
Hawaii Health Systems Corporation

**Financial Report
with Other Supplemental Information
June 30, 2018**

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Independent Auditor's Report

To the Board of Directors
Hawaii Health Systems Corporation

Report on the Financial Statements

We have audited the accompanying financial statements of Hawaii Health Systems Corporation (the "Corporation"), a component unit of the State of Hawaii, as of and for the year ended June 30, 2018 and the related notes to the financial statements, which collectively comprise Hawaii Health Systems Corporation's financial statements, as listed in the table of contents

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our 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 audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of Hawaii Health Systems Corporation as of June 30, 2018 and the respective changes in its financial position and cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As described in Note 2 to the financial statements, the Corporation adopted the provisions of GASB Statement No. 75, *Accounting and Financial Report for Postemployment Benefits Other than Pensions*. Our opinion is not modified with respect to this matter.

As described in Note 1, the financial statements present only Hawaii Health Systems Corporation (a component unit of the State of Hawaii) and do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2018 or the changes in its financial position or its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified in respect to this matter.

To the Board of Directors
Hawaii Health Systems Corporation

Other Matters

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise Hawaii Health Systems Corporation's financial statements. The accompanying other supplemental information, as identified in the table of contents, is presented for the purpose of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole

Required Supplemental Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, schedule of the proportionate share of the net pension liability, schedule of pension contributions, schedule of changes in net OPEB liability, and schedule of OPEB contributions, as identified in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, which 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 supplemental information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated December 11, 2018 on our consideration of Hawaii Health Systems Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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 the 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 Hawaii Health System Corporation's internal control over financial reporting and compliance.



December 11, 2018

This discussion and analysis of Hawaii Health Systems Corporation's (the "Corporation") financial performance provides an overview of the Corporation's financial activities for the fiscal years ended June 30, 2018 and 2017. Please read it in conjunction with the Corporation's financial statements, which begin on page 9.

Using this Annual Report

The Corporation's financial statements consist of three statements: (a) a statement of net position; (b) a statement of revenue, expenses, and changes in net position; and (c) a statement of cash flows. These financial statements and related notes provide information about the activities of the Corporation, including resources held by the Corporation but restricted for specific purposes.

The Statement of Net Position and Statement of Revenue, Expenses, and Changes in Net Position

Our analysis of the Corporation's finances begins on page 9. One of the most important questions asked about the Corporation's finances is, "Is the Corporation as a whole better or worse off as a result of the year's activities?" The statement of net position and the statement of revenue, expenses, and changes in net position report information about the Corporation's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. All of the current year's revenue and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Corporation's net position and changes in net position. The Corporation's net position - the difference between assets and deferred outflows and liabilities and deferred inflows - can be thought of as one way to measure the Corporation's financial health or financial position. Over time, increases or decreases in the Corporation's net position are one indicator of whether its financial health is improving or deteriorating. You will need to consider other nonfinancial factors, however, such as changes in the Corporation's patient base and measures of the quality of service it provides to the community, as well as local economic factors, to assess the overall health of the Corporation.

The Statement of Cash Flows

The final required statement is the statement of cash flows. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities. It provides answers to such questions as, "Where did cash come from?", "What was cash used for?", and "What was the change in cash balance during the reporting period?"

The Corporation's Net Position

The Corporation's net position is the difference between its assets and deferred outflows and liabilities and deferred inflows, reported in the statement of net position on page 9. The Corporation's net position increased by \$313,227,772 after restatement in 2018 for GASB Statement No. 75 and decreased by \$(89,000,840) (18 percent) in 2017, as you can see in the below table.

Hawaii Health Systems Corporation

Management's Discussion and Analysis (Continued)

Assets, Deferred Outflows, Liabilities, Deferred Inflows, and Net Position

Summarized financial information of Hawaii Health Systems Corporation's statement of net position as of June 30, 2018 and 2017 is as follows:

	2018	2017
Assets		
Current assets	\$ 270,520,262	\$ 299,162,372
Capital assets - Net	352,989,995	363,688,690
Other	12,804,398	3,696,653
Total assets	636,314,655	666,547,715
Deferred Outflows	192,593,251	279,905,162
Total assets and deferred outflows	828,907,906	946,452,877
Liabilities		
Current liabilities	99,154,954	136,820,016
Other postemployment liability	541,845,124	387,734,944
Due to the State of Hawaii	19,008,243	20,122,507
Accrued postretirement benefit obligations	530,455,687	916,111,059
Other liabilities	50,383,059	64,113,396
Total liabilities	1,240,847,067	1,524,901,922
Deferred Inflows	30,456,060	16,106,533
Total liabilities and deferred inflows	1,271,303,127	1,541,008,455
Net Position		
Invested in capital assets - Net of related debt	317,035,159	324,570,837
Restricted	98,970	1,301,834
Unrestricted	(759,529,350)	(914,593,801)
Total net position	\$ (442,395,221)	\$ (588,721,130)

At June 30, 2018 and 2017, Hawaii Health Systems Corporation's current assets approximated 43 percent and 45 percent, respectively, of total assets. Current assets decreased approximately \$28.6 million in 2018 primarily due to a decrease in patient accounts receivable of \$38.6 million and an increase in cash and cash equivalents of \$10.0 million. Current assets decreased approximately \$6.8 million in 2017 due to a decrease in due from the State of Hawaii CIP funds of \$26.2 million and a decrease in third-party payor settlements of approximately \$12.5 million. These changes are offset by an increase in cash of \$11.7 million and an increase in patient receivables of \$19.0 million. The increases in cash for both 2018 and 2017 are primarily due to various factors, as reflected in the statement of cash flows. The decrease in due from the State of Hawaii CIP funds, which is included within current assets for 2018 and 2017 is due to the timing of when payments were made from the State to Hawaii Health Systems Corporation.

At June 30, 2018 and 2017, Hawaii Health Systems Corporation's current liabilities approximated 9 percent of total liabilities.

At June 30, 2018 and 2017, Hawaii Health Systems Corporation's portion of net position that is reflected as its net investment in capital assets, net of related debt, was approximately \$317 million and \$325 million, respectively. Total net position was approximately \$(442) million in 2018 and \$(589) million in 2017.

Capital Assets

At June 30, 2018 and 2017, Hawaii Health Systems Corporation's capital assets, net of accumulated depreciation, comprised approximately 55 percent of its total assets. These assets consist mainly of land, hospital buildings, and equipment that are used in Hawaii Health Systems Corporation's operations. The decrease of approximately \$11 million in 2018 is due primarily to depreciation expense incurred in 2018 for these capital assets. The increase of approximately \$5.1 million in 2017 is due to the completion of ongoing construction projects,

Hawaii Health Systems Corporation

Management's Discussion and Analysis (Continued)

A summary of Hawaii Health Systems Corporation's capital assets as of June 30, 2018 and 2017 is as follows:

	2018	2017
Land and land improvements	\$ 7,814,855	\$ 7,814,855
Building and improvements	519,812,210	505,483,896
Equipment	255,443,860	266,900,149
Construction in progress	44,504,036	35,179,719
Total cost	827,574,961	815,378,619
Less accumulated depreciation and amortization	(474,584,966)	(451,689,929)
Capital assets - Net	<u>\$ 352,989,995</u>	<u>\$ 363,688,690</u>

Long-term Debt and Capital Lease Obligations

At June 30, 2018 and 2017, Hawaii Health Systems Corporation had long-term debt and capital lease obligations totaling approximately \$43.8 million and \$48.3 million, respectively. The decrease of \$4.5 million in 2018 and decrease of \$7.5 million in 2017 was due to continuing payments on existing debt obligations along with very little new issuances of capital lease obligations. More detailed information about Hawaii Health Systems Corporation's long-term debt and capital lease obligations is presented in the notes to the financial statements.

Operating Results and Changes in Net Position

Summarized financial information of Hawaii Health Systems Corporation's statement of revenue, expenses, and changes in net position for the years ended June 30, 2018 and 2017 is as follows:

	2018	2017
Operating Revenue	\$ 446,883,149	\$ 679,169,889
Operating Expenses		
Salaries and wages	241,453,293	316,009,476
Employee benefits	220,048,912	233,372,555
Purchased services and professional fees	87,257,245	130,710,043
Medical supplies and drugs	47,099,184	84,419,836
Depreciation	41,122,426	40,400,080
Insurance	9,685,164	6,997,134
Other	55,277,610	67,321,366
Total operating expenses	701,943,834	879,230,490
Operating Loss	(255,060,685)	(200,060,601)
Nonoperating Revenue		
General appropriations from the State of Hawaii	112,301,548	107,365,000
Other nonoperating revenue - Net	32,579,818	(6,336,761)
Total nonoperating revenue	144,881,366	101,028,239
Excess of Expense Over Revenue before Capital Contributions and Transfers	(110,179,319)	(99,032,362)
Capital Contributions	25,138,791	10,031,522
Transfer of Liabilities to the State of Hawaii	403,451,094	-
Transfer Agreement Expense	(5,182,794)	-
Increase (Decrease) in Net Position	<u>\$ 313,227,772</u>	<u>\$ (89,000,840)</u>

Hawaii Health Systems Corporation

Management's Discussion and Analysis (Continued)

Operating Losses

For the years ended June 30, 2018 and 2017, Hawaii Health Systems Corporation's operating expenses exceeded its operating revenue by \$255.1 million and \$200.1 million, respectively. General appropriations from the State of Hawaii totaled \$112.3 million and \$107.4 million in 2018 and 2017, respectively. In addition, appropriations from the State of Hawaii for capital contributions totaled \$25.1 million and \$10.0 million in 2018 and 2017, respectively. These items, along with the other nonoperating revenue and the transfer of certain liabilities to the State of Hawaii, contributed to an increase in net position of \$313.0 million in 2018 and a decrease in net position of \$89.0 million in 2017.

Operating expenses for the fiscal year ended June 30, 2018 were approximately 20.2 percent lower than 2017. Operating expenses for the fiscal year ended June 30, 2018 decreased \$177.3 million from fiscal year 2017, which was primarily due to the transition of operations at Maui Region. Maui Region operating expenses for fiscal year 2018 were \$61,034,479, as compared to \$339,582,199 in fiscal year 2017, a decrease of \$278,547,720. This decrease in operating expenses was offset by a \$56.8 million increase in postemployment benefit expense allocated to the Corporation from the State of Hawaii, \$48.7 million in pension expense allocated to the Corporation from the State of Hawaii, \$18.0 million in employee benefit expense increases charged to the Corporation as part of its payroll payments, and \$11.2 million in collective bargaining pay raises negotiated by the State of Hawaii on the Corporation's behalf.

Operating revenue for the fiscal year ended June 30, 2018 was approximately 34.2 percent lower than 2017. The decrease in operating revenue is primarily due to the transition of HHSC's three Maui Region facilities to Kaiser Permanente, effective July 1, 2017.

Operating expenses for the fiscal year ended June 30, 2017 were approximately 12.4 percent higher than 2016. Operating expenses for the fiscal year ended June 30, 2017 increased \$97.0 million from fiscal year 2016, which was primarily due to increases in purchased services and professional fees of approximately \$14.3 million and an increase in employee benefits of \$66.9 million, with the remainder due to normal inflationary cost increases.

Operating revenue for the fiscal year ended June 30, 2017 was approximately 6 percent higher than 2016. The increase in operating revenue is primarily due to an increase in acute patient days from fiscal year 2016, coupled with an increase in payments from various health plans related to uncompensated care programs. Additional increases in revenue is driven by third-party payor contract negotiations, clinical documentation improvement initiatives, and strategic pricing initiatives.

System-wide Outlook

On July 1, 2017, the Corporation successfully completed the transfer of the operations of the Maui Region facilities to Kaiser Permanente (Kaiser). The Maui Region facilities are now part of Maui Health Systems, a Kaiser Foundation Hospitals LLC. The Maui Region continues to own all capital assets, which are now leased to Kaiser as part of a lease agreement. During fiscal year 2018, the Corporation worked to resolve the remaining assets and liabilities of the Maui Region other than the capital assets. Working with several third-party agencies, the Corporation successfully collected more on the Maui Region receivables as of June 30, 2017 during fiscal year 2018 than originally estimated. The additional funds collected will be used to pay for ongoing costs throughout the term of the lease (e.g., property and directors and officers insurance, record retention, contracted third-party agencies, etc.) and to make payments on past liabilities, such as excess pension costs and workers' compensation claims. Related to the Maui transition, the State provided the Corporation with General Fund appropriations of \$10,517,000 in fiscal year 2018 to pay for the Maui Region's continuing obligations to the rest of the Corporation system, such as the Maui Region share of corporate office costs, electronic medical record system maintenance payments, and contribution to funding Alii Community Care, Inc.'s Roselani Place facility.

In May 2017, Hawaii Governor Ige signed Act 018, SB207 SD2 HD2 CD1, which authorized the expenditure of General Fund funds for a one-time lump-sum cash bonus severance benefit to Maui Region employees who were affected by the transfer of operations. These severance benefits totaling approximately \$30.5 million were paid to the affected Maui Region employees in October 2017, and Maui Region received an equal amount from the State of Hawaii to fund the payment of those severance benefits, which is reported as nonoperating income.

Hawaii Health Systems Corporation

Management's Discussion and Analysis (Continued)

Fiscal year 2018 continued the trend of demonstrating how critical the Corporation's facilities are in terms of access to health care in the State of Hawaii, particularly on the neighbor islands. In fiscal year 2018, the Corporation's acute discharges for the four remaining HHSC regions increased approximately 1.1 percent to 13,753, which accounts for 12.2 percent of all acute care discharges in the State of Hawaii. In fiscal year 2018, the Corporation's emergency department visits for the four remaining HHSC regions increased approximately 4.3 percent to 75,456, representing 16.4 percent of all emergency department visits statewide. The impact of the Corporation's facilities on the neighbor islands is even more impressive. For residents of the County of Hawaii, the Corporation's facilities cared for 69 percent of all acute care discharges and 84 percent of all emergency department visits. For residents of the County of Kauai, the Corporation's facilities cared for 19 percent of all acute care discharges and 37 percent of all emergency department visits.

Despite the high volume of care that is provided at the Corporation's facilities, the Corporation continues to face growing operating losses due to salaries and benefits expense levels much higher than industry norms, resulting from the Corporation's status as a state agency. The Corporation was forced to absorb collective bargaining raises of varying percentages negotiated by the State of Hawaii, which increased salaries and benefits expense by approximately \$10.4 million in fiscal year 2018. Furthermore, the collective bargaining agreements negotiated by the State of Hawaii are meant to cover employees supporting the static business environment of administrative offices, not the dynamic working environment found in the hospitals that Corporation operates. As a result, the work rules and pay schedules dictated by those collective bargaining agreements makes it difficult for the Corporation to operate its facilities efficiently and cost effectively.

In fiscal year 2018, the State assessed the Corporation a fringe benefit rate of 50.54 percent for the first three months of fiscal year 2018 and 56.48 percent for the last nine months of fiscal year 2018. The increase in the fringe benefit rate from fiscal year 2017 equates to almost \$18.2 million in additional salaries and benefits expense. Other private hospitals across the United States pay a fringe benefit rate of between 25-30 percent. The impact to the Corporation of the difference between its fiscal year 2018 fringe benefit rate and the private hospital fringe rate of 30 percent is approximately \$47 million in additional annual expense to the Corporation.

Future Outlook

As long as the State of Hawaii continues to impose collective bargaining pay raises and fringe benefit increases upon the Corporation without providing funding to fully cover those costs, the Corporation's management believes continued increasing General Fund support will be necessary just to maintain the basic safety net services that its facilities currently provide to the communities that they serve. If the Corporation's facilities are forced to further reduce services, it will further reduce access to care in communities where there is already a shortage of healthcare services that the communities need and deserve. In fiscal year 2019, the Corporation has already had to absorb cumulative collective bargaining raises since the start of fiscal year 2018 costing approximately \$24.1 million (with only \$11.2 million in additional General Fund appropriation support) and an increase in the fringe benefit rate to 60.08 percent.

The Corporation is continuously analyzing how to better meet the challenges of delivering vital health care to the communities it serves. In doing so, the Corporation continues to evaluate its current operations to see where there may be opportunities for the system as a whole to operate more efficiently and effectively in providing accessible, high quality services that address the healthcare needs of Hawaii's unique island communities.

Contacting the Corporation's Financial Management

This financial report is designed to provide our patients, suppliers, taxpayers, and creditors with a general overview of the Corporation's finances and to show the Corporation's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Hawaii Health Systems Corporation's corporate office at Hawaii Health Systems Corporation, 3675 Kilauea Avenue, Honolulu, HI 96816.

Hawaii Health Systems Corporation

Statement of Net Position

June 30, 2018

Assets and Deferred Outflows Of Resources

Current Assets

Cash and cash equivalents - State of Hawaii (Note 2)	\$ 14,420,501
Cash and cash equivalents (Note 2)	111,089,957
Patient accounts receivable - Less allowance for doubtful accounts of \$31,572,152 (Notes 2 and 3)	63,118,681
Investments (Note 4)	7,293,429
Supplies and other current assets	11,179,130
Due from the State of Hawaii (Note 6)	53,812,700
Estimated third-party payor settlements	9,605,864

Total current assets 270,520,262

Assets Limited as to Use (Note 2) 11,736,510

Capital Assets - Net (Note 5) 352,989,995

Other Assets 1,067,888

Total assets 636,314,655

Deferred Outflows of Resources

Deferred outflows of resources - Pension (Note 8)	109,442,884
Deferred outflows of resources - Postemployment benefits other than pensions (Note 9)	83,150,367

Total deferred outflows of resources 192,593,251

Total assets and deferred outflows of resources **\$ 828,907,906**

Hawaii Health Systems Corporation

Statement of Net Position (Continued)

June 30, 2018

Liabilities, Deferred Inflows of Resources, and Net Position

Current Liabilities

Accounts payable and accrued expenses	\$ 64,544,248
Current portion of accrued vacation (Note 7)	14,871,289
Current portion of long-term debt (Note 10)	11,986,033
Current portion of capital lease obligations (Note 10)	2,541,521
Current portion of accrued workers' compensation (Note 11)	3,932,000
Other current liabilities	1,279,863

Total current liabilities 99,154,954

Long-term Debt - Less current portion (Note 10) 24,291,662

Capital Lease Obligations - Less current portion (Note 10) 4,939,228

Other Liabilities

Accrued vacation - Less current portion (Note 7)	12,840,265
Accrued workers' compensation - Less current portion (Note 11)	8,100,000
Other postemployment benefit liability (Note 9)	541,845,124
Due to the State of Hawaii (Note 6)	19,008,243
Pension liability (Note 8)	530,455,687
Patients' safekeeping deposits	185,956
Other liabilities	25,948

Total liabilities 1,240,847,067

Deferred Inflows of Resources

Deferred inflows of resources - Pension (Note 8)	29,330,872
Deferred inflows of resources - Postemployment benefits other than pensions (Note 9)	1,125,188

Total deferred inflows of resources 30,456,060

Total liabilities and deferred inflows of resources 1,271,303,127

Net Position

Unrestricted	(759,529,350)
Net investment in capital assets	317,035,159
Restricted for capital purchases (Note 2)	98,970

Total net position (442,395,221)

Total liabilities, deferred inflows of resources, and net position **\$ 828,907,906**

Hawaii Health Systems Corporation

Statement of Revenue, Expenses, and Changes in Net Position

Year Ended June 30, 2018

Operating Revenue	
Net patient service revenue (net of provision for doubtful accounts of \$16,164,308)	\$ 432,887,791
Other revenue	13,995,358
Total operating revenue	<u>446,883,149</u>
Operating Expenses	
Salaries	241,453,293
Employee benefits	220,048,912
Medical supplies and drugs	47,099,184
Depreciation and amortization	41,122,426
Utilities	11,289,207
Repairs and maintenance	12,843,900
Other supplies	12,567,203
Purchased services	74,503,307
Professional fees	12,753,938
Insurance	9,685,164
Rent and lease	5,408,259
Other	13,169,041
Total operating expenses	<u>701,943,834</u>
Operating Loss	(255,060,685)
Nonoperating Revenue (Expense)	
General appropriations from the State of Hawaii	112,301,548
Transfers from State of Hawaii	30,480,914
Restricted contributions	764,352
Interest expense	(2,232,520)
Interest and dividend income	804,015
Other nonoperating revenue - Net	2,763,057
Total nonoperating income	<u>144,881,366</u>
Excess of Expenses Over Revenue before Capital Contributions and Transfers	(110,179,319)
Capital Contributions	25,138,791
Transfer of Liabilities to the State of Hawaii (Note 1)	403,451,094
Transfer Agreement Expense (Note 1)	<u>(5,182,794)</u>
Increase in Net Position	313,227,772
Net Position - Beginning of year - As restated (Note 2)	<u>(755,622,993)</u>
Net Position - End of year	<u><u>\$ (442,395,221)</u></u>

Hawaii Health Systems Corporation

Statement of Cash Flows

Year Ended June 30, 2018

Cash Flows from Operating Activities

Cash received from government, patients, and third-party payors	\$ 465,602,633
Cash payments to employees for services	(385,713,854)
Cash payments to suppliers for services and goods	(209,709,935)
Other receipts from operations	<u>13,995,358</u>
Net cash used in operating activities	(115,825,798)

Cash Flows from Noncapital Financing Activities

Appropriations from the State of Hawaii	112,301,548
Transfers from the State of Hawaii	30,480,914
Other nonoperating revenue - Net	<u>2,763,057</u>
Net cash provided by noncapital financing activities	145,545,519

Cash Flows from Capital and Related Financing Activities

Purchase of capital assets	(5,897,951)
Interest paid	(2,232,520)
Repayments on long-term debt	(1,735,418)
Repayments on capital lease obligations	(4,875,617)
Loss on disposal of capital assets	2,483,126
Restricted capital contributions	<u>1,129,995</u>
Net cash used in capital and related financing activities	(11,128,385)

Cash Flows from Investing Activities

Interest income	804,015
Purchase of short-term investments and assets limited as to use	<u>(8,461,272)</u>
Net cash used in investing activities	<u>(7,657,257)</u>

Net Increase in Cash and Cash Equivalents

10,934,079

Cash and Cash Equivalents - Beginning of year

114,576,379

Cash and Cash Equivalents - End of year

\$ 125,510,458

Statement of Net Position Classification of Cash and Cash Equivalents

Cash and cash equivalents	\$ 111,089,957
Cash and cash equivalents - State of Hawaii	<u>14,420,501</u>
Total cash and cash equivalents	<u><u>\$ 125,510,458</u></u>

Hawaii Health Systems Corporation

Statement of Cash Flows (Continued)

Year Ended June 30, 2018

A reconciliation of operating loss to net cash used in operating activities is as follows:

Cash Flows from Operating Activities

Operating loss	\$ (255,060,685)
Adjustments to reconcile operating loss to net cash from operating activities:	
Provision for doubtful accounts	16,164,308
Depreciation and amortization	41,122,426
Changes in assets and liabilities:	
Patient accounts receivable	19,032,421
Supplies and other assets	370,199
Accounts payable, accrued expenses, and other liabilities	(28,126,911)
Accrued workers' compensation liability	(708,000)
Postemployment benefit liability	305,749,616
Pension liability	(32,596,469)
Deferred outflows and inflows	(167,601,934)
Estimated third-party payor settlements	(2,481,887)
Accrued vacation	(11,688,882)
Net cash used in operating activities	<u>\$ (115,825,798)</u>

Noncash Financing and Investing Activities

Capital assets contributed by the State of Hawaii and others	\$ 25,435,029
Net change in accounts payable related to capital assets acquired	(485,183)
Change in due from the State of Hawaii	661,881
Assets acquired via capital lease	2,059,060
Noncash transfer agreement expense	5,182,794
Noncash transfer to the State of Hawaii	403,451,094

June 30, 2018

Note 1 - Organization

Structure

Hawaii Health Systems Corporation (the "Corporation") is a public body corporate and politic and an instrumentality and agency of the State of Hawaii (the "State"). Hawaii Health Systems Corporation is managed by a chief executive officer under the control of an 18-member board of directors.

In June 1996, the legislature of the State passed Act 262, S.B. 2522. The act, which became effective in fiscal year 1997, transferred all facilities under the administration of the Department of Health - Division of Community Hospitals to Hawaii Health Systems Corporation. Hawaii Health Systems Corporation currently operates the following facilities:

East Hawaii Region:

- Hilo Medical Center
- Hale Ho'ola Hamakua
- Ka'u Hospital
- Yukio Okutsu Veterans Care Home (Yukio is not included in the East Hawaii Region audited financial statements)

West Hawaii Region:

- Kona Community Hospital
- Kohala Hospital

Kauai Region:

- Kauai Veterans Memorial Hospital
- Samuel Mahelona Memorial Hospital

Oahu Region:

- Leahi Hospital
- Maluhia

The operations of the following facilities were transferred to Kaiser Permanente on July 1, 2017:

Maui Region (or HHSC - Maui):

- Maui Memorial Medical Center (MMMC)
- Kula Hospital
- Lanai Community Hospital

Kahuku Medical Center:

Act 262 also amended a previous act to exempt all facilities from the obligation to pay previously allocated central service and departmental administration expenses by the State.

Hawaii Health Systems Corporation is considered to be administratively attached to the Department of Health of the State and is a component unit of the State. The accompanying financial statements relate only to Hawaii Health Systems Corporation and the facilities, and are not intended to present the financial position, results of operations, or cash flows of the Department of Health.

June 30, 2018

Note 1 - Organization (Continued)

Negotiations between Hawaii Health Systems Corporation and the State relating to the transfer of assets and assumption of liabilities pursuant to Act 262 had not been finalized as of June 30, 2018. Accordingly, the assets, liabilities, and net assets of Hawaii Health Systems Corporation reflected in the accompanying statement of revenue, expenses, and changes in net position may be significantly different from those eventually included in the final settlement.

The financial statements are being presented for Hawaii Health Systems Corporation; Hawaii Health Systems Foundation (HHSF); Alii Community Care, Inc. (Alii); and Kona Ambulatory Surgery Center (KASC). HHSF and Alii are nonprofit organizations of which Hawaii Health Systems Corporation is the sole member. The purpose of HHSF is to raise funds and to obtain gifts and grants on behalf of Hawaii Health Systems Corporation. The purpose of Alii is to own, manage, and operate assisted living and other healthcare facilities in the state.

In June 2007, the state legislature passed Act 290, S.B. 1792. This act, which became effective on July 1, 2007, required the establishment of a 7- to 15-member regional system board of directors for each of the five regions of the Hawaii Health Systems Corporation system. Each regional board was given custodial control and responsibility for management of the facilities and other assets in their respective regions. This act also restructured the 13-member Hawaii Health Systems Corporation board of directors to 15 members, composed of 10 members appointed by the governor from nominees submitted by legislative leadership, two at-large members at the governor's discretion, two physician members selected by the Hawaii Health Systems Corporation board, and the State Director of Health.

Act 290 also exempted the regions from the requirements of the state procurement code and other exemptions from state agency laws, such as tax clearance certificate requirements, the concession law, and the sunshine law.

In 2009, the legislature passed Act 182, S.B. 1673, effective July 1, 2009, which allowed the individual facilities or regions of Hawaii Health Systems Corporation to transition into a new legal entity in any form recognized under the laws of the State of Hawaii, including, but not limited to, a nonprofit corporation, a for-profit corporation, a municipal facility, a public benefit corporation, or a combination of the above. The act also amended the requirement for maintenance of services to outline a process that must be followed in order for a facility to substantially reduce or eliminate a direct patient care service. Furthermore, the act reconstituted the Hawaii Health Systems Corporation board of directors to a 12-member board of directors, which includes the five regional chief executive officers, one representative each appointed by the East Hawaii, West Hawaii, Kauai, and Oahu regional boards, two members appointed by the Maui regional board, and the director of the Department of Health as an ex officio nonvoting member.

In June 2011, the legislature passed Act 126, S.B. 1300, effective July 1, 2011, which reconstituted the Hawaii Health Systems Corporation board of directors to a 13-member board of directors by adding an at-large voting member appointed by the governor of the State of Hawaii and changing the voting status of the director of the Department of Health from a nonvoting to a voting member.

In June 2013, the legislature passed Act 278, H.B. 1130, effective July 2013, which reconstituted the Corporation's board of directors by adding five regional members appointed by the governor and making the five regional chief executive officers ex officio, nonvoting members.

Maui Region

In June 2015, the legislature passed Act 103, H.B. 1075, effective June 10, 2015, which allowed for the transition of the management of the Maui Region facilities to a new entity.

June 30, 2018

Note 1 - Organization (Continued)

Following the State of Hawaii legislature passing Act 103, the Maui Region entered into a transfer agreement with Kaiser Permanente (Kaiser). As of July 1, 2017, operations of HHSC - Maui's facilities were transferred to Kaiser. HHSC - Maui continues to own all capital assets that are now leased to Kaiser as part of a lease agreement. As of the transfer date, the main economic function of the region is related to lease activity, and there will be no other significant revenue streams. See Note 10 for further discussion regarding lease activity.

As called for in Act 103, HHSC - Maui made severance payments to qualified employees during the fiscal year ended 2018, which was funded by the State. The severance approximated \$30.5 million and is included within salaries and employee benefits within the statement of revenue, expenses, and changes in net position. The reimbursement from the State, also for \$30.5 million, is included within Transfers from the State of Hawaii within nonoperating revenue in the statement of revenue, expenses, and changes in net position.

Act 103 also called for the transfer of certain liabilities from the Corporation to the State. These liabilities included the net pension liability and other postemployment benefit liability and any related deferred inflows and deferred outflows of resources. As part of Act 103, these liabilities were transferred back to the State. In total, the amount of deferred outflows of resources transferred to the State was \$108,512,305, and the amount of deferred inflows of resources and liabilities transferred to the State was \$511,963,399. The net impact from the removal of the deferred outflows of resources, deferred inflows of resources, and liabilities of \$403,451,094 is included below excess of expenses over revenue within the statement of revenue, expenses, and changes in net position.

The transfer agreement resulted in all inventory of HHSC - Maui as of July 1, 2017 becoming the property of Kaiser. As of the transfer date, HHSC - Maui recognized \$5,182,794 of transfer agreement expense to reflect the change in ownership of inventory, which is included below excess of expenses over revenue within the statement of revenue, expenses, and changes in net position.

Kahuku Medical Center

In June 2007, the state legislature passed Act 113, H.B. 843. This act amended Hawaii Revised Statutes 323F to allow for the assimilation of Kahuku Hospital into Hawaii Health Systems Corporation in a manner and to an extent that was to be negotiated between Kahuku Hospital and Hawaii Health Systems Corporation. The act also specified that none of the liabilities of Kahuku Hospital were to become the liabilities of Hawaii Health Systems Corporation, that Hawaii Health Systems Corporation could adjust the levels of services provided by Kahuku Hospital, and that the employees of Kahuku Hospital were not to be considered employees of the State. This act appropriated \$3,900,000, which was disbursed through the Department of Health of the State, to pay for the cost of acquiring the assets of Kahuku Hospital and to operate the facility. On March 14, 2008, the asset purchase was completed for a purchase price of approximately \$2,652,000 in cash, including transaction costs of \$197,000 in cash, and the facility is now operating as Kahuku Medical Center. The purchase price was allocated to assets based on their respective estimated fair values at the acquisition date.

Liquidity

During the year ended June 30, 2018 Hawaii Health Systems Corporation incurred a loss from operations of approximately \$255 million, and had negative cash flows from operations of approximately \$116 million. Management believes maintaining the current levels of service provided by Hawaii Health Systems Corporation will require continued funding by the State of Hawaii.

Note 2 - Significant Accounting Policies

Basis of Accounting

Hawaii Health Systems Corporation prepares its financial statements using the economic resources measurement focus and the accrual basis of accounting.

June 30, 2018

Note 2 - Significant Accounting Policies (Continued)

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include short-term investments with original maturities of three months or less. It also includes amounts held in the State Treasury. The state director of finance is responsible for the safekeeping of all monies paid into the State Treasury (cash pool). Hawaii Health Systems Corporation's portion of this cash pool at June 30, 2018 is indicated in the accompanying statement of net position as "cash and cash equivalents - State of Hawaii." The Hawaii Revised Statutes authorize the director of finance to invest in obligations of, or guaranteed by, the U.S. government, obligations of the State, federally insured savings and checking accounts, time certificates of deposit, and repurchase agreements with federally insured financial institutions. Cash and deposits with financial institutions are collateralized in accordance with state statutes. All securities pledged as collateral are held either by the State Treasury or by the State's fiscal agents in the name of the State.

Hawaii Health Systems Corporation has cash in financial institutions that is in excess of available depository insurance coverage. The amount of uninsured and uncollateralized deposits totaled approximately \$110,131,000 at June 30, 2018. Accordingly, these deposits were exposed to custodial credit risk. Custodial credit risk is the risk that, in the event of a financial institution failure, Hawaii Health Systems Corporation's deposits might not be returned to it. Hawaii Health Systems Corporation believes that, due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all deposits. As a result, Hawaii Health Systems Corporation evaluates each financial institution with which it deposits funds; only those institutions with an acceptable estimated risk level are used as depositories.

Accounts Receivable

Patient accounts receivable are stated at net realizable value amounts. An allowance for uncollectible accounts is established on an aggregate basis by using historical write-off factors applied to unpaid accounts based on aging. Loss rate factors are based on historical loss experience and adjusted for economic conditions and other trends affecting Hawaii Health Systems Corporation's ability to collect outstanding amounts. Uncollectible amounts are written off against the allowance for doubtful accounts in the period they are determined to be uncollectible. An allowance for contractual adjustments is based on expected payment rates from payors based on current reimbursement methodologies.

Supplies

Supplies consist principally of medical and other supplies and are recorded at the lower of first-in, first-out cost or market.

Capital Assets

Capital assets assumed from the State at inception are recorded at cost less accumulated depreciation. Other capital assets are recorded at cost or acquisition value at the date of donation. Donated buildings, equipment, and land are recognized as revenue when all eligibility requirements have been met, generally at the date of donation. Equipment under capital leases is recorded at the present value of future payments. Buildings, equipment, and improvements are depreciated by the straight-line method using these asset lives:

- Buildings and improvements: 5-40 years
- Equipment: 3-20 years

June 30, 2018

Note 2 - Significant Accounting Policies (Continued)

Gains or losses on the sale of capital assets are reflected in other nonoperating revenue. Normal repairs and maintenance expenses are charged to operations as incurred.

Assets Limited as to Use

Assets limited as to use are restricted net position, patients' safekeeping deposits, restricted deferred contributions, board designated cash, and cash in escrow accounts related to future lease draws. Such restrictions have been externally imposed by contributors or by collateral agreements. Restricted resources are applied before unrestricted resources when an expense is incurred for purposes for which both restricted and unrestricted net position are available. Patients' safekeeping deposits represent funds received or property belonging to the patients that are held by Hawaii Health Systems Corporation in a fiduciary capacity as custodian. Receipts and disbursements of these funds are not reflected in Hawaii Health Systems Corporation's operations.

At June 30, 2018, assets limited as to use consisted of restricted cash of \$11,736,510.

Deferred Outflows/Inflows of Resources

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflow of resources. This separate financial statement element represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (expense/expenditure) until then. Hawaii Health Systems Corporation has two items that qualify for reporting in this category. They are the deferred outflows of resources related to the cost-sharing defined benefit pension plan (see Note 8) and the State of Hawaii OPEB plan (see Note 9).

In addition to liabilities, the statement of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element represents an acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (revenue) until that time. Hawaii Health Systems Corporation has two items that qualify for reporting in this category. They are the deferred inflows of resources related to the cost-sharing defined benefit pension plan (see Note 8) and the State of Hawaii OPEB plan (see Note 9).

Accrued Vacation and Compensatory Pay

Hawaii Health Systems Corporation 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 (such as employer payroll taxes and fringe benefits), in accordance with GASB Statement No. 16, *Accounting for Compensated Absences*. Vacation is earned at a rate of one and three-quarters working days for each month of service. Vacation days may be accumulated to a maximum of 90 days.

Postemployment Benefits

For the purpose of measuring the net OPEB liability, deferred outflows of resources and deferred inflows of resources related to OPEB, and OPEB expense, information about the fiduciary net position of the Hawaii Employer-Union Health Benefits Trust Fund (EUTF) and additions to/deductions from the EUTF's fiduciary net position have been determined on the same basis as they are reported by the EUTF. For this purpose, benefit payments are recognized when due and payable in accordance with the benefit terms.

Pension

For the purpose of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Employees' Retirement System (ERS) and additions to/deductions from the ERS' 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.

June 30, 2018

Note 2 - Significant Accounting Policies (Continued)

Net Position

Net position is classified in three components. Net investment in capital assets consists of capital assets net of accumulated depreciation and is reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. Restricted expendable net position is noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Corporation. Unrestricted net position is the remaining net assets that do not meet the definition of invested in capital assets - net of related debt or restricted.

Operating Revenue and Expenses

Hawaii Health Systems Corporation has defined its operating revenue and expenses as those relating to the provision of healthcare services. The revenue and expenses relating to capital and related financing activities, noncapital financing activities, and investing activities are excluded from that definition.

Net Patient Service Revenue

Net patient service revenue is recorded on an accrual basis in the period in which the related services are provided at established rates, less contractual adjustments and provision for doubtful accounts. Hawaii Health Systems Corporation, as a safety net provider, provides charity care to certain patients; the specific cost of such care for the year ended June 30, 2018 was approximately \$1,280,000.

Hawaii Health Systems Corporation has agreements with third-party payors that provide for payments at amounts different from their established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are recorded on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. The adjustments to the final settlements did not have a significant impact on the fiscal year 2018 financial statements.

The estimated third-party payor settlements are based on estimates because complete information is not currently available to determine the final settlement amounts for certain cost report years. Management has used its best effort, judgment, and certain methodologies to estimate the anticipated final outcome.

A summary of the payment arrangements with major third-party payors is as follows:

- Medicare - Inpatient acute services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge referred to as the inpatient prospective payment system (IPPS). Under the IPPS, each case is categorized into a diagnosis-related group (DRG). Each DRG has a payment weight assigned to it based on the average resources used to treat Medicare patients in that DRG

Outpatient services rendered to Medicare beneficiaries are paid under a prospective payment system called ambulatory payment classifications (APC). Services in each APC are similar clinically and in terms of the resources they require. A payment rate is established for each APC and, depending on the services provided, hospitals may be paid for more than one APC for an encounter.

Skilled nursing services provided to Medicare beneficiaries are paid on a per diem prospective payment system covering all costs (routine, ancillary, and capital) related to the services furnished. The per diem payments for each admission are case-mix adjusted using a resident classification system (resource utilization groups) based on data from resident assessments and relative weights developed from staff time data.

June 30, 2018

Note 2 - Significant Accounting Policies (Continued)

- Medicaid - Inpatient acute services rendered to Medicaid program beneficiaries are reimbursed under a prospectively determined rate per day and per discharge with a cost settlement for capital costs. Medicaid long-term care services are reimbursed based on a price-based case-mix reimbursement system. The case-mix reimbursement system uses the resource utilization groups classification system calculated from the minimum data set assessment. The case-mix reimbursement payment method takes into account a patient's clinical condition and the resources needed to provide care for the patient. Medicaid outpatient services are reimbursed based on a fee schedule using current procedure terminology (CPT) codes established for the State.
- Critical Access Hospital (CAH) - Hawaii Health Systems Corporation has six facilities (Hale Ho'ola Hamakua, Kauai Veterans Memorial Hospital, Kahuku Medical Center, Ka'u Hospital, Kohala Hospital, and Samuel Mahelona Memorial Hospital) that are designated as critical access hospitals (CAHs) by the Centers for Medicare and Medicaid Services (CMS). CAHs are limited-service hospitals located in rural areas that receive cost-based reimbursement. To be designated a CAH, a facility must, among other requirements: (1) be located in a county or equivalent unit of a local government in a rural area, (2) be located more than a 35-mile drive from a hospital or another healthcare facility, or (3) be certified by the State as being a necessary provider of healthcare services to residents in the area. These facilities are paid an interim reimbursement rate throughout the year based on each facility's expected costs per inpatient day or the allowable outpatient cost-to-charge. After the close of each fiscal year, the facility would receive retrospective settlements for the difference between interim payments received and the total allowable cost, as documented in the Medicare cost reports.
- Sole Community Hospital - Hawaii Health Systems Corporation has two facilities (Hilo Medical Center and Kona Community Hospital) that are designated as sole community hospitals by the CMS. Inpatient case rates for services rendered to Medicare beneficiaries are finally determined upon the filing of the annual Medicare cost reports.
- Hawaii Medical Service Association (HMSA) - Inpatient services rendered to HMSA subscribers are reimbursed at prospectively determined case rates. The prospectively determined case rates are not subject to retroactive adjustment. In addition, outpatient surgical procedures and emergency room visits are reimbursed at a negotiated case rate. All other outpatient services are reimbursed based on a fee schedule using standard CPT codes.
- Other Commercial - Hawaii Health Systems Corporation has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment under these agreements includes prospectively determined rates per discharge, discounts from established rates, and prospectively determined daily rates.

State Appropriations

Hawaii Health Systems Corporation recognizes general and capital appropriations at the time allotments are made available to the facility for expenditure.

Effective July 1, 2008, HHSC - Corporate (Corporate) permanently allocated general appropriations to each facility. General appropriations are reflected as nonoperating revenue and capital appropriations are included in capital grants and contributions after the nonoperating revenue (expenses) subtotal in the statement of revenue, expenses, and changes in net position. If restrictions are placed on such appropriations, the restrictions are given separate and discrete accounting recognition.

June 30, 2018

Note 2 - Significant Accounting Policies (Continued)

Bond Interest

Hawaii Health Systems Corporation is allocated an amount for interest paid by the State of general obligation bonds whose proceeds were used for hospital construction. A corresponding contribution from the State is also allocated to Hawaii Health Systems Corporation. The bonds are obligations for the State, to be paid by the State's General Fund, and are not reported as liabilities of Hawaii Health Systems Corporation. For the year ended June 30, 2018, interest expense totaled approximately \$11,103,000.

Risk Management

Hawaii Health Systems Corporation is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; and employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any of the three preceding years. The facilities are self-insured for workers' compensation and disability claims and judgments, as discussed in Note 11.

Change in Accounting Principle

In June 2015, the GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions*, which addresses reporting by governments that provide postemployment benefits other than pensions (OPEB) to their employees and for governments that finance OPEB for employees of other governments. This OPEB standard requires the Corporation to recognize on the face of the financial statements its proportionate share of the net OPEB liability related to its participation in the Hawaii Employer-Union Benefits Trust Fund. The statement also enhances accountability and transparency through revised note disclosures and required supplemental information (RSI). The Corporation implemented this standard during 2018. As a result of implementing this standard, the beginning net position was restated to \$(755,622,993), a reduction of \$166,901,863.

Upcoming Accounting Pronouncements

In November 2016, the Governmental Accounting Standards Board issued GASB Statement No. 83, *Certain Asset Retirement Obligations*, which establishes criteria for determining the timing and pattern of recognition of a liability and a corresponding deferred outflow of resources for asset retirement obligations. The Corporation is currently evaluating the impact this standard will have on the financial statements when adopted. The provisions of this statement are effective for the Corporation's financial statements for the year ending June 30, 2019.

In January 2017, the Governmental Accounting Standards Board issued Statement No. 84, *Fiduciary Activities*. This statement establishes criteria for identifying fiduciary activities of all state and local governments. An activity meeting the criteria should be reported in a fiduciary fund in the basic financial statements. The Corporation is currently evaluating the impact this standard will have on the financial statements when adopted. The provisions of this statement are effective for the Corporation's financial statements for the year ending June 30, 2020.

In June 2017, the Governmental Accounting Standards Board issued GASB Statement No. 87, *Leases*, which improves accounting and financial reporting for leases by governments. This statement requires recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources. The Corporation is currently evaluating the impact this standard will have on the financial statements when adopted. The provisions of this statement are effective for the Corporation's financial statements for the year ending June 30, 2021.

Note 2 - Significant Accounting Policies (Continued)

In March 2018, the GASB issued Statement No. 88, *Certain Disclosures Related to Debt, Including Direct Borrowings and Direct Placements*. This statement establishes criteria to improve the information that is disclosed in the notes to the government financial statements related to debt, including direct borrowings and direct placements. It also clarifies which liabilities governments should include when disclosing information related to debt. The Corporation is currently evaluating the impact this standard will have on the financial statements when adopted. The provisions of this statement are effective for the Corporation's financial statements for the year ending June 30, 2019.

In June 2018, the GASB issued Statement No. 89, *Accounting for Interest Cost Incurred Before the End of a Construction Period*, which simplifies accounting for interest cost incurred before the end of construction and requires those costs to be expensed in the period incurred. As a result, interest cost incurred before the end of a construction period will not be capitalized and included in the historical cost of a capital asset reported in a business-type activity or enterprise fund. This statement also reiterates that, in financial statements prepared using the current financial resources measurement focus, interest cost incurred before the end of a construction period should be recognized as an expenditure on a basis consistent with governmental fund accounting principles. The requirements of the standard will be applied prospectively and result in increased interest expense during periods of construction. The provisions of this statement are effective for the Corporation's financial statements for the June 30, 2021 fiscal year.

Note 3 - Accounts Receivable

Patient accounts receivable consist of amounts due from insurance companies and patients for services rendered by the facilities. The facilities grant credit without collateral to their patients, most of whom are local residents and are insured under third-party payor arrangements. The mix of receivables from patients and third-party payors as of June 30, 2018 is as follows:

Medicare	33.00 %
Medicaid	27.00
HMSA	7.00
Other third-party payors	19.00
Patient and other	14.00
	100.00 %
Total	100.00 %

Note 4 - Fair Value Measurements

Hawaii Health Systems Corporation categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs. Investments that are measured at fair value using net asset value per share (or its equivalent) as a practical expedient are not classified in the fair value hierarchy below.

In instances whereby inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. Hawaii Health Systems Corporation's assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset.

Hawaii Health Systems Corporation has the following recurring fair value measurements as of June 30, 2018:

- U.S. Treasury securities of \$4,511,717 are valued using quoted market prices (Level 2 inputs).
- U.S. government agencies of \$2,678,367 are valued using a matrix pricing model (Level 2 inputs).

June 30, 2018

Note 4 - Fair Value Measurements (Continued)

- Money market funds of \$103,345 are valued using a matrix pricing model (Level 2 inputs).

The fair value of U.S. Treasury obligations, U.S. government agencies, and money market funds at June 30, 2018 were determined primarily based on Level 2 inputs. Hawaii Health Systems Corporation estimates the fair value of these investments using other inputs, such as interest rates and yield curves, that are observable at commonly quoted intervals.

Hawaii Health Systems Corporation's investments are subject to several types of risk, which are examined in more detail below:

Custodial Credit Risk of Investments

Custodial credit risk is the risk that, in the event of the failure of the counterparty, Hawaii Health Systems Corporation will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. All of Hawaii Health Systems Corporation's investments are held by financial institutions registered in Hawaii Health Systems Corporation's name.

Interest Rate Risk

As a means of limiting its exposure to fair value losses arising from interest rates, Hawaii Health Systems Corporation's investment policy generally limits maturities on investments to not more than five years from the date of investment. All of Hawaii Health Systems Corporation's investments at June 30, 2018 have an original maturity date within five years from the date of investment.

Credit Risk

Hawaii Health Systems Corporation's investment policy limits investments in state and U.S. Treasury securities, time certificates of deposit, U.S. government or agency obligations, repurchase agreements, commercial paper, bankers' acceptances, and money market funds maintaining a Triple-A rating. As of June 30, 2018, Hawaii Health Systems Corporation held investments in U.S. Treasury securities and U.S. government agency obligations.

Concentration of Credit Risk

Hawaii Health Systems Corporation's investment policy provides guidelines for portfolio diversification by placing limits on the amount that may be invested in any one issuer, types of investment instruments, and position limits per issue of an investment instrument. There were no investments that individually exceed 5 percent of Hawaii Health Systems Corporation's total investments at June 30, 2018.

Note 5 - Capital Assets

Capital asset activity of the Corporation's governmental activities was as follows:

	Balance July 1, 2017	Transfers and Adjustments	Additions	Retirements	Balance June 30, 2018
Assets not subject to depreciation:					
Land and land improvements	\$ 7,814,855	\$ -	\$ -	\$ -	\$ 7,814,855
Construction in progress	35,179,719	(16,702,363)	26,130,803	(67,772)	44,540,387
Subtotal	42,994,574	(16,702,363)	26,130,803	(67,772)	52,355,242
Assets subject to depreciation:					
Buildings and improvements	505,483,896	14,157,553	166,497	-	519,807,946
Equipment	266,900,149	2,561,028	6,609,557	(20,655,554)	255,415,180
Subtotal	772,384,045	16,718,581	6,776,054	(20,655,554)	775,223,126
Less accumulated depreciation:					
Buildings and improvements	245,058,915	-	19,083,407	-	264,142,322
Equipment	206,631,014	16,218	22,039,019	(18,240,200)	210,446,051
Subtotal	451,689,929	16,218	41,122,426	(18,240,200)	474,588,373
Capital assets - Net	\$ 363,688,690	\$ -	\$ (8,215,569)	\$ (2,483,126)	\$ 352,989,995

The State Department of Accounting and General Services and others transferred capital assets, including construction in progress, aggregating approximately \$25,435,029 to Hawaii Health Systems Corporation during the year ended June 30, 2018.

Note 6 - State of Hawaii Advances and Receivable

The remaining amount due to the State of \$19,008,243 at June 30, 2018 is made up of cash advances to the Department of Health - Division of Community Hospitals, which was assumed by Hawaii Health Systems Corporation at the date of its formation.

At June 30, 2018, \$53,812,700 was due from the State for allotments made to Hawaii Health Systems Corporation before June 30, 2018.

Note 7 - Accrued Vacation

Among the Corporation's short-term and long-term liabilities is accrued vacation.

Activity for the year ended June 30, 2018 as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion	Noncurrent Portion
Accrued vacation - 2018	\$ 39,400,436	\$ 14,092,866	\$ (25,781,748)	\$ 27,711,554	\$ 14,871,289	\$ 12,840,265

Note 8 - Cost-sharing Defined Benefit Pension Plan

Plan Description

All full-time employees of Hawaii Health Systems Corporation are eligible to participate in the Employees' Retirement System of the State of Hawaii (the "ERS"), a cost-sharing, multiple-employer, public employee retirement system covering eligible employees of the state and counties. The ERS issues a publicly available financial report that can be obtained at the ERS' website: <http://ers.ehawaii.gov/>.

June 30, 2018**Note 8 - Cost-sharing Defined Benefit Pension Plan (Continued)*****Benefits Provided***

The ERS is composed of a contributory retirement plan and a noncontributory retirement plan. Eligible employees who were in service and members of the existing contributory plan on June 30, 1984 were given an option to remain in the existing plan or join the noncontributory plan effective January 1, 1985. All new eligible employees hired after June 30, 1984 automatically become members of the noncontributory plan. Both plans provide death and disability benefits and cost of living increases. Benefits are established by state statute. In the contributory plan, employees may elect normal retirement at age 55 with five years of credited service or elect early retirement at any age with 25 years of credited service. Such employees are entitled to retirement benefits, payable monthly for life, of 2 percent of their average final salary, as defined, for each year of credited service. Benefits fully vest on reaching five years of service; retirement benefits are actuarially reduced for early retirement. Covered contributory plan employees are required by state statute to contribute 7.8 percent of their salary to the plan; Hawaii Health Systems Corporation is required by state statute to contribute the remaining amounts necessary to pay contributory plan benefits when due. In the noncontributory plan, employees may elect normal retirement age at age 62 with 10 years of credited service or at age 55 with 30 years of credited service, or elect early retirement at age 55 with 20 years of credited service. Such employees are entitled to retirement benefits, payable monthly for life, of 1.25 percent of their average final salary, as defined, for each year of credited service. Benefits fully vest on reaching 10 years of service; retirement benefits are actuarially reduced for early retirement. Hawaii Health Systems Corporation is required by state statute to contribute all amounts necessary to pay noncontributory plan benefits when due.

On July 1, 2006, a new hybrid contributory plan became effective pursuant to Act 179, Session Laws of Hawaii of 2004. Participants prior to July 1, 2006 could choose to participate in this hybrid plan or remain in the existing plans. New employees hired from July 1, 2006 are required to join the hybrid plan. Participants will contribute 6 percent of their salary to this plan. Furthermore, members in the hybrid plan are eligible for retirement at age 62 with five years of credited service or at age 55 and 30 years of credited service. Members will receive a multiplier of 2 percent for each year of credited service in the hybrid plan. The benefit payment options are similar to the current contributory plan.

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 rate for fiscal year 2018 was 17 percent. Contributions to the pension plan from the Corporation were approximately 32.3 million for the fiscal year ended June 30, 2018.

The employer is required to make all contributions for members in the ERS. For contributory plan employees hired prior to July 1, 2012, general employees are required to contribute 7.8 percent of their salary. Hybrid plan members hired prior to July 1, 2012 are required to contribute 6.0 percent of their salary. Hybrid plan members hired after June 30, 2012 are required to contribute 8.0 percent of their salary.

Net Pension Liability, Deferrals, and Pension Expense

At June 30, 2018, the Corporation reported a liability of approximately \$530 million for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2017, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Corporation's proportion of the net pension liability was based on the Corporation's actuarially required contribution for the year ended June 30, 2018 relative to all other contributing employers. At June 30, 2018, the Corporation's proportion was 7.04 percent, which was an increase from its proportion measurement at June 30, 2017 of 6.85 percent.

June 30, 2018

Note 8 - Cost-sharing Defined Benefit Pension Plan (Continued)

In connection with the Maui Region transfer agreement, employees of the Maui Region are no longer active state employees. Beginning in fiscal year 2018, the pension obligation and expense related to those employees is no longer allocated to the Corporation.

For the year ended June 30, 2018, the Corporation recognized pension expense of approximately \$48,730,000. At June 30, 2018, the Corporation reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between expected and actual experience	\$ 8,719,005	\$ (5,892,473)
Net difference between projected and actual earnings on plan investments	33,389,913	(55,524,402)
Changes in assumptions	30,937,473	33,389,912
Changes in proportion	2,261,582	(1,303,909)
Employer contributions to the plan subsequent to the measurement date	34,134,911	-
Total	\$ 109,442,884	\$ (29,330,872)

The \$34,134,911 reported as deferred outflows of resources resulting from contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the years ending June 30, 2019. Amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Years Ending June 30	Amount
2019	\$ 10,611,515
2020	15,797,732
2021	13,282,784
2022	6,183,920
2023	101,150

Actuarial Assumptions

The total pension liability in the June 30, 2017 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	2.5%
Salary increases	3.5%
Investment rate of return	7.0% Per year, compounded annually, including inflation

There were no changes to ad hoc postemployment benefits, including COLA.

Postretirement mortality rates are based on the 2016 Public Retirees of Hawaii mortality table with adjustments based on generational projections of the BB projection table for 2016 and full generational projections in future years. Preretirement mortality rates are based on multiples of RP-2014 mortality table based on the occupation of the member.

The actuarial assumptions used in the June 30, 2017 valuation were based on the results of an actuarial experience study for the five-year period ended June 30, 2016. The ERS updates its experience studies every five years.

Note 8 - Cost-sharing Defined Benefit Pension Plan (Continued)

Discount Rate

The discount rate used to measure the total pension liability was 7.00 percent, consistent with the 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 ERS 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.

Projected Cash Flows

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.

The long-term expected rate of return on pension plan investments was determined using a building-block method 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
Broad growth	63 %	6 %
Principal protection	7	1
Real return	10	4
Crisis risk offset	20	3

Sensitivity of the Net Pension Liability to Changes in the Discount Rate

The following presents the net pension liability of the Corporation at June 30, 2018, calculated using the discount rate of 7.00 percent, as well as what the Corporation's net pension liability would be if it were calculated using a discount rate that is 1 percentage point lower (6.00 percent) or 1 percentage point higher (8.00 percent) than the current rate:

	1 Percent Decrease (6.00%)	Current Discount Rate (7.00%)	1 Percent Increase (8.00%)
Net pension liability	\$ 688,867,513	\$ 530,455,687	\$ 401,574,442

Note 8 - Cost-sharing Defined Benefit Pension Plan (Continued)

Pension Plan Fiduciary Net Position

Detailed information about the pension plan's fiduciary net position is available in a separately issued ERS financial report, which is available at <http://www.ers.ehawaii.gov>. The 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 revenue is recorded in the accounting period in which it is earned and becomes 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.

Note 9 - Retirement Benefits

Plan Descriptions

The State provides certain healthcare and life insurance benefits to all qualified employees. Pursuant to Act 88, SLH 2001, the State contributes to the EUTF, an agent multiple-employer defined benefit plan that replaced the Hawaii Public Employees Health Fund effective July 1, 2003. The EUTF was established to provide a single delivery system of health benefits for state and county workers, retirees, and their dependents. The EUTF issues a publicly available annual financial report that can be obtained at <http://eutf.hawaii.gov>.

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

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

For employees hired on or after July 1, 2001 and who retire with fewer than 10 years of service, the State makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the State pays 50 percent of the base monthly contribution. For those retiring with at least 15 years but fewer than 25 years of service, the State pays 75 percent of the base monthly contribution. For employees retiring with at least 25 years of service, the State pays 100 percent 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.

Employees Covered by Benefit Terms

At July 1, 2017, the following number of plan members for the entire plan were covered by the benefit terms (plan members for the Corporation only are not available):

Inactive plan members or beneficiaries currently receiving benefits	35,374
Inactive plan members entitled to but not yet receiving benefits	8,124
Active plan members	50,101
Total plan members	93,599

Note 9 - Retirement Benefits (Continued)

Contributions

Contributions are governed by HRS Chapter 87A and may be amended through legislation. Contributions to the OPEB plan from the Corporation was \$44,768,084 for the fiscal year ended June 30, 2018. The Corporation is required to make all contributions for members.

OPEB Liabilities, OPEB Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to OPEB

At June 30, 2018, the Corporation reported a net OPEB liability of approximately \$542 million. The net OPEB liability was measured as of July 1, 2017, and the total OPEB liability used to calculate the net OPEB liability was determined by an actuarial valuation as of that date.

There were no changes between the measurement date, July 1, 2017, and the reporting date, June 30, 2018, that are expected to have a significant effect on the net OPEB liability.

For the year ended June 30, 2018, the Corporation recognized OPEB expense of approximately \$56,823,000. At June 30, 2018, the Corporation reported deferred outflows of resources and deferred inflows of resources related to OPEB from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Net differences between projected and actual earnings on OPEB plan investments	\$ -	\$ (1,125,188)
Contributions subsequent to the measurement date	83,150,367	-
Total	<u>\$ 83,150,367</u>	<u>\$ (1,125,188)</u>

The \$83,150,367 reported as deferred outflows of resources related to OPEB resulting from the Corporation's contributions subsequent to the measurement date will be recognized as a reduction of the net OPEB liability in the year ending June 30, 2019. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to OPEB will be recognized in OPEB expense as follows:

Year Ending June 30	Amount
2019	\$ (281,274)
2020	(281,274)
2021	(281,274)
2022	<u>(281,366)</u>
Total	<u>\$ (1,125,188)</u>

Note 9 - Retirement Benefits (Continued)

Actuarial Assumptions

The total OPEB liability in the July 1, 2017 actuarial valuation was determined using the following actuarial assumptions adopted by the board of trustees of the Hawaii Employer-Union Health Benefits Trust Fund of the State of Hawaii, on January 8, 2018, based on the experience study covering the five-year period ended June 30, 2015:

Inflation	2.50%
Salary increases	3.50 percent to 7.00 percent including inflation
Investment rate of return	7.00%
Healthcare cost trend rates:	
PPO*	Initial rates of 6.60 percent, 6.60 percent, and 9.00 percent; declining to a rate of 4.86 percent after 14 years
HMO*	Initial rate of 9.00 percent; declining to a rate of 4.86 percent after 14 years
Part B and base monthly contribution	Initial rates of 2.00 percent and 5.00 percent; declining to a rate of 4.70 percent after 14 years
Dental	3.50%
Vision	2.50%
Life insurance	0.00%

*Blended rates for medical and prescription drug

Mortality rates are based on system-specific mortality tables utilizing scale BB to project generational morality improvement.

The long-term expected rate of return on OPEB plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of OPEB 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 asset class are summarized in the following table:

	<u>Target Allocation</u>
Asset class:	
U.S. equity	19.00 %
International equity	19.00
U.S. Microcap	7.00
Private equity	10.00
REITs	6.00
Core real estate	10.00
Global options	7.00
Core bonds	3.00
Long treasuries	7.00
Trend following	7.00
TIPS	5.00
Total	<u>100.00 %</u>

Note 9 - Retirement Benefits (Continued)

Single Discount Rate

The discount rate used to measure the net OPEB liability was 7.00 percent, based on the expected rate of return on OPEB plan investments of 7.00 percent and the municipal bond rate of 3.56 percent (based on the daily rate closest to but not later than the measurement date of the Fidelity “20-year Municipal GO AA index”). Beginning with the fiscal year 2019 contribution, the State’s funding policy is to pay the recommended actuarially determined contribution, which is based on layered, closed amortization periods. Based on those assumptions, the OPEB plan’s fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive plan members. Therefore, the long-term expected rate of return on OPEB plan investments was applied to all periods of projected benefit payments to determine the total OPEB liability.

OPEB Plan Fiduciary Net Position

The OPEB plan’s fiduciary net position has been determined on the same basis used by the OPEB plan. The EUTF’s financial statements are prepared using the accrual basis of accounting under which revenue is recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of the timing of the cash flows. Employer 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 on a trade-date basis. Administrative expenses are financed exclusively with investment income.

There were no significant changes after the report measurement date. Detailed information about the OPEB plan’s fiduciary net position is available in the separately issued EUTF financial report. EUTF’s complete financial statements are available at <http://eutf.hawaii.gov>.

Changes in Net OPEB Liability

The following table represents a schedule of changes in the net OPEB liability. The ending balances are as of the measurement date, July 1, 2017.

	Total OPEB Liability	Plan Fiduciary Net Position	Net OPEB Liability
Beginning Balance	\$ 558,792,274	\$ 27,876,453	\$ 530,915,821
Service cost	14,995,443	-	14,995,443
Interest on the total OPEB liability	45,532,641	-	45,532,641
Employer contributions	-	44,768,084	(44,768,084)
Net investment income	-	4,482,250	(4,482,250)
Benefit payments	(22,512,114)	(22,512,114)	-
Administrative expense	-	(11,479)	11,479
Other	-	359,926	(359,926)
Net changes	38,015,970	27,086,667	10,929,303
Ending Balance	\$ 596,808,244	\$ 54,963,120	\$ 541,845,124

June 30, 2018

Note 9 - Retirement Benefits (Continued)

Sensitivity of the Net OPEB Liability to Changes in the Discount Rate and Healthcare Cost Trend Rates

The following table presents the Corporation's net OPEB liability calculated using the discount rate of 7.00 percent, as well as what the State's net OPEB liability would be if it were calculated using a discount rate that is 1 percentage point lower (6.00 percent) or 1 percentage point higher (8.00 percent) than the current discount rate:

	1% Decrease (6.00%)	Discount Rate (7.00%)	1% Increase (8.00%)
Net OPEB liability	\$ 461,306,488	\$ 541,845,124	\$ 643,493,941

The following table presents the State's net OPEB liability calculated using the assumed healthcare cost trend rate, as well as what the State's net OPEB liability would be if it were calculated using the trend rate that is 1 percentage point lower or 1 percentage point higher than the current healthcare cost trend rate:

	1% Decrease	Healthcare Cost Trend Rate	1% Increase
Net OPEB liability	\$ 635,954,172	\$ 541,845,124	\$ 465,691,360

Note 10 - Long-term Debt

Long-term debt activity for the year ended June 30, 2018 can be summarized as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Due within One Year
Long-term debt	\$ 38,013,113	\$ -	\$ (1,735,418)	\$ 36,277,695	\$ 11,986,033
Capital leases	10,297,306	2,059,060	(4,875,617)	7,480,749	2,541,521

The long-term debt obligations are summarized as follows:

Roselani Place

In September 2007, Alii exercised its option to purchase its 113-unit assisted living and Alzheimer facility and personal property from the developer/landlord for \$16 million. In connection with the purchase, Alii also assumed the land lease on which the facility is situated, and a parking license covering real property adjacent to the facility.

In connection with the purchase agreement, Alii also reached an agreement with the developer/landlord concerning an arbitration award that was rendered in favor of the developer/landlord in January 2006 for \$1.9 million. The arbitration decision was on appeal to the Intermediate Court of Appeals of the State of Hawaii. Alii and the developer/landlord agreed to settle the \$1.9 million judgment for \$500,000. This settlement payment is in addition to the \$16 million purchase price.

The note payable requires monthly payments of \$126,433, including interest at 5.9 percent, through October 2027. The note is collateralized by certain property and equipment. At June 30, 2018, the balance payable was \$10,880,726.

June 30, 2018

Note 10 - Long-term Debt (Continued)***Maui Bonds***

In 2012, MMMC issued general obligation bonds. These bonds were executed in two parts: Series 2012A and Series 2012B. The Series 2012A bonds were issued to refinance MMMC's existing \$8 million loan, which had been held with the Bank of Montreal. Total borrowing under the first agreement was \$8,100,000. These bonds carry an interest rate of 4.05 percent. The Series 2012A bonds are secured by a loan note guarantee issued by the United States Department of Agriculture (USDA) through its Rural Development division. The Series 2012B bonds provided initial funding for the purpose of construction of a physician clinic adjacent to the hospital, partial funding for a building renovation, and equipment associated with imaging services. Borrowing costs under the second agreement totaled \$901,000. These bonds carried a variable interest rate that started at 5 percent until September 1, 2017, at which point the rate shall reset on each September 1, occurring every five years thereafter at a rate equal to 3.75 percent over the prevailing five-year FHLB Bulled Rate (Seattle). In the event that such rate is no longer available or practicable, a similar index, as mutually agreed upon by the issuer and holders of the bonds, will be used. The effective interest rate on the Series 2012B bonds as of June 30, 2018 was 5.875 percent. The Series 2012B bonds are unsecured. The bonds are payable in annual installments ranging from \$172,000 to \$978,000. In connection with the Series 2012A and Series 2012B bond issuance, MMMC is subject to certain financial covenants. As of June 30, 2018, MMMC was not in compliance with those covenants; however, a waiver of the covenant requirement for the Series 2012A bonds was granted, and the Series 2012B bonds are shown as current in the financial statements.

In January 2015, MMMC issued Revenue Bond Number 3, the proceeds of which were used to refinance the previously issued Series 2013 bonds. These bonds were issued under the existing master trust indenture dated April 1, 2008. Monthly payments are due in the amount of \$46,433, including principal and interest, through January 2045 when all remaining principal and accrued interest are payable. Revenue Bond Number 3 carries an interest rate of 3.50 percent. In connection with the Revenue Bond Number 3, MMMC is subject to certain financial covenants. As of June 30, 2018, MMMC was not in compliance with the debt service coverage ratio covenant, and as a result, some debt is presented as current in the financial statements.

Hilo Residency Training Program

In June 2001, Hawaii Health Systems Corporation acquired land, building, and medical equipment of \$11,893,162 from Hilo Residency Training Program, Inc. (H RTP) to ensure the uninterrupted operation of the Hilo Medical Center Cancer Treatment Center and its radiation and medical oncology services. As part of the acquisition, Hawaii Health Systems Corporation assumed H RTP's outstanding balances on the loans and notes payable of \$11,893,162 from Central Pacific Bank and the United States Department of Agriculture (USDA). The assets and related liabilities have been recorded in the facility's accounting records. The loans and notes payable are collateralized by a security interest in the capital assets acquired from H RTP, as well as any rights, interest, and other tangible assets relating to such property. In October 2007, the loans and notes payable to Central Pacific Bank and the USDA were refinanced into a single note payable to Academic Capital.

The note payable requires monthly payments, including interest, totaling \$64,069 through September 2032. The note payable is secured by certain assets of Hilo Medical Center (HMC). At June 30, 2018, the balance payable was \$7,397,996.

Kahuku Medical Center

In July 2012, Kahuku Medical Center entered into a purchase and maintenance services agreement with Holden Hospital Supply, Inc. to finance the purchase and maintenance of an oxygen generator. The note requires monthly payments of \$4,188 through maturity on June 30, 2019. The agreement also includes the financing of electrical and additional charges related to the oxygen generator. Interest is not a component of the agreement. At June 30, 2018, the balance of the loan was \$6,697.

Note 10 - Long-term Debt (Continued)

In April 2014, Kahuku Medical Center entered into a loan secured by a mortgage, to finance the purchase of land. The agreement required monthly principal and interest payments of \$12,481 through maturity at April 2019. At June 30, 2018, the balance of the loan was \$122,007.

Hawaii Health Systems Corporation has entered into various capital leases, including a lease with Siemens for the financing of an electronic medical records system. The capital leases require monthly payments aggregating to approximately \$625,000, including interest, per month. The capital leases expire at various times through 2027.

Debt Service Requirements to Maturity

The table below indicates the future scheduled principal and interest payments as of June 30, 2018. While presentation of the statement of net position contains certain amounts that are included within current portion of long-term debt, the schedule below has been prepared based on contractually scheduled payments as of June 30, 2018:

Years Ending June 30	Long-term Debt		Capital Lease Obligation	
	Principal	Interest	Principal	Interest
2019	\$ 1,770,522	\$ 1,720,037	\$ 2,541,521	\$ 249,615
2020	1,732,147	1,627,730	1,419,181	190,947
2021	1,826,468	1,530,441	1,168,760	140,882
2022	1,925,803	1,428,758	1,003,155	98,935
2023	2,036,440	1,321,744	409,737	67,283
2024-2028	10,508,358	4,786,258	938,395	106,824
2029-2033	6,574,464	2,587,415	-	-
2034-2038	3,871,934	1,527,765	-	-
Thereafter	6,031,559	728,746	-	-
Total	<u>\$ 36,277,695</u>	<u>\$ 17,258,894</u>	<u>\$ 7,480,749</u>	<u>\$ 854,486</u>

Note 11 - Commitments and Contingencies

Professional Liability

Hawaii Health Systems Corporation maintains professional and general liability insurance with a private insurance carrier with a \$35 million limit per claim and a \$39 million aggregate. Hawaii Health Systems Corporation has also purchased additional excess insurance with a \$10 million per claim and aggregate limit. Hawaii Health Systems Corporation’s general counsel advises that, in the unlikely event any judgments rendered against Hawaii Health Systems Corporation exceed Hawaii Health Systems Corporation’s professional liability coverage, such amounts would likely be paid from an appropriation from the State’s General Fund. Settled claims have not exceeded the coverage provided by the insurance carrier in any of the past three fiscal years. The Corporation has accrued approximately \$1,380,000 as of June 30, 2018, as current liabilities on the statement of net position.

Workers’ Compensation Liability

Hawaii Health Systems Corporation is self-insured for workers’ compensation claims. Hawaii Health Systems Corporation pays a portion of wages for injured workers (as required by law), medical bills, judgments as stipulated by the State’s Department of Labor, and other costs. Hawaii Health Systems Corporation also directly provides treatment for injured workers. The estimated liability is based on actuarial projections of costs using historical claims-paid data. Estimates are continually monitored and reviewed and, as settlements are made or estimates adjusted, differences are reflected in current operations. Hawaii Health Systems Corporation has accrued a liability of \$12,032,000 for unpaid claims as of June 30, 2018.

June 30, 2018

Note 11 - Commitments and Contingencies (Continued)

	2018	2017
Estimated liability - Beginning of year	\$ 12,740,000	\$ 13,462,000
Estimated claims incurred - Including changes in estimates	3,304,000	3,301,000
Claim payments	<u>(4,012,000)</u>	<u>(4,023,000)</u>
Estimated liability - End of year	<u>\$ 12,032,000</u>	<u>\$ 12,740,000</u>

Operating Leases

MMMC and Alii entered into various operating leases and related sublease agreements. Future minimum lease payments and sublease receipts at June 30, 2018 are as shown in the below table. Additionally, MMMC now received lease income as a result of transferring hospital operations to Kaiser. The lease income amounts are shown in the table and a description of the income is provided below the table.

Years Ending June 30	Lease Payments	Lease Income
2019	\$ 1,281,249	\$ 1,782,373
2020	1,319,678	1,502,966
2021	1,359,147	1,477,874
2022	1,266,908	1,558,913
2023	1,039,134	1,471,719
Thereafter	<u>362,977</u>	<u>23,975,632</u>
Total	<u>\$ 6,629,093</u>	<u>\$ 31,769,477</u>

Lease Income

In relation to the transfer of the HHSC - Maui Region hospital operations to Kaiser in 2018, the two parties signed a lease agreement wherein Kaiser leases the property and equipment owned by the region. The lease was effective as of July 1, 2017, has a 30-year term, and calls for monthly payments to the Corporation for annual base minimum rent and for reimbursement of capital leases to which the Corporation remains obligated. Total lease income included within other operating revenue in the statement of revenue, expenses, and changes in net position for the year ended June 30, 2018 was approximately \$2,171,000.

Annually, payments for minimum base rent range from approximately \$1,067,000 in the first year of the lease to \$1,555,000 in the 26th year of the lease, and payments for principal and interest on capital lease obligations range from approximately \$1,062,000 in the first year of the lease to approximately \$170,000 in the 10th year of the lease, which is the last year payments are required for capital lease obligations. The future minimum lease payments for these leases are shown in the lease income column of the above table.

Ceded Lands

The Office of Hawaiian Affairs (OHA) and the State are presently in litigation involving the State's alleged failure to properly account for and pay to OHA monies due to OHA under the provisions of the Hawaii State Constitution and Chapter 10 of the Hawaii Revised Statutes for use by the State of certain ceded lands.

June 30, 2018

Note 11 - Commitments and Contingencies (Continued)

During the 2006 legislative session, the State of Hawaii Legislature enacted Act 178, which provided interim measures to ensure that a certain amount of proceeds was made available to OHA from the prorated portion of the public land trust for the betterment of the conditions of native Hawaiians. The act provided that the state agencies that collect receipts from the use of lands within the public land trust transfer a total of \$3,775,000 to OHA within 30 days of the close of each fiscal quarter (or \$15,100,000 per fiscal year), beginning with the 2006 fiscal year. In addition, the act appropriated \$17,500,000 out of the State's general revenue to pay OHA for underpayments of the State's use of lands in the public land trust for the period from July 1, 2001 to June 30, 2005.

On September 20, 2006, the governor of the State of Hawaii issued Executive Order No. 06-06, which established procedures for the state agencies to follow in order to carry out the requirements of Act 178. Each state agency that collects receipts from the use of ceded or public land trust land is to determine OHA's share of such receipts by calculating the ceded/nonceded fraction of the parcel that generated the receipt, multiplying the receipt by the ceded/nonceded fraction, and multiplying that result by 20 percent. The resulting amounts are to be deposited into a trust holding account established for such purpose and within 10 days of the close of each fiscal quarter, the amounts are to be transferred to OHA. Within a specified period after the close of each quarter, the director of finance is to reconcile the actual amounts transferred to OHA with the required amount of \$2.1 million and adjust each specific agency's payments accordingly.

For the year ended June 30, 2018, there were no payments made to OHA.

Litigation

Hawaii Health Systems Corporation is a party to certain litigation arising in the normal course of business. In management's opinion, the outcome of such litigation will not have a material impact on Hawaii Health Systems Corporation's financial statements.

Required Supplemental Information

Hawaii Health Systems Corporation

Required Supplemental Information Schedule of Pension Contributions Employee's Retirement System of the State of Hawaii

	Year Ended June 30				
	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>
Contractually required contribution	\$ 33,088,000	\$ 50,418,500	\$ 51,584,604	\$ 49,213,969	\$ 53,279,576
Contributions in relation to the contractually required contribution	<u>33,088,000</u>	<u>50,418,500</u>	<u>51,584,604</u>	<u>50,272,620</u>	<u>47,500,308</u>
Contribution (Excess) Deficiency	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (1,058,651)</u>	<u>\$ 5,779,268</u>
Corporation's Covered Employee Payroll	\$ 172,037,521	\$ 282,760,136	\$ 288,121,862	\$ 285,988,382	\$ 268,597,949
Contributions as a Percentage of Covered Employee Payroll	19.2 %	17.8 %	17.9 %	17.6 %	17.7 %

Hawaii Health Systems Corporation

Required Supplemental Information Schedule of the Proportionate Share of the Net Pension Liability Employees' Retirement System of the State of Hawaii

	Year Ended June 30				
	2018	2017	2016	2015	2014
Corporation's proportion of the net pension liability	4.1 %	6.9 %	7.1 %	7.3 %	7.2 %
Corporation's proportionate share of the net pension liability	\$ 530,455,687	\$ 916,111,059	\$ 623,325,233	\$ 583,997,239	\$ 638,368,793
Corporation's covered employee payroll	\$ 172,037,521	\$ 282,760,136	\$ 288,121,862	\$ 285,988,382	\$ 268,597,949
Corporation's Proportionate Share of the Net Pension Liability as a Percentage of its Covered Employee Payroll	308.3 %	324.0 %	216.3 %	204.2 %	237.7 %
Plan Fiduciary Net Position as a Percentage of Total Pension Liability	54.8 %	51.3 %	62.4 %	63.9 %	58.0 %

Hawaii Health Systems Corporation

Note to Pension Required Supplemental Information Schedules

Years Ended June 30, 2018

The comparability of trend information is affected by changes in actuarial assumptions, benefit provisions, actuarial funding methods, accounting policies, and other changes. Those changes usually affect trends in contribution requirements and in ratios that use the pension and other postemployment benefit obligations as a factor.

The schedule of contributions is presented to show the responsibility of the Corporation in meeting the actuarial requirements to maintain the system on a sound financial basis.

The schedule of the proportionate share of the net pension liability and schedule of contributions are schedules that are required in implementing GASB Statement No. 68. The schedule of the proportionate share of the net pension liability represents, in actuarial terms, the accrued liability less the market value of assets. The schedule of contributions is a comparison of the Corporation's contributions to the actuarially determined contributions.

The information presented in the schedule of contributions was used in the actuarial valuation for purposes of determining the actuarially determined contribution rate. Additional information as of the latest actuarial valuation for the pension plan follows.

Valuation Methods and Assumptions Used to Determine Contribution for Fiscal Year 2017:

Actuarial cost method	Entry age, normal
Amortization method	Level percent, closed
Remaining amortization period	27 years
Asset valuation method	Market
Inflation	2.5 percent
Salary increases	3.5 percent wage inflation
Investment rate of return	7.0 percent per year, compounded annually including inflation

Hawaii Health Systems Corporation

Required Supplemental Information Schedule of Changes in Net OPEB Liability and Related Ratios

	Last One Fiscal Year
	<u>2018</u>
Total OPEB Liability	
Service cost	\$ 14,995,443
Interest on the total OPEB liability	45,532,641
Benefit payments	<u>(22,512,114)</u>
Net Change in Total OPEB Liability	38,015,970
Total OPEB Liability - Beginning of year	<u>558,792,274</u>
Total OPEB Liability - End of year	<u>\$ 596,808,244</u>
Plan Fiduciary Net Position	
Employer contributions	\$ 44,768,084
Net investment income	4,482,250
Net change in plan fiduciary position	359,926
Benefit payments	(22,512,114)
Other	<u>(11,479)</u>
Net Change in Plan Fiduciary Net Position	27,086,667
Plan Fiduciary Net Position - Beginning of year	<u>27,876,453</u>
Plan Fiduciary Net Position - End of year	<u>\$ 54,963,120</u>
Net OPEB Liability - Ending	<u>\$ 541,845,124</u>
Plan Fiduciary Net Position as a Percentage of Total OPEB Liability	9.21 %
Covered Payroll	\$ 191,546,061
Net OPEB Liability as a Percentage of Covered Payroll	282.88 %

Other Supplemental Information

Hawaii Health Systems Corporation

Supplemental Schedule of Reconciliation of Cash on Deposit and Assets Limited as to Use with the State of Hawaii

June 30, 2018

Cash and Cash Equivalents - State of Hawaii

Special funds:

Appropriation symbol S-18-303-H	\$ 640,586
Appropriation symbol S-18-350-H	7,500,002
Appropriation symbol S-18-351-H	403,607
Appropriation symbol S-18-352-H	256,683
Appropriation symbol S-10-355-H	154
Appropriation symbol S-10-371-H	3,847
Appropriation symbol S-10-358-H	1
Appropriation symbol S-17-365-H	748,709
Appropriation symbol S-17-312-H	908,505
Appropriation symbol S-17-359-H	1,014,797
Appropriation symbol S-17-373-H	405,345
Appropriation symbol S-17-353-H	296,211
Appropriation symbol S-17-354-H	<u>2,242,054</u>
Total per State	14,420,501

Assets Limited as to Use - Patient Funds

Appropriation symbol T-04-923-H	4,129
Appropriation symbol T-04-919-H	<u>1,044</u>
Total per State	5,173

Reconciling Items

Patients' safekeeping deposits held by financial institutions	199,091
Restricted assets held by financial institutions	<u>11,532,246</u>
Total per HHSC	<u><u>\$ 11,736,510</u></u>

	Hilo Medical Center	Hale Ho'ola Hamakua	Ka'u Hospital	Yukio Okutsu Veterans Care Home - Hilo	Kona Community Hospital	Kohala Hospital	Maui Memorial Medical Center	Kula Hospital	Lanai Community Hospital	Leahi Hospital	Maluhia	Kahuku	Kauai Veterans Memorial Hospital	Samuel Mahelona Memorial Hospital	Facilities	Hawaii Health Systems Corporation	Eliminations	HHSC Combined	Hawaii Health Systems Foundation	Alii Community Care - Maui	Alii Community Care - Kona	Kona Ambulatory Surgery Center	Eliminations	HHSC Consolidated	
Assets and Deferred Outflows of Resources																									
Current Assets																									
Cash and cash equivalents	\$ 16,676,424	\$ 9,916	\$ 10,117	\$ 3,759,351	\$ 18,057,011	\$ 2,528,928	\$ 27,556,744	\$ 3,477,051	\$ 355,139	\$ 6,358,909	\$ 5,705,807	\$ 929,137	\$ 12,004,777	\$ 62,457	\$ 97,491,768	\$ 11,201,973	\$ -	\$ 108,693,741	\$ 39,671	\$ 889,990	\$ 1,265,809	\$ 200,746	\$ -	\$ 111,089,957	
Cash and cash equivalents - State of Hawaii	7,500,002	403,607	256,683	-	2,242,054	296,211	154	3,847	1	908,505	748,709	-	1,014,797	405,345	13,779,915	640,586	-	14,420,501	-	-	-	-	-	-	14,420,501
Patient accounts receivable - Less allowances for doubtful accounts	27,802,026	1,728,915	574,688	1,134,622	14,721,583	1,097,730	5,910,795	177,979	9,667	1,581,836	1,671,506	2,346,982	2,062,668	1,871,597	62,692,594	-	-	62,692,594	-	90,404	173,960	161,723	-	-	63,118,681
Investments	7,293,429	-	-	-	-	-	-	-	-	-	-	-	-	-	7,293,429	-	-	7,293,429	-	-	-	-	-	-	7,293,429
Due from the State of Hawaii	14,859,000	-	-	-	7,041,000	994,000	8,253,000	1,307,000	1,834,000	4,654,000	3,190,000	1,812,000	4,779,000	5,089,700	53,812,700	-	-	53,812,700	-	-	-	-	-	-	53,812,700
Due from affiliates - Net	-	15,523,215	2,841,123	-	1,524,256	-	5,475,311	-	-	2,636,746	124,787	-	-	8,147,094	36,272,532	3,076,460	(39,348,992)	-	-	-	-	-	-	-	-
Supplies and other current assets	5,392,506	239,252	178,293	5,141	2,965,382	44,555	272,645	8	860	104,358	148,761	809,705	644,950	133,716	10,940,132	22,370	-	10,962,502	-	24,484	114,034	78,110	-	-	11,179,130
Estimated third-party payor settlements	2,223,062	-	-	-	1,468,840	241,389	515,348	1,476,058	152,671	844,906	751,507	-	1,003,210	1,018,004	9,694,995	-	-	9,694,995	-	-	-	-	(89,131)	-	9,605,864
Total current assets	81,746,449	17,904,905	3,860,904	4,899,114	48,020,126	5,202,813	47,983,997	6,441,943	2,352,338	17,089,260	12,341,077	5,897,824	21,509,402	16,727,913	291,978,065	14,941,389	(39,348,992)	267,570,462	39,671	1,004,878	1,553,803	440,579	(89,131)	270,520,262	
Assets Limited as to Use	20,402	13,141	8,935	-	10,115,526	-	862,744	-	-	96,726	59,033	854	10,128	15,025	11,202,514	533,996	-	11,736,510	-	-	-	-	-	-	11,736,510
Capital Assets - Net	57,229,411	15,507,219	4,673,204	20,904,013	34,097,979	5,120,087	123,259,106	17,416,122	4,915,326	15,706,034	11,303,264	7,585,495	14,975,670	9,211,049	341,903,979	720,634	-	342,624,613	-	7,694,624	133,935	2,536,823	-	-	352,989,995
Other Assets	852,839	-	-	-	391,897	-	164,801	-	-	-	-	-	-	-	1,409,537	-	-	1,409,537	-	-	50,248	-	(391,897)	-	1,067,888
Total assets	139,849,101	33,425,265	8,543,043	25,803,127	92,625,528	10,322,900	172,270,648	23,858,065	7,267,664	32,892,020	23,703,374	13,484,173	36,495,200	25,953,987	646,494,095	16,196,019	(39,348,992)	623,341,122	39,671	8,699,502	1,737,986	2,977,402	(481,028)	636,314,655	
Deferred Outflows of Resources																									
Deferred outflows of resources - Pension	46,633,786	3,887,212	2,494,054	-	18,479,549	2,420,971	-	-	-	6,892,641	5,917,160	-	12,272,509	4,750,230	103,748,112	5,694,772	-	109,442,884	-	-	-	-	-	-	109,442,884
Deferred outflows of resources - Postemployment benefits other than pensions	35,805,532	2,903,185	1,896,102	-	13,982,952	1,900,882	-	-	-	5,287,515	4,469,160	-	9,122,425	3,536,493	78,904,246	4,246,121	-	83,150,367	-	-	-	-	-	-	83,150,367
Total assets and deferred outflows of resources	\$ 222,288,419	\$ 40,215,662	\$ 12,933,199	\$ 25,803,127	\$ 125,088,029	\$ 14,644,753	\$ 172,270,648	\$ 23,858,065	\$ 7,267,664	\$ 45,072,176	\$ 34,089,694	\$ 13,484,173	\$ 57,890,134	\$ 34,240,710	\$ 829,146,453	\$ 26,136,912	\$ (39,348,992)	\$ 815,934,373	\$ 39,671	\$ 8,699,502	\$ 1,737,986	\$ 2,977,402	\$ (481,028)	\$ 828,907,906	

June 30, 2018

	Hilo Medical Center	Hale Ho'ola Hamakua	Ka'u Hospital	Yukio Okutsu Veterans Care Home - Hilo	Kona Community Hospital	Kohala Hospital	Maui Memorial Medical Center	Kula Hospital	Lanai Community Hospital	Leahi Hospital	Maluhia	Kahuku	Kauai Veterans Memorial Hospital	Samuel Mahelona Memorial Hospital	Facilities	Hawaii Health Systems Corporation	Eliminations	HHSC Combined	Hawaii Health Systems Foundation	Alii Community Care - Maui	Alii Community Care - Kona	Kona Ambulatory Surgery Center	Eliminations	HHSC Consolidated	
Liabilities, Deferred Inflows of Resources, and Net Position																									
Current Liabilities																									
Estimated third-party payor settlements	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 89,131	\$ -	\$ -	\$ 89,131	\$ -	\$ -	\$ 89,131	\$ -	\$ -	\$ -	\$ -	\$ (89,131)	\$ -
Accounts payable and accrued expenses	29,703,844	1,546,765	1,020,338	567,773	8,782,789	608,927	6,097,963	618,348	62,990	1,851,408	1,765,201	2,394,354	4,370,888	1,599,187	60,990,775	2,560,194	-	63,550,969	-	50,347	1,346,954	46,146	(450,168)	64,544,248	
Current portion of accrued vacation	6,190,310	396,664	205,968	87,741	2,268,631	336,580	-	-	-	1,110,029	819,676	365,668	1,554,506	764,331	14,100,104	771,185	-	14,871,289	-	-	-	-	-	-	14,871,289
Current portion of long-term debt	341,483	-	-	-	-	-	10,611,269	-	-	-	-	128,704	-	-	11,081,456	-	-	11,081,456	-	904,577	-	-	-	-	11,986,033
Current portion of capital lease obligations	985,888	-	-	-	404,398	-	619,915	-	-	-	-	-	-	-	2,010,201	527,071	-	2,537,272	-	-	4,249	-	-	-	2,541,521
Due to affiliates - Net	19,654,758	59,063	27,490	436,693	382,427	963,153	-	2,917,472	3,317,055	33,956	2,152,434	1,056,331	6,792,837	27,319	37,820,988	-	(39,171,156)	(1,350,168)	-	-	900,000	-	450,168	-	-
Current portion of accrued workers' compensation	940,000	151,000	17,000	-	375,000	17,000	1,165,000	422,000	16,000	396,000	185,000	-	167,000	81,000	3,932,000	-	-	3,932,000	-	-	-	-	-	-	3,932,000
Other current liabilities	-	176,390	145,218	-	-	-	453,546	-	-	-	-	-	23,141	60,000	858,295	2,000	-	860,295	-	419,341	227	-	-	-	1,279,863
Total current liabilities	57,816,283	2,329,882	1,416,014	1,092,207	12,213,245	1,925,660	18,947,693	3,957,820	3,396,045	3,391,393	4,922,311	4,034,188	12,908,372	2,531,837	130,882,950	3,860,450	(39,171,156)	95,572,244	-	1,374,265	2,251,430	46,146	(89,131)	99,154,954	
Long-term Debt - Less current portion	7,056,513	-	-	-	-	-	7,259,000	-	-	-	-	-	-	-	14,315,513	-	-	14,315,513	-	9,976,149	-	-	-	-	24,291,662
Capital Lease Obligations - Less current portion	1,403,923	-	-	-	1,131,937	-	2,282,308	-	-	-	-	-	-	-	4,818,168	121,060	-	4,939,228	-	-	-	-	-	-	4,939,228
Other Liabilities																									
Accrued vacation - Less current portion	5,473,874	350,757	182,130	-	1,676,742	248,766	-	-	-	1,325,918	1,180,581	-	1,007,711	658,869	12,105,348	693,733	-	12,799,081	-	-	41,184	-	-	-	12,840,265
Accrued workers' compensation - Less current portion	2,526,000	195,000	151,000	-	1,368,000	183,000	1,963,000	9,000	37,000	134,000	288,000	-	635,000	257,000	7,746,000	354,000	-	8,100,000	-	-	-	-	-	-	8,100,000
Other postemployment benefit liability	233,386,807	19,086,123	12,255,804	-	90,897,468	11,741,462	-	-	-	33,690,684	29,009,259	-	60,501,831	23,266,543	513,835,981	28,009,143	-	541,845,124	-	-	-	-	-	-	541,845,124
Due to the State of Hawaii	-	506,153	-	-	7,605,205	528,149	-	-	-	6,416,791	491,450	-	1,043,345	2,417,150	19,008,243	-	-	19,008,243	-	-	-	-	-	-	19,008,243
Due to affiliates - Net	-	-	-	-	-	-	-	-	-	-	-	177,836	-	-	177,836	-	(177,836)	-	-	-	-	-	-	-	-
Pension liability	213,295,485	19,042,212	11,779,631	-	91,517,019	11,067,040	-	-	-	40,300,839	33,189,738	-	63,627,967	24,917,419	508,737,350	21,718,337	-	530,455,687	-	-	-	-	-	-	530,455,687
Other liabilities	-	1,500	-	-	3,833	-	-	-	-	-	-	-	16,135	4,480	25,948	-	-	25,948	-	-	-	-	-	-	25,948
Patients' safekeeping deposits	20,402	13,141	8,935	-	-	-	-	-	-	90,021	32,813	285	6,378	13,981	185,956	-	-	185,956	-	-	-	-	-	-	185,956
Total liabilities	520,979,287	41,524,768	25,793,514	1,092,207	206,413,449	25,694,077	30,452,001	3,966,820	3,433,045	85,349,646	69,114,152	4,212,309	139,746,739	54,067,279	1,211,839,293	54,756,723	(39,348,992)	1,227,247,024	-	11,350,414	2,292,614	46,146	(89,131)	1,240,847,067	
Deferred Inflows of Resources																									
Deferred inflows of resources - Pension	12,497,931	1,041,779	668,411	-	4,952,549	648,824	-	-	-	1,847,239	1,585,809	-	3,289,053	1,273,069	27,804,664	1,526,208	-	29,330,872	-	-	-	-	-	-	29,330,872
Deferred inflows of resources - Postemployment benefits other than pensions	484,409	38,987	25,836	-	189,612	26,872	-	-	-	72,913	60,679	-	121,564	47,462	1,068,334	56,854	-	1,125,188	-	-	-	-	-	-	1,125,188
Total deferred inflows of resources	12,982,340	1,080,766	694,247	-	5,142,161	675,696	-	-	-	1,920,152	1,646,488	-	3,410,617	1,320,531	28,872,998	1,583,062	-	30,456,060	-	-	-	-	-	-	30,456,060
Total liabilities and deferred inflows of resources	533,961,627	42,605,534	26,487,761	1,092,207	211,555,610	26,369,773	30,452,001	3,966,820	3,433,045	87,269,798	70,760,640	4,212,309	143,157,356	55,387,810	1,240,712,291	56,339,785	(39,348,992)	1,257,703,084	-	11,350,414	2,292,614	46,146	(89,131)	1,271,303,127	
Net Position																									
Unrestricted	(359,114,812)	(17,897,091)	(18,227,766)	3,806,907	(119,085,747)	(16,845,107)	31,904,245	2,475,123	(1,080,707)	(57,903,656)	(47,998,745)	1,825,370	(100,247,021)	(30,359,193)	(728,748,200)	(30,674,233)	-	(759,422,433)	39,671	535,190	(684,314)	394,433	(391,897)	(759,529,350)	
Net investment in capital assets	47,441,604	15,507,219	4,673,204	20,904,013	32,561,644	5,120,087	109,901,662	17,416,122	4,915,326	15,706,034	11,303,264	7,446,494	14,975,670	9,211,049	317,083,392	471,360	-	317,554,752	-	(3,186,102)	129,686	2,536,823	-	317,035,159	
Restricted for capital purchases	-	-	-	-	56,522	-	12,740	-	-	-	24,535	-	4,129	1,044	98,970	-	-	98,970	-	-	-	-	-	-	98,970
Total net position	(311,673,208)	(2,389,872)	(13,554,562)	24,710,920	(86,467,581)	(11,725,020)	141,818,647	19,891,245	3,834,619	(42,197,622)	(36,670,946)	9,271,864	(85,267,222)	(21,147,100)	(411,565,838)	(30,202,873)	-	(441,768,711)	39,671	(2,650,912)	(554,628)	2,931,256	(391,897)	(442,395,221)	
Total liabilities, deferred inflows of resources, and net position	\$ 222,288,419	\$ 40,215,662	\$ 12,933,199	\$ 25,803,127	\$ 125,088,029	\$ 14,644,753	\$ 172,270,648	\$ 23,858,065	\$ 7,267,664	\$ 45,072,176	\$ 34,089,694	\$ 13,484,173	\$ 57,890,134	\$ 34,240,710	\$ 829,146,453	\$ 26,136,912	\$ (39,348,992)	\$ 815,934,373	\$ 39,671	\$ 8,699,502	\$ 1,737,986	\$ 2,977,402	\$ (481,028)	\$ 828,907,906	

Statement of Revenue, Expenses, and Changes in Net Position (Deficit) of Facilities

Year Ended June 30, 2018

	Hilo Medical Center	Hale Ho'ola Hamakua	Ka'u Hospital	Yukio Okutsu Veterans Care Home - Hilo	Kona Community Hospital	Kohala Hospital	Maui Memorial Medical Center	Kula Hospital	Lanai Community Hospital	Leahi Hospital	Maluhia	Kahuku	Kauai Veterans Memorial Hospital	Samuel Mahelona Memorial Hospital	Facilities	Hawaii Health System Corporation	Eliminations	HHSC Combined	Hawaii Health Systems Foundation	Alii Community Care - Maui	Alii Community Care - Kona	Kona Ambulatory Surgery Center	Eliminations	HHSC Consolidated	
Operating Revenue																									
Net patient service revenue	\$ 184,843,651	\$ 17,435,368	\$ 8,208,158	\$ 13,843,017	\$ 90,729,338	\$ 9,275,574	\$ 9,503,683	\$ 1,141,876	\$ 141,100	\$ 14,749,753	\$ 14,228,542	\$ 12,101,004	\$ 34,469,484	\$ 17,566,528	\$ 428,237,076	\$ -	\$ -	\$ 428,237,076	\$ -	\$ -	\$ 3,898,534	\$ 752,181	\$ -	\$ 432,887,791	
Other revenue	2,714,225	144,578	108,176	-	625,706	5,088	3,067,143	9,210	915	208,515	77,038	639,920	276,503	238,087	8,115,104	-	-	8,115,104	-	4,581,006	1,273,386	25,862	-	13,995,358	
Total operating revenue	187,557,876	17,579,946	8,316,334	13,843,017	91,355,044	9,280,662	12,570,826	1,151,086	142,015	14,958,268	14,305,580	12,740,924	34,745,987	17,804,615	436,352,180	-	-	436,352,180	-	4,581,006	5,171,920	778,043	-	446,883,149	
Operating Expenses																									
Salaries	83,135,639	7,653,760	4,726,740	5,234,006	33,575,660	4,402,853	25,827,952	1,802,377	727,007	11,903,505	10,710,993	6,367,166	20,683,970	8,768,155	225,519,783	9,695,782	-	235,215,565	-	-	5,594,061	643,667	-	241,453,293	
Employee benefits	91,662,778	8,358,570	5,035,887	450,300	35,488,331	4,764,993	1,316,821	1,863,199	(211,906)	13,655,431	11,436,661	2,683,858	21,514,992	8,927,344	206,947,259	11,355,914	-	218,303,173	-	-	1,729,784	15,955	-	220,048,912	
Medical supplies and drugs	28,260,499	808,569	259,737	671,165	11,379,699	44,418	182,544	9,368	652	408,749	289,299	1,424,127	1,796,882	719,636	46,255,344	-	-	46,255,344	-	-	473,223	370,617	-	47,099,184	
Depreciation and amortization	6,920,637	775,440	539,007	747,105	5,044,338	379,182	17,240,454	1,191,412	365,415	1,122,643	704,467	1,167,142	2,503,218	929,541	39,630,001	375,859	-	40,005,860	-	893,007	43,922	179,637	-	41,122,426	
Utilities	3,804,629	588,931	265,381	991,365	1,497,603	177,689	-	1,542	(695)	843,051	632,740	410,564	991,826	449,680	10,654,306	343,852	-	10,998,158	-	271,796	19,253	-	-	11,289,207	
Repairs and maintenance	4,269,145	363,284	78,492	155,848	3,690,905	171,011	26,133	-	-	388,421	323,718	377,857	491,579	107,599	10,443,992	1,710,715	-	12,154,707	-	70,670	296,219	322,304	-	12,843,900	
Other supplies	4,518,238	695,497	330,235	463,036	1,751,082	419,243	-	702	316	739,440	840,143	448,355	785,109	513,034	11,504,430	600,237	-	12,104,667	-	421,222	41,314	-	-	12,567,203	
Purchased services	33,300,732	2,364,258	1,383,129	1,565,435	19,897,780	1,908,021	4,118,322	66,810	11,227	494,649	678,975	1,564,962	5,419,313	1,537,774	74,311,387	(172,114)	-	74,139,273	-	38,647	325,387	-	-	74,503,307	
Professional fees	5,769,912	283,995	36,332	90,964	202,167	446,098	-	-	-	38,095	51,257	1,289,141	1,466,944	268,253	9,943,158	328,489	-	10,271,647	-	2,729,431	(727,029)	479,889	-	12,753,938	
Insurance	710,792	108,305	38,585	1,446,822	377,876	32,889	3,947,095	125,987	18,163	110,614	151,196	90,532	547,429	150,187	7,856,472	332,690	-	8,189,162	-	108,516	1,387,486	-	-	9,685,164	
Rent and lease	2,699,349	42,364	48,122	51,037	603,152	87,450	5,610	509	-	27,459	1,709	204,316	318,915	39,089	4,129,081	210,328	-	4,339,409	-	215,361	853,489	-	-	5,408,259	
Other	4,086,293	234,604	108,694	736,263	1,164,300	232,855	1,936,426	382,105	78,932	185,152	127,536	777,791	905,024	204,514	11,160,489	1,299,986	-	12,460,475	168	185,505	522,893	-	-	13,169,041	
Total operating expenses	269,138,643	22,277,577	12,850,341	12,603,346	114,672,893	13,066,702	54,601,357	5,444,011	989,111	29,917,209	25,948,694	16,805,811	57,425,201	22,614,806	658,355,702	26,081,738	-	684,437,440	168	4,934,155	10,560,002	2,012,069	-	701,943,834	
Operating (Loss) Income	(81,580,767)	(4,697,631)	(4,534,007)	1,239,671	(23,317,849)	(3,786,040)	(42,030,531)	(4,292,925)	(847,096)	(14,958,941)	(11,643,114)	(4,064,887)	(22,679,214)	(4,810,191)	(222,003,522)	(26,081,738)	-	(248,085,260)	(168)	(353,149)	(5,388,082)	(1,234,026)	-	(255,060,685)	
Nonoperating Revenue (Expense)																									
General appropriations from the State of Hawaii	41,606,000	2,436,000	1,815,000	-	21,101,000	1,940,000	-	-	-	9,884,000	8,365,000	1,800,000	9,826,545	3,010,000	101,783,545	10,518,003	-	112,301,548	-	-	-	-	-	-	112,301,548
Transfers from State of Hawaii	-	-	-	-	-	-	26,346,919	3,613,376	520,619	-	-	-	-	-	30,480,914	-	-	30,480,914	-	-	-	-	-	-	30,480,914
Restricted contributions	858,876	-	56,000	-	607,337	6,880	(764,741)	-	-	-	-	-	-	-	764,352	-	-	764,352	-	-	-	-	-	-	764,352
Interest expense	(521,399)	-	-	(1,261)	(73,186)	(7,029)	(887,861)	(1,300)	(306)	(1,341)	(486)	(19,084)	(37,742)	(658)	(1,551,653)	(8,655)	-	(1,560,308)	-	(670,260)	(1,952)	-	-	(2,232,520)	
Interest and dividend income	185,945	5,816	831	5,988	27,657	7,692	233,286	4,928	295	15,346	11,676	-	50,573	3,848	553,881	232,092	-	785,973	-	18,042	-	-	-	804,015	
Corporate allocation to affiliates	(3,165,790)	(263,063)	(147,490)	-	(2,230,427)	(245,602)	(2,079,199)	-	-	(528,157)	(471,583)	-	(1,098,770)	(424,916)	(10,654,997)	10,654,997	-	-	-	-	-	-	-	-	
Other nonoperating revenue - Net	1,367,743	129,079	(6,793)	23,102	(6,752,289)	30,860	581,134	(3,407)	31,012	205,263	-	-	410,724	(273,628)	(4,257,200)	9,355	-	(4,247,845)	-	-	5,837,447	-	1,173,455	2,763,057	
Total nonoperating income (expense)	40,331,375	2,307,832	1,717,548	27,829	12,680,092	1,732,801	23,429,538	3,613,597	551,620	9,575,111	7,904,607	1,780,916	9,151,330	2,314,646	117,118,842	21,405,792	-	138,524,634	-	(652,218)	5,835,495	-	1,173,455	144,881,366	
Excess of Revenue (Under) Over Expenses	(41,249,392)	(2,389,799)	(2,816,459)	1,267,500	(10,637,757)	(2,053,239)	(18,600,993)	(679,328)	(295,476)	(5,383,830)	(3,738,507)	(2,283,971)	(13,527,884)	(2,495,545)	(104,884,680)	(4,675,946)	-	(109,560,626)	(168)	(1,005,367)	447,413	(1,234,026)	1,173,455	(110,179,319)	
Capital Contributions	11,352,636	-	-	-	2,100,442	994,000	(251,366)	29,400	186,558	3,321,300	2,058,531	1,633,217	1,311,637	2,402,436	25,138,791	-	-	25,138,791	-	-	-	1,172,000	(1,172,000)	25,138,791	
Transfer (to) from Affiliate	(366,210)	(34,949)	(19,664)	-	(159,265)	(6,510)	(130,962)	(23,574)	(5,272)	138,509	167,463	-	(61,868)	(25,316)	(527,618)	(1,046,112)	-	(1,573,730)	-	1,573,730	-	-	-	-	
Transfer Agreement Expense	-	-	-	-	-	-	(4,974,307)	(150,756)	(57,731)	-	-	-	-	-	(5,182,794)	-	-	(5,182,794)	-	-	-	-	-	-	(5,182,794)
Transfer of Liabilities to the State of Hawaii	-	-	-	-	-	-	350,220,409	46,159,400	7,071,285	-	-	-	-	-	403,451,094	-	-	403,451,094	-	-	-	-	-	-	403,451,094
(Decrease) Increase in Net Position	(30,262,966)	(2,424,748)	(2,836,123)	1,267,500	(8,696,580)	(1,065,749)	326,262,781	45,335,142	6,899,364	(1,924,021)	(1,512,513)	(650,754)	(12,278,115)	(118,425)	317,994,793	(5,722,058)	-	312,272,735	(168)	568,363	447,413	(62,026)	1,455	313,227,772	
Net Position - Beginning of year - As restated	(281,410,242)	34,876	(10,718,439)	23,443,420	(77,771,001)	(10,659,271)	(184,444,134)	(25,443,897)	(3,064,745)	(40,273,601)	(35,158,433)	9,922,618	(72,989,107)	(21,028,675)	(729,560,631)	(24,480,815)	-	(754,041,446)	39,839	(3,219,275)	(1,002,041)	2,993,282	(393,352)	(755,622,993)	
Net Position - End of year	\$ (311,673,208)	\$ (2,389,872)	\$ (13,554,562)	\$ 24,710,920	\$ (86,467,581)	\$ (11,725,020)	\$ 141,818,647	\$ 19,891,245	\$ 3,834,619	\$ (42,197,622)	\$ (36,670,946)	\$ 9,271,864	\$ (85,267,222)	\$ (21,147,100)	\$ (411,565,838)	\$ (30,202,873)	\$ -	\$ (441,768,711)	\$ 39,671	\$ (2,650,912)	\$ (554,628)	\$ 2,931,256	\$ (391,897)	\$ (442,395,221)	

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

Independent Auditor's Report

To Management and the Board of Directors
Hawaii Health Systems Corporation

We have audited, 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, the financial statements of Hawaii Health Systems Corporation (the "Corporation"), which comprise the basic statement of net position as of June 30, 2018 and the related basic statements of revenue, expenses, and changes in net position and cash flows for the year then ended, and the related notes to the financial statements and have issued our report thereon dated December 11, 2018.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Corporation'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 Corporation's internal control. Accordingly, we do not express an opinion on the effectiveness of the Corporation'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 Corporation's financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies described in the accompanying schedule of findings as Findings 2018-02, 2018-03, 2018-04, 2018-06, 2018-07, and 2018-08 to be material weaknesses. 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. We consider the deficiencies described in the accompanying schedule of findings as Findings 2018-01 and 2018-05 to be significant deficiencies.

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. We did identify any deficiencies in internal control that we consider to be material weaknesses. However, additional material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Corporation'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*.

To Management and the Board of Directors
Hawaii Health Systems Corporation

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 Corporation'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 Corporation's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Plante & Moreau, PLLC

December 11, 2018

Section II - Financial Statement Audit Findings

Reference Number	Finding
2018-01	<p>Finding Type - Significant deficiency, Alii Community Care, Inc.</p> <p>Criteria - Property and equipment lapse schedules for Roselani Place should be reviewed by a second individual to ensure proper depreciation calculations are being prepared. Reconciliation of the detailed lapse schedule to the general ledger is essential to ensure amounts presented in the financial statements are accurate.</p> <p>Condition - A property and equipment lapse schedule is not being updated properly at Roselani Place. Also, depreciation expense had not been recorded correctly in fiscal year 2018.</p> <p>Context - Property and equipment amounts recorded in the general ledger did not have adequate supporting documentation.</p> <p>Cause - An adjustment to depreciation expense of \$17,223 needed to be recorded in fiscal year 2018.</p> <p>Effect - The statement of net position and statement of revenue, expenses, and changes in net position were misstated throughout the year. An adjusting journal entry was posted to correct this misstatement.</p> <p>Recommendation - We recommend management at Roselani Place perform formal review of property and equipment accounts to ensure what is being reported is properly supported by lapse schedules or other detailed records. Additionally, management should document their review of a reconciliation between the detailed lapse schedule and the general ledger to ensure all asset activity is captured properly.</p> <p>Views of Responsible Officials - The ACC Board Management Liaison will work directly with the Roselani Place accountant to review property and equipment accounts to ensure what is being reported is properly supported by lapse schedules or other detailed reports. This review process will occur monthly and will include proper documentation of reconciliation activity between the lapse schedules and the general ledger to ensure accurate capturing of asset activity.</p>

Section II - Financial Statement Audit Findings (Continued)

Reference Number	Finding
2018-02	<p>Finding Type - Material weakness, Alii Community Care, Inc.</p> <p>Criteria - Financial statements should be reported on an accrual basis throughout the year at Alii - Kona, a division of Alii Community Care, Inc.</p> <p>Condition - Alii - Kona reported financial results on a cash basis throughout 2018.</p> <p>Context - Generally accepted accounting principles require the accrual basis of accounting.</p> <p>Cause - Decision by management to report financial results on cash basis.</p> <p>Effect - The statement of revenue, expenses, and changes in net position was misstated throughout the year. Adjusting journal entries were posted to correct this misstatement.</p> <p>Recommendation - We recommend management review the decision to report financial results in accordance with generally accepted accounting principles on an interim basis.</p> <p>Views of Responsible Officials - The Alii Community Care, Inc. Board will review and evaluate Alii Health Center - Kona's cash accounting methodology based on concerns raised by Plante & Moran, PLLC.</p>

Section II - Financial Statement Audit Findings (Continued)

Reference Number	Finding
2018-03	<p>Finding Type - Material weakness, Kahuku Medical Center (KMC)</p> <p>Criteria - Account balances and manual journal entries should be reconciled and reviewed periodically to ensure the balance in the general ledger is accurate.</p> <p>Condition - Account balances were not properly stated on the trial balance received. Completed construction projects funded by the State of Hawaii were not capitalized during the year and depreciation expense was not recorded for these assets. Additionally, the receivable balance from the State of Hawaii was not appropriately adjusted for completion of capital improvement projects during the year.</p> <p>Context - Multiple balances not being appropriately trued up at year end. Adjustments were made to the following balances:</p> <ul style="list-style-type: none"> (1) Accounts receivable (2) Accounts payable (3) Fixed assets (4) Net assets <p>These adjustments resulted in an overstatement of State Grant CIP and an understatement of building improvements amounts due from the State of Hawaii and corresponding understatement of capitalized assets of approximately \$1,270,000, net decreases in expenses of approximately \$63,000. The adjustments impacted the balance sheet accounts and the net effect on income resulted in approximately \$30,000 in depreciation that had not been recognized.</p> <p>Cause - Appropriate review, tracking, and monitoring procedures were not in place during the year.</p> <p>Effect - Multiple account adjustments were identified as a result of audit procedures.</p> <p>Recommendation - We recommend Kahuku Medical Center put appropriate review controls in place to ensure balances are appropriately stated at the end of each period. We also recommend that KMC put appropriate procedures in place to track capital improvement projects as they are in progress, and the related funding from the State of Hawaii. Upon project completion, these assets should be placed in service and depreciated.</p> <p>Views of Responsible Officials - Considering the mid-year transition of accounting personnel, existing and new personnel have dedicated abundant time and resources streamlining practices to improve the efficiency and effectiveness of the accounting function for KMC.</p> <p>As part of management's plan, the accounting personnel have implemented and are keeping more detailed records of invoices paid by the State of Hawaii specific to capital improvement projects. Accounting personnel recorded a corresponding decrease in the receivable balance of amounts due from the State of Hawaii to reflect the completion of specific capital improvement projects. In addition, accounting personnel are reviewing project invoices more closely to identify when each project has been completed and should be placed into service within the fixed asset tracking spreadsheet.</p> <p>As a result of management's executed plan, management has corrected the account balances and implemented and developed procedures to monitor and properly review the aforementioned account balances: accounts receivable, accounts payable, fixed assets, and net assets.</p>

Section II - Financial Statement Audit Findings (Continued)

Reference Number	Finding
2018-04	<p>Finding Type - Material weakness, Kauai Region</p> <p>Criteria - Account balances should be reconciled and reviewed periodically to ensure the balance in the general ledger is accurate.</p> <p>Condition - Account balances were not appropriately stated on the trial balance received.</p> <p>Context - Lack of review led to multiple balances not being appropriately trued up at year end. Adjustments were made to the following balances:</p> <ul style="list-style-type: none">(1) Cash(2) Accounts receivable(3) Third-party settlements(4) Due from affiliates(5) Accounts payable(6) Accrued salaries and wages(7) Accrued vacation <p>These adjustments resulted in a net decrease in operating losses of approximately \$1,409,000, in addition to passed adjustments.</p> <p>Cause - Appropriate review and monitoring was not fully in place at year end.</p> <p>Effect - Multiple account adjustments were identified as a result of audit procedures.</p> <p>Recommendation - We would recommend that Kauai Veterans Memorial Hospital and Samuel Mahelona Memorial Hospital put appropriate controls in place to ensure balances are appropriately stated at the end of each period.</p> <p>Views of Responsible Officials - Personnel have dedicated abundant time and resources streamlining practices to improve the efficiency and effectiveness of the accounting function for the hospitals. As a result of the executed plan, management has corrected these account balances at June 30, 2018 and is working to implement appropriate procedures going forward.</p>

Section II - Financial Statement Audit Findings (Continued)

Reference Number	Finding
2018-05	<p>Finding Type - Significant deficiency, East Hawaii Region</p> <p>Criteria - Reports used to determine accrued vacation should be reviewed to ensure proper parameters are set.</p> <p>Condition - Detail review of the reports utilized in the accrual calculations were not performed.</p> <p>Context - Multiple employees were improperly populating or absent from the report used in the accrual process.</p> <p>Cause - Reports generated to assist in the accrual process were not created with the appropriate parameters.</p> <p>Effect - Adjustments to accrued vacation accounts were identified as a result of audit procedures.</p> <p>Recommendation - We recommend the East Hawaii Region increase testing performed on accrued vacation reports in looking at new employees with significant hours accrued or prior employees no longer listed who previously had significant hours accrued.</p> <p>Views of Responsible Officials - Management has corrected the error and continues to improve procedures relating to report production and internal review processes.</p>

Reference Number	Finding
2018-06	<p>Finding Type - Material weakness, East Hawaii Region</p> <p>Criteria - Invoices for expenses should be reviewed at year end and subsequent to year end to ensure that all liabilities and expenses related to the year are appropriately recorded.</p> <p>Condition - Accounts payable was not appropriately reviewed for cut-off at year end.</p> <p>Context - Multiple items were improperly excluded from accounts payable during the prior fiscal year, resulting in an understatement of prior year accounts payable and expenses.</p> <p>Cause - Invoices for expenses were not appropriately reviewed throughout the year-end close process.</p> <p>Effect - Accounts payable and expenses for the prior fiscal year were understated by approximately \$1.9 million.</p> <p>Recommendation - We recommend the East Hawaii Region closely monitor all invoices received at, and subsequent to, year end to ensure that the appropriate liabilities and related expenses are recorded.</p> <p>Views of Responsible Officials - Management has corrected the error and continues to improve procedures to properly review invoices near cut-off periods.</p>

Section II - Financial Statement Audit Findings (Continued)

Reference Number	Finding
2018-07	<p>Finding Type - Material weakness, Maui Region</p> <p>Criteria - The bad debt and contractual allowances should be adjusted so that net accounts receivable accurately reflects the region's best estimate of future cash collections.</p> <p>Condition - The bad debt allowance was not adequately reviewed to ensure that net accounts receivable approximated the estimated future cash collections on services previously provided to patients</p> <p>Context - The bad debt allowance and provision for bad debts were understated by \$2 million as of June 30, 2018.</p> <p>Cause - A sufficient analysis of expected future cash collections was not completed to ensure the bad debt allowance was properly stated.</p> <p>Effect - As a result of this deficiency, the bad debt allowance and provision for bad debts were understated as of June 30, 2018.</p> <p>Recommendation - We recommend management complete a detailed analysis to compare estimated future cash collections to net accounts receivable on the general ledger.</p> <p>Views of Responsible Officials and Planned Corrective Actions - Management has corrected the issue.</p>

Reference Number	Finding
2018-08	<p>Finding Type - Material weakness, Kahuku Medical Center</p> <p>Criteria - There are not appropriate controls in place to ensure appropriate segregation of duties within the accounting department.</p> <p>Condition - Roles and responsibilities are not appropriately allocated among individuals in the accounting department to ensure adequate control.</p> <p>Context - Reconciliations and account balances as stated could be compromised.</p> <p>Cause - Lack of appropriate oversight, delegation, and role allocation.</p> <p>Effect - As a result of this, reconciliations and accounts balances as stated could be compromised.</p> <p>Recommendation - We recommend appropriate controls be put into place to ensure appropriate segregation of duties.</p> <p>Views of Responsible Officials and Planned Corrective Actions - Management is taking steps to correct the issue.</p>