



**Highways Division
Department of Transportation
State of Hawaii**

Financial Statements
(With Independent Auditors' Report Thereon)

June 30, 2017

Submitted by
**THE AUDITOR
STATE OF HAWAII**

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Financial Statements

June 30, 2017

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Independent Auditors' Report

The Auditor
State of Hawaii:

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities and each major fund of the Highways Division, Department of Transportation, State of Hawaii (the Highways Division), as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the Highways Division's basic financial statements as listed in the table of contents.

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 opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of the Highways Division as of June 30, 2017, and the respective changes in financial position and the respective budgetary comparison of the State Highway Fund thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter – Relationship to the State of Hawaii

As discussed in Note 1, the financial statements of the Highways Division are intended to present the financial position and the changes in financial position of only that portion of the governmental activities and each major fund of the State of Hawaii that is attributable to the transactions of the Highways Division. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2017, and the changes in its financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinions are not modified with respect to this matter.

Other Matter – Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management’s discussion and analysis 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 Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated January 26, 2018, on our consideration of the Highways 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 solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Highways Division’s 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 Highways Division’s internal control over financial reporting and compliance.

KKDL Y LLC

Honolulu, Hawaii
January 26, 2018

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Management's Discussion and Analysis – Unaudited

June 30, 2017

The following Management's Discussion and Analysis (MD&A) of the Highways Division, Department of Transportation, State of Hawaii (the Highways Division) activities and financial performance provides the reader with an introduction and overview to the financial statements of the Highways Division as of and for the year ended June 30, 2017. 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 Territorial Highway Department was created by the Territorial Legislature on April 24, 1925 by Act 78 to qualify Hawaii for participation in the Federal-Aid Program. The purpose of the Federal-Aid Program was to ensure the development of an integrated network of highways in the United States. Congress defined that the Federal government would provide the funds for construction on a matching contribution basis while the State or its political subdivisions would administer the highway.

The Department of Transportation was created in 1959 by the Hawaii State Government Reorganization Act. In creating the new department, the legislature transferred the responsibilities of the old Highway Department to the Highways Division of the new Department of Transportation.

The mission of the Highways Division is to facilitate the rapid, safe, and economical movement of people and goods within the State by providing, maintaining, and operating land transportation facilities and support services. The major goals of the Highways Division are to plan, design, construct, and maintain highway facilities. In addition, the Highways Division, together with the Statewide Transportation Planning Office, implements innovative and diverse approaches to congestion management to increase the efficiency of the transportation system.

The Highways Division is managed by the Division Administrator. Each island in the system is managed by a district manager with the exception of the Maui District, which includes the islands of Molokai and Lanai. The Staff Services Office, headed by the Administrative Services Officer, is responsible for personnel, budget, procurement, financial management, and methods, standards and evaluation functions of the Highways Division. Other major functional operations within the Highways Division include Project Coordination and Technical Services Office, Engineering Services Office, Motor Vehicle Safety Office, Planning Branch, Design Branch, Rights-of-Way Branch, Materials Testing and Research Branch, Construction and Maintenance Branch, and Traffic Branch.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the Highways Division's basic financial statements. The Highways Division's basic financial statements consist of three sections: 1) government-wide financial statements, 2) fund financial statements and 3) notes to the basic financial statements. These sections are described as follows:

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Management's Discussion and Analysis – Unaudited

June 30, 2017

Government-Wide Financial Statements

The government-wide statements report information about the Highways Division as a whole in a manner similar to a private-sector business. The statements provide both long-term and short-term information about the Highways Division's overall financial status. They are prepared using the economic resources measurement focus and the accrual basis of accounting. They take into account all revenues and expenses connected with the fiscal year, regardless of when cash is received or paid. The government-wide financial statements include the following two statements:

The *Statement of Net Position* presents all of the Highways Division's assets, deferred outflows of resources, and liabilities, with the difference reported as "net position." Over time, increases or decreases in the Highways Division's net position are an indicator of whether its financial health is improving or deteriorating.

The *Statement of Activities* presents information showing how the Highways Division's net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods.

The Highways Division's activities are considered governmental activities and are primarily funded by taxes, charges for services, and intergovernmental revenues.

The government-wide financial statements can be found on pages 15 and 16 of this report.

Fund Financial Statements

Governmental Funds

A fund is a grouping of related accounts that are used to maintain control over resources that have been segregated for specific activities or objectives. The Highways Division, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All funds of the Highways Division are considered governmental funds.

The fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on the balances of spendable resources available at the end of the fiscal year. Fund financial statements are prepared using the current financial resources measurement focus and the modified-accrual basis of accounting. These statements provide a detailed short-term view of the Highways Division's finances that assist in determining whether there will be adequate financial resources available to meet the current needs of the Highways Division.

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Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the Highways Division's near-term financing decisions. A reconciliation to facilitate this comparison between governmental fund financial statements and government-wide financial statements is included on pages 19 and 22 of this report.

The Highways Division has three governmental funds, all of which are considered major funds for presentation purposes. That is, each major fund is presented in a separate column in the governmental funds balance sheet and in the governmental funds statement of revenues, expenditures, and changes in fund balances. The Highways Division's three governmental funds are the State Highway Fund (SHF) (a Special Revenue Fund), the Debt Service Fund, and the Capital Projects Fund.

The governmental funds financial statements can be found on pages 17 through 22 of this report.

Statement of Revenues and Expenditures - Budget and Actual (Non-GAAP Budgetary Basis) - State Highway Fund

The governmental funds financial statements are followed by a budgetary comparison statement, which compares the SHF's original budget, final budget, and actual amounts prepared on a budgetary basis. A reconciliation between the actual SHF revenues and expenditures compared to the SHF revenues and expenditures prepared for budgetary purposes is included in Note 3 to the basic financial statements.

The Statement of Revenues and Expenditures - Budget and Actual (Non-GAAP Budgetary Basis) - State Highway Fund can be found on page 23 of this report.

Fiduciary Funds

Fiduciary funds are used to account for assets held by the Highways Division on behalf of other departments of the State. The statement of fiduciary net position of the agency fund can be found on page 24.

Notes to the Basic Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and the governmental funds financial statements. The notes to the basic financial statements can be found on pages 25 through 62 of this report.

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FINANCIAL HIGHLIGHTS

Government-wide Financial Statements

The assets and deferred outflows of resources of the Highways Division exceeded its liabilities at June 30, 2017 by \$5 billion. Of this amount, \$209 million is considered unrestricted and may be used to meet the Highways Division's ongoing obligations.

The current year change in net position was a decrease of \$33 million. This resulted from a decrease in net position before transfers of \$67 million, offset by transfers of \$34 million, which included a transfer from the State general fund of \$37 million to provide assistance to the Highways Division's operations, reduced by transfers of \$3 million to other State departments for debt service payments on general obligation bonds.

Fund Financial Statements

At June 30, 2017, the Highways Division's Governmental Funds reported a combined ending fund balance of \$396 million. The combined fund balance increased by \$18 million from the prior year's ending fund balance.

The Highways Division's State Highway Fund (SHF), the major operating fund, reported an ending fund balance of \$253 million. There was a \$64 million decrease in fund balance for the year ended June 30, 2017.

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GOVERNMENT-WIDE FINANCIAL ANALYSIS

Statements of Net Position

As noted earlier, net position may serve over time as a useful indicator of the Highways Division's financial position. The Highways Division's assets and deferred outflows of resources exceeded liabilities by \$5 billion at June 30, 2017 and 2016.

	<u>2017</u>	<u>2016</u>
Assets		
Current and other assets	\$ 494,585,360	\$ 449,232,275
Capital assets, net	<u>5,048,468,132</u>	<u>5,031,609,267</u>
Total assets	<u>5,543,053,492</u>	<u>5,480,841,542</u>
 Deferred Outflows of Resources		
Deferred charge on refunding, net	<u>12,612,116</u>	<u>751,619</u>
 Liabilities		
Current liabilities	100,444,199	71,436,109
Long-term liabilities	<u>593,654,496</u>	<u>515,352,826</u>
Total liabilities	<u>694,098,695</u>	<u>586,788,935</u>
 Net Position		
Net investment in capital assets	4,599,373,082	4,643,081,471
Restricted	53,562,533	31,870,137
Unrestricted	<u>208,631,298</u>	<u>219,852,618</u>
Total net position	<u>\$ 4,861,566,913</u>	<u>\$ 4,894,804,226</u>

The largest portion of the Highways Division's net position (95% at June 30, 2017 and 2016) reflects its net investment in capital assets (e.g., land and land improvements, buildings and improvements, vehicles and equipment, and infrastructure), which is net of any related debt used to acquire those assets that is still outstanding and deferred charge on refunding, net. The Highways Division uses these capital assets to provide services to citizens; therefore, these assets are not available for future spending. Although the Highways Division's net investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay the debt must be provided from other sources, since capital assets themselves cannot be used to liquidate these liabilities.

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An additional portion of the Highways Division's net position (1% at June 30, 2017 and 2016) represents resources that are subject to restrictions as to how they may be used. This primarily relates to net assets reserved for payment of the Highways Division's revenue bond debt service and capital projects activity. The remaining balance of unrestricted net position may be used to meet the Highways Division's on-going obligations to citizens and creditors.

Current and other assets increased by \$45 million or 10% from June 30, 2016 to June 30, 2017, due primarily to the increase in cash and cash equivalents of \$90 million as a result of the issuance of revenue bonds in September 2016 and an increase in restricted cash and cash equivalents for revenue bond debt service of \$14 million. This increase was offset by the decrease in other assets of \$52 million related to the use of acquisition fund proceeds under an equipment lease purchase agreement.

Capital assets, net increased by \$17 million from June 30, 2016 to June 30, 2017, primarily due to net additions to capital assets of \$220 million, offset by depreciation expense of \$203 million.

Current liabilities increased by \$16 million or 22% from June 30, 2016 to June 30, 2017, primarily due to a \$14 million increase in accounts and contracts payable related to capital and operating expenses, and a \$14 million increase in revenue bonds payable from restricted assets.

Long-term liabilities increased by \$92 million or 18% from June 30, 2016 to June 30, 2017, primarily due to an increase in revenue bonds payable attributable to the issuance of revenue bonds in September 2016, offset by principal repayments during the year.

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Statements of Activities

The following condensed financial information was derived from the government-wide Statements of Activities and reflects how the Highways Division's net position changed during the year.

	2017	2016
Expenses:		
Depreciation expense	\$ 203,075,015	\$ 202,549,264
Operations and maintenance	179,981,077	178,254,738
Administration of Highways Division	43,494,774	34,551,843
Interest expense	19,514,929	18,107,045
Motor Vehicle Safety Office	15,581,275	14,525,237
Surcharge on gross receipts	10,028,814	12,077,445
Other	17,995,650	9,146,487
Total expenses	489,671,534	469,212,059
Revenues:		
Program revenues:		
Capital grants and contributions	79,083,600	112,876,627
Operating grants and contributions	68,454,371	82,201,259
Charges for services	54,630,631	55,218,469
Total program revenues	202,168,602	250,296,355
General revenues:		
Taxes	216,761,182	222,174,654
Investment income and other	3,447,084	2,566,853
Total general revenues	220,208,266	224,741,507
Total revenues	422,376,868	475,037,862
Change in net position before transfers	(67,294,666)	5,825,803
Transfers	34,057,353	(2,329,807)
Change in net position	(33,237,313)	3,495,996
Net Position, beginning of year	4,894,804,226	4,891,308,230
Net Position, end of year	\$ 4,861,566,913	\$ 4,894,804,226

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Total revenues decreased by \$53 million or 11% from \$475 million in fiscal year 2016 to \$422 million in fiscal year 2017, due primarily to a decrease in program revenues of \$48 million or 19%, and a decrease in general revenues of \$5 million or 2%.

Program revenues, which comprise charges for services, as well as capital and operating grants, accounted for 48% and 53% of total revenues in fiscal years 2017 and 2016, respectively. The largest components of program revenues (73% for fiscal year 2017 and 78% for fiscal year 2016) resulted from capital and operating grants and contributions primarily from the Federal Highway Administration for the maintenance and construction of roads and other infrastructure. Capital and operating grants and contributions decreased by \$47 million from \$195 million in fiscal year 2016 to \$148 million in fiscal year 2017.

General revenues, which consist of taxes, including state fuel taxes, vehicle weight taxes and penalties, and rental motor and tour vehicle surcharge taxes, as well as investment income, accounted for 52% and 47% of total revenues in fiscal year 2017 and 2016, respectively.

Total expenses increased by \$21 million or 4% from \$469 million in fiscal year 2016 to \$490 million in fiscal year 2017. Administrative expenses, other expenses, operations and maintenance, and interest expense increased by \$9 million, \$9 million, \$2 million, and \$1 million respectively.

The fiscal year 2017 decrease in net position of \$33 million resulted from the decrease in net position before transfers of \$67 million offset by transfers of \$34 million, which included a transfer from the State general fund of \$37 million to provide assistance to the Highways Division's operations, reduced by transfers of \$3 million to other State departments for debt service payments on general obligation bonds. The fiscal year 2016 increase in net position of \$4 million resulted from the increase in net position before transfers of \$6 million and a transfer out of \$2 million to other State departments for the payment of debt service on general obligation bonds.

FINANCIAL ANALYSIS OF THE HIGHWAYS DIVISION'S GOVERNMENTAL FUNDS

As noted earlier, the Highways Division uses fund accounting to ensure and demonstrate compliance with finance-related requirements.

The focus of the Highways Division's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the Highways Division's financing requirements.

**HIGHWAYS DIVISION
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At June 30, 2017, the Highways Division's Governmental Funds reported combined ending fund balance of \$396 million, representing an increase of \$18 million from the prior year. \$253 million of the fund balance is committed to indicate that amounts can only be used for specific purposes pursuant to formal action of the Legislature. \$143 million of the fund balance is restricted to indicate that amounts are restricted to specific purposes imposed by external parties.

At June 30, 2016, the Highways Division's Governmental Funds reported combined ending fund balance of \$378 million, representing an increase of \$65 million from the prior year. \$317 million of the fund balance is committed to indicate that amounts can only be used for specific purposes pursuant to formal action of the Legislature. \$61 million of the fund balance is restricted to indicate that amounts are restricted to specific purposes imposed by external parties.

The SHF is the major operating fund of the Highways Division. The State imposes taxes, fees, and charges relating to the operation and use of motor vehicles on the public highways of the State. These funds are deposited into the SHF established under Section 248-8, Hawaii Revised Statutes (HRS). Monies deposited in the SHF are used for acquisition, planning, design, construction, operation, repair, and maintenance of the State Highway System.

The current taxes, fees, and charges deposited to the SHF consist of: (1) the highway fuel taxes; (2) the vehicle registration fees; (3) the vehicle weight tax; and (4) the rental motor vehicle and tour vehicle surcharge taxes. Together, these taxes, fees and charges accounted for most of the receipts of the SHF. Other sources of revenues include interest earnings on monies previously credited to the SHF, vehicle weight tax penalties, certain rental income from State Highway System properties, passenger motor vehicle inspection charges, overweight permits, sales of surplus lands, commercial license fees, and other miscellaneous revenues.

At June 30, 2017 and 2016, the total fund balance of the SHF was \$253 million and \$317 million, respectively. SHF's fund balance decreased by \$64 million in the current year compared to a \$91 million increase in the prior year. The current year decrease was mainly due to revenues under expenditures of \$13 million and net transfers out of \$51 million.

The Debt Service Fund (DSF) is used to track the revenue bond debt service for the Highways Division. Debt service requirements are primarily transferred from the SHF. The debt service expenditures were \$72 million and \$33 million for fiscal year 2017 and fiscal year 2016, respectively.

The Capital Projects Fund accounts for the Highways Division's capital improvements program. At June 30, 2017, the CPF had a total fund balance of \$143 million. The CPF fund balance increased by \$82 million in fiscal year 2017 as compared to a \$26 million decrease in the prior year. The significant increase in the current year fund balance was mainly due to \$133 million in other financing sources from the revenue bond issuances.

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STATE HIGHWAY FUND BUDGETARY HIGHLIGHTS

The final SHF budget had total revenues of \$278 million. The actual revenues on a budgetary basis were \$37 million or 13% more than the final budget, primarily due to an unbudgeted transfer from the State General Fund for highway construction, repair, and maintenance.

Expenditures on the budgetary actual basis were \$30 million or 10% lower than the final budgeted amounts. The majority of the difference was due to actual operations and maintenance expenditures being \$19 million lower than the final budget. The lower than budgeted expenditures were mainly a result of 1) lower electricity and special maintenance expenditures, 2) lower payroll expenditures due to staffing vacancies, and 3) planned projects that were deferred for higher priority projects. Additionally, actual expenditures related to the administration of the Highways Division was \$9 million less than budgeted due to lower than anticipated debt service payments and lower than anticipated administrative expenses such as insurance, consulting services, and surcharges.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

The Highways Division's investment in capital assets as of June 30, 2017 amounted to \$5 billion, net of accumulated depreciation of \$6 billion. This investment in capital assets includes land and land improvements, buildings and building improvements, vehicles and equipment, infrastructure assets and construction in progress. Infrastructure assets consist of land, roadways, tunnels and bridges, and miscellaneous roadway components.

During fiscal year 2017, the Highways Division had bid openings for 11 projects, with contract amounts totaling approximately \$77 million. There were 6 projects on Oahu, 2 projects on Maui, (includes Molokai and Lanai), 2 project on Hawaii, and 1 project on Kauai.

During fiscal year 2016, the Highways Division had bid openings for 16 projects, with contract amounts totaling approximately \$67 million. There were 13 projects on Oahu, 2 projects on Maui, (includes Molokai and Lanai), and 1 project on Hawaii.

Additional information on the Highways Division's capital assets can be found in Note 8 to the basic financial statements.

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Long-Term Debt

As of June 30, 2017, outstanding State of Hawaii Highway Revenue Bonds amounted to \$463 million, compared to \$408 million as of June 30, 2016. These revenue bonds are payable solely from, and collateralized solely by, certain revenues held in the State Highway Fund. The proceeds of the revenue bonds are used to finance highway capital improvement projects and other related projects for the State Highways System.

In September 2016, the Highways Division issued \$103,395,000 in State of Hawaii Revenue Bonds Series 2016A (2016A Bonds). The 2016A Bonds bear interest at rates ranging from 2.0% to 5.0% and mature in annual installments through 2030.

In September 2016, the Highways Division also issued \$101,090,000 in State of Hawaii Revenue Bonds Series 2016B (2016B Bonds). The 2016B Bonds bear interest at rates ranging from 1.26% to 5.0% and mature in annual installments through 2036. The Highways Division issued the bonds to advance refund \$111,590,000 of the outstanding callable series 2008 and 2011A bonds with interest rates ranging from 4.8% to 6.0%. The net proceeds were used to purchase U.S. Treasury securities. These securities were deposited in an irrevocable trust to provide for all future debt service on the refunded portion of the 2008 and 2011A series bonds. As a result, that portion of the 2008 and 2011A series bonds are considered defeased, and the Highways Division has removed the liability from its accounts. The advance refunding provided net present value savings of \$17 million.

The Highways Division's revenue bond rating by Moody's Investors Service, Inc., Standard & Poor's Corporation, and Fitch IBCA, Inc. are "Aa2," "AA+," and "AA," respectively.

Generally, a rating agency bases its rating on the information and materials furnished to it and on investigations, studies, and assumptions of its own. There is no assurance that such ratings will continue for any given period of time or that such ratings will not be revised downward, suspended, or withdrawn entirely by the rating agencies if, in the judgment of such rating agencies, circumstances so warrant. The State undertakes no responsibility to oppose any such revision, suspension, or withdrawal.

See Notes 10 and 11 to the basic financial statements for additional information on the State of Hawaii Highway Revenue Bonds.

The Highways Division entered into an equipment lease purchase agreement to fund the acquisition and installation of energy conservation measures at selected Highways Division locations. Lease payments will commence on August 1, 2017 and continue through August 1, 2031 at an interest rate of 2.63%. See Note 15 to the basic financial statements for further information on this capital lease obligation, which amounted to \$62 million at June 30, 2017 and 2016.

Additional information on the Highways Division's other long-term liabilities can be found in Note 10 to the basic financial statements.

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REQUEST FOR INFORMATION

This financial report is designed to provide a general overview of the Highways 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 to Kam Kin Sin, Acting Administrative Services Officer, State of Hawaii, Department of Transportation, Highways Division, 869 Punchbowl Street, Honolulu, Hawaii, 96813.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Governmental Activities

Statement of Net Position

June 30, 2017

Assets:	
Cash and cash equivalents	\$ 419,653,216
Receivables, net:	
Due from U.S. government	22,386,464
Due from city and counties	10,306,310
Due from State of Hawaii	855,389
Other receivables	188,490
Prepaid expenses	51,417
Restricted cash and cash equivalents:	
Revenue bond debt service	24,197,299
Security deposits	8,386,463
Other assets	8,560,312
Capital assets, net of accumulated depreciation	<u>5,048,468,132</u>
Total assets	<u>5,543,053,492</u>
Deferred Outflows of Resources:	
Deferred charge on refunding, net	<u>12,612,116</u>
Liabilities:	
Accounts payable	29,761,995
Accrued payroll	4,929,892
Accrued interest payable	1,494,064
Contracts payable:	
Current portion	24,470,835
Retainage payable	7,188,351
Other liabilities	15,300
Payable from restricted assets:	
Revenue bonds - due within one year	13,420,000
Interest payable	10,777,299
Security deposits	8,386,463
Long-term liabilities:	
Due within one year:	
Accrued vacation payable	3,937,273
Workers' compensation payable	1,095,057
Capital lease obligation	1,731,203
Revenue bonds payable	27,345,000
Due after one year:	
Accrued vacation payable	8,462,282
Workers' compensation payable	5,632,597
Capital lease obligation	60,241,710
Revenue bonds payable	<u>485,209,374</u>
Total liabilities	<u>694,098,695</u>
Net Position:	
Net investment in capital assets	4,599,373,082
Restricted for debt service and capital projects activity	53,562,533
Unrestricted	<u>208,631,298</u>
Total net position	<u>\$ 4,861,566,913</u>

See accompanying notes to the basic financial statements.

**HIGHWAYS DIVISION
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Governmental Activities

Statement of Activities

Year Ended June 30, 2017

Expenses:

Operations and maintenance:	
Oahu highways and services	\$ 91,168,610
Kauai highways and services	19,001,405
Maui highways and services	7,833,885
Hawaii highways and services	19,321,778
Molokai highways and services	5,641,443
Lanai highways and services	3,283,944
Pass through for County highways and services	33,730,012
Depreciation expense	203,075,015
Administration of Highways Division	43,494,774
Capital projects	17,995,650
Motor Vehicle Safety Office	15,581,275
Surcharge on gross receipts	10,028,814
Interest expense	19,514,929
	<hr/>
Total expenses	489,671,534

Program Revenues:

Capital grants and contributions	79,083,600
Operating grants and contributions	68,454,371
Charges for services:	
Vehicle registration fees	45,023,660
Other fees and permits	3,080,882
Penalties and fines	5,216,127
Rentals	1,309,962
	<hr/>
Total program revenues	202,168,602

General Revenues:

Taxes:	
State fuel taxes	83,020,652
Vehicle weight taxes and penalties	80,553,737
Rental motor and tour vehicle surcharge taxes	53,186,793
Investment income	2,694,345
Non-imposed fringe benefits	752,739
	<hr/>
Total general revenues	220,208,266
	<hr/>
Total revenues	422,376,868
	<hr/>
Change in net position before transfers	(67,294,666)

Transfers

	<hr/>
Change in net position	34,057,353
	<hr/>
	(33,237,313)

Net Position:

Beginning of year	<hr/>
	4,894,804,226
End of year	<hr/>
	\$ 4,861,566,913

See accompanying notes to the basic financial statements.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Governmental Funds

Balance Sheet

June 30, 2017

	<u>State Highway Fund</u>	<u>Debt Service Fund</u>	<u>Capital Projects Fund</u>	<u>Total</u>
Assets:				
Cash and cash equivalents	\$ 212,852,490	\$ -	\$ 206,800,726	\$ 419,653,216
Receivables:				
Due from capital projects fund	53,896,112	-	-	53,896,112
Due from U.S. government	13,109,366	-	9,277,098	22,386,464
Due from city and counties	10,298,445	-	7,865	10,306,310
Due from State of Hawaii	855,389	-	-	855,389
Other receivables	188,490	-	-	188,490
Prepaid expenses	-	-	51,417	51,417
Restricted cash and cash equivalents:				
Revenue bond debt service	-	24,197,299	-	24,197,299
Security deposits	8,386,463	-	-	8,386,463
Other assets	8,560,312	-	-	8,560,312
Total assets	<u>\$ 308,147,067</u>	<u>\$ 24,197,299</u>	<u>\$ 216,137,106</u>	<u>\$ 548,481,472</u>

See accompanying notes to the basic financial statements.

(Continued)

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Governmental Activities (Continued)

Balance Sheet

June 30, 2017

	State Highway Fund	Debt Service Fund	Capital Projects Fund	Total
Liabilities:				
Accounts payable	\$ 26,166,949	\$ -	\$ 3,595,046	\$ 29,761,995
Accrued payroll	4,929,892	-	-	4,929,892
Contracts payable:				
Current portion	10,286,985	-	14,183,850	24,470,835
Retainage payable	5,366,265	-	1,822,086	7,188,351
Payable from restricted assets:				
Revenue bond debt service	-	24,197,299	-	24,197,299
Security deposits	8,386,463	-	-	8,386,463
Due to State Highway Fund	-	-	53,896,112	53,896,112
Other liabilities	15,300	-	-	15,300
	<u>55,151,854</u>	<u>24,197,299</u>	<u>73,497,094</u>	<u>152,846,247</u>
Fund Balances:				
Restricted - Capital Projects Fund	-	-	142,588,595	142,588,595
Committed - State Highway Fund	252,995,213	-	-	252,995,213
Nonspendable - prepaid expenses	-	-	51,417	51,417
	<u>252,995,213</u>	<u>-</u>	<u>142,640,012</u>	<u>395,635,225</u>
Total liabilities and fund balances	<u>\$ 308,147,067</u>	<u>\$ 24,197,299</u>	<u>\$ 216,137,106</u>	<u>\$ 548,481,472</u>

See accompanying notes to the basic financial statements.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Position

June 30, 2017

Total Fund Balances - Governmental Funds		\$ 395,635,225
Amounts reported for governmental activities in the statement of net position are different because:		
Capital assets used in governmental activities are not financial resources and therefore are not reported in the Governmental Funds financial statements. These assets consist of:		
Governmental capital assets	\$ 10,846,691,449	
Less accumulated depreciation	<u>(5,798,223,317)</u>	
		5,048,468,132
Accrued interest payable is not recognized in governmental funds		(1,494,064)
Deferred charges on refunding are recorded as expenditures in Governmental Funds financial statements when incurred. However, in Government-Wide financial statements, such amounts are recorded as a deferred outflow of resources and amortized over the life of the related bonds.		12,612,116
Long-term liabilities are not due and payable in the current period and therefore are not reported in the Governmental Funds financial statements:		
Revenue bonds payable	(512,554,374)	
Capital lease obligation	(61,972,913)	
Accrued vacation payable	(12,399,555)	
Workers' compensation payable	<u>(6,727,654)</u>	
		<u>(593,654,496)</u>
Net Position of Governmental Activities		<u>\$ 4,861,566,913</u>

See accompanying notes to the basic financial statements.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Governmental Funds

Statement of Revenues, Expenditures, and Changes in Fund Balances

Year Ended June 30, 2017

	<u>State Highway Fund</u>	<u>Debt Service Fund</u>	<u>Capital Projects Fund</u>	<u>Total</u>
Expenditures:				
Operations and maintenance:				
Oahu highways and services	\$ 154,207,658	\$ -	\$ -	\$ 154,207,658
Kauai highways and services	22,519,323	-	-	22,519,323
Maui highways and services	23,490,152	-	-	23,490,152
Hawaii highways and services	28,003,222	-	-	28,003,222
Molokai highways and services	5,641,443	-	-	5,641,443
Lanai highways and services	3,283,944	-	-	3,283,944
Pass through for County highways and services	33,730,012	-	-	33,730,012
Administration of Highways Division	59,708,527	-	-	59,708,527
Motor Vehicle Safety Office	15,581,275	-	-	15,581,275
Surcharge on gross receipts	10,028,814	-	-	10,028,814
Capital projects	-	-	128,826,038	128,826,038
Debt service:				
Principal payments	-	51,210,000	-	51,210,000
Interest expense	-	20,743,109	-	20,743,109
Bond issuance cost	-	-	1,014,836	1,014,836
Total expenditures	<u>356,194,370</u>	<u>71,953,109</u>	<u>129,840,874</u>	<u>557,988,353</u>
Program Revenues:				
Charges for services:				
Vehicle registration fees	45,023,660	-	-	45,023,660
Other fees and permits	3,061,156	-	-	3,061,156
Penalties and fines	5,216,127	-	-	5,216,127
Rentals	1,309,962	-	-	1,309,962
Operating grants and contributions	68,454,371	-	-	68,454,371
Capital grants and contributions	-	-	79,103,326	79,103,326
Total program revenues	<u>123,065,276</u>	<u>-</u>	<u>79,103,326</u>	<u>202,168,602</u>

See accompanying notes to the basic financial statements.

(Continued)

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Governmental Funds

Statement of Revenues, Expenditures, and Changes in Fund Balances (Continued)

Year Ended June 30, 2017

	State Highway Fund	Debt Service Fund	Capital Projects Fund	Total
General Revenues:				
Taxes:				
State fuel taxes	\$ 83,020,652	\$ -	\$ -	\$ 83,020,652
Vehicle weights taxes and penalties	80,553,737	-	-	80,553,737
Rental motor and tour vehicle surcharge taxes	53,186,793	-	-	53,186,793
Investment income	2,694,345	-	-	2,694,345
Non-imposed fringe benefits	752,739	-	-	752,739
	220,208,266	-	-	220,208,266
Total general revenues				
Revenues under expenditures	(12,920,828)	(71,953,109)	(50,737,548)	(135,611,485)
Other Financing Sources (Uses):				
Transfers in	-	71,953,109	13,581,077	85,534,186
Transfers out	(51,476,833)	-	-	(51,476,833)
Issuance of revenue bonds	-	-	204,485,000	204,485,000
Premium on revenue bonds	-	-	43,096,286	43,096,286
Payments for current refunding of revenue bonds	-	-	(128,188,095)	(128,188,095)
	(51,476,833)	71,953,109	132,974,268	153,450,544
Total other financing sources (uses)				
Revenues and other financing sources over (under) expenditures and other financing uses	(64,397,661)	-	82,236,720	17,839,059
Fund Balances:				
Beginning of year	317,392,874	-	60,403,292	377,796,166
End of year	\$ 252,995,213	\$ -	\$ 142,640,012	\$ 395,635,225

See accompanying notes to the basic financial statements.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
HIGHWAYS DIVISION**

Reconciliation of the Governmental Funds Statement of Revenues, Expenditures,
and Changes in Fund Balances to the Statement of Activities

Year Ended June 30, 2017

Net Change in Fund Balances - Total Governmental Funds		\$ 17,839,059
Amounts reported for governmental activities in the statement of activities are different because:		
Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense:		
Expenditures for capital assets	\$ 219,944,632	
Loss of disposal of capital assets	(10,752)	
Less current fiscal year depreciation	<u>(203,075,015)</u>	16,858,865
Capital debt proceeds provide current financial resources to governmental funds; however, issuing debt increases long-term liabilities in the statement of net assets.		
Capital lease obligation		(307,808)
Borrowings provide current financial resources to governmental funds; however, issuing debt increases long-term liabilities in the statement of net assets. In the current period, proceeds were received from:		
Issuance of revenue bonds	(204,485,000)	
Premium on revenue bonds	<u>(43,096,286)</u>	(247,581,286)
Repayment of long-term debt is reported as expenditures in the Governmental Funds financial statements, but the repayment reduces long-term liabilities in the Government-Wide financial statements:		
Bond principal repayment	37,790,000	
Change in debt service liability recognized in debt service fund	<u>13,420,000</u>	51,210,000
Payments for the current refunding of revenue bonds are reported as other financing uses in the Governmental Funds financial statements. However, in the Government-Wide financial statements, these amounts are reported as follows:		
Bond principal repayment	111,590,000	
Write-offs related to refunded bonds:		
Unamortized bond premiums	3,022,204	
Deferred charge on refunding	<u>13,574,910</u>	128,187,114
Original issue premium and deferred charge on refunding are reported as incurred in governmental funds as they require the use of current financial resources. However, in the Government-Wide financial statements, these amounts are deferred and amortized to expense over the remaining life of the related bond:		
Amortization of bond premiums	5,760,282	
Amortization of deferred charge on refunding	<u>(1,714,413)</u>	4,045,869
Other revenues and expenditures in the Government-Wide financial statements do not provide or use current financial resources and therefore are not reported as revenues and expenditures in Governmental Funds financial statements.		
		<u>(3,489,126)</u>
Change in Net Position - Governmental Activities		<u>\$ (33,237,313)</u>

See accompanying notes to the basic financial statements.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

State Highway Fund

Statement of Revenues and Expenditures - Budget and Actual (Non-GAAP Budgetary Basis)

Year Ended June 30, 2017

	<u>Original</u>	<u>Final</u>	<u>Actual on Budgetary Basis</u>	<u>Variance Over (Under)</u>
Revenues:				
State fuel taxes	\$ 83,021,000	\$ 83,021,000	\$ 83,020,652	\$ (348)
Vehicle weight taxes	53,187,000	53,187,000	53,186,793	(207)
Rental motor and tour vehicle surcharge taxes	83,526,000	83,526,000	81,521,921	(2,004,079)
Vehicle registration fees	45,734,000	45,734,000	45,734,122	122
Investment income	2,677,000	2,677,000	2,674,324	(2,676)
Other fees and penalties	9,679,000	9,679,000	11,686,466	2,007,466
Transfer from State general fund	-	-	37,000,000	37,000,000
	<u>277,824,000</u>	<u>277,824,000</u>	<u>314,824,278</u>	<u>37,000,278</u>
Expenditures:				
Operations and maintenance:				
Oahu highways and services	106,678,552	107,022,572	102,025,062	(4,997,510)
Kauai highways and services	16,535,002	16,589,558	15,797,980	(791,578)
Maui highways and services	22,402,052	22,477,610	20,777,480	(1,700,130)
Hawaii highways and services	27,322,054	27,454,931	16,885,068	(10,569,863)
Molokai highways and services	8,029,492	8,034,676	6,898,850	(1,135,826)
Lanai highways and services	716,179	721,363	632,718	(88,645)
Administration of Highways Division including debt service	98,136,323	98,005,922	89,048,932	(8,956,990)
Surcharge on gross receipts	9,785,071	10,209,247	9,309,514	(899,733)
Motor Vehicle Safety Office	9,211,944	9,284,448	8,712,769	(571,679)
	<u>298,816,669</u>	<u>299,800,327</u>	<u>270,088,373</u>	<u>(29,711,954)</u>
Revenues over (under) expenditures and other uses	<u>\$ (20,992,669)</u>	<u>\$ (21,976,327)</u>	<u>\$ 44,735,905</u>	<u>\$ 66,712,232</u>

See accompanying notes to the basic financial statements.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Agency Fund

Statement of Fiduciary Net Position

June 30, 2017

Asset:

Cash and cash equivalents	\$ 2,276,774
Total asset	<u>\$ 2,276,774</u>

Liability:

Due to others	\$ 2,276,774
Total liability	<u>\$ 2,276,774</u>

See accompanying notes to the basic financial statements.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Notes to the Basic Financial Statements

June 30, 2017

(1) Financial Reporting Entity

Act 1, Session Laws of Hawaii (SLH), Second Special Session 1959, the Hawaii State Government Reorganization Act of 1959 (the Act), established the Department of Transportation (the Department) whose function is to establish, maintain, and operate transportation facilities of the State of Hawaii (the State), including highways, airports, harbors and such other transportation facilities and activities as may be authorized by law. The Department's activities are carried out through three primary operating divisions: Airports, Harbors, and Highways (the Highways Division). Through the Highways Division, the Department has general supervision of the management and maintenance of the State Highways System and the location, design, and construction of new highways and facilities. The Highways Division provides supervision to assure completion of State highway contracts in accordance with plans and specifications.

Taxes, fees and charges authorized and collected relating to the operation and use of motor vehicles on public highways of the State are deposited into the State Highway Fund, and expenditures for purposes of the Act are made from the State Highway Fund.

The State Highway Fund also includes the Motor Vehicle Safety Office (MVSO). The MVSO was originally established as the Highway Safety Coordinator's Office to implement the 1967 Hawaii Highway Safety Act. It was reorganized by the 1977 State Legislature to encompass the additional duty of the safety of operations of heavy motor vehicles. The MVSO is assigned as a staff office under the Highways Division.

The accompanying financial statements present only the activities of the Highways Division and are not intended to present fairly the financial position of the governmental activities and the respective major funds of the State, and the respective changes in financial position and the respective budgetary comparison for the year then ended in conformity with accounting principles generally accepted in the United States of America (GAAP).

(2) Significant Accounting Policies

Basis of Presentation

The Highways Division's financial statements are prepared in conformity with GAAP. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing accounting and financial reporting principles.

Governmental Funds Financial Statements

The accounts of the Highways Division are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Notes to the Basic Financial Statements

June 30, 2017

expenditures. Government resources are allocated to and accounted for in individual funds based upon the purposes for which they are to be spent and the means by which spending activities are controlled. For financial reporting purposes, the Highways Division includes all funds that are controlled by or dependent on the Highways Division's administrative head. Control by or dependence on the Division was determined on the basis of statutory authority and monies flowing through the Highways Division to each fund or account.

Governmental funds are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recognized when measurable and available. The Highways Division considers all revenues reported in the governmental funds to be available if the revenues are collected within 90 days after year-end. Revenues susceptible to accrual include federal grants and tax and fee revenues. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, claims and judgments, and compensated absences, which are recognized as expenditures when payment is due. General capital asset acquisitions are reported as expenditures in governmental funds. Proceeds of general long-term debt are reported as other financing sources.

A description of the funds administered by the Highways Division are included in the governmental funds financial statements follows:

State Highway Fund – The State Highway Fund generally accounts for revenues and expenditures for highway operations, maintenance and administration.

The State Highway Fund is a special revenue fund of the State established by Section 248-8, Hawaii Revised Statutes (HRS). All fuel taxes collected under Section 243-4, HRS except county fuel taxes, aviation fuel taxes, and taxes on fuel sold for use by small boats are deposited in the State Highway Fund.

Section 248-9, HRS provides that monies in the State Highway Fund shall be expendable by the Department of Transportation for the design, construction, reconstruction, repair and maintenance, and for acquisition of rights-of-way for public highways included in the State Highway Fund established under Section 264-41, HRS.

Debt Service Fund – The Debt Service Fund accounts for the Highways Division's financial resources obtained and used for the payment of principal and interest on State of Hawaii Highway Revenue Bonds.

Capital Projects Fund – The Capital Projects Fund accounts for the Highways Division's construction projects and the related sources of financing.

The accompanying financial statements include highway projects authorized by legislative acts through June 30, 2017.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Notes to the Basic Financial Statements

June 30, 2017

GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, provides guidance on classifying fund balances into specially defined classifications and clarifies definitions for governmental fund types.

Nonspendable – Balances that cannot be spent because they are either (a) not in spendable form or (b) legally or contractually required to be maintained intact.

Restricted – Balances that are restricted for specific purposes by external parties such as creditors, grantors or other governments.

Committed – Balances that can only be used for specific purposes pursuant to constraints imposed by formal action of the state legislature.

Assigned – Balances that are constrained by management to be used for specific purposes, but are neither restricted nor committed.

Unassigned – Residual balances that are not contained in the other classifications.

Government-Wide Financial Statements

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met. The effect of interfund activity has been removed from these financial statements.

Statement of Net Position – The statement of net position includes all capital assets and long-term liabilities that are excluded from the Governmental Funds financial statements. The net position is reported in three categories: net investment in capital assets; restricted for debt service and capital projects activity; and unrestricted.

Statement of Activities – The statement of activities reports expenses and revenues in a format that focuses on the cost of the Highways Division's programs. Revenues are classified as either program revenues or general revenues. Program revenues include charges paid by users, as well as capital or operating grants. Revenues that are not classified as program revenues, including all taxes are presented as general revenues.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Notes to the Basic Financial Statements

June 30, 2017

Fiduciary Fund Financial Statement

The agency fund is used to account for assets held by the Highways Division on behalf of other departments of the State. Cash and cash equivalents reported in the agency fund statement of fiduciary net position consist of amounts held in State Treasury, including deposits received and held for others in the amount of \$2,276,774 at June 30, 2017.

Cash and Cash Equivalents

Cash and cash equivalents consist of amounts held in State Treasury as discussed in Note 4. The State's investments held in the State Treasury are reported at fair value within the fair value hierarchy established by GAAP.

Restricted Cash and Cash Equivalents

Restricted cash and cash equivalents consist of amounts held in State Treasury, the use of which is legally restricted. Restricted cash and cash equivalents accounts for the principal and interest amounts accumulated to make debt service payments on the Highways Division's revenue bonds and also include security deposits collected from third parties.

Fair Value Measurements

The Highways Division measures the fair value of assets and liabilities as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market in an orderly transaction between market participants at the measurement date. The fair value hierarchy distinguishes between independent observable inputs and unobservable inputs used to measure fair value, as follows:

- Level 1* - Quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2* - Inputs other than quoted market prices included in Level 1 that are observable for an asset or liability, either directly or indirectly.
- Level 3* - Unobservable inputs for an asset or liability reflecting the reporting entity's own assumptions. Level 3 inputs are used to measure fair value to the extent that observable Level 1 or 2 inputs are not available.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Notes to the Basic Financial Statements

June 30, 2017

Receivables

Receivables are reported at their gross value when earned and are reduced by the estimated portion that is expected to be uncollectible. The allowance for uncollectible accounts is based on collection history and current information regarding the credit worthiness of the tenants and others doing business with the Highways Division. When continued collection activity results in receipt of amounts previously written off, revenue is recognized for the amount collected.

Capital Assets

Capital assets, which include land and land improvements, buildings and improvements, vehicles and equipment, infrastructure (i.e., roads, bridges, tunnels), and construction in progress, are reported in the government-wide statement of net position. Such assets are recorded at cost or at estimated fair market value at the date of donation. Capital outlays are recorded as expenditures of the State Highway Fund or Capital Projects Fund in the governmental funds and as assets in the government-wide statement of net assets to the extent the capitalization threshold is met.

Capital assets are depreciated by the straight-line method over their useful lives estimated by management as follows:

<u>Class of Assets</u>	<u>Estimated Useful Life</u>	<u>Capitalization Threshold</u>
Land improvements	15 years	\$ 100,000
Buildings	30 years	\$ 100,000
Building improvements	30 years	\$ 100,000
Vehicles and equipment	5 to 7 years	\$ 5,000
Infrastructure	28 to 75 years	\$ 100,000

Disposals of assets are recorded by removing the costs and related accumulated depreciation from the accounts with the resulting gain or loss recorded in operations.

Repairs and maintenance, and minor replacements, renewals, and betterments are charged against operations. Major replacements, renewals, and betterments are capitalized.

Deferred Outflows/Inflows of Resources

In addition to assets, the statement 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 Highways Division only has one

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Notes to the Basic Financial Statements

June 30, 2017

item that qualifies for reporting in this category. It is the deferred charge on refunding reported in the statement of net position.

In addition to liabilities, the statement of net position may include 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 Highways Division does not have any deferred inflows of resources at June 30, 2017.

Long-Term Obligations

In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities. Bond premiums are deferred and amortized over the life of the bonds using the effective interest method.

In the governmental funds financial statements, bond premiums are recognized as paid. The face amount of debt and any related premium are reported as other financing sources.

Bond Issuance Costs

Costs relating to the issuance of bonds are expensed as incurred in the accompanying financial statements.

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, net amounted to \$12,612,116 at June 30, 2017, and is reported as deferred outflows of resources in the statement of net position.

Compensated Absences

It is the Highways Division's policy to permit employees to accumulate earned but unused vacation and sick leave benefits. There is no liability for unpaid accumulated sick leave since sick leave is not convertible to pay upon termination of employment. All vacation pay is accrued when incurred in the accompanying financial statements.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Notes to the Basic Financial Statements

June 30, 2017

Employees' Retirement System

The Highways Division's contributions to the Employees' Retirement System of the State of Hawaii (the ERS) are based on the current contribution rate determined by the State Department of Budget and Finance. The Highways Division's policy is to fund its required contribution each pay period.

Risk Management

The Highways Division is exposed to various risks of loss from torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and injuries to employees. The State is self-insured for workers' compensation as discussed in Note 17. Liabilities related to these losses are reported when it is probable that the losses have occurred and the amount of those losses can be reasonably estimated.

Intrafund and Interfund Transactions

Significant transfers of financial resources between activities included within the same fund are offset within that fund. Transfers of revenues from funds authorized to receive them to funds authorized to expend them have been recorded as transfers in the financial statements.

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. Actual results could differ from those estimates.

Recently Issued Accounting Pronouncements

GASB Statement No. 75

The GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which will become effective for financial statements for the fiscal years beginning after June 15, 2017. This statement addresses accounting and financial reporting for OPEB plans that are provided to the employees of state and local governmental employers. This statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures.

This statement replaces the requirements of GASB Statement No. 45 (Statement No. 45), *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than*

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Notes to the Basic Financial Statements

June 30, 2017

Pensions, as amended, and GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, for OPEB. The Highways Division is currently evaluating the impact that this statement will have on its financial statements.

GASB Statement No. 82

The Highways Division adopted GASB Statement No. 82, *Pension Issues - An Amendment of GASB Statements No. 67, No. 68, and No. 73*, effective July 1, 2016. This statement addresses certain issues that have been raised with respect to GASB Statements No. 67, *Financial Reporting for Pension Plans*, No. 68, *Accounting and Financial Reporting for Pensions*, and No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*. This statement did not have a significant effect on the Highways Division's financial statements.

GASB Statement No. 83

The GASB issued Statement No. 83, *Certain Asset Retirement Obligations*. This statement provides financial statement users with information about asset retirement obligations that were not addressed in GASB standards by establishing uniform accounting and financial reporting requirements for these obligations. The requirements of this statement are effective for reporting periods beginning after June 15, 2018. The Highways Division is currently evaluating the impact that this statement will have on its financial statements.

GASB Statement No. 85

The GASB issued Statement No. 85, *Omnibus 2017*. The objective of this statement is to address practice issues that have been identified during the implementation and application of certain GASB statements. The requirements of this statement are effective for reporting periods beginning after June 15, 2017. The Highways Division is currently evaluating the impact that this statement will have on its financial statements.

GASB Statement No. 87

The GASB issued Statement No. 87, *Leases*. The objective of this statement is to improve accounting and financial reporting for leases by governments. This statement requires recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the lease agreements. The requirements of this statement are effective for reporting periods beginning after December 15, 2019. The Highways Division is currently evaluating the impact that this statement will have on its financial statements.

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(3) Budget and Budgetary Accounting

State Highway Fund

In the statement of revenues and expenditures - budget and actual (non-GAAP budgetary basis) for the State Highway Fund, amounts reflected as original and amended budgeted revenues are the official estimates as compiled by the Highways Division's management and the State Department of Budget and Finance at the time of budget consideration and adoption by the State Legislature. Revenue received from federal grants-in-aid is not included in the statement of revenues and expenditures - budget and actual (non-GAAP budgetary basis) for the State Highway Fund since such grants are normally reimbursements of costs incurred on approved projects.

In the case of expenditures, the original and amended budgeted amounts reflected on the statement of revenues and expenditures - budget and actual (non-GAAP budgetary basis) for the State Highway Fund are derived primarily from acts of the State Legislature and from other authorizations contained in other specific appropriation acts in various Session Laws of Hawaii.

Allotments are made and expenditures are controlled at the program level for the State Highway Fund. Allotments for the State Highway Fund lapse at year-end.

The reconciliation of the budgetary actual revenues over expenditures as shown on the statement of revenues and expenditures - budget and actual (non-GAAP budgetary basis) for the State Highway Fund to the Governmental Funds statement of revenues, expenditures, and changes in fund balances for the State Highway Fund is as follows:

Revenues over expenditures and other uses, non-GAAP budgetary basis	\$ 44,735,905
Federal grants in aid	68,454,371
Expenditures incurred on energy savings lease	(57,342,616)
Transfer from State general fund reported as revenues	(37,000,000)
Pass through expenditures for county projects	(33,730,012)
Transfers out of the Highways Division for debt service	2,942,647
Other adjustments to modified accrual basis of accounting	<u>(981,123)</u>
Revenues over expenditures, before other financing sources (uses), GAAP basis	<u><u>\$ (12,920,828)</u></u>

Capital Projects Fund

Excess Capital Projects Fund allotments lapse after completion of the project, which is generally two or three years subsequent to allotment.

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(4) Cash and Cash Equivalents

Cash and cash equivalents at June 30, 2017, consisted of amounts held in State Treasury and are reflected in the accompanying financial statements at June 30, 2017 as follows:

	Governmental Activities	Agency Fund	Total
Cash and cash equivalents	\$ 419,653,216	\$ 2,276,774	\$ 421,929,990
Restricted cash and cash equivalents:			
Reserve bond debt service	24,197,299	-	24,197,299
Security deposits	8,386,463	-	8,386,463
Total cash and cash equivalents	\$ 452,236,978	\$ 2,276,774	\$ 454,513,752

Amounts Held in State Treasury

The State pools all excess funds into an investment pool that is administered by the State Department of Budget and Finance and is used by various state departments and agencies, including the Highways Division. The Director of Finance is responsible for the safekeeping of all monies paid into the State Treasury. The Director of Finance pools and invests any monies of the State, which in the Director of Finance’s judgment, are in excess of the amounts necessary for meeting the specific requirements of the State. Investment earnings are allocated to the pool participants based upon their equity interest in the pooled monies. Legally authorized investments are listed in the Hawaii Revised Statutes.

At June 30, 2017, amounts held in State Treasury by the Highways Division totaled \$454,513,752. The amounts held in State Treasury reported in the accompanying statement of net position reflects the Highways Division’s relative position in the State’s investment pool based upon the average monthly investment balance of each participant in the investment pool.

Information relating to the cash and investments 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 is included in the comprehensive annual financial report (CAFR) of the State.

The carrying amount of unrestricted and restricted deposits in the State treasury (cash, time certificates of deposit, and money market accounts) for the primary government as of June 30, 2017 was \$2,117,946,000 and \$833,213,000, respectively, and unrestricted cash for the fiduciary funds as of June 30, 2017 was \$289,116,000.

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The following table presents the fair value of the investments included in the State's investment pool at June 30, 2017 (amounts expressed in thousands):

	<u>Reported Value</u>	<u>Fair Value Measurements Using</u>		
		<u>Quoted Prices in Active Markets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Primary government:				
Investments measured by fair value level:				
U.S. government securities	\$ 2,307,970	\$ 552,527	\$ 1,755,443	\$ -
Mututal funds	37,127	37,127	-	-
	<u>2,345,097</u>	<u>\$ 589,654</u>	<u>\$ 1,755,443</u>	<u>\$ -</u>
Investments measured at amortized cost:				
Certificates of deposit	<u>1,242,753</u>			
Total investments	<u>\$ 3,587,850</u>			
Fiduciary funds:				
Investments by fair value level:				
Equity securities	\$ 413,652	\$ 413,652	\$ -	\$ -
U.S. government securities	306,888	47,645	259,243	-
Mutual funds	132,899	132,899	-	-
Derivatives	(148)	-	(148)	-
	<u>853,291</u>	<u>\$ 594,196</u>	<u>\$ 259,095</u>	<u>\$ -</u>
Investments at net asset value (NAV):				
Commingled funds:				
Domestic equity	358,322			
International equity	377,205			
Domestic core fixed income	224,097			
Domestic inflation-linked fixed income	52,061			
Alternative investments	<u>74,919</u>			
	1,939,895			
Investments measured at amortized cost:				
Certificates of deposit	<u>107,164</u>			
Total investments	<u>\$ 2,047,059</u>			

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Cash and Cash Equivalents, Certificates of Deposit, and Repurchase Agreements

The State considers all cash and investments with original maturities of three months or less to be cash equivalents. The carrying amounts for cash equivalents, certificates of deposit, and repurchase agreements are measured at amortized cost.

Debt Securities, Equity Securities, Mutual Funds, Commingled Funds, and Alternative Investments

The following methods and assumptions were used by the State in estimating the fair value of its financial instruments:

Debt securities – Debt securities held by the State consist of U.S. government obligations including U.S. Treasury bills and U.S. Treasury notes and bonds. The fair value of these investments are based on quoted prices in active markets or other observable inputs, including pricing matrices. These investments are categorized in either Level 1 or 2 of the fair value hierarchy.

Mutual funds – The mutual funds held by the State are open-ended mutual funds that are registered with the Securities Exchange Commission (SEC). The fair value of these mutual funds are valued at the daily closing price as reported by the fund. These funds are required to publish their daily NAV and to transact at that price. These investments are categorized in Level 1 of the fair value hierarchy.

Equity securities – Equity securities held by the State are valued at the closing price reported on the active market on which the individual securities are traded. These investments are categorized as Level 1 of the fair value hierarchy.

Commingled funds and alternative investments – Investments in commingled funds and alternative investments are valued at the NAV of units of a bank commingled investment vehicle and two limited partnerships, respectively. The NAV is based on the fair value of the underlying assets.

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The following table presents the State's investments by maturity period at June 30, 2017 (amounts expressed in thousands):

	Reported Value	Maturity (in years)		
		Less than 1	1-5	>5
Primary government:				
Certificates of deposit	\$ 1,242,753	\$ 1,187,710	\$ 55,043	\$ -
U.S. government securities	2,307,970	704,940	1,603,030	-
	<u>\$ 3,550,723</u>	<u>\$ 1,892,650</u>	<u>\$ 1,658,073</u>	<u>\$ -</u>
Mutual funds	37,127			
	<u>\$ 3,587,850</u>			
Fiduciary funds:				
Certificates of deposit	\$ 107,164	\$ 102,418	\$ 4,746	\$ -
U.S. government securities	306,888	60,788	246,100	-
Derivatives	(148)	-	(148)	-
	413,904	<u>\$ 163,206</u>	<u>\$ 250,698</u>	<u>\$ -</u>
Equity securities	413,652			
Mutual funds	132,899			
Commingled funds	1,011,685			
Alternative investments	74,919			
Total investments	<u>\$ 2,047,059</u>			

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.

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Credit Risk

The State's general investment policy limits 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. 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.

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair value of an investment. The asset allocation and investment policy allows for active and passive investments in international securities. The foreign currency risk exposure to the State arises from the international equity investment holdings, including commingled funds, common stocks, and exchange traded funds.

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(5) Tax and Fee Revenues

State Fuel Tax

The primary source of revenue for the State Highway Fund is the state tax on liquid (motor vehicle) fuel. For fiscal year 2017, the tax imposed on each gallon of fuel was as follows:

Gasoline	16 cents
Diesel fuel:	
Non-highway use	1 cents
Highway use	16 cents
Liquefied petroleum gas	5.2 cents

Vehicle Weight Tax and Penalties

The vehicle weight tax was 1.75 to 2.25 cents per pound of net vehicle weight, to a maximum of \$300 per vehicle.

Rental Motor and Tour Vehicle Surcharge Taxes

The rental motor vehicle surcharge tax was \$3 a day that a rental motor vehicle is rented or leased.

The tour vehicle surcharge tax was \$65 a month for tour vehicles categorized by the Public Utilities Commission as an over 25-passenger carrier vehicle and \$15 a month for tour vehicles categorized as an 8 to 25 passenger carrier vehicle.

Vehicle Registration and Motor Carrier Safety Inspection Fees

The vehicle registration fee was \$45 per vehicle, of which \$5 is earmarked for deposit into the Emergency Medical Services (EMS) special fund. During the year ended June 30, 2017 the Highways Division collected approximately \$5,639,000 on behalf of the EMS special fund.

The motor carrier safety inspection fee was \$1.50 per vehicle.

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(6) Federal Grants-In-Aid

The Highways Division has projects in progress in which part of the funding is being provided by the Federal Highway Administration (FHWA) through grants-in-aid. Such projects are generally accounted for in the Capital Projects and State Highway Funds. At June 30, 2017, receivables totaling \$22,386,464 from the U.S. government are comprised of billed costs, pending reimbursement, as well as unbilled costs, which are eligible for reimbursement.

In addition, the MVSO has projects in progress in which part of the funding is being provided through federal grants-in-aid. The grants contain various compliance requirements, which must be met by the MVSO, including a matching of the grant amounts with state and local highway safety expenditures as defined in a formula. MVSO's matching requirement is met through the expenditures of the Division of Driver Education, The Judiciary, State of Hawaii. Cost reimbursement by the FHWA and National Highway Traffic Safety Administration (NHTSA) are subject to final audit by federal agencies. In addition, FHWA and NHTSA reserve the right to examine the Highways Division for economy, efficiency, and program results. The Highways Division's management believes that any federal aid received as of June 30, 2017 that might be required to be repaid to the FHWA or NHTSA based on federal audits would not be material to the financial position of the various funds of the Highways Division at June 30, 2017, or the results of operations of such funds for the year then ended.

(7) Non-Imposed Fringe Benefits

Payroll fringe benefit costs of employees of the Highways Division are assumed by the State and are not charged to the Highways Division's operating funds. These costs approximating \$753,000 for fiscal year 2017 have been reported as revenues and expenditures in the State Highway Fund.

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(8) Capital Assets

Changes in capital assets during the year ended June 30, 2017 was as follows:

	Balance July 1, 2016	Additions	Deductions	Transfers	Balance June 30, 2017
Nondepreciable assets:					
Land	\$ 440,848,550	\$ 338,891	\$ (3,926)	\$ -	\$ 441,183,515
Construction in progress	347,477,785	210,495,078	(6,826)	(111,428,921)	446,537,116
Infrastructure	819,369,450	-	-	-	819,369,450
Total nondepreciable assets	<u>1,607,695,785</u>	<u>210,833,969</u>	<u>(10,752)</u>	<u>(111,428,921)</u>	<u>1,707,090,081</u>
Depreciable assets:					
Land improvements	2,215,473	-	-	-	2,215,473
Buildings and improvements	48,033,623	-	-	1,097,584	49,131,207
Vehicles and equipment	73,350,878	9,110,663	(1,083,081)	-	81,378,460
Infrastructure	8,896,544,891	-	-	110,331,337	9,006,876,228
	9,020,144,865	9,110,663	(1,083,081)	111,428,921	9,139,601,368
Less accumulated depreciation	<u>(5,596,231,383)</u>	<u>(203,075,015)</u>	<u>1,083,081</u>	<u>-</u>	<u>(5,798,223,317)</u>
Total depreciable assets, net	<u>3,423,913,482</u>	<u>(193,964,352)</u>	<u>-</u>	<u>111,428,921</u>	<u>3,341,378,051</u>
Total capital assets, net	<u>\$ 5,031,609,267</u>	<u>\$ 16,869,617</u>	<u>\$ (10,752)</u>	<u>\$ -</u>	<u>\$ 5,048,468,132</u>

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(9) Net Position

At June 30, 2017, net position consisted of the following:

Net investment in capital assets:

Net property, plant and equipment	\$ 5,048,468,132
Less: Revenue bonds payable	(525,974,374)
Add: Unspent revenue bond proceeds	121,609,824
Add: Deferred charge on refunding, net	12,612,116
Less: Capital lease obligation, net of unused proceeds and financed interest cost	<u>(57,342,616)</u>
Total net investment in capital assets	<u>4,599,373,082</u>

Restricted for debt service and capital projects activity:

Restricted for capital projects	142,588,595
Restricted for debt service	24,197,299
Restricted for security deposits	8,386,463
Less: Unspent revenue bond proceeds	<u>(121,609,824)</u>
Total restricted for debt service and capital activity	<u>53,562,533</u>

Unrestricted

	<u>208,631,298</u>
Total net position	<u><u>\$ 4,861,566,913</u></u>

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(10) General Long-Term Liabilities

Changes in general long-term liabilities during the year ended June 30, 2017 were as follows:

	<u>Balance July 1, 2016</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance June 30, 2017</u>	<u>Amount Due Within One Year</u>
Accrued vacation payable	\$ 11,499,550	\$ 5,054,563	\$ (4,154,558)	\$ 12,399,555	\$ 3,937,273
Workers' compensation payable	5,632,597	2,190,114	(1,095,057)	6,727,654	1,095,057
Capital lease obligation	61,665,105	307,808	-	61,972,913	1,731,203
Revenue bonds payable	407,890,000	204,485,000	(149,380,000)	462,995,000	40,765,000
Revenue bonds payable - unamortized premium	28,665,574	43,096,286	(8,782,486)	62,979,374	-
Total governmental activities long-term liabilities	<u>\$ 515,352,826</u>	<u>\$ 255,133,771</u>	<u>\$ (163,412,101)</u>	<u>\$ 607,074,496</u>	<u>\$ 47,528,533</u>

(11) Revenue Bonds

In 1993, the Director of the Department of Transportation issued the *Certificate of the Director of Transportation Providing for the Issuance of State of Hawaii Highway Revenue Bonds* (Certificate). Subsequent issues of revenue bonds were covered by supplemental certificates to the original 1993 Certificate.

These revenue bonds are payable solely from, and collateralized solely by, the revenues held in the State Highway Fund consisting primarily of highway fuel taxes, vehicle registration fees, vehicle weight taxes, rental motor vehicle and tour vehicle surcharge taxes, and interest earnings on monies previously credited to the State Highway Fund. The proceeds of the revenue bonds are used to

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finance certain highway capital improvement projects and other related projects for the State Highways System.

On July 1, 1998, the Highways Division issued \$94,920,000 in State of Hawaii Highway Revenue Bond, Series 1998 (1998 Bonds). The 1998 Bonds bear interest at rates ranging from 4.0% to 5.5% and mature in increasing annual installments through 2018. The 1998 Bonds maturing on and after July 1, 2009 through July 1, 2016 are subject to redemption at the option of the State on or after July 1, 2008 at prices at 100% of face value plus accrued interest.

On February 20, 2005, the Highways Division issued \$60,000,000 in State of Hawaii Revenue Bonds Series A (2005A Bonds). The 2005A Bonds bear interest at rates ranging from 3.0% to 5.0% and mature in annual installments through 2021. The 2005A Bonds maturing on and after July 1, 2016 are subject to redemption at the option of the State at 100% plus accrued interest. These bonds were issued at a premium of \$3,155,926, which will be amortized over the life of the bonds using the effective interest method.

On February 20, 2005, the Highways Division issued \$123,915,000 in State of Hawaii Revenue Bonds Series B (2005B Bonds) with interest rates ranging from 3.0% to 5.25% and mature in annual installments through 2021. The 2005B Bonds were issued to refund \$128,705,000 of outstanding bonds (refunded bonds) with interest rates ranging from 4.95% to 5.6% comprised of the following:

<u>Series</u>	<u>Interest Rates</u>	<u>Principal Refunded</u>
1996	5.25-5.60%	\$ 26,135,000
1998	5.00-5.25%	\$ 30,275,000
2000	4.95-5.50%	\$ 31,340,000
2001	5.25-5.38%	\$ 40,955,000

On December 17, 2008, the Highways Division issued \$125,175,000 in State of Hawaii Revenue Bonds, Series 2008 (2008 Bonds). The 2008 Bonds bear interest at rates ranging from 4.0% to 5.25% and mature in annual installments through 2029. The 2008 Bonds maturing on and after January 1, 2020 are subject to redemption at the option of the State at 100% plus accrued interest. These bonds were issued at a premium of \$857,616, which will be amortized over the life of the bonds using the effective interest method.

On December 15, 2011, the Highways Division issued \$112,270,000 in State of Hawaii Revenue Bonds Series 2011A (2011A Bonds). The 2011A Bonds bear interest at rates ranging from 0.75% to 5.0% and mature in annual installments through 2032. These bonds were issued at a premium of \$13,152,124, which will be amortized over the life of the bonds using the effective interest method.

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On December 15, 2011, the Highways Division also issued \$5,095,000 in State of Hawaii Revenue Bonds Series 2011B (2011B Bonds) with an interest rate of 4.0% and mature in annual installments through 2032. These bonds were issued at a premium of \$466,702, which will be amortized over the life of the bonds using the effective interest method. The 2011B bonds were issued to provide funds for a current refunding of the outstanding 2001 Bonds. The payments for the current refunding of revenue bonds amounted to \$5,400,000.

On August 14, 2014, the Highways Division issued \$103,375,000 in State of Hawaii Revenue Bonds Series 2014A (2014A Bonds). The 2014A Bonds bear interest at rates ranging from 2.0% to 5.0% and mature in annual installments through 2034. These bonds were issued at a premium of \$17,291,491, which will be amortized over the life of the bonds using the effective interest method.

On August 14, 2014, the Highways Division also issued \$32,285,000 in State of Hawaii Revenue Bonds Series 2014B (2014B Bonds). The 2014B Bonds bear interest at rates ranging from 3.0% to 5.0% and mature in annual installments through 2026. These bonds were issued at a premium of \$5,865,358, which will be amortized over the life of the bonds using the effective interest method.

On August 14, 2014, the Highways Division also issued \$28,020,000 in State of Hawaii Revenue Bonds Series 2014C (2014C Bonds). The 2014C Bonds bear interest at rates ranging from 0.4% to 1.6% and mature in annual installments through 2018.

On September 8, 2016, the Highways Division issued \$103,395,000 in State of Hawaii Revenue Bonds Series 2016A (2016A Bonds). The 2016A Bonds bear interest at rates ranging from 2.0% to 5.0% and mature in annual installments through 2030. These bonds were issued at a premium of \$17,107,039, which will be amortized over the life of the bonds using the effective interest method.

On September 8, 2016, the Highways Division also issued \$101,090,000 in State of Hawaii Revenue Bonds Series 2016B (2016B Bonds). The 2016B Bonds bear interest at rates ranging from 1.26% to 5.0% and mature in annual installments through 2036. These bonds were issued at a premium of \$25,989,247, which will be amortized over the life of the bonds using the effective interest method. The Highways Division issued the bonds to advance refund \$111,590,000 of the outstanding callable series 2008 and 2011A bonds with interest rates ranging from 4.8% to 6.0%. The net proceeds of \$128,188,095 (after an additional contribution of \$2,019,488, payment of \$513,820 in underwriting fees, insurance, and other issuance costs, and payment of \$396,820 in accrued interest) were used to purchase U.S. Treasury securities. These securities were deposited in an irrevocable trust to provide for all future debt service on the refunded portion of the 2008 and 2011A series bonds. As a result, that portion of the 2008 and 2011A series bonds are considered defeased, and the Highways Division has removed the liability from its accounts. Although the advance refunding resulted in the recognition of an accounting loss approximating \$13,575,000, for the year ended June 30, 2017, the Highways Division in effect reduced its aggregate debt service payments by approximately \$22,185,000 over the next 13 years and obtained an economic gain

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(difference between the present values of the old and new debt service payments) of approximately \$17,415,000.

The following is a summary of revenue bonds issued and outstanding at June 30, 2017:

<u>Series</u>	<u>Interest Rates</u>	<u>Final Maturity Date (July 1)</u>	<u>Original Amount of Issue</u>	<u>Outstanding Amount</u>
1998	4.00-5.50%	2018	\$ 94,920,000	\$ 27,580,000
2005	3.00-5.25%	2021	183,915,000	27,630,000
2008	4.00-5.25%	2029	125,175,000	17,475,000
2011	0.75-5.00%	2032	117,365,000	57,255,000
2014	0.40-5.00%	2034	163,680,000	130,560,000
2016	1.26-5.00%	2036	204,485,000	202,495,000
			<u>\$ 889,540,000</u>	462,995,000
				Add: unamortized premium 62,979,374
				Less: current portion (40,765,000)
				<u>\$ 485,209,374</u>

During 2017, \$71,953,109 was transferred from the State Highway and Capital Projects Funds to the Debt Service Fund for repayment of revenue bonds principal of \$37,790,000 and \$13,420,000 on January 1, 2017 and July 1, 2017, and interest of \$9,965,810 and \$10,777,299 due on January 1, 2017 and July 1, 2017, respectively.

The approximate maturities in each of the next five years and thereafter are as follows:

<u>Years Ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2018	\$ 40,765,000	\$ 21,185,548	\$ 61,950,548
2019	42,735,000	19,298,794	62,033,794
2020	29,845,000	17,630,175	47,475,175
2021	30,695,000	16,193,925	46,888,925
2022	27,980,000	14,879,081	42,859,081
2023-2027	129,280,000	57,107,775	186,387,775
2028-2032	117,550,000	25,963,150	143,513,150
2033-2036	44,145,000	4,092,750	48,237,750
Total	<u>\$ 462,995,000</u>	<u>\$ 176,351,198</u>	<u>\$ 639,346,198</u>

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(12) Transfers

Transfers are accounted for in the Governmental Funds statement of revenues, expenditures, and changes in fund balances as other financing sources and uses, and in the government-wide statement of activities as transfers, and are summarized as follows:

	<u>State Highway Fund</u>	<u>Debt Service Fund</u>	<u>Capital Projects Fund</u>	<u>Total</u>
Funding of revenue bond debt service	\$ (71,556,289)	\$ 71,953,109	\$ (396,820)	\$ -
Funding of highway capital projects	(13,977,897)	-	13,977,897	-
Funding from State general fund	37,000,000	-	-	37,000,000
Reimbursement to State for debt service on general obligation bonds	(2,942,647)	-	-	(2,942,647)
	<u>\$ (51,476,833)</u>	<u>\$ 71,953,109</u>	<u>\$ 13,581,077</u>	<u>\$ 34,057,353</u>

Funding of Highway Capital Projects

Funding of highway capital projects by the State Highway Fund is recognized when received by the Capital Projects Fund.

Funding from State General Fund

In response to the revenue estimates for the Highways Division falling well below planned expenditures, the legislature appropriated \$37,000,000 of State general funds (Act 195, SLH 2016) to be transferred to the Highways Division for highway construction, repair, and maintenance expenditures. This transfer is included in revenues in the accompanying statement of revenues and expenditures – budget and actual (non-GAAP budgetary basis).

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Reimbursement to State for Debt Service

Allocated portions of the State's general obligation bonds have been designated by the Director of Finance, State of Hawaii, to be reimbursed from the State Highway Fund. These bonds are the obligations of the State and are not included in these financial statements. The amount of the Highways Division's reimbursement to the State for debt service is primarily determined by the Director of Finance, State of Hawaii.

All future reimbursement obligations related to the general obligation bonds were paid in full as of June 30, 2017.

Debt service reimbursements are accounted for as expenditures of the Administration of Highway Division program on the Statement of revenues and expenditures - budget and actual (non-GAAP budgetary basis) for the State Highway Fund, and are accounted for as other financing transfers out of the State Highway Fund on the Governmental Funds statement of revenues, expenditures, and changes in fund balances. Reimbursement payments of \$2,942,647 consisted of \$2,875,467 for principal and \$67,180 for interest for the year ended June 30, 2017.

(13) Retirement Benefits

Pension Plan

Plan Description

Generally, all full-time employees of the State and counties, which includes the Highways Division, are required to be members of the ERS, a cost-sharing multiple-employer defined benefit pension plan that administers the State's pension benefits program. Benefits, eligibility, and contribution requirements are governed by HRS Chapter 88 and can be amended through legislation.

Benefits Provided

The ERS Pension Trust is comprised of three pension classes for membership purposes and considered to be a single plan for accounting purposes since all assets of the ERS may legally be used to pay the benefits of any of the ERS members or beneficiaries. The ERS provides retirement, disability, and death benefits with three membership classes known as the noncontributory, contributory, and hybrid retirement classes. The three classes provide a monthly retirement allowance equal to the benefit multiplier (generally 1.25% or 2%) multiplied by the average final compensation multiplied by years of credited service. Average final compensation for members hired prior to July 1, 2012 is an average of the highest salaries during any three years of credited service, excluding any salary paid in lieu of vacation for employees hired January 1, 1971 or later and the average of the highest salaries during any five years of credited service including any salary

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paid in lieu of vacation for members hired prior to January 1, 1971. For members hired after June 30, 2012, average final compensation is an average of the highest salaries during any five years of credited service excluding any salary paid in lieu of vacation.

Each retiree's original retirement allowance is increased on each July 1 beginning the calendar year after retirement. Retirees first hired as members prior to July 1, 2012 receive a 2.5% increase each year of their original retirement allowance without a ceiling. Retirees first hired as members after June 30, 2012 receive a 1.5% increase each year of their original retirement allowance without a ceiling. The annual increase is not compounded.

The following summarizes the provisions relevant to the largest employee groups of the respective membership class. Retirement benefits for certain groups, such as police officers, firefighters, some investigators, sewer workers, judges, and elected officials, vary from general employees.

Noncontributory Class

Retirement Benefits

General employees' retirement benefits are determined as 1.25% of average final compensation multiplied by the years of credited service. Employees with ten years of credited service are eligible to retire at age 62. Employees with 30 years of credited service are eligible to retire at age 55.

Disability Benefits

Members are eligible for service-related disability benefits regardless of length of service and receive a lifetime pension of 35% of their average final compensation. Ten years of credited service is required for ordinary disability. Ordinary disability benefits are determined in the same manner as retirement benefits but are payable immediately, without an actuarial reduction, and at a minimum of 12.5% of average final compensation.

Death Benefits

For service-connected deaths, the surviving spouse/reciprocal beneficiary receives a monthly benefit of 30% of the average final compensation until remarriage or re-entry into a new reciprocal beneficiary relationship. Additional benefits are payable to surviving dependent children up to age 18. If there is no spouse/reciprocal beneficiary or dependent children, no benefit is payable.

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Ordinary death benefits are available to employees who were active at the time of death with at least ten years of credited service. The surviving spouse/reciprocal beneficiary (until remarriage/reentry into a new reciprocal beneficiary relationship) and dependent children (up to age 18) receive a benefit equal to a percentage of member's accrued maximum allowance unreduced for age or, if the member was eligible for retirement at the time of death, the surviving spouse/reciprocal beneficiary receives 100% joint and survivor lifetime pension and the dependent children receive a percentage of the member's accrued maximum allowance unreduced for age.

Contributory Class for Members Hired Prior to July 1, 2012

Retirement Benefits

General employees' retirement benefits are determined as 2% of average final compensation multiplied by the years of credited service. General employees with five years of credited service are eligible to retire at age 55.

Police officers and firefighters' retirement benefits are determined using the benefit multiplier of 2.5% for qualified service, up to a maximum of 80% of average final compensation. Police officers and firefighters with five years of credited service are eligible to retire at age 55. Police officers and firefighters with 25 years of credited service are eligible to retire at any age, provided the last five years is service credited in these occupations.

Disability Benefits

Members are eligible for service-related disability benefits regardless of length of service and receive a one-time payment of the member's contributions and accrued interest plus a lifetime pension of 50% of their average final compensation. Ten years of credited service is required for ordinary disability. Ordinary disability benefits are determined as 1.75% of average final compensation multiplied by the years of credited service but are payable immediately, without an actuarial reduction, and at a minimum of 30% of average final compensation.

Death Benefits

For service-connected deaths, the surviving spouse/reciprocal beneficiary receives a lump sum payment of the member's contributions and accrued interest plus a monthly benefit of 50% of the average final compensation until remarriage or re-entry into a new reciprocal beneficiary relationship. If there is no surviving spouse/reciprocal beneficiary, surviving children (up to age 18) or dependent parents are eligible for the monthly benefit. If there is no spouse/reciprocal beneficiary or dependent children/parents, the ordinary death benefit is payable to the designated beneficiary.

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Ordinary death benefits are available to employees who were active at time of death with at least one year of service. Ordinary death benefits consist of a lump sum payment of the member's contributions and accrued interest plus a percentage of the salary earned in the 12 months preceding death, or 50% Joint and Survivor lifetime pension if the member was not eligible for retirement at the time of death but was credited with at least ten years of service and designated one beneficiary, or 100% Joint and Survivor lifetime pension if the member was eligible for retirement at the time of death and designated one beneficiary.

Contributory Class for Members Hired After June 30, 2012

Retirement Benefits

General employees' retirement benefits are determined as 1.75% of average final compensation multiplied by the years of credited service. General employees with ten years of credited service are eligible to retire at age 60.

Police officers and firefighters' retirement benefits are determined using the benefit multiplier of 2.25% for qualified service, up to a maximum of 80% of average final compensation. Police officers and firefighters with ten years of credited service are eligible to retire at age 60. Police officers and firefighters with 25 years of credited service are eligible to retire at any age, provided the last five years is service credited in these occupations.

Disability and Death Benefits

Members are eligible for service-related disability benefits regardless of length of service and receive a lifetime pension of 50% of their average final compensation plus refund of contributions and accrued interest. Ten years of credited service is required for ordinary disability. Ordinary disability benefits are 1.75% of average final compensation for each year of service for police officers and firefighters and are payable immediately, without an actuarial reduction, at a minimum of 30% of average final compensation.

Death benefits for contributory members hired after June 30, 2012 are generally the same as those for contributory members hired June 30, 2012 and prior.

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Hybrid Class for Members Hired Prior to July 1, 2012

Retirement Benefits

General employees' retirement benefits are determined as 2% of average final compensation multiplied by the years of credited service. General employees with five years of credited service are eligible to retire at age 62. General employees with 30 years of credited service are eligible to retire at age 55.

Disability Benefits

Members are eligible for service-related disability benefits regardless of length of service and receive a lifetime pension of 35% of their average final compensation plus refund of their contributions and accrued interest. Ten years of credited service is required for ordinary disability. Ordinary disability benefits are determined in the same manner as retirement benefits but are payable immediately, without an actuarial reduction, and at a minimum of 25% of average final compensation.

Death Benefits

For service-connected deaths, the designated surviving spouse/reciprocal beneficiary receives a lump sum payment of the member's contributions and accrued interest plus a monthly benefit of 50% of the average final compensation until remarriage or re-entry into a new reciprocal beneficiary relationship. If there is no surviving spouse/reciprocal beneficiary, surviving dependent children (up to age 18) or dependent parents are eligible for the monthly benefit. If there is no spouse/reciprocal beneficiary or dependent children/parents, the ordinary death benefit is payable to the designated beneficiary.

Ordinary death benefits are available to employees who were active at time of death with at least five years of service. Ordinary death benefits consist of a lump sum payment of the member's contributions and accrued interest plus a percentage multiplied by 150%, or 50% Joint and Survivor lifetime pension if the member was not eligible for retirement at the time of death but was credited with at least ten years of service and designated one beneficiary, or 100% Joint and Survivor lifetime pension if the member was eligible for retirement at the time of death and designated one beneficiary.

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Hybrid Class for Members Hired After June 30, 2012

Retirement Benefits

General employees' retirement benefits are determined as 1.75% of average final compensation multiplied by the years of credited service. General employees with ten years of credited service are eligible to retire at age 65. Employees with 30 years of credited service are eligible to retire at age 60. Sewer workers, water safety officers, and emergency medical technicians may retire with 25 years of credited service at age 55.

Disability and Death Benefits

Provisions for disability and death benefits generally remain the same except for ordinary death benefits. Ordinary death benefits are available to employees who were active at time of death with at least ten years of service. Ordinary death benefits consist of a lump sum payment of the member's contributions and accrued interest, or 50% Joint and Survivor lifetime pension if the member was not eligible for retirement at the time of death but was credited with at least ten years of service and designated one beneficiary, or 100% Joint and Survivor lifetime pension if the member was eligible for retirement at the time of death and designated one beneficiary.

Contributions

Contributions are established by HRS Chapter 88 and may be amended through legislation. The employer rate is set by statute based on the recommendations of the ERS actuary resulting from an experience study conducted every five years. Since July 1, 2005, the employer contribution rate is a fixed percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liabilities. The contribution rates for fiscal year 2017 were 25.0% for police officers and firefighters and 17.0% for all other employees.

On May 18, 2017, the Governor signed into law Act 17 SLH 2017. Per Act 17, future employer contributions from the State and counties are expected to increase pursuant to a phased-in contribution rate increase over four years beginning July 1, 2017. The rate for police and firefighters increases to 28.0% on July 1, 2017; 31.0% on July 1, 2018; 36.0% on July 1, 2019; and 41.0% on July 1, 2020, and the rate for all other employees increases to 18.0% on July 1, 2017; 19.0% on July 1, 2018; 22.0% on July 1, 2019; and 24.0% on July 1, 2020.

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The employer is required to make all contributions for noncontributory members. Contributory members hired prior to July 1, 2012 are required to contribute 7.8% of their salary, except for police officers and firefighters who are required to contribute 12.2% of their salary. Contributory members hired after June 30, 2012 are required to contribute 9.8% of their salary, except for police officers and firefighters who are required to contribute 14.2% of their salary. Hybrid members hired prior to July 1, 2012 are required to contribute 6.0% of their salary. Hybrid members hired after June 30, 2012 are required to contribute 8.0% of their salary.

The Highways Division's contributions to the ERS for fiscal years 2017, 2016, and 2015 were approximately \$8,783,000, \$8,652,000, and \$8,182,000, respectively. The Highways Division contributed 100% of its required contribution for each of those years.

Pension Liability, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pension

Measurement of the actuarial valuation of the pension liability, pension expense, and deferred outflows of resources and deferred inflows of resources related to pension is made for the State as a whole and is not separately computed for the individual state departments and agencies such as the Highways Division. The State's policy on the accounting and reporting for its pension plan allocates the pension liability, pension expense, and deferred outflows of resources and deferred inflows of resources related to pension to only component units and proprietary funds that are reported separately in stand-alone departmental financial statements or in the State's CAFR based upon a systematic methodology. Accordingly, the Highways Division's proportionate share of the State's pension liability, pension expense, and deferred outflows of resources and deferred inflows of resources related to pension is not reported in the accompanying financial statements.

Additional disclosures and required supplementary information stipulated by Statement Nos. 68 and 71 pertaining to the State's net pension liability, pension expense, and deferred outflows of resources and deferred inflows of resources related to pension can be found in the State's CAFR. The State's CAFR can be obtained at the Department of Accounting and General Services' website: <http://hawaii.gov/dags/rpts>.

Post-Retirement 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.

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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, or through the EUTF's website: <http://eutf.hawaii.gov/>.

For employees hired before July 1, 1996, the State pays the entire base monthly contribution for employees retiring with ten or more years of credited service, and 50% of the base monthly contribution for employees retiring with fewer than ten 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 ten years of service, the State makes no contributions. For those retiring with at least ten 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. 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 ten years of service, the State makes no contributions. For those retiring with at least ten 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.

The State is required to contribute the annual required contribution of the employer (ARC), an amount actuarially determined. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal costs each year and to amortize any unfunded actuarial liabilities over a period not to exceed 30 years.

The State's CAFR includes the required footnote disclosures and required supplementary information in accordance with the provisions of GASB Statement No. 45, including the actuarial methods and assumptions used.

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Contributions

Contributions are financed on a pay-as-you-go basis and the Highways Division's contributions for the years June 30, 2017, 2016, and 2015 were approximately \$4,513,000, \$4,765,000, and \$5,053,000, respectively.

OPEB Liability

The actuarial valuation of the EUTF does not provide other postemployment benefits (OPEB) information by department or agency. The State's policy on the accounting and reporting for OPEB is to allocate a portion of the State's ARC, interest, and any adjustment to the ARC, to component units and proprietary funds that are reported separately in stand-alone departmental financial statements or in the State's CAFR. Accordingly, the Highways Division's proportionate share of the State's OPEB liability is not reported in the accompanying financial statements.

Other OPEB Matters

Act 268, SLH 2013, requires the EUTF to establish and administer separate trust accounts for each public employer for the purpose of receiving irrevocable employer contributions to prefund postemployment 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.

Deferred Compensation Plan

The State offers its employees a deferred compensation plan created in accordance with Section 457 of the Internal Revenue Code. The plan, which is available to all State employees, permits employees to defer a portion of their compensation 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 accompanying financial statements.

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(14) Transactions With Other Government Agencies

The State assesses a surcharge of 5% for central service expenses on all receipts of the State Highway Fund, after deducting any amounts pledged, charged, or encumbered for the payment of bonds and interest during the year. During fiscal year 2017, the assessment amounted to approximately \$10,029,000, which is included as the caption surcharge on gross receipts expense/expenditures in the accompanying financial statements.

The Highways Division is also assessed a percentage of the cost of the general administration expenses of the Department. During fiscal year 2017, assessments net of amounts refunded amounted to approximately \$6,293,000 which is included in administration of Highways Division expense/expenditures in the accompanying financial statements.

(15) Lease Commitments

Capital Lease Obligation

On July 8, 2015, the Highways Division entered into an equipment lease purchase agreement for the acquisition and installation of energy conservation measures at selected Highways Division locations. Proceeds of \$60,286,091 were deposited into an acquisition fund held in trust by an acquisition fund custodian to provide for future payments as requested by the Highways Division. The agreement also provided for financing of interest expense through August 1, 2016, which amounted to \$1,686,822. Annual lease payments will commence on August 1, 2017 and continue through August 1, 2031 at an interest rate of 2.63%. Costs incurred for the acquisition and installation of energy conservation measures through June 30, 2017, which amounted to \$57,342,616, are included in construction in progress. Unused proceeds in the acquisition fund at June 30, 2017 amount to \$8,560,312 and are reported as other assets in the accompanying statement of net position and balance sheet.

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Future minimum lease payments are as follows:

Years Ending June 30,	Principal	Interest	Total
2018	\$ 1,731,203	\$ 1,629,888	\$ 3,361,091
2019	1,984,121	1,584,357	3,568,478
2020	2,254,406	1,532,175	3,786,581
2021	2,543,062	1,472,884	4,015,946
2022	2,851,146	1,406,001	4,257,147
2023-2027	19,628,343	5,723,609	25,351,952
2028-2032	30,980,632	2,581,833	33,562,465
	<u>\$ 61,972,913</u>	<u>\$ 15,930,747</u>	<u>\$ 77,903,660</u>

Operating Leases

Rental Expenditures

The Highways Division leases office space under various operating lease agreements expiring at various dates through fiscal year 2019. Rental expenditures are recorded based on the terms of the lease agreements.

Scheduled annual minimum rental payments are as follows:

Years Ending June 30,	
2018	\$ 599,000
2019	<u>249,000</u>
Total	<u>\$ 848,000</u>

The total rental expenditures during fiscal year 2017 for operating leases were approximately \$966,000.

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Rental Revenue

The Highways Division is a lessor of various properties under non-cancelable lease agreements that expire through fiscal year 2044. Scheduled annual minimum revenues through 2022 and in five-year increments thereafter are as follows:

Years Ending June 30,	
2018	\$ 454,000
2019	517,000
2020	517,000
2021	517,000
2022	517,000
2023-2027	2,408,000
2028-2032	1,353,000
2033-2037	973,000
2038-2042	370,000
2043-2044	<u>77,000</u>
Total	<u><u>\$ 7,703,000</u></u>

(16) Commitments

Condemnation Proceedings

The Highways Division occasionally finds it necessary to condemn property for construction of highways. These proceedings require the Highways Division to compensate existing property owners for the fair market value of their real property. Prior to the determination of the fair market value, the Highways Division is required to deposit funds in State courts for these proceedings. The amount of funds deposited in the State courts was approximately \$30,700 at June 30, 2017. Such funds deposited may not be sufficient to cover the full amount required for compensation purposes. Management, however, believes any additional compensation in excess of amounts deposited with State courts will not be material to the financial statements of the Highways Division. The funds deposited in the State courts are reflected in capital projects expenditures in the governmental fund statement of revenue, expenditures, and changes in fund balances and in capital assets on the government-wide statement of net position in the year in which the deposits were made.

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Accumulated Sick Leave

Full-time employees are credited with sick leave at the rate of one and three-quarters days for each month. It may be taken only in the event of illness and is not convertible to pay upon termination of employment. However, an employee who retires or leaves government service in good standing with 60 days or more of unused sick leave is entitled to additional service credits in the ERS. Accumulated sick leave at June 30, 2017 amounted to approximately \$25,503,000.

(17) Risk Management

The Highways Division records a liability for risk financing and 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 ten fiscal years. A summary of the State's underwriting risks is as follows:

Property Insurance

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

Crime Insurance

The State also has a crime insurance policy for various types of coverages with a limit of loss of \$10 million per occurrence with a \$500,000 deductible per occurrence, except for claims expense coverage, which has a \$100,000 limit per occurrence and a \$1,000 deductible. Losses under the deductible amount are paid by the Risk Management Office of the Department of Accounting and General Services and losses not covered by insurance are paid from legislative appropriations of the State's general fund.

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General Liability (Including Torts)

Liability claims under \$10,000 and automobile claims up to \$15,000 are handled by the Risk Management Office. All other claims are handled by the Department of the Attorney General. The State has personal injury and property damage liability, including automobile and public errors and omissions, insurance policy in force with a \$4 million self-insured retention per occurrence. The annual aggregate per occurrence is \$7.5 million and for crime loss, \$10 million with no aggregate limit.

Losses under the deductible amount or over the aggregate limit are paid from legislative appropriations of the State's General Fund.

Self-Insured Risks

The State generally self-insures its automobile no-fault and workers' compensation losses. Automobile losses up to \$15,000 are administered by the Risk Management Office. The State administers its workers' compensation losses.

Reserve for Losses

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 Highways 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. Accrued workers' compensation amounted to approximately \$6,728,000 at June 30, 2017.

(18) Contingent Liabilities and Other

The State is the defendant in lawsuits seeking damages allegedly related to State highways and highway construction contracts. 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 Highways Division's financial position. In addition, the State has not determined whether the ultimate liabilities, if any, will be imposed on the State Highway Fund. Accordingly, no provision for any liabilities that might result from the lawsuits have been made in the accompanying financial statements.

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The Highways Division is subject to laws and regulations relating to the protection of the environment. The Division has been identified by the State Department of Health (DOH) as a potentially responsible party for petroleum contamination in the Honolulu Harbor/Iwilei area. Pursuant thereto, the Division entered into a voluntary agreement with the DOH 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. Potential remedial alternatives are still being studied. At this stage, 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 environmental impact, (2) the undetermined allocation among the potentially responsible parties, (3) the ongoing review of reasonable remediation alternatives, and (4) continued discussion with the regulatory authorities. As a result, it is not possible to reasonably estimate the amount of the potential cost to the IDPP and allocable share of the Division, and if there would be a material impact to the Division's financial statements. Accordingly, no estimate of loss has been recorded in the accompanying financial statements.

(19) Subsequent Events

The Highways Division has evaluated subsequent events through January 26, 2018, the date the financial statements were available to be issued. There are no other matters to disclose.