KKDLY LLC
CERTIFIED PUBLIC ACCOUNTANTS

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, 2016 and 2015

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, 2016 and 2015

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PART I

INTRODUCTION SECTION

KKDLY LLC
CERTIFIED PUBLIC ACCOUNTANTS

December 29, 2016

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, 2016 and 2015. We transmit herewith our independent auditors' 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 audit 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 grant agreements that may have a direct and material effect on the determination of financial statement amounts.

Scope of Audit

We performed an audit of the Harbors Division's financial statements as of and for the years ended June 30, 2016 and 2015, 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.

As part of the audit of the Harbors Division's financial statements, we performed tests of the Harbors Division's 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. We also considered the Harbors Division's system of internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements.

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Organization of Report

This report has been organized into three parts as follows:

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

2. The Financial Section includes management's discussion and analysis, the Harbors Division's financial statements and the related notes, and other supplementary information as of and for the years ended June 30, 2016 and 2015, 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*.

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We would like to take this opportunity to express our appreciation for the courtesy and assistance extended to us by the personnel of the Harbors Division during the course of our 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, 2016 and 2015, and the related statements of revenues, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Harbors Division as of June 30, 2016 and 2015, 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 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, 2016 and 2015, and 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 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our 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 included in Schedules 1 through 4 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 included in Schedules 1 through 4 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, 2016, on our consideration of the Harbors Division's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Harbors Division's internal control over financial reporting and compliance.

KKDLY LLC

Honolulu, Hawaii
December 29, 2016

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

Management's Discussion and Analysis

June 30, 2016 and 2015

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, 2016 and 2015. 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).

Financial Highlights

- The Harbors Division's net position at June 30, 2016 and 2015 amounted to $798.5 million and $759.8 million, respectively. Net position increased by $38.8 million in fiscal year 2016, an increase of 5.1%. Net position increased by $16.5 million in fiscal year 2015, an increase of 2.2%.

- Operating income amounted to $55.8 million in fiscal year 2016, an increase of $2.7 million or 5.1% as compared to 2015. Operating income amounted to $53.1 million in fiscal year 2015, an increase of $3.0 million or 5.8% as compared to 2014.

A summary of operations and changes in net position for the fiscal years ended June 30, 2016, 2015, and 2014 follows:

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

	Year Ended June 30			2016 – 2015		2015 – 2014	
	2016	2015	2014	Increase (decrease)	% Change	Increase (decrease)	% Change
Operating revenues	$ 130,126	$ 123,209	$ 121,338	$ 6,917	5.6%	$ 1,871	1.5%
Nonoperating revenues	1,725	1,454	1,041	271	18.6	413	39.7
Total revenues	131,851	124,663	122,379	7,188	5.8	2,284	1.9
Depreciation and amortization	26,033	23,335	23,633	2,698	11.6	(298)	(1.3)
Other operating expenses	48,330	46,806	47,560	1,524	3.3	(754)	(1.6)
Nonoperating expenses	18,728	16,890	18,502	1,838	10.9	(1,612)	(8.7)
Total expenses	93,091	87,031	89,695	6,060	7.0	(2,664)	(3.0)
Income before capital contributions and transfers	38,760	37,632	32,684	1,128	3.0	4,948	15.1
Capital contributions	-	285	-	(285)	(100.0)	285	100.0
Transfers out	-	-	(300)	-	0.0	300	(100.0)
Increase	$ 38,760	$ 37,917	$ 32,384	$ 843	2.2	$ 5,533	17.1

Operating Revenues

Total operating revenues for fiscal year 2016 were $130.1 million compared to $123.2 million for fiscal year 2015. Total operating revenues for fiscal year 2015 were $123.2 million compared to $121.3 million for fiscal year 2014. Operating revenues consist primarily of service revenues and rental revenues, which accounted for 81.4% and 17.9%, respectively, in fiscal year 2016, and 79.9% and 19.0%, respectively, in fiscal year 2015, 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 2016 and 2015 were $106.0 million and $98.4 million, respectively.

Service revenues for fiscal year 2016 increased $7.5 million or 7.7% as compared to fiscal year 2015. Wharfage revenue from cargo movements increased by $6.2 million from $82.5 million in fiscal year 2015 to $88.7 million in fiscal year 2016 due primarily to increases in tariff rates that took effect on July 1, 2015 of 3% that were applied to the rates then in effect. In addition, passenger fees increased by $457,000 as described below.

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 as described below.

During fiscal year 2016, approximately 1.0 million passengers (inbound and outbound) passed through the harbors as compared to 1.01 million passengers in fiscal year 2015 and 1.15 million passengers in fiscal year 2014.

Passenger fee revenue increased by $457,000 or 6.9% from $6.6 million in 2015 to $7.0 million in fiscal year 2016, due primarily to the change in the embark and debark fee to $7.00 per passenger, effective July 1, 2015, from that assessed through June 30, 2015 of $6.50 per passenger, a result of changes in the fee rate structure that took effect July 1, 2012, partially offset by a decrease of approximately 0.10 million passengers.

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.

Rental Revenues

Rental revenues in fiscal year 2016 was $23.3 million, which was consistent with fiscal year 2015 rental revenues or $23.4 million.

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.

Operating Expenses

Operating expenses, excluding depreciation and amortization, for fiscal years 2016 and 2015 amounted to \$48.3 million and \$46.8 million, respectively. The increase in operating expenses for fiscal year 2016 in comparison to fiscal year 2015 of \$1.5 million or 3.3% was due primarily to increases in maintenance costs of \$2.2 million and personnel services costs of \$1.3 million, offset by a decrease in costs of harbor operations of \$2.2 million.

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 an increase in personnel services costs of \$912,000, offset by a decrease in costs of fireboat operations of \$1.6 million.

Harbor operations costs for fiscal year 2016 decreased by \$2.2 million as compared to fiscal year 2015 due primarily to decreases in ceded land assessments of \$5.9 million. In accordance with Act 178, SLH 2006, approximately \$5.3 million was refunded to the Harbors Division. This was offset by an increase in harbor operating costs of \$2.7 million, which included approximately \$600,000 of storm drain cleaning costs at facilities located on the island of Oahu to comply with the 2014 EPA Consent Decree, increased utilities costs such as electricity, water charges, and sewer fees and waste disposal fees, and an increase in harbor security costs of \$1.0 million due primarily to higher contract hourly labor rates. In fiscal year 2015, Harbor operations costs remained consistent with fiscal year 2014.

Personnel services costs for fiscal year 2016 increased by \$1.3 million as compared to fiscal year 2015 due primarily to increases in wages and employee benefits costs paid of \$1.0 million attributable to the collective bargaining agreements that became effective July 1, 2013 for all Harbors Division employees and an increase in workers' compensation expense of \$350,000. In fiscal year 2015, personnel services 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 attributable to the collective bargaining agreements that became effective July 1, 2013 for all Harbors Division employees.

Central services costs for fiscal year 2016 increased by approximately \$452,000 as compared to fiscal year 2015 due primarily to higher revenues resulting from the tariff increases of 3% implemented July 1, 2015 against which the 5% State assessment is applied. In fiscal year 2015, central services costs remained consistent with fiscal year 2014.

General administration costs in fiscal year 2016 was \$2.6 million, which was consistent with 2015 general administration costs of \$2.7 million. General administration costs in fiscal year 2015 was \$2.7 million, which was consistent with 2014 general administration costs of \$3.0 million.

Harbor maintenance expenses for fiscal year 2016 increased by $2.2 million as compared to fiscal year 2015 due primarily to increases in maintenance costs of $1.0 million and increases in fiscal year 2016 special maintenance costs of $1.1 million expended for maintenance projects that did not extend the service life of harbor assets. In fiscal year 2015, harbor maintenance expenses 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.

A summary of the Harbors Division's net position at June 30, 2016, 2015, and 2014 are shown below:

Table 2
Condensed Statements of Net Position
(In Thousands)

	As of June 30			2016 – 2015		2015 – 2014	
	2016	2015	2014	Increase (decrease)	% Change	Increase (decrease)	% Change
Assets:							
Current and other assets	$ 421,321	$ 414,819	$ 422,572	$ 6,502	1.6%	$ (7,753)	(1.8%)
Capital assets, net	795,090	780,490	745,637	14,600	1.9	34,853	4.7
Total assets	1,216,411	1,195,309	1,168,209	21,102	1.8	27,100	2.3
Deferred outflows of resources	6,908	6,633	4,311	275	4.1	2,322	53.9
Liabilities:							
Current liabilities	46,709	49,746	46,398	(3,037)	(6.1)	3,348	7.2
Long-term liabilities	376,541	389,919	382,830	(13,378)	(3.4)	7,089	1.9
Total liabilities	423,250	439,665	429,228	(16,415)	(3.7)	10,437	2.4
Deferred inflows of resources	1,550	2,520	-	(970)	(38.5)	2,520	100.0
Net position:							
Net investment in capital assets	528,706	528,581	510,870	125	0.0	17,711	3.5
Restricted	76,907	73,588	88,455	3,319	4.5	(14,867)	(16.8)
Unrestricted	192,905	157,589	143,967	35,316	22.4	13,622	9.5
Total net position	$ 798,518	$ 759,758	$ 743,292	$ 38,760	5.1	$ 16,466	2.2

Net Position

The largest portion of the Harbors Division's net position (66.2% and 69.6% at June 30, 2016 and 2015, respectively), net investment in capital assets, represents its investment in capital assets (e.g., land, wharves, buildings, improvements, and equipment), less related indebtedness outstanding to acquire those capital assets. The Harbors Division uses these capital assets to provide services to its users of the harbors system; consequently, these assets are not available for future spending. Although the Harbors Division's net investment in its capital assets is reported net of related debt, the resources required to repay this debt must be provided annually from operations, since it is unlikely the capital assets themselves will be liquidated to pay for such liabilities.

The restricted portion of the Harbors Division's net position (9.6% and 9.7% at June 30, 2016 and 2015, 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 (24.2% and 20.7% at June 30, 2016 and 2015, 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 $798.5 million at June 30, 2016, an increase in net position of $38.8 million or 5.1% from 2015. 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. The increase in net position of $16.5 million or 2.2% from 2014 was primarily due to income before capital contributions of $37.6 million, offset by the cumulative effect of adopting GASB Statement No. 68 of $21.5 million in 2015.

Capital Assets and Debt Administration

Capital Assets

As of June 30, 2016 and 2015, the Harbors Division had $795.1 million and $780.5 million, respectively invested in capital assets as shown in Table 3. There was a net increase (additions, deductions, and depreciation) of $14.6 million in 2016 from the prior year, and a net increase in 2015 of $34.9 million from 2014.

Table 3
Capital Assets
(In Thousands)

	As of June 30			2016 – 2015		2015 – 2014	
	2016	2015	2014	Increase (decrease)	% Change	Increase (decrease)	% Change
Land and land improvements	$ 557,918	$ 534,933	$ 533,894	$ 22,985	4.3%	$ 1,039	0.2%
Wharves	269,153	269,153	269,153	-	-	-	-
Other improvements	95,611	91,114	73,946	4,497	4.9	17,168	23.2
Buildings	106,081	97,262	97,259	8,819	9.1	3	0.0
Equipment	20,865	19,109	18,130	1,756	9.2	979	5.4
Total at cost	1,049,628	1,011,571	992,382	38,057	3.8	19,189	1.9
Less accumulated depreciation	(355,149)	(329,165)	(305,967)	(25,984)	7.9	(23,198)	7.6
	694,479	682,406	686,415	12,073	1.8	(4,009)	(0.6)
Construction in progress	100,611	98,084	59,222	2,527	2.6	38,862	65.6
Total capital assets, net	$ 795,090	$ 780,490	$ 745,637	$ 14,600	1.9	$ 34,853	4.7

During 2016, the Harbors Division wrote-off approximately $3.1 million of capital improvement project costs that have been deemed to have no future use nor continuing value for the Harbors Division. These project costs included expenditures for feasibility studies and other planning costs related to the Nawiliwili Harbor, the Hilo Harbor, the Hana Harbor, and the Honolulu Harbor.

Major capital asset additions to the statewide harbors system for the fiscal year ended June 30, 2016, included the following:

- $21.8 million Construction of Building and Yard Improvements at Piers 34 and 35, Honolulu Harbor, Oahu Island

- $9.0 million Construction of Pier 2 Improvements, Kawaihae Harbor, Hawaii Island

- $4.4 million Construction of Improvements at Kumau St. Entrance Pier 4 Inter-island Cargo Terminal, Hilo Harbor, Hawaii Island

- $465,000 Replacement of Bullrails at Pier 1, Kahului Harbor, Maui Island

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 Island

- $437,000 Construction of South Basin Perimeter Fence, Kawaihae Harbor, Hawaii Island

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

- $47.0 million Design and Construction of Pier 4 Inter-island Cargo Terminal Facility, Hilo Harbor, Hawaii Island

- $12.6 million Design and Construction of Piers 12 and 15 Improvements, Honolulu Harbor, Oahu Island

- $1.4 million Piers 31a and 32 Installation of Fire Suppression System, Honolulu Harbor, Oahu Island

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

- $15.4 million Land Acquisition and Design of Improvements, Kahului Harbor, Maui Island

- $5.5 million Piers 24-28 Design and Coordination of Joint Development Agreement Area Improvements, Honolulu Harbor, Oahu Island

- $180.0 million Kapalama Container Terminal Yard and Wharf Design, Honolulu Harbor, Oahu Island

- $7.0 million Pier 1 Shed Modifications Phase II, Hilo Harbor, Hawaii Island
- $2.0 million Pier 2 Strengthening, Hilo Harbor, Hawaii Island

The Harbors Division is committed under contracts awarded for capital improvement projects totaling $85.9 million as of June 30, 2016.

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

Indebtedness

Harbors System Revenue Bonds and Reimbursable General Obligation Bonds

Harbor system revenue bonds have been issued pursuant to the *Certificate of the Director of Transportation Providing for the Issuance of 1997 State of Hawaii Harbor Revenue Bonds* (the 1997 Certificate) and are collateralized by a charge and lien on the Harbors Division's revenues. The proceeds from these bonds are used for harbor and waterfront improvements. As of June 30, 2016 and 2015, outstanding harbor system revenue bonds amounted to $323.4 million and $337.5 million, respectively.

On December 6, 2016, the Harbors Division issued $14,565,000 in Series 2016 A, $68,535,000 in Series 2016 B, $8,135,000 in Series 2016 C, and $22,425,000 in Series 2016 D Revenue Refunding Bonds (the Bonds). The Bonds bear interest from 1.99% to 3.09% with maturity dates through January 2031. The Series A 2016 Revenue Bonds refunded $16,195,000 of 2004 B Bonds, the Series B 2016 Revenue Bonds refunded $71,625,000 of 2006 A Bonds, the Series C 2016 Revenue Bonds refunded $7,365,000 of 2007 A Bonds, and Series D 2016 Revenue Bonds refunded $22,315,000 of 2007 A Bonds. The refunding of 2004 B, 2006 A, and 2007 A Bonds provided net present value savings of approximately $15,900,000.

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, 2016 and 2015, outstanding reimbursable general obligation bonds amounted to $27.4 million and $29.3 million, respectively. There have been no issuances of reimbursable general obligation bonds to finance the harbor and waterfront improvements during fiscal years 2016 and 2015.

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

Credit Rating and Bond Insurance

All harbor system revenue bonds issued since 1997 through June 30, 2010 have been issued with bond insurance. A new reserve policy replaced all previously issued surety bonds and the portion of the reserve requirement allocable to the Series B of 2010 Revenue Bonds. The surety policy was amended effective August 2, 2013 to include the reserve requirement allocable to the Series A of 2013 Revenue Refunding Bonds. The Series A of 2010 Revenue Bonds are secured by a cash deposit of $11.5 million. As of June 30, 2016, the underlying ratings for harbor system revenue bonds were as follows:

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

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

Bond Covenants

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

The Harbors Division coverage ratio as of June 30, 2016 was 3.16 under the 1997 Certificate as compared to the ratio of 2.97 as of June 30, 2015.

Request for Information

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

Harbors Division

Department of Transportation

State of Hawaii

(An Enterprise Fund of the State of Hawaii)

Statements of Net Position

June 30, 2016 and 2015

Assets:	**2016**	**2015**
Current assets:		
Cash and cash equivalents *(Note 3)*	$ 235,715,532	$ 204,477,053
Receivables, less allowance for doubtful accounts of $5,229,605 in 2016 and $4,531,148 in 2015	11,017,620	10,511,592
Notes receivable, less allowance for doubtful accounts of $3,777,650 in 2016 and 2015 *(Notes 14 and 15)*	-	-
Due from other State agencies	613,599	475,126
Interest receivable	198,392	374,031
Other receivables	-	13,873
Other current assets	59,872	84,595
	247,605,015	215,936,270
Restricted assets:		
Cash and cash equivalents−restricted for debt service payments and reserve requirements *(Notes 3, 6, and 7)*	34,589,991	34,249,829
Total current assets	282,195,006	250,186,099
Noncurrent assets:		
Cash and cash equivalents−restricted for *(Notes 3 and 7):*		
Capital improvement projects	123,626,575	151,098,895
Other	15,499,371	13,534,489
	139,125,946	164,633,384
Capital assets *(Notes 4, 9, and 16)*		
Nondepreciable facilities	280,022,844	280,022,844
Depreciable facilities, net	414,456,153	402,382,646
Construction in progress	100,611,285	98,084,300
Total capital assets, net	795,090,282	780,489,790
Total noncurrent assets	934,216,228	945,123,174
Total assets	1,216,411,234	1,195,309,273
Deferred Outflows of Resources:		
Deferred charge on refunding, net *(Note 2)*	3,468,642	3,889,744
Deferred outflows related to pension *(Notes 2 and 11)*	3,438,916	2,743,246
Total deferred outflows of resources	6,907,558	6,632,990

Liabilities:	**2016**	**2015**
Current liabilities (payable from current assets):		
Accounts payable *(Note 18)*	$ 4,887,807	$ 6,463,961
Accrued workers' compensation *(Notes 5 and 12)*	223,370	70,620
Contracts payable, including retainages *(Note 18)*	3,406,648	201,818
Accrued vacation *(Note 5)*	727,397	674,661
Due to Department of Budget and Finance	3,209,549	3,232,786
	12,454,771	10,643,846
Current liabilities (payable from restricted assets):		
Contracts payable, including retainages	6,500,552	12,140,557
Revenue bonds payable, current maturities *(Notes 2, 5, 6, and 7)*	15,138,483	14,465,124
General obligation bonds payable, current maturities (*Notes 5 and 8*)	2,022,854	1,932,016
Accrued interest payable - revenue bonds *(Note 6)*	8,269,958	8,624,796
Security deposits	2,322,297	1,939,171
	34,254,144	39,101,664
Total current liabilities	46,708,915	49,745,510
Long-term liabilities:		
Accrued workers' compensation *(Notes 5 and 12)*	366,120	311,614
Net pension liability *(Notes 2, 5, and 11)*	23,096,737	21,594,854
Other postretirement benefits payable *(Notes 5 and 11)*	17,317,087	15,292,205
Long-term debt, less current maturities:		
Revenue bonds payable, net *(Notes 2, 5, 6, and 7)*	308,624,361	323,762,844
General obligation bonds payable *(Notes 5 and 8)*	25,376,867	27,399,721
Accrued vacation *(Note 5)*	1,760,280	1,558,280
Total long-term liabilities	376,541,452	389,919,518
Total liabilities	423,250,367	439,665,028
Deferred Inflows of Resources:		
Deferred inflows related to pension *(Notes 2 and 11)*	1,550,401	2,519,629
Net Position:		
Net investment in capital assets	528,706,431	528,581,097
Restricted - revenue bond requirements	34,589,991	34,249,829
Restricted - for capital improvement projects	42,316,502	39,337,627
Unrestricted	192,905,100	157,589,053
Total net position	$ 798,518,024	$ 759,757,606

See accompanying notes to financial statements.

Harbors Division

Department of Transportation

State of Hawaii

(An Enterprise Fund of the State of Hawaii)

Statements of Revenues, Expenses, and Changes in Net Position

Years Ended June 30, 2016 and 2015

	2016	2015
Operating revenues, net *(Note 6)* :		
Services	$ 105,975,067	$ 98,435,099
Rentals *(Note 10)*	23,326,907	23,413,433
Others	823,814	1,360,805
	130,125,788	123,209,337
Operating expenses:		
Depreciation and amortization, including depreciation of capital assets of $26,032,754 during 2016 and $23,197,458 during 2015 *(Note 4)*	26,032,754	23,335,556
Personnel services *(Note 11)*	18,989,780	17,687,378
Harbor operations *(Note 13)*	16,356,221	18,540,951
Maintenance	4,403,290	2,242,822
State of Hawaii, surcharge for central service expenses *(Note 14)*	4,262,892	3,811,197
General administration	2,565,691	2,710,029
Department of Transportation, general administration expenses *(Note 14)*	1,652,190	1,780,600
Fireboat operations *(Note 14)*	99,640	32,604
	74,362,458	70,141,137
Operating income	55,763,330	53,068,200
Nonoperating revenues (expenses):		
Interest expense *(Notes 6, 8, and 9)*	(15,543,769)	(16,784,842)
Loss on disposal of capital assets	(3,057,783)	-
Interest income *(Note 3):*		
Deposits in investment pool	1,724,617	1,453,840
Amortization of bond premium, discount, and deferred charge on refunding	(125,977)	(104,868)
	(17,002,912)	(15,435,870)
Income before capital contributions and transfers	38,760,418	37,632,330
Capital contributions	-	284,458
Increase in net position	38,760,418	37,916,788
Net position, beginning of year	759,757,606	721,840,818
Net position, end of year	$ 798,518,024	$ 759,757,606

See accompanying notes to financial statements.

Harbors Division

Department of Transportation

State of Hawaii

(An Enterprise Fund of the State of Hawaii)

Statements of Cash Flows

Years Ended June 30, 2016 and 2015

	2016	**2015**
Cash flows from operating activities:		
Cash received from customers	$ 129,855,049	$ 121,800,046
Cash paid to suppliers	(26,350,102)	(28,342,177)
Cash paid to employees	(18,002,344)	(15,712,019)
Net cash provided by operating activities	85,502,603	77,745,850
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(46,787,554)	(52,844,436)
Interest paid on bonds	(18,442,086)	(19,180,537)
Principal paid on bonds	(16,102,016)	(15,349,233)
Government grants received in aid of construction	-	284,458
Net cash used in capital and related financing activities	(81,331,656)	(87,089,748)
Cash flows provided by investing activities:		
Interest received	1,900,256	1,178,110
Net increase (decrease) in cash and cash equivalents	6,071,203	(8,165,788)
Cash and cash equivalents at beginning of year	403,360,266	411,526,054
Cash and cash equivalents at end of year	$ 409,431,469	$ 403,360,266

(Continued on following page)

Harbors Division

Department of Transportation

State of Hawaii

(An Enterprise Fund of the State of Hawaii)

Statements of Cash Flows (Continued)

Years Ended June 30, 2016 and 2015

	2016	2015
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 55,763,330	$ 53,068,200
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation of capital assets	26,032,754	23,197,458
Other amortization	-	138,098
Provision for doubtful accounts	698,457	625,343
Changes in assets, deferred outflows, liabilities, and deferred inflows:		
Receivables	(1,329,085)	(1,753,277)
Other current assets	24,723	852,731
Deferred outflows related to pension	(695,670)	(2,743,246)
Payables	1,628,676	104,552
Accrued workers' compensation	207,256	(184,911)
Accrued vacation	254,736	(57,756)
Due to Department of Budget and Finance	(23,237)	(27,174)
Security deposits	383,126	(254,183)
Net pension liability	1,501,883	144,266
Other postretirement benefits payable	2,024,882	2,116,120
Deferred inflows related to pension	(969,228)	2,519,629
Net cash provided by operating activities	$ 85,502,603	$ 77,745,850

	2016	2015
Supplemental disclosure of noncash capital and related financial activities:		
Amortization of bond premium, discount, and deferred charge on refunding	$ (125,977)	$ (104,868)

See accompanying notes to financial statements.

1. Financial Reporting Entity

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

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

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

2. Summary of Significant Accounting Policies

Measurement Focus and Basis of Accounting

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

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.

Amounts Held in State Treasury

The State's investments held in the State Treasury are reported at fair value within the fair value hierarchy established by GAAP. Investments in U.S. government obligations are reported at fair value based on quoted prices or other observable inputs, including pricing matrices. Investments in certificates of deposit and repurchase agreements are reported at fair value using cost-based measures due to the nonparticipating nature of these securities.

Fair Value Measurements

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

Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 - Inputs other than quoted market prices included in Level 1 that are observable for an asset or liability, either directly or indirectly.

Level 3 - Unobservable inputs for an asset or liability reflecting the reporting entity's own assumptions. Level 3 inputs are used to measure fair value to the extent that observable Level 1 or 2 inputs are not available.

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).

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

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

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

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 $3,468,642 and $3,889,744 at June 30, 2016 and 2015, respectively, and are reported as deferred outflows of resources in the statements of net position.

Deferred Outflows/Inflows of Resources

In addition to assets, the statements of net position will report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expense) until then. The Harbors Division’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, 2016 and 2015 was approximately $698,500 and $625,300, respectively. Operating revenues also exclude revenues related to capital and related financing activities, noncapital financing activities, and investing activities.

The Harbors Division has pledged its future operating revenues, net of certain operating expenses, to repay $323,370,000 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 $510,875,000. 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 $31,187,000 and $90,376,000 respectively, for the year ended June 30, 2016, and approximately $31,176,000 and $84,738,000 respectively, for the year ended June 30, 2015.

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.

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.

Recently Issued Accounting Pronouncements

GASB Statement No. 72

The Harbors Division adopted GASB Statement No. 72, *Fair Value Measurement and Application*, effective July 1, 2015. The statement requires governments to measure certain assets and liabilities at fair value using a consistent and more detailed definition of fair value and accepted valuation techniques. The statement also enhances fair value application guidance and disclosure. This statement did not have a material effect on the Harbors Division's financial statements.

GASB Statement No. 75

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

This statement replaces the requirements of GASB Statement No. 45 (Statement No. 45), *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than 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 this statement will have on its financial statements.

GASB Statement No. 76

The Harbors Division adopted GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, effective July 1, 2015. The statement supersedes GASB No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. The statement reduces GAAP to two categories of authoritative GAAP and addresses the use of authoritative and nonauthoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP. This statement did not have a material effect on the Harbors Division's financial statements.

GASB Statement No. 82

The GASB issued Statement No. 82, *Pension Issues - An Amendment of GASB Statements No. 67, No. 68, and No. 73*. This statement addresses certain issues that have been raised with respect to Statements No. 67, *Financial Reporting for Pension Plans*, No. 68, *Accounting and Financial Reporting for Pensions*, and No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*. The requirements of this statement are effective for reporting periods beginning after June 15, 2016. The Harbors Division is currently evaluating the impact that this statement will have on its financial statements.

3. Cash and Cash Equivalents

Cash and cash equivalents at June 30, 2016 and 2015 consisted of the following:

	2016	2015
Amounts held in State Treasury	$ 406,008,171	$ 402,931,756
Petty cash and other	3,423,298	428,510
	$ 409,431,469	$ 403,360,266

Such amounts are reflected in the statements of net position at June 30, 2016 and 2015 as follows:

	2016	2015
Current assets:		
Unrestricted	$ 235,715,532	$ 204,477,053
Restricted:		
Revenue bond debt service payments	23,134,958	22,794,796
Revenue bond cash reserve requirements	11,455,033	11,455,033
Noncurrent assets:		
Restricted:		
Capital improvement projects:		
Unspent bond proceeds	81,310,073	111,761,268
Construction - special purpose funds	42,316,502	39,337,627
Other-bond reserve requirements and security deposits	15,499,371	13,534,489
	$ 409,431,469	$ 403,360,266

Amounts Held in State Treasury

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

At June 30, 2016 and 2015, amounts held in State Treasury by the Harbors Division totaled $406,008,171 and $402,931,756, respectively. The amounts held in State Treasury reported in the accompanying statement of net position reflects the Harbors Division's relative position in the State's investment pool based upon the average monthly investment balance of each participant in the investment pool.

Information relating to the cash and investments in State Treasury is determined on a statewide basis and not for individual departments or agencies. Information regarding the carrying amount and corresponding bank balances of the investment pool and collateralization of the investment pool balances is included in the comprehensive annual financial report (CAFR) of the State.

The Employer-Union Benefits Trust Fund of the State of Hawaii maintains an investment pool that is held separately from the State investment pool. Accordingly, those investments are not presented in the accompanying State investment pool disclosures.

The following table presents the fair value of the investments included in the State's investment pool at June 30, 2016 (amounts expressed in thousands):

	June 30, 2016			
		Fair Value Measurements Using		
	Reported Value	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Primary government:				
Investments measured by fair value level:				
U.S. government securities	$ 2,079,266	$ 948,149	$ 1,131,117	$ -
Investments measured at amortized cost:				
Certificates of deposit	861,410			
Repurchase agreements	29,704			
Total investments	$ 2,970,380			
Fiduciary funds:				
Investments measured by fair value level:				
U.S. government securities	$ 157,539	$ 71,838	$ 85,701	$ -
Investments measured at amortized cost:				
Certificates of deposit	65,266			
Repurchase agreements	2,250			
Total investments	$ 225,055			

Investments in U.S. government securities consist of U.S. treasury bills and U.S. treasury notes and bonds, and are valued based on quoted prices in active markets or other observable inputs, including pricing matrices. Investments in certificates of deposit and repurchase agreements are valued at amortized cost.

The following table presents the investments included in the State's investment pool by maturity period at June 30, 2016 (amounts in thousands):

		Maturity (in years)		
	Fair Value	**Less than 1**	**1-5**	**>5**
Primary government:				
U.S. government securities	$ 2,079,266	$ 997,545	$ 1,073,773	$ 7,948
Certificates of deposit	861,410	829,635	31,775	-
Repurchase agreements	29,704	29,704	-	-
Total investments	$ 2,970,380	$ 1,856,884	$ 1,105,548	$ 7,948
Fiduciary funds:				
U.S. government securities	$ 157,539	$ 75,581	$ 81,356	$ 602
Certificates of deposit	65,266	62,859	2,407	-
Repurchase agreements	2,250	2,250	-	-
Total investments	$ 225,055	$ 140,690	$ 83,763	$ 602

Interest Rate Risk

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

Credit Risk

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

Custodial Risk

For an investment, custodial risk is the risk that, in the event of the failure of the counterparty, the State will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The State's investments are held at broker/dealer firms, which are protected by the Securities Investor Protection Corporation (SIPC) up to a maximum amount. 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.

4. Capital Assets

Capital asset activity for the years ended June 30, 2016 and 2015 were as follows:

	Balance July 1, 2015	Additions	Deductions	Balance June 30, 2016
Nondepreciable assets:				
Land improvements	$ 280,022,844	$ -	$ -	$ 280,022,844
Depreciable assets:				
Land improvements	254,909,373	22,985,138	-	277,894,511
Wharves	269,153,315	-	-	269,153,315
Other improvements	91,114,188	4,496,627	-	95,610,815
Buildings	97,262,046	8,819,057	-	106,081,103
Equipment	19,108,831	1,805,439	(49,070)	20,865,200
Total at cost	1,011,570,597	38,106,261	(49,070)	1,049,627,788
Less accumulated depreciation for:				
Land improvements	91,179,049	8,275,994	-	99,455,043
Wharves	141,610,421	8,297,056	-	149,907,477
Other improvements	42,833,247	5,181,003	-	48,014,250
Buildings	40,618,878	2,833,674	-	43,452,552
Equipment	12,923,512	1,445,027	(49,070)	14,319,469
Total accumulated depreciation	329,165,107	26,032,754	(49,070)	355,148,791
Construction in progress	98,084,300	42,056,507	(39,529,522)	100,611,285
Total capital assets, net	$ 780,489,790	$ 54,130,014	$ (39,529,522)	$ 795,090,282

	Balance July 1, 2014	Additions	Deductions	Balance June 30, 2015
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	992,382,178	19,188,419	-	1,011,570,597
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	305,967,649	23,197,458	-	329,165,107
Construction in progress	59,222,312	57,314,830	(18,452,842)	98,084,300
Total capital assets, net	$ 745,636,841	$ 53,305,791	$ (18,452,842)	$ 780,489,790

5. Long-Term Liabilities

The changes in long-term liabilities were as follows:

	Balance July 1, 2015	Additions	Deductions	Balance June 30, 2016	Current	Noncurrent
Accrued workers' compensation (Note 12)	$ 382,234	$ 349,925	$ 142,669	$ 589,490	$ 223,370	$ 366,120
Accrued vacation	2,232,941	1,222,945	968,209	2,487,677	727,397	1,760,280
Net pension liability (Note 11)	21,594,854	3,522,225	2,020,342	23,096,737	-	23,096,737
Other postretirement benefits payable (Note 11)	15,292,205	3,427,302	1,402,420	17,317,087	-	17,317,087
General obligation bonds (Note 8)	29,331,737	-	1,932,016	27,399,721	2,022,854	25,376,867
Revenue bonds (Note 6)	337,540,000	-	14,170,000	323,370,000	14,865,000	308,505,000
Unamortized premium	687,968	-	295,124	392,844	273,483	119,361
Revenue bonds, net	338,227,968	-	14,465,124	323,762,844	15,138,483	308,624,361
	$ 407,061,939	$ 8,522,397	$ 20,930,780	$ 394,653,556	$ 18,112,104	$ 376,541,452

	Balance July 1, 2014	Additions	Deductions	Balance June 30, 2015	Current	Noncurrent
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	352,049,202	-	13,821,234	338,227,968	14,465,124	323,762,844
	$ 399,259,099	$ 27,814,723	$ 20,011,883	$ 407,061,939	$ 17,142,421	$ 389,919,518

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.

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

Notes to Financial Statements

June 30, 2016 and 2015

The following is a summary of the Revenue Bonds issued and outstanding at June 30, 2016:

Year of Issue	Final Redemption Date	Interest Rate	Original Amount of Issue	Current: Principal Due July 1, 2016	Current: Principal Due January 1, 2017	Total Current	Noncurrent
2004	January 1, 2024	2.50-6.00%	$ 52,030,000	$ -	$ 1,665,000	$ 1,665,000	$ 14,530,000
2006	January 1, 2031	4.00-5.25%	96,570,000	-	3,250,000	3,250,000	68,375,000
2007	July 1, 2027	4.25-5.50%	51,645,000	2,105,000	-	2,105,000	31,895,000
2010	July 1, 2040	3.00-5.75%	201,390,000	7,005,000	-	7,005,000	172,935,000
2013	July 1, 2029	3.25%	23,615,000	840,000	-	840,000	20,770,000
			$ 425,250,000	$ 9,950,000	$ 4,915,000	14,865,000	308,505,000
				Unamortized premium		273,483	119,361
						$ 15,138,483	$ 308,624,361

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: Principal Due July 1, 2015	Current: Principal Due January 1, 2016	Total Current	Noncurrent
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
			$ 425,250,000	$ 9,505,000	$ 4,665,000	14,170,000	323,370,000
				Unamortized premium		295,124	392,844
						$ 14,465,124	$ 323,762,844

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

Fiscal Year Ending June 30	Principal	Interest	Total
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	18,025,000	13,172,000	31,197,000
2022-2026	82,710,000	52,726,331	135,436,331
2027-2031	70,975,000	33,953,138	104,928,138
2032-2036	37,710,000	19,569,231	57,279,231
2037-2041	49,935,000	7,337,954	57,272,954
	$ 323,370,000	$ 187,504,846	$ 510,874,846

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 $23,134,958 as of June 30, 2016, for principal payments of $9,950,000 and $4,915,000 due on July 1, 2016 and January 1, 2017, respectively, and for interest payments $8,269,958 due on July 1, 2016.

7. Harbor Revenue Bond Requirements

1997 Certificate – Minimum Net Revenue Requirement

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

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

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

The Harbor Revenue Bond debt service requirements, including minimum sinking fund payments during the current fiscal year, computed in accordance with Section 6.03 of the 1997 Certificate totaled $31,186,685. Net revenues of the Public Undertaking, as defined by the 1997 Certificate amounted to $98,681,251 or 3.16 times the minimum net revenue requirement for the fiscal year ended June 30, 2016, and $92,566,451 or 2.97 times the minimum net revenue requirement for the fiscal year ended June 30, 2015.

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, 2016 and 2015.

(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, 2016 and 2015.

(*3) Harbor Debt Service Reserve Account*

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

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

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

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

(4) Harbor Reserve and Contingency Account

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

8. General Obligation Bonds

In fiscal 2006, the State issued $350,000,000 of General Obligation bonds, Series DI, dated March 23, 2006; in fiscal 2007, the State issued $350,000,000 of General Obligation bonds, Series DJ, dated March 28, 2007; and in fiscal 2008, the State issued $375,000,000 of General Obligation bonds, Series DK, dated May 1, 2008. Interest rates on outstanding Series DI, Series DJ, and Series DK General Obligation bonds range from 3.80% 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, 2016 and 2015, outstanding reimbursable general obligation bonds amounted to approximately $27,400,000 and $29,332,000, respectively.

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

Fiscal Year Ending June 30	Principal	Interest	Total
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	2,450,903	929,861	3,380,764
2022-2026	14,210,023	2,694,025	16,904,048
2027-2028	2,029,019	144,052	2,173,071
	$ 27,399,721	$ 8,581,191	$ 35,980,912

9. Interest Cost

Total combined interest cost incurred related to Revenue and General Obligation Bonds for the fiscal years ended June 30, 2016 and 2015 amounted to approximately $18,087,000 and $19,249,000, respectively. Of this amount, approximately $2,543,000 and $2,464,000 were capitalized during fiscal years ended June 30, 2016 and 2015, respectively, as part of the construction cost of harbor facilities.

10. Leasing Operations

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

The following is a schedule of approximate future minimum lease rentals on noncancelable operating leases as of June 30, 2016.

Fiscal Year Ending June 30	Amount
2017	$ 6,059,000
2018	5,773,000
2019	5,222,000
2020	5,198,000
2021	5,255,000
2022-2026	25,819,000
2027-2031	24,110,000
2032-2036	18,357,000
2037-2041	11,999,000
2042-2046	9,031,000
2047-2051	2,771,000
2052-2056	2,574,000
2057-2061	947,000
	$ 123,115,000

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

11. Retirement Benefits

Pension Plan

Plan Description

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

Benefits Provided

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

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

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

Noncontributory Class

Retirement Benefits

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

Disability Benefits

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

Death Benefits

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

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

Contributory Class for Members Hired Prior to July 1, 2012

Retirement Benefits

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

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

Disability Benefits

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

Death Benefits

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

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

Contributory Class for Members Hired After June 30, 2012

Retirement Benefits

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

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

Disability and Death Benefits

Members are eligible for service-related disability benefits regardless of length of service and receive a lifetime pension of 50% of their average final compensation plus refund of contributions and accrued interest. Ten years of credited service is required for ordinary disability. Ordinary disability benefits are 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 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.

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

Contributions

Contributions are established by HRS Chapter 88 and may be amended through legislation. The employer rate is set by statute based on the recommendations of the ERS actuary resulting from an experience study conducted every five years. Since July 1, 2005, the employer contribution rate is a fixed percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liabilities. The contribution rates for fiscal years 2016 and 2015 were 25.0% and 24.0%, respectively, for police officers and firefighters, and 17.0% and 16.5%, respectively, for all other employees. Contributions to the ERS from the Harbors Division were $2,045,758 and $1,882,115 for the fiscal years ended June 30, 2016 and 2015, respectively.

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 Pension

Measurement of the actuarial valuation of the pension liability, pension expense, and deferred outflows of resources and deferred inflows of resources related to pension is made for the State as a whole and is not separately computed for the individual state departments and agencies such as the Harbors Division. The State allocates the pension liability, pension expense, and deferred outflows of resources and deferred inflows of resources related to pension 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, and deferred outflows of resources and deferred inflows of resources related to pension can be found in the State's CAFR.

At June 30, 2016 and 2015, the Harbors Division reported a net pension liability of $23,096,737 and $21,594,854, respectively, for its proportionate share of the State's net pension liability. The net pension liability was measured as of June 30, 2015 and 2014, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of those dates.

The Harbors Division's proportionate share of the State's 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, 2015, the State's proportion was 57.24%, which was a decrease of 1.24% from its proportion measured as of June 30, 2014. The Harbors Division's share of the State's net pension liability at June 30, 2015 was .47%

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 Harbors Division's proportionate share of the State's net pension liability.

For the years ended June 30, 2016 and 2015, the Harbors Division recognized pension expense of $1,918,220 and $1,845,009, respectively. At June 30, 2016 and 2015, the Harbors Division reported deferred outflows of resources and deferred inflows of resources related to pension from the following sources:

	Deferred Outflows of Resources	
	2016	**2015**
Contributions subsequent to the measurement date	$ 2,631,747	$ 2,432,629
Changes in assumptions	555,934	-
Differences between expected and actual experience	220,525	271,528
Changes in proportion and differences between contributions and proportionate share of contributions	30,710	39,089
	$ 3,438,916	$ 2,743,246

	Deferred Inflows of Resources	
	2016	**2015**
Net difference between projected and actual earnings on pension plan investments	$ 749,490	$ 2,513,506
Differences between expected and actual experience	655,113	6,123
Changes in proportion and differences between contributions and proportionate share of contributions	145,798	-
	$ 1,550,401	$ 2,519,629

The $2,631,747 reported as deferred outflows of resources related to pension at June 30, 2016 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, 2017. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pension at June 30, 2016 will be recognized in pension expense as follows:

Year Ended June 30:	
2017	$ (325,717)
2018	(325,717)
2019	(325,717)
2020	258,527
2021	(24,608)
	$ (743,232)

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% compounded annually including inflation

The investment rate of return changed from 7.75% used in the June 30, 2014 actuarial valuation to 7.65% used in the June 30, 2015 actuarial valuation.

The same rates were applied to all periods. There were no changes to ad hoc postemployment benefits including cost of living adjustments.

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

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 ERS 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 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:

Asset Class	Target Allocation	Long-term Expected Real Rate of Return
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	5.0%	7.7%
Total investments	100.0%	

*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, which includes the Harbors Division, will be made at statutorily required rates, actuarially determined. Based on those assumptions, the pension 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 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 7.65%, 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 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%)
Harbor Division's proportionate share of the State's net pension liability	$ 29,588,266	$ 23,096,737	$ 17,398,179

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 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://www.ers.ehawaii.gov.

Postemployment Health Care and Life Insurance Benefits

The State, pursuant to Act 88, SLH of 2001, is a participating employer in an agent, multiple-employer defined benefit plan providing certain health care and life insurance benefits to all qualified employees. The Employer-Union Health Benefits Trust Fund (the EUTF) was established on July 1, 2003 to provide 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 ten or more years of credited service, and 50% of the base monthly contribution for employees retiring with fewer than ten years of credited service. A retiree can elect a family plan to cover dependents.

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

For employees hired on or after July 1, 2001, and who retire with less than ten years of service, the State makes no contributions. For those retiring with at least ten years but fewer than 15 years of service, the State pays 50% of the base monthly contribution. For those retiring with at least 15 years but fewer than 25 years of service, the State pays 75% of the base monthly contribution. For those employees retiring with at least 25 years of service, the State pays 100% of the base monthly contribution. Only single plan coverage is provided for retirees in this category. Retirees can elect family coverage, but must pay the difference.

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

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 ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and to amortize any unfunded actuarial liabilities over a period not to exceed 30 years. The State allocates the ARC to the various departments and agencies based upon a systematic methodology.

The Harbors Division's contributions for the years ended June 30, 2016, 2015, and 2014 were approximately \$1,402,000, \$1,162,000, and \$1,116,000, respectively, which represents 40.9%, 35.4%, and 33.8%, respectively, of the ARC.

The table below summarizes the components of the annual OPEB cost that have been allocated to the Harbors Division by the State for the years ended June 30, 2016 and 2015:

	2016	2015
Annual required contribution	$ 3,427,000	$ 3,278,000
Contribution made	(1,402,000)	(1,162,000)
Increase in net OPEB obligation	2,025,000	2,116,000
Net OPEB obligation, beginning of the year	15,292,000	13,176,000
Net OPEB obligation, end of the year	$ 17,317,000	$ 15,292,000
Actual contributions made as a percentage of ARC	40.9%	35.4%

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.

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.

The State’s CAFR includes the required footnote disclosures and required supplementary information in accordance with the provisions of Statement No. 45.

Deferred Compensation Plan

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

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

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. 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 and earthquake, which individually is a $200,000,000 aggregate loss, and terrorism, which is $50,000,000 per occurrence and a $10,000 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 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 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. Accrued workers' compensation amounted to approximately $589,000 and $382,000 at June 30, 2016 and 2015, 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, 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.

The 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, 2016 and 2015 are approximately $6,747,000 and $12,684,000, respectively, of OHA ceded land expenses. During the fiscal year June 30, 2016, in accordance with Act 178, SLH 2006, approximately $5,254,000 was refunded to the Harbors Division.

During November 2016, the Harbors Division was notified that OHA contracted a new 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, 2016.

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 $4,263,000 and $3,811,000 for the fiscal years ended June 30, 2016 and 2015, respectively.

The Harbors Division is assessed a percentage of DOT's general administration expenses. The assessments amounted to approximately $1,652,000 and $1,781,000 for the fiscal years ended June 30, 2016 and 2015, respectively.

The Harbors Division incurred costs of approximately $100,000 and $33,000 for fireboat operation services during the fiscal years ended June 30, 2016 and 2015, 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.

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 Kalaeloa Harbors on Oahu. In addition to the six commercial harbors included in the plan, the law placed Hana Harbor on Maui under the jurisdiction of the Harbors System and included appropriations for its upgrade. The Act authorizes the DOT to issue harbor revenue bonds to finance the improvements. The cost of the Harbors Modernization Plan, originally estimated at $842 million, was revised to $618 million in 2008. Act 200 also designated the ATDC as the entity responsible for the management and implementation of the HMP under the direction of the DOT.

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

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

15. Aloha Tower Complex Development

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

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

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

On January 18, 2006, an Agreement amending the Aloha Tower Project Memorandum of Understanding and Aloha Tower Ground Lease was executed, effective as of June 30, 2005, and retroactive to July 1, 2004 (the Amendment). The Amendment required ATDC to pay $225,000 as a minimum annual base payment for losses in revenues owing in the fiscal year beginning July 1, 2004. From July 1, 2005, subject to the approval of the Deputy Director for the Harbors Division, the base payment of $225,000 was to be reduced by expenses incurred by ATDC for the Hawaii Harbors Project Office. The Amendment also required an equity participation payment to be made in an amount of 50% of the difference between the total revenues and total operating expenses of ATDC for a fiscal year (the equity payment), provided that if the equity payment exceeds two and one-half times the actual operating expenses of ATDC for such fiscal year, ATDC must make a supplemental payment equal to 75% of the difference between the equity payment and the product of two and one-half times the actual operating expenses of ATDC. These payments were to be applied to reduce the amount owed to the Harbors Division for losses in revenues by ATDC prior to

July 1, 2004. The balance owed to the Harbors Division by ATDC under this Amendment as of June 30, 2016 and 2015 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.

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 a memorandum of understanding (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 MOU with the ATDC and HLRP whereby ATDC agreed to abate rent under the lease between ATDC and HLRP for the period retroactive to July 1, 2014 to June 30, 2015 in consideration for the construction of HLRP improvements to create student and faculty residences and various university spaces for Hawaii Pacific University and to memorialize the understanding of the parties with respect to various aspects of its agreement.

$1.0 million in rent was abated for fiscal year July 1, 2014 to June 30, 2015. As ATDC did not receive any revenues during this period, it did not remit 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 Harbors Division expects an equity participation payment to be remitted in fiscal years subsequent to 2016.

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 Modernization 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.

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, 2016 and 2015, 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 $103,029,000 and $102,689,000 at June 30, 2016 and 2015, respectively.

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 costs for this contract totaled $26,245,600 and will be financed by a tax-exempt lease bearing an annual interest rate of 2.74%.

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, 2016 and 2015 were approximately $6,044,000 and $5,861,000, respectively.

Environmental Issues

Iwilei District Participating Parties

The Harbors Division is subject to laws and regulations relating to the protection of the environment. The Harbors Division has been identified by the State Department of Health as a potentially responsible party for petroleum contamination in the Honolulu Harbor/Iwilei area. Pursuant thereto, the Harbors Division entered into a voluntary agreement with the Department of Health and other third parties to share in the responsibility for the investigation and potential remediation of petroleum contamination in the Iwilei District. This group of potentially responsible parties, known as the Iwilei District Participating Parties (IDPP), has conducted various investigations to determine potential contamination in the Iwilei area from 1997 to present, which investigations have determined the existence of petroleum contamination at various locations. The remediation alternative selected involves the management of the contamination in-place with limited extraction, plume monitoring, 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 $2,599,000 as of June 30, 2016.

Environmental Protection Agency

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

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

On September 18, 2014, the U.S. Department of Justice lodged a proposed Consent Decree with the United States District Court for the District of Hawaii in the lawsuit entitled United States et al. v. Hawaii Department of Transportation, Civil Case No. 14-00408. The Department agreed to correct federal Clean Water Act violations at Honolulu and Kalaeloa Barbers Point Harbors on Oahu, modify departmental administrative and operational procedures and pay a civil penalty of $600,000 plus interest to the U.S. Department of Justice and $600,000 plus interest to the Hawaii Department of Health. Under the conditions of the Consent Decree, the Department is required to implement structural changes to management and a comprehensive stormwater management plan over the life of the Consent Decree. The Consent Decree was entered on November 5, 2014 and payments of $600,160 were 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 $757,000 has been paid as of June 30, 2016. 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 which was later amended to $800,000, of which approximately $285,000 has been paid as of June 30, 2016.

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

On December 6, 2016, the Harbors Division issued $14,565,000 in Series 2016 A, $68,535,000 in Series 2016 B, $8,135,000 in Series 2016 C, and $22,425,000 in Series 2016 D Revenue Refunding Bonds (the Bonds). The Bonds bear interest from 1.99% to 3.09% with maturity dates through January 2031. The Series A 2016 Revenue Bonds refunded $16,195,000 of 2004 B Bonds, the Series B 2016 Revenue Bonds refunded $71,625,000 of 2006 A Bonds, the Series C 2016 Revenue Bonds refunded $7,365,000 of 2007 A Bonds, and Series D 2016 Revenue Bonds refunded $22,315,000 of 2007 A Bonds. The refunding of 2004 B, 2006 A, and 2007 A Bonds provided net present value savings of approximately $15,900,000.

The Harbors Division has evaluated subsequent events from the statements of net position date through December 29, 2016, the date at which the financial statements were available to be issued, and determined that there are no other items to disclose.

SUPPLEMENTARY INFORMATION

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

Cash and Cash Equivalents of the Public Undertaking

June 30, 2016

Unrestricted cash and cash equivalents	$ 235,715,532
Restricted cash and cash equivalents:	
For construction−revenue bonds	81,310,073
For revenue bond debt service payments	23,134,958
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	42,316,502
For security deposits	2,322,297
For risk management	2,279,416
	173,715,937
	$ 409,431,469

With Director of Finance, State of Hawaii	$ 406,008,171
On hand	3,423,298
	$ 409,431,469

See accompanying independent auditors' report.

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

Revenue Bonds of the Public Undertaking

June 30, 2016

	Final Redemption Date	Interest Rate	Original Amount of Issue	Balance at June 30, 2016 Current	Noncurrent	Total
Issue of 2004	January 1, 2024	2.50-6.00%	$ 52,030,000	$ 1,665,000	$ 14,530,000	$ 16,195,000
Issue of 2006	January 1, 2031	4.00-5.25%	96,570,000	3,250,000	68,375,000	71,625,000
Issue of 2007	July 1, 2027	4.25-5.50%	51,645,000	2,105,000	31,895,000	34,000,000
Issue of 2010	July 1, 2040	3.00-5.75%	201,390,000	7,005,000	172,935,000	179,940,000
Issue of 2013	July 1, 2029	3.25%	23,615,000	840,000	20,770,000	21,610,000
			$ 425,250,000	$ 14,865,000	$ 308,505,000	$ 323,370,000

See accompanying independent auditors' report.

Schedule 3

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

Income from Operations Before Depreciation

Year Ended June 30, 2016

		District									
		Oahu		Hawaii		Maui			Kauai		
	Statewide	Honolulu	Kalaeloa	Hilo	Kawaihae	Kahului	Kaunakakai	Kaumalapau	Nawiliwili	Port Allen	Total
Operating revenues, net											
Services:											
Wharfage	$ -	$ 69,753,627	$ 2,924,555	$ 2,868,201	$ 3,797,271	$ 6,199,699	$ 227,939	$ 291,206	$ 2,683,747	$ -	$ 88,746,245
Pax debark/embark	-	2,848,664	-	1,861,433	4,319	951,993	4,340	-	1,369,569	-	7,040,318
Dockage	-	3,534,588	736,257	286,532	97,317	445,042	32,116	6,428	353,927	2,840	5,495,047
Demurrage	-	1,519,714	-	487,646	177,235	95,906	-	-	41,767	-	2,322,268
Mooring charges	-	320,922	-	14,296	34,743	206	2,721	-	-	538,928	911,816
Port entry	-	643,064	125,599	77,151	39,635	89,155	11,812	5,205	69,761	2,406	1,063,788
Cleaning charges	-	189,338	3,373	-	-	-	-	-	-	62	192,773
Other services	-	15,768	164,150	1,257	6,102	94	-	-	3,739	11,702	202,812
Total services	-	78,825,685	3,953,934	5,596,516	4,156,622	7,782,095	278,928	302,839	4,522,510	555,938	105,975,067
Rentals:											
Wharf space and land	-	9,128,834	2,239,080	68,393	379,212	222,806	15,318	300	326,669	242,698	12,623,310
Storage	-	3,758,848	86,040	231,126	232,120	236,398	-	-	243,842	11,755	4,800,129
Automobile parking	-	993,096	1,452	86,552	8,106	130,048	1,551	-	97,812	12,463	1,331,080
Pipeline water	-	77,873	6,543	35,922	859	63,117	-	-	67,042	-	251,356
Other pipeline	-	906,872	1,529,197	630,295	94,624	832,422	18,253	-	200,376	108,993	4,321,032
Total rentals	-	14,865,523	3,862,312	1,052,288	714,921	1,484,791	35,122	300	935,741	375,909	23,326,907
Others:											
Sale of utilities	-	242,735	106,551	14,049	476	75,302	-	-	51,938	8,302	499,353
Miscellaneous	-	219,628	1,681	36,844	4,041	18,715	19,325	453	685	23,089	324,461
Total others	-	462,363	108,232	50,893	4,517	94,017	19,325	453	52,623	31,391	823,814
Total operating revenues	-	94,153,571	7,924,478	6,699,697	4,876,060	9,360,903	333,375	303,592	5,510,874	963,238	130,125,788
Operating expenses before depreciation and amortization:											
Personnel services	7,846,569	7,724,901	202,175	887,008	72,896	1,084,375	62,667	-	1,053,523	55,666	18,989,780
Harbor operations	8,013,017	5,141,413	726,828	523,788	458,745	784,689	17,003	-	655,563	35,175	16,356,221
Maintenance	275,532	2,702,307	465,911	225,230	14,560	305,680	113,551	87,800	207,950	4,769	4,403,290
State of Hawaii, surcharge for central service expenses	4,262,892	-	-	-	-	-	-	-	-	-	4,262,892
General administration	2,462,472	42,099	282	22,671	5,086	12,846	254	-	18,375	1,606	2,565,691
Department of Transportation, general administration expenses	1,652,190	-	-	-	-	-	-	-	-	-	1,652,190
Fireboat operations	-	99,640	-	-	-	-	-	-	-	-	99,640
Subtotal	24,512,672	15,710,360	1,395,196	1,658,697	551,287	2,187,590	193,475	87,800	1,935,411	97,216	48,329,704
Allocation of statewide expenses (1)	(24,512,672)	17,736,343	1,492,787	1,262,067	918,536	1,763,376	62,800	57,190	1,038,121	181,452	-
Total operating expenses before depreciation and amortization	-	33,446,703	2,887,983	2,920,764	1,469,823	3,950,966	256,275	144,990	2,973,532	278,668	48,329,704
Income from operations before depreciation and amortization	$ -	$ 60,706,868	$ 5,036,495	$ 3,778,933	$ 3,406,237	$ 5,409,937	$ 77,100	$ 158,602	$ 2,537,342	$ 684,570	$ 81,796,084

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, 2016

Net revenues, as defined by the 1997 Certificate:		
Operating income before depreciation and amortization	$	81,796,084
Add:		
Interest income		1,724,617
State of Hawaii, surcharge for central service expenses		4,262,892
Cash available in the harbor reserve and contingency account		10,897,658
	$	98,681,251
Harbor revenue bond debt service requirements under the 1997 Certificate, including minimum sinking fund payments	$	31,186,685
Ratio of net revenues to harbor revenue bond debt service requirements		3.16

See accompanying independent auditors' report.

PART III

INTERNAL CONTROL AND COMPLIANCE SECTION

KDLY LLC
CERTIFIED PUBLIC ACCOUNTANTS

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, 2016 and 2015, 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, 2016.

Internal Control over Financial Reporting

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

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

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

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Compliance and Other Matters

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

Purpose of this Report

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

KKDLY LLC

Honolulu, Hawaii
December 29, 2016