

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

Financial Statements
Fiscal Year Ended June 30, 2012

Submitted by

**THE AUDITOR
STATE OF HAWAII**



A Hawaii Limited Liability Partnership

January 25, 2013

Office of the Auditor
State of Hawaii

Mr. Alvin A. Takeshita
Highways Administrator - Department of Transportation, Highways Division
869 Punchbowl Street
Honolulu, HI 96813

Dear Mr. Takeshita:

This is our report on the financial audit of the Highways Division of the Department of Transportation of the State of Hawaii (the Division) as of and for the fiscal year ended June 30, 2012. Our audit was performed in accordance with the terms of our contract with the State of Hawaii and with the requirements of the U.S. Office of Management and Budget (OMB) Circular A-133, *Government Auditing Standards*, Audits of States, Local Governments, and Non-Profit Organizations.

OBJECTIVES OF THE AUDIT

The primary purpose of our audit was to form an opinion on the fairness of the presentation of the Division's basic financial statements as of and for the fiscal year ended June 30, 2012, and to comply with the requirements of OMB Circular A-133. The objectives of the audit were as follows:

1. To provide a basis for an opinion on the fairness of the presentation of the Division's basic financial statements.
2. To determine whether expenditures and other disbursements have been made and revenues and other receipts to which the Division is entitled have been collected and accounted for in accordance with the laws, rules and regulations, and policies and procedures of the State of Hawaii and the federal government.
3. To determine whether the Division has established sufficient internal controls to properly manage federal financial assistance programs and to comply with the applicable laws and regulations.
4. To determine whether the Division has complied with the laws and regulations that may have a material effect on the basic financial statements and on its major federal financial assistance programs.

SCOPE OF THE AUDIT

Our audit was performed in accordance with auditing standards generally accepted in the United States of America as prescribed by the American Institute of Certified Public Accountants; *Government Auditing Standards*, issued by the Comptroller General of the United States; and the provisions of OMB Circular A-133. The scope of our audit included an examination of the transactions and accounting records of the Division for the fiscal year ended June 30, 2012.

ORGANIZATION OF THE REPORT

This report is presented in four parts as follows:

- Part I – The basic financial statements and related notes of the Division as of and for the fiscal year ended June 30, 2012, and our opinion on the basic financial statements.
- Part II – Our report on internal control over financial reporting and compliance.
- Part III – Our report on compliance with requirements applicable to each major program and internal control over compliance.
- Part IV – The schedule of findings and questioned costs.

We wish to express our sincere appreciation for the cooperation and assistance extended by the officers and staff of the Division.

Sincerely,



Wilcox Choy
Partner

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PART I
FINANCIAL SECTION



A Hawaii Limited Liability Partnership

Independent Auditor's Report

Office of the Auditor
State of Hawaii:

We have audited the accompanying financial statements of the governmental activities and each major fund of the Highways Division of the Department of Transportation of the State of Hawaii (Division), as of and for the year ended June 30, 2012, which collectively comprise the Division's basic financial statements as listed in the preceding table of contents. These financial statements are the responsibility of the Division's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Division's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note 1, the financial statements of the Division are intended to present the financial position and the changes in financial position of only that portion of the governmental activities and each major fund of the State of Hawaii that is attributable to the transactions of the Division. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2012, and the changes in its financial position for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of the Division, as of June 30, 2012, and the respective changes in financial position and the respective budgetary comparison of the State Highway Fund thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 25, 2013, on our consideration of the Division's internal control over financial reporting and our

tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 8 through 19 be presented to supplement the basic financial statements. Such information, although not a required part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Division's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic 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 audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the 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 basic financial statements as a whole.

KMH LLP

KMH LLP

Honolulu, Hawaii
January 25, 2013

State of Hawaii, Department of Transportation, Highways Division

Management's Discussion and Analysis – Unaudited
As of and for the Year Ended June 30, 2012

The following Management's Discussion and Analysis (MD&A) of the Highways Division, Department of Transportation, State of Hawaii (Division) activities and financial performance provides the reader with an introduction and overview to the financial statements of the Division for the year ended June 30, 2012. This discussion has been prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section.

The Territorial Highway Department was created by the Territorial Legislature on April 24, 1925 by Act 78 to qualify Hawaii for participation in the Federal-Aid Program. The purpose of the Federal-Aid Program was to ensure the development of an integrated network of highways in the United States. Congress defined that the Federal government would provide the funds for construction on a matching contribution basis while the State or its political subdivisions would administer the highway.

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

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

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

**State of Hawaii,
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Management's Discussion and Analysis – Unaudited
As of and for the Year Ended June 30, 2012

FINANCIAL HIGHLIGHTS

Government-wide Financial Statements

The assets of the Division exceeded its liabilities at June 30, 2012 by \$5 billion. Of this amount, \$121 million is considered unrestricted and may be used to meet the Division's ongoing obligations.

The current year change in net assets was a decrease of \$86 million. This resulted from a deficiency of revenues under expenditures of \$78 million and a transfer of \$8 million to other State departments for debt service payments on general obligation bonds. The deficiency of revenues under expenditures was significantly impacted by depreciation expense of \$212 million.

Fund Financial Statements

At June 30, 2012, the Division's Governmental Funds reported a combined ending fund balance of \$256 million. The combined fund balance increased by \$83 million from the prior year's ending fund balance.

The Division's State Highway Fund (SHF), the major operating fund, reported an ending fund balance of \$149 million. There was a \$12 million increase in fund balance for the year ended June 30, 2012.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

State of Hawaii, Department of Transportation, Highways Division

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Government-wide Financial Statements

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

The Statement of Net Assets presents all of the Division's assets and liabilities, with the difference between the two reported as "net assets." Over time, increases or decreases in the Division's net assets are an indicator of whether its financial health is improving or deteriorating.

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

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

The government-wide financial statements can be found on pages 20 to 22 of this report.

Fund Financial Statements

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

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

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Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the Division's near-term financing decisions. A reconciliation to facilitate this comparison between governmental fund financial statements and government-wide financial statements is included on pages 25 and 28 of this report.

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

The basic governmental funds financial statements can be found on pages 23 through 28 of this report.

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

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

The Statement of Revenues and Expenditures—Budget and Actual—State Highway Fund (Non-GAAP Budgetary Basis) can be found on page 29 of this report.

Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and the governmental funds financial statements. The notes to the financial statements can be found on pages 31 through 59 of this report.

**State of Hawaii,
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Management's Discussion and Analysis – Unaudited
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GOVERNMENT-WIDE FINANCIAL ANALYSIS

Statements of Net Assets

As noted earlier, net assets may serve over time as a useful indicator of the Division's financial position. The Division's assets exceeded liabilities by \$5 billion at June 30, 2012 and 2011.

	<u>2012</u>	<u>2011</u>
Assets		
Current and other assets	\$ 377,354,145	\$ 271,443,127
Capital assets – net of accumulated depreciation	<u>5,147,810,133</u>	<u>5,213,653,561</u>
Total assets	<u>\$ 5,525,164,278</u>	<u>\$ 5,485,096,688</u>
Liabilities		
Current liabilities	\$ 117,622,964	\$ 101,619,885
Long-term liabilities	<u>443,629,252</u>	<u>333,849,568</u>
Total liabilities	<u>561,252,216</u>	<u>435,469,453</u>
Net Assets		
Invested in capital assets—net of related debt	4,775,723,985	4,871,319,824
Restricted	67,039,502	36,798,970
Unrestricted	<u>121,148,575</u>	<u>141,508,441</u>
Total net assets	<u>4,963,912,062</u>	<u>5,049,627,235</u>
Total liabilities and net assets	<u>\$ 5,525,164,278</u>	<u>\$ 5,485,096,688</u>

The largest portion of the Division's net assets (96 percent at June 30, 2012 and 2011) reflects its investment in capital assets (e.g., land and land improvements, buildings and improvements, vehicles and equipment, and infrastructure), less any related debt used to acquire those assets that is still outstanding. The Division uses these capital assets to provide services to citizens; therefore, these assets are not available for future spending. Although the Division's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay the debt must be provided from other sources, since capital assets themselves cannot be used to liquidate these liabilities.

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Management's Discussion and Analysis – Unaudited
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An additional portion of the Division's net assets (1.4 percent and 0.7 percent at June 30, 2012 and 2011, respectively) represents resources that are subject to restrictions as to how they may be used. This primarily relates to net assets reserved for payment of the Division's revenue bond debt service. The remaining balance of unrestricted net assets may be used to meet the Division's on-going obligations to citizens and creditors.

Capital assets – net decreased by \$66 million from June 30, 2011 to June 30, 2012 primarily because depreciation expense more than offset additions to construction in progress.

Long-term liabilities increased by \$110 million from June 30, 2011 to June 30, 2012 primarily due to the issuance of State of Hawaii Revenue Bonds Series 2011A and 2011B.

**State of Hawaii,
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Statements of Activities

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

	<u>2012</u>	<u>2011</u>
EXPENSES:		
Program expenses:		
Operations and maintenance Administration of Highways Division	\$ 201,355,983	\$ 149,615,646
Surcharge on gross receipts	34,032,227	32,440,157
Motor Vehicle Safety Office	8,924,378	7,477,835
Capital projects	10,791,210	9,446,524
Depreciation expense	17,657,330	14,370,589
Loss on disposal of capital assets	211,857,418	217,495,152
Debt service/interest expense	906,164	980,691
Total expenses	<u>17,340,483</u>	<u>16,186,581</u>
	502,865,193	448,013,175
REVENUES:		
Program revenues:		
Charges for services	43,024,180	26,308,185
Operating grants and contributions	85,304,289	52,232,669
Capital grants and contributions	<u>101,733,835</u>	<u>131,600,401</u>
Total program revenues	<u>230,062,304</u>	<u>210,141,255</u>
General revenues:		
Taxes	194,007,289	166,501,902
Investment income	315,935	6,650,150
Other	<u>930,967</u>	<u>553,385</u>
Total general revenues	<u>195,254,191</u>	<u>173,705,437</u>
Total revenues	<u>425,316,495</u>	<u>383,846,692</u>
Decrease in net assets before transfers (Carried forward)	<u>\$ (77,548,698)</u>	<u>\$ (64,166,483)</u>

**State of Hawaii,
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Management's Discussion and Analysis – Unaudited
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	<u>2012</u>	<u>2011</u>
Decrease in net assets before transfers (Brought forward)	\$ (77,548,698)	\$ (64,166,483)
Transfers	<u>(8,166,475)</u>	<u>(11,152,104)</u>
Change in net assets	(85,715,173)	(75,318,587)
Net Assets, beginning of year	<u>5,049,627,235</u>	<u>5,124,945,822</u>
Net Assets, end of year	<u><u>\$ 4,963,912,062</u></u>	<u><u>\$ 5,049,627,235</u></u>

Program revenues, which comprise charges for services as well as operating and capital grants, accounted for 54 percent and 55 percent of total revenues in fiscal years 2012 and 2011, respectively. The largest components of program revenues (81 percent and 87 percent for fiscal years 2012 and 2011, respectively) resulted from operating and capital grants and contributions from the Federal Highway Administration for the maintenance and construction of roads and other infrastructure.

Revenues not classified as program revenues are considered general revenues and primarily consist of taxes.

The fiscal year 2012 decrease in net assets of \$86 million resulted from the excess of expenses over revenues of \$78 million due primarily to depreciation expense of \$212 million and a transfer out of \$8 million to other State departments for the payment of debt service on general obligation bonds.

The fiscal year 2011 decrease in net assets of \$75 million resulted from the excess of expenses over revenues of \$64 million due primarily to depreciation expense of \$218 million and a transfer out of \$11 million to other State departments for the payment of debt service on general obligation bonds.

FINANCIAL ANALYSIS OF THE DIVISION'S GOVERNMENTAL FUNDS

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

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

**State of Hawaii,
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Management's Discussion and Analysis – Unaudited
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At June 30, 2012, the Division's Governmental Funds reported combined ending fund balances of \$256 million, representing an increase of \$83 million from the prior year. \$156 million of the fund balance is committed to indicate that amounts can only be used for specific purposes pursuant to formal action of the Legislature. \$100 million of the fund balance is restricted to indicate that amounts are restricted to specific purposes imposed by external parties.

At June 30, 2011, the Division's Governmental Funds reported combined ending fund balances of \$174 million, representing a decrease of \$49 million from the prior year. All of the fund balance is assigned to indicate that it is not available for new spending primarily because it has already been committed to liquidate contracts and purchase orders of the prior period.

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

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

At June 30, 2012 and 2011, the total fund balance of the SHF was \$149 million and \$137 million, respectively. SHF's fund balance increased by \$12 million in the current year compared to a \$3 million decrease in the prior year. During the current year, the Division's charges for services increased by \$17 million from prior year due to increase in the various fees and permit rates.

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The Debt Service Fund ("DSF") is used to track the revenue bond debt service for the Division. Debt service requirements are transferred from the SHF. The debt service expense on the government-wide financial statements was generally consistent from fiscal year 2011 to fiscal year 2012.

The Capital Projects Fund ("CPF") accounts for the Division's capital improvements program. At June 30, 2012, the CPF had a total fund balance of \$107 million. The CPF fund balance increased by \$70 million in fiscal year 2012 compared to a \$45 million decrease in the prior year. The change from the prior year was due primarily to the issuance of State of Hawaii Revenue Bonds Series 2011A and 2011B.

STATE HIGHWAY FUND BUDGETARY HIGHLIGHTS

The final SHF budget had total revenues of \$231 million. The actual revenues on a budgetary basis were \$2 million more than the final budget, primarily due to an increase in rental motor and tour vehicle surcharge tax and other fees and penalties.

Expenditures on the budgetary actual basis were \$13 million lower than the final budgeted amounts. The difference was primarily due to significant repairs and maintenance work that was budgeted being deferred into future periods.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

The Division's investment in capital assets as of June 30, 2012 amounted to \$5.1 billion, net of accumulated depreciation of \$4.8 billion. This investment in capital assets includes land and land improvements, buildings and building improvements, vehicles and equipment, infrastructure assets and construction in progress. Infrastructure assets consist of land, roadways, tunnels and bridges, and miscellaneous roadway components.

During fiscal year 2012, the Division put out 22 projects to bid with a contract amount of approximately \$22 million. There were 10 projects on Oahu, 4 projects on Hawaii, 6 project on Maui, (includes Molokai and Lanai), and 2 project on Kauai.

During fiscal year 2011, the Division put out 11 projects to bid with a contract amount of approximately \$23 million. There were 5 projects on Oahu, 4 projects on Hawaii, 1 project on Maui, (includes Molokai and Lanai), and 1 project on Kauai.

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At June 30, 2012, the Division had \$349 million in contracts encumbered in the Capital Projects Fund. This amount represents projects in the in-house planning stage and contracts awarded in fiscal year 2012, with construction expected to start in fiscal year 2012.

At June 30, 2011, the Division had \$347 million in contracts encumbered in the Capital Projects Fund. This amount represents projects in the in-house planning stage and contracts awarded in fiscal year 2011, with construction expected to start in fiscal year 2011.

Additional information on the Division's capital assets can be found in Note 7 to the attached financial statements.

Long-Term Debt

As of June 30, 2012, \$446 million in Highway Revenue Bonds were outstanding, compared to \$344 million as of June 30, 2011.

See Note 10 for additional information on Highway Revenue Bonds.

As of June 30, 2012, \$18 million in State of Hawaii General Obligation Bonds were outstanding, compared to \$26 million as of June 30, 2011. These bonds are considered general obligations of the State, and not the Division. Accordingly, no amounts are recorded by the Division for these liabilities. The Division makes debt service payments to repay principal and interest on these amounts. The payments for the fiscal year ended June 30, 2012 amounted to \$8 million, and the amount was recorded as an other financing use and transfer out in the financial statements.

See Note 11 for further information on general obligation bonds.

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

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

Additional information on the Division's long-term liabilities can be found in Note 9 to the attached financial statements.

REQUEST FOR INFORMATION

This financial report is designed to provide a general overview of the Division's finances for all interested parties. Questions concerning any of the information provided in this report or requests for additional information should be addressed to Gerald Dang, Administrative Services Officer, State of Hawaii, Department of Transportation, Highways Division, 869 Punchbowl Street, Honolulu, Hawaii, 96813.

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

Statement of Net Assets
June 30, 2012

<u>Assets</u>	<u>Governmental Activities</u>
Cash	\$ 282,489,397
Receivables, net of allowance for doubtful accounts:	
Due from U.S. Government	38,202,805
Due from City and Counties	10,871,417
Due from State of Hawaii	226,861
Other receivables	3,161,316
Prepaid Expenses	28,941
Restricted Cash:	
Revenue bond debt service	29,201,630
Security deposits	11,458,677
Bond Issuance Costs, net of accumulated amortization of \$2,495,739	1,713,101
Capital Assets, net of accumulated depreciation	<u>5,147,810,133</u>
Total assets	<u><u>\$ 5,525,164,278</u></u>

See accompanying notes to the basic financial statements.

**State of Hawaii,
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Statement of Net Assets
June 30, 2012

	<u>Governmental Activities</u>
Accounts Payable	\$ 30,865,516
Accrued Payroll	4,029,752
Contracts Payable:	
Current portion	29,716,836
Retained payable	8,590,259
Payable from Restricted Assets:	
Revenue bonds payable - due within one year	18,305,000
Interest payable	10,896,630
Security deposits	11,458,677
Other Liabilities	3,760,294
Long Term Liabilities:	
Due within one year:	
Workers' compensation payable	1,073,359
Accrued vacation payable	3,030,204
Revenue bonds payable	8,015,000
Due after one year:	
Workers' compensation payable	3,342,922
Accrued vacation payable	8,413,367
Revenue bonds payable	419,754,400
Total liabilities	<u>561,252,216</u>
Net Assets:	
Invested in capital assets, net of related debt	4,775,723,985
Restricted for debt service and capital activity	67,039,502
Unrestricted	<u>121,148,575</u>
Total net assets	<u>4,963,912,062</u>
Total liabilities and net assets	<u><u>\$ 5,525,164,278</u></u>

See accompanying notes to the basic financial statements.

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

Statement of Activities
For the Fiscal Year Ended June 30, 2012

	Governmental Activities
Expenses:	
Operations and maintenance:	
Oahu highways and services	\$ 100,580,120
Hawaii highways and services	28,135,769
Maui highways and services	17,911,256
Kauai highways and services	11,582,412
Molokai highways and services	759,269
Lanai highways and services	219,153
Pass through for County highways and services	42,168,004
Administration of Highways Division	34,032,227
Surcharge on gross receipts	8,924,378
Motor Vehicle Safety Office	10,791,210
Capital projects	17,657,330
Loss on disposal of capital assets	906,164
Depreciation expense	211,857,418
Interest expense	17,340,483
Total expenses	<u>502,865,193</u>
Program Revenues:	
Charges for services:	
Vehicle registration fees	36,126,961
Other fees and permits	3,458,278
Penalties and fines	2,026,969
Rentals	1,411,972
Operating grants and contributions	85,304,289
Capital grants and contributions	101,733,835
Total program revenues	<u>230,062,304</u>
General Revenues:	
Taxes:	
State fuel taxes	86,980,157
Rental motor and tour vehicle surcharge taxes	44,987,347
Vehicle weight taxes and penalties	62,039,785
Investment income	315,935
Non-imposed fringe benefits	930,967
Total general revenues	<u>195,254,191</u>
Deficiency of revenues under expenditures	<u>(77,548,698)</u>
Transfers	<u>(8,166,475)</u>
Change in net assets	(85,715,173)
Net Assets:	
Beginning of year	<u>5,049,627,235</u>
End of year	<u>\$ 4,963,912,062</u>

See accompanying notes to the basic financial statements.

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

Balance Sheet – Governmental Funds
June 30, 2012

<u>Assets</u>	<u>State Highway Fund</u>	<u>Debt Service Fund</u>	<u>Capital Projects Fund</u>	<u>Total</u>
Cash	\$ 132,228,948	\$ -	\$ 150,260,449	\$ 282,489,397
Receivables, net of allowance for doubtful accounts:				
Due from Capital Projects Fund	29,592,213	-	-	29,592,213
Due from U.S. Government	22,368,576	-	15,834,229	38,202,805
Due from City and Counties	10,871,417	-	-	10,871,417
Due from State of Hawaii	226,861	-	-	226,861
Other receivables	1,267,193	-	-	1,267,193
Prepaid Expenses	-	-	28,941	28,941
Restricted Cash:				
Revenue bond debt service	-	29,201,630	-	29,201,630
Security deposits	11,458,677	-	-	11,458,677
Total assets	<u>\$ 208,013,885</u>	<u>\$ 29,201,630</u>	<u>\$ 166,123,619</u>	<u>\$ 403,339,134</u>

See accompanying notes to the basic financial statements.

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

Balance Sheet – Governmental Funds
June 30, 2012

<u>Liabilities and Fund Balances</u>	<u>State Highway Fund</u>	<u>Debt Service Fund</u>	<u>Capital Projects Fund</u>	<u>Total</u>
Accounts Payable	\$ 22,592,944	\$ -	\$ 8,272,572	\$ 30,865,516
Accrued Payroll	4,029,752	-	-	4,029,752
Contracts Payable:				
Current portion	13,149,644	-	16,567,192	29,716,836
Retainage payable	3,852,693	-	4,737,566	8,590,259
Payable from Restricted Assets:				
Matured bonds and interest payable	-	29,201,630	-	29,201,630
Security deposits	11,458,677	-	-	11,458,677
Due to State Highway Fund	-	-	29,592,213	29,592,213
Other Liabilities	3,760,294	-	-	3,760,294
	<u>58,844,004</u>	<u>29,201,630</u>	<u>59,169,543</u>	<u>147,215,177</u>
Total liabilities				
Fund Balances:				
Restricted - Capital Projects Fund	-	-	100,367,447	100,367,447
Committed - State Highway Fund	149,169,881	-	6,557,688	155,727,569
Nonspendable - prepaid expenses	-	-	28,941	28,941
	<u>149,169,881</u>	<u>-</u>	<u>106,954,076</u>	<u>256,123,957</u>
Total fund balances				
	<u>\$ 208,013,885</u>	<u>\$ 29,201,630</u>	<u>\$ 166,123,619</u>	<u>\$ 403,339,134</u>

See accompanying notes to the basic financial statements.

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

Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets
June 30, 2012

Total Fund Balances - Governmental Funds		\$ 256,123,957
Amounts reported for governmental activities in the statement of net assets are different because:		
Capital assets used in governmental activities are not financial resources and therefore are not reported in the Governmental Funds financial statements. These assets consist of:		
Governmental capital assets	9,942,420,982	
Less accumulated depreciation	<u>(4,794,610,849)</u>	
		5,147,810,133
Bonds issuance costs are recorded as expenditures in governmental funds financial statements when incurred. However, in Government-Wide financial statements, such amounts are recorded as a deferred charge and amortized over the life of the related bonds		1,713,101
Long-term liabilities are not due and payable in the current period and therefore are not reported in the Governmental Funds financial statements:		
Accrued vacation payable	(11,443,571)	
Accrued workers' compensation payable	(4,416,281)	
Revenue bonds payable	<u>(427,769,400)</u>	
		(443,629,252)
Long term receivables are not due and receivable in the current period and therefore are not reported in the Governmental Funds financial statements		<u>1,894,123</u>
Net Assets of Governmental Activities		<u><u>\$ 4,963,912,062</u></u>

See accompanying notes to the basic financial statements.

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

Statement of Revenues, Expenditures, and Changes in Fund Balances – Governmental Funds
For the Fiscal Year Ended June 30, 2012

	<u>State Highway Fund</u>	<u>Debt Service Fund</u>	<u>Capital Projects Fund</u>	<u>Total</u>
Expenditures:				
Operations and maintenance:				
Oahu highways and services	\$ 100,583,954	\$ -	\$ -	\$ 100,583,954
Hawaii highways and services	28,248,353	-	-	28,248,353
Maui highways and services	17,795,873	-	-	17,795,873
Kauai highways and services	11,611,964	-	-	11,611,964
Molokai highways and services	759,269	-	-	759,269
Lanai highways and services	219,153	-	-	219,153
Pass through for County highways and services	42,168,004	-	-	42,168,004
Administration of Highways Division	35,424,064	-	-	35,424,064
Surcharge on gross receipts	8,924,378	-	-	8,924,378
Motor Vehicle Safety Office	10,791,209	-	-	10,791,209
Capital projects	-	-	163,292,577	163,292,577
Debt service:				
Principal payments	-	22,465,000	-	22,465,000
Interest expense	-	18,906,097	-	18,906,097
Total expenditures	<u>256,526,221</u>	<u>41,371,097</u>	<u>163,292,577</u>	<u>461,189,895</u>
Program Revenues:				
Charges for services:				
Vehicle registration fees	36,126,961	-	-	36,126,961
Other fees and permits	3,458,278	-	-	3,458,278
Penalties and fines	2,026,969	-	-	2,026,969
Rentals	1,411,972	-	-	1,411,972
Operating grants and contributions	86,278,433	-	-	86,278,433
Capital grants and contributions	-	-	101,733,837	101,733,837
Total program revenues	<u>129,302,613</u>	<u>-</u>	<u>101,733,837</u>	<u>231,036,450</u>

See accompanying notes to the basic financial statements.

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

Statement of Revenues, Expenditures, and Changes in Fund Balances – Governmental Funds
For the Fiscal Year Ended June 30, 2012

	<u>State Highway Fund</u>	<u>Debt Service Fund</u>	<u>Capital Projects Fund</u>	<u>Total</u>
General Revenues:				
Taxes:				
State fuel taxes	\$ 86,980,157	\$ -	\$ -	\$ 86,980,157
Rental motor and tour vehicle surcharge taxes	44,987,347	-	-	44,987,347
Vehicle weights taxes and penalties	62,039,785	-	-	62,039,785
Investment income	315,935	-	-	315,935
Non-imposed fringe benefits	930,967	-	-	930,967
Total general revenues	<u>195,254,191</u>	<u>-</u>	<u>-</u>	<u>195,254,191</u>
Revenues over (under) expenditures	<u>68,030,583</u>	<u>(41,371,097)</u>	<u>(61,558,740)</u>	<u>(34,899,254)</u>
Other Financing (Uses) Sources:				
Transfers in	-	41,371,097	6,557,688	47,928,785
Transfers out	(56,095,260)	-	-	(56,095,260)
Issuance of revenue bonds	5,095,000	-	112,270,000	117,365,000
Premium on revenue bonds	466,702	-	13,152,124	13,618,826
Payments for current refunding of revenue bonds	(5,400,000)	-	-	(5,400,000)
Total other financing (uses) sources	<u>(55,933,558)</u>	<u>41,371,097</u>	<u>131,979,812</u>	<u>117,417,351</u>
Revenues and other financing sources over expenditures and other financing uses	12,097,025	-	70,421,072	82,518,097
Fund Balances:				
Beginning of year	<u>137,072,856</u>	<u>-</u>	<u>36,533,004</u>	<u>173,605,860</u>
End of year	<u>\$ 149,169,881</u>	<u>\$ -</u>	<u>\$ 106,954,076</u>	<u>\$ 256,123,957</u>

See accompanying notes to the basic financial statements.

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

Reconciliation of the Statement of Revenues, Expenditures and
Changes in Fund Balances to the Statement of Activities
For the Fiscal Year Ended June 30, 2012

Net Change in Fund Balances - Total Governmental Funds		\$ 82,518,097
Amounts reported for governmental activities in the statement of activities are different because:		
Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense:		
Expenditures for capital assets	146,920,154	
Loss of disposal of capital assets	(906,164)	
Less current fiscal year depreciation	<u>(211,857,418)</u>	(65,843,428)
Borrowings provide current financial resources to governmental funds; however, issuing debt increases long-term liabilities in the statement of net assets. In the current period, proceeds were received from:		
Issuance of revenue bonds	(117,365,000)	
Premium on revenue bonds	<u>(13,618,826)</u>	(130,983,826)
Repayment of bond principal is reported as expenditures in the Governmental Funds financial statements, but the repayment reduces long-term liabilities in the Government-Wide financial statements:		
Bond principal repayment	21,730,000	
Payment for current refunding of revenue bonds	5,400,000	
Change in debt service liability recognized in debt service fund	<u>735,000</u>	27,865,000
Bond issue costs, original issue premium, and deferred amount on refunding are reported as incurred in governmental funds as they require the use of current financial resources. However, in the Government-Wide financial statements, these expenses are deferred and amortized to expense over the remaining life of the related bond:		
Amortization of bond premiums	2,510,247	
Amortization of deferred loss on refunding	(628,260)	
Amortization of deferred bond issuance costs, net of current year issuance costs of \$738,044	<u>421,671</u>	2,303,658
Other revenues and expenditures in the Government-Wide financial statements do not provide or use current financial resources and therefore are not reported as revenues and expenditures in governmental funds financial statements		<u>(1,574,674)</u>
Change in Net Assets - Governmental Activities		<u>\$ (85,715,173)</u>

See accompanying notes to the basic financial statements.

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

State Highway Fund

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

For the Fiscal Year Ended June 30, 2012

	<u>Original</u>	<u>Final</u>	<u>Actual on Budgetary Basis</u>	<u>Variance Over (Under)</u>
Revenues:				
State fuel taxes	\$ 91,583,000	\$ 90,466,000	\$ 86,980,157	\$ (3,485,843)
Rental motor and tour vehicle surcharge taxes	44,550,000	44,550,000	44,987,347	437,347
Vehicle weights taxes	54,595,000	54,595,000	58,678,638	4,083,638
Vehicle registration fees	32,999,000	32,999,000	34,311,039	1,312,039
Investment income	5,000,000	5,000,000	1,132,168	(3,867,832)
Other fees and penalties	3,389,000	3,389,000	6,453,434	3,064,434
	<u>232,116,000</u>	<u>230,999,000</u>	<u>232,542,783</u>	<u>1,543,783</u>
Expenditures:				
Operations and maintenance:				
Oahu highways and services	82,971,062	82,840,525	82,793,524	(47,001)
Hawaii highways and services	22,557,598	21,846,219	15,444,575	(6,401,644)
Maui highways and services	20,447,878	17,772,024	17,689,725	(82,299)
Kauai highways and services	13,283,171	13,886,454	13,486,453	(400,001)
Molokai highways and services	1,639,359	3,709,826	3,562,599	(147,227)
Lanai highways and services	501,148	1,226,026	993,139	(232,887)
Administration of Highways				
Division including debt service	69,583,841	69,583,835	64,426,316	(5,157,519)
Surcharge on gross receipts	10,320,511	10,320,511	9,054,515	(1,265,996)
Motor Vehicle Safety Office	6,817,705	6,817,692	7,731,012	913,320
	<u>228,122,273</u>	<u>228,003,112</u>	<u>215,181,858</u>	<u>(12,821,254)</u>
Revenues over expenditures and other uses	<u>\$ 3,993,727</u>	<u>\$ 2,995,888</u>	<u>\$ 17,360,925</u>	<u>\$ 14,365,037</u>

See accompanying notes to the basic financial statements.

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

Agency Fund
Statement of Asset and Liability
June 30, 2012

	<u>Asset</u>	<u>Agency Fund</u>
Cash		\$ 11,888,541
Total asset		<u>\$ 11,888,541</u>
	<u>Liability</u>	
Due to Others		\$ 11,888,541
Total liability		<u>\$ 11,888,541</u>

See accompanying notes to the basic financial statements.

State of Hawaii, Department of Transportation, Highways Division

Notes to the Basic Financial Statements
June 30, 2012

1. Financial Reporting Entity

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

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

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

2. Significant Accounting Policies

a. Basis of Presentation

The Division's financial statements are prepared in conformity with accounting principles generally accepted in the United States of America.

b. Governmental Funds Financial Statements

The accounts of the Division are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures. Government resources are allocated to and accounted for in individual funds based upon the purposes for which they are to be spent and the means by which spending

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

Notes to the Basic Financial Statements
June 30, 2012

2. Significant Accounting Policies (continued)

b. Governmental Funds Financial Statements (continued)

activities are controlled. For financial reporting purposes, the Division includes all funds that are controlled by or dependent on the Division's administrative head. Control by or dependence on the Division was determined on the basis of statutory authority and monies flowing through the Division to each fund or account.

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

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

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

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

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

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

Notes to the Basic Financial Statements
June 30, 2012

2. Significant Accounting Policies (continued)

b. Governmental Funds Financial Statements (continued)

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

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

The accompanying financial statements include highway projects authorized by legislative acts through June 30, 2012.

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

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

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

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

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

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

c. Government-Wide Financial Statements

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

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

Notes to the Basic Financial Statements
June 30, 2012

2. Significant Accounting Policies (continued)

c. Government-Wide Financial Statements (continued)

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

Statement of Net Assets – The statement of net assets includes all capital assets and long-term liabilities that are excluded from the Governmental Funds financial statements. The net assets are reported in three categories: invested in capital assets, net of related debt; restricted for current portion of revenue bonds; and unrestricted.

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

d. Fiduciary Fund Financial Statements

The agency fund is used to account for assets held by the Division on behalf of other departments of the State. Cash reported in the agency fund statement of assets and liabilities includes cash in the State Treasury, including deposits received and held for others in the amount of \$11,888,541 at June 30, 2012.

e. Cash and Restricted Cash

The State has an established policy whereby all unrestricted and certain restricted cash is invested in the State’s investment pool. Section 36-21, HRS, authorizes the State to invest in obligations of the State, the U.S. Treasury, agencies and instrumentalities, certificates of deposit, and bank repurchase agreements.

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

Notes to the Basic Financial Statements
June 30, 2012

2. Significant Accounting Policies (continued)

e. Cash and Restricted Cash (continued)

Information relating to individual bank balances, insurance, and collateral of cash deposits is not available since such information is determined on a statewide basis and not for individual departments or divisions. A portion of the bank balances is covered by federal deposit insurance or by collateral held by the State Treasury, or by the State's fiscal agents in the name of the State. Other bank balances are held by fiscal agents in the State's name for the purpose of satisfying outstanding bond obligations. Accordingly, these deposits are exposed to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, the State's deposits may not be returned to it. For demand or checking accounts and certificates of deposit, the State requires that the depository banks pledge collateral based on the daily available bank balance to limit its exposure to custodial credit risk. The use of daily available bank balances to determine collateral requirements results in the available balances being under-collateralized at various times during the fiscal year. All securities pledged as collateral are held either by the State Treasury or by the State's fiscal agents in the name of the State. The State also requires that no more than 60% of the State's total funds available for deposit and on deposit in the State Treasury may be deposited in any one financial institution.

At June 30, 2012, a portion of the State Treasury Investment Pool was invested in auction rate securities, in which the State would determine the fair value related to these auction rate securities and allocate any change in values to the respective departments or agencies. The change in fair value allocated to the Division amounted to an approximately \$706,000 loss, which is recorded in investment income in the accompanying financial statements.

Restricted cash consists of monies and other resources, the use of which is legally restricted. Restricted cash accounts for the principal and interest amounts accumulated to make debt service payments on the Division's revenue bonds and also include security deposits collected from third parties.

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

Notes to the Basic Financial Statements
June 30, 2012

2. Significant Accounting Policies (continued)

f. Receivables

Receivables are reported at their gross value when earned and are reduced by the estimated portion that is expected to be uncollectible. The allowance for uncollectible accounts is based on collection history and current information regarding the credit worthiness of the tenants and others doing business with the Division. When continued collection activity results in receipt of amounts previously written off, revenue is recognized for the amount collected. At June 30, 2012, the allowance for uncollectible receivables was approximately \$437,000.

g. Capital Assets

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

<u>Class of Assets</u>	<u>Estimated Useful Life</u>	<u>Capitalization Threshold</u>
Land improvements	15 years	\$ 100,000
Buildings	30 years	\$ 100,000
Building improvements	30 years	\$ 100,000
Vehicles and equipment	5 to 7 years	\$ 5,000
Infrastructure	13 to 75 years	\$ 100,000

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

Notes to the Basic Financial Statements
June 30, 2012

2. Significant Accounting Policies (continued)

g. Capital Assets (continued)

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

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

h. Accrued Vacation and Compensatory Pay

The Division accrues all vacation and compensatory pay at current salary rates, including additional amounts for certain salary-related expenses associated with the payment of compensated absences, in accordance with GASB Statement No. 16, *Accounting for Compensated Absences*. Vacation is earned at the rate of 168 or 96 hours per calendar year, depending on the employee's date of hire. Accumulation of such vacation is limited to 720 hours at calendar year-end and is convertible to pay upon termination of employment.

i. Long-Term Obligations

In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities. Bond premiums, issuance costs, and deferred amounts on refunding are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium and deferred amounts on refunding. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the governmental funds financial statements, bond premiums and issuance costs are recognized as paid. The face amount of debt and any related premium are reported as other financing sources. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

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

Notes to the Basic Financial Statements
June 30, 2012

2. Significant Accounting Policies (continued)

j. Employees' Retirement System

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

k. Risk Management

The Division is exposed to various risks of loss from torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and injuries to employees. The State is self-insured for workers' compensation as discussed in Note 16. Liabilities related to these losses are reported when it is probable that the losses have occurred and the amount of those losses can be reasonably estimated.

l. Intrafund and Interfund Transactions

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

m. 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 revenues and expenses during the reporting period. Actual results could differ from those estimates.

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

Notes to the Basic Financial Statements
June 30, 2012

2. Significant Accounting Policies (continued)

n. Recently Issued Accounting Pronouncements

In December 2010, the GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. This Statement incorporates FASB, APB, and ARB pronouncements, not conflicting with GASB pronouncements, and issued on or before November 30, 1989, into the GASB authoritative literature. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2011. Management is currently assessing the impact of GASB Statement No. 62 on its financial position and results of operations and has not determined if the adoption will have a material effect on its financial statements.

In June 2011, the GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. This Statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2011. Management is currently assessing the impact of GASB Statement No. 63 on its financial position and results of operations and has not determined if the adoption will have a material effect on its financial statements.

In June 2012, the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions*. This Statement requires governments providing defined benefit pensions to recognize their long-term obligation for pension benefits as a liability, and to more comprehensively and comparably measure the annual costs of pension benefits. The provisions of this Statement are effective for periods beginning after June 15, 2014. Management is currently assessing the impact of GASB Statement No. 68 on its financial position and results of operations and has not determined if the adoption will have a material effect on its financial statements.

**State of Hawaii,
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Notes to the Basic Financial Statements
June 30, 2012

3. Budget and Budgetary Accounting

a. State Highway Fund

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

In the case of expenditures, the original and amended budgeted amounts reflected on the Governmental Fund State Highway Fund Statement of Revenues and Expenditures - Budget and Actual (non-GAAP budgetary basis) are derived from: the Supplemental Appropriations Act of 2006 (Act 160, SLH 2006) authorizations for expenditures for operating purposes for the Division of \$221,185,420 and the MVSO \$6,817,692.

Allotments are made and expenditures are controlled at the program level reflected in the Governmental Funds State Highway Fund Statement of Revenues and Expenditures - Budget and Actual (non-GAAP budgetary basis). State Highway Fund allotments lapse at year-end.

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

Revenues over expenditures and other uses, non-GAAP budgetary basis	\$ 17,360,925
Federal grants-in-aid	86,278,433
Operating transfers out of the Division for debt service	8,166,475
Pass through expenditures for county projects	(42,168,004)
Net decrease in the fair value of State Treasury Investment Pool	(705,615)
Other adjustments to modified accrual basis of accounting	<u>(901,631)</u>
Revenues over expenditures, before transfers	<u><u>\$ 68,030,583</u></u>

**State of Hawaii,
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Notes to the Basic Financial Statements
June 30, 2012

3. Budget and Budgetary Accounting (continued)

b. Capital Projects Fund

Excess Capital Projects Fund allotments lapse after completion of the project, which is generally two or three years subsequent to allotment. Funds allotted as part of a qualified federal award program do not lapse.

4. Tax and Fee Revenues

a. State Fuel Tax

The primary source of revenue for the State Highway Fund is the state tax on liquid (motor vehicle) fuel. For fiscal year 2012, the tax imposed on each gallon of fuel was as follows:

Gasoline	17 cents
Diesel Fuel:	
Non-highway use	2 cents
Highway use	17 cents
Liquefied Petroleum Gas	5.2 cents

b. Vehicle Weight Tax and Penalties

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

c. Rental Motor and Tour Vehicle Surcharge Taxes

The rental motor vehicle surcharge tax was \$7.50 a day that a rental motor vehicle is rented or leased. On July 1, 2012, Act 104 took effect and reverted the rental motor vehicle surcharge tax to \$3 a day indefinitely.

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

d. Vehicle Registration and Motor Carrier Safety Inspection Fees

The vehicle registration fee was \$45 per vehicle, of which \$5 is earmarked for deposit into the Emergency Medical Services (EMS) special fund. During the year ended June 30, 2012 the Division collected approximately \$5,197,000 on behalf of the EMS special fund.

**State of Hawaii,
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Notes to the Basic Financial Statements
June 30, 2012

4. Tax and Fee Revenues (continued)

d. Vehicle Registration and Motor Carrier Safety Inspection Fees (continued)

All amounts were disbursed to the EMS special fund. Accordingly, no amounts are reported in the financial statements at June 30, 2012. The motor carrier safety inspection fee was \$1.50 per vehicle every six months.

5. Federal Grants-In-Aid

The Division has projects in progress in which part of the funding is being provided by the Federal Highway Administration (FHWA) through grants-in-aid. Such projects are generally accounted for in the Capital Projects and State Highway Funds. At June 30, 2012, receivables totaling \$38,202,805 from the U.S. Government are comprised of billed costs, pending reimbursement, as well as unbilled costs, which are eligible for reimbursement.

In addition, the MVSO has projects in progress in which part of the funding is being provided through federal grants-in-aid. The grants contain various compliance requirements, which must be met by the MVSO, including a matching of the grant amounts with state and local highway safety expenditures as defined in a formula. MVSO's matching requirement is met through the expenditures of the Division of Driver Education, The Judiciary, State of Hawaii. Cost reimbursement by the FHWA and National Highway Traffic Safety Administration (NHTSA) are subject to final audit by federal agencies. In addition, FHWA and NHTSA reserve the right to examine the Division for economy, efficiency, and program results. The Division's management believes that any federal aid received as of June 30, 2012 that might be required to be repaid to the FHWA or NHTSA based on federal audits would not be material to the financial position of the various funds of the Division at June 30, 2012, or the results of operations of such funds for the year then ended.

6. Non-Imposed Fringe Benefits

Payroll fringe benefit costs of employees of the Division are assumed by the State and are not charged to the Division's operating funds. These costs totaling \$930,967 for fiscal year 2012 have been reported as revenues and expenditures in the State Highway Fund.

**State of Hawaii,
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Notes to the Basic Financial Statements
June 30, 2012

7. Capital Assets

Changes in capital assets during the year ended June 30, 2012 was as follows:

	Balance July 1, 2011	Additions	Deductions	Transfers	Balance June 30, 2012
Nondepreciable					
assets:					
Land	\$ 435,954,868	\$ 593,222	\$ (850,000)	\$ -	\$ 435,698,090
Construction in progress	322,668,366	144,303,981	-	(143,153,246)	323,819,101
Software under development	7,993,620	1,956,232	-	-	9,949,852
Infrastructure	815,459,799	-	-	3,909,651	819,369,450
Total	<u>1,582,076,653</u>	<u>146,853,435</u>	<u>(850,000)</u>	<u>(139,243,595)</u>	<u>1,588,836,493</u>
Depreciable assets:					
Land improvements	2,215,473	-	-	-	2,215,473
Buildings and improvements	36,733,173	-	-	5,204,682	41,937,855
Vehicles and equipment	58,976,776	66,719	(680,185)	-	58,363,310
Infrastructure	8,117,425,573	-	(396,635)	134,038,913	8,251,067,851
Total	8,215,350,995	66,719	(1,076,820)	139,243,595	8,353,584,489
Less accumulated depreciation	<u>(4,583,774,087)</u>	<u>(211,857,418)</u>	<u>1,020,656</u>	<u>-</u>	<u>(4,794,610,849)</u>
Depreciable assets, net	<u>3,631,576,908</u>	<u>(211,790,699)</u>	<u>(56,164)</u>	<u>139,243,595</u>	<u>3,558,973,640</u>
Capital assets, net	<u>\$ 5,213,653,561</u>	<u>\$ (64,937,264)</u>	<u>\$ (906,164)</u>	<u>\$ -</u>	<u>\$ 5,147,810,133</u>

**State of Hawaii,
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Notes to the Basic Financial Statements
June 30, 2012

8. Net Assets

At June 30, 2012 net assets consisted of the following:

Invested in Capital Assets, Net of Related Debt:	
Net property, plant and equipment	\$ 5,147,810,133
Less: Revenue bonds payable	(446,074,400)
Add: Unspent debt proceeds	<u>73,988,252</u>
	4,775,723,985
 Restricted for Debt Service and Capital Activity:	
Restricted for capital projects	100,367,447
Restricted for debt service	29,201,630
Restricted for security deposits	11,458,677
Less: Unspent debt proceeds	<u>(73,988,252)</u>
	67,039,502
 Unrestricted	 <u>121,148,575</u>
 Total net assets	 <u><u>\$ 4,963,912,062</u></u>

**State of Hawaii,
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Notes to the Basic Financial Statements
June 30, 2012

9. General Long-Term Liabilities

Changes in general long-term liabilities during the year ended June 30, 2012 were as follows:

	Balance July 1, 2011	Additions	Reductions	Balance June 30, 2012	Amount Due Within One Year
Accrued vacation payable	\$ 11,180,354	\$ 4,339,732	\$ (4,076,515)	\$ 11,443,571	\$ 3,030,204
Workers' compensation payable	4,078,969	2,373,811	(2,036,499)	4,416,281	1,073,359
Revenue bonds payable – unamortized premium	9,542,338	13,618,826	(2,510,247)	20,650,917	-
Revenue bonds payable – deferred loss on defeasance	(2,859,777)	-	628,260	(2,231,517)	-
Revenue bonds payable	<u>337,420,000</u>	<u>117,365,000</u>	<u>(27,130,000)</u>	<u>427,655,000</u>	<u>26,320,000</u>
Total governmental activities long-term liabilities	<u>\$ 359,361,884</u>	<u>\$ 137,697,369</u>	<u>\$ (35,125,001)</u>	<u>\$ 461,934,252</u>	<u>\$ 30,423,563</u>

10. Revenue Bonds

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

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

**State of Hawaii,
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Notes to the Basic Financial Statements
June 30, 2012

10. Revenue Bonds (continued)

On July 1, 1998, the Division issued \$94,920,000 in State of Hawaii Highway Revenue Bond, Series 1998 (1998 Bonds). The 1998 Bonds bear interest at rates ranging from 4.5% to 5.5% and mature in increasing annual installments through 2018. The 1998 Bonds maturing on and after July 1, 2009 through July 1, 2016 are subject to redemption at the option of the State on or after July 1, 2008 at prices ranging from 101% to 100% plus accrued interest.

On October 1, 2000, the Division issued \$50,000,000 in State of Hawaii Highway Revenue Bond, Series 2000 (2000 Bonds). The 2000 Bonds bear interest at rates ranging from 4.4% to 5.5% and mature in increasing annual installments through 2020. The 2000 Bonds maturing on and after July 1, 2011 through July 1, 2020 were subject to redemption at the option of the State after July 1, 2010 at a price of 100% plus accrued interest. The Division elected to redeem the bonds on July 1, 2010.

On October 3, 2001, the Division issued \$70,000,000 in State of Hawaii Highway Revenue Bond, Series 2001 (2001 Bonds). The 2001 Bonds bear interest at rates ranging from 3.8% to 5.4% and mature in increasing annual installments through 2022. The 2001 Bonds maturing on and after July 1, 2011 are subject to redemption at the option of the State at redemption of 100% plus accrued interest. These bonds were issued at a premium of \$2,787,593, which will be amortized over the life of the bonds using the effective interest method.

On April 15, 2003, the Division issued \$44,940,000 in State of Hawaii Highway Revenue Bonds, Series 2003 (Refunding Series of 2003) with interest rates ranging from 2.00% to 5.25% to refund \$45,350,000 of its outstanding State of Hawaii Revenue Bonds, Series 1993 (1993 Bonds) with interest rates ranging from 2.6% to 5.0%. The net proceeds of \$46,749,377 (after payment of \$452,013 in underwriting fees, insurance, and other costs), along with an additional \$519,500 from the State Highways Fund were deposited in an irrevocable trust with an escrow agent to be used to purchase non-callable direct obligations of the United States, maturing in amounts and bearing interest at such rates sufficient to meet the debt service requirements of the 1993 Bonds. On July 1, 2003, the refunded bonds were redeemed at a price of 102%. As a result, the refunded portion of the 1993 Bonds is considered to be defeased and the liability for those bonds has been removed from the financial statements.

The refunding resulted in a difference between the reacquisition price and the net carrying amount of the refunded debt of \$1,399,377. This difference, reported in the accompanying financial statements as a deduction from Highways revenue bonds, is being charged to interest expense over the next 21 years. The Division in effect reduced its aggregate debt service payments by

**State of Hawaii,
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Notes to the Basic Financial Statements
June 30, 2012

10. Revenue Bonds (continued)

\$4,165,000 over the next 21 years and obtained an economic gain (difference between the present values of the old and new debt service payment) of approximately \$3,687,000.

On February 20, 2005, the Division issued \$60,000,000 in State of Hawaii Revenue Bonds Series A (2005A Bonds). The 2005A Bonds bear interest at rates ranging from 3.0% to 5.0% and mature in annual installments through 2025. The 2005A Bonds maturing on and after July 1, 2016 are subject to redemption at the option of the State at 100% plus accrued interest. These bonds were issued at a premium of \$3,155,926, which will be amortized over the life of the bonds using the effective interest method.

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

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

The net proceeds of \$137,847,002 (after payment of \$1,581,758 in underwriting fees, insurance, and other costs), along with an additional \$1,401,015 from the Highways Revenue Fund were deposited in an irrevocable trust with an escrow agent to be used to purchase non-callable direct obligations of the United States, maturing in amounts and bearing interest at such rates sufficient to meet the debt service requirements of the refunded bonds. As a result, the refunded portion of the bonds is considered to be defeased and the liability for those portions of the bonds has been removed from the financial statements. The bonds premium of \$15,000,441 was amortized over the life of the bonds using the effective interest method.

The refunding resulted in a difference between the reacquisition price and the net carrying amount of the refunded debt of \$7,439,199. This difference, reported in the accompanying financial statements as a deduction from Highway revenue bonds, was charged to interest expense over

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Notes to the Basic Financial Statements
June 30, 2012

10. Revenue Bonds (continued)

the next 17 years. As of June 30, 2012, the related refunded bonds have been fully paid off.

On December 17, 2008, the Division issued \$125,175,000 in State of Hawaii Revenue Bonds, Series 2008 (2008 Bonds). The 2008 Bonds bear interest at rates ranging from 4.0% to 6.00% and mature in annual installments through 2029. The 2008 Bonds maturing on and after January 1, 2020 are subject to redemption at the option of the State at 100% plus accrued interest. These bonds were issued at a premium of \$857,616, which will be amortized over the life of the bonds using the effective interest method.

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

On December 15, 2011, the Division issued \$5,095,000 in State of Hawaii Revenue Bonds Series 2011B (2011B Bonds) with interest rates of 4.0% and a premium of \$466,702. The 2011B bonds were issued to provide funds for a current refunding of the outstanding 2001 Bonds. The payments for the current refunding of revenue bonds amounted to \$5,400,000. The Division in effect reduced its aggregate debt service payments by approximately \$1,024,000 over the next 11 years and obtained an economic gain (difference between the present values of the old and new debt service payments) of approximately \$915,000.

**State of Hawaii,
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Notes to the Basic Financial Statements
June 30, 2012

10. Revenue Bonds (continued)

The following is a summary of revenue bonds issued and outstanding at June 30, 2012:

<u>Series</u>	<u>Interest Rate</u>	<u>Final Maturity Date (July 1)</u>	<u>Original Amount of Issue</u>	<u>Outstanding Amount</u>
1998	4.00% - 5.50%	2018	\$ 94,920,000	\$ 27,580,000
2003	2.00% - 5.25%	2013	44,940,000	10,465,000
2005	3.00% - 5.25%	2025	183,915,000	158,830,000
2008	4.00% - 6.00%	2029	125,175,000	113,415,000
2011	0.75% - 5.00%	2032	117,365,000	117,365,000
			<u>\$ 566,315,000</u>	427,655,000
		Add: unamortized premium		20,650,917
		Less: deferred amount on refunding		(2,231,517)
		Less: current portion		<u>(26,320,000)</u>
		Noncurrent portion		<u>\$ 419,754,400</u>

During 2012, \$41,371,097 was transferred from the State Highway Fund to the Debt Service Fund for repayment of revenue bonds principal of \$4,160,000 and \$18,305,000 due on January 1, 2012 and July 1, 2012, respectively and interest of \$8,009,467 and \$10,896,630 due on January 1, 2012 and July 1, 2012, respectively.

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

Notes to the Basic Financial Statements
June 30, 2012

10. Revenue Bonds (continued)

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

<u>Years Ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2013	\$ 26,320,000	\$ 21,047,122	\$ 47,367,122
2014	27,685,000	19,658,023	47,343,023
2015	29,170,000	18,371,891	47,541,891
2016	30,580,000	16,946,785	47,526,785
2017	32,075,000	15,430,173	47,505,173
2018-2022	134,850,000	54,481,322	189,331,322
2023-2027	87,795,000	28,926,213	116,721,213
2028-2032	59,180,000	7,880,775	67,060,775
Total	<u>\$ 427,655,000</u>	<u>\$ 182,742,304</u>	<u>\$ 610,397,304</u>

11. Operating Transfers

Operating transfers accounted for in the governmental funds statement of revenues, expenditures, and changes in fund balances as other financing sources and uses, and on the government-wide statement of activities as transfers, are summarized as follows:

Description	State Highway	Debt Service	Capital Projects	Total
	<u>Fund</u>	<u>Fund</u>	<u>Fund</u>	
Funding of highway capital projects	\$ (6,557,688)	\$ -	\$ 6,557,688	\$ -
Reimbursement to State for debt service on general obligation bonds	(8,166,475)	-	-	(8,166,475)
Funding of revenue bond debt service	<u>(41,371,097)</u>	<u>41,371,097</u>	<u>-</u>	<u>-</u>
	<u>\$ (56,095,260)</u>	<u>\$ 41,371,097</u>	<u>\$ 6,557,688</u>	<u>\$ (8,166,475)</u>

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

Notes to the Basic Financial Statements
June 30, 2012

11. Operating Transfers (continued)

a. Funding of Highway Capital Projects

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

b. Reimbursement to State for Debt Service

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

The annual amounts required to amortize the designated portions of general obligation bonds as of June 30, 2012 are as follows:

Years Ending June 30,	Principal	Interest	Total
2013	\$ 4,495,130	\$ 325,076	\$ 4,820,206
2014	3,785,344	223,132	4,008,476
2015	3,609,440	153,095	3,762,535
2016	2,240,785	89,018	2,329,803
2017	1,913,573	50,371	1,963,944
2018-2021	961,722	16,754	978,476
Total	<u>\$ 17,005,994</u>	<u>\$ 857,446</u>	<u>\$ 17,863,440</u>

Debt service reimbursements are accounted for as expenditures of the Administration of Highway Division program on the Governmental Funds State Highway Fund Statement of Revenues and Expenditures - Budget and Actual (non-GAAP budgetary basis) and are accounted for as other financing transfers out of the State Highway Fund on the Governmental Funds statement of revenues, expenditures, and changes in fund balances. Reimbursement payments of \$8,166,475 consisted of \$7,517,802 for principal and \$648,673 for interest for the year ended June 30, 2012.

**State of Hawaii,
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Notes to the Basic Financial Statements
June 30, 2012

12. Retirement Benefits

a. Employees' Retirement System (ERS)

All eligible employees of the State and counties are required by Chapter 88, HRS, to become members of the Employees' Retirement System of the State of Hawaii (ERS), a cost-sharing multiple-employer public employee retirement plan. The ERS is governed by a Board of Trustees. All contributions, benefits and eligibility requirements are established by HRS Chapter 88 and can be amended by legislative action. The ERS issues a comprehensive annual financial report that is available to the public. That report may be obtained by writing to the ERS at 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813.

Prior to June 30, 1984, the plan was a contributory plan only. In 1984, legislation was enacted to add a new non-contributory plan for members of the ERS who are also covered under Social Security. Police officers, firefighters, judges, elected officials, and persons employed in positions not covered by Social Security are precluded from the non-contributory plan. The non-contributory plan provides for reduced benefits and covers most eligible employees hired after June 30, 1984. Employees hired before that date were allowed to continue under the contributory plan or to elect the new non-contributory plan and receive a refund of employee contributions. All benefits vest after five and ten year credited service under the contributory and non-contributory plans, respectively.

Both plan options provide a monthly retirement allowance based on the employee's age, years of credited service, and average final compensation (AFC). The AFC is the average salary earned during the five highest paid years of service, including the vacation payment, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after that date is based on the three highest paid years of service, excluding the vacation payment.

On July 1, 2006, a new hybrid contributory plan became effective pursuant to Act 179, SLH of 2004. Members in the hybrid plan are eligible for retirement at age 62 with 5 years of credited services or age 55 and 30 years of credit service. Members will receive a benefit multiplier of 2% for each year of credited service in the hybrid plan. The benefit payment options are similar to the current contributory plan. Almost 58,000 current members, all members of the noncontributory plan and certain members of the contributory plan are eligible to join the new hybrid plan. Most of the new employees hired from July 1, 2006 are required to join the new hybrid plan.

**State of Hawaii,
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Notes to the Basic Financial Statements
June 30, 2012

12. Retirement Benefits (continued)

a. Employees' Retirement System (ERS) (continued)

Most covered employees of the contributory option are required to contribute 7.8% of their salary. The funding method used to calculate the total employer contribution requirement is the Entry Age Normal Actuarial Cost Method. Effective July 1, 2005, employer contribution rates are a fixed percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liability.

Employees in the hybrid plan are required to contribute 6.0% of their salary and are fully vested for benefits upon receiving five years of credited service. The Division may also make contributions for these members.

The Division's contribution to the ERS for fiscal years 2012, 2011, and 2010 was approximately \$6,642,000, \$6,442,000, and \$6,708,000, respectively, and represented the required contributions for each year.

b. Post-Retirement Health Care and Life Insurance Benefits

Plan Description

The Division contributes to the Hawaii Employer-Union Health Benefits Trust Fund (EUTF), an agent multiple-employer defined benefit plan that replaced the Hawaii Public Employees Health Fund effective July 1, 2003, pursuant to Act 88, SLH of 2001. The EUTF was established to provide a single delivery system of health benefits for state and county workers, retirees, and their dependents. The eligibility requirements for retiree health benefits are as follows:

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

For employees hired after June 30, 1996 but before July 1, 2001, and who retire with at less than 10 years of service, the Division makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the Division pays 50% of the base monthly contribution. For those retiring with at least 15 years but fewer than 25 years of service, the

**State of Hawaii,
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Notes to the Basic Financial Statements
June 30, 2012

12. Retirement Benefits (continued)

b. Post-Retirement Health Care and Life Insurance Benefits (continued)

Division pays 75% of the base monthly contribution. For those employees retiring with at least 25 years of service, the Division pays 100% of the base monthly contribution. Retirees in this category can elect a family plan to cover dependents.

For employees hired on or after July 1, 2001, and who retire with less than 10 years of service, the Division makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the Division pays 50% of the base monthly contribution. For those retiring with at least 15 years but fewer than 25 years of service, the Division pays 75% of the base monthly contribution. For those employees retiring with at least 25 years of service, the Division pays 100% of the base monthly contribution. Only single plan coverage is provided for retirees in this category. Retirees can elect family coverage but must pay the difference.

State Policy

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

Amount of Contributions Made

Contributions are financed on a pay-as-you-go basis and the Division's contributions for the years June 30, 2012, 2011, and 2010 were approximately \$3,526,000, \$3,064,000, and \$2,936,000, respectively.

The State's Comprehensive Annual Financial Report includes the required footnote disclosures and required supplementary information on the State's OPEB plans.

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

Notes to the Basic Financial Statements
June 30, 2012

12. Retirement Benefits (continued)

c. Deferred Compensation Plan

The State established a deferred compensation plan (plan) in accordance with Section 457 of the Internal Revenue Code, which enables State employees to defer a portion of their compensation. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

All amounts of deferred compensation, as well as property and rights purchased with those amounts and income attributable to those amounts, are held in trust by third-party agents for the exclusive benefit of participants and their beneficiaries. The assets and liabilities of the deferred compensation plan are not reflected in the Division's financial statements.

13. Transactions With Other Government Agencies

The State assesses a surcharge of 5% for central service expenses on all receipts of the State Highway Fund, after deducting any amounts pledged, charged, or encumbered for the payment of bonds and interest during the year. During fiscal year 2012, the assessment amounted to approximately \$8,925,000 which is included as the caption surcharge on gross receipts expense/expenditures in the accompanying financial statements.

The Division is also assessed a percentage of the cost of the general administration expenses of the Department. During fiscal year 2012 assessments net of amounts refunded amounted to approximately \$5,341,000 which is included in administration of Highways division expense/expenditures in the accompanying financial statements.

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

Notes to the Basic Financial Statements
June 30, 2012

14. Operating Leases

a. Rental Expenditures

The Division leases office and baseyard space under various long-term operating lease agreements expiring at various dates through fiscal year 2019. Rental expenditures are recorded based on the terms of the lease agreements. Scheduled annual minimum rental payments through 2017 and thereafter are as follows:

Years Ending June 30,	
2013	\$ 957,000
2014	957,000
2015	957,000
2016	957,000
2017	957,000
2018-2019	1,913,000
Total	<u>\$ 6,698,000</u>

The total rental expenditures during fiscal year 2012 for operating leases were approximately \$1,242,000.

b. Rental Revenue

The Division is a lessor of various properties under non-cancelable lease agreements that expire through fiscal year 2044. Scheduled annual minimum revenues through 2017 and in five-year increments thereafter are as follows:

Years Ending June 30,	
2013	\$ 365,000
2014	370,000
2015	376,000
2016	381,000
2017	387,000
2018-2022	1,881,000
2023-2027	1,840,000
2028-2032	664,000
2033-2037	392,000
2038-2042	370,000
2043-2044	77,000
Total	<u>\$ 7,103,000</u>

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

Notes to the Basic Financial Statements
June 30, 2012

15. Commitments

a. Condemnation Proceedings

The Division occasionally finds it necessary to condemn property for construction of highways. These proceedings require the Division to compensate existing property owners for the fair market value of their real property. Prior to the determination of the fair market value, the Division is required to deposit funds in State courts for these proceedings. The amount of funds deposited in the State courts was approximately \$773,400 at June 30, 2012. Such funds deposited may not be sufficient to cover the full amount required for compensation purposes. Management, however, believes any additional compensation in excess of amounts deposited with State courts will not be material to the financial statements of the Division. The funds deposited in the State courts are reflected in capital projects expenditures in the governmental fund statement of revenue, expenditures, and changes in fund balances and in capital assets on the government-wide statement of net assets in the year in which the deposits were made.

b. Accumulated Sick Leave

Sick leave accumulates at the rate of one and three-quarters working days for each month of service without limit. It may be taken only in the event of illness and is not convertible to pay upon termination of employment. Accordingly, no liability for sick pay is recorded in the Division's financial statements. However, a public employee who retires or leaves government service in good standing with 60 days or more of unused sick leave is entitled to additional service credits in the ERS. Accumulated sick leave at June 30, 2012 aggregated approximately \$23,528,000.

16. Risk Management

a. Property and Liability Insurance

The Division is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and workers' compensation. The State generally retains the first \$1 million per occurrence of property losses and the first \$4 million with respect to general liability claims. Losses in excess of those retention amounts are insured with commercial insurance carriers. The limit per occurrence for property losses is \$225 million for windstorm, boiler and machinery and \$50 million for terrorism. The annual aggregate limit for property loss is \$225 million for flood and earthquake. The limit per occurrence of general liability losses is \$15 million. For certain general liability claims, the

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

Notes to the Basic Financial Statements
June 30, 2012

16. Risk Management (continued)

a. Property and Liability Insurance (continued)

annual aggregate limit is \$15 million. The State also has an insurance policy to cover crime risk with a deductible of \$500,000 per occurrence and a \$10 million annual aggregate limit.

b. Workers' Compensation

The State is self-insured for workers' compensation. Accordingly, the Division is liable for workers' compensation claims filed by its employees. Liabilities for workers' compensation claims are established if information indicates that it is probable that liabilities have been incurred and the amount of those claims can be reasonably estimated. The basis for estimating the liabilities for unpaid claims include the effects of specific incremental claim adjustment expenses, salvage and subrogation, and other allocated or unallocated claim adjustment expenses. These liabilities include an amount for claims that have been incurred but not reported. The workers' compensation reserve amounted to \$4,416,281 at June 30, 2012.

17. Contingent Liabilities and Other

The Division was a defendant in court in a lawsuit seeking damages related to an accident that occurred on State highways. On April 18, 2012, the jury returned a verdict against the Division and awarded the plaintiffs \$3,278,833. Although the Division is currently appealing the decision, these amounts have been reflected in administration of Highways Division expenses/expenditures in the Division's financial statements.

The State is the defendant in lawsuits seeking damages allegedly related to State highways and highway construction contracts. While the ultimate liabilities, if any, in the disposition of these matters are presently difficult to estimate, it is management's belief that the outcomes are not likely to have a material adverse effect on the Division's financial position. In addition, the State has not determined whether the ultimate liabilities, if any, will be imposed on the State Highway Fund. Accordingly, no provision for any liabilities that might result from the lawsuits have been made in the accompanying financial statements.

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

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

Notes to the Basic Financial Statements
June 30, 2012

17. Contingent Liabilities and Other (continued)

the Division entered into a voluntary agreement with the DOH and other third parties to share in the responsibility for the investigation and potential remediation of petroleum contamination in the Iwilei District.

This group of potentially responsible parties known as the Iwilei District Participating Parties (IDPP) has conducted various investigations to determine potential contamination in the Iwilei area from 1997 to present, which investigations have determined the existence of petroleum contamination at various locations. Potential remedial alternatives are still being studied. At this stage, the project has not yet advanced to the stage where total costs to the IDPP can reasonably be estimated, due to: (1) the extent of environmental impact, (2) the undetermined allocation among the potentially responsible parties, (3) the ongoing review of reasonable remediation alternatives, and (4) continued discussion with the regulatory authorities. As a result, it is not possible to reasonably estimate the amount of the potential cost to the IDPP and allocable share of the Division, and if there would be a material impact to the Division's financial statements. Accordingly, no estimate of loss has been recorded in the accompanying financial statement.

18. Subsequent Events

Effective January 2, 2013, Act 310 takes effect. This act transfers the responsibility of the state identification program (ID program) from the Department of the Attorney General to the Division. The ID program will be administered by Honolulu, Maui, Hawaii, and Kauai counties. As a result of the ID program, the Division expects an increase in program revenues of approximately \$1,100,000 in 2013.

SUPPLEMENTARY INFORMATION

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

Schedule of Expenditures of Federal Awards
For the Fiscal Year Ended June 30, 2012

Federal Grantor's Program Title	Federal CFDA Number	Federal Expenditures ^{1,2}
U.S. Department of Transportation		
Highway Planning and Construction	20.205	\$ 138,437,839
ARRA - Highway Planning and Construction	20.205	32,699,721
State and Community Highway Safety Program:		
NHTSA Grant	20.600	3,941,791
Fatal accident reporting system grant	20.600	25,160
Commercial Driver's License Program Improvement	20.232	183,107
Commercial Drivers License Information System Modernization	20.238	50,763
National Motor Carrier Safety Program - Assistance program grant	20.218	503,161
Total U.S. Department of Transportation		175,841,542
U.S. Department of Justice		
National Motor Vehicle Title Information System	16.580	16,627
U.S. Department of Homeland Security		
Driver's License Security Grant Program	97.089	1,302,248
Total Federal Expenditures		\$ 177,160,417

1 The accompanying schedule of expenditures of federal awards is prepared on the cash basis of accounting.

2 Of the federal expenditures presented in the schedule, the Division provided federal awards to subrecipients totaling \$32,111,647.

PART II

**INDEPENDENT AUDITOR'S 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**



A Hawaii Limited Liability Partnership

**Independent Auditor's 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***

Office of the Auditor
State of Hawaii

We have audited the financial statements of the Highways Division of the Department of Transportation of the State of Hawaii (Division), as of and for the year ended June 30, 2012, and have issued our report thereon dated January 25, 2013. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America.

Internal Control over Financial Reporting

Management of the Division is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Division's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Division's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Division's internal control over financial reporting.

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

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Division's financial statements are free of 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*.

We noted certain matters that we reported to management of the Division in a separate letter dated January 25, 2013.

This report is intended solely for the information and use of management, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than those specified parties.

KMH LLP

KMH LLP

Honolulu, Hawaii
January 25, 2013

PART III

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH
REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH
MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE
WITH OMB CIRCULAR A-133**



A Hawaii Limited Liability Partnership

Independent Auditor's Report on Compliance with Requirements that could have a Direct and Material Effect on Each Major Program and Internal Control Over Compliance in Accordance with OMB Circular A-133

Office of the Auditor
State of Hawaii:

Compliance

We have audited the compliance of the Highways Division of the Department of Transportation of the State of Hawaii (Division) with the types of compliance requirements described in the U. S. Office of Management and Budget (OMB) Circular A-133, *Compliance Supplement* that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2012. The Division's major federal programs are identified in the summary of auditor's results section of the accompanying *Schedule of Findings and Questioned Costs*. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Division's management. Our responsibility is to express an opinion on the Division's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Division's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Division's compliance with those requirements.

In our opinion, the Division complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal program for the year ended June 30, 2012.

Internal Control over Compliance

Management of the Division is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Division's internal control over compliance with the requirements that could have a direct and material effect on its major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB circular A-133, but not for the

purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Division's internal control over compliance.

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

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

This report is intended solely for the information and use of management, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than those specified parties.

KMH LLP

KMH LLP

Honolulu, Hawaii
January 25, 2013

PART IV

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

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

Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2012

Section I – Summary of Auditor’s Results

Financial Statements

Type of auditor’s report issued: Unqualified

Internal control over financial reporting:

- Material weakness (es) identified? yes no
- Significant deficiency(ies) identified that are not considered to be material weaknesses? yes no
- Noncompliance material to financial statements noted? yes no

Federal Awards

Internal control over major programs:

- Material weakness(es) identified? yes no
- Significant deficiency(ies) identified that are not considered to be material weaknesses? yes no

Type of auditor’s report issued on compliance for major programs: Unqualified

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133? yes no

Identification of major programs:

CFDA Number
20.205

Name of Federal Program or Cluster
Highway Planning and Construction

Dollar threshold used to distinguish between type A and type B programs? \$3,000,000

Auditee qualified as low-risk auditee? yes no

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

Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2012

Section II – Financial Statement Findings

No matters were reported.

Section III – Federal Award Findings and Questioned Costs

No matters were reported.

Section IV – Summary Schedule of Prior Audit Findings

No matters were reported.