



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

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

June 30, 2015 and 2014

Submitted by  
**THE AUDITOR**  
**STATE OF HAWAII**

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

Financial Statements and Supplementary Information

June 30, 2015 and 2014

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**PART I**

**INTRODUCTION SECTION**

December 29, 2015

The Auditor  
State of Hawaii:

We have completed our audit of the financial statements of the Harbors Division, Department of Transportation, State of Hawaii (the Harbors Division), an enterprise fund of the State of Hawaii, as of and for the years ended June 30, 2015 and 2014, as listed in the table of contents. We transmit herewith our reports containing our opinion on those financial statements and our report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with *Government Auditing Standards*.

### **Audit Objectives**

The objectives of the audits were as follows:

1. To provide an opinion on the fair presentation of the Harbors Division's financial statements in accordance with accounting principles generally accepted in the United States of America.
2. To consider the Harbors Division's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements.
3. To perform tests of the Harbors Division's compliance with laws, regulations, contracts, and grants that may have a direct and material effect on the determination of financial statement amounts.

### **Scope of Audit**

We performed the audits of the Harbors Division's financial statements as of and for the years ended June 30, 2015 and 2014, in accordance with auditing standards generally accepted in the United States of America, as adopted by the American Institute of Certified Public Accountants, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

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

## Organization of Report

This report has been organized into three parts as follows:

1. The Introduction Section describes briefly the objectives and scope of our audits and the organization and contents of this report.
2. The Financial Section includes management's discussion and analysis, the Harbors Division's financial statements and the related notes, required supplementary information, and other supplementary information as of and for the years ended June 30, 2015 and 2014, and our independent auditors' report thereon.
3. The Internal Control and Compliance Section contains our independent auditors' report on the Harbors Division's internal control over financial reporting and on compliance and other matters based on an audit of the financial statements performed in accordance with *Government Auditing Standards*.

\* \* \* \* \*

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

Very truly yours,

*KKDLY LLC*

**PART II**

**FINANCIAL SECTION**

## Independent Auditors' Report

The Auditor  
State of Hawaii:

### Report on the Financial Statements

We have audited the accompanying financial statements of the Harbors Division, Department of Transportation, State of Hawaii (the Harbors Division), an enterprise fund of the State of Hawaii, which comprise the statements of net position as of June 30, 2015 and 2014, and the related statements of revenues, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to financial statements.

### *Management's Responsibility for the Financial Statements*

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

### *Auditors' Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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



## ***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Harbors Division as of June 30, 2015 and 2014, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

## ***Emphasis of Matters***

### *Change in Accounting Principles*

As discussed in Note 2 to the financial statements, the Harbors Division adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment to GASB Statement No. 27* (Statement No. 68), and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date, an amendment of GASB Statement No. 68*, effective July 1, 2014. The Harbors Division's financial statements as of and for the year ended June 30, 2014 were not restated because the State's defined benefit pension plan information prepared in accordance with the requirements of Statement No. 68 was not available for periods prior to July 1, 2014. Our opinion is not modified with respect to that matter.

### *Relationship to the State of Hawaii*

As discussed in Note 1 to the financial statements, the financial statements of the Harbors Division are intended to present the financial position, the changes in financial position, and cash flows of only that portion of the business-type activities and each major fund of the State of Hawaii that is attributable to the transactions of the Harbors Division. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2015 and 2014, the changes in its financial position, and where applicable, its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

## ***Other Matters***

### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and the schedule of the Harbors Division's proportionate share of the State's net pension liability identified in the table of contents be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the GASB 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 audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*Other Information*

Our audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Harbors Division's basic financial statements. The supplementary information included in Schedules 1 through 4 is presented for purposes of additional analysis and is not a required part of the basic financial statements.

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

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated December 29, 2015, on our consideration of the Harbors Division's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Harbors Division's internal control over financial reporting and compliance.

*KKDL Y LLC*

Honolulu, Hawaii  
December 29, 2015

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Management's Discussion and Analysis

June 30, 2015 and 2014

The following Management's Discussion and Analysis of the Harbors Division, Department of Transportation, State of Hawaii (the Harbors Division), an enterprise fund of the State of Hawaii, presents the reader with an introduction and overview of the Harbors Division's financial performance for the fiscal years ended June 30, 2015 and 2014. This discussion has been prepared by management and should be read in conjunction with the financial statements, and the notes thereto, which follow this section.

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

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

### **Using the Financial Statements**

The Harbors Division is accounted for as a proprietary fund and utilizes the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. The proprietary fund includes the enterprise fund type, which is used to account for the acquisition, operation, and maintenance of government facilities and services that are entirely or predominantly supported by user charges.

The Harbors Division's financial report includes three financial statements; the statements of net position, the statements of revenues, expenses, and changes in net position, and the statements of cash flows. The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) as promulgated by the Governmental Accounting Standards Board (GASB).

### ***Change in Accounting Principles***

Effective July 1, 2014, the Harbors Division adopted the provisions of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27* (Statement No. 68). This statement establishes standards of accounting and financial reporting for defined benefit pensions and defined contribution pensions provided to the employees of state and local governmental employers through pension plans that are administered through trusts or equivalent arrangements, such as the Employees' Retirement System of the State of Hawaii.

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Simultaneously with the adoption of Statement No. 68, the Harbors Division adopted the provisions of GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date, an amendment of GASB Statement No. 68* (Statement No. 71). This statement amends the requirement related to certain pension contributions made to defined benefit pension plans prior to implementation of Statement No. 68 by employers and nonemployers for contributions made after the measurement date of the government's beginning net pension liability.

As further discussed in Note 2, the restatement of the comparative financial data for the prior periods presented was not practical due to the unavailability of information from the pension plan, therefore the provisions of Statement No. 68 were not applied to prior periods. The cumulative effect of applying the provisions of this statement has been reported as a restatement of the beginning net position for the year ended June 30, 2015. Specifically, the adoption of Statement Nos. 68 and 71 had the effect of decreasing net position as of June 30, 2014 by \$21.5 million. In addition, the Harbors Division recorded a deferred outflow of resources of \$2.7 million, a net pension liability of \$21.6 million, and a deferred inflow of resources of \$2.5 million as of June 30, 2015.

**Financial Highlights**

- The Harbors Division's net position at June 30, 2015 and 2014 amounted to \$759.8 million and \$743.3 million, respectively. Net position increased by \$16.5 million in fiscal year 2015, an increase of 2.2%. Net position increased by \$32.4 million in fiscal year 2014, an increase of 4.6%.
- Operating income amounted to \$53.1 million in fiscal year 2015, an increase of \$3.0 million or 5.8% as compared to 2014. Operating income amounted to \$50.1 million in fiscal year 2014, an increase of \$7.4 million or 17.4% as compared to 2013.

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Management's Discussion and Analysis

June 30, 2015 and 2014

A summary of operations and changes in net position for the fiscal years ended June 30, 2015, 2014, and 2013 follows:

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

	Year Ended June 30			2015 – 2014		2014 – 2013	
	2015	2014	2013	Increase (decrease)	% Change	Increase (decrease)	% Change
Operating revenues	\$ 123,209	\$ 121,338	\$ 112,671	\$ 1,871	1.5%	\$ 8,667	7.7%
Nonoperating revenues	1,454	1,041	867	413	39.7	174	20.1
Total revenues	124,663	122,379	113,538	2,284	1.9	8,841	7.8
Depreciation and amortization	23,335	23,633	22,751	(298)	(1.3)	882	3.9
Other operating expenses	46,806	47,560	47,202	(754)	(1.6)	358	0.8
Nonoperating expenses	16,890	18,502	20,378	(1,612)	(8.7)	(1,876)	(9.2)
Total expenses	87,031	89,695	90,331	(2,664)	(3.0)	(636)	(0.7)
Net increase in the fair value of amounts held in State Treasury	-	-	1,102	-	-	(1,102)	(100.0)
Income before capital contributions and transfers	37,632	32,684	24,309	4,948	15.1	8,375	34.5
Capital contributions	285	-	4,115	285	100.0	(4,115)	(100.0)
Transfers out	-	(300)	(610)	300	(100.0)	310	(50.8)
Increase in net position	37,917	32,384	27,814	5,533	17.1	4,570	16.4
Net position, beginning of year, as previously reported	743,292	710,908	683,094	32,384	4.6	27,814	4.1
Restatement	(21,451)	-	-	(21,451)	(100.0)	-	-
Net position, beginning of year, as restated	721,841	710,908	683,094	10,933	1.5	27,814	4.1
Net position, end of year	\$ 759,758	\$ 743,292	\$ 710,908	\$ 16,466	2.2	\$ 32,384	4.6

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***Operating Revenues***

Total operating revenues for fiscal year 2015 were \$123.2 million compared to \$121.3 million for fiscal year 2014. Total operating revenues for fiscal year 2014 were \$121.3 million compared to \$112.7 million for fiscal year 2013. Operating revenues consist primarily of service revenues and rental revenues, which accounted for 79.9% and 19.0%, respectively, in fiscal year 2015, and 76.1% and 22.0%, respectively, in fiscal year 2014, of the Harbors Division's total operating revenues.

***Service Revenues***

Service revenues are directly related to cargo and ship operations. Service revenues include wharfage, passenger fees, and other ship related fees. Service revenues in fiscal years 2015 and 2014 were \$98.4 million and \$92.4 million, respectively.

Service revenues for fiscal year 2015 increased \$6.1 million or 6.6% as compared to fiscal year 2014. Wharfage revenue from cargo movements increased by \$6.2 million from \$76.3 million in fiscal year 2014 to \$82.5 million in fiscal year 2015 due primarily to increases in tariff rates that took effect on July 1, 2014 of 5% that were applied to the rates then in effect. In addition, passenger fees decreased by \$299,000 from \$6.9 million in fiscal year 2014 to \$6.6 million in fiscal year 2015, mooring charges increased by \$180,000 from \$1.0 million in fiscal year 2014 to \$1.2 million in fiscal year 2015.

Service revenues for fiscal year 2014 increased \$9.7 million or 11.8% as compared to fiscal year 2013. Wharfage revenue from cargo movements increased by \$9.4 million from \$66.9 million in fiscal year 2013 to \$76.3 million in fiscal year 2014 due primarily to increases in tariff rates that took effect on July 1, 2013 of 7% that were applied to the rates then in effect. In addition, passenger fees increased by \$230,000 from \$6.7 million in fiscal year 2013 to \$6.9 million in fiscal year 2014, mooring charges increased by \$263,000 from \$775,000 in fiscal year 2013 to \$1.0 million in fiscal year 2014; dockage fees for fiscal 2014 were at \$5.2 million, consistent with the \$5.1 million earned in fiscal year 2013.

During fiscal year 2015, approximately 1.01 million passengers (inbound and outbound) passed through the harbors as compared to 1.15 million passengers in fiscal year 2014 and 1.21 million passengers in fiscal year 2013.

Passenger fee revenue decreased by \$299,000 or 4.3% from \$6.9 million in 2014 to \$6.6 million in fiscal year 2015, due primarily to a decrease of approximately 0.14 million passengers partially offset by the change, effective July 1, 2014, in the embark and debark fee to \$6.50 per passenger from that assessed through June 30, 2014 of \$6.00 per passenger, a result of changes in the fee rate structure that took effect July 1, 2012.

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Passenger fee revenue increased by \$230,000 or 3.5% from \$6.7 million in 2013 to \$6.9 million in fiscal year 2014, due primarily to changes in the fee rate structure that took effect July 1, 2012, which provided for a change, effective July 1, 2013, in the embark and debark fee to \$6.00 per passenger from that assessed through June 30, 2013 of \$5.50 per passenger.

Passenger counts for fiscal year 2015 decreased by approximately 12.2% due to changes in how passengers were counted under the new rate structure in effect on July 1, 2012. In 2014 passenger counts decreased by approximately 8.0% due to changes in how passengers were counted under the new rate structure in effect on July 1, 2012. Approximately 52.6% of the fiscal year 2015 passengers were in-transit while 51.7% of the fiscal year 2014 passengers were in-transit. The year-over-year percentage decrease is a result of a change in the rate structure.

*Rental Revenues*

Rental revenues in fiscal years 2015 and 2014 were \$23.4 million and \$26.7 million, respectively. Rental revenues for fiscal year 2015 decreased by \$3.3 million or 12.4% from fiscal year 2014 due primarily to the termination of tenant agreements for areas rented at the Kapalama Military Reservation (KMR), effective February 28, 2014 and the termination of a lease agreement with a major harbor user during fiscal year 2015. Rental revenues decreased by \$2.85 million for these agreements during fiscal year 2015.

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

*Operating Expenses*

Operating expenses, excluding depreciation and amortization, for fiscal years 2015 and 2014 amounted to \$46.8 million and \$47.6 million, respectively. The decrease in operating expenses from fiscal year 2014 to fiscal year 2015 of \$750,000 or 1.6% was due primarily to increases in personnel services costs of \$912,000 offset by decreases in costs of fireboat operations of \$1.6 million and general administration expense of \$268,000.

Operating expenses, excluding depreciation and amortization, for fiscal years 2014 and 2013 amounted to \$47.6 million and \$47.2 million, respectively. The increase in operating expenses from fiscal year 2013 to fiscal year 2014 of \$358,000 or 0.8% was due primarily to increases in harbor operations costs of \$369,000, personnel services costs of \$617,000, costs of fireboat operations of \$180,000, administrative expense assessments for services provided by other State of Hawaii departments of \$1.2 million offset by decreases in maintenance expenses of \$543,000 and general administration expense of \$1.5 million.

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*Harbor operations costs* for fiscal year 2015 remained consistent with fiscal year 2014. In fiscal year 2014, Harbor operations costs increased by \$369,000 as compared to fiscal year 2013 due primarily to increases in ceded land assessments of \$154,000, which resulted from increased revenues earned from land parcels, including submerged lands designated as ceded lands and an increase in harbor operating costs and harbor security costs of \$215,000.

*Personnel services costs* for fiscal year 2015 increased by \$912,000 as compared to fiscal year 2014 due primarily to increases in wages and employee benefits costs paid of \$1.0 million, due primarily to the implementation of pay increases provided by Collective Bargaining Agreements that became effective July 1, 2013 for all Harbors Division employees, partially offset by a decrease in the post retirement liability of \$70,000 and by a decrease in workers compensation expense of \$20,000. In fiscal year 2014 personnel services increased by \$617,000 as compared to fiscal year 2013 due primarily to the implementation of pay increases provided by Collective Bargaining Agreements that became effective July 1, 2013 for all Harbors Division employees, partially offset by a decrease in the post retirement liability of \$524,000 and by a decrease in workers compensation expense of \$152,000.

*Central services costs* for fiscal year 2015 remained consistent with fiscal year 2014. In fiscal year 2014, central services costs increased by \$568,000 as compared to fiscal year 2013 due to expected higher earnings resulting from the tariff increases of 7% implemented July 1, 2013 against which the 5% State assessment is applied.

*General administration costs* for fiscal year 2015 decreased by \$268,000 as compared to fiscal year 2014 due primarily to the reduction of property management costs of \$549,000 incurred for the activities conducted by the Harbors Division and its agents for the rental of land and buildings located on a 21.2 acre parcel within the KMR area; these activities ceased effective July 31, 2014. This \$549,000 cost reduction was offset by \$204,000 of higher costs incurred during fiscal year 2015 to maintain the Harbors Division's database over that incurred during fiscal year 2014. The increase in costs for fiscal year 2015 is a result of increased activities incurred to maintain the Harbors Division's database. In fiscal year 2014, general administration costs decreased by \$1.5 million as compared to fiscal year 2013 due primarily to the accrual of an additional provision of \$1.3 million for judgments and claims recorded for fiscal year 2013.

*Harbor maintenance expenses* for fiscal year 2015 increased by \$323,000 as compared to fiscal year 2014 due primarily to decreases in maintenance costs of \$502,000 offset by increases in fiscal year 2015 special maintenance costs of \$825,000 expended for maintenance projects that did not extend the service life of harbor assets. Most of the special maintenance project expenditures for fiscal year 2015 extended the service life of the related harbor assets and were capitalized. In fiscal year 2014, harbor maintenance expenses decreased by \$543,000 as compared to fiscal year 2013 due primarily to increases in maintenance costs of \$134,000 offset by decreases in fiscal year 2014 special maintenance costs of \$677,000 expended for maintenance projects that did not extend the service life of harbor assets. Most of the special maintenance project expenditures for fiscal year 2014 extended the service life of the related harbor assets and were capitalized.



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*Fireboat operations expenses* for fiscal year 2015 decreased by \$1.6 million as compared to fiscal year 2014 due to the termination of the working agreement, effective June 30, 2014, between the Harbors Division and the City and County of Honolulu Fire Department (HFD). Under this working agreement HFD operated the fireboat on behalf of the Harbors Division, the costs of that operation were paid by the Harbors Division. During late June 2015, a consultant was engaged by the Harbors Division to provide an assessment and recommendation of the assets that are needed to provide firefighting activities for the Honolulu Harbor. This assessment activity has commenced and the consultant must provide its report to the Harbors Division by no later than January 31, 2016. In fiscal year 2014, fireboat operations increased by \$180,000 as compared to fiscal year 2013 due to an accrual of estimated operating costs for the three-month period ended June 30, 2014 recorded for fiscal year 2014 that exceeded actual 2014 costs by \$110,000.

***Transfers to Other Department***

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

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Management's Discussion and Analysis

June 30, 2015 and 2014

A summary of the Harbors Division's net position at June 30, 2015, 2014, and 2013 are shown below:

**Table 2**  
**Condensed Statements of Net Position**  
*(In Thousands)*

	As of June 30			2015 – 2014		2014 – 2013	
	2015	2014	2013	Increase (decrease)	% Change	Increase (decrease)	% Change
<b>Assets:</b>							
Current and other assets	\$ 414,819	\$ 422,572	\$ 406,944	\$ (7,753)	-1.8%	\$ 15,628	3.8%
Capital assets	780,490	745,637	739,453	34,853	4.7	6,184	0.8
Total assets	1,195,309	1,168,209	1,146,397	27,100	2.3	21,812	1.9
Deferred outflows of resources	6,633	4,311	4,744	2,322	53.9	(433)	(9.1)
<b>Liabilities:</b>							
Current liabilities	49,746	46,398	43,566	3,348	7.2	2,832	6.5
Long-term liabilities	389,919	382,830	396,667	7,089	1.9	(13,837)	(3.5)
Total liabilities	439,665	429,228	440,233	10,437	2.4	(11,005)	(2.5)
Deferred inflows of resources	2,520	-	-	2,520	100.0	-	-
<b>Net position:</b>							
Net investment in capital assets	528,581	510,870	517,419	17,711	3.5	(6,549)	(1.3)
Restricted	73,588	88,455	93,626	(14,867)	(16.8)	(5,171)	(5.5)
Unrestricted	157,589	143,967	99,863	13,622	9.5	44,104	44.2
Total net position	\$ 759,758	\$ 743,292	\$ 710,908	\$ 16,466	2.2	\$ 32,384	4.6

*Net Position*

The largest portion of the Harbors Division's net position (69.6% and 68.7% at June 30, 2015 and 2014, respectively), net investment in capital assets, represents its investment in capital assets (e.g., land, wharves, buildings, improvements, and equipment), less related indebtedness outstanding to acquire those capital assets. The Harbors Division uses these capital assets to provide services to its users of the harbors system; consequently, these assets are not available for future spending. Although the Harbors Division's net investment in its capital assets is reported net of related debt, the resources required to repay this debt must be provided annually from operations, since it is unlikely the capital assets themselves will be liquidated to pay for such liabilities.

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The restricted portion of the Harbors Division's net position (9.7% and 11.9% at June 30, 2015 and 2014, respectively) represents bond reserve and other funds that are subject to external restrictions on how they may be used.

The unrestricted portion of the Harbors Division's net position (20.7% and 19.4% at June 30, 2015 and 2014, respectively) may be used to meet any of the Harbors Division's ongoing operations or to fund capital improvement projects.

The change in net position is an indicator of whether the overall fiscal condition of the Harbors Division improved or worsened during the fiscal year. The change in net position may serve over time as a useful indicator of the Harbor Division's financial position. Net position or the amount of total assets and deferred outflows of resources that exceed liabilities amounted to \$759.8 million at June 30, 2015, an increase in net position of \$16.5 million or 2.2% from 2014. Net position or the amount of total assets and deferred outflows of resources that exceed liabilities amounted to \$743.3 million at June 30, 2014, an increase in net position of \$32.4 million or 4.6% from 2013.

**Capital Assets and Debt Administration**

*Capital Assets*

As of June 30, 2015 and 2014, the Harbors Division had \$780.5 million and \$745.6 million, respectively invested in capital assets as shown in Table 3. There was a net increase (additions, deductions, and depreciation) of \$34.9 million in 2015 from the prior year, and a net increase in 2014 of \$6.2 million from 2013.

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**Table 3**  
**Capital Assets**  
*(In Thousands)*

	As of June 30			2015 – 2014		2014 – 2013	
	2015	2014	2013	Increase (decrease)	% Change	Increase (decrease)	% Change
Land and land improvements	\$ 534,933	\$ 533,894	\$ 530,509	\$ 1,039	0.2%	\$ 3,385	0.6%
Wharves	269,153	269,153	269,047	-	-	106	0.0
Other improvements	91,114	73,946	73,946	17,168	23.2	-	0.0
Buildings	97,262	97,259	92,251	3	0.0	5,008	5.4
Equipment	19,109	18,130	21,775	979	5.4	(3,645)	(16.7)
Total at cost	1,011,571	992,382	987,528	19,189	1.9	4,854	0.5
Less accumulated depreciation	(329,165)	(305,967)	(286,551)	(23,198)	7.6	(19,416)	6.8
	682,406	686,415	700,977	(4,009)	(0.6)	(14,562)	(2.1)
Construction in progress	98,084	59,222	38,476	38,862	65.6	20,746	53.9
Total capital assets, net	\$ 780,490	\$ 745,637	\$ 739,453	\$ 34,853	4.7	\$ 6,184	0.8

Major capital asset additions to the statewide harbors system for the fiscal year ended June 30, 2015, included the following:

- \$582,000 Replacement of Fire Protection Lines at Piers 52-53, Honolulu Harbor, Oahu
- \$437,000 Construction of South Basin Perimeter Fence, Kawaihae Harbor, Hawaii Island

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

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

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

- \$19.5 million Construction of Building and Yard Improvements at Piers 34 and 35, Honolulu Harbor, Oahu
- \$14.0 million Construction of Inter-Island Cargo Terminal Facility, Hilo Harbor, Hawaii Island
- \$10.8 million Construction of Pier 4 Container Yard, Hilo Harbor, Hawaii Island
- \$2.2 million Piers 51B, 52, and 53 Sand Island Container Yard Reconstruction, Honolulu Harbor, Oahu
- \$1.5 million Substructure and Waterline Repairs at Pier 35, Honolulu Harbor, Oahu
- \$1.2 million Pier 31 Shed Demolition, Lighting and Drainage Resolution, Honolulu Harbor, Oahu

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

- \$50.0 million Design and Construction of Pier 4 Inter-Island Cargo Terminal Facility, Hilo Harbor, Hawaii Island
- \$15.4 million Land Acquisition and Design of Improvements, Kahului Harbor, Maui
- \$14.0 million Kapalama Container Terminal Yard and Wharf Design, Honolulu Harbor, Oahu
- \$12.0 million Design and Construction of Piers 12 and 15 Improvements, Honolulu Harbor, Oahu
- \$10.0 million Design and Construction of Pier 2 Terminal Improvements, Kawaihae Harbor, Hawaii Island
- \$7.9 million Maritime Wireless Network System, Statewide
- \$7.0 million Pier 1 Shed Modifications Phase II, Hilo Harbor, Hawaii Island
- \$2.0 million Pier 2 Strengthening, Hilo Harbor, Hawaii Island
- \$1.4 million Piers 31a and 32 Installation of Fire Suppression System, Honolulu Harbor, Oahu

The Harbors Division is committed under contracts awarded for capital improvement projects totaling \$86.9 million as of June 30, 2015.



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**Bond Covenants**

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

The Harbors Division coverage ratio as of June 30, 2015 was 2.97 under the 1997 Certificate as compared to the ratio of 2.83 as of June 30, 2014.

**Request for Information**

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

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Statements of Net Position  
June 30, 2015 and 2014

<b>Assets:</b>	<b>2015</b>	<b>2014</b>	<b>Liabilities:</b>	<b>2015</b>	<b>2014</b>
Current assets:			Current liabilities (payable from current assets):		
Cash and cash equivalents <i>(Note 3)</i>	\$ 204,477,053	\$ 165,399,402	Accounts payable <i>(Note 18)</i>	\$ 6,463,961	\$ 5,396,938
Receivables, less allowance for doubtful accounts of \$4,531,148 in 2015 and \$3,906,000 in 2014	10,511,592	9,446,461	Accrued workers' compensation <i>(Notes 5 and 12)</i>	70,620	78,656
Notes receivable, less allowance for doubtful accounts of \$3,777,650 in 2015 and 2014 <i>(Notes 14 and 15)</i>	-	-	Contracts payable, including retainages <i>(Note 18)</i>	201,818	1,164,289
Due from other State agencies	475,126	412,323	Accrued vacation <i>(Note 5)</i>	674,661	672,090
Interest receivable	374,031	98,301	Due to Department of Budget and Finance	<u>3,232,786</u>	<u>3,259,960</u>
Other receivables	13,873	13,873		<u>10,643,846</u>	<u>10,571,933</u>
Materials and supplies, at cost	63,025	63,025			
Prepaid insurance and others	<u>21,570</u>	<u>874,301</u>	Current liabilities (payable from restricted assets):		
	<u>215,936,270</u>	<u>176,307,686</u>	Contracts payable, including retainages	12,140,557	9,398,733
Restricted assets:			Revenue bonds payable, current maturities <i>(Notes 2, 5, 6, and 7)</i>	14,465,124	13,833,900
Cash and cash equivalents--restricted for debt service payments and reserve requirements <i>(Notes 3, 6, and 7)</i>	<u>34,249,829</u>	<u>33,894,516</u>	General obligation bonds payable, current maturities <i>(Notes 5 and 8)</i>	1,932,016	1,844,233
Total current assets	<u>250,186,099</u>	<u>210,202,202</u>	Accrued interest payable - revenue bonds <i>(Note 6)</i>	8,624,796	8,556,343
			Security deposits	1,939,171	2,193,354
Noncurrent assets:				<u>39,101,664</u>	<u>35,826,563</u>
Cash and cash equivalents--restricted for <i>(Notes 3 and 7):</i>			Total current liabilities	<u>49,745,510</u>	<u>46,398,496</u>
Capital improvement projects	151,098,895	198,707,248	Long-term liabilities:		
Other	<u>13,534,489</u>	<u>13,524,888</u>	Accrued workers' compensation <i>(Notes 5 and 12)</i>	311,614	488,489
	<u>164,633,384</u>	<u>212,232,136</u>	Net pension liability <i>(Notes 2, 5, and 11)</i>	21,594,854	-
Capital assets <i>(Notes 4, 9, and 16)</i>			Other postretirement benefits payable <i>(Notes 5 and 11)</i>	15,292,205	13,176,085
Nondepreciable facilities	280,022,844	278,984,247	Long-term debt, less current maturities:		
Depreciable facilities, net	402,382,646	407,430,282	Revenue bonds payable, net <i>(Notes 2, 5, 6, and 7)</i>	323,762,844	338,215,302
Construction in progress	98,084,300	59,222,312	General obligation bonds payable <i>(Notes 5 and 8)</i>	27,399,721	29,331,737
Total capital assets, net	<u>780,489,790</u>	<u>745,636,841</u>	Accrued vacation <i>(Note 5)</i>	<u>1,558,280</u>	<u>1,618,607</u>
Other assets	-	138,098	Total long-term liabilities	<u>389,919,518</u>	<u>382,830,220</u>
Total noncurrent assets	<u>945,123,174</u>	<u>958,007,075</u>	Total liabilities	<u>439,665,028</u>	<u>429,228,716</u>
Total assets	<u>1,195,309,273</u>	<u>1,168,209,277</u>	<b>Deferred Inflows of Resources:</b>		
			Deferred inflows related to pension <i>(Notes 2 and 11)</i>	<u>2,519,629</u>	-
<b>Deferred Outflows of Resources:</b>			<b>Net Position:</b>		
Deferred charge on refunding, net <i>(Note 2)</i>	3,889,744	4,310,845	Net investment in capital assets	528,581,097	510,869,883
Deferred outflows related to pension <i>(Notes 2 and 11)</i>	<u>2,743,246</u>	-	Restricted - revenue bond requirements	34,249,829	33,894,516
Total deferred outflows of resources	<u>6,632,990</u>	<u>4,310,845</u>	Restricted - for capital improvement projects	39,337,627	54,559,878
			Unrestricted	157,589,053	143,967,129
			Total net position	<u>\$ 759,757,606</u>	<u>\$ 743,291,406</u>

See accompanying notes to financial statements.



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Statements of Revenues, Expenses, and Changes in Net Position

Years Ended June 30, 2015 and 2014

	<b>2015</b>	<b>2014</b>
Operating revenues, net ( <i>Note 6</i> ):		
Services	\$ 98,435,099	\$ 92,356,198
Rentals ( <i>Note 10</i> )	23,413,433	26,720,360
Others	1,360,805	2,261,804
	123,209,337	121,338,362
Operating expenses:		
Depreciation and amortization, including depreciation of capital assets of \$23,197,458 during 2015 and \$23,494,969 during 2014 ( <i>Note 4</i> )	23,335,556	23,633,068
Harbor operations ( <i>Note 13</i> )	18,540,951	18,561,432
Personnel services ( <i>Note 11</i> )	17,687,378	16,774,964
State of Hawaii, surcharge for central service expenses ( <i>Note 14</i> )	3,811,197	3,861,000
General administration	2,710,029	2,977,903
Maintenance	2,242,822	1,919,776
Department of Transportation, general administration expenses ( <i>Note 14</i> )	1,780,600	1,792,965
Fireboat operations ( <i>Note 14</i> )	32,604	1,671,882
	70,141,137	71,192,990
Operating income	53,068,200	50,145,372
Nonoperating revenues (expenses):		
Interest expense ( <i>Notes 6, 8, and 9</i> )	(16,784,842)	(18,176,233)
Interest income ( <i>Note 3</i> ):		
Deposits in investment pool	1,453,840	672,837
Amortization of bond premium, discount, and deferred charge on refunding	(104,868)	(72,206)
Gain on disposal of capital assets	-	367,920
Bond issuance costs	-	(253,912)
	(15,435,870)	(17,461,594)
Income before capital contributions and transfers	37,632,330	32,683,778
Capital contributions	284,458	-
Transfers out ( <i>Note 14</i> )	-	(300,000)
Increase in net position	37,916,788	32,383,778
Net position, beginning of year, as previously reported	743,291,406	710,907,628
Restatement ( <i>Note 2</i> )	(21,450,588)	-
Net position, beginning of year, as restated	721,840,818	710,907,628
Net position, end of year	\$ 759,757,606	\$ 743,291,406

See accompanying notes to financial statements.

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Statements of Cash Flows

Years Ended June 30, 2015 and 2014

	<b>2015</b>	<b>2014</b>
Cash flows from operating activities:		
Cash received from customers	\$ 121,800,046	\$ 120,262,892
Cash paid to suppliers	(28,342,177)	(33,545,330)
Cash paid to employees	(15,712,019)	(14,641,062)
Net cash provided by operating activities	77,745,850	72,076,500
Cash flows used in noncapital financing activities:		
Transfers to other department	-	(300,000)
Cash flows from capital and related financing activities:		
Government grants received in aid of construction	284,458	935,608
Acquisition and construction of capital assets	(52,844,436)	(21,822,946)
Interest paid on bonds	(19,180,537)	(20,348,201)
Principal paid on bonds	(15,349,233)	(38,222,503)
Proceeds from bond issuance	-	23,615,000
Bond issuance costs paid	-	(253,912)
Net cash used in capital and related financing activities	(87,089,748)	(56,096,954)
Cash flows provided by investing activities:		
Interest received	1,178,110	750,902
Net increase (decrease) in cash and cash equivalents	(8,165,788)	16,430,448
Cash and cash equivalents at beginning of year	411,526,054	395,095,606
Cash and cash equivalents at end of year	\$ 403,360,266	\$ 411,526,054

*(Continued on following page)*

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Statements of Cash Flows (Continued)

Years Ended June 30, 2015 and 2014

	<b>2015</b>	<b>2014</b>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 53,068,200	\$ 50,145,372
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation of capital assets	23,197,458	23,494,969
Other amortization	138,098	138,098
Provision for doubtful accounts	625,343	189,822
Changes in assets, deferred outflows, liabilities, and deferred inflows:		
Receivables	(1,753,277)	(507,874)
Materials and supplies	-	(1,347)
Prepaid insurance and others	852,731	(31,156)
Deferred outflows related to pension	(2,743,246)	-
Payables	104,552	(2,635,410)
Accrued workers' compensation	(184,911)	(247,700)
Accrued vacation	(57,756)	102,732
Due to Department of Budget and Finance	(27,174)	(125,314)
Security deposits	(254,183)	(632,103)
Net pension liability	144,266	-
Other postretirement benefits payable	2,116,120	2,186,411
Deferred inflows related to pension	2,519,629	-
Net cash provided by operating activities	\$ 77,745,850	\$ 72,076,500

**Supplemental disclosure of noncash operating activities:**

As described in Note 2, the adoption of the GASB pension standards resulted in the restatement of net position (\$21,450,588) as of June 30, 2014, and the recording of deferred outflows of resources (\$2,743,246), net pension liability (\$21,594,854), and deferred inflows of resources (\$2,519,629) as of June 30, 2015.

**Supplemental disclosure of noncash capital and related financial activities:**

Amortization of bond premium, discount, and deferred charge on refunding	\$ (104,868)	\$ (72,206)
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*See accompanying notes to financial statements.*

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Notes to Financial Statements

June 30, 2015 and 2014

**1. Financial Reporting Entity**

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

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

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

**2. Summary of Significant Accounting Policies**

***Measurement Focus and Basis of Accounting***

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

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

***Cash and Cash Equivalents***

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

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***Restricted Assets***

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

***Accounts Receivable and Allowance for Doubtful Accounts***

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

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

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

***Risk Management***

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

***Capital Assets and Depreciation***

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

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

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

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

***Bond Issuance Costs***

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

***Unamortized Debt Premium (Discount)***

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

***Refunding of Debt***

The difference between the reacquisition price and the net carrying amount of the old debt is deferred and amortized as a component of interest expense in a systematic and rational manner over the remaining life of the old debt or the life of the new debt, whichever is shorter. The deferred charge on refunding amounted to \$3,889,744 and \$4,310,845 at June 30, 2015 and 2014, respectively, and are reported as deferred outflows of resources in the statements of net position.

***Deferred Outflows/Inflows of Resources***

In addition to assets, the statements of net position will report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period(s) and so will not be

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recognized as an outflow of resources (expense) until then. The Harbors Division's deferred outflows of resources consist of deferred outflows related to pension (see Note 11) and a deferred charge on refunding as described above.

In addition to liabilities, the statements of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time. The Harbors Division's deferred inflows of resources consist of deferred inflows related to pension (see Note 11).

***Accrued Vacation***

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

***Net Position***

Net position is reported in three categories as follows:

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

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

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

***Operating Revenues***

Operating revenues are those that result from providing goods and services and are reported net of bad debt. The provision for bad debts for the years ended June 30, 2015 and 2014 was approximately \$625,000 and \$190,000, respectively. Operating revenues also exclude revenues related to capital and related financing activities, noncapital financing activities, and investing activities.

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The Harbors Division has pledged its future operating revenues, net of certain operating expenses, to repay \$337,540,000 in Harbor Revenue Bonds. Proceeds from the bonds provided financing for the construction of new facilities and the improvement of existing facilities related to the State's commercial harbors. The bonds are payable solely from the Harbors Division's operating revenues and are payable through July 2040.

The total principal and interest remaining to be paid on the bonds is approximately \$542,062,000. Principal and interest paid (as defined by the Harbor revenue bond debt service requirements under the 1997 certificate) and total operating revenues, net of certain operating expenses, were approximately \$31,176,000 and \$84,738,000 respectively, for the year ended June 30, 2015, and approximately \$31,528,000 and \$84,082,190 respectively, for the year ended June 30, 2014.

***Operating Expenses***

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

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

***Capital Contributions***

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

***Pension***

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pension, and pension expense, information about the fiduciary net position of the Harbor Division's participation in the Employees' Retirement System of the State of Hawaii (the ERS) and additions to/deductions from the ERS's fiduciary net position have been determined on the same basis as they are reported by the ERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with benefit terms. The ERS's investments are reported at fair value.



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Notes to Financial Statements

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***Use of Estimates***

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Significant estimates include the valuation of receivables, the estimated useful lives of capital assets, and reserves for net pension and postemployment benefits, and claims and judgments. Actual results could differ from those estimates.

***Change in Accounting Principles***

Effective July 1, 2014, the Harbors Division adopted the provisions of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27* (Statement No. 68). This statement establishes standards of accounting and financial reporting for defined benefit pensions and defined contribution pensions provided to the employees of state and local governmental employers through pension plans that are administered through trusts or equivalent arrangements, such as the ERS.

Statement No. 68 replaces the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers* (Statement No. 27), as well as the requirements of GASB Statement No. 50, *Pension Disclosures*, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements that meet certain criteria.

Simultaneously with the adoption of Statement No. 68, the Harbors Division adopted the provisions of GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date, an amendment of GASB Statement No. 68* (Statement No. 71). This statement amends the requirement related to certain pension contributions made to defined benefit pension plans prior to implementation of Statement No. 68 by employers and nonemployer contributing entities.

The Harbors Division did not restate the financial statements as of and for the year ended June 30, 2014, because the actuarial information from the State did not provide the required information for the prior year. As such, the Harbors Division included the pension disclosures under Statement No. 27 for the year ended June 30, 2014. The Harbors Division reported the cumulative effect of the change in accounting principles by restating beginning net position in the accompanying 2015 financial statements. Specifically, the adoption of Statement Nos. 68 and 71 had the effect of decreasing net position as of June 30, 2014 by \$21,450,588. In addition, the Harbors Division recorded a deferred outflow of resources of \$2,743,246, a net pension liability of \$21,594,854, and a deferred inflow of resources of \$2,519,629 as of June 30, 2015 in the accompanying financial statements. Refer to Note 11 for additional information regarding the ERS.

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***Recently Issued Accounting Pronouncements***

*GASB Statement No. 72*

The GASB issued Statement No. 72, *Fair Value Measurement and Application* (Statement No. 72), which will become effective for financial statements for the fiscal years beginning after June 15, 2015. This statement addresses accounting and financial reporting issues related to fair value measurements. The definition of *fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This statement provides guidance for determining a fair value measurement for financial reporting purposes and for applying fair value to certain investments. In addition, this statement requires disclosures to be made about fair value measurements, the level of fair value hierarchy, and valuation techniques. The Harbors Division is currently evaluating the impact that Statement No. 72 will have on its financial statements.

*GASB Statement No. 75*

The GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* (Statement No. 75), which will become effective for financial statements for the fiscal years beginning after June 15, 2017. This statement addresses accounting and financial reporting for other postemployment benefits (OPEB) plans that are provided to the employees of state and local governmental employers. In this statement, distinctions are made regarding the particular requirements depending upon whether the OPEB plans through which the benefits are provided are administered through trusts that meet certain criteria, such as the Hawaii Employer-Union Health Benefits Trust Fund of the State of Hawaii.

This statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. For defined benefit OPEB, this statement identifies the methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and required supplementary information requirements about defined benefit OPEB are also addressed.

In addition, this statement details the recognition and disclosure requirements for employers with payables to defined benefit OPEB plans that are administered through trusts that meet the specified criteria and for employers whose employees are provided with defined contribution OPEB.

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This statement replaces the requirements of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, for OPEB. The Harbors Division is currently evaluating the impact that Statement No. 75 will have on its financial statements.

**3. Cash and Cash Equivalents**

Cash and cash equivalents at June 30, 2015 and 2014 consisted of the following:

	<u>2015</u>	<u>2014</u>
Amounts held in State Treasury	\$ 402,931,756	\$ 411,312,143
Petty cash and other	428,510	213,911
	<u>\$ 403,360,266</u>	<u>\$ 411,526,054</u>

Such amounts are reflected in the statements of net position at June 30, 2015 and 2014 as follows:

	<u>2015</u>	<u>2014</u>
Current assets:		
Unrestricted	\$ 204,477,053	\$ 165,399,402
Restricted:		
Revenue bond debt service payments	22,794,796	22,439,483
Revenue bond cash reserve requirements	11,455,033	11,455,033
Noncurrent assets:		
Restricted:		
Capital improvement projects:		
Unspent bond proceeds	111,761,268	144,147,370
Construction - special purpose funds	39,337,627	54,559,878
Other-bond reserve requirements and security deposits	13,534,489	13,524,888
	<u>\$ 403,360,266</u>	<u>\$ 411,526,054</u>

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***Amounts Held in State Treasury***

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

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

At June 30, 2015 and 2014, the amounts reported as amounts held in State Treasury reflects the Harbors Division's relative position in the State's investment pool and amounted to \$402,931,756 and \$411,312,143, respectively.

***Interest Rate Risk***

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

***Credit Risk***

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

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*Custodial Risk*

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

*Concentration of Credit Risk*

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

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

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The Harbors Division's share of the State's investment pool, as provided in the fiscal year 2014 CAFR of the State and summarized in the table below (amounts in thousands), was 14% at June 30, 2014:

	<u>Fair value</u>	<u>Maturity (in years)</u>		
		<u>Less than 1</u>	<u>1-5</u>	<u>&gt;5</u>
Investments - Primary				
Government:				
Certificates of deposit	\$ 947,868	\$ 890,025	\$ 57,843	\$ -
U.S. government securities	1,098,666	257,086	840,670	910
Repurchase agreements	107,712	75,578	32,134	-
	<u>\$ 2,154,246</u>	<u>\$ 1,222,689</u>	<u>\$ 930,647</u>	<u>\$ 910</u>
Investments - Fiduciary Funds:				
Certificates of deposit	\$ 176,603	\$ 165,826	\$ 10,777	\$ -
U.S. government securities	204,698	47,899	156,630	169
Repurchase agreements	20,068	14,081	5,987	-
	<u>401,369</u>	<u>\$ 227,806</u>	<u>\$ 173,394</u>	<u>\$ 169</u>
Mutual funds	<u>408,272</u>			
Total investments	<u>\$ 809,641</u>			

Information relating to the State's investment pool at June 30, 2015 will be included in the CAFR of the State when issued.

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**4. Capital Assets**

Capital asset activity for the years ended June 30, 2015 and 2014 were as follows:

	<b>Balance July 1, 2014</b>	<b>Additions</b>	<b>Deductions</b>	<b>Balance June 30, 2015</b>
Nondepreciable assets:				
Land improvements	\$ 278,984,247	\$ 1,038,597	\$ -	\$ 280,022,844
Depreciable assets:				
Land improvements	254,909,373	-	-	254,909,373
Wharves	269,153,315	-	-	269,153,315
Other improvements	73,945,682	17,168,506	-	91,114,188
Buildings	97,259,371	2,675	-	97,262,046
Equipment	18,130,190	978,641	-	19,108,831
Total at cost	<u>992,382,178</u>	<u>19,188,419</u>	<u>-</u>	<u>1,011,570,597</u>
Less accumulated depreciation for:				
Land improvements	82,287,922	8,891,127	-	91,179,049
Wharves	133,279,554	8,330,867	-	141,610,421
Other improvements	40,653,806	2,179,441	-	42,833,247
Buildings	38,092,928	2,525,950	-	40,618,878
Equipment	11,653,439	1,270,073	-	12,923,512
Total accumulated depreciation	<u>305,967,649</u>	<u>23,197,458</u>	<u>-</u>	<u>329,165,107</u>
Construction in progress	<u>59,222,312</u>	<u>57,314,830</u>	<u>(18,452,842)</u>	<u>98,084,300</u>
Total capital assets, net	<u>\$ 745,636,841</u>	<u>\$ 53,305,791</u>	<u>\$ (18,452,842)</u>	<u>\$ 780,489,790</u>

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



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**5. Long-Term Liabilities**

The changes in long-term liabilities were as follows:

	<b>Balance July 1, 2014</b>	<b>Additions</b>	<b>Deductions</b>	<b>Balance June 30, 2015</b>	<b>Current</b>	<b>Noncurrent</b>
Accrued workers' compensation (Note 12)	\$ 567,145	\$ 198,648	\$ 383,559	\$ 382,234	\$ 70,620	\$ 311,614
Accrued vacation	2,290,697	1,020,176	1,077,932	2,232,941	674,661	1,558,280
Net pension liability (Note 11)	-	23,317,420	1,722,566	21,594,854	-	21,594,854
Other postretirement benefits payable (Note 11)	13,176,085	3,278,479	1,162,359	15,292,205	-	15,292,205
General obligation bonds (Note 8)	31,175,970	-	1,844,233	29,331,737	1,932,016	27,399,721
Revenue bonds (Note 6)	351,045,000	-	13,505,000	337,540,000	14,170,000	323,370,000
Unamortized premium	1,004,202	-	316,234	687,968	295,124	392,844
Revenue bonds, net	<u>352,049,202</u>	<u>-</u>	<u>13,821,234</u>	<u>338,227,968</u>	<u>14,465,124</u>	<u>323,762,844</u>
	<u>\$ 399,259,099</u>	<u>\$ 27,814,723</u>	<u>\$ 20,011,883</u>	<u>\$ 407,061,939</u>	<u>\$ 17,142,421</u>	<u>\$ 389,919,518</u>

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

**6. Revenue Bonds Payable**

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

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

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

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The following is a summary of the Revenue Bonds issued and outstanding at June 30, 2015:

Year of Issue	Final Redemption Date	Interest Rate	Original Amount of Issue	Current		Total Current	Noncurrent
				Principal Due July 1, 2015	Principal Due January 1, 2016		
2004	January 1, 2024	2.50-6.00%	\$ 52,030,000	\$ -	\$ 1,580,000	\$ 1,580,000	\$ 16,195,000
2006	January 1, 2031	4.00-5.25%	96,570,000	-	3,085,000	3,085,000	71,625,000
2007	July 1, 2027	4.25-5.50%	51,645,000	2,000,000	-	2,000,000	34,000,000
2010	July 1, 2040	3.00-5.75%	201,390,000	6,680,000	-	6,680,000	179,940,000
2013	July 1, 2029	3.25%	23,615,000	825,000	-	825,000	21,610,000
			<u>\$ 425,250,000</u>	<u>\$ 9,505,000</u>	<u>\$ 4,665,000</u>	14,170,000	323,370,000
Unamortized premium						295,124	392,844
						<u>\$ 14,465,124</u>	<u>\$ 323,762,844</u>

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

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

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

<u>Fiscal Year Ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2016	\$ 14,170,000	\$ 17,016,685	\$ 31,186,685
2017	14,865,000	16,311,410	31,176,410
2018	15,610,000	15,584,466	31,194,466
2019	16,380,000	14,817,416	31,197,416
2020	17,160,000	14,032,900	31,192,900
2021-2025	86,225,000	56,906,269	143,131,269
2026-2030	72,450,000	37,520,475	109,970,475
2031-2035	42,335,000	21,949,231	64,284,231
2036-2040	47,205,000	10,069,366	57,274,366
2041	11,140,000	313,313	11,453,313
	<u>\$ 337,540,000</u>	<u>\$ 204,521,531</u>	<u>\$ 542,061,531</u>

The debt service requirements reflect the sum of the amounts to be paid in accordance with the repayment schedules of the bonds issued. Principal and interest payments are required to be funded in the 12-month and 6-month periods, respectively, preceding the date on which the payments are due. Accordingly, the debt service requirements include reserves of \$22,794,796 as of June 30, 2015, for principal payments \$14,170,000 due on July 1, 2015 and January 1, 2016, and for interest payments \$8,624,796 due on July 1, 2015.

**7. Harbor Revenue Bond Requirements**

***1997 Certificate – Minimum Net Revenue Requirement***

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

- (1) Together with funds legally available, therefore including any amounts on deposit in the harbor reserve and contingency account; an aggregate sum equal to at least 1.25 times the total amount of: (i) the interest payments for such 12 months on all the Revenue Bonds outstanding under the 1997 Certificate, (ii) the principal amount of the Revenue Bonds maturing by their terms during such 12 months and (iii) the minimum sinking fund payments for all Revenue Bonds required to be made during such 12 months; and
- (2) Without consideration of other funds, shall be at least equal to 1.00 times the bond service for such 12 months.

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The Harbor Revenue Bond debt service requirements, including minimum sinking fund payments during the current fiscal year, computed in accordance with Section 6.03 of the 1997 Certificate totaled \$31,175,891. Net revenues of the Public Undertaking, as defined by the 1997 Certificate amounted to \$92,566,451 or 2.97 times the minimum net revenue requirement for the fiscal year ended June 30, 2015, and \$89,209,935 or 2.83 times the minimum net revenue requirement for the fiscal year ended June 30, 2014.

***Harbor Special Fund***

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

(1) *Harbor Interest Account*

Equal monthly installments sufficient to pay for the interest next becoming due on the Revenue Bonds are required to be paid into this account. This requirement was met as of June 30, 2015 and 2014.

(2) *Harbor Principal Account*

Commencing with the first business day of each fiscal year, equal monthly payments are required to be made to this account sufficient to redeem the Revenue Bonds scheduled for redemption on the following July 1 and January 1. This requirement was met as of June 30, 2015 and 2014.

(3) *Harbor Debt Service Reserve Account*

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

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

In lieu of the credit of monies to the harbor debt service reserve account, the Harbors Division may cause to be so credited a surety bond or an insurance policy payable to the Harbors Division for the benefit of the holders of the Revenue Bonds of a series or a letter of credit in an amount equal to the difference between the reserve requirement and the amounts then on credit to the harbor debt service reserve account. In the event a surety bond,

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

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

(4) *Harbor Reserve and Contingency Account*

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

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**8. General Obligation Bonds**

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

Reimbursable general obligation bonds are general obligations of the State, but since the proceeds were used to finance the harbor and waterfront improvements, the Harbors Division is required to reimburse the State's general fund for the payment of principal and interest on such bonds. As of June 30, 2015 and 2014, outstanding reimbursable general obligation bonds amounted to approximately \$29,332,000 and \$31,176,000 respectively.

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

<u>Fiscal Year Ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2016	\$ 1,932,016	\$ 1,448,637	\$ 3,380,653
2017	2,022,854	1,357,966	3,380,820
2018	2,122,232	1,258,386	3,380,618
2019	2,227,919	1,152,889	3,380,808
2020	2,336,771	1,044,012	3,380,783
2021-2025	13,535,986	3,368,003	16,903,989
2026-2028	5,153,959	399,935	5,553,894
	<u>\$ 29,331,737</u>	<u>\$ 10,029,828</u>	<u>\$ 39,361,565</u>

**9. Interest Cost**

Total combined interest cost incurred related to Revenue and General Obligation Bonds for the fiscal years ended June 30, 2015 and 2014 amounted to approximately \$19,249,000 and \$19,355,000, respectively. Of this amount, approximately \$2,464,000 and \$1,179,000 were capitalized during fiscal years ended June 30, 2015 and 2014, respectively, as part of the construction cost of harbor facilities.

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**10. Leasing Operations**

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

The following is a schedule of approximate future minimum lease rentals on noncancelable operating leases as of June 30, 2015.

<u>Fiscal Year Ending June 30</u>	<u>Amount</u>
2016	\$ 7,291,000
2017	5,959,000
2018	5,673,000
2019	5,122,000
2020	5,098,000
2021-2025	25,608,000
2026-2030	24,587,000
2031-2035	19,972,000
2036-2040	12,725,000
2041-2045	9,813,000
2046-2050	3,687,000
2051-2055	2,599,000
2056-2059	1,445,000
	<u>\$ 129,579,000</u>

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

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**11. Retirement Benefits**

*Employees' Retirement System of the State of Hawaii*

*Plan Description*

All eligible employees of the State and counties, which includes the Harbors Division, are provided with pensions through a cost-sharing multiple-employer defined benefit pension plan administered by the ERS. Benefit terms, eligibility, and contribution requirements are established by Hawaii Revised Statutes (HRS) Chapter 88 and can be amended through legislation.

*Benefits Provided*

The ERS provides retirement, disability, and death benefits that are covered by the provisions of 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. The benefit multiplier decreased by 0.25% for new hybrid and contributory class members hired after June 30, 2012. Average final compensation is an average of the highest salaries during any 3 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 paid in lieu of vacation for employees hired prior to January 1, 1971.

For members hired before July 1, 2012, the original retirement allowance is increased by 2.5% each July 1 following the calendar year of retirement. This cumulative benefit is not compounded and increases each year by 2.5% of the original retirement allowance without a ceiling (2.5% of the original retirement allowance the first year, 5.0% the second year, 7.5% the third year, etc.). For members hired after June 30, 2012 the post-retirement annuity increase was decreased to 1.5% per year.

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 10 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.



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*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.

Ten years of credited service is required for ordinary death benefits. For ordinary death benefits, 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.

***Contributory Class for Employees 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 5 years of credited service are eligible to retire at age 55.

Police and firefighters' retirement benefits are determined as 2.25% of average final compensation for each year of service up to a maximum of 80%. Police and firefighters with 5 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 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.

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*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 to the surviving spouse/reciprocal beneficiary 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.

Ordinary death benefits are available to employees who were active at time of death with at least 1 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 10 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 Employees Hired After June 30, 2012***

*Retirement Benefits*

Judges and elected officers' retirement benefits are determined as 3.0% of average final compensation multiplied by the years of credited service up to a maximum of 75%. Judges and elected officers with 10 years of credited service are eligible to retire at age 60.

Police and firefighters' retirement benefits are determined as 2.25% of average final compensation for each year of service up to a maximum of 80%. Police and firefighters with 10 years of credited service are eligible to retire at age 60.

*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 3.0% of average final compensation for each year of service for judges and elected officers and 1.75% of average final compensation for each year of service for police and firefighters and are payable immediately, without an actuarial reduction, at a minimum of 30% of average final compensation.

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

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***Hybrid Class for Employees 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 5 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 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 to the surviving spouse/reciprocal beneficiary 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.

Ordinary death benefits are available to employees who were active at time of death with at least 5 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 10 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 Employees 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 10 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 EMTs 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 10 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 120%, 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 10 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, or if less than 10 years of service, return of member's contributions and accrued interest.

***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 were 24.0% for police and firefighters and 16.50% for all other employees. Contributions to the ERS from the Harbors Division were \$1,882,115 and \$1,722,566 for the fiscal years ended June 30, 2015 and 2014, respectively.

The employer is required to make all contributions for noncontributory members. For contributory class employees hired prior to July 1, 2012, general employees are required to contribute 7.8% of their salary and police and firefighters are required to contribute 12.2% of their salary. For contributory class employees hired after June 30, 2012, judges and elected officials are required to contribute 9.8% of their salary and police and firefighters are required to contribute 14.2% of their salary. Hybrid members hired prior 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.

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***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, deferred outflows of resources, and deferred inflows of resources is made for the State as a whole and is not separately computed for the individual state departments and agencies such as the Harbors Division. The State allocates the pension liability, pension expense, deferred outflows of resources, and deferred inflows of resources to the various departments and agencies based upon a systematic methodology. Additional disclosures and required supplementary information stipulated by Statement Nos. 68 and 71 pertaining to the State's net pension liability, pension expense, deferred outflows of resources, and deferred inflows of resources can be found in the State's CAFR.

At June 30, 2015, the Harbors Division reported a net pension liability of \$21,594,854 for its proportionate share of the State's net pension liability. The net pension liability was measured as of June 30, 2014, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date.

The Harbors Division's proportionate share of the net pension liability was based on a projection of the Harbors Division's share of the State's long-term share of contributions to the pension plan relative to projected contributions of all participants, actuarially determined. At June 30, 2014, the State's proportion was 58.48%, which was an increase of .85% from its proportion measured as of June 30, 2013. The Harbors Division's share of the State's net pension liability at June 30, 2014 was .46%.

There were no changes in other assumptions and inputs that affected the measurement of the total pension liability since the prior measurement date. There were no changes between the measurement date, June 30, 2014, and the reporting date, June 30, 2015, that are expected to have a significant effect on the proportionate share of the net pension liability.

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For the year ended June 30, 2015, the Harbors Division recognized pension expense of \$1,845,009. At June 30, 2015, the Harbors Division reported deferred outflows of resources and deferred inflows of resources related to pension from the following sources:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Contributions subsequent to the measurement date	\$ 2,432,629	\$ -
Differences between expected and actual experience	271,528	6,123
Changes in proportion and differences between contributions and proportionate share of contributions	39,089	-
Net difference between projected and actual earnings on pension plan investments	-	2,513,506
	<u>\$ 2,743,246</u>	<u>\$ 2,519,629</u>

The \$2,432,629 reported as deferred outflows of resources related to pension resulting from the Harbors Division's contributions subsequent to the measurement date will be recognized as a reduction of net pension liability in the year ended June 30, 2016. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pension will be recognized in pension expense as follows:

**Year Ended June 30:**

2016	\$ (564,489)
2017	(564,489)
2018	(564,489)
2019	(564,489)
2020	48,944
	<u>\$ (2,209,012)</u>

***Actuarial Assumptions***

The total pension liability in the June 30, 2014 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.00%
Payroll growth rate	3.50%
Investment rate of return	7.75% compounded annually including inflation

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The same rates were applied to all periods. There were no changes to ad hoc postemployment benefits including COLA.

Post-retirement mortality rates are based on Client Specific Tables and the 1994 US Group Annuity Mortality Statistic Tables for police and firefighters. Pre-retirement mortality rates are based on the RP-2000 tables.

The actuarial assumptions used in the June 30, 2014 valuation were based on the results of an actuarial experience study for the five-year period ending June 30, 2010. ERS updates their experience studies every five years.

***Long-term Expected Rate of Return on Pension Plan Investments***

The long-term expected rate of return on pension plan investments was determined using a “top down approach” of the Bespoke Client-Constrained Simulation-based Optimization Model (a statistical technique known as “re-sampling with replacement” that directly keys in on specific plan-level risk factors as stipulated by the ERS Board) in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

<b>Asset Class</b>	<b>Target Allocation</b>	<b>Long-term Expected Real Rate of Return</b>
Domestic equity	30.00%	8.50%
International equity	26.00%	9.00%
Total fixed-income	20.00%	3.10%
Real estate	7.00% *	8.46%
Private equity	7.00% *	11.75%
Real return	5.00% *	6.10%
Covered calls	5.00%	7.65%
Total investments	100.00%	

\*The real estate, private equity, and real return targets will be the percentage actually invested up to 7%, 7%, and 5%, respectively of the total fund. Changes in the real estate private equity, and real return targets will be offset by an equal percentage change in the large cap domestic equity target.

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***Discount Rate***

The discount rate used to measure the net pension liability was 7.75%. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current contribution rate and that contributions from the State, which includes the Harbors Division, will be made at statutorily required rates, actuarially determined. Based on those assumptions, the ERS's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all period of projected benefit payments to determine the total pension liability. There has been no change in the discount rate since the prior measurement date.

***Sensitivity of the Harbors Division's Proportionate Share of the State's Net Pension Liability to Changes in the Discount Rate***

The following presents the Harbors Division's proportionate share of the State's net pension liability calculated using the discount rate of 7.75%, as well as what the Harbors Division's proportionate share of the State's net pension liability would be if it were calculated using a discount rate that is 1-percentage point lower (6.75%) or 1-percentage point higher (8.75%) than the current rate:

	<b>1% Decrease (6.75%)</b>	<b>Discount Rate (7.75%)</b>	<b>1% Increase (8.75%)</b>
Harbor Division's proportionate share of the State's net pension liability	\$ 27,351,460	\$ 21,594,854	\$ 15,784,274

***Pension Plan Fiduciary Net Position***

The pension plan's fiduciary net position is determined on the same basis used by the ERS. The ERS financial statements are prepared using the accrual basis of accounting under which expenses are recorded when the liability is incurred, and revenues are recorded in the accounting period in which they are earned and become measurable. Employer and member contributions are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan. Investment purchases and sales are recorded as of their trade date. Administrative expenses are financed exclusively with investment income.

There were no significant changes after the report measurement date. Detailed information about the pension plan's fiduciary net position is available in the separately issued ERS financial report. ERS's complete financial statements are available at <http://ers.ehawaii.gov/>.



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***Pension Contributions Under GASB Statement No. 27***

For periods prior to June 30, 2014, the funding method used to calculate the total employer contribution was the Entry Age Normal Actuarial Cost Method. Effective July 1, 2005, the employer contribution rates are a fixed percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liability.

The Harbors Division's share of the State's actual pension contribution was approximately \$1,723,000, \$1,553,000, and \$1,384,000 for the years ended June 30, 2014, 2013, and 2012, respectively, which equal the required contributions for each year. Measurement of assets and actuarial valuations are made for the ERS as a whole and are not separately computed for individual participating employers such as the Harbors Division.

***Postemployment Health Care and Life Insurance Benefits***

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

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

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

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

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

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

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

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

	<b>June 30, 2015</b>	<b>June 30, 2014</b>
Annual required contribution	\$ 3,278,000	\$ 3,302,000
Contribution made	(1,162,000)	(1,116,000)
Increase in net OPEB obligation	2,116,000	2,186,000
Net OPEB obligation, beginning of the year	13,176,000	10,990,000
Net OPEB obligation, end of the year	\$ 15,292,000	\$ 13,176,000
Actual contributions made as a percentage of ARC	35.4%	33.8%

Contributions are financed on a pay-as-you-go basis and the Harbors Division's contributions for the fiscal years ended June 30, 2015, 2014, and 2013 were approximately \$1,162,000, \$1,116,000, and \$1,020,000, respectively, which represents 35.4%, 33.8%, and 27.3%, respectively, of the annual required contribution.

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

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

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

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

***Deferred Compensation Plan***

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

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

**12. Risk Management**

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

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

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

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

The Harbors Division obtained coverage for certain strategic piers and wharves infrastructure to mitigate its exposure to natural disasters from hurricane, earthquake, and flood (including a tsunami) events. The amount of insurance provided by this difference in conditions policy is \$30,000,000 on an annual aggregate basis on a shared perils basis, subject to a \$5,000,000 deductible per occurrence.

The State and, thus, the Harbors Division are generally self-insured for workers' compensation and automobile claims. The estimated reserve for losses and loss adjustment costs includes the accumulation of estimates for losses and claims reported prior to fiscal year end, estimates (based on projections of historical developments) or claims incurred but not reported, and estimates of costs for investigating and adjusting all incurred and unadjusted claims. Amounts reported are subject to the impact of future changes in economic and social conditions. The Harbors Division believes that, given the inherent variability in any such estimates, the reserves are within a reasonable and acceptable range of adequacy. Reserves are continually monitored and reviewed, and as settlements are made and reserves adjusted, the differences are reported in current operations. A liability for a claim is established if information indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss is reasonably estimable. Accrued workers' compensation amounted to approximately \$382,000 and \$567,000 at June 30, 2015 and 2014, respectively.

**13. Ceded Lands**

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

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

On April 11, 2012, the Governor signed Act 15, SLH 2012 (Act 15), into law. Act 15 conveys fee simple title to nine parcels of land located at Kakaako in Honolulu, valued at approximately \$200,000,000, to OHA, as of July, 1, 2012. Act 15 also satisfies, resolves, discharges, releases,

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waives, extinguishes, prohibits, and bars, finally and completely, any and all claims, disputes, controversies, rights, actions, and causes of action, OHA (or parties claiming through OHA) has asserted or could have asserted to the income and proceeds from the Ceded Lands, under Article XII, Sections 4 and 6 of the Hawaii Constitution or any related statute or act, between November 7, 1978 (the date Article XII, Sections 4, 5, and 6 of the Hawaii Constitution were ratified) and June 30, 2012. Act 15 also withdrew any waiver of sovereign immunity the State may previously have made with respect to OHA's portion of receipts from the Ceded Lands, and affirms that the State does not waive its sovereign immunity to permit a claim or suit to be brought to invalidate the act's operative provisions.

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

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

Included in the Harbors Division's operating expenses in the accompanying statements of revenues, expenses, and changes in net position for the fiscal years ended June 30, 2015 and 2014 are approximately \$12,684,000 and \$10,926,000, respectively, of OHA ceded land expenses.

**14. Transactions with Other Government Agencies**

The State assesses a surcharge of 5% for central service expenses on all receipts of the Harbors Division, after deducting any amounts pledged, charged, or encumbered for the payment of bonds and interest during the fiscal year. The assessments amounted to approximately \$3,811,000 and \$3,861,000 for the fiscal years ended June 30, 2015 and 2014, respectively.

The Harbors Division is assessed a percentage of DOT's general administration expenses. The assessments amounted to approximately \$1,781,000 and \$1,793,000 for the fiscal years ended June 30, 2015 and 2014, respectively.

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The Harbors Division incurred costs of approximately \$33,000 and \$1,672,000 for fireboat operation services provided by the City and County of Honolulu during the fiscal years ended June 30, 2015 and 2014, respectively. Act 69, SLH 2012 was enacted to abolish statutory requirements as of January 1, 2013 to reimburse the City and County of Honolulu for the operation and maintenance of the fireboat and allow for broader flexibility in the management of fireboat operations by the Harbors Division. The Harbors Division is in the process of determining new arrangements to allow for more economical management of a marine response program.

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

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

Act 200, SLH 2008, was enacted to authorize a statewide Harbors Modernization Plan (HMP) to address harbor infrastructure improvements to Kahului Harbor on Maui, Nawiliwili Harbor on Kauai, Hilo and Kawaihae Harbors on Hawaii, and Honolulu and Kalaehoa Harbors on Oahu. In addition to the six commercial harbors included in the plan, the law placed Hana Harbor on Maui under the jurisdiction of the Harbors System and included appropriations for its upgrade. The Act authorizes the DOT to issue harbor revenue bonds to finance the improvements. The cost of the Harbors Modernization Plan, originally estimated at \$842 million, was revised to \$618 million in 2008. Act 200 also designated the ATDC as the entity responsible for the management and implementation of the HMP under the direction of the DOT.

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

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

**15. Aloha Tower Complex Development**

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

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

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

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On January 18, 2006, an Agreement amending the Aloha Tower Project Memorandum of Understanding and Aloha Tower Ground Lease was executed, effective as of June 30, 2005, and retroactive to July 1, 2004 (the Amendment). The Amendment required ATDC to pay \$225,000 as a minimum annual base payment for losses in revenues owing in the fiscal year beginning July 1, 2004. From July 1, 2005, subject to the approval of the Deputy Director for the Harbors Division, the base payment of \$225,000 was to be reduced by expenses incurred by ATDC for the Hawaii Harbors Project Office. The Amendment also required an equity participation payment to be made in an amount of 50% of the difference between the total revenues and total operating expenses of ATDC for a fiscal year (the equity payment), provided that if the equity payment exceeds two and one-half times the actual operating expenses of ATDC for such fiscal year, ATDC must make a supplemental payment equal to 75% of the difference between the equity payment and the product of two and one-half times the actual operating expenses of ATDC. These payments were to be applied to reduce the amount owed to the Harbors Division for losses in revenues by ATDC prior to July 1, 2004. The balance owed to the Harbors Division by ATDC under this Amendment as of June 30, 2015 and 2014 was approximately \$3,761,000 and is included in notes receivable, net of an allowance for doubtful accounts for the entire amount, in the accompanying statements of net position. In addition, the Harbors Division collected \$387,000 from ATDC at June 30, 2014 for losses in revenues due under the Amendment.

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

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



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

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

**16. Kapalama Land Development**

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

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

Plans for the future development of the KMR site will involve the creation of a new cargo container yard and vessel berthing piers. This project is a key priority under the Harbor's New Day Work Plan. The Federal Aviation Administration (FAA) review of the matter led to findings that the use of airport funds towards the purchase of KMR did not represent a permitted use of airport revenue. If Airports Division could not be provided with an equitable amount of land equal to its \$8.2 million investment, the FAA considered the \$8.2 million to be a loan. Due to the importance of the KMR site in serving maritime interests, both divisions and the FAA reached an agreement for the Harbors Division to pay approximately \$9,603,000, of which \$8,191,000 was capitalized as land and improvements, and the remaining balance recorded as interest expense. The Harbors Division paid Airports Division these amounts owed in September 2011. On November 13, 2015, the Harbors Division initiated action to obtain an Executive Order for the set aside of the 21.2 acre KMR parcel.

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Both divisions continue discussions to resolve the use of approximately 11.344 acres of ceded lands owned by the Airports Division near the KMR site of which a portion is planned for inclusion into the KMR container yard development.

**17. Arbitrage**

The Harbors Division is required to annually calculate rebates to the U.S. Treasury on the Revenue Bonds issued from 1986. In accordance with the requirements of Section 148 of Internal Revenue Code of 1986, as amended, rebates are calculated by bond series based on the amount by which the cumulative amount of investment income exceeds the amount that would have been earned had funds been invested at the bond yield. In the opinion of management, rebates payable as of June 30, 2015 and 2014, if any, are not material to the financial statements. Accordingly, no rebates payable have been recorded in the accompanying financial statements.

**18. Commitments and Contingencies**

*Construction and Other Contracts*

The Harbors Division is committed under contracts awarded for construction and other services. These commitments amounted to approximately \$102,689,000 and \$88,984,000 at June 30, 2015 and 2014, respectively.

*Accumulated Sick Leave Pay*

Employees earn sick leave credits at the rate of 14 hours for each month of service depending on the employee's hire date. Unused sick leave may be accumulated without limitation and is not convertible to pay upon termination of employment. Accordingly, no liability for sick pay is recorded. However, for public employees who retire or leave government service in good standing with sixty days or more of unused sick leave, the unused sick leave is converted to additional retirement service credit at the rate of one additional month of service for each 20 days of unused sick leave. The accumulated sick leave liabilities as of June 30, 2015 and 2014 were approximately \$5,861,000 and \$5,602,000, respectively.

*Environmental Issues*

*Iwilei District Participating Parties*

The Harbors Division is subject to laws and regulations relating to the protection of the environment. The Harbors Division has been identified by the State Department of Health as a potentially responsible party for petroleum contamination in the Honolulu Harbor/Iwilei area.

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Pursuant thereto, the Harbors Division entered into a voluntary agreement with the Department of Health and other third parties to share in the responsibility for the investigation and potential remediation of petroleum contamination in the Iwilei District. This group of potentially responsible parties, known as the Iwilei District Participating Parties (IDPP), has conducted various investigations to determine potential contamination in the Iwilei area from 1997 to present, which investigations have determined the existence of petroleum contamination at various locations. The remediation alternative selected involves the management of the contamination in-place with limited extraction, plume monitoring, active institutional controls including education/awareness and outreach of landowners, potential developers and utility operators, and reimbursement of future incremental project costs attributable to the contamination. However, the project has not yet advanced to the stage where total costs to the IDPP can reasonably be estimated due to: (1) the extent of the environmental impact, (2) the undetermined allocation among the potentially responsible parties, and (3) the continued discussion with the regulatory authorities. Although it is not possible to reasonably estimate the Harbors Division cost liability until these items have been resolved, the Harbors Division, in accordance with GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations* (GASB 49), accrued only for the estimated cost of the studies and investigations allocated to the Harbors Division of approximately \$2,529,000 as of June 30, 2015.

*Environmental Protection Agency*

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

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

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

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of the Consent Decree. The Consent Decree was entered on November 5, 2014 and payments of \$600,160 were remitted accordingly to each party.

Harbors Division entered into an agreement with Weston Solutions, Inc., an international environmental consulting firm, to assist in negotiating the Compliance Measures for a cost of approximately \$600,000, which was amended during fiscal year 2015 to \$900,000, of which approximately \$617,000 has been paid as of June 30, 2015. The Harbors Division has also entered into an agreement with EnviroServices and Training Center LLC, a Hawaii environmental consulting firm, to assist the Harbors Division in implementing the Compliance Measures at a cost of approximately \$400,000 of which approximately \$214,000 has been paid as of June 30, 2015.

***Litigation***

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

**19. Subsequent Events**

The Harbors Division executed an energy savings performance contract on September 17, 2015 that provides for the installation of energy conservation measures (ECM) at selected Harbors Division locations. The contractor executed a guarantee of the energy cost savings that should result from these ECMs. The project costs for this contract are funded by a tax-exempt lease bearing an annual interest rate of 2.74%. Payments for this lease are deferred for a two-year period matching the period to construct or to install the ECMs.

The Harbors Division has evaluated subsequent events from the statements of net position date through December 29, 2015, the date at which the financial statements were available to be issued, and determined that there are no other items to disclose.

**REQUIRED SUPPLEMENTARY INFORMATION (UNAUDITED)**

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Required Supplementary Information (Unaudited)

Schedule of the Harbors Division's Proportionate Share of the State's Net Pension Liability

June 30, 2015

Harbors Division's proportion of the State's net pension liability	0.46%
Harbors Division's proportionate share of the State's net pension liability	\$ 21,594,854
Harbors Division's covered-employee payroll	\$ 10,746,619
Harbors Division's proportionate share of the State's net pension liability as a percentage of its covered-employee payroll	200.95%
Plan fiduciary net position as a percentage of total pension liability	63.92%

**Note to Schedule**

The Harbors Division, as a division of the State Department of Transportation, is required to recognize a liability for its proportionate share of the State's net pension liability. The Harbors Division recognizes pension expense and reports deferred outflows of resources and deferred inflows of resources related to pension for its proportionate share of the State's pension expense and deferred outflows of resources and deferred inflows of resources related to pension.

The schedule presents information to illustrate changes in the Harbors Division's proportionate share of the State's net pension liability over a ten-year period when the information is available.

*See accompanying independent auditors' report.*

## **OTHER SUPPLEMENTARY INFORMATION**

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Cash and Cash Equivalents of the Public Undertaking

June 30, 2015

Unrestricted cash and cash equivalents	<u>\$ 204,477,053</u>
Restricted cash and cash equivalents:	
For construction—revenue bonds	111,761,268
For revenue bond debt service payments	22,794,796
For cash reserve requirement for Series A of 2010 revenue bonds	11,455,033
For revenue bond harbors reserve and contingency account	10,897,658
For construction—special purpose funds	39,337,627
For security deposits	1,939,171
For risk management	697,660
	<u>198,883,213</u>
	<u>\$ 403,360,266</u>
With Director of Finance, State of Hawaii	\$ 402,931,756
On hand	428,510
	<u>\$ 403,360,266</u>

*See accompanying independent auditors' report.*



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Revenue Bonds of the Public Undertaking

June 30, 2015

	<b>Final Redemption Date</b>	<b>Interest Rate</b>	<b>Original Amount of Issue</b>	<b>Balance at June 30, 2015</b>		
				<b>Current</b>	<b>Noncurrent</b>	<b>Total</b>
Issue of 2004	January 1, 2024	2.50-6.00%	\$ 52,030,000	\$ 1,580,000	\$ 16,195,000	\$ 17,775,000
Issue of 2006	January 1, 2031	4.00-5.25%	96,570,000	3,085,000	71,625,000	74,710,000
Issue of 2007	July 1, 2027	4.25-5.50%	51,645,000	2,000,000	34,000,000	36,000,000
Issue of 2010	July 1, 2040	3.00-5.75%	201,390,000	6,680,000	179,940,000	186,620,000
Issue of 2013	July 1, 2029	3.25%	23,615,000	825,000	21,610,000	22,435,000
			<u>\$ 425,250,000</u>	<u>\$ 14,170,000</u>	<u>\$ 323,370,000</u>	<u>\$ 337,540,000</u>

*See accompanying independent auditors' report.*

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Income from Operations Before Depreciation

Year Ended June 30, 2015

	District										Total
	Oahu		Hawaii		Maui		Kauai				
	Statewide	Honolulu	Kalaheo	Hilo	Kawaihae	Kahului	Kaunakakai	Kaunapali	Nawiliwili	Port Allen	
Operating revenues, net											
Services:											
Wharfage	\$ -	\$ 64,775,315	\$ 2,602,393	\$ 2,577,554	\$ 3,629,981	\$ 5,891,913	\$ 241,758	\$ 298,809	\$ 2,519,580	\$ -	\$ 82,537,303
Pax debark/embark	-	2,631,451	-	1,781,098	4,004	885,463	4,193	-	1,277,530	-	6,583,739
Dockage	-	3,212,396	643,274	263,869	75,963	446,346	45,987	7,970	381,966	2,825	5,080,596
Demurrage	-	1,024,741	-	351,045	97,597	162,422	-	-	42,321	-	1,678,126
Mooring charges	-	589,946	-	17,998	42,105	993	5,846	-	-	561,283	1,218,171
Port entry	-	634,121	123,893	76,003	38,665	90,606	11,117	7,364	73,542	2,695	1,058,006
Cleaning charges	-	236,592	-	-	-	-	-	-	486	162	237,240
Other services	-	11,566	417	583	11,390	2,450	-	-	2,950	12,562	41,918
Total services	-	73,116,128	3,369,977	5,068,150	3,899,705	7,480,193	308,901	314,143	4,298,375	579,527	98,435,099
Rentals:											
Wharf space and land	-	10,035,445	1,915,265	66,290	381,311	205,593	14,709	300	379,469	227,746	13,226,128
Storage	-	3,424,287	52,340	258,353	282,333	253,334	1,764	-	172,211	10,430	4,455,052
Automobile parking	-	864,282	2,130	98,568	6,994	125,238	2,044	-	129,448	16,232	1,244,936
Pipeline water	-	94,446	5,561	39,397	471	70,941	-	-	77,982	-	288,798
Other pipeline	-	976,174	1,416,332	689,762	43,706	737,356	23,063	-	169,873	142,253	4,198,519
Total rentals	-	15,394,634	3,391,628	1,152,370	714,815	1,392,462	41,580	300	928,983	396,661	23,413,433
Others:											
Sale of utilities	-	339,332	108,649	43,332	295	93,735	-	-	73,670	8,030	667,043
Miscellaneous	-	637,079	3,340	7,801	1,872	23,178	19,250	-	49	1,193	693,762
Total others	-	976,411	111,989	51,133	2,167	116,913	19,250	-	73,719	9,223	1,360,805
Total operating revenues	-	89,487,173	6,873,594	6,271,653	4,616,687	8,989,568	369,731	314,443	5,301,077	985,411	123,209,337
Operating expenses before depreciation and amortization:											
Harbor operations	7,947,438	8,028,386	458,719	469,697	387,986	584,306	13,906	4,932	608,714	36,867	18,540,951
Personnel services	7,291,909	7,094,640	196,465	823,667	80,591	1,083,738	49,293	-	1,015,197	51,878	17,687,378
State of Hawaii, surcharge for central service expenses	3,811,197	-	-	-	-	-	-	-	-	-	3,811,197
General administration	2,445,302	47,070	285	24,915	6,023	132,191	31,220	-	20,740	2,283	2,710,029
Maintenance	474,748	1,016,325	13,757	81,437	105,784	188,652	98,472	9,658	252,942	1,047	2,242,822
Department of Transportation, general administration expenses	1,780,600	-	-	-	-	-	-	-	-	-	1,780,600
Fireboat operations	-	32,604	-	-	-	-	-	-	-	-	32,604
Subtotal	23,751,194	16,219,025	669,226	1,399,716	580,384	1,988,887	192,891	14,590	1,897,593	92,075	46,805,581
Allocation of statewide expenses (1)	(23,751,194)	17,250,536	1,325,030	1,208,993	889,964	1,732,929	71,273	60,616	1,021,894	189,959	-
Total operating expenses before depreciation and amortization	-	33,469,561	1,994,256	2,608,709	1,470,348	3,721,816	264,164	75,206	2,919,487	282,034	46,805,581
Income from operations before depreciation and amortization	\$ -	\$ 56,017,612	\$ 4,879,338	\$ 3,662,944	\$ 3,146,339	\$ 5,267,752	\$ 105,567	\$ 239,237	\$ 2,381,590	\$ 703,377	\$ 76,403,756

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

See accompanying independent auditors' report.

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

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

Year Ended June 30, 2015

Net revenues, as defined by the 1997 Certificate:

Operating income before depreciation and amortization	\$ 76,403,756
Add:	
Interest income	1,453,840
State of Hawaii, surcharge for central service expenses	3,811,197
Cash available in the harbor reserve and contingency account	10,897,658
	\$ 92,566,451

Harbor revenue bond debt service requirements under the 1997 Certificate, including minimum sinking fund payments	\$ 31,175,891
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Ratio of net revenues to harbor revenue bond debt service requirements	2.97
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*See accompanying independent auditors' report.*

**PART III**

**INTERNAL CONTROL AND COMPLIANCE SECTION**

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

The Auditor  
State of Hawaii:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the statements of net position of the Harbors Division, Department of Transportation, State of Hawaii (the Harbors Division), as of June 30, 2015 and 2014, and the related statements of revenues, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to financial statements, which collectively comprise the Harbors Division's basic financial statements, and have issued our report thereon dated December 29, 2015.

**Internal Control over Financial Reporting**

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

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

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

## **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Harbors Division's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

## **Purpose of this Report**

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

**KKDL LLC**

Honolulu, Hawaii  
December 29, 2015