Statutes, now found at section 312-9. This fund is a statutorily-established private charitable trust.
24. Hawaii Rev. Stat., sec. 88-157.
25. Hawaii Rev. Stat., sec. 201F-2.
26. Hawaii Rev. Stat., sec. 201F-3.
27. Act 308, section 5, Session Laws of Hawaii 1992.
28. Ernst & Young, A Study Relating to the Establishment of a Rental Housing Trust Fund in the State of Hawaii, December 1991 at 1.
29. Hawaii Rev. Stat., sec. 6E-33.
30. Act 240, Session Laws of Hawaii 1990. The Auditor's office expanded the scope of its mandate and reviewed a number of funds not designated by the Legislature. (Such as the condominium management education fund, section 514A-131, Hawaii Revised Statutes; the contractor education fund, section 444-29,

A Review of the Definitions of Special, Revolving, and Trust Funds

Hawaii Revised Statutes; and the agriculture loan reserve fund, section 155-14, Hawaii Revised Statutes.) This observation is not a criticism of the Auditor's office. The Auditor's efforts were obviously an attempt to be thorough in analyzing the greater issue of ensuring the fiscal integrity of the State.

31. Auditor, Review of Special and Revolving Funds of the University of Hawaii, Report No. 92-9 (April 1992) at 7.
32. See, e.g., the natural area reserve fund, section 195-9, Hawaii Revised Statutes, and the forest stewardship fund, section 195F-4, Hawaii Revised Statutes, which are funded "from any public or private sources" and which make explicit references to meeting conditions necessary to receive federal moneys.
33. Government Finance Officers Association, Governmental Accounting, Auditing and Financial Reporting (Chicago, Ill.: 1988) at 23.
34. This comment is not meant to and should not be perceived as a criticism of the Auditor's six-part study in response to Act 240. The scope of this study precludes an evaluation of the merits of the Auditor's recommendations in that lengthy work, and it may be that to the extent the Auditor's office criticized a special fund for not meeting this third criteria, the special fund was flawed in other ways.
35. Department of Accounting and General Services, State of Hawaii Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 1992.
36. Id. at 106.
37. Id. at 130.
38. Id. at 29.
39. Id. at 46.
40. Id. at 47.
41. Id. at 136.
42. Id. at 127.

Chapter 4

THE DEPARTMENT OF HAWAIIAN HOME LANDS FUNDS

The confusion with, and overuse of, state funds can be demonstrated by an examination of the funds established throughout the years in the Hawaiian Homes Commission Act, 1920.

- 1921 The funds started out at a very basic level with one revolving fund, the Hawaiian home loan fund.
- 1941 The first two special funds, the Hawaiian home development fund and the Hawaiian home administration account, were added.
- 1948 Another revolving fund, the Hawaiian home operating fund, was added.
- 1972 Four new revolving funds were added: the Hawaiian home farm loan fund, the Hawaiian home commercial loan fund, the Hawaiian home repair fund, and the Anahola-Kekaha fund.
- 1973 Another special fund, the Hawaiian loan guarantee fund, was added.
- 1974 Three more revolving funds were added: the Papakolea home replacement loan fund, the Keaukaha-Waiakea home replacement fund, and the Keaukaha-Waiakea home construction fund.
- 1976 Two more revolving funds were added, the statewide replacement loan fund and the Hawaiian home general home loan fund.

At this point, there were three special funds and eleven revolving funds.

- 1978 The Legislature must have realized that these funds were getting out of control, for in 1978 it terminated six of the revolving funds, leaving only the Hawaiian home loan fund, the Hawaiian home operating fund, the Hawaiian home farm loan fund, and the Hawaiian home repair loan fund, and added three new revolving funds, the Hawaiian home general loan fund, the additional receipts loan fund, and the Hawaiian home replacement loan fund, for a total of seven. However, in the same year, the Legislature added four special funds, the Hawaiian loan interest fund, the borrowed money fund, the Hawaiian home trust fund, and the Hawaiian home education fund, for a total of seven special funds.

- 1981 Another special fund was added, the native Hawaiian rehabilitation fund.
- 1983 The name of the Hawaiian loan interest fund was changed to the Hawaiian home interest fund.
- 1986 The seven revolving funds were reduced to two, the original Hawaiian home loan fund and the Hawaiian home general fund, while the functions of the Hawaiian home operating fund and the Hawaiian home replacement loan fund were collapsed into the Hawaiian home general loan fund. In the most interesting switch for the purposes of this study, the Hawaiian home operating fund, which was established in 1948 as a revolving fund, was changed into a special fund. It continued to perform the same functions as it had, plus the functions of the Hawaiian home development fund, which it replaced. Also in 1986, the number of special funds was reduced from eight to five, as the Hawaiian home education fund, the borrowed money fund, and the Hawaii loan guarantee fund were discontinued, and the Hawaiian home interest fund was changed to the Hawaiian home receipts fund.
- 1989 In 1989 the legislature provided for the establishment of separate special funds for each undertaking secured by revenue bonds.¹

At present, the Hawaiian Homes Commission Act contains two revolving and five special funds, a far cry from the maximum of eleven revolving funds in 1976 and the maximum eight special funds in 1981.

This history demonstrates both the excessive use, at least in the past, of special and revolving funds, and the lack of clear boundaries between the popular conception of special funds, on the one hand, and revolving funds on the other. To have four repair or replacement funds for three separate areas (Anahola-Kekaha, Keaukaha-Waiakea, and Papakolea), plus a statewide repair loan fund, for example, is a waste of time and effort. It signifies a piecemeal approach to the problem of home maintenance and repair. The replacement of these funds with the more inclusive Hawaiian home general loan fund and Hawaiian home replacement loan fund is more efficient and effective, as it allows prompt relief to be granted without this delay.

It is also interesting that the operating fund, which for thirty-eight years was dubbed a revolving fund, was reclassified as a special fund in 1986, while retaining all of the same functions and adding others. As noted in Chapter 3, this may be another example of how the vague definitions of the types of funds confuse legislative decision-making through a failure of providing positive guidelines on the characteristics of special or revolving funds.

There has also been some recent disagreement over the correct specification of all the special funds. House Bill No. 2017, Regular Session of 1993, as originally introduced, changed the designation of all the special funds to trust funds. The bill passed the House and the first Senate committee. The bill was amended in the Ways and Means committee by deleting that change and restoring the designation of the funds as special funds.

Summary

The rapid growth and subsequent cutback of the funds in the Hawaiian Homes Commission Act echoes the history of funds of the State in general. The Act started out in 1921 with one fund and maintained it for twenty years. Three funds were added in the forties, and that number remained stable for twenty-four years until eleven funds were added in the seventies. The Legislature tried to cut back the number of revolving funds in the late seventies, but added a number of new special funds so that the total number of funds did not decrease by much. The number of funds was reduced drastically in 1986, and is maintained at two revolving and five special funds today. There is also a provision allowing the establishment of special funds for undertakings secured by revenue bonds.

The Hawaiian Homes Commission Act is not the only area to show an excessive use of funds. As described earlier, a 1980 national study placed Hawaii at the top of the ranking with 4000 state funds, while the majority of states had less than 100, or less than 3 percent of that total.

CHART

Hawaiian Homes Commission Funds by year
(+ = fund added that year)
(r = revolving fund)
(s = special fund)

- 1921 Hawaiian home loan fund (r)
- 1941 Hawaiian home loan fund (r)
 - + Hawaiian home development fund (s)
 - + Hawaiian home administration account (s)
- 1948 Hawaiian home loan fund (r)
 - Hawaiian home development fund (s)
 - Hawaiian home administration account (s)
 - + Hawaiian home operating fund (r)

- 1972
 - Hawaiian home loan fund (r)
 - Hawaiian home development fund (s)
 - Hawaiian home administration account (s)
 - Hawaiian home operating fund (r)
 - + Hawaiian home farm loan fund (r)
 - + Hawaiian home commercial loan fund (r)
 - + Hawaiian home repair fund (r)
 - + Anahola-Kekaha fund (r)

- 1973
 - Hawaiian home loan fund (r)
 - Hawaiian home development fund (s)
 - Hawaiian home administration account (s)
 - Hawaiian home operating fund (r)
 - Hawaiian home farm loan fund (r)
 - Hawaiian home commercial loan fund (r)
 - Hawaiian home repair fund (r)
 - Anahola-Kekaha fund (r)
 - + Hawaiian loan guarantee fund (s)

- 1974
 - Hawaiian home loan fund (r)
 - Hawaiian home development fund (s)
 - Hawaiian home administration account (s)
 - Hawaiian home operating fund (r)
 - Hawaiian home farm loan fund (r)
 - Hawaiian home commercial loan fund (r)
 - Hawaiian home repair fund (r)
 - Anahola-Kekaha fund (r)
 - Hawaiian loan guarantee fund (s)
 - + Papakolea home replacement loan fund (r)
 - + Keaukaha-Waiakea home replacement fund (r)
 - + Keaukaha-Waiakea construction fund (r)

- 1976
 - Hawaiian home loan fund (r)
 - Hawaiian home development fund (s)
 - Hawaiian home administration account (s)
 - Hawaiian home operating fund (r)
 - Hawaiian home farm loan fund (r)
 - Hawaiian home commercial loan fund (r)
 - Hawaiian home repair fund (r)
 - Anahola-Kekaha fund (r)
 - Hawaiian loan guarantee fund (s)

The Department of Hawaiian Home Lands Funds

- Papakolea home replacement loan fund (r)
- Keaukaha-Waiakea home replacement fund (r)
- Keaukaha-Waiakea construction fund (r)
- + The statewide repair loan fund (r)
- + Hawaiian home general home loan fund (r)

- 1978
 - Hawaiian home loan fund (r)
 - + Additional receipts loan fund (r)
 - Hawaiian home operating fund (r)
 - Hawaiian home farm loan fund (r)
 - Hawaiian home repair loan fund (r)
 - Hawaiian home development fund (s)
 - Hawaiian home administration account (s)
 - Hawaiian loan guarantee fund (s)
 - + Hawaiian home general loan fund (r)
 - + Hawaiian home replacement loan fund (r)
 - + Hawaiian loan interest fund (s)
 - + Borrowed money fund (s)
 - + Hawaiian home trust fund (s)
 - + Hawaiian home education fund (s)

- 1981
 - Hawaiian home loan fund (r)
 - Additional receipts loan fund (r)
 - Hawaiian home operating fund (r)
 - Hawaiian home farm loan fund (r)
 - Hawaiian home repair loan fund (r)
 - Hawaiian home development fund (s)
 - Hawaiian home administration account (s)
 - Hawaiian loan guarantee fund (s)
 - Hawaiian home general loan fund (r)
 - Hawaiian home replacement loan fund (r)
 - Hawaiian loan interest fund (s)
 - Borrowed money fund (s)
 - Hawaiian home trust fund (s)
 - Hawaiian home education fund (s)
 - + Native Hawaiian rehabilitation fund (s)

- 1986
 - Hawaiian home loan fund (r)
 - Hawaiian home general fund (r)
 - Hawaiian home operating fund (changes from r to s)
 - Hawaiian home administration account (s)
 - Hawaiian home trust fund (s)

Native Hawaiian rehabilitation fund (s)
Hawaiian home receipts fund (name was changed from
the Hawaiian home interest fund) (s)

- 1989
 - Hawaiian home loan fund (r)
 - Hawaiian home general fund (r)
 - Hawaiian home operating fund (s)
 - Hawaiian home administration account (s)
 - Hawaiian home trust fund (s)
 - Native Hawaiian rehabilitation fund (s)
 - Hawaiian home receipts fund (s)
- + Separate special funds for each undertaking secured by revenue bonds.

Endnotes

1. Hawaiian Homes Commission Act, section 213.5.

Chapter 5

USE OF FUNDS IN OTHER STATES

Hawaii is not the only state to use the terms "special fund" and "revolving fund". However, many of the other states that do use the terms do not define them. The definitions in the few states that have them are reviewed below to determine whether these definitions would be more suitable than Hawaii's current definitions. Definitions of the term "trust fund" are also reviewed.

Special Funds

Vermont defines a special fund as a fund "created to account for specific revenues earmarked to finance particular or restricted programs and activities."¹ This definition is similar to the standard governmental accounting definition of a "special revenue" fund. A special revenue fund is defined as one that "account[s] for the proceeds of specific revenue sources ... that are legally restricted to expenditure for specified purposes."² The term "special revenue fund" will be discussed further in the next chapter. Vermont's definition differs from Hawaii's as Vermont ascribes a particular source for each fund. In Hawaii's definition, the **source** of the money does not matter -- only the **use** of the funds are described. Vermont has a better definition than Hawaii in that it actually classifies the term in a way that sets it apart from other types of funds. If Hawaii were to adopt this type of definition, however, Hawaii would have to either restructure many of its special funds, or rename them as many would no longer qualify as special funds under Vermont's definition.

Connecticut defines a special fund as "any fund which is to be used only in accordance with specific regulations or restrictions, including any fund created by a law authorizing and requiring the receipts of specific taxes or other revenues to be used to finance particular activities."³ In this definition, Connecticut combines the vague generality of Hawaii's statute with the more focused definition of a special revenue fund. This hybrid definition is not a successful candidate for Hawaii, however, as it does not clarify what a special fund is; it merely adds a specific type of fund to the same overly-broad definition.

Iowa defines a special fund as "all government fees and other revenue receipts earmarked to finance a governmental agency to which no general fund appropriation is made by the state."⁴ This definition is not helpful in our context as Hawaii uses special funds to fund programs, not agencies, and some of these funds also receive general fund appropriations.⁵

Both Washington and Oregon use the term "dedicated funds" rather than special funds, but their definitions match Hawaii's definition of "special fund" almost exactly. Both states define a dedicated fund as a fund "that by law is dedicated, appropriated, or set aside for a limited object or purpose; but 'dedicated fund' does not include a revolving fund or a trust fund."⁶ Again, these definitions are so broad that they might as well be omitted, for every fund besides the general fund is set aside for a limited purpose.

Revolving Funds

Several states use a revolving fund to record transactions involving the sale of goods and services to other state agencies as well as to others.⁷ Oregon and Washington use a definition almost identical to that of Hawaii: "a fund ... established by law, from which is paid the cost of goods or services furnished to or by a state agency, and which is replenished through charges made for such goods or services or through transfers from other accounts or funds."⁸

Florida's definition of the term is extremely broad: "a cash fund ... established from an appropriation, to be used by an agency or the judicial branch in making authorized expenditures."⁹ This definition provides little guidance into the nature of a revolving fund.

Trust Funds

The term "trust fund" is less confusing to define than special or revolving fund, as trust funds are more widely recognized, and also are defined in government accounting texts, unlike the other two terms. However, even trust funds are not immune from the general confusion surrounding the other terms: one state has created a trust fund "to be known as the working capital revolving fund", a particularly unusual hybrid.¹⁰

The definition of trust fund in Oregon and Washington match Hawaii's definition almost exactly: a trust fund is a fund "in which designated persons or classes of persons have a vested beneficial interest or equitable ownership, or which was created, established by a gift, grant, contribution, devise, or bequest that limits the use of the fund to designated objects or purposes".¹¹

Connecticut defines trust funds as "any fund consisting of resources received and held by the state as trustee to be expended or invested in accordance with the conditions of the trust".¹² This is a simplified version of the Hawaii definition. For that reason, it is not preferable to Hawaii's more detailed version as it is almost circular (a trust fund is a fund in which the state is a trustee) in its reasoning and does not aid the reader in determining

whether the nature of the fund demands that it be a trust fund as opposed to another type of fund.

Florida's definition initially appears to have the same difficulty, but its additional provisions are helpful in distinguishing trust funds from other funds. The statute states that trust funds "shall consist of moneys received by the state which under law or under trust agreement are segregated for a purpose authorized by law". In addition, it requires that each trust fund, in its statutory enabling legislation, specify:

- (1) The name of the trust fund;
- (2) The agency or branch of government responsible for administering it;
- (3) The requirements or purposes that the trust fund is established to meet;
- (4) The sources of money to be credited to the trust fund, or specific sources of receipts to be deposited into the trust fund;
- (5) The purposes, programs, or services for which the trust moneys may be spent, pursuant to specific appropriations; and
- (6) That the trust funds shall be abolished according to other statutory requirements.¹³

While the statute, unlike Hawaii's, does not specify the nature of a trust fund, the other indicia would be generally helpful in clarifying the parameters of a particular trust fund. Hawaii might want to consider a similar statutory scheme to provide guidance to persons proposing to establish trust funds.

Summary

While other states use the terms special, revolving, and trust funds, few of them define the terms. Of those that do, little guidance is available in the definitions of special and revolving funds to help distinguish those terms from other types of funds. The definitions of "trust fund" are not as detailed as Hawaii's, and in this respect, the more detailed Hawaii version (as also followed by Washington and Oregon) is to be preferred. Hawaii's version could be enhanced by requiring, as Florida does, that the elements of the trust be specified in the enabling legislation.

Endnotes

1. Section 585, Title 32, Vermont Statutes Annotated (1992 Supp.).
2. Government Finance Officers Association, Governmental Accounting, Auditing and Financial Reporting (Chicago, Ill.: 1988) at 11.
3. Connecticut General Statutes Annotated (1993), sec. 4-69 (32).
4. Iowa Code Annotated (1993 Supp.), sec. 8.2.
5. E.g., the special school lunch fund contained in section 296-44, Hawaii Revised Statutes, which the Auditor states is "supported heavily by general fund appropriations." Auditor, Review of the Special and Revolving Funds of the Departments of Commerce and Consumer Affairs, Education, Health, and Human Services, Report No. 92-8 (1992) at 19.
6. 1991 Oregon Revised Statutes, sec. 291.002(3); Revised Code of Washington (1993), sec. 43.88.020(8).
7. ReImond P. Van Daniker, Research Report: Preferred Accounting Practices for State Governments (Lexington, Ky.: Council of State Governments, 1983) at 48. According to Van Daniker, in 1983 the number of states using revolving funds was seven.
8. Revised Code of Washington (1993), sec. 43.88.020(9); 1991 Oregon Revised Statutes, sec. 291.002(4).
9. Florida Statutes Annotated (1993 Supp.), sec. 216.011(gg).
10. Illinois Compiled Statutes 1992, sec. 105/6.
11. Revised Code of Washington, sec. 43.88.020(10); 1991 Oregon Revised Statutes, sec. 291.002(5).
12. Connecticut General Statutes Annotated (1993), sec. 4-69(33).
13. Florida Statutes 1991 (1992 Supp.), sec. 215.3207. The 1993 supplement removes paragraph (5), but it is included here as an example of how detailed a Hawaii statute could be.

Chapter 6

GOVERNMENTAL ACCOUNTING TEXTS

Standard governmental accounting texts use a much more detailed scheme of fund classification than is presented in the *Hawaii Revised Statutes*. In general, these texts classify funds into seven groups:

- The general fund
- Special revenue funds
- Capital project funds
- Debt service funds
- Trust and agency funds
- Internal service funds
- Enterprise funds¹

Some texts also include an eighth type, a special assessment fund, but the latest text drops that term.

The latest texts also sort the funds into three basic types: governmental, proprietary, and fiduciary. Those definitions are:

- **Governmental Funds**
 - (1) **The General Fund**--to account for all financial resources except those required to be accounted for in another fund.
 - (2) **Special Revenue Funds**--to account for the proceeds of specific revenue sources (other than expendable trusts or for major capital projects) that are legally restricted to expenditure for specified purposes.
 - (3) **Capital Projects Funds**--to account for financial resources to be used for the acquisition or construction of major capital facilities (other than those financed by proprietary funds and trust funds).

- (4) **Debt Service Funds**--to account for the accumulation of resources for, and the payment of, general long-term debt principal and interest.
- **Proprietary Funds**
 - (1) **Enterprise funds**--to account for operations:
 - (a) That are financed and operated in a manner similar to private business enterprises--where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or
 - (b) Where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.
 - (2) **Internal Service Funds**--to account for the financing of goods or service provided by one department or agency to other departments or agencies of the governmental unit, or to other governmental units, on a cost-reimbursement basis.
- **Fiduciary Funds**
 - (1) **Trust and agency funds**--to account for assets held by a governmental unit in a trustee capacity or as an agent for individuals, private organizations, other governmental units, and/or other funds. These include:
 - (a) expendable trust funds;
 - (b) nonexpendable trust funds;
 - (c) pension trust funds; and
 - (d) agency funds.²

None of the texts uses the term "special funds", except occasionally as a shorthand version of the term "special revenue funds". That definition is quite different from Hawaii's special funds definition. In Hawaii, a special fund is a broad catchall term for any fund that is not the general, a revolving, or a trust fund. While its use may be a special one, there is no

requirement that specifies its source of funds. In contrast, the texts' definition of special funds places emphasis on the sources of the revenues -- a special revenue fund is created to store specific revenue sources. As one text states: "Whenever a tax or other revenue source is authorized by a legislative body to be used for a specified purpose only, a municipality availing itself of that source is expected to create a special revenue fund in order to be able to demonstrate that all revenue from that source was used for the specified purpose only."³

One thirty-two year old study of state special funds supports the concept that special funds refers to a class of funds, rather than a particular type of funds. The study lists eight specific types of funds (including the general fund, special revenue funds, working capital funds, and trust funds) and adds that "[s]pecial funds not falling into [these] categories are disapproved. They are said to seriously complicate the budget process and financial administration. The funds bring about inflexibility."⁴

The term "revolving fund" is difficult to find in the texts. Only in the older books does it appear in the text itself, while in the newer it is relegated to the glossaries. It is used as a synonym for or as a prior use of the terms "intragovernmental service fund", "internal service fund,"⁵ or "working capital fund".⁶ In both usages, the term revolving fund has a more limited function⁷ than it does in Hawaii, referring primarily to funds financing transactions between departments on a cost-reimbursement basis. In comparison, while Hawaii's definition does pick up on the theme of expenditures replenished through charges, it is far broader as it is not limited to interdepartmental transfers, and includes the ability of permitting the revolving fund to be replenished through transfers from other accounts or funds.

One commentator on the subject states that the recommended accounting practice for revolving funds is to reclassify them into two types according to primary customer. If the goods and services are provided to the general public, an "enterprise fund" should be used, and if they are provided to other state agencies, they should be classified as an "internal service fund".⁸

The fact that Hawaii's funding scheme differs from these texts does not automatically indicate that Hawaii's scheme is inadequate. But it should be noted that at least one of the texts expounding the scheme described in this chapter states that its principles have been "declared to be appropriate for state and local government units by the National Council on Governmental Accounting and [have] also been recognized by the American Institute of Certified Public Accountants as being in conformity with generally accepted accounting principles."⁹

The foregoing does not necessarily mean that any other method of structuring funds is invalid. The real proof of validity is whether Hawaii's statutory structuring of funds is clear, consistent, and useful. The foregoing chapters seem to indicate that Hawaii's scheme is not. It is confusing in its breadth and in its usage.

Act 289 also directs the Bureau to define, evaluate, and recommend, if applicable, other types of funds that may be suitable for consideration by the State. The Bureau does not have the ability to perform this function, as a full review of the way Hawaii's funds are handled at present and could be handled under a new scheme would require expertise in the field of government accounting which the Bureau does not have. However, the scheme of funds discussed in this chapter appears to be highly recommended by official bodies experienced in governmental accounting systems, such as the National Council on Governmental Accounting, the American Institutes of Certified Public Accountants, and the Government Finance Officers Association. If the Legislature agrees that the state's current definitions of special, revolving, and trust funds are inadequate, then the Department of Accounting and General Services and the Department of Budget and Finance, the agencies having the greatest amount of expertise in the area as well as the agencies that would be affected most directly by any changes, should be directed to report on the implications of substituting the definitions discussed in this chapter, and the specific changes to the State's financial accounting system that these changes would entail.

Endnotes

1. See, e.g., Leon E. Hay and R.M. Mikesell, Governmental Accounting, 5th ed., (Homewood, Ill., Richard D. Irwin, Inc., 1974) [hereafter Hay]; National Committee on Governmental Accounting, Governmental Accounting, Auditing, and Financial Reporting (Chicago, Ill.: 1968); Cornelius E. Tierney & Philip T. Calder, Governmental Accounting: Procedures and Practices, 1985 (Elsevier, NY: 1985) [hereafter Tierney]; Municipal Finance Officers Association of the United States and Canada, Governmental Accounting, Auditing, and Financial Reporting (Chicago, Ill.: 1980) [hereafter MFOA]; and Government Finance Officers Association, Governmental Accounting, Auditing and Financial Reporting (Chicago, Ill.: 1988) [hereafter GFOA]. The first two texts call the internal service fund the intragovernmental service fund.
2. GFOA, *supra* n. 1, at 11.
3. Hay, *supra* n. 1, at 55.
4. Hugh J. Reber, State Special Funds: a Background Study of Criteria (San Francisco: Griffenhagen-Kroeger, Inc., June 1961) at 28-29 (emphasis omitted). The eight funds listed are: the general fund, special revenue funds, working capital funds, special assessment funds (now disapproved of by latest sources), bond funds, sinking funds, trust and agency funds, and utility or other enterprise funds.
5. See Hay, *supra* n. 1, at 746; MFOA, *supra* n. 1, at 73; and GFOA, *supra* n. 1, at 176.
6. Lloyd Morey and Robert Phillip Hackett, Fundamentals of Governmental Accounting (New York: John Wiley & Sons), second edition, 1951 at 43 [hereafter Morey].
7. The 1951 definition of working capital funds as follows: "Working capital funds, sometimes called "revolving" funds (emphasis added), are those funds established with a fixed amount of capital to take care of a manufacturing or service operation which is self-sustaining in nature. Their receipts may consist

of sales of products to outside parties or of transfers from other funds. ... The principal requirement is that the capital sums be kept intact, being represented by cash, receivables, or inventory. Therefore they are not expendable. They are most frequently employed in internal operations, to serve other departments, though they may involve transactions with outside parties." Morey, *supra* n. 6, at 184. Revolving fund is defined in a glossary in 1988 as "either an internal service fund or an imprest account accounted for as an asset of a fund." GFOA, *supra* n. 1, at 176. An imprest fund is a petty cash fund. An internal service fund is defined as a fund that accounts for the financing of goods or service provided by one department or agency to other departments or agencies of the governmental unit, or to other governmental units, on a cost-reimbursement basis. *Id.* at 11.

8. Relmond P. Van Daniker, Research Report: Preferred Accounting Practices for State Governments, (Lexington, KY: Council of State Governments 1983) at 48. This also appears to be the federal use of the term. One official federal glossary defines revolving fund as a "fund established to finance a cycle of operations through amounts received by the fund. There are three types of revolving funds: public enterprise, intragovernmental revolving, and trust revolving accounts." United States General Accounting Office, A Glossary of Terms Used in the Federal Budget Process 3rd ed., (Washington, D.C.: March 1981: PAD-81-27) at 25.
9. Tierney, *supra* n. 1, at unnumbered preface.

Chapter 7

ANALYSIS

The preceding chapters illustrate the problems with Hawaii's current definitions of special, revolving, and trust funds. In this chapter, each term will be reviewed and suggestions given.

Trust Fund

The definition of this term is accurate in its delineation of the two ways in which a fund can qualify as a trust fund:

- (1) When there are beneficiaries who have a vested beneficial interest in or equitable ownership of the money; and
- (2) When the money is donated with specific limitations.

Trust funds are defined in standard governmental accounting texts and in those texts are usually broken down into three¹ classes: expendable trust funds (where both principal and interest may be expended), nonexpendable trusts (where only the interest may be spent), and pension trust funds (to hold public employee retirement systems funds).² It might be useful to add the definitions of expendable and nonexpendable to Hawaii's trust fund definition to encourage the creator of a trust fund to specify this most important distinction.

The definition also could be improved by requiring, as Florida does, that the elements of the trust fund be specified in the enabling legislation. For instance, it should be required that each trust specify the agency responsible for administration, the specific sources of all receipts to be deposited, the purpose of the trust fund, and when and how, if ever, it may be terminated.

Revolving Funds

The term revolving fund is little-used in standard governmental accounting texts and, while some other states do use the term, very few define it. Of those that do, the definitions are not helpful in focussing on the essential qualities of this term. One commentator takes the position that revolving funds should really be broken down into two types, enterprise (if the functions benefit the general public) or intragovernmental (if they benefit other state agencies). This is apparently the way the federal government uses the term as well. It may

be that Hawaii should follow suit and substitute these terms for the broader term revolving fund.

In the alternative, if the State wishes to keep the concept of a fund that is circular in nature, which provides goods or services, the fees for which replenish the fund, the State could tighten its existing definition by removing the part of the definition that permits a revolving fund to be replenished through transfers from other accounts or funds. This restructuring of the definition would permit a revolving fund to be created only if the fund could replenish itself. This does not mean that funds could never be added from an outside source. There may be occasions when outside appropriations are necessary, such as in the case of a disaster revolving fund immediately after a disaster, when a transfusion of money from the general fund will enable the fund to make loans to a greater number of needy people. But a fund that counts on regular transfusions of cash from sources other than itself should have to justify its continued existence outside the general fund by other means.

Lowell Kalapa, President of the Tax Foundation of Hawaii, suggests an even more stringent definition of revolving fund. According to Kalapa, a revolving fund should only be used for loans. The fund would be generated by a one-time general fund appropriation, but after that, it should be wholly funded by the repayments, plus interest on the loans.³ This would be even more narrow than the definition suggested above because of the restriction to loan-only types of funds. At present, revolving funds are used for a much wider variety of functions, including running programs,⁴ providing funds for training,⁵ and paying claims against the state and purchasing insurance.⁶

Special Funds

The problem that lies at the heart of the definition of this term is that it is being used two ways: to describe a class of funds, and to describe a particular type of fund. It is used to describe a class of funds in its statutory definition. The term special fund means funds set aside by law for a particular purpose, but excluding revolving and trust funds. This definition is perceived as inadequate because it lists no positive characteristics of a special fund. All that is known of a special fund is that it is set aside for a specific purpose. But that characteristic applies to every fund except the general fund. This "definition" is so broad that it has to be qualified by the exclusion of revolving and trust funds.

By seeing how the term "special funds" is used in chapter 36, *Hawaii Revised Statutes*, however, the reason for the term becomes clearer. There are several sections of chapter 36 that apply only to special funds, such as section 36-27 which permits the director of finance to withdraw a specified amount from special funds to cover central service expenses. Using the term "special fund" as a shorthand term for all other funds decreases verbiage in the statutes.

However, convenience is not the only consideration to take into account. It is important to note that when the Department of Accounting and General Services prepares its annual fiscal report for the State, the special and revolving funds are not listed as such but are placed in the special revenue funds category, even though these terms do not follow the technical definition of such a fund. The fact that the State's accountant cannot find a proper place to put these funds should be a red flag.

Another problem arising with the term "special fund" is that in Hawaii, it is also used to mean a particular type of fund, like the stadium special fund, the agriculture park special fund, and the supreme court law library special fund. Because the definition is so broad and vague, there are literally no criteria for these "special funds" other than that they be for a specified purpose. They need not be tied to a revenue source, be financially self-sustaining, or be needed to assure the payment on the State's long term debt. They simply can be created because someone wants it. This is not good fiscal management policy. The government accounting fund categories described in Chapter 6 have specific, time-tested reasons for having their funds excluded from the general fund. The myriad of funds created in Hawaii under the rubric of "special fund" have no such controls. This does not mean that every special fund in Hawaii has no justification for its existence. It does mean that the potential for overuse of these private "pockets of money" exists, and with their overuse, the creation of a drain on the general fund that is struggling to meet a host of other state responsibilities.

One statute does require special funds that are not encumbered by the end of the fiscal year to be transferred back to the general fund.⁷ However, agencies usually manage to encumber the proceeds in funds in time to escape this restriction. While the statutes do permit the individual departments to transfer back to the general fund moneys deemed to exceed the fund's fiscal year requirements,⁸ the Legislature does not have the ability on its own to wrest excess moneys out of the special fund and back into the general fund. Some funds may contain moneys hoarded against a rainy day, while other funds and projects that are needy in the present suffer from lack of accessible funds.

One recommendation for special funds is that their use be substituted in the *Hawaii Revised Statutes* with special revenue funds, as defined in governmental accounting texts. This substitution should be done by the Department of Accounting and General Services and the Department of Budget and Finance so that the budget and accounting departments are in full agreement on the terms and so that the terms are crafted to be as specific as possible.

Lowell Kalapa of the Tax Foundation of Hawaii has a different recommendation.⁹ He thinks that special funds should remain as a discrete type of fund, but that it should be a user-charge fund, underwritten by the user charges only, with no general fund appropriations, to be used to benefit the users. Existing examples of this type of special fund would be the

University of Hawaii - Manoa Campus Agricultural diagnostic service special fund,¹⁰ which charges fees to persons who want their soil, water, or plants analyzed, and which fees are used to cover the operating expenses of providing these analyses; and the boating special fund, which receives fuel taxes, rental fees, and slip fees from small boat owners, and which is expended on operating the boating facilities and other program activities. At present, not all of the special funds meet these criteria; there are special funds that benefit the community as a whole, for example, and have no user fees to help the fund sustain itself.¹¹

Kalapa further notes that one rationale given for retaining special or revolving funds is that they are required by the federal government. Kalapa points out that many times, the necessity is an illusion, and the federal requirements would be satisfied with a paper trail consisting of a segregated government account, rather than a special fund. In the future, when this rationale is given, it would be in the State's interest to have confirmation whether a special fund is truly necessary for federal purposes or not.

Nonconforming Funds

If the Legislature were to adopt these or other suggestions that would narrow the definition of special and revolving funds, the next issue would be the fate of the existing funds which do not meet these criteria. To the extent that the Legislature does not wish to terminate these nonconforming funds altogether, either because it finds the goals of the funds to be worthy even though the mechanism is not, or because the existence of the fund is required by federal law, the Legislature could continue the fund on a temporary basis by changing it into an account.

When funds are changed into accounts, they lose their status as separate entities and become entries of the general fund. They can still hold money, but they would lapse at the end of the fiscal biennium. This means that the unused moneys will become available to the general fund again. Kentucky used this mechanism recently to reduce its number of funds from 34 to 4.¹²

Summary

The current definition of trust funds is accurate in that it describes the two legal relationships that should cause the State to take the part of a trustee: when the State holds moneys for beneficiaries who are vested or who have an equitable ownership in the money, and when money is given the State by others for a particular purpose. The definition could be improved upon by adding the classifications of expendable and nonexpendable trusts, and by requiring the elements of the trust be enumerated in the enabling legislation for each trust fund.

Analysis

The current definition of revolving fund is overly broad. It could be improved upon in several different ways. The term "revolving fund" could be abolished, and the standard governmental accounting terms enterprise and internal service funds could be used, with all revolving funds not meeting these characteristics to be repealed or changed to accounts. Another option would be to retain the term but to restrict the funding sources so that the fund could only replenish itself. A third option would be to restrict these funds to loans only so that they would never, after the initial start-up appropriation, receive a general fund or other type of fund transfer.

The definition of special fund is too vague and too broad. The definition could be improved by one of two methods. The first is by changing the definition to the standard governmental accounting term "special revenue fund", and repealing or changing into an account any special funds that do not conform to that definition. The second is to retain the term but to restrict special funds to user-charge funds that are maintained by user charges and that never receive any general fund appropriations.

Endnotes

1. Agency funds are usually included with the trust funds.
2. Government Finance Officers Association, Governmental Accounting, Auditing and Financial Reporting (Chicago, Ill.: 1988) [hereafter GFOA] at 79.
3. Interview with Lowell Kalapa, President of the Tax Foundation, October 14, 1993.
4. E.g., the wildlife revolving fund, section 183D-10.5, Hawaii Revised Statutes, which is used to fund wildlife programs.
5. E.g., the vocational and technical training projects revolving fund, section 304-8.4, Hawaii Revised Statutes.
6. E.g., the state risk management revolving fund, section 41D-4, Hawaii Revised Statutes.
7. Hawaii Rev. Stat., sec. 37-41.
8. Hawaii Rev. Stat., sec. 37-53.
9. Kalapa interview, October 14, 1993.
10. This fund is administratively established pursuant to section 304-8, Hawaii Revised Statutes. See Auditor, Review of Special and Revolving Funds of the University of Hawaii, Report No. 92-9 (April 1992).
11. See, e.g., the works-of-art special fund, section 103-8.5, Hawaii Revised Statutes, which is funded by CIP revenues and which benefits the general public by acquiring and displaying art in state buildings; and the criminal forfeiture fund, section 712A-16, Hawaii Revised Statutes, which receives half the net proceeds

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from the sale of forfeited property, and which is used to train police officers, pay informant awards, and pay the expenses of seizing and selling the property.

12. Interview with Ron Carson, Governor's office, Kentucky, on September 9, 1993.

Chapter 8

FINDINGS AND RECOMMENDATIONS

Findings

1. The current definition of the term "special fund" is too broad and vague. The only requirements for a special fund are that it be for a specified purpose and that it not be a revolving or trust fund. No other justification for the fund need exist. The current definition is so vague that "special trust" and "special revolving" funds have been created, despite the fact that the definition of a special fund excludes revolving and trust funds.
2. Other states do use the term special fund, but most of them do not define the term. Of those that do, they either use a definition similar to that of a special revenue fund or are as equally broad as Hawaii's.
3. Standard government accounting texts do not use the term "special fund," except occasionally as a synonym for "special revenue fund." A special revenue fund accounts for the proceeds of specific revenue sources, other than expendable trusts or for major capital projects, that are legally restricted to expenditure for specified purposes. This definition contains more restrictions than does the Hawaii definition of special fund.
4. The current definition of the term "revolving fund" is overly broad. It applies not only to funds from which is paid the costs of goods or services rendered and which is replenished by the charges made for those goods or services, but also to funds that are replenished from other accounts or funds. While some revolving funds do truly "revolve" the amounts of money, others are dependent upon outside sources.
5. While other states do use the term revolving fund, many do not define the term. Of those that do, the definition is either identical to Hawaii's, or even more broad.
6. Standard government accounting texts do not use the term "revolving fund" in their discussion of funds, although it is noted in their glossaries as a synonym for, or as a prior use of, the terms "internal service" fund (earlier known as the "intragovernmental service fund") or "working capital fund". This usage refers primarily to funds that finance transactions between departments on a cost-reimbursement basis. In comparison, Hawaii's definition is far broader as it is not limited to interdepartmental transfers, and includes the loophole that permits the revolving fund to be replenished through transfers from other accounts or funds.

7. One commentator on the subject states that the recommended accounting practice for revolving funds is to reclassify them into two types according to primary customer. If the goods and services are provided to the general public, an "enterprise fund" should be used, and if they are provided to other state agencies, they should be classified as an "internal service fund."
8. The current definition of "trust fund" is adequate as it describes the legal relationships that need to be created in order for the State to assume duties as trustee. The definition could be improved by requiring the elements to be enumerated in each new trust fund. An additional section establishing the State's duties as trustee, while not part of the definition per se, would aid in administering trust funds.
9. One state that defines the term "trust fund" also lists in its statutes the elements that each trust fund needs, and requires these elements to be stated in the fund's enabling legislation.
10. The term "trust fund" is contained in standard government accounting texts and does not conflict with Hawaii's definition. It divides trust funds into four classes: expendable trust funds, nonexpendable trust funds, pension funds, and agency funds, which distinction the Hawaii definition does not make.
11. As the terms special and revolving funds are not standard government accounting terms, when the Department of Accounting and General Services compiles the State's annual report, these funds are generally placed in the special revenue fund category, which is the least inappropriate category.
12. Standard government accounting texts uniformly criticize the widespread use of funds, and indicate that the minimum number of funds compatible with legal and operating requirements be maintained.
13. The problem with an excessive number of funds is that they tie up state money and exclude it from the general fund, to the detriment of the many other state programs that compete for the limited amount of general fund moneys.
14. A 1980 study of state funds found that Hawaii had the largest number of state funds. Hawaii's 4000 funds dwarfed the majority of states, which had less than 100 funds.
15. Hawaii has a history of widespread use of funds. Studies were made in 1958 and 1991-92 recommending a reduction in funds. Some reduction was made, but Hawaii still maintains a large number of funds.

Recommendations

1. The definition of "special fund" should be changed by adding provisions that would justify their guaranteed funding and the exclusion of their moneys from the general fund. The State can do this in either of two ways: by changing the definition to that of "special revenue fund," or by following the Tax Foundation of Hawaii's recommendation of changing the structure of all special funds to user-charge funds, underwritten by user charges only and never funded with general fund appropriations.
2. The definition of "revolving fund" should be changed. The Legislature could either redefine the term narrowly, so that after the initial general fund appropriation, the fund is entirely self-supporting; or the funds could be substituted by using the standard terms "enterprise" and "internal service" funds; or the term could be retained but used for loan funds only.
3. The current definition of "trust fund" should be retained and modified. The new definition should describe the difference between an expendable and nonexpendable trust fund. The new definition should list each element of a trust fund and require that each statute creating a trust fund list all elements. The Legislature may also want to consider legislation specifying the State's responsibilities as trustee and requiring an annual report on each trust fund.
4. Funds which do not fall within the parameters of the new definitions should be reviewed by the Legislature to determine whether they should be abolished or retained. If they are to be retained, they should be shifted to accounts within the general fund, which would make their funds lapse every two years. This would give the Legislature the opportunity to review each account on a biennial basis to determine the appropriate level of funding, given other competing state needs.
5. If a fund is sought to be retained on the grounds that the federal government requires it, the appropriate agency within the federal government should be approached to determine if a special fund is necessary or whether an account would suffice.

APPENDIX A

ACT 289

SECTION 65. Provided that the office of the auditor shall perform financial and management audits of the department of Hawaiian home lands; provided further that the financial audit shall include, but not be limited to, an evaluation of the internal controls, use and expenditures, transfers and investment practices, and adequacy, effectiveness and efficiency of the financial accounting system of the department, relating to loan, revolving, special, and general funds, and other means of financing such as donations and grants, if applicable, and recommendations for any changes necessary; provided further that the management audit shall include an assessment of the effectiveness of the department's management practices, including but not limited to an assessment of its recordkeeping, accounting and database information, the department's practices relative to the use of temporary hires, transfers between funds and use of funds, from all sources, the department's management of its homestead awards program and management practices relating to the proper support of the department's programs; provided further that the legislative reference bureau shall complete a study to review and recommend more meaningful definitions of the terms: special funds, revolving funds, and trust funds; provided further that the study shall include but not be limited to a discussion and implications of the use of a trust as it applies to trust funds; provided further that the study shall define, evaluate and recommend, if applicable, other types of funds that may be suitable for consideration, for whatever reasons by the State; provided further that the results of this study shall have general applicability to the State; and provided further that these audits and study shall be submitted to the legislature for review no later than twenty days prior to the convening of the 1994 regular session.