

**FINANCIAL AUDIT OF THE  
STATE OF HAWAII  
DEPARTMENT OF HEALTH  
WATER POLLUTION CONTROL REVOLVING FUND**

Fiscal Year Ended June 30, 2016

**Submitted by  
The Auditor  
State of Hawaii**



**STATE OF HAWAII  
DEPARTMENT OF HEALTH  
WATER POLLUTION CONTROL REVOLVING FUND**

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**STATE OF HAWAII  
DEPARTMENT OF HEALTH  
WATER POLLUTION CONTROL REVOLVING FUND**

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**PART I**  
**FINANCIAL SECTION**

## INDEPENDENT AUDITOR'S REPORT

To the Auditor  
State of Hawaii

### Report on the Financial Statements

We have audited the accompanying financial statements of the State of Hawaii, Department of Health, Water Pollution Control Revolving Fund (the "Fund"), as of and for the fiscal year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the Fund's basic financial statements as listed in the table of contents.

### Management's Responsibility for the Financial Statements

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

### Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's 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 reasonable 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 Fund as of June 30, 2016, and the changes in its financial position and its cash flows for the fiscal year then ended in accordance with accounting principles generally accepted in the United States of America.

### **Emphasis of Matter**

As discussed in Note B, the financial statements of the Fund, 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 proprietary fund type activities of the State of Hawaii and the State of Hawaii, Department of Health that are attributable to the transactions of the Fund. They do not purport to, and do not, present fairly the respective financial position of the State of Hawaii or the State of Hawaii, Department of Health as of June 30, 2016, the respective changes in its financial position, or its cash flows for the fiscal year then ended in accordance 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*

Management has omitted the management's discussion and analysis, the schedule of proportionate share of the net pension liability, the schedule of contributions, and the schedule of funding progress that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

#### *Supplementary Information*

Our audit was conducted for the purpose of forming an opinion on the Fund's basic financial statements. The supplementary information on pages 32 through 36 is presented for purposes of additional analysis and is not a required part of the basic financial statements.

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

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

In accordance with *Government Auditing Standards*, we have also issued our report dated December 9, 2016 on our consideration of the Fund'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 Fund's internal control over financial reporting and compliance.

N&K CPAs, Inc.

Honolulu, Hawaii  
December 9, 2016

**State of Hawaii**  
**Department of Health**  
**Water Pollution Control Revolving Fund**  
**STATEMENT OF NET POSITION**  
**June 30, 2016**

**ASSETS AND DEFERRED OUTFLOWS OF RESOURCES**

Current assets	
Equity in cash and cash equivalents and investments in State Treasury	\$ 154,394,787
Loan fees receivable	328,021
Accrued interest on loans	387,824
Other accrued interest	229,871
Due from State Treasury	30,265
Current maturities of loans receivable	<u>29,233,656</u>
Total current assets	184,604,424
Loans receivable, net of current maturities	321,251,818
Capital assets, net of accumulated depreciation	<u>2,629</u>
Total assets	505,858,871
Deferred outflows of resources related to pensions	<u>445,645</u>
Total assets and deferred outflows of resources	<u>\$ 506,304,516</u>

See accompanying notes to the financial statements.



**State of Hawaii**  
**Department of Health**  
**Water Pollution Control Revolving Fund**  
**STATEMENT OF NET POSITION (Continued)**  
**June 30, 2016**

**LIABILITIES, DEFERRED INFLOWS OF RESOURCES AND NET POSITION**

Current liabilities	
Accounts payable and other accrued liabilities	\$ <u>207,868</u>
Total current liabilities	207,868
Accrued vacation, net of current portion	210,655
Net pension liability	2,552,978
Other postemployment benefits	<u>1,526,838</u>
Total liabilities	4,498,339
Deferred inflows of resources related to pensions	84,727
Net position	
Net investment in capital assets	2,629
Restricted - expendable	<u>501,718,821</u>
Total net position	<u>501,721,450</u>
Total liabilities, deferred inflows of resources and net position	\$ <u><u>506,304,516</u></u>

See accompanying notes to the financial statements.

**State of Hawaii**  
**Department of Health**  
**Water Pollution Control Revolving Fund**  
**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION**  
**Fiscal Year Ended June 30, 2016**

<b>OPERATING REVENUES</b>	
Interest income from loans	\$ 1,542,935
Administrative loan fees	<u>1,585,917</u>
Total operating revenues	3,128,852
<b>OPERATING EXPENSES</b>	
Administrative	2,343,537
Principal forgiveness for ARRA	7,438,075
Principal forgiveness for SRF	<u>10,102</u>
Total operating expenses	<u>9,791,714</u>
Operating loss	(6,662,862)
<b>NONOPERATING REVENUES</b>	
State contributions	2,172,000
Federal contributions	23,058,155
Other interest income	<u>928,511</u>
Total nonoperating revenues	<u>26,158,666</u>
Change in net position	19,495,804
<b>NET POSITION</b>	
Beginning of fiscal year	<u>482,225,646</u>
End of fiscal year	\$ <u>501,721,450</u>

See accompanying notes to the financial statements.

**State of Hawaii**  
**Department of Health**  
**Water Pollution Control Revolving Fund**  
**STATEMENT OF CASH FLOWS**  
**Fiscal Year Ended June 30, 2016**

**CASH FLOWS FROM OPERATING ACTIVITIES**

Payments to employees	\$ (1,736,976)
Payments to vendors	<u>(326,144)</u>
Net cash used in operating activities	(2,063,120)

**CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES**

State contributions	2,172,000
Federal contributions	<u>22,878,235</u>
Net cash provided by noncapital financing activities	25,050,235

**CASH FLOWS FROM INVESTING ACTIVITIES**

Principal repayments on loans	28,162,154
Disbursement of loan proceeds	(44,100,102)
Interest income from loans	1,574,845
Administrative loan fees	1,521,942
Other interest income	<u>864,141</u>
Net cash used in investing activities	<u>(11,977,020)</u>

Net increase in cash	<u>11,010,095</u>
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**EQUITY IN CASH AND CASH EQUIVALENTS AND INVESTMENTS IN STATE TREASURY**

Beginning of fiscal year	<u>143,384,692</u>
End of fiscal year	<u>\$ 154,394,787</u>

See accompanying notes to the financial statements.

**State of Hawaii  
Department of Health  
Water Pollution Control Revolving Fund  
STATEMENT OF CASH FLOWS (Continued)  
Fiscal Year Ended June 30, 2016**

<b>Reconciliation of operating loss to net cash used in operating activities</b>	
Operating loss	\$ (6,662,862)
Adjustment to reconcile operating loss to net cash used in operating activities	
Depreciation	8,752
Principal forgiveness for ARRA	7,438,075
Principal forgiveness for SRF	10,102
Interest income from loans	(1,542,935)
Administrative loan fees	(1,585,917)
Pension expense	259,163
In-kind contribution from the Environmental Protection Agency	195,664
Change in assets, deferred outflows of resources, liabilities, and deferred inflows of resources	
Due from State Treasury	(2,152)
Accounts payable and other accrued liabilities	(47,703)
Net deferred outflows / inflows of resources related to pensions	(253,006)
Other postemployment benefits	<u>119,699</u>
Net cash used in operating activities	<u>\$ (2,063,120)</u>
 <b>Disclosure of noncash investing, capital, and financing activities</b>	
In-kind contribution from the Environmental Protection Agency	\$ 195,664

See accompanying notes to the financial statements.

**State of Hawaii**  
**Department of Health**  
**Water Pollution Control Revolving Fund**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2016**

**NOTE A - ESTABLISHMENT AND PURPOSE OF THE FUND**

The Clean Water Act of 1987 (the "Act") provides for the U.S. Environmental Protection Agency ("EPA") to make grants to states for the purpose of making loans to finance the construction of publicly owned wastewater treatment works, implementation of a non-point source pollution control management program, and implementation of an estuary conservation and management program. Under the Act, the State of Hawaii ("State") was eligible to receive up to \$72 million in federal capitalization grants. Although the Act expired on September 30, 1995, the State continues to receive capitalization grants from the EPA.

In 1988, the State Legislature established the Water Pollution Control Revolving Fund (the "Fund") to implement the federal loan program. The Fund is administered by the Wastewater Branch, Environmental Management Division of the State of Hawaii, Department of Health (the "Department"). The Fund's primary purpose is to provide loans in perpetuity to county and State agencies for the construction of wastewater treatment facilities. Such loans may be at or below market interest rates and must be fully amortized within twenty years. Prior to July 1, 2015, the first repayment of principal and interest occurs no later than one year after the notice to proceed for construction or the final agreement date, whichever is later. Beginning July 1, 2015, the first repayment of principal and interest occurs no later than one year after the final loan disbursement, one year after the project completion date or three years after the final agreement date, whichever is earliest.

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES**

- (1) ***Basis of Presentation*** - The accompanying financial statements are intended to present the financial position, results of operations and cash flows of only that portion of the State and Department that is attributable to the transactions of the Fund and do not purport to present the financial position, results of operations or cash flows of the State or Department.

The financial statements of the Fund are presented using the economic resources measurement focus and the accrual basis of accounting in accordance with accounting principles prescribed by the Governmental Accounting Standards Board ("GASB") for proprietary funds.

Revenues are reported when earned and expenses are reported when a liability is incurred, regardless of the timing of the related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services or goods in connection with a proprietary fund's principal ongoing operations. Revenues

**State of Hawaii**  
**Department of Health**  
**Water Pollution Control Revolving Fund**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2016**

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)**

and expenses not meeting this definition are reported as nonoperating revenues and expenses. The principal operating revenues of the Fund are interest income and administrative loan fees on loans made to county governments. Federal grants, State matching funds and interest income from sources other than loans are reported as nonoperating revenues. Principal forgiveness for loans and ARRA advances are reported as operating expenses.

- (2) **Use of Estimates** - In preparing financial statements in conformity with accounting principles generally accepted in the United States, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The most significant estimates relate to the allowance for doubtful accounts, depreciable lives of capital assets, and the pensions and other postemployment benefits (“OPEB”) liability.
- (3) **Equity in Cash and Cash Equivalents and Investments in State Treasury** - All monies of the Fund are held in the State Treasury. The State Director of Finance is responsible for the safekeeping of cash in the State Treasury in accordance with State laws. The Director of Finance may invest any monies of the State, which in the Director’s judgment, are in excess of the amounts necessary for meeting the immediate requirements of the State. Effective August 1, 1999, cash is pooled with funds from other State agencies and departments and deposited into approved financial institutions or in the State Treasury Investment Pool System. Funds in the investment pool accrue interest based on the average weighted cash balances of each account.

At June 30, 2016, information relating to the types, insurance, collateral, and related interest rate, credit and custodial risks of funds deposited with the State Treasury was not available since such information is determined on a statewide basis and not for individual departments. Cash deposits with the State Treasury are either federally insured or collateralized with obligations of the State or the United States of America. 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.

- (4) **ARRA Advances** - The Fund received American Recovery and Reinvestment Act (“ARRA”) stimulus money that was used to provide construction grants with no interest or loan fees and 100 percent principal forgiveness upon completion of approved projects. The Fund is allowed to use up to 4 percent of the ARRA funds for administrative costs, and has elected to use \$600,000 for administrative costs, with the remaining amount committed to grants. ARRA funds provided to counties have been classified as “ARRA Advances” on the statement of net position upon disbursement. The ARRA advances will be completely forgiven and expensed once all the conditions and compliance requirements have been satisfied by the counties. If conditions and compliance requirements are not met, the grants will convert to loans, requiring repayment of principal, interest and loan fees.

**State of Hawaii**  
**Department of Health**  
**Water Pollution Control Revolving Fund**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2016**

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)**

- (5) **Loans Receivable** - Loans made to counties are funded by federal capitalization grants, State matching funds, repayments and investment interest income. Loan funds are disbursed to local agencies as they expend for the purposes of the loan and request reimbursement from the Fund. Interest is calculated from the date that loan funds are disbursed. After the final disbursement has been made, the payment schedule identified in the loan agreement is adjusted for the actual amounts disbursed and interest accrued during the project period. The capitalization grants for federal fiscal years 2010 through 2014 allow for portions of loans to be forgiven upon satisfaction of certain requirements.
- (6) **Administrative Loan Fees** - The administrative loan fee program pays for the Fund's administration, including employee salaries and benefits. The program applies an administrative fee to all loans as provided for in Chapter 11-65 of the Hawaii Administrative Rules.
- (7) **Capital Assets** - Capital assets are defined as those assets with estimated useful lives greater than one year and with an acquisition cost greater than \$5,000. Such assets are recorded at cost or, if donated, at fair value at the date of donation. Depreciation of capital assets is provided for on a straight-line basis over the estimated useful lives (5-7 years) of the respective assets.
- (8) **Accrued Vacation** - Vacation pay is accrued as earned by employees. Vacation pay can accumulate at the rate of one and three-quarters working days for each month of service up to 720 hours at calendar year-end and is convertible to pay upon termination of employment. The current portion of the accrued vacation balance is included in the accounts payable and other accrued liabilities balance.
- (9) **Accumulated Sick Leave** - Sick leave accumulates at the rate of one and three-quarters working days for each month of service without limit, but may be taken only in the event of illness and is not convertible to pay upon termination of employment. However, a State employee who retires or leaves government service in good standing with 60 days or more of unused sick leave is entitled to additional service credit in the Employees' Retirement System of the State of Hawaii ("ERS"). At June 30, 2016, accumulated sick leave was approximately \$1,144,200.
- (10) **Net Position** - The Fund's net position is classified into two net position categories.
- Net investment in capital assets* consists of capital assets, net of accumulated depreciation and outstanding debt attributable to the acquisition, construction or improvement of those assets.

**State of Hawaii**  
**Department of Health**  
**Water Pollution Control Revolving Fund**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2016**

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)**

*Restricted-expendable* consists of restricted assets less liabilities whose use by the Fund are subject to externally-imposed stipulations that can be fulfilled by actions of the Fund pursuant to those stipulations or that expire by the passage of time.

- (11) **Administrative Costs** - The accompanying financial statements do not reflect certain administrative costs, which are paid for by other sources of funding from the Department. These costs include the Department's and State's overhead costs which the Department does not assess to the Fund, since they are not practical to determine.
- (12) **Fund Accounts** - The Fund consists of State revolving fund ("SRF") and State activity. The SRF activity exclusively consists of federal capitalization grant loans, state matching contributions, federal administration, Water Resources Reform and Development Act administrative funds, principal loan repayments, and interest from loans and other earning assets. The State activity consists of the State loan funds, State grant funds, non-point source funds, and State loan administration fees.
- (13) **Expenses** - The statement of revenues, expenses and changes in fund net position presents expenses on a functional basis. The natural classifications of expenses are presented in the supplemental schedule of operating expenses.
- (14) **Deferred Outflows of Resources and Deferred Inflows of Resources** - Deferred outflows of resources represent a consumption of net position that applies to a future period and will not be recognized as an outflow of resources (expense) until that time. Deferred inflows of resources represent an acquisition of net position that applies to a future period and will not be recognized as an inflow of resources (revenue) until that time.
- (15) **Pensions** - For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of 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. Investments are reported at their fair value.
- (16) **New Accounting Pronouncements** - The Government Accounting Standards Board (the "GASB") issued Statement No. 72, *Fair Value Measurement and Application*. The Statement will enhance comparability of financial statements among governments by requiring measurement of certain assets and liabilities at fair value using a consistent and more detailed definition of fair value and accepted valuation techniques. The Statement will also enhance fair value application guidance and disclosure. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2015. Management has adopted this Statement as presented in the Fund's financial statements.



**State of Hawaii**  
**Department of Health**  
**Water Pollution Control Revolving Fund**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2016**

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)**

The GASB issued Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets that are not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*. The Statement establishes accounting and financial reporting requirements by employers and governmental nonemployer contributing entities for pensions that are not within the scope of Statement No. 68. The requirements of this Statement are effective for fiscal years beginning after June 15, 2015, except those provisions that address employers and governmental nonemployer contributing entities for pensions that are not within the scope of Statement No. 68, which are effective for fiscal years beginning after June 15, 2016. Management has adopted the applicable requirements of this Statement as presented in the Fund's financial statements.

The GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. The Statement replaces GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*. The Statement will require the liability of employers for defined benefit OPEB to be measured as the portion of the present value of projected benefit payments to be provided to current active and inactive employees that is attributed to those employees' past periods of service, less the amount of the OPEB plan's fiduciary net position. The requirements of this Statement are effective for fiscal years beginning after June 15, 2017. Management has not yet determined the effect this Statement will have on the Fund's financial statements, but anticipates that it will materially impact the Fund's financial statements.

The GASB issued Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. The Statement reduces the generally accepted accounting principles ("GAAP") to two categories of authoritative GAAP. The first category of authoritative GAAP consists of GASB Statements of Governmental Accounting Standards. The second category includes GASB Implementation Guides, GASB Technical Bulletins, and guidance from the American Institute of Certified Public Accountants that is cleared by the GASB. The requirements of this Statement are effective for reporting periods beginning after June 15, 2015. Management has adopted the applicable requirements of this Statement as presented in the Fund's financial statements.

The GASB issued Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*. The Statement amends the scope and applicability of Statement No. 68 to exclude certain pensions provided to employees of state or local governmental employers through a cost-sharing multiple-employer defined benefit pension. The requirements of this Statement are effective for reporting periods beginning after December 15, 2015. Management has not yet determined the effect this Statement will have on the Fund's financial statements.

**State of Hawaii**  
**Department of Health**  
**Water Pollution Control Revolving Fund**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2016**

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)**

The GASB issued Statement No. 79, *Certain External Investment Pools and Pool Participants*. The Statement addresses how certain state and local government external investment pools - and participants in those pools - may measure and report their investments. The requirements of this Statement are effective for reporting periods beginning after June 15, 2015, except for certain provisions, which are effective for reporting periods beginning after December 15, 2015. Management has determined that this Statement does not have a material effect on the Fund's financial statements.

The GASB issued Statement No. 82, *Pension Issues an amendment of GASB Statements No. 67, No. 68, and No. 73*. This Statement addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. The requirements of this Statement are effective for reporting periods beginning after June 15, 2016, except for the requirements of this Statement for the selection of assumptions in a circumstance in which an employer's pension liability is measured as of a date other than the employer's most recent fiscal year-end. In that circumstance, the requirements for the selection of assumptions are effective for that employer in the first reporting period in which the measurement date of the pension liability is on or after June 15, 2017. Management has not yet determined the effect this Statement will have on the Fund's financial statements.

**NOTE C - LOANS RECEIVABLE**

At June 30, 2016, loans receivable were as follows:

Twenty-two loans receivable from the City & County of Honolulu; due in annual or semi-annual payments, including interest ranging from 0.00% to 3.02%, commencing not later than one year after project completion, notice to proceed, final loan disbursement, or three years after loan agreement date. Final payment is due not later than twenty years after project completion. \$ 253,515,981

Five loans receivable from the County of Hawaii; due in annual or semi-annual payments, including interest ranging from 0.25% to 0.50%, commencing not later than one year after project completion, notice to proceed, final loan disbursement, or three years after loan agreement date. Final payment is due not later than twenty years after project completion. 27,463,251

Balance carried forward \$ 280,979,232

**State of Hawaii  
Department of Health  
Water Pollution Control Revolving Fund  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2016**

**NOTE C - LOANS RECEIVABLE (Continued)**

Balance brought forward	\$ 280,979,232
Twenty-two loans receivable from the County of Maui; due in annual or semi-annual payments, including interest ranging from 0.25% to 2.60%, commencing not later than one year after project completion, notice to proceed, final loan disbursement, or three years after loan agreement date. Final payment is due not later than twenty years after project completion.	46,801,265
Nine loans receivable from the County of Kauai; due in semi-annual or quarterly payments, including interest ranging from 0.25% to 2.13%, commencing not later than one year after project completion, notice to proceed, final loan disbursement, or three years after loan agreement date. Final payment is due not later than twenty years after project completion.	<u>22,704,977</u>
	350,485,474
Less: current maturities	<u>29,233,656</u>
	<b>\$ <u>321,251,818</u></b>

Loans are expected to mature at various dates through 2035. The scheduled principal payments on loans maturing in subsequent fiscal years are as follows:

<u>Fiscal Year Ending June 30,</u>	<u>Amount</u>
2017	\$ 29,233,656
2018	28,986,899
2019	27,984,752
2020	26,510,568
2021	26,190,558
Thereafter	<u>211,579,041</u>
	<b>\$ <u>350,485,474</u></b>

Management believes that all loans will be repaid according to the loan terms or portions will be forgiven upon satisfaction of certain requirements; accordingly, no provision for uncollectible amounts has been recorded.

In fiscal year 2016, \$7,448,177 in loans were forgiven. All loans forgiven were in accordance with the required conditions.

At June 30, 2016, \$47,482,850 and \$60,700,684 were committed to be loaned to the County of Hawaii and County of Maui, respectively, under existing loan agreements. As of the same date, \$32,333,482 and \$18,600,000 were committed to be loaned to the City and County of Honolulu and County of Kauai, respectively, under existing loan agreements.

**State of Hawaii**  
**Department of Health**  
**Water Pollution Control Revolving Fund**  
**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2016**

**NOTE D - CONTRIBUTED CAPITAL**

The Fund is capitalized by grants from the EPA and matching funds from the State. The following summarizes the EPA capitalization grants and ARRA funds awarded, amounts drawn on each grant, and the balances available for future loans at June 30, 2016:

Budget Period	Amount	Total Draws at June 30, 2015	EPA Draws	Total 2016 Cash Draws	Funds Available
09/30/11 - 06/30/18	\$ 11,436,000	\$ 11,372,362	--	\$ 63,638	\$ --
09/28/12 - 06/30/19	10,946,000	9,963,902	--	982,098	--
09/30/13 - 06/30/20	10,341,000	9,941,440	--	399,560	--
10/01/14 - 06/30/21	10,859,000	61	--	10,858,939	--
10/01/15 - 06/30/19	<u>10,804,000</u>	--	<u>230,000</u>	<u>10,574,000</u>	--
	<u>\$ 54,386,000</u>	<u>\$ 31,277,765</u>	<u>\$ 230,000</u>	<u>\$ 22,878,235</u>	<u>\$ --</u>

The State is required to match 20 percent of the estimated amount of the grant from the EPA and does so in the year that the capitalization grant is awarded. The State is not required to match funds for ARRA awards. Through June 30, 2016, the Fund was in compliance with the 20 percent State matching requirement. The required State match through June 30, 2016 approximated \$56.8 million, of which the entire amount has been utilized.

**NOTE E - CAPITAL ASSETS**

Capital asset activity for the fiscal year ended June 30, 2016 was as follows:

	Balance at June 30, 2015	Additions	Retirements/ Disposals	Balance at June 30, 2016
Equipment	\$ 84,518	\$ --	\$ --	\$ 84,518
Accumulated depreciation	<u>(73,137)</u>	<u>(8,752)</u>	<u>--</u>	<u>(81,889)</u>
	<u>\$ 11,381</u>	<u>\$ (8,752)</u>	<u>\$ --</u>	<u>\$ 2,629</u>

**NOTE F - ACCRUED VACATION**

The changes to the accrued vacation liability during 2016 were as follows:

Balance at July 1, 2015	\$ 295,440
Increase	100,810
Decrease	<u>(105,395)</u>
Balance at June 30, 2016	290,855
Less: Current portion	<u>(80,200)</u>
Noncurrent portion	<u>\$ 210,655</u>

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**NOTE G - EMPLOYEE BENEFIT PLANS**

**(1) Pension Plan**

**Plan Description** - Generally, all full-time employees of the State and counties are required to be members of the ERS, a cost-sharing multiple-employer defined benefit pension plan that administers the State's pension benefits program. Benefits, eligibility, and contribution requirements are governed by HRS Chapter 88 and can be amended through legislation. The ERS issues publicly available annual financial reports that can be obtained at ERS' website: <http://www.ers.ehawaii.gov>.

**Benefits Provided** - The ERS Pension Trust is comprised of three pension classes for membership purposes and considered to be a single plan for accounting purposes since all assets of the ERS may legally be used to pay the benefits of any of the ERS members or beneficiaries. The ERS provides retirement, disability and death benefits with three membership classes known as the noncontributory, contributory and hybrid retirement classes. The three classes provide a monthly retirement allowance equal to the benefit multiplier (generally 1.25% or 2%) multiplied by the average final compensation multiplied by years of credited service. Average final compensation for members hired prior to July 1, 2012 is an average of the highest salaries during any three years of credited service, excluding any salary paid in lieu of vacation for members 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 members hired prior to January 1, 1971. For members hired after June 30, 2012, average final compensation is an average of the highest salaries during any five years of credited service excluding any salary paid in lieu of vacation.

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

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

*Noncontributory Class*

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

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**NOTE G - EMPLOYEE BENEFIT PLANS (Continued)**

*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.

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

*Contributory Class for Members Hired prior to July 1, 2012*

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

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

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

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**NOTE G - EMPLOYEE BENEFIT PLANS (Continued)**

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

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

*Contributory Class for Members Hired After June 30, 2012*

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

Police officers and firefighters' retirement benefits are determined using the benefit multiplier of 2.25% for qualified service, up to a maximum of 80% of average final compensation. Police officers and firefighters with ten years of credited service are eligible to retire at age 60. Police officers and firefighters with five years of credited service are eligible to retire at age 55. Police officers and fire fighters with 25 years of credited service are eligible to retire at any age, provided the last five years is service credited in these occupations.

*Disability and Death Benefits* - Members are eligible for service-related disability benefits regardless of length of service and receive a lifetime pension of 50% of their average final compensation plus refund of contributions and accrued interest. Ten years of credited service is required for ordinary disability. Ordinary disability benefits are 3% 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 officers and firefighters and are payable immediately, without an actuarial reduction, at a minimum of 30% of average final compensation.

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

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**NOTE G - EMPLOYEE BENEFIT PLANS (Continued)**

*Hybrid Class for Members Hired Prior to July 1, 2012*

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

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

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

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

*Hybrid Class for Members Hired After June 30, 2012*

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

*Disability and Death Benefits* - Provisions for disability and death benefits generally remain the same except for ordinary death benefits. Ordinary death benefits are available to employees who were active at time of death with at least ten years of service. Ordinary death benefits consist of a lump sum payment of the member's contributions and accrued interest, or 50% Joint and Survivor lifetime pension if the



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**NOTE G - EMPLOYEE BENEFIT PLANS (Continued)**

member was not eligible for retirement at the time of death but was credited with at least ten years of service and designated one beneficiary, or 100% Joint and Survivor lifetime pension if the member was eligible for retirement at the time of death and designated one beneficiary.

**Contributions** - Contributions are governed by HRS Chapter 88 and may be amended through legislation. The employer rate is set by statute based on the recommendations of the ERS actuary resulting from an experience study conducted every five years. Since July 1, 2005, the employer contribution rate is a fixed percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liabilities. The contribution rates for fiscal year 2016 were 25.00% for police officers and firefighters and 17.00% for all other employees. Contributions to the pension plan from the Fund were \$253,007 for the fiscal year ended June 30, 2016.

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

**Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions** - At June 30, 2016, the Fund reported a liability of \$2,552,978 for its proportionate share of the net pension liability of the State. The net pension liability was measured as of June 30, 2015, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The State's proportion of the net pension liability was based on a projection 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, 2015, the Fund's proportion was 0.0500% which increased from its proportion measured as of June 30, 2014 of 0.0100%.

There were no changes in other assumptions and inputs that affected the measurement of the total pension liability since the prior measurement date other than the investment return assumption. Fiscal year 2016 was the first year of the three-year phase-in of the investment return assumption. The investment return rate decreased beginning in fiscal year 2016 to 7.65% and will continue to decrease to 7.55% in fiscal year 2017 and to 7.50% in fiscal year 2018, and will remain at 7.50% thereafter. There were no other changes between the measurement date, June 30, 2015, and the reporting date, June 30, 2016, that are expected to have a significant effect on the proportionate share of the net pension liability.

**State of Hawaii  
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June 30, 2016**

**NOTE G - EMPLOYEE BENEFIT PLANS (Continued)**

For the year ended June 30, 2016, the Fund recognized pension expense of \$259,163. At June 30, 2016, the Fund reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Differences between expected and actual experience	\$ 477	\$ (69,175)
Changes of assumptions	59,142	--
Net difference between projected and actual earnings on pension plan investments	133,019	--
Changes in proportion and difference between Fund contributions and proportionate share of contributions	--	(15,552)
Fund contributions subsequent to the measurement date	<u>253,007</u>	<u>--</u>
	<u>\$ 445,645</u>	<u>\$ (84,727)</u>

The \$253,007 reported as deferred outflows of resources related to pensions resulting from Fund contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2017. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

<u>Fiscal Year Ending June 30,</u>	<u>Amount</u>
2017	\$ 47,291
2018	47,291
2019	47,291
2020	(37,536)
2021	<u>3,574</u>
Total	<u>\$ 107,911</u>

**Actuarial Assumptions** - The total pension liability in the June 30, 2015 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	7.65% per year, compounded annual including inflation

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**NOTE G - EMPLOYEE BENEFIT PLANS (Continued)**

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 Static Tables. Pre-retirement mortality rates are based on custom tables with RP-2000 rates.

The actuarial assumptions used in the June 30, 2015 valuation were based on the most recent experience study dated December 20, 2010. Between experience studies, the Board of Trustees of the Employees' Retirement System of the State of Hawaii elected to lower the investment return assumption effective with the June 30, 2015 valuation.

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 a 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:

<u>Asset Class</u>	<u>Target Allocation</u>	<u>Long-term Expected Real Rate of Return</u>
Domestic equity	30.0%	8.5%
International equity	26.0%	9.3%
Total fixed income	20.0%	3.1%
Real estate	7.0% *	9.2%
Private equity	7.0% *	11.9%
Real return	5.0% *	6.7%
Covered calls	<u>5.0%</u>	7.7%
	<u>100.0%</u>	

\* The real estate, private equity and real return targets will be the percentage actually invested up to 7.0%, 7.0% and 5.0%, 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.

**Discount Rate** - The discount rate used to measure the net pension liability was 7.65%, a decrease from the 7.75% rate used at the prior measurement date. 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 will be made at statutorily required rates, actuarially determined. Based on those assumptions, the pension

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**NOTES TO FINANCIAL STATEMENTS**  
**June 30, 2016**

**NOTE G - EMPLOYEE BENEFIT PLANS (Continued)**

plan'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 periods of projected benefit payments to determine the total pension liability.

**Sensitivity of the Fund's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate** - The following presents the Fund's proportionate share of the net pension liability calculated using the discount rate of 7.65%, as well as what the Fund's proportionate share of the net pension liability would be if it were calculated using a discount rate that is one percentage point lower (6.65%) or one percentage point higher (8.65%) than the current rate:

	1% Decrease (6.65%)	Discount Rate (7.65%)	1% Increase (8.65%)
Fund's proportionate share of the net pension liability	\$ <u>3,215,318</u>	\$ <u>2,552,978</u>	\$ <u>1,890,637</u>

**Pension Plan Fiduciary Net Position** - The pension plan's fiduciary net position is determined on the same basis used by the pension plan. 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' complete financial statements are available at: <http://www.ers.ehawaii.gov>.

**Payables to the Pension Plan** - At June 30, 2016, the amount payable to the ERS was approximately \$17,000.

**(2) 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 an unforeseeable emergency.

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 NOTES TO FINANCIAL STATEMENTS  
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**NOTE G - EMPLOYEE BENEFIT PLANS (Continued)**

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 has the duty of due care that would be required of an ordinary prudent investor.

**(3) Postemployment Healthcare and Life Insurance Benefits**

The State contributes to the Hawaii Employer-Union Health Benefits Trust Fund ("EUTF"), an agent multiple-employer defined benefit plan. The EUTF was established to provide a single delivery system of health benefits for state and county workers, retirees, and their dependents. The eligibility requirements for retiree health benefits are based on date of hire.

*State Policy* - The actuarial valuation of the EUTF does not provide OPEB information by department or agency. Accordingly, the State's policy on the accounting and reporting for OPEB is to allocate a portion of the State's Annual Required Contribution ("ARC"), interest, and any adjustment to the ARC, to component units and proprietary funds that are reported separately in stand-alone departmental financial statements or in the State's CAFR. The basis for the allocation is the proportionate share of the State's total covered employee headcount by each component unit or proprietary fund for retiree health benefits.

*Annual OPEB Cost* - The components of the allocated annual OPEB cost (annual required contribution, interest on net OPEB obligation, and adjustment to annual required contribution) are insignificant to the Fund's financial statements. The following table shows the allocated annual OPEB cost that has been allocated to the Fund for the year ended June 30, 2016:

Annual OPEB cost	\$	258,123
Less: contributions made		<u>(138,424)</u>
Increase in net OPEB obligation		119,699
Net OPEB obligation		
Beginning of year		<u>1,407,139</u>
End of year	\$	<u>1,526,838</u>

*Amount of Contributions Made* - Contributions are financed on a pay-as-you-go basis and the Fund's contributions for the fiscal years ended June 30, 2016, 2015, and 2014, approximated \$138,000, \$124,000, and \$112,000, respectively.

*Required Supplementary Information and Disclosures* - The State's CAFR includes the required footnote disclosures and supplementary information on the State's OPEB plan.

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**NOTE H - INSURANCE COVERAGE**

Insurance coverage is maintained at the State level. The State is self-insured for substantially all perils including workers' compensation. Expenditures for workers' compensation and other insurance claims are appropriated annually from the State's general fund.

The Department is covered by the State's self-insured workers' compensation program for medical expenses of injured Department employees. However, the Department is required to pay temporary total and temporary partial disability benefits as long as the employee is on the Department's payroll. Because actual claim liabilities depend on such complex factors as inflation, changes in legal doctrines, and damage awards, the process used in computing claims liability does not necessarily result in an exact amount. Claim liabilities may be re-evaluated periodically to take into consideration recently settled claims, the frequency of claims, and other economic and social factors.

Workers' compensation benefit claims reported as well as incurred but not reported were reviewed at year end. The estimated losses from these claims were not material.

## **SUPPLEMENTARY INFORMATION**

**State of Hawaii**  
**Department of Health**  
**Water Pollution Control Revolving Fund**  
**SCHEDULE OF CASH RECEIPTS, DISBURSEMENTS AND CASH BALANCE**  
**Fiscal Year Ended June 30, 2016**

**RECEIPTS**

Principal repayments on loans	\$ 28,162,154
Interest income from loans	1,574,845
State contributions	2,172,000
Federal contributions	22,878,235
Administrative loan fees	1,521,942
Other interest income	<u>864,141</u>
Total receipts	57,173,317

**DISBURSEMENTS**

Disbursement of loan proceeds	44,100,102
Administrative	<u>2,063,120</u>
Total disbursements	<u>46,163,222</u>
Excess of receipts over disbursements	11,010,095

**EQUITY IN CASH AND CASH EQUIVALENTS AND INVESTMENTS IN STATE TREASURY**

Beginning of fiscal year	<u>143,384,692</u>
End of fiscal year	\$ <u><u>154,394,787</u></u>



**State of Hawaii**  
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**Water Pollution Control Revolving Fund**  
**COMBINING STATEMENT OF NET POSITION**  
**June 30, 2016**

	State Revolving Fund Activity	State Activity	Total
<b>ASSETS AND DEFERRED OUTFLOWS OF RESOURCES</b>			
Current assets			
Equity in cash and cash equivalents and investments in State Treasury	\$ 151,398,976	\$ 2,995,811	\$ 154,394,787
Loan fees receivable	--	328,021	328,021
Accrued interest on loans	387,824	--	387,824
Other accrued interest	229,871	--	229,871
Due from State Treasury	--	30,265	30,265
Due from SRF (to State)	(1,724)	1,724	--
Current maturities of loans receivable	<u>29,233,656</u>	<u>--</u>	<u>29,233,656</u>
Total current assets	181,248,603	3,355,821	184,604,424
Loans receivable, net of current maturities	321,251,818	--	321,251,818
Capital assets, net of accumulated depreciation	<u>--</u>	<u>2,629</u>	<u>2,629</u>
Total assets	502,500,421	3,358,450	505,858,871
Deferred outflows of resources related to pensions	<u>--</u>	<u>445,645</u>	<u>445,645</u>
Total assets and deferred outflows of resources	<u>\$ 502,500,421</u>	<u>\$ 3,804,095</u>	<u>\$ 506,304,516</u>

**State of Hawaii**  
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**Water Pollution Control Revolving Fund**  
**COMBINING STATEMENT OF NET POSITION (Continued)**  
**June 30, 2016**

	State Revolving Fund Activity	State Activity	Total
<b>LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION</b>			
Current liabilities			
Accounts payable and other accrued liabilities	\$ <u>83,155</u>	\$ <u>124,713</u>	\$ <u>207,868</u>
Total current liabilities	83,155	124,713	207,868
Accrued vacation, net of current portion	83,077	127,578	210,655
Net pension liability	--	2,552,978	2,552,978
Other postemployment benefits	<u>--</u>	<u>1,526,838</u>	<u>1,526,838</u>
Total liabilities	166,232	4,332,107	4,498,339
Deferred inflows of resources related to pensions	--	84,727	84,727
Net position			
Net investment in capital assets	--	2,629	2,629
Restricted - expendable	<u>502,334,189</u>	<u>(615,368)</u>	<u>501,718,821</u>
Total net position	<u>502,334,189</u>	<u>(612,739)</u>	<u>501,721,450</u>
Total liabilities, deferred inflows of resources, and net position	\$ <u><u>502,500,421</u></u>	\$ <u><u>3,804,095</u></u>	\$ <u><u>506,304,516</u></u>

**State of Hawaii  
Department of Health  
Water Pollution Control Revolving Fund  
COMBINING STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN  
FUND NET POSITION  
Fiscal Year Ended June 30, 2016**

	<u>State Revolving Fund Activity</u>	<u>State Activity</u>	<u>Total</u>
<b>OPERATING REVENUES</b>			
Interest income from loans	\$ 1,542,935	\$ --	\$ 1,542,935
Administrative loan fees	<u>--</u>	<u>1,585,917</u>	<u>1,585,917</u>
Total operating revenues	1,542,935	1,585,917	3,128,852
<b>OPERATING EXPENSES</b>			
Administrative	957,870	1,385,667	2,343,537
Principal forgiveness for ARRA	7,438,075	--	7,438,075
Principal forgiveness for SRF	<u>10,102</u>	<u>--</u>	<u>10,102</u>
Total operating expenses	<u>8,406,047</u>	<u>1,385,667</u>	<u>9,791,714</u>
Operating income (loss)	(6,863,112)	200,250	(6,662,862)
<b>NONOPERATING REVENUES</b>			
State contributions	2,172,000	--	2,172,000
Federal contributions	23,058,155	--	23,058,155
Other interest income	<u>928,511</u>	<u>--</u>	<u>928,511</u>
Total nonoperating revenues	26,158,666	--	26,158,666
Change in net position	19,295,554	200,250	19,495,804
<b>NET POSITION</b>			
Beginning of fiscal year	<u>483,038,635</u>	<u>(812,989)</u>	<u>482,225,646</u>
End of fiscal year	\$ <u>502,334,189</u>	\$ <u>(612,739)</u>	\$ <u>501,721,450</u>

**State of Hawaii**  
**Department of Health**  
**Water Pollution Control Revolving Fund**  
**SCHEDULE OF OPERATING EXPENSES**  
**Fiscal Year Ended June 30, 2016**

	<u>State Revolving Fund Activity</u>	<u>State Activity</u>	<u>Total</u>
Principal forgiveness for ARRA	\$ 7,438,075	\$ --	\$ 7,438,075
Personnel	726,116	879,267	1,605,383
Pension expense	--	259,163	259,163
Intergovernmental personnel agreement expenses	195,664	--	195,664
Professional services	--	162,979	162,979
Travel	11,719	23,547	35,266
Services rendered by other State agencies	9,166	23,224	32,390
Rental	6,684	6,367	13,051
Telephone	3,302	7,023	10,325
Principal forgiveness for SRF	10,102	--	10,102
Depreciation	--	8,752	8,752
Office and other supplies	1,801	2,402	4,203
Training	1,745	1,993	3,738
Advertising and printing	--	1,989	1,989
Miscellaneous	<u>1,673</u>	<u>8,961</u>	<u>10,634</u>
 Total operating expenses	 \$ <u>8,406,047</u>	 \$ <u>1,385,667</u>	 \$ <u>9,791,714</u>

**PART II**

**REPORT ON INTERNAL CONTROL OVER  
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS**

**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**

**INDEPENDENT AUDITOR'S REPORT**

To the Auditor  
State of Hawaii

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the State of Hawaii, Department of Health, Water Pollution Control Revolving Fund (the "Fund"), as of and for the fiscal year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the Fund's basic financial statements, and have issued our report thereon dated December 9, 2016.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the Fund'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 Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Fund'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 Fund'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.

*N&K CPAs, Inc.*

Honolulu, Hawaii  
December 9, 2016

**PART III**

**REPORT ON COMPLIANCE FOR A FEDERAL PROGRAM  
AND ON INTERNAL CONTROL OVER COMPLIANCE**



**REPORT ON COMPLIANCE FOR A FEDERAL PROGRAM AND ON INTERNAL  
CONTROL OVER COMPLIANCE WHEN USING THE PROGRAM-SPECIFIC AUDIT  
OPTION TO SATISFY THE UNIFORM GUIDANCE**

**INDEPENDENT AUDITOR'S REPORT**

To the Auditor  
State of Hawaii

**Report on Compliance for Capitalization Grants for Clean Water State Revolving  
Funds Program**

We have audited the State of Hawaii, Department of Health, Water Pollution Control Revolving Fund's (the "Fund") compliance with the types of compliance requirements described in the *OMB Compliance Supplement* and the *Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs* that could have a direct and material effect on its Capitalization Grants for Clean Water State Revolving Funds Program (the "Program") for the fiscal year ended June 30, 2016.

**Management's Responsibility**

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to the Program.

**Auditor's Responsibility**

Our responsibility is to express an opinion on compliance for the Fund's Program based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance, require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the compliance requirements referred to above that could have a direct and material effect on the Program occurred. An audit includes examining, on a test basis, evidence about the Fund's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for the Fund's Program. However, our audit does not provide a legal determination of the Fund's compliance.

### **Opinion on Compliance for Capitalization Grants for Clean Water State Revolving Funds**

In our opinion, the Fund complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its Program for the fiscal year ended June 30, 2016.

### **Report on Internal Control Over Compliance**

Management of the Fund is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Fund's internal control over compliance with the types of requirements that could have a direct and material effect on its Program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for its Program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control over compliance.

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

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

N&K CPAs, Inc.

ACCOUNTANTS | CONSULTANTS

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance and the *Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs*. Accordingly, this report is not suitable for any other purpose.

N&K CPAs, Inc.

Honolulu, Hawaii  
December 9, 2016