



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

Financial Statements and Supplementary Information
(With Independent Auditors' Report Thereon)

June 30, 2017 and 2016

Submitted by
THE AUDITOR
STATE OF HAWAII

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

Financial Statements and Supplementary Information

June 30, 2017 and 2016

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PART I

INTRODUCTION SECTION

December 21, 2017

The Auditor
State of Hawaii:

We have completed our audit of the financial statements of the Harbors Division, Department of Transportation, State of Hawaii (the Harbors Division), an enterprise fund of the State of Hawaii, as of and for the years ended June 30, 2017 and 2016. We transmit herewith our independent auditors' report containing our opinion on those financial statements and our report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with *Government Auditing Standards*.

Audit Objectives

The objectives of the audit were as follows:

1. To provide an opinion on the fair presentation of the Harbors Division's financial statements in accordance with accounting principles generally accepted in the United States of America.
2. To consider the Harbors Division's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements.
3. To perform tests of the Harbors Division's compliance with laws, regulations, contracts, and grant agreements that may have a direct and material effect on the determination of financial statement amounts.

Scope of Audit

We performed an audit of the Harbors Division's financial statements as of and for the years ended June 30, 2017 and 2016, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

As part of the audit of the Harbors Division's financial statements, we considered the Harbors Division's internal control over financial reporting to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We also performed tests of the Harbors Division's compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts.

Organization of Report

This report has been organized into three parts as follows:

1. The Introduction Section describes briefly the objectives and scope of our audit and the organization and contents of this report.
2. The Financial Section includes management's discussion and analysis, the Harbors Division's financial statements and the related notes, and other supplementary information as of and for the years ended June 30, 2017 and 2016, and our independent auditors' report thereon.
3. The Internal Control and Compliance Section contains our independent auditors' report on the Harbors Division's internal control over financial reporting and on compliance and other matters based on an audit of the financial statements performed in accordance with *Government Auditing Standards*.

* * * * *

We would like to take this opportunity to express our appreciation for the courtesy and assistance extended to us by the personnel of the Harbors Division during the course of our engagement. Should you wish to discuss any of the matters contained herein, we will be pleased to meet with you at your convenience.

Very truly yours,

KKDLY LLC

PART II
FINANCIAL SECTION

Independent Auditors' Report

The Auditor
State of Hawaii:

Report on the Financial Statements

We have audited the accompanying financial statements of the Harbors Division, Department of Transportation, State of Hawaii (the Harbors Division), an enterprise fund of the State of Hawaii, which comprise the statements of net position as of June 30, 2017 and 2016, and the related statements of revenues, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Harbors Division as of June 30, 2017 and 2016, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

Change in Accounting Principle

As discussed in Note 2, the Harbors Division adopted Governmental Accounting Standards Board Statement (GASB) No. 82, *Pension Issues – An Amendment of GASB Statements No. 67, No. 68, and No. 73*, effective July 1, 2016. Our opinion is not modified with respect to this matter.

Relationship to the State of Hawaii

As discussed in Note 1, the financial statements of the Harbors Division are intended to present the financial position, the changes in financial position and, where applicable, cash flows of only that portion of the business-type activities and proprietary fund type of the State of Hawaii that is attributable to the transactions of the Harbors Division. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2017 and 2016, and the changes in its financial position, or, where applicable, its cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

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

Other Information

Our audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Harbors Division's basic financial statements. The supplementary information included in Schedules 1 through 4 is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The supplementary information included in Schedules 1 through 4 is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information included in Schedules 1 through 4 is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 21, 2017, on our consideration of the Harbors Division's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to solely describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Harbors Division's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Harbors Division's internal control over financial reporting and compliance.

KKDL Y LLC

Honolulu, Hawaii
December 21, 2017

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Management's Discussion and Analysis

June 30, 2017 and 2016

The following Management's Discussion and Analysis of the Harbors Division, Department of Transportation, State of Hawaii (the Harbors Division), an enterprise fund of the State of Hawaii, presents the reader with an introduction and overview of the Harbors Division's financial performance for the fiscal years ended June 30, 2017 and 2016. This discussion has been prepared by management and should be read in conjunction with the financial statements, and the notes thereto, which follow this section.

The statewide system of commercial harbors consists of ten harbors on six islands. The system plays a vital role in Hawaii's economy as the ports serve as the primary means for goods to enter and exit the state. Hawaii imports approximately 80% of what it consumes, the majority of which enters the state through the commercial harbors system.

The Harbors Division is self-sustaining. The Department of Transportation, State of Hawaii (DOT), is authorized to impose and collect rates and charges for the use of the harbors system and its properties to generate revenues to fund operating expenses. The Capital Improvements Program (CIP) is also funded by the Harbors Division's revenues and proceeds from the issuance of harbors system revenue bonds.

Using the Financial Statements

The Harbors Division is accounted for as a proprietary fund and utilizes the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. The proprietary fund includes the enterprise fund type, which is used to account for the acquisition, operation, and maintenance of government facilities and services that are entirely or predominantly supported by user charges.

The Harbors Division's financial report includes three financial statements; the statements of net position, the statements of revenues, expenses, and changes in net position, and the statements of cash flows. The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) as promulgated by the Governmental Accounting Standards Board (GASB).

Change in Accounting Principles

Effective July 1, 2016, the Harbors Division adopted the provisions of GASB Statement No. 82, *Pension Issues – An Amendment of GASB Statements No. 67, No. 68, and No. 73* (Statement No. 82). This statement addresses certain issues that have been raised with respect to GASB Statements No. 67, *Financial Reporting for Pension Plans*, No. 68, *Accounting and Financial Reporting for Pensions*, and No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope GASB Statement No. 68*, and *Amendments to Certain Provisions of GASB Statements 67 and 68*.

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As further discussed in Note 2, the restatement of the comparative financial data for the prior periods presented was not practical due to the unavailability of information from the pension plan, therefore the provisions of Statement No. 82 were not applied to prior periods. The cumulative effect of applying the provisions of this statement has been reported as a restatement of the beginning net position for the year ended June 30, 2017. Specifically, the adoption of Statement No. 82 had the effect of decreasing net position as of June 30, 2016 by approximately \$586,000.

Financial Highlights

- The Harbors Division's net position at June 30, 2017 and 2016 amounted to \$834.6 million and \$797.9 million (as restated), respectively. Net position increased by \$36.7 million in fiscal year 2017, an increase of 4.6%. Net position increased by \$38.8 million in fiscal year 2016, an increase of 5.1%.
- Operating income amounted to \$49.2 million in fiscal year 2017, a decrease of \$6.6 million or 11.8% as compared to 2016. Operating income amounted to \$55.8 million in fiscal year 2016, an increase of \$2.7 million or 5.1% as compared to 2015.

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Management's Discussion and Analysis

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A summary of operations and changes in net position for the fiscal years ended June 30, 2017, 2016, and 2015 follows:

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

	Year Ended June 30			2017-2016		2016-2015	
	2017	2016	2015	Increase (decrease)	% Change	Increase (decrease)	% Change
Operating revenues	\$ 137,621	\$ 130,126	\$ 123,209	\$ 7,495	5.8%	\$ 6,917	5.6%
Nonoperating revenues	2,431	1,725	1,454	706	40.9	271	18.6
Total revenues	140,052	131,851	124,663	8,201	6.2	7,188	5.8
Depreciation expense	30,869	26,033	23,335	4,836	18.6	2,698	11.6
Other operating expenses	57,583	48,330	46,806	9,253	19.1	1,524	3.3
Nonoperating expenses	15,160	18,728	16,890	(3,568)	(19.1)	1,838	10.9
Total expenses	103,612	93,091	87,031	10,521	11.3	6,060	7.0
Income before capital contributions	36,440	38,760	37,632	(2,320)	(6.0)	1,128	3.0
Capital contributions	300	-	285	300	100.0	(285)	(100.0)
Increase in net position	36,740	38,760	37,917	(2,020)	(5.2)	843	2.2
Net position, beginning of year, as previously reported	798,518	759,758	743,292	38,760	5.1	16,466	2.2
Restatement	(586)	-	(21,451)	(586)	(100.0)	21,451	(100.0)
Net position, beginning of year, as restated	797,932	759,758	721,841	38,174	5.0	37,917	5.3
Net position, end of year	\$ 834,672	\$ 798,518	\$ 759,758	\$ 36,154	4.5	\$ 38,760	5.1

Operating Revenues

Total operating revenues for fiscal year 2017 were \$137.6 million compared to \$130.1 million for fiscal year 2016. Total operating revenues for fiscal year 2016 were \$130.1 million compared to \$123.2 million for fiscal year 2015. Operating revenues consist primarily of service revenues and rental revenues, which accounted for 82.2% and 16.6%, respectively, in fiscal year 2017, and 81.4% and 17.9%, respectively, in fiscal year 2016, of the Harbors Division's total operating revenues.

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Service Revenues

Service revenues are directly related to cargo and ship operations. Service revenues include wharfage, passenger fees, and other ship related fees. Service revenues in fiscal years 2017 and 2016 were \$113.2 million and \$106.0 million, respectively.

Service revenues for fiscal year 2017 increased \$7.2 million or 6.8% as compared to fiscal year 2016. Wharfage revenue from cargo movements increased by \$6.7 million from \$88.7 million in fiscal year 2016 to \$95.4 million in fiscal year 2017 due primarily to two increases in tariff rates that took effect during fiscal year 2017, one increase of 3% on July 1, 2016 and the other increase of 17% on February 1, 2017 both increases were applied to the rates then in effect. In addition, passenger fees increased by \$1.1 million as described below.

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

During fiscal year 2017, approximately 1.08 million passengers (inbound and outbound) passed through the harbors as compared to 1.0 million passengers in fiscal year 2016 and 1.01 million passengers in fiscal year 2015.

Passenger fee revenue increased by \$1.1 million or 15.7% from \$7.0 million in 2016 to \$8.1 million in fiscal year 2017, due primarily to the change in the embark and debark fee to \$7.50 per passenger, effective July 1, 2016, from that assessed through June 30, 2016 of \$7.00 per passenger, and by an increase of approximately 0.08 million passengers in fiscal year 2017.

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

Rental Revenues

Rental revenues for fiscal year 2017 were \$22.9 million, a decrease from fiscal year 2016 of approximately \$0.4 million, due to a settlement of a tenant dispute.

Rental revenues for fiscal year 2016 were \$23.3 million, which was consistent with fiscal year 2015 rental revenues of \$23.4 million.

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Operating Expenses

Operating expenses, excluding depreciation expense, for fiscal years 2017 and 2016 amounted to \$57.6 million and \$48.3 million, respectively. The increase in operating expenses for fiscal year 2017 in comparison to fiscal year 2016 of \$9.3 million or 19.1% was due primarily to increases in costs of harbor operations of \$5.3 million and personnel services costs of \$2.5 million.

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

Harbor operations costs for fiscal year 2017 increased by \$5.3 million as compared to fiscal year 2016 due primarily to the increases in ceded land assessments of \$6.8 million, which was partially offset by a decrease in harbor operating costs of approximately \$1.5 million. The \$6.8 million increase in ceded land assessments for fiscal year 2017, is in accordance with Act 178, SLH 2006, as approximately \$5.3 million was refunded to the Harbors Division in fiscal year 2016. No such refunds were received in fiscal year 2017. Harbor operating costs decreased by approximately \$1.5 million, due primarily to the non-recurrence of approximately \$0.6 million paid to third-party contractors incurred for fiscal year 2016, for the costs of storm drain cleaning costs at facilities located on the island of Oahu, to comply with the 2014 EPA Consent Decree. During fiscal year 2017, these tasks were performed by Harbors Division personnel. Utilities costs, such as electricity, water charges, and sewer fees and waste disposal fees also decreased.

Harbor operations costs for fiscal year 2016 decreased by \$2.2 million as compared to fiscal year 2015 due primarily to decreases in ceded land assessments of \$5.9 million. In accordance with Act 178, SLH 2006, approximately \$5.3 million was refunded to the Harbors Division. This was offset by an increase in harbor operating costs of \$2.7 million, which included approximately \$0.6 million of storm drain cleaning costs at facilities located on the island of Oahu to comply with the 2014 EPA Consent Decree, an increase in utilities costs such as electricity, water charges, and sewer fees and waste disposal fees, and an increase in harbor security costs of \$1.0 million due primarily to higher contract hourly labor rates.

Personnel services costs for fiscal year 2017 increased by \$2.5 million as compared to fiscal year 2016 due primarily to an increase in pension expense of \$2.4 million recognized in accordance with GASB Statement Nos. 68, 73, and 82, as well as increases in wages and employee benefits costs attributable to the collective bargaining unit agreements effective April 1, 2017. In fiscal year 2016, personnel services increased by \$1.3 million as compared to fiscal year 2015 due primarily to increases in wages and employee benefits costs paid of \$1.0 million attributable to the collective bargaining agreements that became effective July 1, 2014 for all Harbors Division employees and an increase in workers' compensation expense of \$350,000.

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Harbor maintenance expenses for fiscal year 2017 decreased by \$0.4 million as compared to fiscal year 2016 due primarily to lower maintenance costs. In fiscal year 2016, harbor maintenance expenses increased by \$2.2 million as compared to fiscal year 2015 due primarily to increases in maintenance costs of \$1.0 million and increases in fiscal year 2016 special maintenance costs of \$1.1 million expended for maintenance projects that did not extend the service life of harbor assets.

A summary of the Harbors Division's net position at June 30, 2017, 2016, and 2015 are shown below:

Table 2
Condensed Statements of Net Position
(In Thousands)

	As of June 30			2017-2016		2016-2015	
	2017	2016	2015	Increase (decrease)	% Change	Increase (decrease)	% Change
Assets:							
Current and other assets	\$ 446,802	\$ 421,321	\$ 414,819	\$ 25,481	6.0%	\$ 6,502	1.6%
Capital assets, net	829,720	795,090	780,490	34,630	4.4	14,600	1.9
Total assets	1,276,522	1,216,411	1,195,309	60,111	4.9	21,102	1.8
Deferred outflows of resources	15,574	6,908	6,633	8,666	125.4	275	4.1
Liabilities:							
Current liabilities	57,103	46,709	49,746	10,394	22.3	(3,037)	(6.1)
Long-term liabilities	399,699	376,541	389,919	23,158	6.2	(13,378)	(3.4)
Total liabilities	456,802	423,250	439,665	33,552	7.9	(16,415)	(3.7)
Deferred inflows of resources	622	1,551	2,519	(929)	(59.9)	(968)	(38.4)
Net position:							
Net investment in capital assets	528,734	528,706	528,581	28	0.0	125	0.0
Restricted	143,999	76,907	73,588	67,092	87.2	3,319	4.5
Unrestricted	161,939	192,905	157,589	(30,966)	(16.1)	35,316	22.4
Total net position	\$ 834,672	\$ 798,518	\$ 759,758	\$ 36,154	4.5	\$ 38,760	5.1

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Net Position

The largest portion of the Harbors Division's net position (63.3% and 66.2% at June 30, 2017 and 2016, respectively), net investment in capital assets, represents its investment in capital assets (e.g., land, wharves, buildings, improvements, and equipment), less related indebtedness outstanding to acquire those capital assets. The Harbors Division uses these capital assets to provide services to its users of the harbors system; consequently, these assets are not available for future spending. Although the Harbors Division's net investment in its capital assets is reported net of related debt, the resources required to repay this debt must be provided annually from operations, since it is unlikely the capital assets themselves will be liquidated to pay for such liabilities.

The restricted portion of the Harbors Division's net position (17.3% and 9.6% at June 30, 2017 and 2016, respectively) represents bond reserve and other funds that are subject to external restrictions on how they may be used.

The unrestricted portion of the Harbors Division's net position (19.4% and 24.2% at June 30, 2017 and 2016, respectively) may be used to meet any of the Harbors Division's ongoing operations or to fund capital improvement projects.

The change in net position is an indicator of whether the overall fiscal condition of the Harbors Division improved or worsened during the fiscal year. The change in net position may serve over time as a useful indicator of the Harbor Division's financial position. Net position or the amount of total assets and deferred outflows of resources that exceed liabilities and deferred inflows of resources amounted to \$834.6 million at June 30, 2017, an increase in net position of \$36.7 million or 4.6% from 2016. Net position, as restated, amounted to \$797.9 million at June 30, 2016, an increase in net position of \$38.1 million or 5.0% from 2015.

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Capital Assets and Debt Administration

Capital Assets

As of June 30, 2017 and 2016, the Harbors Division had \$829.7 million and \$795.1 million, respectively invested in capital assets as shown in Table 3. There was a net increase (additions, deductions, and depreciation) of \$34.6 million in 2017 from the prior year, and a net increase in 2016 of \$14.6 million from 2015.

Table 3
Capital Assets
(In Thousands)

	As of June 30			2017-2016		2016-2015	
	2017	2016	2015	Increase (decrease)	% Change	Increase (decrease)	% Change
Land and land improvements	\$ 566,713	\$ 557,918	\$ 534,933	\$ 8,795	1.6%	\$ 22,985	4.3%
Wharves	278,758	269,153	269,153	9,605	3.6	-	-
Other improvements	91,114	91,114	91,114	-	-	-	-
Buildings	113,923	110,578	97,262	3,345	3.0	13,316	13.7
Equipment	25,831	20,865	19,109	4,966	23.8	1,756	9.2
Total at cost	1,076,339	1,049,628	1,011,571	26,711	2.5	38,057	3.8
Less accumulated depreciation	(386,017)	(355,149)	(329,165)	(30,868)	8.7	(25,984)	7.9
	690,322	694,479	682,406	(4,157)	(0.6)	12,073	1.8
Construction in progress	139,398	100,611	98,084	38,787	38.6	2,527	2.6
Total capital assets, net	\$ 829,720	\$ 795,090	\$ 780,490	\$ 34,630	4.4	\$ 14,600	1.9

Depreciation expense amounted to \$30.9 million and \$26.0 million for the fiscal years 2017 and 2016, respectively, an increase of \$4.9 million.

During 2017 and 2016, the Harbors Division wrote-off approximately \$0.7 million and \$3.1 million, respectively, of capital improvement project costs that have been deemed to have no future use nor continuing value for the Harbors Division. These project costs included expenditures for feasibility studies and other planning costs related to the Nawiliwili Harbor, the Hilo Harbor, the Hana Harbor, and the Honolulu Harbor.

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Major capital asset additions to the statewide harbors system for the fiscal year ended June 30, 2017, included the following:

- \$14.9 million Design and Construction of Piers 12 and 15 Improvements, Honolulu Harbor, Oahu Island
- \$1.4 million Piers 31a and 32 Installation of Fire Suppression System, Honolulu Harbor, Oahu Island
- \$2.0 million Improvements to a State-wide Maritime Wireless System

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

- \$47.0 million Design and Construction of Pier 4 Inter-island Cargo Terminal Facility, Hilo Harbor, Hawaii Island
- \$26.3 million Installation of Energy Conservation Measures

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

- \$15.4 million Land Acquisition and Design of Improvements, Kahului Harbor, Maui Island
- \$5.5 million Piers 24-28 Design and Coordination of Joint Development Agreement Area Improvements, Honolulu Harbor, Oahu Island
- \$7.0 million Pier 1 Shed Modifications Phase II, Hilo Harbor, Hawaii Island
- \$2.0 million Pier 2 Strengthening, Hilo Harbor, Hawaii Island
- \$300.0 million Kapalama Wharf and Pier Design, Honolulu Harbor, Oahu Island

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

- \$21.8 million Construction of Building and Yard Improvements at Piers 34 and 35, Honolulu Harbor, Oahu Island
- \$9.0 million Construction of Pier 2 Improvements, Kawaihae Harbor, Hawaii Island

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- \$4.4 million Construction of Improvements at Kumau St. Entrance Pier 4 Inter-island Cargo Terminal, Hilo Harbor, Hawaii Island
- \$465,000 Replacement of Bullrails at Pier 1, Kahului Harbor, Maui Island

In addition to those capital asset additions, during the fiscal year ended June 30, 2016, the Harbors Division was in the process of constructing the following projects statewide:

- \$47.0 million Design and Construction of Pier 4 Inter-island Cargo Terminal Facility, Hilo Harbor, Hawaii Island
- \$1.4 million Piers 31a and 32 Installation of Fire Suppression System, Honolulu Harbor, Oahu Island
- \$12.6 million Design and Construction of Piers 12 and 15 Improvements, Honolulu Harbor, Oahu Island
- \$26.3 million Installation of Energy Conservation Measures

In October 2017, the Harbors Division executed a contract in the amount of \$164,000,000 to construct the improvements for the Kapalama Container Terminal Yard project, Honolulu Harbor, Oahu Island.

The Harbors Division is committed under contracts awarded for capital improvement projects totaling \$46.7 million as of June 30, 2017.

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

Indebtedness

Harbors System Revenue Bonds and Reimbursable General Obligation Bonds

Harbor system revenue bonds have been issued pursuant to the *Certificate of the Director of Transportation Providing for the Issuance of 1997 State of Hawaii Harbor Revenue Bonds* (the 1997 Certificate) and are collateralized by a charge and lien on the Harbors Division's revenues. The proceeds from these bonds are used for harbor and waterfront improvements. As of June 30, 2017 and 2016, outstanding harbor system revenue bonds amounted to \$309.5 million and \$323.4 million, respectively.

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On December 6, 2016, the Harbors Division issued \$14,565,000 in Series 2016 A, \$68,535,000 in Series 2016 B, and \$8,135,000 in Series 2016 C Refunding Bonds (the Bonds). The Bonds bear interest from 1.99% to 2.89% with maturity dates through January 2031. The Series A 2016 Revenue Bonds refunded \$16,195,000 of 2004 B Bonds, the Series B 2016 Revenue Bonds refunded \$71,625,000 of 2006 A Bonds, and the Series C 2016 Revenue Bonds refunded \$7,365,000 of 2007 A Bonds. The refunding of 2004 B, 2006 A, and 2007 A Bonds provided net present value savings of approximately \$12,932,000.

On July 5, 2017, the Harbors Division issued \$22,425,000 in Series 2016 D Revenue Refunding Bonds (the Bonds). The Bonds bear interest at 3.09% with a maturity date of July 1, 2027, and refunded \$22,315,000 of 2007 A Bonds. The refunding of 2007 A Bonds provided net present value savings of approximately \$2,959,000.

Reimbursable general obligation bonds are general obligations of the State, but since the proceeds were used to finance the harbor and waterfront improvements, the Harbors Division is required to reimburse the State's general fund for the payment of principal and interest on such bonds. As of June 30, 2017 and 2016, outstanding reimbursable general obligation bonds amounted to \$25.4 million and \$27.4 million, respectively. There have been no issuances of reimbursable general obligation bonds to finance the harbor and waterfront improvements during fiscal years 2017 and 2016.

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

Credit Rating and Bond Insurance

All harbor system revenue bonds issued since 1997 through June 30, 2010 have been issued with bond insurance. A new reserve policy replaced all previously issued surety bonds and the portion of the reserve requirement allocable to the Series B of 2010 Revenue Bonds. The surety policy was amended effective August 2, 2013 to include the reserve requirement allocable to the Series A of 2013 Revenue Refunding Bonds. The Series A of 2010 Revenue Bonds are secured by a cash deposit of \$11.5 million. As of June 30, 2017, the underlying ratings for harbor system revenue bonds were as follows:

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

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

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Bond Covenants

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

The Harbors Division coverage ratio as of June 30, 2017 was 3.15 under the 1997 Certificate as compared to the ratio of 3.16 as of June 30, 2016.

Request for Information

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

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Statements of Net Position
June 30, 2017 and 2016

Assets:	2017	2016	Liabilities:	2017	2016
Current assets:			Current liabilities (payable from current assets):		
Cash and cash equivalents <i>(Note 3)</i>	\$ 208,340,548	\$ 235,715,532	Accounts payable <i>(Note 19)</i>	\$ 7,570,939	\$ 4,887,807
Receivables, less allowance for doubtful accounts of \$5,034,493 in 2017 and \$5,229,605 in 2016	11,521,736	11,017,620	Contracts payable, including retainages <i>(Note 19)</i>	1,857,111	3,406,648
Notes receivable, less allowance for doubtful accounts of \$3,760,600 in 2017 and \$3,777,650 in 2016 <i>(Notes 15 and 16)</i>	-	-	Accrued interest payable - capital lease obligation <i>(Note 9)</i>	554,699	-
Interest receivable	101,576	198,392	Accrued workers' compensation <i>(Notes 5 and 13)</i>	258,383	223,370
Due from other State agencies	-	613,599	Accrued vacation <i>(Note 5)</i>	724,575	727,397
Other current assets <i>(Note 9)</i>	8,465,522	59,872	Capital lease obligation <i>(Notes 5 and 9)</i>	716,734	-
	228,429,382	247,605,015	Due to other State agencies	8,410,930	3,209,549
				20,093,371	12,454,771
Restricted assets:			Current liabilities (payable from restricted assets):		
Cash and cash equivalents--restricted for debt service payments and reserve requirements <i>(Notes 3, 6, and 7)</i>	34,322,403	34,589,991	Contracts payable, including retainages	9,526,125	6,500,552
Total current assets	262,751,785	282,195,006	Revenue bonds payable, current maturities <i>(Notes 5, 6, and 7)</i>	16,034,641	15,138,483
Noncurrent assets:			General obligation bonds payable, current maturities <i>(Notes 5 and 8)</i>	2,122,232	2,022,854
Cash and cash equivalents--restricted for <i>(Notes 3 and 7):</i>			Accrued interest payable - revenue bonds <i>(Note 6)</i>	6,899,600	8,269,958
Capital improvement projects	167,286,516	123,626,575	Security deposits	2,426,748	2,322,297
Other	16,763,020	15,499,371		37,009,346	34,254,144
	184,049,536	139,125,946	Total current liabilities	57,102,717	46,708,915
Capital assets <i>(Notes 4, 9, and 17)</i>			Long-term liabilities:		
Nondepreciable assets	278,993,847	278,993,847	Accrued workers' compensation <i>(Notes 5 and 13)</i>	382,509	366,120
Depreciable assets, net	411,328,207	415,485,150	Net pension liability <i>(Notes 5 and 12)</i>	35,453,242	23,096,737
Construction in progress	139,398,063	100,611,285	Other postretirement benefits payable <i>(Notes 5 and 12)</i>	18,761,705	17,317,087
Total capital assets, net	829,720,117	795,090,282	Long-term debt, less current maturities:		
			Revenue bonds payable, net <i>(Notes 5, 6, and 7)</i>	293,712,804	308,624,361
Total noncurrent assets	1,013,769,653	934,216,228	General obligation bonds payable <i>(Notes 5 and 8)</i>	23,254,635	25,376,867
Total assets	1,276,521,438	1,216,411,234	Capital lease obligation <i>(Notes 5 and 9)</i>	26,275,925	-
			Accrued vacation <i>(Note 5)</i>	1,858,258	1,760,280
			Total long-term liabilities	399,699,078	376,541,452
			Total liabilities	456,801,795	423,250,367
Deferred Outflows of Resources:			Deferred Inflows of Resources:		
Deferred outflows related to pension <i>(Notes 2 and 12)</i>	12,053,213	3,438,916	Deferred inflows related to pension <i>(Note 12)</i>	621,673	1,550,401
Deferred charge on refunding, net <i>(Note 2)</i>	3,520,610	3,468,642			
Total deferred outflows of resources	15,573,823	6,907,558	Net Position:		
			Net investment in capital assets	528,733,989	528,706,431
			Restricted - revenue bond requirements	34,322,403	34,589,991
			Restricted - for capital improvement projects	109,676,283	42,316,502
			Unrestricted	161,939,118	192,905,100
			Total net position	\$ 834,671,793	\$ 798,518,024

See accompanying notes to financial statements.

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Statements of Revenues, Expenses, and Changes in Net Position

Years Ended June 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Operating revenues, net (<i>Note 6</i>):		
Services	\$ 113,161,394	\$ 105,975,067
Rentals (<i>Note 11</i>)	22,878,352	23,326,907
Others	1,581,308	823,814
	<u>137,621,054</u>	<u>130,125,788</u>
Operating expenses:		
Depreciation (<i>Note 4</i>)	30,868,569	26,032,754
Harbor operations (<i>Note 14</i>)	21,696,225	16,356,221
Personnel services (<i>Note 12</i>)	21,490,091	18,989,780
State of Hawaii, surcharge for central service expenses (<i>Note 15</i>)	4,900,977	4,262,892
Maintenance	3,994,558	4,403,290
General administration	2,944,090	2,565,691
Department of Transportation, general administration expenses (<i>Note 15</i>)	2,557,828	1,652,190
Other	-	99,640
	<u>88,452,338</u>	<u>74,362,458</u>
Operating income	<u>49,168,716</u>	<u>55,763,330</u>
Nonoperating revenues (expenses):		
Interest expense (<i>Notes 6, 8, and 10</i>)	(13,648,896)	(15,543,769)
Interest income (<i>Note 3</i>)	2,431,114	1,724,617
Amortization of bond premium, discount, and deferred charge on refunding, and bond issuance costs	(797,634)	(125,977)
Loss on disposal of capital assets	(713,542)	(3,057,783)
	<u>(12,728,958)</u>	<u>(17,002,912)</u>
Income before capital contributions and transfers	36,439,758	38,760,418
Capital contributions	300,000	-
Increase in net position	<u>36,739,758</u>	<u>38,760,418</u>
Net position, beginning of year, as previously reported	798,518,024	759,757,606
Restatement (<i>Note 2</i>)	(585,989)	-
Net position, beginning of year, as restated	<u>797,932,035</u>	<u>759,757,606</u>
Net position, end of year	<u>\$ 834,671,793</u>	<u>\$ 798,518,024</u>

See accompanying notes to financial statements.

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Statements of Cash Flows

Years Ended June 30, 2017 and 2016

	2017	2016
Cash flows from operating activities:		
Cash received from customers	\$ 142,071,368	\$ 129,855,049
Cash paid to suppliers	(34,997,469)	(26,350,102)
Cash paid to employees	(17,574,166)	(18,002,344)
Net cash provided by operating activities	89,499,733	85,502,603
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(41,186,616)	(46,787,554)
Principal paid on bonds	(107,157,854)	(16,102,016)
Proceeds from bond issuance	91,235,000	-
Interest paid on bonds	(17,637,175)	(18,442,086)
Net cash used in capital and related financing activities	(74,746,645)	(81,331,656)
Cash flows provided by investing activities:		
Interest received	2,527,930	1,900,256
Net increase in cash and cash equivalents	17,281,018	6,071,203
Cash and cash equivalents at beginning of year	409,431,469	403,360,266
Cash and cash equivalents at end of year	\$ 426,712,487	\$ 409,431,469

(Continued on following page)

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Statements of Cash Flows (Continued)

Years Ended June 30, 2017 and 2016

	2017	2016
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 49,168,716	\$ 55,763,330
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	30,868,569	26,032,754
Provision for doubtful accounts	(195,112)	698,457
Changes in assets, deferred outflows, liabilities, and deferred inflows:		
Receivables	304,595	(1,329,085)
Other current assets	59,872	24,723
Deferred outflows related to pension	(9,200,286)	(695,670)
Deferred charge on refunding	(965,001)	-
Payables	1,133,595	1,628,676
Accrued workers' compensation	51,402	207,256
Accrued vacation	95,156	254,736
Due to other State agencies	5,201,381	(23,237)
Security deposits	104,451	383,126
Net pension liability	12,356,505	1,501,883
Other postretirement benefits payable	1,444,618	2,024,882
Deferred inflows related to pension	(928,728)	(969,228)
Net cash provided by operating activities	\$ 89,499,733	\$ 85,502,603

Supplemental disclosure of noncash operating activities:

As described in Note 2, the adoption of GASB Statement No. 82, effective July 1, 2017, reduced net position as of June 30, 2016 by \$585,989 and the deferred outflows related to pension by \$585,989.

Supplemental disclosure of noncash capital and related financing activities:

Amounts included in contracts payable for the acquisition of capital assets	\$ 9,526,125	\$ 6,500,552
Interest capitalized in capital assets	\$ 3,919,715	\$ 2,543,479
Capital lease obligation	\$ 26,992,659	\$ -
Amortization of bond premium, discount, and deferred charge on refunding	\$ (797,634)	\$ (125,977)
Capital contributions	\$ 300,000	\$ -

See accompanying notes to financial statements.

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1. Financial Reporting Entity

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

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

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

2. Summary of Significant Accounting Policies

Measurement Focus and Basis of Accounting

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

An enterprise fund is used to account for the acquisition, operation, and maintenance of government facilities and services that are entirely or predominantly supported by user charges. The Harbors Division's operations are accounted for using the economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Cash and Cash Equivalents

Cash and cash equivalents include all cash and investments with original maturities of three months or less and amounts held in State Treasury.

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Amounts Held in State Treasury

The State's investments held in the State Treasury are reported at fair value within the fair value hierarchy established by GAAP. Investment earnings are allocated to the pool participants, including the Harbors Division, based upon their equity interest in the pooled monies.

Fair Value Measurements

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

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

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

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

Restricted Assets

Restricted assets consist primarily of amounts for the principal and interest accumulated to make debt service payments, amounts restricted for capital improvement projects including unspent bond proceeds, amounts restricted for bond reserve requirements, security deposits, and customer advances.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are reported at their gross value when earned, reduced by an allowance for doubtful accounts.

Accounts are written-off upon the approval of the State Department of the Attorney General, when it believes, after considering economic conditions, business conditions, and collection efforts, that the accounts are uncollectible.

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The allowance for doubtful accounts is increased by charges to operating income and decreased by charge-offs (net of recoveries). Management’s periodic evaluation of the adequacy of the allowance is based on the adverse situations that may affect the customer’s ability to repay, historical experience, and current economic conditions. Past due status is determined based on contractual terms.

Risk Management

The Harbors Division is exposed to various risks for losses related to, among other risks, torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and workers’ compensation. A liability for a claim for a risk of loss is established if information indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated.

Capital Assets and Depreciation

Capital assets are stated at cost. Depreciation of capital assets is computed using the straight-line method over the estimated useful lives of the assets. Disposals of assets are recorded by removing the cost and related accumulated depreciation from the accounts with the resulting gain or loss reflected in nonoperating revenues (expenses).

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

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

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

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Unamortized Debt Premium (Discount)

Debt premium (discount) is amortized using the effective interest rate method over the term of the related debt, and the unamortized balance is reflected as an addition or deduction to the related liabilities in the statements of net position.

Refunding of Debt

The difference between the reacquisition price and the net carrying amount of the old debt is deferred and amortized as a component of interest expense in a systematic and rational manner over the remaining life of the old debt or the life of the new debt, whichever is shorter. The deferred charge on refunding amounted to \$3,520,610 and \$3,468,642 at June 30, 2017 and 2016, respectively, and are reported as deferred outflows of resources in the statements of net position.

Deferred Outflows/Inflows of Resources

In addition to assets, the statements of net position will report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expense) until then. The Harbors Division's deferred outflows of resources consist of deferred outflows related to pension (see Note 12) and a deferred charge on refunding as described above.

In addition to liabilities, the statements of net position will report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time. The Harbors Division's deferred inflows of resources consist of deferred inflows related to pension (see Note 12).

Accrued Vacation

The Harbors Division accrues all vacation and compensatory pay at current salary rates, including additional amounts for certain salary-related expenses associated with the payment of compensated absences. Vacation is earned at the rate of 168 hours per calendar year, depending on an employee's date of hire. Accumulation of such vacation credits is limited to 720 hours at calendar year-end and is convertible to pay upon termination of employment.

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Net Position

Net position is reported in three categories as follows:

Net investment in capital assets - represents the Harbors Division's investment in capital assets, less related indebtedness outstanding to acquire those capital assets.

Restricted - represents bond reserve and capital project funds that are subject to external restrictions on how they may be used.

Unrestricted - may be used to meet any of the Harbors Division's ongoing operations or fund capital improvement projects.

Operating Revenues

Operating revenues are those that result from providing goods and services and are reported net of bad debt. The provision for (recovery of) bad debts for the years ended June 30, 2017 and 2016 was approximately (\$195,000) and \$698,500, respectively. Operating revenues also exclude revenues related to capital and related financing activities, noncapital financing activities, and investing activities.

The Harbors Division has pledged its future operating revenues, net of certain operating expenses, to repay \$309,470,000 in Harbor Revenue Bonds. Proceeds from the bonds provided financing for the construction of new facilities and the improvement of existing facilities related to the State's commercial harbors. The bonds are payable solely from the Harbors Division's operating revenues and are payable through July 2040.

The total principal and interest remaining to be paid on the bonds is approximately \$465,313,000. Principal and interest paid (as defined by the Harbor revenue bond debt service requirements under the 1997 certificate) and total operating revenues, net of certain operating expenses, were approximately \$31,176,000 and \$90,440,000 respectively, for the year ended June 30, 2017, and approximately \$31,187,000 and \$90,376,000 respectively, for the year ended June 30, 2016.

Operating Expenses

All expenses related to operating the Harbors Division are reported as operating expenses. Interest income, interest expense, gain (loss) on disposal of capital assets, and the amortization of bond premium, discount, and deferred charge on refunding are reported as nonoperating revenues (expenses).

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When an expense is incurred for which unrestricted and restricted resources are available to pay the expense, it is the Harbors Division's policy to apply the expense to unrestricted resources first, then to restricted resources.

Capital Contributions

The Harbors Division receives federal grants restricted for capital asset acquisition and facility development. Grants are considered earned as the related allowable expenditures are incurred, and are reported in the statements of revenues, expenses, and changes in net position, after nonoperating revenues (expenses) as capital contributions.

Pension

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pension, and pension expense, information about the fiduciary net position of the Harbor Division's participation in the Employees' Retirement System of the State of Hawaii (the ERS) and additions to/deductions from the ERS's fiduciary net position have been determined on the same basis as they are reported by the ERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with benefit terms. The ERS's investments are reported at fair value.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Significant estimates include the valuation of receivables, the estimated useful lives of capital assets, and reserves for net pension and postemployment benefits, and claims and judgments. Actual results could differ from those estimates.

Change in Accounting Principle

Effective July 1, 2016, the Harbors Division adopted the provisions of GASB Statement No. 82, *Pension Issues – An Amendment of GASB Statements No. 67, No. 68, and No. 73* (Statement No. 82). This statement addresses certain issues that have been raised with respect to GASB Statements No. 67, *Financial Reporting for Pension Plans*, No. 68, *Accounting and Financial Reporting for Pensions*, and No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement No. 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*.

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The Harbors Division reported the cumulative effect of this change in accounting principle by restating beginning net position in the accompanying 2017 financial statements. Specifically, the adoption of Statement No. 82 had the effect of decreasing net position as of June 30, 2016 by \$585,989. In addition, the Harbors Division reduced deferred outflows related to pension by \$585,989 as of June 30, 2017 in the accompanying financial statements.

Recently Issued Accounting Pronouncements

GASB Statement No. 75

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

This statement replaces the requirements of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (Statement No. 45), as amended, and GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, for OPEB. The Harbors Division is currently evaluating the impact that this statement will have on its financial statements.

GASB Statement No. 83

The GASB issued Statement No. 83, *Certain Asset Retirement Obligations*. This statement provides financial statement users with information about asset retirement obligations that were not addressed in GASB standards by establishing uniform accounting and financial reporting requirements for these obligations. The requirements of this statement are effective for reporting periods beginning after June 15, 2018. The Harbors Division is currently evaluating the impact that this statement will have on its financial statements.

GASB Statement No. 85

The GASB issued Statement No. 85, *Omnibus 2017*. The objective of this statement is to address practice issues that have been identified during the implementation and application of certain GASB statements. The requirements of this statement are effective for reporting periods beginning after June 15, 2017. The Harbors Division is currently evaluating the impact that this statement will have on its financial statements.

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GASB Statement No. 87

The GASB issued Statement No. 87, *Leases*. The objective of this statement is to improve accounting and financial reporting for leases by governments. This statement requires recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the lease agreements. The requirements of this statement are effective for reporting periods beginning after December 15, 2019. The Harbors Division is currently evaluating the impact that this statement will have on its financial statements.

3. Cash and Cash Equivalents

Cash and cash equivalents at June 30, 2017 and 2016 consisted of the following:

	<u>2017</u>	<u>2016</u>
Amounts held in State Treasury	\$ 424,509,267	\$ 406,008,171
Petty cash and other	<u>2,203,220</u>	<u>3,423,298</u>
	<u>\$ 426,712,487</u>	<u>\$ 409,431,469</u>

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Such amounts are reflected in the statements of net position at June 30, 2017 and 2016 as follows:

	2017	2016
Current assets:		
Unrestricted	\$ 208,340,548	\$ 235,715,532
Restricted:		
Revenue bond debt service payments	22,867,370	23,134,958
Revenue bond cash reserve requirements	11,455,033	11,455,033
Noncurrent assets:		
Restricted:		
Capital improvement projects:		
Construction - special purpose funds	109,676,283	42,316,502
Unspent bond proceeds	57,610,233	81,310,073
Other-bond reserve requirements and security deposits	16,763,020	15,499,371
	\$ 426,712,487	\$ 409,431,469

Amounts Held in State Treasury

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

At June 30, 2017 and 2016, amounts held in State Treasury by the Harbors Division totaled \$424,509,267 and \$406,008,171, respectively. The amounts held in State Treasury reported in the accompanying statements of net position reflects the Harbors Division's relative position in the State's investment pool based upon the average monthly investment balance of each participant in the investment pool.

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

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

	June 30, 2016			
	Reported Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Primary government:				
Investments measured by fair value level:				
U.S. government securities	\$ 2,079,266	\$ 948,149	\$ 1,131,117	\$ -
Mutual funds	36,214	36,214	-	-
	<u>2,115,480</u>	<u>\$ 984,363</u>	<u>\$ 1,131,117</u>	<u>\$ -</u>
Investments measured at amortized cost:				
Certificates of deposit	861,410			
Repurchase agreements	29,704			
Total investments	<u>\$ 3,006,594</u>			
Fiduciary funds:				
Investments measured by fair value level:				
Equity securities	\$ 303,129	\$ 303,129	\$ -	\$ -
U.S. government securities	157,539	71,838	85,701	-
Mutual funds	104,809	104,809	-	-
	<u>565,477</u>	<u>\$ 479,776</u>	<u>\$ 85,701</u>	<u>\$ -</u>
Investments measured by net asset value (NAV):				
Commingled funds:				
Domestic equity	294,662			
International equity	234,594			
Domestic core fixed income	175,886			
Domestic inflation-linked fixed income	199,848			
	<u>1,470,467</u>			
Investments measured at amortized cost:				
Certificates of deposit	65,266			
Repurchase agreements	2,250			
Total investments	<u>\$ 1,537,983</u>			

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Information relating to the fair value of investments in the State's investment pool at June 30, 2017 will be included in the State's CAFR when issued.

Cash and Cash Equivalents, Certificates of Deposit, and Repurchase Agreements

The State considers all cash and investments with original maturities of three months or less to be cash equivalents. The carrying amounts for cash equivalents, certificates of deposit, and repurchase agreements are measured at amortized cost.

Debt Securities, Equity Securities, Mutual Funds, and Commingled Funds

The following methods and assumptions were used by the State in estimating the fair value of its financial instruments:

Debt securities – Debt securities held by the State consist of U.S. government obligations including U.S. Treasury bills and U.S. Treasury notes and bonds. The fair value of these investments are based on quoted prices in active markets or other observable inputs, including pricing matrices. These investments are categorized in either Level 1 or 2 of the fair value hierarchy.

Equity securities – Equity securities held by the State are valued at the closing price reported on the active market on which the individual securities are traded. These investments are categorized in Level 1 of the fair value hierarchy.

Mutual funds – The mutual funds held by the State are open-ended mutual funds that are registered with the Securities Exchange Commission (SEC). The fair value of these mutual funds are valued at the daily closing price as reported by the fund. These funds are required to publish their daily NAV and to transact at that price. These investments are categorized in Level 1 of the fair value hierarchy.

Commingled funds – Investments in commingled funds are valued at the NAV of units of a bank commingled investment vehicle. The NAV is based on the fair value of the underlying assets held by the fund less its liabilities. The State has no unfunded commitments with regard to these commingled funds.

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

	Reported Value	Maturity (in years)		
		Less than 1	1-5	>5
Primary government:				
Certificates of deposit	\$ 861,410	\$ 829,635	\$ 31,775	\$ -
U.S. government securities	2,079,266	997,545	1,073,773	7,948
Repurchase agreements	29,704	29,704	-	-
	<u>2,970,380</u>	<u>\$ 1,856,884</u>	<u>\$ 1,105,548</u>	<u>\$ 7,948</u>
Mutual funds	36,214			
Total investments	<u>\$ 3,006,594</u>			
Fiduciary funds:				
Certificates of deposit	\$ 65,266	\$ 62,859	\$ 2,407	\$ -
U.S. government securities	157,539	75,581	81,356	602
Repurchase agreements	2,250	2,250	-	-
	<u>225,055</u>	<u>\$ 140,690</u>	<u>\$ 83,763</u>	<u>\$ 602</u>
Equity securities	303,129			
Mutual funds	104,809			
Commingled funds	904,990			
Total investments	<u>\$ 1,537,983</u>			

Information relating to the State's investment pool by maturity period at June 30, 2017 will be included in the State's CAFR when issued.

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.

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Credit Risk

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

Custodial Risk

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

Concentration of Credit Risk

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

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair value of an investment. The State's asset allocation and investment policy allows for active and passive investments in international securities. The foreign currency risk exposure to the State arises from the international equity, including commingled funds and common stocks.

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4. Capital Assets

Capital asset activity for the years ended June 30, 2017 and 2016 were as follows:

	Balance July 1, 2016	Additions	Deductions	Balance June 30, 2017
Nondepreciable assets:				
Land improvements	\$ 278,993,847	\$ -	\$ -	\$ 278,993,847
Depreciable assets:				
Land improvements	278,923,508	8,795,011	-	287,718,519
Wharves	269,153,315	9,605,017	-	278,758,332
Other improvements	91,114,188	-	-	91,114,188
Buildings	110,577,730	3,345,748	-	113,923,478
Equipment	20,865,200	4,965,850	-	25,831,050
Total at cost	<u>1,049,627,788</u>	<u>26,711,626</u>	<u>-</u>	<u>1,076,339,414</u>
Less accumulated depreciation for:				
Land improvements	99,455,043	9,273,498	-	108,728,541
Wharves	149,907,477	8,128,757	-	158,036,234
Other improvements	48,014,250	8,824,579	-	56,838,829
Buildings	43,452,552	2,876,424	-	46,328,976
Equipment	14,319,469	1,765,311	-	16,084,780
Total accumulated depreciation	<u>355,148,791</u>	<u>30,868,569</u>	<u>-</u>	<u>386,017,360</u>
Construction in progress	<u>100,611,285</u>	<u>65,017,339</u>	<u>(26,230,561)</u>	<u>139,398,063</u>
Total capital assets, net	<u>\$ 795,090,282</u>	<u>\$ 60,860,396</u>	<u>\$ (26,230,561)</u>	<u>\$ 829,720,117</u>

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	Balance July 1, 2015	Additions	Deductions	Balance June 30, 2016
Nondepreciable assets:				
Land improvements	\$ 278,993,847	\$ -	\$ -	\$ 278,993,847
Depreciable assets:				
Land improvements	255,938,370	22,985,138	-	278,923,508
Wharves	269,153,315	-	-	269,153,315
Other improvements	91,114,188	-	-	91,114,188
Buildings	97,262,046	13,315,684	-	110,577,730
Equipment	19,108,831	1,805,439	(49,070)	20,865,200
Total at cost	<u>1,011,570,597</u>	<u>38,106,261</u>	<u>(49,070)</u>	<u>1,049,627,788</u>
Less accumulated depreciation for:				
Land improvements	91,179,049	8,275,994	-	99,455,043
Wharves	141,610,421	8,297,056	-	149,907,477
Other improvements	42,833,247	5,181,003	-	48,014,250
Buildings	40,618,878	2,833,674	-	43,452,552
Equipment	12,923,512	1,445,027	(49,070)	14,319,469
Total accumulated depreciation	<u>329,165,107</u>	<u>26,032,754</u>	<u>(49,070)</u>	<u>355,148,791</u>
Construction in progress	<u>98,084,300</u>	<u>42,056,507</u>	<u>(39,529,522)</u>	<u>100,611,285</u>
Total capital assets, net	<u>\$ 780,489,790</u>	<u>\$ 54,130,014</u>	<u>\$ (39,529,522)</u>	<u>\$ 795,090,282</u>

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5. Long-Term Liabilities

The changes in long-term liabilities were as follows:

	Balance July 1, 2016	Additions	Deductions	Balance June 30, 2017	Current	Noncurrent
Accrued workers' compensation (Note 13)	\$ 589,490	\$ 799,901	\$ 748,499	\$ 640,892	\$ 258,383	\$ 382,509
Accrued vacation	2,487,677	1,056,582	961,426	2,582,833	724,575	1,858,258
Capital lease obligation (Note 9)	-	26,992,659	-	26,992,659	716,734	26,275,925
Net pension liability (Note 12)	23,096,737	14,402,263	2,045,758	35,453,242	-	35,453,242
Other postretirement benefits payable (Note 12)	17,317,087	3,388,458	1,943,840	18,761,705	-	18,761,705
General obligation bonds (Note 8)	27,399,721	-	2,022,854	25,376,867	2,122,232	23,254,635
Revenue bonds (Note 6)	323,370,000	91,235,000	105,135,000	309,470,000	15,970,000	293,500,000
Unamortized premium	392,844	-	115,399	277,445	64,641	212,804
Revenue bonds, net	<u>323,762,844</u>	<u>91,235,000</u>	<u>105,250,399</u>	<u>309,747,445</u>	<u>16,034,641</u>	<u>293,712,804</u>
	<u>\$ 394,653,556</u>	<u>\$ 137,874,863</u>	<u>\$ 112,972,776</u>	<u>\$ 419,555,643</u>	<u>\$ 19,856,565</u>	<u>\$ 399,699,078</u>

	Balance July 1, 2015	Additions	Deductions	Balance June 30, 2016	Current	Noncurrent
Accrued workers' compensation (Note 13)	\$ 382,234	\$ 349,925	\$ 142,669	\$ 589,490	\$ 223,370	\$ 366,120
Accrued vacation	2,232,941	1,222,945	968,209	2,487,677	727,397	1,760,280
Net pension liability (Note 12)	21,594,854	3,522,225	2,020,342	23,096,737	-	23,096,737
Other postretirement benefits payable (Note 12)	15,292,205	3,427,302	1,402,420	17,317,087	-	17,317,087
General obligation bonds (Note 8)	29,331,737	-	1,932,016	27,399,721	2,022,854	25,376,867
Revenue bonds (Note 6)	337,540,000	-	14,170,000	323,370,000	14,865,000	308,505,000
Unamortized premium	687,968	-	295,124	392,844	273,483	119,361
Revenue bonds, net	<u>338,227,968</u>	<u>-</u>	<u>14,465,124</u>	<u>323,762,844</u>	<u>15,138,483</u>	<u>308,624,361</u>
	<u>\$ 407,061,939</u>	<u>\$ 8,522,397</u>	<u>\$ 20,930,780</u>	<u>\$ 394,653,556</u>	<u>\$ 18,112,104</u>	<u>\$ 376,541,452</u>

6. Revenue Bonds Payable

Pursuant to authorization from the State Legislature, the Director of DOT issued the 1997 Certificate, which provides for the issuance of bonds at any time and from time-to-time upon compliance with certain conditions of the 1997 Certificate.

The Harbor Revenue Bonds (Revenue Bonds) are collateralized by a charge and lien on the revenues of the Public Undertaking as defined in the 1997 Certificate.

The Revenue Bonds are subject to redemption at the option of the Director of DOT and the State during specific years at prices ranging from 102% to 100% of face value.

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On December 6, 2016, the Harbors Division issued \$14,565,000 in Series 2016 A, \$68,535,000 in Series 2016 B, and \$8,135,000 in Series 2016 C Refunding Bonds (the Bonds). The Bonds bear interest from 1.99% to 2.89% with maturity dates through January 2031. The Series A 2016 Revenue Bonds refunded \$16,195,000 of 2004 B Bonds, the Series B 2016 Revenue Bonds refunded \$71,625,000 of 2006 A Bonds, and the Series C 2016 Revenue Bonds refunded \$7,365,000 of 2007 A Bonds. The refunding of 2004 B, 2006 A, and 2007 A Bonds provided net present value savings of approximately \$12,932,000.

The following is a summary of the Revenue Bonds issued and outstanding at June 30, 2017:

Year of Issue	Final Redemption Date	Interest Rate	Original Amount of Issue	Current		Total Current	Noncurrent
				Principal Due July 1, 2017	Principal Due January 1, 2018		
2007	July 1, 2027	5.25%	\$ 51,645,000	\$ 2,215,000	\$ -	\$ 2,215,000	\$ 22,315,000
2010	July 1, 2040	3.00-5.75%	201,390,000	7,165,000	-	7,165,000	165,770,000
2013	July 1, 2029	3.25%	23,615,000	1,050,000	-	1,050,000	19,720,000
2016	January 1, 2031	1.99%-2.89%	91,235,000	-	5,540,000	5,540,000	85,695,000
			<u>\$ 367,885,000</u>	<u>\$ 10,430,000</u>	<u>\$ 5,540,000</u>	15,970,000	293,500,000
				Unamortized premium		64,641	212,804
						<u>\$ 16,034,641</u>	<u>\$ 293,712,804</u>

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

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

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

<u>Fiscal Year Ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2018	\$ 15,970,000	\$ 13,390,863	\$ 29,360,863
2019	16,740,000	12,660,288	29,400,288
2020	17,345,000	12,054,376	29,399,376
2021	17,270,000	11,436,243	28,706,243
2022	18,065,000	10,754,984	28,819,984
2023-2027	79,570,000	44,206,306	123,776,306
2028-2032	63,585,000	29,168,122	92,753,122
2033-2037	39,885,000	17,392,234	57,277,234
2038-2041	41,040,000	4,779,281	45,819,281
	<u>\$ 309,470,000</u>	<u>\$ 155,842,697</u>	<u>\$ 465,312,697</u>

The debt service requirements reflect the sum of the amounts to be paid in accordance with the repayment schedules of the bonds issued. Principal and interest payments are required to be funded in the 12-month and 6-month periods, respectively, preceding the date on which the payments are due. Accordingly, the debt service requirements include reserves of \$22,867,370 as of June 30, 2017, for principal payments of \$10,430,000 and \$5,540,000 due on July 1, 2017 and January 1, 2018, respectively, and for interest payments \$6,897,370 due on July 1, 2017.

7. Harbor Revenue Bond Requirements

1997 Certificate – Minimum Net Revenue Requirement

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

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

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

The Harbor Revenue Bond debt service requirements, including minimum sinking fund payments during the current fiscal year, computed in accordance with Section 6.03 of the 1997 Certificate totaled \$31,176,410. Net revenues of the Public Undertaking, as defined by the 1997 Certificate amounted to \$98,267,034 or 3.15 times the minimum net revenue requirement for the fiscal year ended June 30, 2017, and \$98,681,251 or 3.16 times the minimum net revenue requirement for the fiscal year ended June 30, 2016.

Harbor Special Fund

All revenues are deposited into this fund and applied in the order of priority set forth under the 1997 Certificate. Section 5.01 of the 1997 Certificate requires that the following accounts be established:

- (1) *Harbor Interest Account*

Equal monthly installments sufficient to pay for the interest next becoming due on the Revenue Bonds are required to be paid into this account. This requirement was met as of June 30, 2017 and 2016.

- (2) *Harbor Principal Account*

Commencing with the first business day of each fiscal year, equal monthly payments are required to be made to this account sufficient to redeem the Revenue Bonds scheduled for redemption on the following July 1 and January 1. This requirement was met as of June 30, 2017 and 2016.

- (3) *Harbor Debt Service Reserve Account*

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

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

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

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

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(4) *Harbor Reserve and Contingency Account*

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

8. General Obligation Bonds

In fiscal 2006, the State issued \$350,000,000 of General Obligation bonds, Series DI, dated March 23, 2006; in fiscal 2007, the State issued \$350,000,000 of General Obligation bonds, Series DJ, dated March 28, 2007; and in fiscal 2008, the State issued \$375,000,000 of General Obligation bonds, Series DK, dated May 1, 2008. Interest rates on outstanding Series DI, Series DJ, and Series DK General Obligation bonds range from 4.00% to 5.00%.

Reimbursable general obligation bonds are general obligations of the State, but since the proceeds were used to finance the harbor and waterfront improvements, the Harbors Division is required to reimburse the State's general fund for the payment of principal and interest on such bonds. As of June 30, 2017 and 2016, outstanding reimbursable general obligation bonds amounted to approximately \$25,377,000 and \$27,400,000, respectively.

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

<u>Fiscal Year Ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2018	\$ 2,122,232	\$ 1,258,386	\$ 3,380,618
2019	2,227,919	1,152,889	3,380,808
2020	2,336,771	1,044,012	3,380,783
2021	2,450,903	929,861	3,380,764
2022	2,572,554	808,084	3,380,638
2023-2027	12,773,004	1,986,124	14,759,128
2028	893,484	43,869	937,353
	<u>\$ 25,376,867</u>	<u>\$ 7,223,225</u>	<u>\$ 32,600,092</u>

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9. Capital Lease Obligation

The Harbors Division entered into an equipment lease purchase agreement to fund the installation and acquisition of energy conservation measures at selected Harbors Division locations. Proceeds of \$26,245,564 were deposited into an acquisition fund held in trust by an acquisition fund custodian to provide for future payments as requested by the Harbors Division. The agreement also provided for the financing of interest expense through October 1, 2016 amounting to \$747,095, which applied toward the principal of the capital lease obligation. The capital lease obligation amounted to \$26,992,659 at June 30, 2017. Annual lease payments will commence on October 1, 2017 and continue through October 1, 2032 at an interest rate of 2.74%. Costs incurred for the installation and acquisition of energy conservation measures through June 30, 2017, which amounted to \$19,081,836, including additional capitalized interest of \$554,699 for the period October 2, 2016 through June 30, 2017, are included in construction in progress. Unused proceeds in the acquisition fund at June 30, 2017 amounted to \$8,465,522, and are reported as other current assets in the accompanying statements of financial position.

Future minimum lease commitments are as follows:

Fiscal Year Ending June 30	Principal	Interest	Total
2018	\$ 716,734	\$ 739,599	\$ 1,456,333
2019	812,396	719,960	1,532,356
2020	914,562	697,700	1,612,262
2021	1,023,606	672,642	1,696,248
2022	1,139,923	644,595	1,784,518
2023-2027	7,729,347	2,683,093	10,412,440
2028-2032	11,995,800	1,404,694	13,400,494
2033	2,660,291	72,893	2,733,184
	<u>\$ 26,992,659</u>	<u>\$ 7,635,176</u>	<u>\$ 34,627,835</u>

10. Interest Cost

Total combined interest cost incurred related to Revenue and General Obligation Bonds for the fiscal years ended June 30, 2017 and 2016 amounted to approximately \$16,267,000 and \$18,087,000, respectively. Of this amount, approximately \$2,618,000 and \$2,543,000 were capitalized during fiscal years ended June 30, 2017 and 2016, respectively, as part of the construction cost of harbor facilities.

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An additional \$1,302,000 of interest cost incurred related to the capital lease obligation (see Note 9) was capitalized for the fiscal year ended June 30, 2017.

11. Leasing Operations

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

The following is a schedule of approximate future minimum lease rentals on noncancelable operating leases as of June 30, 2017:

<u>Fiscal Year Ending June 30</u>	<u>Amount</u>
2018	\$ 5,726,000
2019	5,175,000
2020	5,152,000
2021	5,206,000
2022	5,270,000
2023-2027	25,206,000
2028-2032	22,979,000
2033-2037	16,455,000
2038-2042	11,120,000
2043-2047	7,343,000
2048-2052	2,617,000
2053-2057	2,481,000
2058-2059	517,000
	<u>\$ 115,247,000</u>

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

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12. Retirement Benefits

Pension Plan

Plan Description

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

Benefits Provided

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

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

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

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Noncontributory Class

Retirement Benefits

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

Disability Benefits

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

Death Benefits

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

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

Contributory Class for Members Hired Prior to July 1, 2012

Retirement Benefits

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

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

Disability Benefits

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

Death Benefits

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

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

Contributory Class for Members Hired After June 30, 2012

Retirement Benefits

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

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

Disability and Death Benefits

Members are eligible for service-related disability benefits regardless of length of service and receive a lifetime pension of 50% of their average final compensation plus refund of contributions and accrued interest. Ten years of credited service is required for ordinary disability. Ordinary disability benefits are 1.75% of average final compensation for each year of service for police officers and firefighters and are payable immediately, without an actuarial reduction, at a minimum of 30% of average final compensation.

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

Hybrid Class for Members Hired Prior to July 1, 2012

Retirement Benefits

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

Disability Benefits

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

Death Benefits

For service-connected deaths, the designated surviving spouse/reciprocal beneficiary receives a lump sum payment of the member's contributions and accrued interest plus a monthly benefit of 50% of the average final compensation until remarriage or re-entry into a new reciprocal

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beneficiary relationship. If there is no surviving spouse/reciprocal beneficiary, surviving dependent children (up to age 18) or dependent parents are eligible for the monthly benefit. If there is no spouse/reciprocal beneficiary or dependent children/parents, the ordinary death benefit is payable to the designated beneficiary.

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

Hybrid Class for Members Hired After June 30, 2012

Retirement Benefits

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

Disability and Death Benefits

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

Contributions

Contributions are established by HRS Chapter 88 and may be amended through legislation. The employer rate is set by statute based on the recommendations of the ERS actuary resulting from an experience study conducted every five years. Since July 1, 2005, the employer contribution rate is a fixed percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liabilities. The contribution rates for fiscal years 2017 and 2016 were 25.0% for police officers and firefighters, and 17.0% for all other employees. Contributions to the

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ERS from the Harbors Division were \$2,084,894 and \$2,045,758 for the fiscal years ended June 30, 2017 and 2016, respectively.

On May 18, 2017, the Governor signed into law Act 17 SLH 2017. Per Act 17, future employer contributions from the State and counties are expected to increase pursuant to a phased-in contribution rate increase over four years beginning July 1, 2017. The rate for police and firefighters increases to 28.0% on July 1, 2017; 31.0% on July 1, 2018; 36.0% on July 1, 2019; and 41.0% on July 1, 2020, and the rate for all other employees increases to 18.0% on July 1, 2017; 19.0% on July 1, 2018; 22.0% on July 1, 2019; and 24.0% on July 1, 2020.

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

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

Measurement of the actuarial valuation of the pension liability, pension expense, and deferred outflows of resources and deferred inflows of resources related to pension is made for the State as a whole and is not separately computed for the individual state departments and agencies such as the Harbors Division. The State allocates the pension liability, pension expense, and deferred outflows of resources and deferred inflows of resources related to pension to the various departments and agencies based upon a systematic methodology. Additional disclosures and required supplementary information stipulated by Statement Nos. 68 and 71 pertaining to the State's net pension liability, pension expense, and deferred outflows of resources and deferred inflows of resources related to pension can be found in the State's CAFR.

At June 30, 2017 and 2016, the Harbors Division reported a net pension liability of \$35,453,242 and \$23,096,737, respectively, for its proportionate share of the State's net pension liability. The net pension liability was measured as of June 30, 2016 and 2015, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of those dates.

At June 30, 2017 and 2016, the Harbors Division's share of the State's net pension liability at June 30, 2016 was 0.48%.

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There were significant changes in actuarial assumptions effective June 30, 2016 based on the Five-Year Experience Study report dated July 5, 2016, that resulted in a significant increase in the measurement of the total pension liability. Primary drivers for the increase include a decrease in the investment return assumption and discount rate from 7.65% as of June 30, 2015 to 7.00% as of June 30, 2016; and a decrease in the mortality assumptions for longer life expectancy and an explicit assumption for continued future mortality improvement (generational approach).

There were no other changes between the measurement date, June 30, 2016, and the reporting date, June 30, 2017, that are expected to have a significant effect on the Harbors Division's proportionate share of the State's net pension liability.

For the years ended June 30, 2017 and 2016, the Harbors Division recognized pension expense of \$4,327,549 and \$1,918,220, respectively. At June 30, 2017 and 2016, the Harbors Division reported deferred outflows of resources and deferred inflows of resources related to pension from the following sources:

	Deferred Outflows of Resources	
	2017	2016
Contributions subsequent to the measurement date	\$ 2,084,894	\$ 2,631,747
Changes in assumptions	6,823,098	555,934
Net difference between projected and actual earnings on pension plan investments	2,298,626	-
Differences between expected and actual experience	725,969	220,525
Changes in proportion and differences between contributions and proportionate share of contributions	120,626	30,710
	<u>\$ 12,053,213</u>	<u>\$ 3,438,916</u>

	Deferred Inflows of Resources	
	2017	2016
Differences between expected and actual experience	\$ 508,894	\$ 655,113
Changes in proportion and differences between contributions and proportionate share of contributions	112,779	145,798
Net difference between projected and actual earnings on pension plan investments	-	749,490
	<u>\$ 621,673</u>	<u>\$ 1,550,401</u>

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The \$2,084,894 reported as deferred outflows of resources related to pension at June 30, 2017 resulting from the Harbors Division’s contributions subsequent to the measurement date will be recognized as a reduction of net pension liability in the year ended June 30, 2018. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pension at June 30, 2017 will be recognized in pension expense as follows:

Year Ended June 30:

2018	\$ 1,775,863
2019	1,775,863
2020	2,430,128
2021	2,149,728
2022	<u>1,215,064</u>
	<u><u>\$ 9,346,646</u></u>

Actuarial Assumptions

The total pension liability in the June 30, 2016 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	2.50%
Payroll growth rate	3.50%
Investment rate of return	7.00% compounded annually including inflation

There were no changes to ad hoc postemployment benefits including cost of living adjustments.

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

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The long-term expected rate of return on pension plan investments was determined using a "top down approach" of the Bespoke Client-Constrained Simulation-based Optimization Model (a statistical technique known as "re-sampling with a replacement" that directly keys in on specific plan-level risk factors as stipulated by the ERS Board) in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.

The target allocation and best estimates of geometric real rates of return for each major asset class are summarized in the following table:

Strategic Allocation (Risk-based Classes)	Target Allocation	Long-term Expected Geometric Rate of Return
Broad growth	63.00%	8.35%
Principal protection	7.00%	2.20%
Real return	10.00%	6.15%
Crisis risk offset	20.00%	5.50%
	<u>100.00%</u>	

Discount Rate

The discount rate used to measure the net pension liability was 7.00%, a decrease from the 7.65% rate used at the prior measurement date. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current contribution rate and that contributions from the State, which includes the Harbors Division, will be made at statutorily required rates, actuarially determined. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

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Sensitivity of the Harbors Division's Proportionate Share of the State's Net Pension Liability to Changes in the Discount Rate

The following presents the Harbors Division's proportionate share of the State's net pension liability calculated using the discount rate of 7.00%, as well as what the Harbors Division's proportionate share of the State's net pension liability would be if it were calculated using a discount rate that is one-percentage point lower (6.00%) or one-percentage point higher (8.00%) than the current rate:

	1% Decrease (6.00%)	Discount Rate (7.00%)	1% Increase (8.00%)
Harbor Division's proportionate share of the State's net pension liability	\$ 46,457,457	\$ 35,453,242	\$ 27,934,089

Pension Plan Fiduciary Net Position

The pension plan's fiduciary net position is determined on the same basis used by the pension plan. The ERS financial statements are prepared using the accrual basis of accounting under which expenses are recorded when the liability is incurred, and revenues are recorded in the period in which they are earned and become measurable. Employer and member contributions are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan. Investment purchases and sales are recorded as of their trade date. Administrative expenses are financed exclusively with investment income.

There were no significant changes after the report measurement date. Detailed information about the pension plan's fiduciary net position is available in the separately issued ERS financial report. ERS's complete financial statements are available at <http://www.ers.ehawaii.gov>.

Postemployment Health Care and Life Insurance Benefits

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

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

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

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

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

Measurement of the actuarial valuation and the annual required contribution (ARC) is made for the State as a whole in accordance with Statement No. 45 and is not separately computed for the individual state departments and agencies such as the Harbors Division. The actuarial valuation was performed as of July 1, 2015. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and to amortize any unfunded actuarial liabilities over a period not to exceed 30 years. The State allocates the ARC to the various departments and agencies based upon a systematic methodology.

The Harbors Division's contributions for the years ended June 30, 2017, 2016, and 2015 were approximately \$1,944,000, \$1,402,000, and \$1,162,000, respectively, which represents 57.4%, 40.9%, and 35.4%, respectively, of the ARC.

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The table below summarizes the components of the annual OPEB cost that have been allocated to the Harbors Division by the State for the years ended June 30, 2017 and 2016:

	2017	2016
Annual required contribution	\$ 3,389,000	\$ 3,427,000
Contribution made	(1,944,000)	(1,402,000)
Increase in net OPEB obligation	1,445,000	2,025,000
Net OPEB obligation, beginning of the year	17,317,000	15,292,000
Net OPEB obligation, end of the year	\$ 18,762,000	\$ 17,317,000
Actual contributions made as a percentage of ARC	57.4%	40.9%

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Actuarially determined amounts are subject to continual revisions as actual results are compared with past expectations and new estimates are made about the future.

Refer to State's CAFR for the methods and assumptions used by the State, required footnote disclosures, and required supplementary information in accordance with the provisions of Statement No. 45.

Act 268, SLH 2013, requires the EUTF to establish and administer separate trust accounts for each public employer for the purpose of receiving irrevocable employer contributions to prefund post-employment health and other benefit costs for retirees and their beneficiaries. It establishes the Hawaii EUTF Trust Fund Task Force to examine further steps to address the unfunded liability and requires all public employers to make annual required public employer contributions effective fiscal year 2014.

Commencing fiscal year 2019, the annual public employer contribution shall be equal to the annual required contribution, as determined by an actuary retained by the EUTF board. In any fiscal year, should an employer's contribution be less than the annual required public employer contribution, the difference shall be transferred to the appropriate trust account from a portion of all general excise tax revenues, for the State, or transient accommodations tax revenues, for the counties.

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The EUTF issues an annual financial report that is available to the public. That report may be obtained by writing to the EUTF at P.O. Box 2121, Honolulu, Hawaii 96805-2121.

Deferred Compensation Plan

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

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

13. Risk Management

The Harbors Division is exposed to various risks of loss related to, among other risks, torts; theft of, damage to, or destruction of assets; errors and omissions; and workers' compensation. The Harbors Division records a liability for insurance related losses if it is determined that a loss has been incurred and the amount can be reasonably estimated.

The State retains various risks and insures certain excess layers with commercial insurance companies. 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 ten fiscal years.

The State has an insurance policy with a variety of insurers in a variety of layers 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 terrorism, which is \$50,000,000 per occurrence and a \$10,000 deductible.

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

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General liability claims (including torts) up to \$10,000 and automobile claims up to \$15,000 are handled by the State's Risk Management Office. All other claims are handled by the State Department of the Attorney General. 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 \$7,500,000 and for crime loss, \$10,000,000 with no aggregate limit.

The Harbors Division obtained coverage for certain strategic piers and wharves infrastructure to mitigate its exposure to natural disasters from hurricane, earthquake, and flood (including a tsunami) events. The amount of insurance provided by this difference in conditions policy is \$30,000,000 on an annual aggregate basis on a shared perils basis, subject to a \$5,000,000 deductible per occurrence.

The State generally self-insures for its automobile no-fault and workers' compensation losses. A liability for workers' compensation and general liability claims is established if information indicates that a loss has been incurred as of June 30, 2017, and the amount of the loss can be reasonably estimated. The liability also includes an estimate for amounts incurred but not reported.

Amounts reported are subject to the impact of future changes in economic and social conditions. The Harbors Division believes that, given the inherent variability in any such estimates, the reserves are within a reasonable and acceptable range of adequacy. Reserves are continually monitored and reviewed, and as settlements are made and reserves adjusted, the differences are reported in current operations. Accrued workers' compensation amounted to approximately \$641,000 and \$589,000 at June 30, 2017 and 2016, respectively.

14. Ceded Lands

In previous years, the State was a defendant in a lawsuit filed by the Office of Hawaiian Affairs (OHA) related to the determination of ceded land payments due to OHA. During 2006, the State of Hawaii Supreme Court reaffirmed the dismissal of the lawsuit by OHA.

In 2006, the Legislature enacted Act 178, SLH 2006 (Act 178), to re-establish a mechanism for OHA to receive a portion of the income and proceeds from the Ceded Lands, for native Hawaiians, under Article XII, Sections 4 and 6 of the Hawaii Constitution. Among other things, Act 178 directs state agencies that collect receipts from the Ceded Lands to annually transfer a total of \$15,100,000 in four equal quarterly installments to OHA, and directs the Governor to issue an executive order to establish procedures for this purpose. The Governor issued Executive Order No. 06-06 on September 20, 2006.

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On April 11, 2012, the Governor signed Act 15, SLH 2012 (Act 15), into law. Act 15 conveys fee simple title to nine parcels of land located at Kakaako in Honolulu, valued at approximately \$200,000,000, to OHA, as of July 1, 2012. Act 15 also satisfies, resolves, discharges, releases, waives, extinguishes, prohibits, and bars, finally and completely, any and all claims, disputes, controversies, rights, actions, and causes of action, OHA (or parties claiming through OHA) has asserted or could have asserted to the income and proceeds from the Ceded Lands, under Article XII, Sections 4 and 6 of the Hawaii Constitution or any related statute or act, between November 7, 1978 (the date Article XII, Sections 4, 5, and 6 of the Hawaii Constitution were ratified) and June 30, 2012. Act 15 also withdrew any waiver of sovereign immunity the State may previously have made with respect to OHA's portion of receipts from the Ceded Lands, and affirms that the State does not waive its sovereign immunity to permit a claim or suit to be brought to invalidate the act's operative provisions.

Until the Legislature alters the amount or establishes a different means for implementing Article XII, Sections 4 and 6 of the Hawaii Constitution, Act 178 serves as the means for satisfying the State's obligation to provide OHA with a portion of the income and proceeds from the Ceded Lands, for native Hawaiians.

Included in the Harbors Division's operating expenses in the accompanying statements of revenues, expenses, and changes in net position for the fiscal years ended June 30, 2017 and 2016 are approximately \$13,539,000 and \$6,747,000, respectively, of OHA ceded land expenses.

The Harbors Division was notified in March, 2014 that OHA contracted a consultant to conduct an audit of public land trust revenues of all state agencies, including the Harbors Division, for the fiscal year ended June 30, 2012. While, the audit report was issued in October 2014, the ultimate outcome of the audit is not known.

In November 2016, the Harbors Division was notified that OHA contracted a new consultant to conduct an audit of public land trust revenues of all state agencies, including the Harbors Division, for the fiscal year ended June 30, 2016. Final issuance of the report is pending.

15. Transactions with Other Government Agencies

The State assesses a surcharge of 5% for central service expenses on all receipts of the Harbors Division, after deducting any amounts pledged, charged, or encumbered for the payment of bonds and interest during the fiscal year. The assessments amounted to approximately \$4,901,000 and \$4,263,000 for the fiscal years ended June 30, 2017 and 2016, respectively.

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The Harbors Division is assessed a percentage of DOT's general administration expenses. The assessments amounted to approximately \$2,558,000 and \$1,652,000 for the fiscal years ended June 30, 2017 and 2016, respectively.

The Hawaii Harbors Task Force was formed in April 2005 by the Governor's office to respond on a priority basis to the pressing demands for infrastructure improvements in Honolulu Harbor. The Aloha Tower Development Corporation (ATDC) was tasked to work in partnership with the Harbors Division with the executive officer of the ATDC serving as the chief executive of the Hawaii Harbors Project Office. The ATDC was assigned to plan and execute major long-term redevelopment projects such as the former Kapalama Military Reservation and various projects at Honolulu Harbor. ATDC was an agency attached to the Department of Business, Economic Development & Tourism (DBEDT).

Act 200, SLH 2008, was enacted to authorize a statewide Harbors Modernization Plan (HMP) to address harbor infrastructure improvements to Kahului Harbor on Maui, Nawiliwili Harbor on Kauai, Hilo and Kawaihae Harbors on Hawaii, and Honolulu and Kalaeloa Harbors on Oahu. In addition to the six commercial harbors included in the plan, the law placed Hana Harbor on Maui under the jurisdiction of the Harbors System and included appropriations for its upgrade. The Act authorizes the DOT to issue harbor revenue bonds to finance the improvements. The cost of the Harbors Modernization Plan, originally estimated at \$842 million, was revised to \$618 million in 2008. Act 200 also designated the ATDC as the entity responsible for the management and implementation of the HMP under the direction of the DOT.

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

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

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Special Fund pursuant to Act 152. The \$2.8 million offset a portion of the \$7.8 million balance owed by ATDC to the Harbors Division for losses in revenue, obligations which were operating expenses for ATDC.

16. Aloha Tower Complex Development

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

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

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

On January 18, 2006, an Agreement amending the Aloha Tower Project Memorandum of Understanding and Aloha Tower Ground Lease was executed, effective as of June 30, 2005, and retroactive to July 1, 2004 (the Amendment). The Amendment required ATDC to pay \$225,000 as a minimum annual base payment for losses in revenues owing in the fiscal year beginning July 1, 2004. From July 1, 2005, subject to the approval of the Deputy Director for the Harbors Division, the base payment of \$225,000 was to be reduced by expenses incurred by ATDC for the Hawaii Harbors Project Office. The Amendment also required an equity participation payment to be made in an amount of 50% of the difference between the total revenues and total operating expenses of

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ATDC for a fiscal year (the equity payment), provided that if the equity payment exceeds two and one-half times the actual operating expenses of ATDC. These payments were to be applied to reduce the amount owed to the Harbors Division for losses in revenues by ATDC prior to July 1, 2004. The balance owed to the Harbors Division by ATDC under this Amendment as of June 30, 2017 and 2016 was approximately \$3,761,000, and is included in notes receivable, net of allowance for doubtful accounts for the entire amount, in the accompanying statements of net position.

At its meeting on July 13, 2011, the ATDC Board approved the transfer of the leasehold interest of the Marketplace to a new operator, Hawaii Lifestyle Retail Properties, (HLRP). HLRP is a limited liability company that consisted at that time of two legal entities, Lifestyle Retail Properties LLC (LRP) and Hawaii Downtown Holdings LLC (HDH); HDH being solely owned by Hawaii Pacific University (HPU). After the transfer of the lease to HLRP in mid 2011, ATDC discussed various development proposals with HLRP culminating in a memorandum of understanding (MOU) dated December 15, 2011. In the 2012 Hawaii Legislative Session, HPU received legislative support for the issuance of special purpose revenue bonds for improvements to their facilities. In mid 2012, a dispute arose among the owners of HLRP which ultimately resulted in HDH buying out LRP's interest in HLRP and HDH taking control of the leasehold interest in late 2012. The terms of ATDC's MOU with HLRP, which were performance-based and had not been met, terminated on January 1, 2014. Since the resolution of the owners' dispute within HLRP, HLRP has been reformulating its plans for improvements to the Marketplace leasehold property.

Subsequent to the year ended June 30, 2014, the State, by its Interim Director of the DOT, entered into a successor MOU with the ATDC and HLRP whereby ATDC agreed to abate rent under the lease between ATDC and HLRP for the period retroactive to July 1, 2014 to June 30, 2015 in consideration for the construction of HLRP improvements to create student and faculty residences and various university spaces for Hawaii Pacific University and to memorialize the understanding of the parties with respect to various aspects of its agreement.

The successor memorandum of understanding also amended the punchlist obligations owed to the Harbors Division which had a total value of \$3.5 million, depending upon when actual payments are made by the operator within a six year timeframe ending June 2017. The amendment provided that in consideration of ATDC's issuance of any renewed leases, HLRP shall pay the Harbors Division the sum of \$1,750,000 on or before December 31, 2021.

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17. Kapalama Land Development

Between 1990 and 1993, the State acquired three parcels of land totaling approximately 61.8 acres within the Kapalama Military Reservation area, comprised primarily of areas adjacent or near to Piers 39 through 41 at Honolulu Harbor (the KMR site).

Governor's Executive Order No. 3497 set aside two parcels comprising 40.6 acres to the Harbors Division for harbor purposes on September 24, 2002. The set-aside of the remaining 21.2 acre parcel is pending. This parcel was purchased for approximately \$34.9 million and involved the use of approximately \$8.2 million of the Department of Transportation, Airports Division's (Airports Division) funds. There have been ongoing efforts between the Harbors Division and Airports Division to resolve the use of the parcel and the \$8.2 million in Airport Division's funds. As a result, action on the issuance of the Executive Order for the remaining parcel was deferred until the matter could be resolved.

Plans for the future development of the KMR site will involve the creation of a new cargo container yard and vessel berthing piers. This project is a key priority under the HMP. The Federal Aviation Administration (FAA) review of the matter led to findings that the use of airport funds towards the purchase of KMR did not represent a permitted use of airport revenue. If Airports Division could not be provided with an equitable amount of land equal to its \$8.2 million investment, the FAA considered the \$8.2 million to be a loan. Due to the importance of the KMR site in serving maritime interests, both divisions and the FAA reached an agreement for the Harbors Division to pay approximately \$9,603,000, of which \$8,191,000 was capitalized as land and improvements, and the remaining balance recorded as interest expense. The Harbors Division paid Airports Division these amounts owed in September 2011. On November 13, 2015, the Harbors Division initiated action to obtain an Executive Order for the set aside of the 21.2 acre KMR parcel.

During the fiscal year ended June 30, 2017, both divisions continued its discussions to resolve the use of approximately 11.344 acres of ceded lands under the management and control of the Airports Division that are located near the KMR site of which a portion is planned for inclusion into the KMR container yard development.

Both divisions executed an agreement on December 12, 2017, subject to the FAA's approval, which established the acceptance of the value of these approximately 11.344 acres at \$32,820,000. This agreement requires that the full sum of \$32,820,000 must be remitted by no later than June 30, 2019, with the initial payment of \$16,410,000 to be made no later than June 30, 2018. The divisions also executed a Revocable Permit, i.e., a tenancy agreement as of November 1, 2017, which allows the Harbors Division access to the 11.344 acres and requires monthly installments of approximately \$145,000 to be paid by the Harbors Division to the Airports Division. These installment payments will be applied cumulatively towards the payment of the aforementioned \$32,820,000.

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18. Arbitrage

The Harbors Division is required to annually calculate rebates to the U.S. Treasury on the Revenue Bonds issued from 1986. In accordance with the requirements of Section 148 of Internal Revenue Code of 1986, as amended, rebates are calculated by bond series based on the amount by which the cumulative amount of investment income exceeds the amount that would have been earned had funds been invested at the bond yield. In the opinion of management, rebates payable as of June 30, 2017 and 2016, if any, are not material to the financial statements. Accordingly, no rebates payable have been recorded in the accompanying financial statements.

19. Commitments and Contingencies

Construction and Other Contracts

The Harbors Division is committed under contracts awarded for construction and other services. These commitments amounted to approximately \$62,578,000 and \$103,029,000 at June 30, 2017 and 2016, respectively.

Accumulated Sick Leave Pay

Employees earn sick leave credits at the rate of 14 hours for each month of service depending on the employee's hire date. Unused sick leave may be accumulated without limitation and is not convertible to pay upon termination of employment. Accordingly, no liability for sick pay is recorded. However, for public employees who retire or leave government service in good standing with sixty days or more of unused sick leave, the unused sick leave is converted to additional retirement service credit at the rate of one additional month of service for each 20 days of unused sick leave. The accumulated sick leave liabilities as of June 30, 2017 and 2016 were approximately \$6,057,000 and \$6,044,000, respectively.

Environmental Issues

Iwilei District Participating Parties

The Harbors Division is subject to laws and regulations relating to the protection of the environment. The Harbors Division has been identified by the State Department of Health as a potentially responsible party for petroleum contamination in the Honolulu Harbor/Iwilei area. Pursuant thereto, the Harbors Division entered into a voluntary agreement with the Department of Health and other third parties to share in the responsibility for the investigation and potential remediation of petroleum contamination in the Iwilei District. This group of potentially responsible parties, known as the Iwilei District Participating Parties (IDPP), has conducted various

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investigations to determine potential contamination in the Iwilei area from 1997 to present, which investigations have determined the existence of petroleum contamination at various locations. The remediation alternative selected involves the management of the contamination in-place with limited extraction, plume monitoring, active institutional controls including education/awareness and outreach of landowners, potential developers and utility operators, and reimbursement of future incremental project costs attributable to the contamination. However, the project has not yet advanced to the stage where total costs to the IDPP can reasonably be estimated due to: (1) the extent of the environmental impact, (2) the undetermined allocation among the potentially responsible parties, and (3) the continued discussion with the regulatory authorities. Although it is not possible to reasonably estimate the Harbors Division cost liability until these items have been resolved, the Harbors Division, in accordance with GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations* (GASB 49), accrued only for the estimated cost of the studies and investigations allocated to the Harbors Division of approximately \$2,599,000 as of June 30, 2017.

Environmental Protection Agency

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

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

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

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Harbors Division entered into an agreement with Weston Solutions, Inc., an international environmental consulting firm, to assist in negotiating the Compliance Measures for a cost of approximately \$600,000, which was amended during fiscal year 2015 to \$900,000, of which has been fully paid as of June 30, 2017. The Harbors Division has also entered into an agreement with EnviroServices and Training Center LLC, a Hawaii environmental consulting firm, to assist the Harbors Division in implementing the Compliance Measures at a cost of approximately \$400,000 which was later amended to \$800,000, of which approximately \$545,000 has been paid as of June 30, 2017.

Litigation

The Harbors Division is subject to a number of lawsuits arising in the ordinary course of its operations. While the ultimate liabilities, if any, in the disposition of these matters are presently difficult to estimate, it is management's belief that the outcomes are not likely to have a material adverse effect on the Harbors Division's financial position. Accordingly, no provisions for any liabilities that might result have been made in the accompanying financial statements.

20. Subsequent Events

On July 5, 2017, the Harbors Division issued \$22,425,000 in Series 2016 D Revenue Refunding Bonds (the Bonds). The Bonds bear interest at 3.09% with a maturity date of July 1, 2027. Proceeds of the Bonds were used to refund \$22,315,000 of 2007 A Bonds. The refunding of 2007 A Bonds provided net present value savings of approximately \$2,959,000.

The Harbors Division has evaluated subsequent events from the statements of net position date through December 21, 2017 the date at which the financial statements were available to be issued, and determined that there are no other items to disclose.

SUPPLEMENTARY INFORMATION

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Cash and Cash Equivalents of the Public Undertaking

June 30, 2017

Unrestricted cash and cash equivalents	<u>\$ 208,340,548</u>
Restricted cash and cash equivalents:	
For construction—special purpose funds	109,676,283
For construction—revenue bonds	57,610,233
For revenue bond debt service payments	22,867,370
For cash reserve requirement for Series A of 2010 revenue bonds	11,455,033
For revenue bond harbors reserve and contingency account	10,897,658
For security deposits	2,426,748
For risk management and other	<u>3,438,614</u>
	<u>218,371,939</u>
	<u><u>\$ 426,712,487</u></u>
With Director of Finance, State of Hawaii	\$ 424,509,267
On hand	<u>2,203,220</u>
	<u><u>\$ 426,712,487</u></u>

See accompanying independent auditors' report.

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Revenue Bonds of the Public Undertaking

June 30, 2017

	<u>Final Redemption Date</u>	<u>Interest Rate</u>	<u>Original Amount of Issue</u>	<u>Balance at June 30, 2017</u>		
				<u>Current</u>	<u>Noncurrent</u>	<u>Total</u>
Issue of 2007	July 1, 2027	5.25%	\$ 51,645,000	\$ 2,215,000	\$ 22,315,000	\$ 24,530,000
Issue of 2010	July 1, 2040	3.00-5.75%	201,390,000	7,165,000	165,770,000	172,935,000
Issue of 2013	July 1, 2029	3.25%	23,615,000	1,050,000	19,720,000	20,770,000
Issue of 2016 Series A	January 1, 2024	1.99%	14,565,000	1,940,000	12,625,000	14,565,000
Issue of 2016 Series B	January 1, 2031	2.46-2.89%	68,535,000	3,600,000	64,935,000	68,535,000
Issue of 2016 Series C	July 1, 2020	2.34%	8,135,000	-	8,135,000	8,135,000
			<u>\$ 367,885,000</u>	<u>\$ 15,970,000</u>	<u>\$ 293,500,000</u>	<u>\$ 309,470,000</u>

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Income from Operations Before Depreciation

Year Ended June 30, 2017

	District										Total
	Oahu		Hawaii			Maui		Kauai			
	Statewide	Honolulu	Kalaheo	Hilo	Kawaihae	Kahului	Kaunakakai	Kaunapali	Nawiliwili	Port Allen	
Operating revenues, net:											
Services:											
Wharfage	\$ -	\$ 74,095,097	\$ 3,205,949	\$ 3,684,704	\$ 3,969,913	\$ 7,001,802	\$ 257,436	\$ 284,608	\$ 2,907,180	\$ -	\$ 95,406,689
Pax debark/embark	-	3,282,256	-	2,110,620	4,425	1,114,508	4,823	-	1,626,341	-	8,142,973
Dockage	-	3,007,046	651,156	261,796	106,933	422,563	15,361	4,560	395,132	2,556	4,867,103
Demurrage	-	1,405,204	-	325,628	224,530	105,605	-	-	16,747	71	2,077,785
Mooring charges	-	541,894	-	15,144	33,160	431	2,925	-	-	672,847	1,266,401
Port entry	-	638,384	114,348	74,772	38,757	92,669	11,172	4,703	66,568	2,516	1,043,889
Cleaning charges	-	279,827	122	-	-	-	-	-	-	-	279,949
Other services	-	56,107	25	2,321	4,357	1,870	-	-	1,107	10,818	76,605
Total services	-	83,305,815	3,971,600	6,474,985	4,382,075	8,739,448	291,717	293,871	5,013,075	688,808	113,161,394
Rentals:											
Wharf space and land	-	5,535,083	2,280,466	68,288	398,969	200,124	14,610	300	353,495	242,698	9,094,033
Storage	-	5,526,305	134,333	380,910	341,151	719,791	2,954	-	253,214	12,518	7,371,176
Automobile parking	-	1,009,170	1,452	85,463	8,897	159,805	903	-	85,090	8,909	1,359,689
Pipeline water	-	107,099	4,571	38,706	1,031	74,983	-	-	54,841	-	281,231
Other pipeline	-	1,150,898	1,535,893	706,280	117,129	882,796	16,516	-	255,123	107,588	4,772,223
Total rentals	-	13,328,555	3,956,715	1,279,647	867,177	2,037,499	34,983	300	1,001,763	371,713	22,878,352
Others:											
Sale of utilities	-	319,880	124,693	31,074	1,104	81,263	-	-	39,837	9,348	607,199
Miscellaneous	-	889,681	840	8,405	5,717	61,906	6,989	-	111	460	974,109
Total others	-	1,209,561	125,533	39,479	6,821	143,169	6,989	-	39,948	9,808	1,581,308
Total operating revenues	-	97,843,931	8,053,848	7,794,111	5,256,073	10,920,116	333,689	294,171	6,054,786	1,070,329	137,621,054
Operating expenses before depreciation expense:											
Harbor operations	13,567,079	5,058,364	615,094	535,071	456,418	805,626	13,601	1,550	608,907	34,515	21,696,225
Personnel services	9,866,799	7,913,629	212,201	1,010,070	84,088	1,157,848	61,627	-	1,124,480	59,349	21,490,091
State of Hawaii, surcharge for central service expenses	4,900,977	-	-	-	-	-	-	-	-	-	4,900,977
Maintenance	409,726	2,217,608	(57,078)	412,083	63,312	192,547	92,754	13,324	639,305	10,977	3,994,558
General administration	2,412,876	163,287	2,118	30,102	9,367	303,868	491	432	20,185	1,364	2,944,090
Department of Transportation, general administration expenses	2,557,828	-	-	-	-	-	-	-	-	-	2,557,828
Subtotal	33,715,285	15,352,888	772,335	1,987,326	613,185	2,459,889	168,473	15,306	2,392,877	106,205	57,583,769
Allocation of statewide expenses (1)	(33,715,285)	23,970,432	1,973,083	1,909,451	1,287,666	2,675,280	81,749	72,068	1,483,340	262,216	-
Total operating expenses before depreciation expense	-	39,323,320	2,745,418	3,896,777	1,900,851	5,135,169	250,222	87,374	3,876,217	368,421	57,583,769
Income from operations before depreciation expense	\$ -	\$ 58,520,611	\$ 5,308,430	\$ 3,897,334	\$ 3,355,222	\$ 5,784,947	\$ 83,467	\$ 206,797	\$ 2,178,569	\$ 701,908	\$ 80,037,285

Note (1): Statewide expenses are allocated to the Harbors Division based upon their respective current year operating revenues to total current year operating revenues for all Harbors.

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Harbor Revenue Bonds 1997 Certificate – Minimum Net Revenue
Requirement of the Public Undertaking

Year Ended June 30, 2017

Net revenues, as defined by the 1997 Certificate:

Operating income before depreciation expense	\$ 80,037,285
Add:	
Interest income	2,431,114
State of Hawaii, surcharge for central service expenses	4,900,977
Cash available in the harbor reserve and contingency account	10,897,658
	\$ 98,267,034

Harbor revenue bond debt service requirements under the 1997 Certificate, including minimum sinking fund payments	\$ 31,176,410
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Ratio of net revenues to harbor revenue bond debt service requirements	3.15
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See accompanying independent auditors' report.

PART III

INTERNAL CONTROL AND COMPLIANCE SECTION

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

The Auditor
State of Hawaii:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the statements of net position of the Harbors Division, Department of Transportation, State of Hawaii (the Harbors Division), as of June 30, 2017 and 2016, and the related statements of revenues, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to financial statements, which collectively comprise the Harbors Division's basic financial statements, and have issued our report thereon dated December 21, 2017.

Internal Control over Financial Reporting

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

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

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

Compliance and Other Matters

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

Purpose of this Report

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

KKDL LLC

Honolulu, Hawaii
December 21, 2017