



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

Financial Statements
(With Independent Auditors' Report Thereon)

June 30, 2014

Submitted by
**THE AUDITOR
STATE OF HAWAII**

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Financial Statements

June 30, 2014

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Independent Auditors' Report

The Auditor
State of Hawaii:

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities and each major fund of the Highways Division, Department of Transportation, State of Hawaii (the Highways Division), as of and for the year ended June 30, 2014, and the related notes to the basic financial statements, which collectively comprise the Highways Division's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinions

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 Highways Division as of June 30, 2014, and the respective changes in financial position and the respective budgetary comparison of the State Highway Fund thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

Change in Accounting Principle

As discussed in Note 2 to the financial statements, the Highways Division adopted Governmental Accounting Standards Board Statement No. 65, *Items Previously Reported as Assets and Liabilities*, effective July 1, 2013. Accordingly, the Highways Division retrospectively applied the effects of this adoption to its financial statements as of June 30, 2013. Our opinions are not modified with respect to that matter.

Relationship to the State of Hawaii

As discussed in note 1, the financial statements of the Highways 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 Highways Division. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2014, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America. Our opinions are not modified with respect to this matter.

Other Matter – Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 4 through 14 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 27, 2015, on our consideration of the Highways Division's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Highways Division's internal control over financial reporting and compliance.

KKDL Y LLC

Honolulu, Hawaii
March 27, 2015

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Management's Discussion and Analysis – Unaudited

June 30, 2014

The following Management's Discussion and Analysis (MD&A) of the Highways Division, Department of Transportation, State of Hawaii (the Highways Division) activities and financial performance provides the reader with an introduction and overview to the financial statements of the Highways Division as of and for the year ended June 30, 2014. This discussion has been prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section.

The 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 Highways 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 Highways Division are to plan, design, construct, and maintain highway facilities. In addition, the Highways 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 Highways 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 Highways Division. Other major functional operations within the Highways 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.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

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Government-Wide Financial Statements

The government-wide statements report information about the Highways 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 Highways 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 Position presents all of the Highways Division's assets and liabilities, with the difference between the two reported as "net position." Over time, increases or decreases in the Highways Division's net position are an indicator of whether its financial health is improving or deteriorating.

The Statement of Activities presents information showing how the Highways Division's net position changed during the most recent fiscal year. All changes in net position 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 Highways 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 15 and 16 of this report.

Fund Financial Statements

Governmental Funds

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 Highways Division, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All funds of the Highways 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 Highways Division's finances that assist in determining whether there will be adequate financial resources available to meet the current needs of the Highways 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 Highways 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 19 and 22 of this report.

The Highways 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 Highways Division's three governmental funds are the State Highway Fund (SHF) (a Special Revenue Fund), the Debt Service Fund, and the Capital Projects Fund.

The governmental funds financial statements can be found on pages 17 through 22 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 basic financial statements.

The Statement of Revenues and Expenditures—Budget and Actual—State Highway Fund (Non-GAAP Budgetary Basis) can be found on page 23 of this report.

Fiduciary Funds

Fiduciary funds are used to account for assets held by the Highways Division on behalf of other departments of the State. The statement of fiduciary net position of the agency fund can be found on page 24.

Notes to the Basic 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 basic financial statements can be found on pages 25 through 52 of this report.

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FINANCIAL HIGHLIGHTS

Government-wide Financial Statements

The assets and deferred outflows of resources of the Highways Division exceeded its liabilities at June 30, 2014 by \$5 billion. Of this amount, \$164 million is considered unrestricted and may be used to meet the Highways Division's ongoing obligations.

The current year change in net position was a decrease of \$69 million. This resulted from a deficiency of revenues under expenditures of \$64 million and transfers of \$5 million to other State departments for debt service payments on general obligation bonds and to the County of Maui for a capital improvement project. The deficiency of revenues under expenditures was significantly impacted by depreciation expense of \$201 million.

Fund Financial Statements

At June 30, 2014, the Highways Division's Governmental Funds reported a combined ending fund balance of \$208 million. The combined fund balance decreased by \$27 million from the prior year's ending fund balance.

The Highways Division's State Highway Fund (SHF), the major operating fund, reported an ending fund balance of \$173 million. There was a \$4 million decrease in fund balance for the year ended June 30, 2014.

Change in Accounting Principle

Effective July 1, 2013, the Highways Division adopted GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. Prior to adoption of this statement, the Highways Division capitalized costs relating to the issuance of bonds and amortized those costs over the term of the bonds. Unamortized bond issue costs were reported as an asset in the statement of net position. GASB Statement No. 65 requires that bond issuance costs be recognized as an expense in the period incurred. In addition, prior to adoption of this statement, unamortized deferred charge on refunding was reported as a deduction from revenue bonds payable in the statement of net position. GASB Statement No. 65 requires that the unamortized deferred charge on refunding be reported as deferred outflows of resources in the statement of net position.

As further discussed in Note 2, the Highways Division has elected to retrospectively apply the effects of this change in accounting principle to the accompanying financial statements. With respect to the previously reported unamortized bond issuance costs amounting to \$1.5 million at June 30, 2013, and related amortization of those costs of \$200,000, for the year then ended, the adoption of GASB Statement No. 65 had the effect of decreasing previously reported total assets and net position at June 30, 2013 by \$1.5 million, increasing previously reported change in net position for the year then ended by \$200,000,

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and decreasing previously reported net position at June 30, 2012 by \$1.7 million. In addition, with respect to the unamortized deferred charge on refunding amounting to \$1.7 million at June 30, 2013, the adoption of GASB Statement No. 65 had the effect of increasing previously reported revenue bonds payable and deferred outflows of resources by \$1.7 million at June 30, 2013.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Statements of Net Position

As noted earlier, net position may serve over time as a useful indicator of the Highways Division's financial position. The Highways Division's assets exceeded liabilities by \$5 billion at June 30, 2014 and 2013.

	<u>2014</u>	<u>2013</u>
Assets		
Current and other assets	\$ 311,368,426	\$ 341,474,546
Capital assets – net of accumulated depreciation	<u>5,020,917,531</u>	<u>5,093,534,558</u>
Total assets	<u>5,332,285,957</u>	<u>5,435,009,104</u>
 Deferred Outflows of Resources		
Deferred charge on refunding, net	<u>1,207,948</u>	<u>1,689,755</u>
 Liabilities		
Current liabilities	103,537,802	106,016,018
Long-term liabilities	<u>384,695,727</u>	<u>415,968,853</u>
Total liabilities	<u>488,233,529</u>	<u>521,984,871</u>
 Net Position		
Net investment in capital assets	4,637,635,973	4,703,335,458
Restricted	43,273,413	14,901,059
Unrestricted, as restated	<u>164,350,990</u>	<u>196,477,471</u>
Total net position	<u><u>\$ 4,845,260,376</u></u>	<u><u>\$ 4,914,713,988</u></u>

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The largest portion of the Highways Division's net position (96 percent at June 30, 2014 and 2013) reflects its net investment in capital assets (e.g., land and land improvements, buildings and improvements, vehicles and equipment, and infrastructure), which is net of any related debt used to acquire those assets that is still outstanding and deferred charge on refunding, net. The Highways Division uses these capital assets to provide services to citizens; therefore, these assets are not available for future spending. Although the Highways Division's net 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.

An additional portion of the Highways Division's net position (1 percent at June 30, 2014 and 2013) 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 Highways Division's revenue bond debt service and capital activity. The remaining balance of unrestricted net position may be used to meet the Highways Division's on-going obligations to citizens and creditors.

Capital assets – net decreased by \$73 million from June 30, 2013 to June 30, 2014, primarily because depreciation expense of \$201 million more than offset net additions to capital assets of \$128 million.

Long-term liabilities decreased by \$31 million from June 30, 2013 to June 30, 2014, primarily due to the repayments of State of Hawaii Highway Revenue Bonds amounting to \$28 million.

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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 Highways Division's net position changed during the year.

	<u>2014</u>	<u>2013</u>
Expenses:		
Program expenses:		
Operations and maintenance	\$ 254,462,220	\$ 209,540,455
Depreciation expense	201,002,969	206,119,820
Administration of Highways Division	29,685,789	35,305,049
Debt service/interest expense	16,773,507	17,870,375
Motor Vehicle Safety Office	13,065,617	12,229,621
Surcharge on gross receipts	10,159,432	10,306,863
Other	6,101,590	9,707,983
Total expenses	<u>531,251,124</u>	<u>501,080,166</u>
Revenues:		
Program revenues:		
Operating grants and contributions	118,397,883	103,674,744
Capital grants and contributions	92,832,845	97,095,373
Charges for services	49,189,476	48,547,962
Total program revenues	<u>260,420,204</u>	<u>249,318,079</u>
General revenues:		
Taxes	205,332,242	207,944,400
Investment income and other	1,303,561	2,952,920
Total general revenues	<u>206,635,803</u>	<u>210,897,320</u>
Total revenues	<u>467,056,007</u>	<u>460,215,399</u>
Deficiency of revenues under expenditures	(64,195,117)	(40,864,767)
Transfers	<u>(5,258,495)</u>	<u>(6,620,206)</u>
Change in net position	(69,453,612)	(47,484,973)
Net Position, beginning of year, as restated	<u>4,914,713,988</u>	<u>4,962,198,961</u>
Net Position, end of year, as restated	<u>\$ 4,845,260,376</u>	<u>\$ 4,914,713,988</u>

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Program revenues, which comprise charges for services as well as operating and capital grants, accounted for 56 percent and 54 percent of total revenues in fiscal years 2014 and 2013, respectively. The largest components of program revenues (81 percent for fiscal years 2014 and 2013) resulted from operating and capital grants and contributions primarily 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 2014 decrease in net position of \$69 million resulted from the excess of expenses over revenues of \$64 million due primarily to depreciation expense of \$201 million and a transfer out of \$5 million to other State departments for the payment of debt service on general obligation bonds and capital improvement projects.

The fiscal year 2013 decrease in net position of \$47 million resulted from the excess of expenses over revenues of \$41 million due primarily to depreciation expense of \$206 million and a transfer out of \$7 million to other State departments for the payment of debt service on general obligation bonds and capital improvement projects.

FINANCIAL ANALYSIS OF THE HIGHWAYS DIVISION'S GOVERNMENTAL FUNDS

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

The focus of the Highways 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 Highways Division's financing requirements.

At June 30, 2014, the Highways Division's Governmental Funds reported combined ending fund balances of \$208 million, representing a decrease of \$27 million from the prior year. \$200 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. \$7 million of the fund balance is restricted to indicate that amounts are restricted to specific purposes imposed by external parties.

At June 30, 2013, the Highways Division's Governmental Funds reported combined ending fund balances of \$235 million, representing a decrease of \$22 million from the prior year. \$231 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. \$2 million of the fund balance is restricted to indicate that amounts are restricted to specific purposes imposed by external parties.

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The SHF is the major operating fund of the Highways 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, 2014 and 2013, the total fund balance of the SHF was \$173 million and \$178 million, respectively. SHF's fund balance decreased by \$4 million in the current year compared to a \$29 million increase in the prior year. During the current year, the Highways Division's operations and maintenance expenditures increased by \$49 million from the prior year due primarily to increases in repairs and maintenance of the State Highway System. This was a \$15 million increase in operating grants and contributions from the Federal Highway Administration.

The Debt Service Fund (DSF) is used to track the revenue bond debt service for the Highways Division. Debt service requirements are transferred from the SHF. The debt service expenditures were \$48 million and \$47 million for fiscal year 2014 and fiscal year 2013, respectively.

The Capital Projects Fund (CPF) accounts for the Highways Division's capital improvements program. At June 30, 2014, the CPF had a total fund balance of \$34 million. The CPF fund balance decreased by \$22 million in fiscal year 2014 compared to a \$50 million decrease in the prior year. The change from the prior year was due primarily to the decrease in capital projects expenditures of \$29 million from the prior year.

STATE HIGHWAY FUND BUDGETARY HIGHLIGHTS

The final SHF budget had total revenues of \$258 million. The actual revenues on a budgetary basis were \$3 million less than the final budget, primarily due to actual rental motor and tour vehicle surcharge taxes, and other fees and penalties revenues being \$6 million less than budgeted, offset by State fuel taxes and vehicle weight taxes being \$3 million more than budgeted.

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Expenditures on the budgetary actual basis were \$17 million lower than the final budgeted amounts. The difference was primarily due to operations and maintenance expenditures being \$9 million less than budgeted as a result of significant repairs and maintenance work that was budgeted, but deferred into future periods as well as projects that were anticipated to be funded with state monies but subsequently approved for federal funding, and administration of Highways Division expenditures being \$8 million less than budgeted.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

The Highways Division's investment in capital assets as of June 30, 2014 amounted to \$5 billion, net of accumulated depreciation of \$5 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 2014, the Highways Division had bid openings for 15 projects, with contract amounts totaling approximately \$54 million. There were 8 projects on Oahu, 1 project on Hawaii, 4 projects on Maui, (includes Molokai and Lanai), and 2 projects on Kauai.

During fiscal year 2013, the Highways Division had bid openings for 12 projects, with contract amounts totaling approximately \$109 million. There were 3 projects on Oahu, 3 projects on Hawaii, 3 projects on Maui, (includes Molokai and Lanai), and 3 projects on Kauai.

Additional information on the Highways Division's capital assets can be found in Note 8 to the basic financial statements.

Long-Term Debt

As of June 30, 2014, outstanding State of Hawaii Highway Revenue Bonds amounted to \$374 million, compared to \$401 million as of June 30, 2013. These revenue bonds are payable solely from, and collateralized solely by, certain revenues held in the State Highway Fund. The proceeds of the revenue bonds are used to finance highway capital improvement projects and other related projects for the State Highways System.

See Notes 10 and 11 to the basic financial statements for additional information on the State of Hawaii Highway Revenue Bonds.

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As of June 30, 2014, \$9 million of State of Hawaii General Obligation Bonds were outstanding, compared to \$13 million as of June 30, 2013. These bonds are considered general obligations of the State, and not the Highways Division. Accordingly, no amounts are recorded by the Highways Division for these liabilities. The Highways Division makes debt service payments to repay principal and interest on these amounts. The payments for the fiscal year ended June 30, 2014 amounted to \$4 million, and the amount was recorded as an other financing use - transfers in the accompanying financial statements. See Note 12 to the basic financial statements for further information on the general obligation bonds.

The Highways 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.

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 Highways Division's other long-term liabilities can be found in Note 10 to the basic financial statements.

REQUEST FOR INFORMATION

This financial report is designed to provide a general overview of the Highways 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.

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Governmental Activities

Statement of Net Position

June 30, 2014

Assets:

Cash and cash equivalents	\$ 229,693,077
Receivables, net of allowance for doubtful accounts:	
Due from U.S. government	28,328,374
Due from city and counties	11,045,330
Due from State of Hawaii	31,389
Other receivables	1,088,093
Prepaid expenses	641,083
Restricted cash and cash equivalents:	
Revenue bond debt service	29,813,005
Security deposits	10,728,075
Capital assets, net of accumulated depreciation	5,020,917,531
Total assets	5,332,285,957

Deferred outflows of resources:

Deferred charge on refunding, net	1,207,948
Total deferred outflows of resources	1,207,948

Liabilities:

Accounts payable	17,386,686
Accrued payroll	4,218,506
Contracts payable:	
Current portion	34,977,038
Retained payable	6,399,192
Other liabilities	15,300
Payable from restricted assets:	
Revenue bonds payable - due within one year	20,295,000
Interest payable	9,518,005
Security deposits	10,728,075
Long-term liabilities:	
Due within one year:	
Accrued vacation payable	3,460,301
Workers' compensation payable	1,054,558
Revenue bonds payable	8,875,000
Due after one year:	
Accrued vacation payable	7,828,626
Workers' compensation payable	4,007,432
Revenue bonds payable	359,469,810
Total liabilities	488,233,529

Net Position:

Net investment in capital assets	4,637,635,973
Restricted for debt service and capital activity	43,273,413
Unrestricted	164,350,990
Total net position	\$ 4,845,260,376

See accompanying notes to the basic financial statements.

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Governmental Activities

Statement of Activities

Year Ended June 30, 2014

Expenses:

Operations and maintenance:	
Oahu highways and services	\$ 137,850,436
Hawaii highways and services	26,159,916
Maui highways and services	32,238,094
Kauai highways and services	17,145,163
Molokai highways and services	122,280
Lanai highways and services	417,377
Pass through for County highways and services	40,528,954
Depreciation expense	201,002,969
Administration of Highways Division	29,685,789
Motor Vehicle Safety Office	13,065,617
Surcharge on gross receipts	10,159,432
Capital projects	6,019,054
Loss on disposal of capital assets	82,536
Interest expense	16,773,507
	<hr/>
Total expenses	531,251,124

Program Revenues:

Operating grants and contributions	118,397,883
Capital grants and contributions	92,832,845
Charges for services:	
Vehicle registration fees	43,207,968
Other fees and permits	2,992,122
Penalties and fines	1,934,822
Rentals	1,054,564
	<hr/>
Total program revenues	260,420,204

General Revenues:

Taxes:	
State fuel taxes	86,818,521
Vehicle weight taxes and penalties	75,661,480
Rental motor and tour vehicle surcharge taxes	42,852,241
Investment income	706,629
Non-imposed fringe benefits	596,932
	<hr/>
Total general revenues	206,635,803
	<hr/>
Total revenues	467,056,007
	<hr/>
Deficiency of revenues under expenditures	(64,195,117)

Transfers

	<hr/>
Change in net position	(69,453,612)

Net Position:

Beginning of year, as restated	4,914,713,988
	<hr/>
End of year	\$ 4,845,260,376
	<hr/> <hr/>

See accompanying notes to the basic financial statements.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Governmental Funds

Balance Sheet

June 30, 2014

	<u>State Highway Fund</u>	<u>Debt Service Fund</u>	<u>Capital Projects Fund</u>	<u>Total</u>
Assets:				
Cash and cash equivalents	\$ 154,776,103	\$ -	\$ 74,916,974	\$ 229,693,077
Receivables:				
Due from capital projects fund	26,939,181	-	-	26,939,181
Due from U.S. government	18,005,926	-	10,322,448	28,328,374
Due from city and counties	11,045,330	-	-	11,045,330
Due from State of Hawaii	31,389	-	-	31,389
Other receivables	1,088,093	-	-	1,088,093
Prepaid expenses	-	-	641,083	641,083
Restricted cash and cash equivalents:				
Revenue bond debt service	-	29,813,005	-	29,813,005
Security deposits	10,728,075	-	-	10,728,075
Total assets	<u>\$ 222,614,097</u>	<u>\$ 29,813,005</u>	<u>\$ 85,880,505</u>	<u>\$ 338,307,607</u>

See accompanying notes to the basic financial statements.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Governmental Funds

Balance Sheet

June 30, 2014

	<u>State Highway Fund</u>	<u>Debt Service Fund</u>	<u>Capital Projects Fund</u>	<u>Total</u>
Liabilities:				
Accounts payable	\$ 13,233,573	\$ -	\$ 4,153,113	\$ 17,386,686
Accrued payroll	4,218,506	-	-	4,218,506
Contracts payable:				
Current portion	17,599,495	-	17,377,543	34,977,038
Retainage payable	3,451,425	-	2,947,767	6,399,192
Payable from restricted assets:	-			
Matured bonds and interest payable	-	29,813,005	-	29,813,005
Security deposits	10,728,075	-	-	10,728,075
Due to State Highway Fund	-	-	26,939,181	26,939,181
Other liabilities	15,300	-	-	15,300
	<u>49,246,374</u>	<u>29,813,005</u>	<u>51,417,604</u>	<u>130,476,983</u>
Fund Balances:				
Restricted - Capital Projects Fund	-	-	6,882,637	6,882,637
Committed - State Highway Fund	173,367,723	-	26,939,181	200,306,904
Nonspendable - prepaid expenses	-	-	641,083	641,083
	<u>173,367,723</u>	<u>-</u>	<u>34,462,901</u>	<u>207,830,624</u>
Total liabilities and fund balances	<u>\$ 222,614,097</u>	<u>\$ 29,813,005</u>	<u>\$ 85,880,505</u>	<u>\$ 338,307,607</u>

See accompanying notes to the basic financial statements.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Position

June 30, 2014

Total Fund Balances - Governmental Funds		\$ 207,830,624
Amounts reported for governmental activities in the statement of net position 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	\$ 10,219,886,861	
Less accumulated depreciation	<u>(5,198,969,330)</u>	
		5,020,917,531
Deferred charges on refunding are recorded as expenditures in Governmental Funds financial statements when incurred. However, in Government-Wide financial statements, such amounts are recorded as a deferred outflow of resources and amortized over the life of the related bonds.		
		1,207,948
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	(11,288,927)	
Accrued workers' compensation payable	(5,061,990)	
Revenue bonds payable	<u>(368,344,810)</u>	
		<u>(384,695,727)</u>
Net Position of Governmental Activities		<u><u>\$ 4,845,260,376</u></u>

See accompanying notes to the basic financial statements.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Governmental Funds

Statement of Revenues, Expenditures, and Changes in Fund Balances

Year Ended June 30, 2014

	State Highway Fund	Debt Service Fund	Capital Projects Fund	Total
Expenditures:				
Operations and maintenance:				
Oahu highways and services	\$ 139,623,377	\$ -	\$ -	\$ 139,623,377
Hawaii highways and services	27,050,389	-	-	27,050,389
Maui highways and services	33,864,587	-	-	33,864,587
Kauai highways and services	17,467,295	-	-	17,467,295
Molokai highways and services	122,280	-	-	122,280
Lanai highways and services	417,377	-	-	417,377
Pass through for County highways and services	40,528,954	-	-	40,528,954
Administration of Highways Division	30,556,979	-	-	30,556,979
Motor Vehicle Safety Office	13,065,617	-	-	13,065,617
Surcharge on gross receipts	10,159,432	-	-	10,159,432
Capital projects	-	-	128,708,117	128,708,117
Debt service:				
Principal payments	-	28,825,000	-	28,825,000
Interest expense	-	19,036,010	-	19,036,010
Total expenditures	312,856,287	47,861,010	128,708,117	489,425,414
Program Revenues:				
Charges for services:				
Vehicle registration fees	43,207,968	-	-	43,207,968
Other fees and permits	2,992,122	-	-	2,992,122
Penalties and fines	1,934,822	-	-	1,934,822
Rentals	1,054,564	-	-	1,054,564
Operating grants and contributions	119,317,859	-	-	119,317,859
Capital grants and contributions	-	-	92,832,845	92,832,845
Total program revenues	168,507,335	-	92,832,845	261,340,180

See accompanying notes to the basic financial statements.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Governmental Funds

Statement of Revenues, Expenditures, and Changes in Fund Balances

Year Ended June 30, 2014

	State Highway Fund	Debt Service Fund	Capital Projects Fund	Total
General Revenues:				
Taxes:				
State fuel taxes	\$ 86,818,521	\$ -	\$ -	\$ 86,818,521
Vehicle weights taxes and penalties	75,661,480	-	-	75,661,480
Rental motor and tour vehicle surcharge taxes	42,852,241	-	-	42,852,241
Investment income	706,629	-	-	706,629
Non-imposed fringe benefits	596,932	-	-	596,932
	206,635,803	-	-	206,635,803
Total general revenues				
Revenues over (under) expenditures	62,286,851	(47,861,010)	(35,875,272)	(21,449,431)
Other Financing (Uses) Sources:				
Transfers in	-	47,861,010	14,913,355	62,774,365
Transfers out	(66,782,860)	-	(1,250,000)	(68,032,860)
	(66,782,860)	47,861,010	13,663,355	(5,258,495)
Total other financing (uses) sources				
Revenues and other financing sources under expenditures and other financing uses	(4,496,009)	-	(22,211,917)	(26,707,926)
Fund Balances:				
Beginning of year	177,863,732	-	56,674,818	234,538,550
End of year	\$ 173,367,723	\$ -	\$ 34,462,901	\$ 207,830,624

See accompanying notes to the basic financial statements.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Reconciliation of the Governmental Funds Statement of Revenues, Expenditures, and
Changes in Fund Balances to the Statement of Activities

Year Ended June 30, 2014

Net Change in Fund Balances - Total Governmental Funds		\$ (26,707,926)
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	\$ 128,468,478	
Loss of disposal of capital assets	(82,536)	
Less current fiscal year depreciation	<u>(201,002,969)</u>	(72,617,027)
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	27,685,000	
Change in debt service liability recognized in debt service fund	<u>1,140,000</u>	28,825,000
Original issue premium and deferred charge 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 amounts are deferred and amortized to expense over the remaining life of the related bond:		
Amortization of bond premiums	2,744,310	
Amortization of deferred charge on refunding	<u>(481,807)</u>	2,262,503
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>(1,216,162)</u>
Change in Net Position - Governmental Activities		<u><u>\$ (69,453,612)</u></u>

See accompanying notes to the basic financial statements.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

State Highway Fund

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

Year Ended June 30, 2014

	<u>Original</u>	<u>Final</u>	<u>Actual on Budgetary Basis</u>	<u>Variance Over (Under)</u>
Revenues:				
State fuel taxes	\$ 85,131,500	\$ 85,131,500	\$ 86,818,521	\$ 1,687,021
Vehicle weight taxes	74,826,000	74,826,000	76,160,229	1,334,229
Rental motor and tour vehicle surcharge taxes	48,307,000	48,307,000	42,852,241	(5,454,759)
Vehicle registration fees	42,714,000	42,714,000	43,136,522	422,522
Investment income	500,000	500,000	700,286	200,286
Other fees and penalties	6,626,600	6,626,600	5,763,482	(863,118)
	<u>258,105,100</u>	<u>258,105,100</u>	<u>255,431,281</u>	<u>(2,673,819)</u>
Expenditures:				
Operations and maintenance:				
Oahu highways and services	100,989,427	101,212,194	98,517,313	(2,694,881)
Hawaii highways and services	27,921,711	28,028,161	26,128,831	(1,899,330)
Maui highways and services	25,062,869	25,177,905	23,160,275	(2,017,630)
Kauai highways and services	17,751,786	17,798,008	16,426,408	(1,371,600)
Molokai highways and services	4,518,999	4,226,260	3,575,935	(650,325)
Lanai highways and services	462,376	564,780	479,205	(85,575)
Administration of Highways Division including debt service	74,740,430	75,066,879	66,634,379	(8,432,500)
Surcharge on gross receipts	9,699,903	9,699,903	10,211,181	511,278
Motor Vehicle Safety Office	9,179,114	9,231,315	8,599,387	(631,928)
	<u>270,326,615</u>	<u>271,005,405</u>	<u>253,732,914</u>	<u>(17,272,491)</u>
Revenues over (under) expenditures and other uses	<u>\$ (12,221,515)</u>	<u>\$ (12,900,305)</u>	<u>\$ 1,698,367</u>	<u>\$ 14,598,672</u>

See accompanying notes to the basic financial statements.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Agency Fund

Statement of Fiduciary Net Position

June 30, 2014

Asset:

Cash and cash equivalents	<u>\$ 6,596,078</u>
Total asset	<u><u>\$ 6,596,078</u></u>

Liability:

Due to others	<u>\$ 6,596,078</u>
Total liability	<u><u>\$ 6,596,078</u></u>

See accompanying notes to the basic financial statements.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Notes to the Basic Financial Statements

June 30, 2014

(1) Financial Reporting Entity

Act 1, Session Laws of Hawaii (SLH), Second Special Session 1959, the Hawaii State Government Reorganization Act of 1959 (the Act), established the Department of Transportation (the Department) whose function is to establish, maintain, and operate transportation facilities of the State of Hawaii (the 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 (the Highways Division). Through the Highways 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 Highways 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 Highways Division.

(2) Significant Accounting Policies

Basis of Presentation

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

Governmental Funds Financial Statements

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

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Notes to the Basic Financial Statements

June 30, 2014

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 Highways 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.

Debt Service Fund – The Debt Service Fund accounts for the Highways 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 Highways Division’s construction projects and the related sources of financing.

The accompanying financial statements include highway projects authorized by legislative acts through June 30, 2014.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Notes to the Basic Financial Statements

June 30, 2014

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

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

Committed – 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.

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.

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 Position – The statement of net position includes all capital assets and long-term liabilities that are excluded from the Governmental Funds financial statements. The net position is reported in three categories: net investment in capital assets; restricted for debt service and capital activity; and unrestricted.

Statement of Activities – The statement of activities reports expenses and revenues in a format that focuses on the cost of the Highways 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.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Notes to the Basic Financial Statements

June 30, 2014

Fiduciary Fund Financial Statement

The agency fund is used to account for assets held by the Highways Division on behalf of other departments of the State. Cash and cash equivalents reported in the agency fund statement of fiduciary net position consist of amounts held in State Treasury, including deposits received and held for others in the amount of \$6,596,078 at June 30, 2014.

Change in Accounting Principle

Effective July 1, 2013, the Highways Division adopted GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This statement redefines certain financial statement elements previously reported as assets and liabilities as deferred outflows of resources and deferred inflows of resources. In addition, this statement changes the method of reporting bond issuance costs.

Prior to adoption of GASB Statement No. 65, the Highways Division capitalized costs relating to the issuance of bonds and amortized those costs over the term of the bonds. Unamortized bond issue costs were reported as a noncurrent asset in the statement of net position. GASB Statement No. 65 requires that bond issuance costs be recognized as an expense in the period incurred.

In addition, prior to adoption of GASB Statement No. 65, unamortized deferred charge on refunding was reported as a deduction from revenue bonds payable in the statement of net position. GASB Statement No. 65 requires that the unamortized deferred charge on refunding be reported as deferred outflows of resources in the statement of net position.

The Highways Division has elected to retrospectively apply the effects of this change in accounting principle to the accompanying financial statements. With respect to unamortized bond issuance costs amounting to \$1,494,925 at June 30, 2013, the adoption of GASB Statement No. 65 had the effect of decreasing previously reported net position at June 30, 2013 by \$1,494,925 as follows:

Net position, as previously reported	\$ 4,916,208,913
Restatement	<u>(1,494,925)</u>
Net position, as restated	<u><u>\$ 4,914,713,988</u></u>

Cash and Cash Equivalents

Cash and cash equivalents consist of amounts held in State Treasury as discussed in Note 4.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Notes to the Basic Financial Statements

June 30, 2014

Restricted Cash and Cash Equivalents

Restricted cash and cash equivalents consist of amounts held in State Treasury, the use of which is legally restricted. Restricted cash and cash equivalents accounts for the principal and interest amounts accumulated to make debt service payments on the Highways Division's revenue bonds and also include security deposits collected from third parties.

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 Highways Division. When continued collection activity results in receipt of amounts previously written off, revenue is recognized for the amount collected.

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 position. 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	28 to 75 years	\$ 100,000

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.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Notes to the Basic Financial Statements

June 30, 2014

Bond Issuance Costs

Costs relating to the issuance of bonds are expensed as incurred in the accompanying financial statements.

Refunding of Debt

The difference between the reacquisition price and the net carrying amount of the old debt is deferred and amortized as a component of interest expense in a systematic and rational manner over the remaining life of the old debt or the life of the new debt, whichever is shorter. The deferred charge on refunding amounted to \$1,207,948 at June 30, 2014, and are reported as deferred outflows of resources in the statement of net position.

Deferred Outflows/Inflows of Resources

In addition to assets, the statement of net position will report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expense) until then. The Highways Division only has one item that qualifies for reporting in this category. It is the deferred charge on refunding reported in the statement of net position.

In addition to liabilities, the statement of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time. The Highways Division does not have any deferred inflows of resources at June 30, 2014.

Accrued Vacation and Compensatory Pay

The Highways 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.

Long-Term Obligations

In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities. Bond premiums 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.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Notes to the Basic Financial Statements

June 30, 2014

In the governmental funds financial statements, bond premiums are recognized as paid. The face amount of debt and any related premium are reported as other financing sources.

Employees' Retirement System

The Highways 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 Highways Division's policy is to fund its required contribution each pay period.

Risk Management

The Highways 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 17. 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.

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.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Recently Issued Accounting Pronouncements

The Highways Division has implemented or is currently analyzing its accounting practices to determine the potential impact on the financial statements for the following GASB Statements:

In March 2012, GASB issued Statement No. 66, *Technical Corrections—2012—An Amendment of GASB Statements No. 10 and No. 62*. This Statement enhances the usefulness of financial reports by resolving conflicting accounting and financial reporting guidance that could diminish the consistency of financial reporting. The Highways Division implemented the provisions of this Statement for the fiscal year ended June 30, 2014.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Notes to the Basic Financial Statements

June 30, 2014

In June 2012, GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions - An Amendment of GASB Statement No. 27*. The objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions. This Statement establishes standards for measuring and recognizing liabilities, deferred outflows of resources, and deferred inflows of resources, and expense/expenditures. Note disclosure and required supplementary information requirements about pensions also are addressed.

In financial statements prepared using the economic resources measurement focus and accrual basis of accounting, a cost-sharing employer that does not have a special funding situation is required to recognize a liability for its proportionate share of the net pension liability (of all employers for benefits provided through the pension plan) - the collective net pension liability. A cost-sharing employer is required to recognize pension expense and report deferred outflows of resources and deferred inflows of resources related to pensions for its proportionate share of collective pension expense and collective deferred outflows of resources and deferred inflows of resources related to pensions.

Application of this Statement is effective for the Highways Division's fiscal year ending June 30, 2015, with early adoption encouraged.

In January 2013, GASB issued Statement No. 69, *Government Combinations and Disposals of Government Operations*. This Statement establishes accounting and financial reporting standards related to government combinations and disposals of government operations. The application of this Statement is effective for the Highways Division's fiscal year ending June 30, 2015, with early adoption encouraged.

In April 2013, GASB issued Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*. The objective of this Statement is to improve accounting and financial reporting by governments extending and receiving nonexchange financial guarantees. The Highways Division implemented the provisions of this Statement for the fiscal year ended June 30, 2014.

In November 2013, GASB issued Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date - An Amendment of GASB Statement No. 68*. The objective of this Statement is to improve accounting and financial reporting by addressing an issue in Statement No. 68 concerning provisions related to certain pension contributions made to defined benefit pension plans prior to implementation of that Statement. The application of this Statement should be applied simultaneously with the provisions of Statement No. 68, which is effective for the Highways Division's fiscal year ending June 30, 2015, with early adoption encouraged.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
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Notes to the Basic Financial Statements

June 30, 2014

(3) Budget and Budgetary Accounting

State Highway Fund

In the statement of revenues and expenditures - budget and actual (non-GAAP budgetary basis) for the State Highway Fund, amounts reflected as original and amended budgeted revenues are the official estimates as compiled by the Highways 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 statement of revenues and expenditures - budget and actual (non-GAAP budgetary basis) for the State Highway Fund 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 statement of revenues and expenditures - budget and actual (non-GAAP budgetary basis) for the State Highway Fund are derived primarily from acts of the State Legislature and from other authorizations contained in other specific appropriation acts in various Session Laws of Hawaii.

Allotments are made and expenditures are controlled at the program level reflected in the statement of revenues and expenditures - budget and actual (non-GAAP budgetary basis) for the State Highway Fund. Allotments for the State Highway Fund lapse at year-end.

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

Revenues over expenditures and other uses, non-GAAP budgetary basis	\$ 1,698,367
Federal grants in aid	119,317,859
Operating transfers out of the Highways Division for debt service	4,008,495
Pass through expenditures for county projects	(40,528,954)
Other adjustments to modified accrual basis of accounting	<u>(22,208,916)</u>
Revenues over expenditures, before transfers, GAAP basis	<u><u>\$ 62,286,851</u></u>

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.

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Notes to the Basic Financial Statements

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(4) Cash and Cash Equivalents

Cash and cash equivalents at June 30, 2014, consisted of amounts held in State Treasury and are reflected in the accompanying financial statements at June 30, 2014 as follows:

	Governmental Activities	Agency Fund	Total
Cash and cash equivalents	\$ 229,693,077	\$ 6,596,078	\$ 236,289,155
Restricted cash and cash equivalents:			
Reserve bond debt service	29,813,005	-	29,813,005
Security deposits	10,728,075	-	10,728,075
Total cash and cash equivalents	\$ 270,234,157	\$ 6,596,078	\$ 276,830,235

Amounts Held in State Treasury

At June 30, 2014, amounts held in State Treasury reflect the Highways Division’s relative position in the State’s investment pool and amounted to \$276,830,235.

The State maintains an investment pool that is used by various state departments and agencies, including the Highways Division. The State Director of Finance (the Director) is responsible for safekeeping of all monies paid into the State Treasury. The Director pools and invests any monies of the State, which, in the Director’s judgment, are in excess of amounts necessary for meeting the specific requirements of the State.

Interest Rate Risk

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

Credit Risk

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

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Custodial Risk

For bank accounts, custodial 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 time certificates of deposit, the State requires that the depository banks pledge collateral based on the daily available bank balances to limit its exposure to custodial credit risk. The use of daily available bank balances to determine collateral requirements results in the available balances being under-collateralized at times during the fiscal year. All securities pledged as collateral are held either by the State Treasury or by the State's fiscal agents in the name of the State. The State 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.

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

Concentration of Credit Risk

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

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

**HIGHWAYS DIVISION
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June 30, 2014

The Highways Division's share of the State's investment pool, as provided in the fiscal year 2014 CAFR of the State and summarized in the table below (amounts in thousands), was 9% at June 30, 2014:

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

(5) Tax and Fee Revenues

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 2014, 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

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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.

Rental Motor and Tour Vehicle Surcharge Taxes

The rental motor vehicle surcharge tax was \$3.00 a day that a rental motor vehicle is rented or leased.

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.

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, 2014 the Highways Division collected approximately \$5,388,700 on behalf of the EMS special fund.

All amounts were disbursed to the EMS special fund. Accordingly, no amounts are reported in the financial statements at June 30, 2014. The motor carrier safety inspection fee was \$1.50 per vehicle every six months.

(6) Federal Grants-In-Aid

The Highways 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, 2014, receivables totaling \$28,328,374 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 Highways Division for economy, efficiency, and program results. The Highways Division's management believes that any federal aid received as of June 30, 2014 that might be required to be repaid to the FHWA or NHTSA based on federal audits would not be material to the

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financial position of the various funds of the Highways Division at June 30, 2014, or the results of operations of such funds for the year then ended.

(7) Non-Imposed Fringe Benefits

Payroll fringe benefit costs of employees of the Highways Division are assumed by the State and are not charged to the Highways Division's operating funds. These costs totaling \$597,000 for fiscal year 2014 have been reported as revenues and expenditures in the State Highway Fund.

(8) Capital Assets

Changes in capital assets during the year ended June 30, 2014 was as follows:

	Balance July 1, 2013	Additions	Deductions	Transfers	Balance June 30, 2014
Nondepreciable assets:					
Land	\$ 438,108,333	\$ 2,136,743	\$ (2,788)	\$ -	\$ 440,242,288
Construction in progress	267,964,865	120,552,323		(19,618,236)	368,898,952
Software under development	13,023,834	1,037,357	-	-	14,061,191
Infrastructure	819,369,450	-	-	-	819,369,450
Total nondepreciable assets	<u>1,538,466,482</u>	<u>123,726,423</u>	<u>(2,788)</u>	<u>(19,618,236)</u>	<u>1,642,571,881</u>
Depreciable assets:					
Land improvements	2,215,473	-	-	-	2,215,473
Building and improvements	44,680,244	-	-	1,191,830	45,872,074
Vehicles and equipment	58,888,463	4,742,055	(1,112,326)	-	62,518,192
Infrastructure	8,448,702,564	-	(419,729)	18,426,406	8,466,709,241
	8,554,486,744	4,742,055	(1,532,055)	19,618,236	8,577,314,980
Less accumulated depreciation	(4,999,418,668)	(201,002,969)	1,452,307	-	(5,198,969,330)
Total depreciable assets, net	<u>3,555,068,076</u>	<u>(196,260,914)</u>	<u>(79,748)</u>	<u>19,618,236</u>	<u>3,378,345,650</u>
Total capital assets, net	<u>\$ 5,093,534,558</u>	<u>\$ (72,534,491)</u>	<u>\$ (82,536)</u>	<u>\$ -</u>	<u>\$ 5,020,917,531</u>

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Notes to the Basic Financial Statements

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(9) Net Position

At June 30, 2014 net position consisted of the following:

Net investment in capital assets:

Net property, plant and equipment	\$ 5,020,917,531
Less: Revenue bonds payable	(388,639,810)
Add: Unspent debt proceeds	4,150,304
Add: Deferred charge on refunding, net	1,207,948
	<hr/>
Total net investment in capital assets	4,637,635,973

Restricted for Debt Service and Capital Activity:

Restricted for capital projects	6,882,637
Restricted for debt service	29,813,005
Restricted for security deposits	10,728,075
Less: Unspent debt proceeds	(4,150,304)
	<hr/>
Total restricted for debt service and capital activity	43,273,413

Unrestricted

	<hr/>
	164,350,990
	<hr/>
Total net position	\$ 4,845,260,376
	<hr/> <hr/>

**HIGHWAYS DIVISION
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Notes to the Basic Financial Statements

June 30, 2014

(10) General Long-Term Liabilities

Changes in general long-term liabilities during the year ended June 30, 2014 were as follows:

	<u>Balance July 1, 2013</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance June 30, 2014</u>	<u>Amount Due Within One Year</u>
Accrued vacation payable	\$ 11,430,623	\$ 4,465,726	\$ (4,607,422)	\$ 11,288,927	3,460,301
Workers' compensation payable	4,624,110	1,492,437	(1,054,557)	5,061,990	1,054,558
Revenue bonds payable - unamortized premium	17,734,120	-	(2,744,310)	14,989,810	-
Revenue bonds payable	<u>401,335,000</u>	<u>-</u>	<u>(27,685,000)</u>	<u>373,650,000</u>	<u>29,170,000</u>
Total governmental activities long-term liabilities	<u>\$ 435,123,853</u>	<u>\$ 5,958,163</u>	<u>\$ (36,091,289)</u>	<u>\$ 404,990,727</u>	<u>\$ 33,684,859</u>

(11) 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.

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On July 1, 1998, the Highways 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 4.0% 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 April 15, 2003, the Highways 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. There were no defeased bonds outstanding at June 30, 2013.

On February 20, 2005, the Highways 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 Highways 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

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On December 17, 2008, the Highways 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 Highways 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 Highways Division issued \$5,095,000 in State of Hawaii Revenue Bonds Series 2011B (2011B Bonds) with interest rates of 4.0% and mature in annual installments through 2032. These bonds were issued at a premium of \$466,702, which will be amortized over the life of the bonds using the effective interest method. 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 following is a summary of revenue bonds issued and outstanding at June 30, 2014:

<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
2005	3.00-5.25%	2025	183,915,000	131,835,000
2008	4.00-6.00%	2029	125,175,000	104,545,000
2011	0.75-5.00%	2032	117,365,000	109,690,000
			<u>\$ 521,375,000</u>	<u>373,650,000</u>
				Add: unamortized premium 14,989,810
				Less: current portion <u>(29,170,000)</u>
				Noncurrent portion <u>\$ 359,469,810</u>

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During 2014, \$47,861,010 was transferred from the State Highway Fund to the Debt Service Fund for repayment of revenue bonds principal of \$8,530,000 and \$20,295,000 due on January 1, 2014 and July 1, 2014, respectively and interest of \$9,518,005 and \$9,518,005 due on January 1, 2014 and July 1, 2014, respectively.

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>
2015	\$ 29,170,000	\$ 18,458,592	\$ 47,628,592
2016	30,580,000	16,946,785	47,526,785
2017	32,075,000	15,430,173	47,505,173
2018	33,640,000	13,801,644	47,441,644
2019	35,325,000	12,085,070	47,410,070
2020-2024	100,120,000	42,871,758	142,991,758
2025-2029	87,590,000	19,993,288	107,583,288
2030-2032	25,150,000	2,536,550	27,686,550
Total	<u>\$ 373,650,000</u>	<u>\$ 142,123,860</u>	<u>\$ 515,773,860</u>

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(12) 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:

	<u>State Highway Fund</u>	<u>Debt Service Fund</u>	<u>Capital Projects Fund</u>	<u>Total</u>
Funding of highway capital projects	\$ (14,913,355)	\$ -	14,913,355	\$ -
Reimbursement to State for debt service on general obligation bonds	(4,008,495)	-	-	(4,008,495)
Transfer of funds to County of Maui for capital improvement project	-	-	(1,250,000)	(1,250,000)
Funding of revenue bond debt service	(47,861,010)	47,861,010	-	-
	<u>\$ (66,782,860)</u>	<u>\$ 47,861,010</u>	<u>\$ 13,663,355</u>	<u>\$ (5,258,495)</u>

Funding of Highway Capital Projects

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

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 Highways Division's reimbursement to the State for debt service is primarily determined by the Director of Finance, State of Hawaii.

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The annual amounts required to amortize the designated portions of general obligation bonds as of June 30, 2014 are as follows:

<u>Years Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2015	\$ 3,609,451	\$ 153,104	\$ 3,762,555
2016	2,240,796	89,026	2,329,822
2017	1,913,584	50,379	1,963,963
2018	954,094	15,984	970,078
2019	2,433	389	2,822
2020-2021	5,344	425	5,769
Total	<u>\$ 8,725,702</u>	<u>\$ 309,307</u>	<u>\$ 9,035,009</u>

Debt service reimbursements are accounted for as expenditures of the Administration of Highway Division program on the Governmental Funds statement of revenues and expenditures - budget and actual (non-GAAP budgetary basis) for the State Highway Fund, 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 \$4,008,495 consisted of \$3,785,354 for principal and \$223,141 for interest for the year ended June 30, 2014.

(13) Retirement Benefits

Employees' Retirement System of the State of Hawaii

Plan Description

All eligible employees of the State and counties, which includes the Highways Division are required by Chapter 88, Hawaii Revised Statutes (HRS), to become members of the Employees' Retirement System of the State of Hawaii (the ERS), a cost-sharing, multiple-employer defined benefit public employee retirement plan. The ERS provides retirement benefits, as well as death and disability benefits. All contributions, benefits, and eligibility requirements are established by Chapter 88, HRS, and can be amended by legislative action. The ERS is governed by a Board of Trustees. 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, or through the ERS's website: www.ers.hawaii.gov.

Prior to June 30, 1984, the plan consisted of only a contributory plan. In 1984, legislation was enacted to add a new noncontributory 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 noncontributory plan. The

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noncontributory 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 noncontributory plan and receive a refund of employee contributions. All benefits vest after five and ten years of credited service under the contributory and noncontributory plans, respectively.

Both plans 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 service or age 55 and 30 years of credited service. Members 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 were eligible to join the new hybrid plan. Most of the new employees hired after July 1, 2006, were required to join the hybrid plan.

Effective July 1, 2012, the hybrid contributory plan was revised by Act 163, SLH 2011. Members joining the hybrid plan on or after that date are eligible for retirement at age 65 with 10 years of credited service or age 60 with 30 years of credited service. Members will receive a benefit multiplier of 1.75% for each year of credited service in the hybrid plan. The benefit options remain similar to the current contributory plan.

Funding Policy

Covered employees of the contributory plan who became members as of June 30, 2012 or after June 30, 2012 are required to contribute 7.8% or 9.8% of their salary, respectively. Police officers, firefighters, investigators of the departments of the County Prosecuting Attorney and the Attorney General, narcotics enforcement investigators, and public safety investigators who became members as of June 30, 2012 or after June 30, 2012 are required to contribute 12.2% or 14.2% of their salary, respectively. Covered employees of the hybrid plan who became members as of June 30, 2012 or after June 30, 2012 are required to contribute 6% or 8% of their salary, respectively. 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.

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The Highways Division's contribution to the ERS for fiscal years 2014, 2013, and 2012 was approximately \$7,879,000, \$7,447,000, and \$6,642,000, respectively. The Highways Division contributed 100% of its required contribution for each of those years. Measurement of assets and actuarial valuations are made for the ERS as a whole and are not separately computed for individual participating employers such as the Highways Division.

Post-Retirement Health Care and Life Insurance Benefits

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

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

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

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

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

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

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The State is required to contribute the annual required contribution of the employer (ARC), an amount actuarially determined. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal costs each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years.

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

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 ARC, interest, and any adjustment to the ARC, to component units and proprietary funds that are reported separately in stand-alone departmental financial statements or in the State's CAFR. The basis for the allocation is the proportionate share of 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 Highways Division's contributions for the years June 30, 2014, 2013, and 2012 were approximately \$5,100,000, \$4,890,000, and \$3,526,000, respectively.

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 Highways Division's financial statements.

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(14) 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 2014, the assessment amounted to approximately \$10,795,000 which is included as the caption surcharge on gross receipts expense/expenditures in the accompanying financial statements.

The Highways Division is also assessed a percentage of the cost of the general administration expenses of the Department. During fiscal year 2014, assessments net of amounts refunded amounted to approximately \$6,161,000 which is included in administration of Highways Division expense/expenditures in the accompanying financial statements.

(15) Operating Leases

Rental Expenditures

The Highways 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 are as follows:

Years Ending June 30,	
2015	\$ 957,000
2016	957,000
2017	957,000
2018	957,000
2019	<u>399,000</u>
Total	<u>\$ 4,227,000</u>

The total rental expenditures during fiscal year 2014 for operating leases were approximately \$1,311,000.

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Rental Revenue

The Highways Division is a lessor of various properties under non-cancelable lease agreements that expire through fiscal year 2044. Scheduled annual minimum revenues through 2018 and in five-year increments thereafter are as follows:

Years Ending June 30,	
2015	\$ 434,000
2016	440,000
2017	446,000
2018	452,000
2019	415,000
2020-2024	1,650,000
2025-2029	1,165,000
2030-2034	428,000
2035-2039	370,000
2040-2044	<u>299,000</u>
Total	<u><u>\$ 6,099,000</u></u>

(16) Commitments

Condemnation Proceedings

The Highways Division occasionally finds it necessary to condemn property for construction of highways. These proceedings require the Highways 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 Highways Division is required to deposit funds in State courts for these proceedings. The amount of funds deposited in the State courts was approximately \$994,000 at June 30, 2014. 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 Highways 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 position in the year in which the deposits were made.

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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 Highways 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, 2014 aggregated approximately \$24,818,000.

(17) Risk Management

The Highways Division is exposed to various risks of loss related to, among other risks, torts; theft of, damage to, or destruction of assets; errors and omissions; workers' compensation and acts of terrorism. The State retains various risks and insures certain excess layers with commercial insurance companies. The excess layers insured with commercial insurance companies are consistent with the prior fiscal year. Settled claims have not exceeded the coverage provided by commercial insurance companies in any of the past three fiscal years.

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

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

The State has personal injury and property damage liability, including automobile and public errors and omissions, insurance policy in force with a \$4,000,000 self-insured retention per occurrence. The annual aggregate per occurrence is \$15,000,000 and for crime loss, \$10,000,000 with no aggregate limit.

The State is self-insured for workers' compensation. Accordingly, the Highways 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 approximately \$5,062,000 at June 30, 2014.

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(18) Contingent Liabilities and Other

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 Highways 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 Highways 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, 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 statements.

(19) Subsequent Events

On August 14, 2014, the Highways Division issued \$103,375,000 in Series A, \$32,285,000 in Series B and \$28,020,000 in Series C of 2014 Revenue Refunding Bonds (the Bonds). The Bonds bear interest from 0.4% to 5.0% with maturity dates through January 2034. The Series B 2014 Revenue Bonds refunded \$36,195,000 of 2005 A Bonds and Series C 2014 Revenue Bonds refunded \$26,435,000 of 2005 B Bonds. The refunding of 2005 A and 2005 B Bonds provided net present value savings of approximately \$5.1 million as measured from the closing date at a fixed coupon rate of 4.85% and 1.32%, respectively.

The Highways Division has evaluated subsequent events through March 27, 2015, the date the financial statements were available to be used.