KDLY LLC
CERTIFIED PUBLIC ACCOUNTANTS

Harbors Division
Department of Transportation
State of Hawaii

(An Enterprise Fund of the State of Hawaii)

Financial Statements and Supplemental Information
(With Independent Auditors' Report Thereon)

June 30, 2014 and 2013

Submitted by

THE AUDITOR
STATE OF HAWAII

Harbors Division
Department of Transportation
State of Hawaii
(An Enterprise Fund of the State of Hawaii)

Financial Statements and Supplemental Information

June 30, 2014 and 2013

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PART I

INTRODUCTION SECTION

KKDLY LLC
CERTIFIED PUBLIC ACCOUNTANTS

December 22, 2014

The Auditor
State of Hawaii:

We have completed our audit of the financial statements of the Harbors Division, Department of Transportation, State of Hawaii (the Harbors Division), an enterprise fund of the State of Hawaii, as of and for the years ended June 30, 2014 and 2013, as listed in the table of contents. We transmit herewith our reports containing our opinion on those financial statements and our 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.*

Audit Objectives

The objectives of the audits were as follows:

1. To provide an opinion on the fair presentation of the Harbors Division's financial statements in accordance with accounting principles generally accepted in the United States of America.

2. To consider the Harbors Division's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements.

3. To perform tests of the Harbors Division's compliance with laws, regulations, contracts, and grants that may have a direct and material effect on the determination of financial statement amounts.

Scope of Audit

We performed the audits of the Harbors Division's financial statements as of and for the years ended June 30, 2014 and 2013, in accordance with auditing standards generally accepted in the United States of America, as adopted by the American Institute of Certified Public Accountants, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

As part of the audits of the Harbors Division's financial statements, we performed tests of the Harbors Division's compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. We also considered the Harbors Division's system of internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements.

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Organization of Report

This report has been organized into three parts as follows:

1. The Introduction Section describes briefly the objectives and scope of our audits and the organization and contents of this report.

2. The Financial Section includes management's discussion and analysis, the Harbors Division's financial statements and the related notes, and supplemental information, as of and for the years ended June 30, 2014 and 2013, and our independent auditors' report thereon.

3. The Internal Control and Compliance Section contains our report on the Harbors Division's internal control over financial reporting and on compliance and other matters based on an audit of the financial statements performed in accordance with *Government Auditing Standards*.

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We would like to take this opportunity to express our appreciation for the courtesy and assistance extended to us by the personnel of the Harbors Division during the course of our audit. Should you wish to discuss any of the matters contained herein, we will be pleased to meet with you at your convenience.

Very truly yours,

KKDLY LLC

PART II

FINANCIAL SECTION

Independent Auditors' Report

The Auditor
State of Hawaii:

Report on the Financial Statements

We have audited the accompanying financial statements of the Harbors Division, Department of Transportation, State of Hawaii (the Harbors Division), an enterprise fund of the State of Hawaii, which comprise the statements of net position as of June 30, 2014 and 2013, and the related statements of revenues, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Harbors Division as of June 30, 2014 and 2013, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

Change in Accounting Principle

As discussed in Note 2 to the financial statements, the Harbors Division adopted Governmental Accounting Standards Board Statement No. 65, *Items Previously Reported as Assets and Liabilities*, effective July 1, 2013. Accordingly, the Harbors Division retrospectively applied the effects of this adoption to its financial statements as of and for the year ended June 30, 2013. Our opinion is not modified with respect to that matter.

Relationship to the State of Hawaii

As discussed in Note 1 to the financial statements, the financial statements of the Harbors Division are intended to present the financial position, the changes in financial position, and cash flows of only that portion of the business-type activities and each major fund of the State of Hawaii that is attributable to the transactions of the Harbors Division. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2014 and 2013, the changes in its financial position, and where applicable, its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 6 through 18 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Harbors Division's basic financial statements. The supplementary information included in Schedules 1 through 5 is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 22, 2014, on our consideration of the Harbors Division'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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Harbors Division's internal control over financial reporting and compliance.

KKDLY LLC

Honolulu, Hawaii
December 22, 2014

Harbors Division
Department of Transportation
State of Hawaii
(An Enterprise Fund of the State of Hawaii)

Management's Discussion and Analysis

June 30, 2014 and 2013

The following Management's Discussion and Analysis of the Harbors Division, Department of Transportation, State of Hawaii (the Harbors Division), an enterprise fund of the State of Hawaii, presents the reader with an introduction and overview of the Harbors Division's financial performance for the fiscal years ended June 30, 2014 and 2013. This discussion has been prepared by management and should be read in conjunction with the financial statements, and the notes thereto, which follow this section.

The statewide system of commercial harbors consists of ten harbors on six islands. The system plays a vital role in Hawaii's economy as the ports serve as the primary means for goods to enter and exit the state. Hawaii imports approximately 80% of what it consumes, the majority of which enters the state through the commercial harbors system.

The Harbors Division is self-sustaining. The Department of Transportation, State of Hawaii (DOT), is authorized to impose and collect rates and charges for the use of the harbors system and its properties to generate revenues to fund operating expenses. The Capital Improvements Program (CIP) is also funded by the Harbors Division's revenues and proceeds from the issuance of harbors system revenue bonds.

Using the Financial Statements

The Harbors Division is accounted for as a proprietary fund and utilizes the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. The proprietary fund includes the enterprise fund type, which 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 Harbors Division's financial report includes three financial statements; the statements of net position, the statements of revenues, expenses, and changes in net position, and the statements of cash flows. The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) as promulgated by the Governmental Accounting Standards Board (GASB).

Change in Accounting Principle

Effective July 1, 2013, the Harbors Division adopted GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. Prior to adoption of this statement, the Harbors Division capitalized costs relating to the issuance of bonds and amortized those costs over the term of the bonds. Unamortized bond issue costs were reported as a noncurrent asset in the statements of net position. GASB Statement No. 65 requires that bond issuance costs be recognized as an expense in the period incurred. In addition, prior to adoption of this statement, unamortized deferred charge on refunding was reported as a deduction from revenue bonds payable in the statements of net position. GASB Statement No. 65 requires that the unamortized deferred charge on refunding be reported as deferred outflows of resources in the statements of net position.

As further discussed in Note 2, the Harbors Division has elected to retrospectively apply the effects of this change in accounting principle to the accompanying financial statements. With respect to the previously reported unamortized bond issuance costs amounting to $3.4 million and $3.6 million at June 30, 2013 and 2012, respectively, and related amortization of those costs of $219,000 and $246,000, respectively, for the years then ended, the adoption of GASB Statement No. 65 had the effect of decreasing previously reported total assets and net position at June, 30, 2013 and 2012 by $3.4 million and $3.6 million, respectively, and increasing previously reported change in net position for the years then ended by $219,000 and $246,000, respectively. In addition, with respect to the unamortized deferred charge on refunding amounting to $4.7 million and $5.2 million at June 30, 2013 and 2012, respectively, the adoption of GASB Statement No. 65 had the effect of increasing previously reported revenue bonds payable and deferred outflows of resources by $4.7 million and $5.2 million at June 30, 2013 and 2012, respectively.

Financial Highlights

- The Harbors Division's net position at June 30, 2014 and 2013 amounted to $743.3 million and $710.9 million, respectively. Net position increased by $32.4 million in fiscal year 2014, an increase of 4.6%. Net position increased by $27.8 million in fiscal year 2013, an increase of 4.1%.

- Operating income amounted to $50.1 million in fiscal year 2014, an increase of $7.4 million or 17.4% as compared to 2013. Operating income amounted to $42.7 million in fiscal year 2013, an increase of $2.6 million or 6.4% as compared to 2012.

Harbors Division
Department of Transportation
State of Hawaii
(An Enterprise Fund of the State of Hawaii)

Management's Discussion and Analysis

June 30, 2014 and 2013

A summary of operations and changes in net position for the fiscal years ended June 30, 2014, 2013, and 2012 follows:

Table 1
Condensed Statement of Revenues,
Expenses, and Changes in Net Position
(In Thousands)

	Year Ended June 30			2014 – 2013		2013 – 2012	
	2014	2013 (A)	2012 (A)	Increase (decrease)	% Change	Increase (decrease)	% Change
Operating revenues	$ 121,338	$ 112,671	$ 103,877	$ 8,667	7.7%	$ 8,794	8.5%
Nonoperating revenues	1,041	867	801	174	20.1	66	8.2
Total revenues	122,379	113,538	104,678	8,841	7.8	8,860	8.5
Depreciation and amortization	23,633	22,751	20,561	882	3.9	2,190	10.7
Other operating expenses	47,560	47,202	43,170	358	0.8	4,032	9.3
Nonoperating expenses	18,502	20,378	20,850	(1,876)	(9.2)	(472)	(2.3)
Total expenses	89,695	90,331	84,581	(636)	(0.7)	5,750	6.8
Net increase (decrease) in the fair value of amounts held in State Treasury	-	1,102	(408)	(1,102)	(100.0)	1,510	370.1
Income before capital contributions and transfers	32,684	24,309	19,689	8,375	34.5	4,620	23.5
Capital contributions	-	4,115	19,357	(4,115)	(100.0)	(15,242)	(78.7)
Transfers out	(300)	(610)	-	310	(50.8)	(610)	(100.0)
Increase in net position	$ 32,384	$ 27,814	$ 39,046	$ 4,570	16.4%	$ (11,232)	(28.8%)

(A) As restated. See page 6, *Change in Accounting Principle*.

Operating Revenues

Total operating revenues for fiscal year 2014 were $121.3 million compared to $112.7 million for fiscal year 2013. Total operating revenues for fiscal year 2013 were $112.7 million compared to $103.9 million for fiscal year 2012. Operating revenues consist primarily of service revenues and rental revenues, which accounted for 76.1% and 22.0%, respectively, in fiscal year 2014, and 73.3% and 24.8%, respectively, in fiscal year 2013, of the Harbors Division's total operating revenues.

Service Revenues

Service revenues are directly related to cargo and ship operations. Service revenues include wharfage, passenger fees, and other ship related fees. Service revenues in fiscal years 2014 and 2013 were $92.4 million and $82.6 million, respectively.

Service revenues for fiscal year 2014 increased $9.7 million or 11.8% as compared to fiscal year 2013. Wharfage revenue from cargo movements increased by $9.4 million from $66.9 million in fiscal year 2013 to $76.3 million in fiscal year 2014 due primarily to increases in tariff rates that took effect on July 1, 2013 of 7% that were applied to the rates then in effect. In addition, passenger fees increased by $0.2 million from $6.7 million in fiscal year 2013 to $6.9 million in fiscal year 2014, mooring charges increased by $0.2 million from $0.8 million in fiscal year 2013 to $1.0 million in fiscal year 2014; dockage fees for fiscal 2014 were at $5.2 million, consistent with the $5.1 million earned in fiscal year 2013.

Service revenues for fiscal year 2013 increased $10.7 million or 14.8% as compared to fiscal year 2012. Wharfage revenue from cargo movements increased by $9.8 million from $57.1 million in fiscal year 2012 to $66.9 million in fiscal year 2013 due primarily to increases in tariff rates that took effect on July 1, 2012 of 10% that were applied to the rates then in effect. In addition, dockage fees decreased by $0.2 million from $5.3 million in fiscal year 2012 to $5.1 million in fiscal year 2013 and passenger fees increased by $1.0 million from $5.7 million in fiscal year 2012 to $6.7 million in fiscal year 2013.

During fiscal year 2014, approximately 1.15 million passengers (inbound and outbound) passed through the harbors as compared to 1.210 million passengers in fiscal year 2013 and 1.15 million passengers in fiscal year 2012.

Passenger fee revenue increased by $0.2 million or 3.5% from $6.7 million in 2013 to $6.9 million in fiscal year 2014, due primarily to changes in the fee rate structure that took effect July 1, 2012, which provided for a change, effective July 1, 2013, in the embark and debark fee to $6.00 per passenger from that assessed through June 30, 2013 of $5.50 per passenger.

Passenger fee revenue increased by $1.0 million or 16.0%, from $5.7 million in 2012 to $6.7 million in fiscal year 2013, due primarily to changes in the passenger fee rate structure that took effect on July 1, 2012. Prior to July 1, 2011, passengers on American flagged vessels were assessed a debark fee of $2.50 and an embark fee of $2.50 at Honolulu Harbor and an in-transit fee of $1.85 per passenger at each in-transit neighbor island port as their vessels were on a continuous voyage whose point of origination and termination was a state port. Passengers on a foreign flagged vessel were assessed a $2.50 debark fee and a $2.50 embark fee at every call made at a State commercial port. Effective July 1, 2011, U.S. and foreign flagged passengers were charged a $5.00 embark fee and a $5.00 debark fee at the first and last port calls and a $5.00 in-transit fee at each in-transit port between the first and last ports. Effective July 1, 2012, the embark and debark fee increased to $5.50 per passenger. An administrative interpretation was made by the Deputy Director, Harbors Division, that for cruiseships with an itinerary calling on multiple commercial harbors, passengers aboard foreign-flagged vessels would be assessed a $5.50 per passenger embark fee and a $5.50 per passenger debark fee at the first commercial harbor port call, and a $5.50 in-transit fee at each commercial harbor port call thereafter.

Passenger counts for fiscal year 2014 decreased by approximately 8.0% due to changes in how passengers were counted under the new rate structure in effect on July 1, 2012. In 2013 passenger counts increased by approximately 8.6% due to changes in how passengers were counted under the new rate structure in effect on July 1, 2012. Approximately 51.7% of the fiscal year 2014 passengers were in-transit while 50% of the fiscal year 2013 passengers were in-transit. The year-over-year percentage decrease is a result of a change in the rate structure.

Rental Revenues

Rental revenues in fiscal years 2014 and 2013 were $26.7 million and $27.9 million, respectively. The decrease in rental revenue of $1.2 million or 4.3% from fiscal year 2013 to fiscal year 2014 was due primarily to the loss of rental fees of approximately $1.6 million resulting from the February 28, 2014 termination of tenant agreements for areas rented at the Kapalama Military Reservation that were in effect during fiscal year 2013 and for eight months of fiscal year 2014.

Rental revenues in fiscal years 2013 and 2012 were $27.9 million and $29.0 million, respectively. The decrease in rental revenue of $1.1 million or 3.6% from fiscal year 2012 to fiscal year 2013 was due primarily to a $2.8 million transfer of funds from the Department of Business, Economic Development & Tourism (DBEDT) on behalf of the Aloha Tower Special Fund in fiscal year 2012 pursuant to Act 152, SLH 2011 (see Note 14).

Operating Expenses

Operating expenses, excluding depreciation and amortization, for fiscal years 2014 and 2013 amounted to $47.6 million and $47.2 million, respectively. The increase in operating expenses from fiscal year 2013 to fiscal year 2014 of $357,000 or 0.8% was due primarily to increases in harbor operations costs of approximately $369,000, personnel services costs of approximately $617,000, costs of fireboat operations of approximately $180,000, administrative expense assessments for services provided by other State of Hawaii departments of approximately $1.2 million offset by decreases in maintenance expenses of approximately $543,000 and general administration expense of approximately $1.5 million.

Operating expenses, excluding depreciation and amortization, for fiscal years 2013 and 2012 amounted to $47.2 million and $43.2 million, respectively. The increase in operating expenses from fiscal year 2012 to fiscal year 2013 of $4.0 million or 9.3% was due primarily to increases in harbor operations costs of approximately $542,000, personnel services costs of approximately $1.7 million, general administration expenses of approximately $936,000, and maintenance expenses of approximately $668,000.

Harbor operations costs for fiscal year 2014 increased by approximately $369,000 as compared to fiscal year 2013 due primarily to increases in ceded land assessments of approximately $154,000, which resulted from increased revenues earned from land parcels, including submerged lands designated as ceded lands and an increase in harbor operating costs and harbor security costs of approximately $215,000.

Harbor operations costs for fiscal year 2013 increased by approximately $542,000 as compared to fiscal year 2012 due primarily to an increase in ceded land assessments of approximately $1.6 million, which resulted from increased revenues earned from the land parcels designated as ceded lands and an increase in harbor security costs of approximately $634,000. These increases in harbor operations costs for fiscal year 2013 were partially offset as in fiscal year 2012, the Harbors Division recorded project cost write-downs related to asset impairment of approximately $1.7 million for potential projects that were considered to be no longer viable. In fiscal year 2012, the harbor operations expenses increased by approximately $3.7 million as compared to fiscal year 2011 due primarily to an increase of $1.7 million for expenses related to potential projects ($459,000 for feasibility studies to modify Kawaihae Harbor and $914,000 for Environmental Impact Studies and a Rapid Response EIS for Kahului Harbor related to the operation of a statewide ferry such as that of the Hawaii Superferry), and an increase in ceded land assessments of approximately $1.5 million, which resulted from increased revenues earned from the land parcels

Personnel services costs for fiscal year 2014 increased by approximately $617,000 as compared to fiscal year 2013 due primarily to increases in wages and employee benefits costs paid of approximately $1.3 million, due primarily to the implementation of pay increases provided by Collective Bargaining Agreements that became effective July 1, 2013 for all Harbors Division employees, partially offset by a decrease in the post retirement liability of approximately $524,000 and by a decrease in workers compensation expense of approximately $152,000. In fiscal year 2013 personnel services increased by approximately $1.7 million as compared to fiscal year 2012 due primarily to increases in wages and employee benefits costs paid of approximately $1.2 million, an increase in the post retirement liability of approximately $721,000 offset by a decrease in workers compensation expense of $226,000.

Central services costs for fiscal year 2014 increased by approximately $568,000 as compared to fiscal year 2013 due to expected higher earnings resulting from the tariff increases of 7% implemented July 1, 2013 against which the 5% State assessment is applied. In fiscal year 2013, central services costs increased by $568,000 as compared to fiscal year 2012 due to expected higher earnings resulting from the tariff increases of 10% implemented July 1, 2012 against which the 5% State assessment is applied.

General administration costs for fiscal year 2014 decreased by approximately $1.5 million as compared to fiscal year 2013 due primarily to the accrual of an additional provision of $1.3 million for judgments and claims recorded for fiscal year 2013. In fiscal year 2013, general administration costs increased by approximately $936,000 as compared to fiscal year 2012 due primarily to the accrual of an additional provision of $1.3 million for judgments and claims recorded for fiscal year 2013 that were offset by the payment made in fiscal year 2012 of $257,000 to the U.S. Army Corps of Engineers for the Harbors Division's share of a GIS study.

Harbor maintenance expenses for fiscal year 2014 decreased by approximately $543,000 as compared to fiscal year 2013 due primarily to increases in maintenance costs of $134,000 offset by decreases in fiscal year 2014 special maintenance costs of $677,000 expended for maintenance projects that did not extend the service life of harbor assets. Most of the special maintenance project expenditures for fiscal year 2014 extended the service life of the related harbor assets and were capitalized. In fiscal year 2013, harbor maintenance expenses increased by approximately $668,000 as compared to fiscal year 2012 due primarily to increases in maintenance costs of $505,000 and special maintenance costs of $163,000 expended for maintenance projects that did not extend the service life of harbor assets. Most of the special maintenance project expenditures for fiscal year 2012 extended the service life of the related harbor assets and were capitalized.

Fireboat operations expenses for fiscal year 2014 increased by approximately $180,000 as compared to fiscal year 2013 due to an accrual of estimated operating costs for the three-month period ended June 30, 2014 recorded for fiscal year 2014 that exceeded actual 2014 costs by approximately $110,000. In fiscal year 2013, fireboat operations decreased by $476,000 as compared to fiscal year 2012 primarily because of an accrual of estimated operating costs for the three-month period ended June 30, 2012 recorded for fiscal year 2012 that exceeded the actual costs incurred by approximately $150,000, with the remaining decrease in these expenses resulting from lower operating costs incurred during fiscal year 2013.

Department of Transportation, general administration expenses for fiscal year 2014 increased as compared to fiscal year 2013 by approximately $669,000 due to higher assessments for the year. These assessments are based upon estimated annual revenues.

Transfers to Other Department

During the fiscal year ended June 30, 2014 and 2013, the Harbors Division transferred $300,000 and $610,632, respectively to the Department of Land and Natural Resources, State of Hawaii, to pay for the compensatory mitigation plan related to the dredging of Hilo Harbor as part of the construction of the Inter-Island Cargo Terminal Facility and to design and construct commuter ferry improvements at Molokai's Kaunakakai Harbor.

Harbors Division
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Management's Discussion and Analysis

June 30, 2014 and 2013

A summary of the Harbors Division's net position at June 30, 2014, 2013, and 2012 are shown below:

Table 2
Condensed Statements of Net Position
(In Thousands)

	As of June 30			2014 – 2013		2013 – 2012	
	2014	2013 (A)	2012 (A)	Increase (decrease)	% Change	Increase (decrease)	% Change
Current and other assets	$ 422,572	$ 406,944	$ 415,996	$ 15,628	3.8%	$ (9,052)	(2.2%)
Capital assets	745,637	739,453	712,925	6,184	0.8	26,528	3.7
Total assets	1,168,209	1,146,397	1,128,921	21,812	1.9	17,476	1.5
Deferred outflows of resources	4,311	4,744	5,234	(433)	(9.1)	(490)	(9.4)
Current liabilities	46,398	43,566	42,189	2,832	6.5	1,377	3.3
Long-term liabilities	382,830	396,667	408,872	(13,837)	(3.5)	(12,205)	(3.0)
Total liabilities	429,228	440,233	451,061	(11,005)	(2.5)	(10,828)	(2.4)
Net position:							
Net investment in capital assets	510,870	517,419	514,514	(6,549)	(1.3)	2,905	0.6
Restricted	88,455	93,626	84,359	(5,171)	(5.5)	9,267	11.0
Unrestricted	143,967	99,863	84,221	44,104	44.2	15,642	18.6
Total net position	$ 743,292	$ 710,908	$ 683,094	$ 32,384	4.6%	$ 27,814	4.1%

(A) As restated. See page 6, *Change in Accounting Principle*.

Net Position

The largest portion of the Harbors Division's net position (68.7% and 72.8% at June 30, 2014 and 2013, respectively), net investment in capital assets, represents its investment in capital assets (e.g., land, wharves, buildings, improvements, and equipment), less related indebtedness outstanding to acquire those capital assets. The Harbors Division uses these capital assets to provide services to its users of the harbors system; consequently, these assets are not available for future spending. Although the Harbors Division's net investment in its capital assets is reported net of related debt, the resources required to repay this debt must be provided annually from operations, since it is unlikely the capital assets themselves will be liquidated to pay for such liabilities.

The restricted portion of the Harbors Division's net position (11.9% and 13.2% at June 30, 2014 and 2013, respectively) represents bond reserve and other funds that are subject to external restrictions on how they may be used.

The unrestricted portion of the Harbors Division's net position (19.4% and 14.0% at June 30, 2014 and 2013, respectively) may be used to meet any of the Harbors Division's ongoing operations or to fund capital improvement projects.

The change in net position is an indicator of whether the overall fiscal condition of the Harbors Division improved or worsened during the fiscal year. The change in net position may serve over time as a useful indicator of the Harbor Division's financial position. Net position or the amount of total assets and deferred outflows of resources that exceed liabilities amounted to $743.3 million at June 30, 2014, an increase in net position of $32.4 million or 4.6% from 2013. Net position or the amount of total assets and deferred outflows of resources that exceed liabilities amounted to $710.9 million at June 30, 2013, an increase in net position of $27.8 million or 4.1% from 2012.

Capital Assets and Debt Administration

Capital Assets

As of June 30, 2014 and 2013, the Harbors Division had $745.6 million and $739.5 million, respectively invested in capital assets as shown in Table 3. There was a net increase (additions, deductions, and depreciation) of $6.1 million in 2014 from the prior year, and a net increase in 2013 of $26.5 million from 2012.

Table 3
Capital Assets
(In Thousands)

	As of June 30			2014 – 2013		2013 – 2012	
	2014	2013	2012	Increase (decrease)	% Change	Increase (decrease)	% Change
Land and land improvements	$ 533,894	$ 530,509	$ 509,017	$ 3,385	0.6%	$ 21,492	4.2%
Wharves	269,153	269,047	258,798	106	0.0	10,249	4.0
Other improvements	73,946	73,946	70,610	-	0.0	3,336	4.7
Buildings	97,259	92,251	90,559	5,008	5.4	1,692	1.9
Equipment	18,130	21,775	19,755	(3,645)	(16.7)	2,020	10.2
Total at cost	992,382	987,528	948,739	4,854	0.5	38,789	4.1
Less accumulated depreciation	(305,967)	(286,551)	(264,027)	(19,416)	6.8	(22,524)	8.5
	686,415	700,977	684,712	(14,562)	(2.1)	16,265	2.4
Construction in progress	59,222	38,476	28,213	20,746	53.9	10,263	36.4
Total capital assets, net	$ 745,637	$ 739,453	$ 712,925	$ 6,184	0.8%	$ 26,528	3.7%

Major capital asset additions to the statewide harbors system for the fiscal year ended June 30, 2014, included the following:

- $4.9 million Pier 1 Shed Modifications, Hilo Harbor, Hawaii Island
- $2.0 million Access and Electrical Improvements, Kalaeloa Barbers Point Harbor, Oahu
- $1.1 million Pier 39 Yard Lighting and Shed Demolition, Honolulu Harbor, Oahu

Major capital asset additions to the statewide harbors system for the fiscal year ended June 30, 2013, included the following:

- $20.7 million Purchase of Land at Kalaeloa Harbor, Oahu
- $3.5 million Various Harbor Security Improvements on Hawaii Island, and on Kauai, including the Reconstruction of Fences on Hawaii Island, on Maui and on Kauai
- $1.7 million Substructure Repairs at Piers 1, 2, 10 and 21, Honolulu Harbor, Oahu
- $1.5 million Purchase of Various Security Equipment
- $1.3 million Waterline and Piles Repairs at Piers 24-26, Honolulu Harbor, Oahu
- $1.0 million Substructure Repairs at Piers 1, 2 and 3, Kahului Harbor, Maui

In addition to those capital asset additions, the Harbors Division is currently in the process of constructing the following projects statewide:

- $19.5 million Construction of Building and Yard Improvements at Piers 34 and 35, Honolulu Harbor, Oahu
- $14.0 million Construction of Inter-Island Cargo Terminal Facility, Hilo Harbor, Hawaii Island
- $10.8 million Construction of Pier 4 Container Yard, Hilo Harbor, Hawaii Island
- $1.5 million Substructure and Waterline Repairs at Pier 35, Honolulu Harbor, Oahu
- $1.2 million Pier 31 Shed Demolition, Lighting and Drainage Resolution, Honolulu Harbor, Oahu

Finally, the Harbors Division is currently designing improvements, some of which include the following projects statewide:

- $50.0 million Design and Construction of Pier 4 Inter-Island Cargo Terminal Facility, Hilo Harbor, Hawaii Island
- $15.4 million Land Acquisition and Design of Improvements, Kahului Harbor, Maui
- $14.0 million Kapalama Container Terminal Yard and Wharf Design, Honolulu Harbor, Oahu
- $12.0 million Design and Construction of Piers 12 and 15 Improvements, Honolulu Harbor, Oahu

- $10.0 million Design and Construction of Pier 2 Terminal Improvements, Kawaihae Harbor, Hawaii Island

- $7.9 million Maritime Wireless Network System, Statewide

- $7.0 million Pier 1 Shed Modifications Phase II, Hilo Harbor, Hawaii Island

- $2.0 million Pier 2 Strengthening, Hilo Harbor, Hawaii Island

The Harbors Division is committed under contracts awarded for capital improvement projects totaling approximately $61.3 million as of June 30, 2014.

Additional information regarding the Harbors Division's capital assets can be found in Note 4.

Indebtedness

Harbors System Revenue Bonds and Reimbursable General Obligation Bonds

Harbor system revenue bonds have been issued pursuant to the *Certificate of the Director of Transportation Providing for the Issuance of 1997 State of Hawaii Harbor Revenue Bonds* (the 1997 Certificate) and are collateralized by a charge and lien on the Harbors Division's revenues. The proceeds from these bonds are used for harbor and waterfront improvements. As of June 30, 2014 and 2013, outstanding harbor system revenue bonds amounted to $351.0 million and $363.9 million, respectively.

In August 2013, the Harbors Division issued $23.6 million of Series A of 2013 Revenue Refunding Bonds through a private placement transaction with Capital One Public Funding, LLC. These bonds refunded the Series A of 2000 and Series B of 2002 Revenue Bonds.

Reimbursable general obligation bonds are general obligations of the State, but since the proceeds were used to finance the harbor and waterfront improvements, the Harbors Division is required to reimburse the State's general fund for the payment of principal and interest on such bonds. As of June 30, 2014 and 2013, outstanding reimbursable general obligation bonds amounted to $31.2 million and $32.9 million, respectively. There have been no issuances of reimbursable general obligation bonds to finance the harbor and waterfront improvements during fiscal years 2014 and 2013.

Additional information regarding the Harbors Division's indebtedness can be found in Notes 5, 6, 7, and 8.

Credit Rating and Bond Insurance

All harbor system revenue bonds issued since 1997 through June 30, 2010 have been issued with bond insurance. A new reserve policy replaced all previously issued surety bonds and the portion of the reserve requirement allocable to the Series B of 2010 Revenue Bonds. The surety policy was amended effective August 2, 2013 to include the reserve requirement allocable to the Series A of 2013 Revenue Refunding Bonds. The Series A of 2010 Revenue Bonds are secured by a cash deposit of $11.5 million. As of June 30, 2014, the underlying ratings for harbor system revenue bonds were as follows:

- Standard and Poor's A+
- Moody's Investors Service A2
- Fitch IBCA, Inc. A+

Ratings made by Standard and Poor's, Moody's Investors Service and Fitch IBCA, Inc. may be changed, suspended, or withdrawn as a result of changes in, or unavailability of, information. Ratings provided by these rating companies are not "market ratings," as the ratings are not a recommendation to buy, hold, or sell any security.

Bond Covenants

Bond covenants allow the issuance of additional debt, on parity, as to a lien on the net revenues of the Harbors Division provided certain net revenue ratios are met. Net revenues of the Harbors Division must be at least 1.25 times the debt service requirements under the 1997 Certificate.

The Harbors Division coverage ratio as of June 30, 2014 was 2.83 under the 1997 Certificate as compared to the ratio of 2.55 as of June 30, 2013.

Request for Information

The financial report is designed to provide a general overview of the Harbors Division's finances for all interested parties. Questions concerning any of the information provided in this report or requests for additional information should be addressed in writing to the Harbors Administrator, State of Hawaii, Department of Transportation, Harbors Division, 79 S. Nimitz Highway, Honolulu, Hawaii, 96813, or by e-mail to *davis.k.yogi@hawaii.gov.*

Harbors Division

Department of Transportation

State of Hawaii

(An Enterprise Fund of the State of Hawaii)

Statements of Net Position

June 30, 2014 and 2013

Assets	**2014**	**2013**
Current assets:		
Cash and cash equivalents *(Note 3)*	$ 165,399,402	$ 133,217,857
Receivables, less allowance for doubtful accounts of $3,906,000 in 2014 and $3,716,000 in 2013	9,446,461	9,125,570
Notes receivable, less allowance for doubtful accounts of $3,777,650 in 2014 and $4,164,150 in 2013 *(Notes 14 and 15)*	-	-
Interest receivable	98,301	176,366
Due from the Federal government	-	935,608
Due from other State agencies	412,323	412,323
Other receivables	13,873	16,712
Materials and supplies, at cost	63,025	61,678
Prepaid insurance and others	874,301	843,145
	176,307,686	144,789,259
Restricted assets:		
Cash and cash equivalents *(Notes 3, 6, and 7)*	33,894,516	33,659,027
Total current assets	210,202,202	178,448,286
Noncurrent assets:		
Cash and cash equivalents−restricted *(Notes 3 and 7)*	212,232,136	228,218,722
Capital assets *(Notes 4, 9, and 16)*		
Nondepreciable facilities	278,984,247	278,984,247
Depreciable facilities, net	407,430,282	421,993,227
Construction in progress	59,222,312	38,475,562
Total capital assets, net	745,636,841	739,453,036
Other assets	138,098	276,196
Total noncurrent assets	958,007,075	967,947,954
Total assets	1,168,209,277	1,146,396,240
Deferred outflows of resources:		
Deferred charge on refunding, net *(Notes 2 and 6)*	4,310,845	4,744,410
Total deferred outflows of resources	4,310,845	4,744,410

Liabilities	**2014**	**2013**
Current liabilities (payable from current assets):		
Accounts payable *(Note 18)*	$ 5,396,938	$ 9,011,521
Accrued workers' compensation *(Notes 5 and 12)*	78,656	133,807
Contracts payable, including retainages *(Note 18)*	1,164,289	185,116
Accrued vacation *(Note 5)*	672,090	616,787
Due to Department of Budget and Finance	3,259,960	3,385,274
	10,571,933	13,332,505
Current liabilities (payable from restricted assets):		
Contracts payable, including retainages	9,398,733	3,090,092
Revenue bonds payable, current maturities *(Notes 2, 5, 6, and 7)*	13,833,900	13,011,741
General obligation bonds payable, current maturities (*Notes 5 and 8*)	1,844,233	1,757,503
Accrued interest payable - revenue bonds	8,556,343	9,548,993
Security deposits	2,193,354	2,825,457
	35,826,563	30,233,786
Total current liabilities	46,398,496	43,566,291
Long-term liabilities:		
Accrued workers' compensation *(Notes 5 and 12)*	488,489	681,038
Other postretirement benefits payable *(Notes 5 and 11)*	13,176,085	10,989,674
Long-term debt, less current maturities:		
Revenue bonds payable, net *(Notes 2, 5, 6, and 7)*	338,215,302	352,248,871
General obligation bonds payable *(Notes 5 and 8)*	29,331,737	31,175,970
Accrued vacation *(Note 5)*	1,618,607	1,571,178
Total long-term liabilities	382,830,220	396,666,731
Total liabilities	429,228,716	440,233,022
Net Position		
Net investment in capital assets	510,869,883	517,418,709
Restricted - revenue bond requirements	33,894,516	33,659,027
Restricted - for capital projects	54,559,878	59,966,434
Unrestricted, as restated *(Note 2)*	143,967,129	99,863,458
Total net position	$ 743,291,406	$ 710,907,628

See accompanying notes to financial statements.

Harbors Division

Department of Transportation

State of Hawaii

(An Enterprise Fund of the State of Hawaii)

Statements of Revenues, Expenses, and Changes in Net Position

Years Ended June 30, 2014 and 2013

	2014	2013
Operating revenues, net *(Note 6)* :		
Services	$ 92,356,198	$ 82,621,790
Rentals *(Note 10)*	26,720,360	27,922,446
Others	2,261,804	2,126,295
	121,338,362	112,670,531
Operating expenses:		
Depreciation and amortization, including depreciation of capital assets of $23,494,969 during 2014 and $22,612,573 during 2013 *(Note 4)*	23,633,068	22,750,671
Harbor operations *(Note 13)*	18,561,432	18,192,431
Personnel services *(Note 11)*	16,774,964	16,157,634
State of Hawaii, surcharge for central service expenses *(Note 14)*	3,861,000	3,293,227
General administration	2,977,903	4,480,978
Maintenance	1,919,776	2,462,386
Department of Transportation, general administration expenses *(Note 14)*	1,792,965	1,123,618
Fireboat operations *(Note 14)*	1,671,882	1,492,160
	71,192,990	69,953,105
Operating income	50,145,372	42,717,426
Nonoperating revenues (expenses):		
Interest expense *(Notes 6, 8, and 9)*	(18,176,233)	(20,249,732)
Interest income *(Note 3):*		
Deposits in investment pool	672,837	867,495
Net increase in the fair value of amounts held in State Treasury *(Note 3)*	-	1,102,327
Gain (loss) on disposal of capital assets	367,920	(5,375)
Bond issuance costs	(253,912)	-
Amortization of bond premium, discount, and deferred charge on refunding	(72,206)	(123,316)
	(17,461,594)	(18,408,601)
Income before capital contributions and transfers	32,683,778	24,308,825
Capital contributions	-	4,115,303
Transfers out *(Note 14)*	(300,000)	(610,632)
Increase in net position	32,383,778	27,813,496
Net position, beginning of year, as restated *(Note 2)*	710,907,628	683,094,132
Net position, end of year, as restated *(Note 2)*	$ 743,291,406	$ 710,907,628

See accompanying notes to financial statements.

Harbors Division

Department of Transportation

State of Hawaii

(An Enterprise Fund of the State of Hawaii)

Statements of Cash Flows

Years Ended June 30, 2014 and 2013

	2014	2013
Cash flows from operating activities:		
Cash received from customers	$ 120,262,892	$ 112,321,191
Cash paid to suppliers	(33,545,330)	(27,385,613)
Cash paid to employees	(14,641,062)	(13,724,964)
Net cash provided by operating activities	72,076,500	71,210,614
Cash flows used in noncapital financing activities:		
Transfers to other department	(300,000)	(610,632)
Cash flows from capital and related financing activities:		
Government grants received in aid of construction	935,608	9,548,111
Acquisition and construction of capital assets	(21,822,946)	(50,951,861)
Principal paid on bonds	(38,222,503)	(13,718,481)
Proceeds from bond issuance	23,615,000	-
Interest paid on bonds	(20,348,201)	(21,170,765)
Bond issuance costs paid	(253,912)	-
Net cash used in capital and related financing activities	(56,096,954)	(76,292,996)
Cash flows from investing activities:		
Interest received	750,902	869,240
Change in fair value of investments of pooled cash balances	-	1,102,327
Net cash provided by investing activities	750,902	1,971,567
Net increase (decrease) in cash and cash equivalents	16,430,448	(3,721,447)
Cash and cash equivalents at beginning of year	395,095,606	398,817,053
Cash and cash equivalents at end of year	$ 411,526,054	$ 395,095,606

(Continued on following page)

Harbors Division

Department of Transportation

State of Hawaii

(An Enterprise Fund of the State of Hawaii)

Statements of Cash Flows (Continued)

Years Ended June 30, 2014 and 2013

	2014	2013
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 50,145,372	$ 42,717,426
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation of capital assets	23,494,969	22,612,573
Other amortization	138,098	138,098
Provision for doubtful accounts	189,822	105,200
Changes in assets and liabilities:		
Receivables	(507,874)	(529,837)
Materials and supplies	(1,347)	183,092
Prepaid insurance and others	(31,156)	-
Payables	(2,635,410)	3,283,809
Accrued vacation	102,732	2,950
Accrued workers' compensation	(247,700)	(88,783)
Other postretirement benefits payable	2,186,411	2,710,789
Security deposits	(632,103)	(3,078)
Due to Department of Budget and Finance	(125,314)	78,375
Net cash provided by operating activities	$ 72,076,500	$ 71,210,614
Supplemental disclosure of noncash capital and related financial activities:		
Amortization of bond premium, discount, and deferred charge on refunding	$ (72,206)	$ (123,316)

See accompanying notes to financial statements.

1. Financial Reporting Entity

In 1959, the Harbors Division was established within the Department of Transportation of the State of Hawaii (the DOT) effective July 1, 1961. All functions and powers to administer, control, and supervise all State of Hawaii (the State) harbors and water navigational facilities were assigned to the Director of the DOT on that date.

The Harbors Division is part of the DOT, which is part of the executive branch of the State. The State Comptroller maintains the central accounts for all State funds and publishes financial statements for the State annually, which include the Harbors Division's financial activities. The accompanying financial statements present only the activities of the Harbors Division and are not intended to present fairly the financial position of the State and the changes in its financial position and cash flows of its business–type activities in conformity with accounting principles generally accepted in the United States of America (GAAP).

The "Certificate of the Director of Transportation Providing for the Issuance of 1997 State of Hawaii Harbor Revenue Bonds," dated March 1, 1997 (1997 Certificate), defines the "Undertaking" as all of the harbor and waterfront improvements and other properties under the jurisdiction, control, and management of the Harbors Division, except those principally used for recreation and the landing of fish.

2. Summary of Significant Accounting Policies

Measurement Focus and Basis of Accounting

The accounting policies of the Harbors Division conform to GAAP as applicable to enterprise activities of governmental units, as promulgated by the Governmental Accounting Standards Board (GASB). The Harbors Division applies all applicable GASB Statements and Interpretations.

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 Harbors Division's operations are accounted for using the economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Change in Accounting Principle

Effective July 1, 2013, the Harbors Division adopted GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This statement redefines certain financial statement elements previously reported as assets and liabilities as deferred outflows of resources and deferred inflows of resources. In addition, this statement changes the method of reporting bond issuance costs.

Prior to adoption of GASB Statement No. 65, the Harbors Division capitalized costs relating to the issuance of bonds and amortized those costs over the term of the bonds. Unamortized bond issue costs were reported as a noncurrent asset in the statements of net position. GASB Statement No. 65 requires that bond issuance costs be recognized as an expense in the period incurred.

In addition, prior to adoption of GASB Statement No. 65, unamortized deferred charge on refunding was reported as a deduction from revenue bonds payable in the statements of net position. GASB Statement No. 65 requires that the unamortized deferred charge on refunding be reported as deferred outflows of resources in the statements of net position.

The Harbors Division has elected to retrospectively apply the effects of this change in accounting principle to the accompanying financial statements. With respect to unamortized bond issuance costs amounting to $3,403,285 at June 30, 2013, and related amortization of those costs of $218,744 for the year then ended, the adoption of GASB Statement No. 65 had the effect of decreasing previously reported total assets and net position at June, 30, 2013 by $3,403,285, and increasing previously reported change in net position for the year then ended by $218,744, as well as decreasing previously reported net position at June 30, 2012 by $3,622,029. In addition, with respect to the unamortized deferred charge on refunding amounting to $4,744,410 at June 30, 2013, the adoption of GASB Statement No. 65 had the effect of increasing previously reported revenue bonds payable and deferred outflows of resources by $4,744,410.

Cash and Cash Equivalents

Cash and cash equivalents include all cash and investments with original maturities of three months or less and amounts held in State Treasury.

Restricted Assets

Restricted assets consist of monies and other resources, including amounts for the principal and interest accumulated to make debt service payments, unspent bond proceeds, amounts restricted for bond reserve requirements, security deposits, and customer advances.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are reported at their gross value when earned, reduced by an allowance for doubtful accounts.

Accounts are written-off upon the approval of the State Department of the Attorney General, when it believes, after considering economic conditions, business conditions, and collection efforts, that the accounts are uncollectible.

The allowance for doubtful accounts is increased by charges to operating income and decreased by charge-offs (net of recoveries). Management's periodic evaluation of the adequacy of the allowance is based on the adverse situations that may affect the customer's ability to repay, historical experience, and current economic conditions. Past due status is determined based on contractual terms.

Risk Management

The Harbors Division is exposed to various risks for losses related to, among other risks, torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and injuries to employees. A liability for a claim for a risk of loss is established if information indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss is reasonably estimable.

Capital Assets and Depreciation

Capital assets are stated at cost. Depreciation of capital assets is computed using the straight-line method over the estimated useful lives of the assets. Disposals of assets are recorded by removing the cost and related accumulated depreciation from the accounts with the resulting gain or loss reflected in nonoperating revenues (expenses).

Capital assets and their related estimated useful lives used to compute depreciation are as follows:

	Useful Lives	Capitalization Threshold
Land improvements	10 – 100 years	$ 100,000
Wharves	10 – 100 years	100,000
Buildings	5 – 50 years	100,000
Other improvements	5 – 50 years	100,000
Equipment	5 – 20 years	5,000

Maintenance and repairs, as well as minor replacements, renewals, and betterments, are charged to operations. Major renewals, replacements, and betterments which extend the service lives of the related assets are capitalized in the year incurred. Interest cost is capitalized during the period of construction for capital improvement projects, except those projects funded by grants from the State or the Federal government.

Bond Issuance Costs

Costs relating to the issuance of bonds are expensed as incurred and are reflected in nonoperating revenues (expenses).

Unamortized Debt Premium (Discount)

Debt premium (discount) is amortized using the effective interest rate method over the term of the related debt, and the unamortized balance is reflected as an offset against the related liabilities in the statements of net position.

Refunding of Debt

The difference between the reacquisition price and the net carrying amount of the old debt is deferred and amortized as a component of interest expense in a systematic and rational manner over the remaining life of the old debt or the life of the new debt, whichever is shorter. The deferred charge on refunding amounted to $4,310,845 and $4,744,410 at June 30, 2014 and 2013, respectively, and are reported as deferred outflows of resources in the statements of net position.

Deferred Outflows/Inflows of Resources

In addition to assets, the statements of net position will report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expense) until then. The Harbors Division only has one item that qualifies for reporting in this category. It is the deferred charge on refunding reported in the statements of net position.

In addition to liabilities, the statements of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time. The Harbors Division does not have any deferred inflows of resources at June 30, 2014 and 2013.

Accrued Vacation

The Harbors Division accrues all vacation and compensatory pay at current salary rates, including additional amounts for certain salary-related expenses associated with the payment of compensated absences. Vacation is earned at the rate of 168 hours per calendar year, depending on an employee's date of hire. Accumulation of such vacation credits is limited to 720 hours at calendar year-end and is convertible to pay upon termination of employment.

Net Position

Net position is reported in three categories as follows:

Net investment in capital assets - represents the Harbors Division's investment in capital assets, less related indebtedness outstanding to acquire those capital assets.

Restricted - represents bond reserve funds that are subject to external restrictions on how they may be used.

Unrestricted - may be used to meet any of the Harbors Division's ongoing operations or fund capital improvement projects.

Operating Revenues

Operating revenues are those that result from providing goods and services and are reported net of bad debt. The provision for bad debts for the years ended June 30, 2014 and 2013 was approximately $190,000 and $105,000, respectively. Operating revenues also exclude revenues related to capital and related financing activities, noncapital financing activities, and investing activities.

The Harbors Division has pledged its future operating revenues, net of certain operating expenses, to repay $351,045,000 in Harbor Revenue Bonds. Proceeds from the bonds provided financing for the construction of new facilities and the improvement of existing facilities related to the State's commercial harbors. The bonds are payable solely from the Harbors Division's operating revenues and are payable through July 2040.

The total principal and interest remaining to be paid on the bonds is approximately $573,237,000. Principal and interest paid (as defined by the Harbor revenue bond debt service requirements under the 1997 certificate) and total operating revenues, net of certain operating expenses, were approximately $31,528,000 and $84,082,190 respectively, for the year ended June 30, 2014, and approximately $31,531,000 and $75,858,000 respectively, for the year ended June 30, 2013.

Operating Expenses

All expenses related to operating the Harbors Division are reported as operating expenses. Interest income, interest expense, financing costs, and gain (loss) on disposal of capital assets are reported as nonoperating revenues (expenses).

When an expense is incurred for which unrestricted and restricted resources are available to pay the expense, it is the Harbors Division's policy to apply the expense to unrestricted resources first, then to restricted resources.

Capital Contributions

The Harbors Division receives federal grants restricted for capital asset acquisition and facility development. Grants are considered earned as the related allowable expenditures are incurred, and are reported in the statements of revenues, expenses, and changes in net position, after nonoperating revenues (expenses) as capital contributions.

Use of Estimates

The preparation of financial statements in conformity with GAAP 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. Significant estimates include the valuation of receivables, the estimated useful lives of capital assets, and reserves for postemployment benefits and claims and judgments. Actual results could differ from those estimates.

Recently Issued Accounting Pronouncements

GASB Statement No. 68

The GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27*, which will become effective for financial statements for fiscal years beginning after June 15, 2014. This statement establishes standards of accounting and financial reporting for defined benefit pensions and defined contribution pensions provided to the employees of state and local governmental employers through pension plans that are administered through trusts or equivalent arrangements in which:

- Contributions from employers and nonemployer contributing entities to the pension plan and earnings on those contributions are irrevocable.

- Pension plan assets are dedicated to providing pensions to plan members in accordance with the benefit terms.

- Pension plan assets are legally protected from the creditors of employers, nonemployer contributing entities, and the pension plan administrator. If the plan is a defined benefit pension plan, plan assets also are legally protected from creditors of the plan members.

This statement replaces the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, as well as the requirements of GASB Statement No. 50, *Pension Disclosures*, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements that meet certain criteria. The requirements of GASB Statements No. 27 and No. 50 remain applicable for pensions that are not covered by the scope of this statement.

The Harbors Division is currently evaluating the impact that GASB Statement No. 68 will have on its financial statements.

GASB Statement No. 71

The GASB issued Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date, an amendment of GASB Statement No. 68*, which should be applied simultaneously with the provisions of GASB Statement No. 68. This statement amends the requirement related to certain pension contributions made to defined benefit pension plans prior to implementation of GASB Statement No. 68 by employers and nonemployer contributing entities. The Harbors Division is currently evaluating the impact that GASB Statement No. 71 will have on its financial statements.

3. Cash and Cash Equivalents

Cash and cash equivalents at June 30, 2014 and 2013 consisted of the following:

	2014	2013
Amounts held in State Treasury	$ 411,312,143	$ 393,251,972
Petty cash and other	213,911	1,843,634
	$ 411,526,054	$ 395,095,606

Such amounts are reflected in the statements of net position at June 30, 2014 and 2013 as follows:

	2014	2013
Current assets:		
Unrestricted	$ 165,399,402	$ 133,217,857
Restricted	33,894,516	33,659,027
Noncurrent assets:		
Restricted	212,232,136	228,218,722
	$ 411,526,054	$ 395,095,606

Amounts Held in State Treasury

The State maintains an investment pool that is used by various state departments and agencies, including the Harbors Division. The amount reported as amounts held in State Treasury reflects the Harbors Division’s relative position in the State’s investment pool. For demand or checking accounts and time certificates of deposits, the State requires that the depository banks pledge collateral based on the daily available bank balances to limit its exposure to custodial credit risk. The use of daily available bank balances to determine collateral requirements results in the available balances being under-collateralized at times during the fiscal year. All securities pledged as collateral are held either by the State Treasury or by the State’s fiscal agents in the name of the State.

The State Director of Finance (the Director) is responsible for the safekeeping of all monies paid into the State Treasury. The Director pools and invests any monies of the State, which, in the Director’s judgment, are in excess of amounts necessary for meeting the specific requirements of the State. Legally authorized investments include obligations of or guaranteed by the U.S. government, obligations of the State, federally insured savings and checking accounts, time certificates of deposit, repurchase agreements, commercial paper, banker’s acceptances, and money market funds maintaining a Triple-A rating.

At June 30, 2014 and 2013, the amounts reported as amounts held in State Treasury reflects the Harbors Division's relative position in the State's investment pool and amounted to $411,312,143 and $393,251,972, respectively.

At June 30, 2012, a portion of the State's investment pool was invested in auction rate securities collateralized by student loans issued by the federal government. The State settled its position in these auction rate securities during the year ended June 30, 2013. During fiscal year 2013, the Harbors Division's allocated share of the adjustment to record the gain on the final settlement amounted to $1,102,327. This is reflected as a net increase in the fair value of amounts held in State Treasury in the accompanying statements of revenues, expenses, and changes in net position.

Interest Rate Risk

As a means of limiting its exposure to fair value losses arising from rising interest rates, the State's investment policy generally limits maturities on investments to not more than five years from the date of investment.

Credit Risk

The State's investment policy limits its investments to investments in state and U.S. Treasury securities, time certificates of deposit, U.S. government or agency obligations, repurchase agreements, commercial paper, banker's acceptances, and money market funds maintaining a Triple-A rating.

Custodial Risk

For an investment, custodial risk is the risk that, in the event of the failure of the counterparty, the State will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The State's investments are held at broker/dealer firms, which are protected by the Securities Investor Protection Corporation (SIPC) up to a maximum amount. In addition, excess-SIPC coverage is provided by the firms' insurance policies. In addition, the State requires the institutions to set aside in safekeeping certain types of securities to collateralize repurchase agreements. The State monitors the market value of these securities and obtains additional collateral when appropriate.

Concentration of Credit Risk

The State's policy provides guidelines for portfolio diversification by placing limits on the amount the State may invest in any one issuer, types of investment instruments, and position limits per issue of an investment instrument.

Information relating to the amounts held in State Treasury is determined on a statewide basis and not for individual departments or agencies. Information regarding the carrying amount and corresponding bank balances of the investment pool and collateralization of the investment pool balances, as well as interest rate risk, credit risk, custodial risk, and concentration of credit risk, is included in the Comprehensive Annual Financial Report (CAFR) of the State.

The Harbors Division's share of the State's investment pool, as provided in the fiscal year 2013 CAFR of the State and summarized in the table below (amounts in thousands), was 14% at June 30, 2013:

		Maturity (in years)		
	Fair value	**Less than 1**	**1-5**	**>5**
Investments - Primary Government:				
Certificates of deposit	$ 976,243	$ 878,619	$ 97,624	$ -
U.S. government securities	1,092,462	567,854	320,667	203,941
Repurchase agreements	255,683	219,887	35,796	-
	$ 2,324,388	$ 1,666,360	$ 454,087	$ 203,941
Investments - Fiduciary Funds:				
Certificates of deposit	$ 166,308	$ 149,677	$ 16,631	$ -
U.S. government securities	186,106	99,614	50,716	35,776
Repurchase agreements	43,557	37,459	6,098	-
	$ 395,971	$ 286,750	$ 73,445	$ 35,776

Information relating to the State's investment pool at June 30, 2014 will be included in the CAFR of the State when issued.

4. Capital Assets

Capital asset activity for the years ended June 30, 2014 and 2013 were as follows:

	Balance July 1, 2013	Additions	Deductions	Balance June 30, 2014
Nondepreciable assets:				
Land improvements	$ 278,984,247	$ -	$ -	$ 278,984,247
Depreciable assets:				
Land improvements	251,525,051	3,384,322	-	254,909,373
Wharves	269,047,228	106,087	-	269,153,315
Other improvements	73,945,682	-	-	73,945,682
Buildings	92,250,714	5,008,657	-	97,259,371
Equipment	21,775,483	447,538	(4,092,831)	18,130,190
Total at cost	987,528,405	8,946,604	(4,092,831)	992,382,178
Less accumulated depreciation for:				
Land improvements	73,181,393	9,106,529	-	82,287,922
Wharves	124,755,778	8,523,776	-	133,279,554
Other improvements	38,399,310	2,254,496	-	40,653,806
Buildings	35,732,803	2,360,125	-	38,092,928
Equipment	14,481,647	1,250,043	(4,078,251)	11,653,439
Total accumulated depreciation	286,550,931	23,494,969	(4,078,251)	305,967,649
Construction in progress	38,475,562	29,331,169	(8,584,419)	59,222,312
Total capital assets, net	$ 739,453,036	$ 14,782,804	$ (8,598,999)	$ 745,636,841

	Balance July 1, 2012	**Additions**	**Deductions**	**Balance June 30, 2013**
Nondepreciable assets:				
Land improvements	$ 258,284,247	$ 20,700,000	$ -	$ 278,984,247
Depreciable assets:				
Land improvements	250,732,745	792,306	-	251,525,051
Wharves	258,798,133	10,249,095	-	269,047,228
Other improvements	70,610,158	3,345,415	(9,891)	73,945,682
Buildings	90,559,353	1,691,361	-	92,250,714
Equipment	19,754,461	2,115,268	(94,246)	21,775,483
Total at cost	948,739,097	38,893,445	(104,137)	987,528,405
Less accumulated depreciation for:				
Land improvements	64,127,673	9,053,720	-	73,181,393
Wharves	117,056,011	7,699,767	-	124,755,778
Other improvements	36,457,524	1,941,786	-	38,399,310
Buildings	33,362,015	2,370,788	-	35,732,803
Equipment	13,024,005	1,546,512	(88,870)	14,481,647
Total accumulated depreciation	264,027,228	22,612,573	(88,870)	286,550,931
Construction in progress	28,213,475	26,820,981	(16,558,894)	38,475,562
Total capital assets, net	$ 712,925,344	$ 43,101,853	$ (16,574,161)	$ 739,453,036

5. Long-Term Liabilities

The changes in long-term liabilities were as follows:

	Balance July 1, 2013	Additions	Deductions	Balance June 30, 2014	Current	Noncurrent
Accrued workers' compensation (Note 12)	$ 814,845	$ 248,278	$ 495,978	$ 567,145	$ 78,656	$ 488,489
Accrued vacation	2,187,965	1,056,780	954,048	2,290,697	672,090	1,618,607
Other postretirement benefits payable (Note 11)	10,989,674	3,301,739	1,115,328	13,176,085	-	13,176,085
General obligation bonds (Note 8)	32,933,473	-	1,757,503	31,175,970	1,844,233	29,331,737
Revenue bonds (Note 6)	363,895,000	23,615,000	36,465,000	351,045,000	13,505,000	337,540,000
Less:						
Unamortized discount	(15,415)	-	(15,415)	-	-	-
Unamortized premium	1,381,027	-	376,825	1,004,202	328,900	675,302
Revenue bonds, net	365,260,612	23,615,000	36,826,410	352,049,202	13,833,900	338,215,302
	$ 412,186,569	$ 28,221,797	$ 41,149,267	$ 399,259,099	$ 16,428,879	$ 382,830,220

	Balance July 1, 2012	Additions	Deductions	Balance June 30, 2013	Current	Noncurrent
Accrued workers' compensation (Note 12)	$ 903,628	$ 105,617	$ 194,400	$ 814,845	$ 133,807	$ 681,038
Accrued vacation	2,185,015	886,117	883,167	2,187,965	616,787	1,571,178
Other postretirement benefits payable (Note 11)	8,278,885	3,730,780	1,019,991	10,989,674	-	10,989,674
General obligation bonds (Note 8)	34,611,954	-	1,678,481	32,933,473	1,757,503	31,175,970
Revenue bonds (Note 6)	375,935,000	-	12,040,000	363,895,000	12,655,000	351,240,000
Less:						
Unamortized discount	(17,270)	-	(1,855)	(15,415)	(1,857)	(13,558)
Unamortized premium	1,748,771	-	367,744	1,381,027	358,598	1,022,429
Revenue bonds, net	377,666,501	-	12,405,889	365,260,612	13,011,741	352,248,871
	$ 423,645,983	$ 4,722,514	$ 16,181,928	$ 412,186,569	$ 15,519,838	$ 396,666,731

6. Revenue Bonds Payable

Pursuant to authorization from the State Legislature, the Director of DOT issued the 1997 Certificate, which provides for the issuance of bonds at any time and from time-to-time upon compliance with certain conditions of the 1997 Certificate.

The Harbor Revenue Bonds (Revenue Bonds) are collateralized by a charge and lien on the revenues of the Public Undertaking as defined in the 1997 Certificate.

The Revenue Bonds are subject to redemption at the option of the Director of DOT and the State during specific years at prices ranging from 102% to 100% of face value.

In August 2013, the Harbors Division issued $23,615,000 of Series A of 2013 Revenue Refunding Bonds through a private placement transaction with Capital One Public Funding, LLC. The Harbors Division's net proceeds of $23,347,000 (after payment of $268,000 in underwriting fees), were used to advance refund the Series A of 2000 and Series B of 2002 Revenue Bonds. The 2013 refunding resulted in a difference between the acquisition price and net carrying amount of the refunded debt of $571,000. This difference is included in deferred charge on refunding in the accompanying statements of net position. This bond refunding provided net present value savings of approximately $3.94 million as measured from the closing date at a fixed coupon rate of 3.25%.

The following is a summary of the Revenue Bonds issued and outstanding at June 30, 2014:

Year of Issue	Final Redemption Date	Interest Rate	Original Amount of Issue	Current: Principal Due July 1, 2014	Current: Principal Due January 1, 2015	Total Current	Noncurrent
2004	January 1, 2024	2.50-6.00%	$ 52,030,000	$ -	$ 1,505,000	$ 1,505,000	$ 17,775,000
2006	January 1, 2031	4.00-5.25%	96,570,000	-	2,930,000	2,930,000	74,710,000
2007	July 1, 2027	4.25-5.50%	51,645,000	1,920,000	-	1,920,000	36,000,000
2010	July 1, 2040	3.00-5.75%	201,390,000	6,315,000	-	6,315,000	186,620,000
2013	July 1, 2029	3.25%	23,615,000	835,000	-	835,000	22,435,000
			$ 425,250,000	$ 9,070,000	$ 4,435,000	13,505,000	337,540,000
Less:							
Unamortized premium						328,900	675,302
						$ 13,833,900	$338,215,302

The following is a summary of the Revenue Bonds issued and outstanding at June 30, 2013:

Year of Issue	Final Redemption Date	Interest Rate	Original Amount of Issue	Current: Principal Due July 1, 2013	Current: Principal Due January 1, 2014	Total Current	Noncurrent
2000	July 1, 2029	5.75%	$ 79,405,000	$ -	$ -	$ -	$ 14,670,000
2002	July 1, 2019	3.00-5.50%	24,420,000	610,000	-	610,000	8,795,000
2004	January 1, 2024	2.50-6.00%	52,030,000	-	1,430,000	1,430,000	19,280,000
2006	January 1, 2031	4.00-5.25%	96,570,000	-	2,780,000	2,780,000	77,640,000
2007	July 1, 2027	4.25-5.50%	51,645,000	4,475,000	-	4,475,000	37,920,000
2010	July 1, 2040	3.00-5.75%	201,390,000	3,360,000	-	3,360,000	192,935,000
			$ 505,460,000	$ 8,445,000	$ 4,210,000	12,655,000	351,240,000
Less:							
Unamortized discount						(1,857)	(13,558)
Unamortized premium						358,598	1,022,429
						$13,011,741	$352,248,871

Debt service requirements to maturity for the Revenue Bonds are as follows:

Fiscal Year Ending June 30	Principal	Interest	Total
2015	$ 13,505,000	$ 17,670,891	$ 31,175,891
2016	14,170,000	17,016,685	31,186,685
2017	14,865,000	16,311,410	31,176,410
2018	15,610,000	15,584,466	31,194,466
2019	16,380,000	14,817,416	31,197,416
2020-2024	89,575,000	61,247,394	150,822,394
2025-2029	72,620,000	41,124,250	113,744,250
2030-2034	48,025,000	24,533,650	72,558,650
2035-2039	44,620,000	12,650,025	57,270,025
2040-2041	21,675,000	1,236,234	22,911,234
	$ 351,045,000	$ 222,192,421	$ 573,237,421

The debt service requirements reflect the sum of the amounts to be paid in accordance with the repayment schedules of the bonds issued. Principal and interest payments are required to be funded in the 12-month and 6-month periods, respectively, preceding the date on which the payments are due. Accordingly, the debt service requirements include reserves of $22,439,483 as of June 30, 2014, for principal payments $13,505,000 due on July 1, 2014 and January 1, 2015, and for interest payments $8,934,483 due on July 1, 2014.

7. Harbor Revenue Bond Requirements

1997 Certificate – Minimum Net Revenue Requirement

Pursuant to Section 6.03 of the 1997 Certificate, the Harbors Division covenants and agrees that so long as any of the Revenue Bonds remain outstanding, it will enforce and collect fees, rates, rents, and charges for the Public Undertaking that will yield net revenue, as defined by the 1997 Certificate, for the immediately ensuing 12 months, in an amount at least sufficient to:

(1) Together with funds legally available, therefore including any amounts on deposit in the harbor reserve and contingency account; an aggregate sum equal to at least 1.25 times the total amount of: (i) the interest payments for such 12 months on all the Revenue Bonds outstanding under the 1997 Certificate, (ii) the principal amount of the Revenue Bonds maturing by their terms during such 12 months and (iii) the minimum sinking fund payments for all Revenue Bonds required to be made during such 12 months; and

(2) Without consideration of other funds, shall be at least equal to 1.00 times the bond service for such 12 months.

The Harbor Revenue Bond debt service requirements, including minimum sinking fund payments during the current fiscal year, computed in accordance with Section 6.03 of the 1997 Certificate totaled $31,528,177. Net revenues of the Public Undertaking, as defined by the 1997 Certificate amounted to $89,209,935 or 2.83 times the minimum net revenue requirement for the fiscal year ended June 30, 2014, and $80,526,477 or 2.55 times the minimum net revenue requirement for the fiscal year ended June 30, 2013.

Harbor Special Fund

All revenues are deposited into this fund and applied in the order of priority set forth under the 1997 Certificate. Section 5.01 of the 1997 Certificate requires that the following accounts be established:

(1) *Harbor Interest Account*

Equal monthly installments sufficient to pay for the interest next becoming due on the Revenue Bonds are required to be paid into this account. This requirement was met as of June 30, 2014 and 2013.

(2) *Harbor Principal Account*

Commencing with the first business day of each fiscal year, equal monthly payments are required to be made to this account sufficient to redeem the Revenue Bonds scheduled for redemption on the following July 1 and January 1. This requirement was met as of June 30, 2014 and 2013.

(*3)* *Harbor Debt Service Reserve Account*

In order to provide a reserve for the payment of the principal and interest on the Revenue Bonds, the Harbors Division is required to deposit in the harbor revenue special fund an amount equal to the lesser of: (a) the average annual bond service on such series and (b) the amount permitted by the Internal Revenue Code of 1986 in order that the interest on such series is excluded from gross income for federal income tax purposes.

Furthermore, the Harbors Division is required to satisfy the reserve requirement of maximum aggregate bond service by no later than the first date on which a principal installment is payable on July 1 or January 1 of each fiscal year.

In lieu of the credit of monies to the harbor debt service reserve account, the Harbors Division may cause to be so credited a surety bond or an insurance policy payable to the Harbors Division for the benefit of the holders of the Revenue Bonds of a series or a letter of credit in an amount equal to the difference between the reserve requirement and the amounts then on credit to the harbor debt service reserve account. In the event a surety bond, insurance policy, or letter of credit is secured to satisfy that portion of the reserve requirement allocable to a series of Revenue Bonds, so long as such surety bond, insurance policy, or letter of credit is in effect, the owners of such series of Revenue Bonds shall not be entitled to payment from or a lien on the funds on deposit in the harbor revenue special fund credited to the harbor debt service reserve account to satisfy that portion of the reserve requirement allocable to other series of Revenue Bonds, nor shall the owners of Revenue Bonds of such other series be entitled to any payment from such surety bond, insurance policy, or letter of credit. The surety bond, insurance policy, or letter of credit shall be payable (upon the giving of notice as required thereunder) on any date on which monies will be required to be applied from the harbor debt service reserve account to the payment of the principal or interest on any Revenue Bonds of such series and such withdrawals may not be made from amounts credited to the harbor debt service reserve account for such series of Revenue Bonds.

Prior to the use of a surety bond, insurance policy, or letter of credit pursuant to the provisions of this paragraph (other than any such use at the time of issuance of the 1997 Series Revenue Bonds), DOT shall receive written confirmation from the rating agency that the rating on the Revenue Bonds outstanding as then in effect shall not be reduced as a result of such use. If a disbursement is made pursuant to a surety bond, an insurance policy, or a letter of credit provided pursuant to this paragraph, the Harbors Division shall be obligated either: (a) to reinstate the maximum limits of such surety bond, insurance policy, or letter of credit or (b) to credit to the harbor debt service reserve account, funds in the amount of the disbursement made under such surety bond, insurance policy, or letter of credit, or a combination of such alternatives, as shall provide that the amount credited to the harbor debt service reserve account allocable to a series of Revenue Bonds equals that portion of the reserve requirement allocable to such series; provided, however, a failure to immediately restore such reserve requirement shall not constitute an event of default if the reserve requirement is restored within the time period permitted by Section 11.01(c) (90 days following the required notice). Notwithstanding the provisions of Section 11.01(c), the Harbors Division shall not permit any surety bond, insurance policy, or letter of credit which has been established in lieu of a deposit into the harbor revenue special fund for credit to the harbor debt service reserve account to terminate or expire prior to depositing to such fund for credit to such account the amount satisfied previously by the surety bond, insurance policy, or letter of credit.

(4) Harbor Reserve and Contingency Account

Monies on credit to the harbor reserve and contingency account may be used to make up any deficiency with respect to any series of Revenue Bonds in the harbor interest account, the harbor principal account and the harbor debt service reserve account. To the extent not used to make up any such deficiencies, monies on credit to the harbor reserve and contingency account may be used for any other purpose within the jurisdiction, powers, duties, and functions of the Harbors Division.

8. General Obligation Bonds

In fiscal 2006, the State issued $350,000,000 of General Obligation bonds, Series DI, dated March 23, 2006; in fiscal 2007, the State issued $350,000,000 of General Obligation bonds, Series DJ, dated March 28, 2007; and in fiscal 2008, the State issued $375,000,000 of General Obligation bonds, Series DK, dated May 1, 2008. Interest rates on outstanding Series DI, Series DJ, and Series DK General Obligation bonds range from 3.25% to 5.00%.

Reimbursable general obligation bonds are general obligations of the State, but since the proceeds were used to finance the harbor and waterfront improvements, the Harbors Division is required to reimburse the State's general fund for the payment of principal and interest on such bonds. As of June 30, 2014 and 2013, outstanding reimbursable general obligation bonds amounted to approximately $31,176,000 and $32,933,000, respectively.

Debt service requirements to maturity for the General Obligation Bonds are as follows:

Fiscal Year Ending June 30	Principal	Interest	Total
2015	$ 1,844,233	$ 1,536,820	$ 3,381,053
2016	1,932,016	1,448,637	3,380,653
2017	2,022,854	1,357,966	3,380,820
2018	2,122,232	1,258,386	3,380,618
2019	2,227,919	1,152,889	3,380,808
2020-2024	12,896,100	4,007,716	16,903,816
2025-2028	8,130,616	804,234	8,934,850
	$ 31,175,970	$ 11,566,648	$ 42,742,618

9. Interest Cost

Total combined interest cost incurred related to Revenue and General Obligation Bonds for the fiscal years ended June 30, 2014 and 2013 amounted to approximately $19,355,000 and $20,877,000, respectively. Of this amount, approximately $1,179,000 and $627,000 were capitalized during fiscal years ended June 30, 2014 and 2013, respectively, as part of the construction cost of harbor facilities.

10. Leasing Operations

The Harbors Division's leasing operations consist principally of the leasing of land, wharf, and building space under revocable permits and long-term leases. The revocable permits provide for tenancy on a month-to-month basis and are renewable annually at the option of the State. The long-term leases, which are classified as operating leases, expire in various years through September 2058. These leases generally call for rental increases every five to ten years based on a step-up or independent appraisals of the fair rental value of the leased property.

The following is a schedule of approximate future minimum lease rentals on noncancelable operating leases as of June 30, 2014.

Fiscal Year Ending June 30	Amount
2015	$ 7,615,000
2016	7,376,000
2017	5,957,000
2018	5,671,000
2019	5,120,000
2020-2024	25,680,000
2025-2029	24,771,000
2030-2034	21,472,000
2035-2039	13,741,000
2040-2044	10,585,000
2045-2049	4,695,000
2050-2054	2,611,000
2055-2059	1,957,000
	$137,251,000

The above schedule does not include estimated future rental revenue for certain leases beyond their first 15 years. An estimate could not be made due to rental reopenings after the 15th year in which rental rates will be based upon the prevailing fair value.

11. Retirement Benefits

Employees' Retirement System of the State of Hawaii

Plan Description

All eligible employees of the State and counties, which includes the Harbors Division, are required by Chapter 88, Hawaii Revised Statutes (HRS), to become members of the Employees' Retirement System of the State of Hawaii (the ERS), a cost-sharing, multiple-employer defined benefit public employee retirement plan. The ERS provides retirement benefits, as well as death and disability benefits. All contributions, benefits, and eligibility requirements are established by Chapter 88, HRS, and can be amended by legislative action. The ERS is governed by a Board of Trustees. The ERS issues a comprehensive annual financial report that is available to the public. That report may be obtained by writing to the ERS at 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813, or through the ERS's website: www.ers.hawaii.gov.

Prior to June 30, 1984, the plan consisted of only a contributory plan. In 1984, legislation was enacted to add a new noncontributory plan for members of the ERS who are also covered under Social Security. Police officers, firefighters, judges, elected officials and persons employed in positions not covered by Social Security are precluded from the noncontributory plan. The noncontributory plan provides for reduced benefits and covers most eligible employees hired after June 30, 1984. Employees hired before that date were allowed to continue under the contributory plan or to elect the new noncontributory plan and receive a refund of employees contributions. All benefits vest after five and ten years of credited service under the contributory and noncontributory plans, respectively.

Both plans provide a monthly retirement allowance based on the employee's age, years of credited service, and average final compensation (AFC). The AFC is the average salary earned during the five highest paid years of service, including the vacation payment, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after that date is based on the three highest paid years of service, excluding the vacation payment.

On July 1, 2006, a new hybrid contributory plan became effective pursuant to Act 179, SLH of 2004. Members in the hybrid plan are eligible for retirement at age 62 with 5 years of credited service or age 55 and 30 years of credited service. Members receive a benefit multiplier of 2% for each year of credited service in the hybrid plan. The benefit payment options are similar to the current contributory plan. Almost 58,000 current members, all members of the noncontributory plan, and certain members of the contributory plan were eligible to join the new hybrid plan. Most of the new employees hired after July 1, 2006, were required to join the hybrid plan.

Effective July 1, 2012, the hybrid contributory plan was revised by Act 163, SLH 2011. Members joining the hybrid plan on or after that date are eligible for retirement at age 65 with 10 years of credited service or age 60 with 30 years of credited service. Members will receive a benefit multiplier of 1.75% for each year of credited service in the hybrid plan. The benefit options remain similar to the current contributory plan.

Funding Policy

Covered employees of the contributory plan who became members as of June 30, 2012 or after June 30, 2012 are required to contribute 7.8% or 9.8% of their salary, respectively. Police officers, firefighters, investigators of the departments of the County Prosecuting Attorney and the Attorney General, narcotics enforcement investigators, and public safety investigators who became members as of June 30, 2012 or after June 30, 2012 are required to contribute 12.2% or 14.2% of their salary, respectively. Covered employees of the hybrid plan who became members as of June 30, 2012 or after June 30, 2012 are required to contribute 6% or 8% of their salary, respectively. The funding method used to calculate the total employer contribution requirement is the Entry Age Normal Actuarial Cost Method. Effective July 1, 2005, employer contribution rates are a fixed percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liability.

Total contributions by the Harbors Division for the fiscal years ended June 30, 2014, 2013, and 2012 were approximately $1,722,000, $1,553,000, and $1,384,000 respectively. The Harbors Division contributed 100% of its required contribution for each of those years. Measurement of assets and actuarial valuations are made for the ERS as a whole and are not separately computed for individual participating employers such as the Harbors Division.

Postemployment Health Care and Life Insurance Benefits

The State, pursuant to Act 88, SLH of 2001, is a participating employer in an agent, multiple-employer defined benefit plan providing certain health care and life insurance benefits to all qualified employees. The Employer-Union Health Benefits Trust Fund (the EUTF) was established on July 1, 2003 to provide a single delivery system of health benefits for state and county workers, retirees, and their dependents.

For employees hired before July 1, 1996, the State pays the entire base monthly contribution for employees retiring with 10 or more years of credited service, and 50% of the base monthly contribution for employees retiring with fewer than 10 years of credited service. A retiree can elect a family plan to cover dependents.

For employees hired after June 30, 1996, but before July 1, 2001, and who retire with fewer than 10 years of service, the State makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the State pays 50% of the retired employees' base monthly contribution. For those retiring with at least 15 years but fewer than 25 years of service, the State pays 75% of the base monthly contribution. For those employees retiring with at least 25 years of service, the State pays 100% of the base monthly contribution. Retirees in this category can elect a family plan to cover dependents.

For employees hired on or after July 1, 2001, and who retire with fewer than 10 years of service, the State makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the State pays 50% of the base monthly contribution. For those retiring with at least 15 years but fewer than 25 years of service, the State pays 75% of the base monthly contribution.

For those employees retiring with at least 25 years of service, the State pays 100% of the base monthly contribution. Only single plan coverage is provided for retirees in this category. Retirees can elect family coverage, but must pay the difference.

For active employees, the employer's contributions are based upon negotiated collective bargaining agreements. Employer contributions for employees not covered by collective bargaining agreements and for retirees are prescribed by the HRS.

Measurement of the actuarial valuation and the annual required contribution (ARC) is made for the State as a whole and is not separately computed for the individual state departments and agencies such as the Harbors Division. The State allocates the ARC to the various departments and agencies based upon a systematic methodology.

The table below summarizes the components of the annual OPEB cost that have been allocated to the Harbors Division by the State.

	June 30, 2014	June 30, 2013
Annual required contribution	$ 3,302,000	$ 3,731,000
Contribution made	(1,116,000)	(1,020,000)
Increase in net OPEB obligation	2,186,000	2,711,000
Net OPEB obligation, beginning of the year	10,990,000	8,279,000
Net OPEB obligation, end of the year	$ 13,176,000	$ 10,990,000
Actual contributions made as a percentage of ARC	33.8%	27.3%

Contributions are financed on a pay-as-you-go basis and the Harbors Division's contributions for the fiscal years ended June 30, 2014, 2013, and 2012 were approximately $1,116,000, $1,020,000, and $735,000, respectively, which represents 33.8%, 27.3%, and 27.0%, respectively, of the annual required contribution.

The State's CAFR includes the required footnote disclosures and required supplementary information on the State's OPEB plans, including the actuarial methods and assumptions used. The State's CAFR can be obtained at the Department of Accounting and General Services' website: http://hawaii.gov/dags/rpts.

On July 3, 2013, the Governor signed into law Act 268, Session Laws of Hawaii 2013. Act 268 requires the EUTF to establish and administer separate trust accounts for each public employer for the purpose of receiving irrevocable employer contributions to prefund post-employment health and other benefit costs for retirees and their beneficiaries. It establishes the Hawaii EUTF Trust Fund Task Force to examine further steps to address the unfunded liability and requires all public employers to make annual required public employer contributions effective fiscal year 2014.

Commencing fiscal year 2019, the annual public employer contribution shall be equal to the annual required contribution, as determined by an actuary retained by the EUTF board. In any fiscal year, should an employer's contribution be less than the annual required public employer contribution, the difference shall be transferred to the appropriate trust account from a portion of all general excise tax revenues, for the State, or transient accommodations tax revenues, for the counties.

The EUTF issues an annual financial report that is available to the public. That report may be obtained by writing to the EUTF at P.O. Box 2121, Honolulu, Hawaii 96805-2121.

Deferred Compensation Plan

The State offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all State employees, permits employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

All plan assets are held in a trust fund to protect them from claims of general creditors. The State has no responsibility for loss due to the investment or failure of investment of funds and assets in the plan, but does have the duty of due care that would be required of an ordinary prudent investor. Accordingly, the assets and liabilities of the State's deferred compensation plan are not reported in the State's or the Harbors Division's financial statements.

12. Risk Management

The Harbors Division is exposed to various risks of loss related to, among other risks, torts; theft of, damage to, or destruction of assets; errors and omissions; workers' compensation and acts of terrorism. The Harbors Division records a liability for insurance related losses if it is determined that a loss has been incurred and the amount can be reasonably estimated.

The State retains various risks and insures certain excess layers with commercial insurance companies. The excess layers insured with commercial insurance companies are consistent with the prior fiscal year. Settled claims have not exceeded the coverage provided by commercial insurance companies in any of the past three fiscal years.

The State has an insurance policy for property coverage. The deductible for coverage is 3% of loss subject to a $1,000,000 per occurrence minimum. This policy includes windstorm, earthquake, flood damage, terrorism, and boiler and machinery coverage. The limit of loss per occurrence is $200,000,000 except for flood, which individually is a $200,000,000 aggregate loss, and earthquake, which individually is a $100,000,000 aggregate loss, and terrorism, which is $50,000,000 per occurrence and a $10,000 deductible.

The State also has a crime insurance policy for various types of coverages with a limit of loss of $10,000,000 per occurrence with a $500,000 deductible per occurrence, except for clients property, which has a $5,000,000 limit per occurrence, and claims expense coverage, which has a $100,000 limit per occurrence and a $1,000 deductible.

The Harbors Division obtained coverage for certain strategic piers and wharves infrastructure to mitigate its exposure to natural disasters from hurricane, earthquake, and flood (including a tsunami) events. The amount of insurance provided by this difference in conditions policy is $25,000,000 on an annual aggregate basis on a shared perils basis.

The State and, thus, the Harbors Division are generally self-insured for workers' compensation and automobile claims. The estimated reserve for losses and loss adjustment costs includes the accumulation of estimates for losses and claims reported prior to fiscal year end, estimates (based on projections of historical developments) or claims incurred but not reported, and estimates of costs for investigating and adjusting all incurred and unadjusted claims. Amounts reported are subject to the impact of future changes in economic and social conditions. The Harbors Division believes that, given the inherent variability in any such estimates, the reserves are within a reasonable and acceptable range of adequacy. Reserves are continually monitored and reviewed, and as settlements are made and reserves adjusted, the differences are reported in current operations. A liability for a claim is established if information indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss is reasonably estimable.

13. Ceded Lands

In previous years, the State was a defendant in a lawsuit filed by the Office of Hawaiian Affairs (OHA) related to the determination of ceded land payments due to OHA. During 2006, the State of Hawaii Supreme Court reaffirmed the dismissal of the lawsuit by OHA.

In 2006, the Legislature enacted Act 178, SLH 2006 (Act 178), to re-establish a mechanism for OHA to receive a portion of the income and proceeds from the Ceded Lands, for native Hawaiians, under Article XII, Sections 4 and 6 of the Hawaii Constitution. Among other things, Act 178 directs state agencies that collect receipts from the Ceded Lands to annually transfer a total of $15,100,000 in four equal quarterly installments to OHA, and directs the Governor to issue an executive order to establish procedures for this purpose. The Governor issued Executive Order No. 06-06 on September 20, 2006.

On April 11, 2012, the Governor signed Act 15, SLH 2012 (Act 15), into law. Act 15 conveys fee simple title to nine parcels of land located at Kakaako in Honolulu, valued at approximately $200,000,000, to OHA, as of July, 1, 2012. Act 15 also satisfies, resolves, discharges, releases, waives, extinguishes, prohibits, and bars, finally and completely, any and all claims, disputes, controversies, rights, actions, and causes of action, OHA (or parties claiming through OHA) has asserted or could have asserted to the income and proceeds from the Ceded Lands, under Article XII, Sections 4 and 6 of the Hawaii Constitution or any related statute or act, between November 7, 1978 (the date Article XII, Sections 4, 5, and 6 of the Hawaii Constitution were ratified) and June 30, 2012. Act 15 also withdrew any waiver of sovereign immunity the State may previously have made with respect to OHA's portion of receipts from Ceded Lands, and affirms that the State does not waive its sovereign immunity to permit a claim or suit to be brought to invalidate the act's operative provisions.

Until the Legislature alters the amount or establishes a different means for implementing Article XII, Sections 4 and 6 of the Hawaii Constitution, Act 178 serves as the means for satisfying the State's obligation to provide OHA with a portion of the income and proceeds from the Ceded Lands, for native Hawaiians.

Harbors Division was notified in March, 2014 that OHA contracted a consultant to conduct an audit of public land trust revenues of all state agencies, including the Harbors Division, for the fiscal year ended June 30, 2012. The outcome of the audit is not known.

Included in the Harbors Division's operating expenses in the accompanying statements of revenues, expenses, and changes in net position for the fiscal years ended June 30, 2014 and 2013 are approximately $10,926,000 and $10,773,000, respectively, of OHA ceded land expenses.

14. Transactions with Other Government Agencies

The State assesses a surcharge of 5% for central service expenses on all receipts of the Harbors Division, after deducting any amounts pledged, charged, or encumbered for the payment of bonds and interest during the fiscal year. The assessments amounted to approximately $3,861,000 and $3,293,000 for the fiscal years ended June 30, 2014 and 2013, respectively.

The Harbors Division is assessed a percentage of DOT's general administration expenses. The assessments amounted to approximately $1,793,000 and $1,124,000 for the fiscal years ended June 30, 2014 and 2013, respectively.

The Harbors Division incurred costs of approximately $1,672,000 and $1,492,000 for fireboat operation services provided by the City and County of Honolulu during the fiscal years ended June 30, 2014 and 2013, respectively. Act 69, SLH 2012 was enacted to abolish statutory requirements as of January 1, 2013 to reimburse the City and County of Honolulu for the operation and maintenance of the fireboat and allow for broader flexibility in the management of fireboat operations by the Harbors Division. The Harbors Division is in the process of determining new arrangements to allow for more economical management of a marine response program.

During the fiscal years ended June 30, 2014 and 2013, the Harbors Division transferred $300,000 and $610,632, respectively to the Department of Land and Natural Resources, State of Hawaii, to pay for the compensatory mitigation plan related to the dredging of Hilo Harbor as part of the construction of the Inter-Island Cargo Terminal Facility and to design and construct commuter ferry improvements at Molokai's Kaunakakai Harbor. These transfers were funded by capital appropriations made pursuant to Act 91, SLH 1999 and pursuant to Act 164, SLH 2011 as amended by Act 106, SLH 2012.

The Hawaii Harbors Task Force was formed in April 2005 by the Governor's office to respond on a priority basis to the pressing demands for infrastructure improvements in Honolulu Harbor. The Aloha Tower Development Corporation (ATDC) was tasked to work in partnership with the Harbors Division with the executive officer of the ATDC serving as the chief executive of the Hawaii Harbors Project Office. The ATDC was assigned to plan and execute major long-term redevelopment projects such as the former Kapalama Military Reservation and various projects at Honolulu Harbor. ATDC was an agency attached to the Department of Business, Economic Development & Tourism (DBEDT).

Act 200, Session Laws of Hawaii (SLH), 2008, was enacted to authorize a statewide Harbors Modernization Plan (HMP) to address harbor infrastructure improvements to Kahului Harbor on Maui, Nawiliwili Harbor on Kauai, Hilo and Kawaihae Harbors on Hawaii, and Honolulu and Kalaeloa Harbors on Oahu. In addition to the six commercial harbors included in the plan, the law placed Hana Harbor on Maui under the jurisdiction of the Harbors System and included appropriations for its upgrade. The Act authorizes the DOT to issue harbor revenue bonds to finance the improvements. The cost of the Harbors Modernization Plan, originally estimated at

\$842 million, was revised to \$618 million in 2008. Act 200 also designated the ATDC as the entity responsible for the management and implementation of the HMP under the direction of the DOT.

The State Legislature in its 2009 legislative session questioned ATDC's role and effectiveness and provided operational funding for only FY2010 of the FY2009-2011 biennium. In its 2010 legislative session, the Legislature did not restore operating funds to ATDC for FY2011, effectively terminating its operations on June 30, 2010. Contracts executed by ATDC for HMP projects were assigned to the Harbors Division, which assumed management and implementation responsibilities for the HMP. The modernization projects have been integrated into the administration's New Day Work Projects, a capital improvements program comprised of priority public works projects critical to create jobs and jumpstart the economy.

In the 2011 legislative session, Act 152, SLH 2011 was enacted to remove ATDC from DBEDT and place the agency under the Department of Transportation for administrative purposes, redefine the boundaries of the Aloha Tower complex and repealed references to the HMP, effective July 1, 2011. Act 152 provides that ATDC is headed by a three-member board comprised of the Directors of Transportation and DBEDT and the Deputy Director of Harbors. The Director of DBEDT chairs the board and the Deputy Director of Harbors serves as the acting Chief Executive Officer for the ATDC. Act 152 also provided that the unencumbered and unexpended fund balance in the Aloha Tower Fund shall lapse to the credit of the Harbor Special Fund to be used for operating expenses for the ATDC. DBEDT transferred the balance of approximately \$2.8 million to the Harbor Special Fund pursuant to Act 152. The \$2.8 million offset a portion of the \$7.8 million balance owed by ATDC to the Harbors Division for losses in revenue, obligations which were operating expenses for ATDC. In fiscal year 2012, as a result of this \$2.8 million transfer of funds, the Harbor's Division recorded \$2.8 million of additional rental revenue.

15. Aloha Tower Complex Development

The ATDC is a state agency established under HRS Chapter 206J, primarily to redevelop the Aloha Tower complex. The complex originally encompassed Piers 5 to 23 of Honolulu Harbor, but its boundaries were redefined by Act 152, SLH 2011. In September 1993, the Harbors Division entered into a lease with ATDC for certain portions of the Aloha Tower complex. ATDC is required annually to reimburse the Harbors Division for any losses in revenues during the term of the lease caused by any action of ATDC or the developer and to provide replacement facilities for maritime activities at no cost to the Harbors Division.

In September 1993, the ATDC subleased lands surrounded by Piers 8 and 9 and a portion of land surrounded by Pier 10 to a developer. The sublease required the developer to construct, at the developer's cost, various facilities including a Marketplace. The developer and the Harbors Division entered into a capital improvements, maintenance, operations, and securities agreement (Operations Agreement). The Operations Agreement allows the Harbors Division to operate the harbor facilities.

The developer later went into bankruptcy. The subsequent operator of the Marketplace assumed the obligations of the sublease and the Operations Agreement in March 1998. This replacement operator has also gone through a bankruptcy proceeding and there is a new operator who has assumed the same obligations. Although the Marketplace construction was substantially completed, several items on a Harbors Division construction punch list have yet to be completed and were pursued with the new operator. Many of the items were completed by the Harbors Division and the actual cost to complete the punchlist items were in dispute. A settlement was reached with the new operator to satisfy the punchlist obligations which have a total value of $3.5 million, depending upon when actual payments are made by the operator within a six-year timeframe.

On January 18, 2006, an Agreement amending the Aloha Tower Project Memorandum of Understanding and Aloha Tower Ground Lease was executed, effective as of June 30, 2005, and retroactive to July 1, 2004 (the Amendment). The Amendment required ATDC to pay $225,000 as a minimum annual base payment for losses in revenues owing in the fiscal year beginning July 1, 2004. From July 1, 2005, subject to the approval of the Deputy Director for the Harbors Division, the base payment of $225,000 was to be reduced by expenses incurred by ATDC for the Hawaii Harbors Project Office. The Amendment also required an equity participation payment to be made in an amount of 50% of the difference between the total revenues and total operating expenses of ATDC for a fiscal year (the equity payment), provided that if the equity payment exceeds two and one-half times the actual operating expenses of ATDC for such fiscal year, ATDC must make a supplemental payment equal to 75% of the difference between the equity payment and the product of two and one-half times the actual operating expenses of ATDC. These payments were to be applied to reduce the amount owed to the Harbors Division for losses in revenues by ATDC prior to July 1, 2004. The balance owed to the Harbors Division by ATDC under this Amendment as of June 30, 2014 and 2013 was approximately $3,761,000 and $4,148,000 respectively, and is included in notes receivable, net of an allowance for doubtful accounts for the entire amount, in the accompanying statements of net assets. In addition, the Harbors Division collected $387,000 and $225,000, respectively from ATDC at June 30, 2014 and 2013 for losses in revenues due under the Amendment.

At its meeting on July 13, 2011, the ATDC Board approved the transfer of the leasehold interest for the Marketplace to a new operator, Hawaii Lifestyle Retail Properties, (HLRP). HLRP is a limited liability company that consisted at that time of two legal entities, Lifestyle Retail Properties LLC (LRP) and Hawaii Downtown Holdings LLC (HDH); HDH being solely owned by Hawaii Pacific University (HPU). After the transfer of the lease to HLRP in mid 2011, ATDC discussed various development proposals with HLRP culminating in an MOU dated December 15, 2011. In the 2012 Hawaii Legislative Session, HPU received legislative support for the issuance of special purpose revenue bonds for improvements to their facilities. In mid 2012, a dispute arose among the owners of HLRP which ultimately resulted in HDH buying out LRP's interest in HLRP and HDH taking control of the leasehold interest in late 2012. The terms of ATDC's MOU with HLRP, which were performance-based and had not been met, terminated on January 1, 2014. Since the resolution of the owners' dispute within HLRP, HLRP has been re-formulating its plans for improvements to the Marketplace leasehold property.

Subsequent to the year ended June 30, 2014, the State, by its Interim Director of the DOT, entered into a successor memorandum of understanding with the ATDC and HLRP whereby ATDC agreed to abate rent under the lease between ATDC and HLRP for the period retroactive to July 1, 2014 to June 30, 2015 in consideration for the construction of HLRP improvements to create student and faculty residences and various university spaces for Hawaii Pacific University and to memorialize the understanding of the parties with respect to various aspects of its agreement.

$1.0 million in rent has been abated for fiscal year July 1, 2014 to June 30, 2015. As ATDC will not be receiving any revenues during this period, it will not be making an equity participation payment to the Harbors Division in an amount of 50% of the difference between the total revenues and total operating expenses of ATDC for the fiscal year, representing a loss of approximately $388,000 to the Harbors Division in fiscal year 2015.

The successor memorandum of understanding also amended the punchlist obligations owed to the Harbors Division which had a total value of $3.5 million, depending upon when actual payments are made by the operator within a six year timeframe ending June, 2016. The amendment provided that in consideration of ATDC's issuance of any renewed leases, HLRP shall pay the Harbors Division the sum of $1,750,000 on or before December 31, 2021.

16. Kapalama Land Development

Between 1990 and 1993, the State acquired three parcels of land totaling approximately 61.8 acres within the Kapalama Military Reservation area, comprised primarily of areas adjacent or near to Piers 39 through 41 at Honolulu Harbor (the KMR site).

Governor's Executive Order No. 3497 set aside two parcels comprising 40.6 acres to the Harbors Division for harbor purposes on September 24, 2002. The set-aside of the remaining 21.2-acre parcel is pending. This parcel was purchased for approximately $34.9 million and involved the use of approximately $8.2 million of the Department of Transportation, Airports Division's (Airports Division) funds. There have been ongoing efforts between the Harbors Division and Airports Division to resolve the use of the parcel and the $8.2 million in Airport Division's funds. As a result, action on the issuance of the Executive Order for the remaining parcel was deferred until the matter could be resolved.

Plans for the future development of the KMR site will involve the creation of a new cargo container yard and vessel berthing piers. This project is a key priority under the Harbor's New Day Work Plan. The Federal Aviation Administration (FAA) review of the matter led to findings that the use of airport funds towards the purchase of KMR did not represent a permitted use of airport revenue. If Airports Division could not be provided with an equitable amount of land equal to its $8.2

million investment, the FAA considered the $8.2 million to be a loan. Due to the importance of the KMR site in serving maritime interests, both divisions and the FAA reached agreement for the Harbors Division to pay approximately $9,603,000, of which $8,191,000 was capitalized as land and improvements, and the remaining balance recorded as interest expense. The Harbors Division paid Airports Division these amounts owed in September 2011. Both divisions continue discussions to resolve the use of approximately 11.344 acres of ceded lands owned by the Airports Division near the KMR site of which a portion is planned for inclusion into the KMR container yard development.

17. Arbitrage

The Harbors Division is required to annually calculate rebates to the U.S. Treasury on the Revenue Bonds issued from 1986. In accordance with the requirements of Section 148 of Internal Revenue Code of 1986, as amended, rebates are calculated by bond series based on the amount by which the cumulative amount of investment income exceeds the amount that would have been earned had funds been invested at the bond yield. In the opinion of management, rebates payable as of June 30, 2014 and 2013, if any, are not material to the financial statements. Accordingly, no rebates payable have been recorded in the accompanying financial statements.

18. Commitments and Contingencies

Construction and Other Contracts

The Harbors Division is committed under contracts awarded for construction and other services. These commitments amounted to approximately $88,984,000 and $59,168,000 at June 30, 2014 and 2013, respectively.

Accumulated Sick Leave Pay

Employees earn sick leave credits at the rate of 14 hours for each month of service depending on the employee’s hire date. Unused sick leave may be accumulated without limitation and is not convertible to pay upon termination of employment. Accordingly, no liability for sick pay is recorded. However, for public employees who retire or leave government service in good standing with sixty days or more of unused sick leave, the unused sick leave is converted to additional retirement service credit at the rate of one additional month of service for each 20 days of unused sick leave. The accumulated sick leave liabilities as of June 30, 2014 and 2013 were approximately $5,602,000 and $4,990,000, respectively.

Environmental Issues

Iwilei District Participating Parties

The Harbors Division is subject to laws and regulations relating to the protection of the environment. The Harbors Division has been identified by the State Department of Health as a potentially responsible party for petroleum contamination in the Honolulu Harbor/Iwilei area. Pursuant thereto, the Harbors Division entered into a voluntary agreement with the Department of Health and other third parties to share in the responsibility for the investigation and potential remediation of petroleum contamination in the Iwilei District. This group of potentially responsible parties, known as the Iwilei District Participating Parties (IDPP), has conducted various investigations to determine potential contamination in the Iwilei area from 1997 to present, which investigations have determined the existence of petroleum contamination at various locations. The remediation alternative selected involves the management of the contamination in-place with limited extraction, plume monitoring and active institutional controls including education/awareness and outreach of landowners, potential developers and utility operators. However, the project has not yet advanced to the stage where total costs to the IDPP can reasonably be estimated due to: (1) the extent of the environmental impact, (2) the undetermined allocation among the potentially responsible parties, and (3) the continued discussion with the regulatory authorities. Although it is not possible to reasonably estimate the Harbors Division cost liability until these items have been resolved, the Harbors Division, in accordance with GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations* (GASB 49), accrued only for the estimated cost of the studies and investigations allocated to the Harbors Division of approximately $2,458,000 as of June 30, 2014.

Environmental Protection Agency

During December 2008, the United States Environmental Protection Agency (EPA) conducted an audit to determine Harbors Division's compliance with its Storm Water Environmental Permits (SWMP). As a follow up to this audit, on June 18, 2009, the EPA issued an Administrative Order directing the Harbors Division to revise its Storm Water Management Plan, upgrade environmental inspections and procedures, improve documentation of environmental inspections and follow up actions, establish "Best Management Practices" (BMPs) standards, and include the use of permanent BMPs in any construction projects that are undertaken on Harbor Division premises.

In July 2012, the EPA and the U.S. Department of Justice provided a Compliance Measures draft for the Harbors Division's review and comment. The Compliance Measures draft is intended to be the Injunctive Relief portion of the comprehensive Consent Decree between the United States, the State of Hawaii Department of Health and the Department of Transportation.

On September 18, 2014, the U.S. Department of Justice lodged a proposed Consent Decree with the United States District Court for the District of Hawaii in the lawsuit entitled United States et al. v. Hawaii Department of Transportation, Civil Case No., 14-00408. The Department agreed to correct federal Clean Water Act violations at Honolulu and Kalaeloa Barbers Point Harbors on Oahu, modify departmental administrative and operational procedures and pay a civil penalty of $600,000 plus interest to the U.S. Department of Justice and $600,000 plus interest to the Hawaii Department of Health. Under the conditions of the Consent Decree, the Department is required to implement structural changes to management and a comprehensive stormwater management plan over the life of the Consent Decree. The Consent Decree was entered on November 5, 2014 and payments of $600,160 were processed accordingly to each party.

Harbors Division entered into an agreement with Weston Solutions, Inc., an international environmental consulting firm, to assist in negotiating the Compliance Measures for a cost of approximately $600,000, of which $499,200 has been paid as of June 30, 2014. The Harbors Division has also entered into an agreement with EnviroServices and Training Center LLC, a Hawaii environmental consulting firm, to assist the Harbors Division in implementing the Compliance Measures at a cost of approximately $400,000 of which $42,400 has been paid as of June 30, 2014.

Molasses Spill

On September 9, 2013, an estimated 233,000 gallons of molasses leaked into Honolulu Harbor from a pipeline maintained and operated by Matson Terminals, Inc. The company's molasses operation have subsequently been suspended. Federal and State agencies are investigating the incident. Matson Terminals, Inc. entered into a plea agreement with Federal criminal prosecutors, paying $1.0 million. It is management's belief that the outcomes are not likely to have a material adverse effect on the Harbors Division's financial position.

Litigation

The Harbors Division is subject to a number of lawsuits arising in the ordinary course of its operations. While the ultimate liabilities, if any, in the disposition of these matters are presently difficult to estimate, it is management's belief that the outcomes are not likely to have a material adverse effect on the Harbors Division's financial position. Accordingly, no provisions for any liabilities that might result have been made in the accompanying financial statements.

19. Subsequent Events

The Harbors Division has evaluated subsequent events from the statements of net position date through December 22, 2014, the date at which the financial statements were available to be issued, and determined that there are no other items to disclose.

SUPPLEMENTAL INFORMATION

Harbors Division
Department of Transportation
State of Hawaii
(An Enterprise Fund of the State of Hawaii)

Cash and Cash Equivalents of the Public Undertaking

June 30, 2014

Unrestricted cash and cash equivalents	$ 165,399,402
Restricted cash and cash equivalents:	
For construction−revenue bonds	144,147,370
For revenue bond debt service payments	22,439,483
For cash reserve requirement for Series A of 2010 revenue bonds	11,455,033
For revenue bond harbors reserve and contingency account	10,897,658
For construction−special purpose funds	54,559,878
For security deposits	2,193,354
For risk management	433,876
	246,126,652
	$ 411,526,054

With Director of Finance, State of Hawaii	$ 411,312,143
On hand	213,911
	$ 411,526,054

See accompanying independent auditors' report.

Schedule 2

Harbors Division
Department of Transportation
State of Hawaii
(An Enterprise Fund of the State of Hawaii)

Construction in Progress of the Public Undertaking

Year Ended June 30, 2014

Project	Balance July 1, 2013	Additions by Source of Funds: Harbor Special Fund	Additions by Source of Funds: Harbor Revenue/GO Bonds	Additions by Source of Funds: Capitalized Interest	Transfer Out	Balance June 30, 2014
Statewide:						
Various Commercial Harbor Security Improvements	$ 46,121	$ -	$ -	$ -	$ -	$ 46,121
State Commercial Harbor Plan and Development Projects	1,602,198	26,087	-	530	-	1,628,815
Development of GIS and AMS for the State of Hawaii DOT Harbors Division	44,158	20,113	25,785	496	-	90,552
Statewide Installation of Breasting Bollards	115,712	123,334	-	-	-	239,046
Harbor Security Improvements at Hilo and Kawaihae Harbors, Hawaii and Nawiliwili and Port Allen Harbors, Kauai	-	5,578	-	-	-	5,578
Statewide Maritime Wireless Network System	1,980,495	7,224	-	-	-	1,987,719
Statewide Environmental Engineering Services	-	65,711	1,825	48		67,584
Honolulu Harbor:						
Reconstruction of Piers 52 and 53 Sand Island Container Yard, Honolulu Harbor, Oahu	-	30,061	-	-	30,061	-
Reconstruction of Pier 51B Container Yard, Honolulu Harbor, Oahu	-	1,414	-	-	1,414	-
Construction of Mooring Bollards at Piers 19-21, Honolulu Harbor	-	52,053	-	-	-	52,053
Subtotal carried forward	3,788,684	331,575	27,610	1,074	31,475	4,117,468

Harbors Division
Department of Transportation
State of Hawaii
(An Enterprise Fund of the State of Hawaii)

Schedule 2

Construction in Progress of the Public Undertaking (continued)

Year Ended June 30, 2014

Project	Balance July 1, 2013	Additions by Source of Funds: Harbor Special Fund	Additions by Source of Funds: Harbor Revenue/GO Bonds	Additions by Source of Funds: Capitalized Interest	Transfer Out	Balance June 30, 2014
Subtotal brought forward	$ 3,788,684	$ 331,575	$ 27,610	$ 1,074	$ 31,475	$ 4,117,468
Honolulu Harbor (continued):						
Planning Services for the Development of the New Kapalama Container Terminal, Honolulu	824,818	2,476	3,416	860	-	831,570
Phase 1 Environmental Assessment of the Former Kapalama Military Reservation Area, Honolulu	99,684	-	-	-	-	99,684
Perimeter Fencing Improvements at Honolulu Harbor and Kalaeloa Barbers Point Harbor	-	2,011	-	-	-	2,011
Construction of Miscellaneous Improvements for Pier 2 Cruise Terminal, Honolulu Harbor, Oahu	-	661	-	-	-	661
Pier 29 Extension, Honolulu Harbor, Oahu	251,708	-	-	-	-	251,708
Condominium Property Regime Piers 30-38, Honolulu Harbor	149,038	-	-	-	-	149,038
General Engineering Services for the Development of the New Kapalama Container Terminal, Honolulu Harbor	777,334	-	36,744	14,157	-	828,235
Methane Mitigation Piers 36-38, Lease Parcels 3, 4, 5, 6 7 and 8, Domestic Commercial Fishing Village, Honolulu Harbor	227,648	39,203	-	-	20,829	246,022
Honolulu Harbor	365,956	9,524	-	-	-	375,480
Rehabilitation of Buildings and Yard Areas at Piers 34 and 35, Honolulu Harbor	480,706	123	2,154,545	60,957	-	2,696,331
Subtotal carried forward	6,965,576	385,573	2,222,315	77,048	52,304	9,598,208

Harbors Division **Schedule 2**
Department of Transportation
State of Hawaii
(An Enterprise Fund of the State of Hawaii)

Construction in Progress of the Public Undertaking (continued)

Year Ended June 30, 2014

Project	Balance July 1, 2013	Additions by Source of Funds: Harbor Special Fund	Additions by Source of Funds: Harbor Revenue/GO Bonds	Additions by Source of Funds: Capitalized Interest	Transfer Out	Balance June 30, 2014
Subtotal brought forward	$ 6,965,576	$ 385,573	$ 2,222,315	$ 77,048	$ 52,304	$ 9,598,208
Honolulu Harbor (continued):						
Demolition of Structures at Kapalama Military Reservation	364,587	34,761	361,503	10,235	-	771,086
Environmental Assessment and Other Pre-Development Studies for Renovation of Facilities at Piers 34 and 35, Honolulu Harbor	443,618	1,160	17,505	1,395	-	463,678
Pier 2 Passenger Terminal Enhancements	-	757	-	-	-	757
Replacement of Fire Protection Lines at Piers 52-53, Honolulu Harbor, Oahu	42,170	9,179	-	-	51,349	-
Environmental and Development Services for Honolulu Harbor	10,937	-	486,553	13,247	-	510,737
Kapalama Container Terminal Wharf and Dredging Design, Honolulu Harbor, Oahu	735,085	5,104	4,580,678	121,824	-	5,442,691
The New Kapalama Container Terminal Yard Design, Honolulu Harbor, Hawaii	1,125,826	5,309	1,514,414	98,179	-	2,743,728
Construction Management Services for Rehabilitation of Building and Yard Areas at Piers 34/35, Honolulu Harbor, Oahu and Building Improvements at Pier 35, Honolulu Harbor, Oahu	43,797	-	100,232	4,842	-	148,871
Subtotal carried forward	9,731,596	441,843	9,283,200	326,770	103,653	19,679,756

Harbors Division **Schedule 2**

Department of Transportation

State of Hawaii

(An Enterprise Fund of the State of Hawaii)

Construction in Progress of the Public Undertaking (continued)

Year Ended June 30, 2014

Project	Balance July 1, 2013	Additions by Source of Funds: Harbor Special Fund	Additions by Source of Funds: Harbor Revenue/GO Bonds	Additions by Source of Funds: Capitalized Interest	Transfer Out	Balance June 30, 2014
Subtotal brought forward	$ 9,731,596	$ 441,843	$ 9,283,200	$ 326,770	$ 103,653	$ 19,679,756
Honolulu Harbor (continued):						
Ke'ehi Industrial Lots Removal of solid waste, Honolulu Harbor, Oahu	-	15,883	-	-		15,883
Pier 39 Shed Demolition and Yard Lighting Improvements, HMP Project, Honolulu Harbor	1,126,067	-	2,486	-	1,128,553	-
Design Specifications for the Relocation of UHSOEST Marine Center from Piers 44-45 to Pier 35, HMP Project, Honolulu Harbor	626,387	-	22,344	31,304	-	680,035
Relocation of Harbors Tenant to Kapalama Military Reservation	1,153	-	-	56	-	1,209
Construction of Improvements Piers 12 and 15, HMP Project Honolulu Harbor	991,708	-	212,990	53,436	-	1,258,134
Demolish Shed at Pier 31, Provide Continuity for Utilities, Including Lighting and Drainage Resolution Honolulu Harbor, Oahu	39,694	1,134,393	-	-	-	1,174,087
Renovations at Pier 35, Honolulu Harbor	503,826	-	-	-	-	503,826
Design Specifications for the Strengthening of Pier 29 to Withstand Potential User Loads Honolulu Harbor, Oahu	11,112	-	-	-	-	11,112
Replace Fire Suppression System Pier 31 and 32 Honolulu Harbor, Oahu	10,064	12,737	-	-	-	22,801
Subtotal carried forward	13,041,607	1,604,856	9,521,020	411,566	1,232,206	23,346,843

Harbors Division **Schedule 2**
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Construction in Progress of the Public Undertaking (continued)

Year Ended June 30, 2014

Project	Balance July 1, 2013	Additions by Source of Funds: Harbor Special Fund	Additions by Source of Funds: Harbor Revenue/GO Bonds	Additions by Source of Funds: Capitalized Interest	Transfer Out	Balance June 30, 2014
Subtotal brought forward	$ 13,041,607	$ 1,604,856	$ 9,521,020	$ 411,566	$ 1,232,206	$ 23,346,843
Honolulu Harbor (continued):						
Repairs to Vent Line and Air Conditioning at Aloha Tower, Honolulu Harbor SM Project to CIP	166,978	81,178	-	-	-	248,156
Bollard Repairs at Piers 52-53, Honolulu Harbor, SM Project to CIP	105,088	86,258	-	-	-	191,346
Substructure and Waterline Repairs at Pier 35, Honolulu Harbor, SM Project to CIP	1,458,898	18,532	-	-	-	1,477,430
Substructure and Fender Repairs at Pier 1, Honolulu Harbor, SM Project to CIP	11,571	544,878	-	-	-	556,449
Maintenance Dredging at Piers 1 & 2, Honolulu Harbor, SM Project to CIP	-	9,249	-	-	-	9,249
Asphalt Pavement Repairs at Piers 39 and 40, Honolulu Harbor, SM Project to CIP	-	159,234	-	-	-	159,234
Substructure Repairs at Pier 10, Honolulu Harbor, SM Project to CIP	164,178	714,119	-	-	-	878,297
Pavement Repairs at Fort Armstrong, Honolulu Harbor, SM Project to CIP	666,566	1,659	-	-	-	668,225
Repair Roof at Matson CFS Shed, Honolulu Harbor SM, Project to CIP	-	365,478	-	-	-	365,478
Substructure Repairs at Pier 1, Honolulu Harbor, SM Project to CIP	-	521,703	-	-	-	521,703
Repair Sheet Piles and Fenders at Pier 39B Honolulu Harbor, SM Project to CIP	-	699,099	-	-	-	699,099
Substructure and Waterline Repairs at Piers 9-11, Honolulu Harbor, SM Project to CIP	-	387	-	-	-	387
Subtotal carried forward	15,614,886	4,806,630	9,521,020	411,566	1,232,206	29,121,896

Harbors Division
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Schedule 2

Construction in Progress of the Public Undertaking (continued)

Year Ended June 30, 2014

Project	Balance July 1, 2013	Additions by Source of Funds: Harbor Special Fund	Additions by Source of Funds: Harbor Revenue/GO Bonds	Additions by Source of Funds: Capitalized Interest	Transfer Out	Balance June 30, 2014
Subtotal brought forward	$ 15,614,886	$ 4,806,630	$ 9,521,020	$ 411,566	$ 1,232,206	$ 29,121,896
Honolulu Harbor (continued):						
Substructure Repairs and Hatch Repairs at Pier 23 Honolulu Harbor, SM Project to CIP	-	551,662	-	-	-	551,662
Pavement Repairs at Matson Terminals Container Yard, Honolulu Harbor, SM Project to CIP	-	693,820	-	-	-	693,820
Expansion Joint Repairs at Pier 39 Honolulu Harbor, SM Project to CIP	-	169,519	-	-	-	169,519
Structural Repairs at Pier 27, Honolulu Harbor, SM Project to CIP	-	262,533	-	-	-	262,533
Relamp Floodlights at Piers 51C through 53 Honolulu Harbor, SM Project to CIP	-	116,615	-	-	-	116,615
Substructure, Fender and Restroom Repairs at Piers 10 and 11, Honolulu Harbor, SM Project to CIP	-	41,787	-	-	-	41,787
Bollard Repairs at Pier 22 Honolulu Harbor SM Project to CIP	-	6,924	-	-	-	6,924
Substructure and Bollard Repairs at Pier 29 Honolulu Harbor, SM Project to CIP	-	13,284	-	-	-	13,284
Repair Sheet Piles and Fenders at Pier 39 Honolulu Harbor SM Project to CIP	-	18,531	-	-	-	18,531
Repair Roof and Gutter System at Pier 2 Terminal Honolulu Harbor, SM Project to CIP	-	18,393	-	-	-	18,393
Subtotal carried forward	15,614,886	6,699,698	9,521,020	411,566	1,232,206	31,014,964

Harbors Division
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Schedule 2

Construction in Progress of the Public Undertaking (continued)

Year Ended June 30, 2014

Project	Balance July 1, 2013	Additions by Source of Funds: Harbor Special Fund	Additions by Source of Funds: Harbor Revenue/GO Bonds	Additions by Source of Funds: Capitalized Interest	Transfer Out	Balance June 30, 2014
Subtotal brought forward	$ 15,614,886	$ 6,699,698	$ 9,521,020	$ 411,566	$ 1,232,206	$ 31,014,964
Honolulu Harbor (continued):						
Substructure Repairs at Pier 52 and 53 Honolulu Harbor, SM Project to CIP	-	20,232	-	-	-	20,232
Repair Waterline at Pier 36, Honolulu Harbor, SM Project to CIP	-	11,431	-	-	-	11,431
Kalaeloa Barbers Point Harbor:						
Access & Electrical Improvements, Kalaeloa Barbers Point Harbor, Oahu	1,807,305	192,910	-	-	2,000,215	-
Planning, Environmental and Development Services for Kalaeloa Barbers Point Harbor, Oahu	187,928	745	806,517	30,594	-	1,025,784
Repair Water Hatches at Piers 5 and 6, Kalaeloa Barbers Point Harbor, Oahu SM Project to CIP	196,205	26,326	-	-	-	222,531
Repair Roll-up Doors at Pier Shed, Kalaeloa Barbers Point Harbor, Oahu SM Project to CIP	-	165,425	-	-	-	165,425
Concrete Repairs at Piers 5 and 6, Kalaeloa Barbers Point Harbor, Oahu SM Project to CIP	-	163,622	-	-	-	163,622
Subtotal carried forward	17,806,324	7,280,389	10,327,537	442,160	3,232,421	32,623,989

Harbors Division **Schedule 2**
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Construction in Progress of the Public Undertaking (continued)

Year Ended June 30, 2014

Project	Balance July 1, 2013	Additions by Source of Funds: Harbor Special Fund	Harbor Revenue/GO Bonds	Capitalized Interest	Transfer Out	Balance June 30, 2014
Subtotal brought forward	$ 17,806,324	$ 7,280,389	$ 10,327,537	$ 442,160	$ 3,232,421	$ 32,623,989
Kahului Harbor:						
Pier 1 Makai Comfort Station and Waterline Improvements, Kahului Harbor, Maui	-	183,951	-	-	183,951	-
Demolition of Pier 2 Shed, Kahului Harbor, Maui	-	2,303	-	-	2,303	-
Kahului Harbor Reconnaissance Study	30	-	-	-	-	30
Planning, Environmental and Development Services for Property Acquisition, Kahului Harbor, Maui	25,981	75,948	24,078	3,924	-	129,931
Replace Perimeter road fence and new fence at Piers 1-2, Kahului Harbor, Maui	-	2,855	-	-	-	2,855
Replacement of Pier 1 Bullrails, Kahului Harbor, Maui	9,007	431,484	-	-	-	440,491
Relocate Maui District Office to the Old Kahului Railroad Building and Associated Improvements and Demolish the Old Kahului Store Building Kahului Harbor, Maui	32,104	651,635	-	-	-	683,739
Port of Kahului Passenger/Cargo Ship Facilities Improvised Explosive Devices (IEDS) Threat Prevention Program	-	3,620	-	-	-	3,620
Repair Trench Panels at Pier 1, Kahului Harbor Maui SM Project to CIP	-	138,714	-	-	-	138,714
Repair Light Poles at Pier 1, Kahului Harbor, Maui SM Project to CIP	15,555	-	-	-	-	15,555
Repair Fender System at Pier 1 Shed Kahului Harbor, Maui SM Project to CIP	99,020	2,891	-	-	-	101,911
Subtotal carried forward	17,988,021	8,773,790	10,351,615	446,084	3,418,675	34,140,835

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Construction in Progress of the Public Undertaking (continued)

Year Ended June 30, 2014

Project	Balance July 1, 2013	Additions by Source of Funds: Harbor Special Fund	Harbor Revenue/GO Bonds	Capitalized Interest	Transfer Out	Balance June 30, 2014
Subtotal brought forward	$ 17,988,021	$ 8,773,790	$ 10,351,615	$ 446,084	$ 3,418,675	$ 34,140,835
Kahului Harbor (continued):						
Repair Fire Sprinkler System at Pier 1 Shed Kahului Harbor, Maui SM Project to CIP	166,183	-	-	-	-	166,183
Substructure Repairs at Pier 2, Kahului Harbor Maui SM Project to CIP	-	229,351	-	-	-	229,351
Hana Harbor:						
Hana Harbor Reconnaissance Study	30	-	-	-	-	30
Planning and Environmental Services for Hana Harbor, Maui, Hawaii	162,166	329	61,916	9,862	-	234,273
Planning and Consulting Engineering Services Infrastructure Renovation and Pier Expansion Hana Harbor, Maui, NWP project	308,773	-	-	15,076	-	323,849
Kaumalapau Harbor:						
Pavement Repairs, Kaumalapau Harbor, Lanai SM Project to CIP	-	238,715	-	-	-	238,715
Repair Concrete Pier, Kaumalapau Harbor, Lanai SM Project to CIP	-	17,213	-	-	-	17,213
Kaunakakai Harbor:						
Ferry System Improvements at Kaunakakai Harbor, Molokai Maui	206,765	5,139	-	-	211,904	-
Deck and Fender Repairs at Kaunakakai Harbor, Molokai SM to CIP	-	406	-	-	-	406
Subtotal carried forward	18,831,938	9,264,943	10,413,531	471,022	3,630,579	35,350,855

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Construction in Progress of the Public Undertaking (continued)

Year Ended June 30, 2014

Project	Balance July 1, 2013	Additions by Source of Funds: Harbor Special Fund	Additions by Source of Funds: Harbor Revenue/GO Bonds	Additions by Source of Funds: Capitalized Interest	Transfer Out	Balance June 30, 2014
Subtotal brought forward	$ 18,831,938	$ 9,264,943	$ 10,413,531	$ 471,022	$ 3,630,579	$ 35,350,855
Hilo Harbor:						
Pier 1 Shed Modifications, Hilo Harbor, Hawaii	4,597,101	295,595	-	-	4,892,696	-
Construction of Inter-Island Cargo Terminal Facility at Hilo Harbor, Hawaii	11,574,427	245,256	1,750,008	473,326	-	14,043,017
Hilo Harbor Reconnaissance Study	5,201	507,995	-	-	-	513,196
Design for Pier 1 Shed Roofing and Siding Improvements, Hilo Harbor, Hawaii	279,550	6,052	-	-	-	285,602
Pier 1 Shed Modifications, Phase II, Hilo Harbor	32,517	765,706	-	-	-	798,223
Design for Pier 4 Inter-island Cargo Terminal HMP Project Hilo Harbor, Hawaii	737,212	671	96,468	38,009	-	872,360
Pier 4 Inter-Island Cargo Terminal, Improvements to Kumau Street Entrance HMP project Hilo Harbor, Hawaii	483,766	3,151	676,630	41,195	-	1,204,742
Strengthening of Pier 2 Hilo Harbor, Hawaii	6,396	-	-	-	-	6,396
Subtotal carried forward	36,548,108	11,089,369	12,936,637	1,023,552	8,523,275	53,074,391

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Schedule 2

Construction in Progress of the Public Undertaking (continued)

Year Ended June 30, 2014

Project	Balance July 1, 2013	Additions by Source of Funds: Harbor Special Fund	Additions by Source of Funds: Harbor Revenue/GO Bonds	Additions by Source of Funds: Capitalized Interest	Transfer Out	Balance June 30, 2014
Subtotal brought forward	$ 36,548,108	$ 11,089,369	$ 12,936,637	$ 1,023,552	$ 8,523,275	$ 53,074,391
Hilo Harbor (continued):						
Demolition of Water Tower and Water System Improvements, Hilo Harbor, Hawaii	1,978	5,940	-	-	-	7,918
Repair Fender System at Pier 2, Hilo Harbor, Hawaii SM Project to CIP	44,352	102,037	-	-	-	146,389
Substructure Repairs at Piers 1 and 2, Hilo Harbor, Hawaii SM Project to CIP	-	130,432	-	-	-	130,432
Repair Pavement and Removal of Crane Rails at Pier 1, Hilo Harbor, Hawaii SM Project to CIP	-	238	-	-	-	238
Kawaihae Harbor:						
Improvements for New Terminal Cargo Facilities at Kawaihae Harbor	331,081	-	12,596	15,847	-	359,524
Construction of South Basin Perimeter Fence at Kawaihae Harbor, Hawaii	4,779	27,973	-	-	-	32,752
Design for Pier 2 Terminal Improvements at Kawaihae Harbor	1,149,379	6,130	3,180,973	139,743	-	4,476,225
Repair Lighting at Pier 2, Kawaihae Harbor Hawaii SM Project to CIP	-	106,097	-	-	-	106,097
Subtotal carried forward	38,079,677	11,468,216	16,130,206	1,179,142	8,523,275	58,333,966

Harbors Division
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Schedule 2

Construction in Progress of the Public Undertaking (continued)

Year Ended June 30, 2014

Project	Balance July 1, 2013	Additions by Source of Funds: Harbor Special Fund	Additions by Source of Funds: Harbor Revenue/GO Bonds	Additions by Source of Funds: Capitalized Interest	Transfer Out	Balance June 30, 2014
Subtotal brought forward	$ 38,079,677	$ 11,468,216	$ 16,130,206	$ 1,179,142	$ 8,523,275	$ 58,333,966
Kawaihae Harbor (continued):						
Pavement Repairs at Pier 2 Kawaihae Harbor, Hawaii SM Project to CIP	-	225,338	-	-	-	225,338
Nawiliwili Harbor:						
Nawiliwili Harbor Channel Modifications Project	263,486	-	-	-	-	263,486
Reconstruction of Pier 2 & Pier 3 Fendering System, Nawiliwili Harbor, Kauai	-	18,528	-	-	18,467	61
Repair Lighting at Pier 3, Nawiliwili Harbor, Kauai SM Project to CIP	-	235	-	-	-	235
Repair Lighting at Pier 1, Nawiliwili Harbor, Kauai SM Project to CIP	-	15,573	-	-	-	15,573
Subtotal carried forward	38,343,163	11,727,890	16,130,206	1,179,142	8,541,742	58,838,659

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Schedule 2

Construction in Progress of the Public Undertaking (continued)

Year Ended June 30, 2014

Project	Balance July 1, 2013	Additions by Source of Funds: Harbor Special Fund	Additions by Source of Funds: Harbor Revenue/GO Bonds	Additions by Source of Funds: Capitalized Interest	Transfer Out	Balance June 30, 2014
Subtotal brought forward	$ 38,343,163	$ 11,727,890	$ 16,130,206	$ 1,179,142	$ 8,541,742	$ 58,838,659
Nawiliwili Harbor (continued):						
Repair Pavement at Pier 3, Nawiliwili Harbor, Kauai SM Project to CIP	-	262,291	-	-	-	262,291
Repair Roll-up Doors Pier 2 Shed, Nawiliwili Harbor, Kauai SM Project to CIP	-	20	-	-	-	20
Port Allen Harbor:						
Installation of Lift Station and Force Main, Port Allen Harbor, Kauai	13,377	15,579	-	-	-	28,956
Repair Roof Monitor and Stanchions Port Allen Harbor, Kauai SM Project to CIP	-	1,588	-	-	-	1,588
Repair Fender, Bollard and Stanchions Port Allen Harbor, Kauai SM Project to CIP	-	12,723	-	-	-	12,723
Other	119,022	1,730	-	-	42,677	78,075
Total	$ 38,475,562	$ 12,021,821	$ 16,130,206	$ 1,179,142	$ 8,584,419	$ 59,222,312

See accompanying independent auditors' report.

Schedule 3

Harbors Division
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Revenue Bonds of the Public Undertaking

June 30, 2014

	Final Redemption Date	Interest Rate	Original Amount of Issue	Balance at June 30, 2014 Current	Noncurrent	Total
Issue of 2004	January 1, 2024	2.50-6.00%	$ 52,030,000	$ 1,505,000	$ 17,775,000	$ 19,280,000
Issue of 2006	January 1, 2031	4.00-5.25%	96,570,000	2,930,000	74,710,000	77,640,000
Issue of 2007	July 1, 2027	4.25-5.50%	51,645,000	1,920,000	36,000,000	37,920,000
Issue of 2010	July 1, 2040	3.00-5.75%	201,390,000	6,315,000	186,620,000	192,935,000
Issue of 2013	July 1, 2029	3.25%	23,615,000	835,000	22,435,000	23,270,000
			$ 425,250,000	$ 13,505,000	$ 337,540,000	$ 351,045,000

See accompanying independent auditors' report.

Schedule 4

Harbors Division
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Income from Operations Before Depreciation

Year Ended June 30, 2014

		District									
		Oahu		Hawaii		Maui			Kauai		
	Statewide	Honolulu	Kalaeloa	Hilo	Kawaihae	Kahului	Kaunakakai	Kaumalapau	Nawiliwili	Port Allen	Total
Operating revenues, net											
Services:											
Wharfage	$ -	$ 60,456,077	$ 2,628,123	$ 2,375,993	$ 2,847,735	$ 5,183,671	$ 228,734	$ 299,551	$ 2,234,416	$ -	$ 76,254,300
Pax debark/embark	-	2,723,166	-	1,915,446	3,432	837,368	3,416	-	1,399,488	-	6,882,316
Dockage	-	3,232,695	634,886	293,253	76,342	448,926	45,502	7,064	410,367	3,016	5,152,051
Demurrage	-	1,392,433	-	110,358	60,544	96,406	-	-	18,070	-	1,677,811
Port entry	-	661,590	110,646	84,123	36,616	90,132	11,269	6,222	72,999	2,832	1,076,429
Mooring charges	-	414,970	46,825	9,474	45,643	32	-	-	-	521,704	1,038,648
Cleaning charges	-	229,948	-	-	-	-	-	-	-	-	229,948
Other services	-	16,224	449	359	7,841	1,800	-	-	5,006	13,016	44,695
Total services	-	69,127,103	3,420,929	4,789,006	3,078,153	6,658,335	288,921	312,837	4,140,346	540,568	92,356,198
Rentals:											
Wharf space and land	-	13,644,999	2,051,872	67,154	417,423	211,039	15,474	300	338,838	223,716	16,970,815
Storage	-	3,143,225	37,553	471,716	423,201	99,534	(195)	-	243,196	11,026	4,429,256
Automobile parking	-	955,236	1,452	101,109	6,904	97,084	363	-	80,338	13,909	1,256,395
Pipeline water	-	104,207	9,589	46,079	172	57,218	-	-	84,074	-	301,339
Other pipeline	-	957,122	1,174,774	595,321	29,646	695,110	22,604	-	137,763	150,215	3,762,555
Total rentals	-	18,804,789	3,275,240	1,281,379	877,346	1,159,985	38,246	300	884,209	398,866	26,720,360
Others:											
Sale of utilities	-	924,674	110,467	53,344	110	79,875	-	-	83,386	7,860	1,259,716
Miscellaneous	-	705,945	195,772	10,803	2,469	50,371	34,551	-	1,544	633	1,002,088
Total others	-	1,630,619	306,239	64,147	2,579	130,246	34,551	-	84,930	8,493	2,261,804
Total operating revenues	-	89,562,511	7,002,408	6,134,532	3,958,078	7,948,566	361,718	313,137	5,109,485	947,927	121,338,362
Operating expenses before depreciation and amortization:											
Harbor operations	10,934,037	5,010,948	499,035	510,119	419,935	455,801	6,778	1,021	684,471	39,287	18,561,432
Personnel services	6,944,626	6,784,081	196,703	798,192	74,336	956,655	48,203	-	935,311	36,857	16,774,964
State of Hawaii, surcharge for central service expenses	3,861,000	-	-	-	-	-	-	-	-	-	3,861,000
General administration	2,499,352	51,676	280	26,399	8,065	364,337	-	-	24,918	2,876	2,977,903
Maintenance	387,928	1,036,505	18,247	71,434	108,443	160,560	22,567	(4,917)	130,556	(11,547)	1,919,776
Department of Transportation, general administration expenses	1,792,965	-	-	-	-	-	-	-	-	-	1,792,965
Fireboat operations	-	1,671,882	-	-	-	-	-	-	-	-	1,671,882
Subtotal	26,419,908	14,555,092	714,265	1,406,144	610,779	1,937,353	77,548	(3,896)	1,775,256	67,473	47,559,922
Allocation of statewide expenses (1)	(26,419,908)	19,501,114	1,524,687	1,335,717	861,822	1,730,701	78,760	68,182	1,112,526	206,399	-
Total operating expenses before depreciation and amortization	-	34,056,206	2,238,952	2,741,861	1,472,601	3,668,054	156,308	64,286	2,887,782	273,872	47,559,922
Income from operations before depreciation and amortization	$ -	$ 55,506,305	$ 4,763,456	$ 3,392,671	$ 2,485,477	$ 4,280,512	$ 205,410	$ 248,851	$ 2,221,703	$ 674,055	$ 73,778,440

Note (1): Statewide expenses are allocated to the Harbors Division based upon their respective current year operating revenues to total current year operating revenues for all Harbors.

See accompanying independent auditors' report.

Harbors Division
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Harbor Revenue Bonds 1997 Certificate – Minimum Net Revenue
Requirement of the Public Undertaking

Year Ended June 30, 2014

Net revenues, as defined by the 1997 Certificate:		
Operating income before depreciation and amortization	$	73,778,440
Add:		
Interest income		672,837
State of Hawaii, surcharge for central service expenses		3,861,000
Cash available in the harbor reserve and contingency account		10,897,658
	$	89,209,935
Harbor revenue bond debt service requirements under the 1997 Certificate, including minimum sinking fund payments	$	31,528,177
Ratio of net revenues to harbor revenue bond debt service requirements		2.83

See accompanying independent auditors' report.

PART III

INTERNAL CONTROL AND COMPLIANCE SECTION

Independent Auditors' 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*

To the Auditor
State of Hawaii:

We have audited, in accordance with the 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, the statements of net position of the Harbors Division, Department of Transportation, State of Hawaii (the Harbors Division), as of June 30, 2014 and 2013, and the related statements of revenues, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to financial statements, which collectively comprise the Harbors Division's basic financial statements, and have issued our report thereon dated December 22, 2014.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Harbors Division's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Harbors Division's internal control. Accordingly, we do not express an opinion on the effectiveness of the Harbors Division's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Harbors Division's financial statements are free from 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*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

KKDLY LLC

Honolulu, Hawaii
December 22, 2014