# Department of Health
# Water Pollution Control Revolving Fund
# State of Hawaii

Financial Statements
June 30, 2018
Together with Independent Auditor's Report

Submitted by

THE AUDITOR
STATE OF HAWAII

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## PART I

## FINANCIAL SECTION

KMHLLP

A Hawaii Limited Liability Partnership

**Independent Auditor's Report**

To the Auditor
State of Hawaii

**Report on the Financial Statements**

We have audited the accompanying financial statements of the State of Hawaii, Water Pollution Control Revolving Fund (WPCRF) as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise the WPCRF's basic financial statements as listed in the table of contents.

**Management's Responsibility for the Financial Statements**

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

**Auditor's Responsibility**

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

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

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



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## Opinion

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

## Emphasis of Matters

As discussed in Note B, the financial statements of WPCRF, are intended to present the financial position, the changes in financial position and cash flows of only that portion of the business-type activities and proprietary fund type activities of the State of Hawaii and the State of Hawaii, Department of Health that are attributable to the transactions of WPCRF. They do not purport to, and do not, present fairly the respective financial position of the State of Hawaii and the State of Hawaii, Department of Health as of June 30, 2018, and the respective changes in its financial position, or its cash flows for the fiscal year 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.

As discussed in Note B to the financial statements of WPCRF, in 2018 the WPCRF adopted Governmental Accounting Standards Board Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions*. As a result of adopting this standard the net position at July 1, 2017 has been restated. Our opinion is not modified with respect to this matter.

## Other Matters

*Required Supplementary Information*

Management has omitted the management's discussion and analysis, the schedule of proportionate share of the net pension liability, the schedule of contributions and the schedule of funding progress that accounting principles generally accepted in the United States of America require to be presented to supplement basic financial statements.

Such missing 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. Our opinion on the basic financial statements is not affected by this missing information.

*Other Information*

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the WPCRF's basic financial statements. The supplementary information on pages 39 to 42 are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The supplementary information 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 audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the 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 is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

The schedule of expenditures of federal awards 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 audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the 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 schedule of expenditures of federal awards 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 November 30, 2018 on our consideration of the WPCRF's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the WPCRF’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 WPCRF’s internal control over financial reporting and compliance.

KMH LLP

KMH LLP

Honolulu, Hawaii
November 30, 2018

## Department of Health
## Water Pollution Control Revolving Fund
## State of Hawaii

Statement of Net Position
June 30, 2018

**Assets and Deferred Outflows of Resources**

| | |
|---|---|
| Current Assets: | |
| Equity in cash and cash equivalents and investments in State Treasury | $ 170,393,501 |
| Loan fees receivable | 353,923 |
| Accrued interest on loans | 325,841 |
| Other accrued interest | 31,780 |
| Due from State Treasury | 1,101,722 |
| Current maturities of loans receivable | 31,059,585 |
| Total current assets | 203,266,352 |
| Loans Receivable, net of current maturities | 321,166,074 |
| Capital Assets, net of accumulated depreciation | 8,712 |
| Total assets | 524,441,138 |
| Deferred Outflows of Resources | 1,232,652 |
| Total assets and deferred outflows of resources | $ 525,673,790 |

**Liabilities, Deferred Inflows of Resources, and Net Position**

| | |
|---|---|
| Current Liabilites: | |
| Accounts Payable and Other Accrued Liabilities | $ 215,954 |
| Accrued Vacation, net of current portion | 194,330 |
| Net Pension Liability | 3,757,650 |
| Other Postemployment Benefits | 3,706,469 |
| Total liabilities | 7,874,403 |
| Deferred Inflows of Resources | 51,736 |
| Net Position: | |
| Net investment in capital assets | 8,712 |
| Restricted - expendable | 517,738,939 |
| Total net position | 517,747,651 |
| Total liabilities, deferred inflows of resources, and net position | $ 525,673,790 |

See accompanying notes to the financial statements.

# Department of Health
# Water Pollution Control Revolving Fund
# State of Hawaii

Statement of Revenues, Expenses and Changes in Net Position
For the Year Ended June 30, 2018

| | |
|---|---|
| Operating Revenues: | |
| Interest income from loans | $ 1,317,117 |
| Administrative loan fees | 1,721,338 |
| Total operating revenue | 3,038,455 |
| Operating Expense: | |
| Administrative | 2,433,539 |
| Operating income | 604,916 |
| Nonoperating Revenues: | |
| State contributions | 2,070,000 |
| Federal contributions | 208,306 |
| Other interest income | 1,614,257 |
| Other income | 15,321 |
| Total nonoperating revenues | 3,907,884 |
| Change in net position | 4,512,800 |
| Net Position: | |
| Beginning of fiscal year, as previously reported | 515,096,701 |
| Restatement due to change in accounting principle | (1,861,850) |
| Beginning of fiscal year, as restated | 513,234,851 |
| End of fiscal year | $ 517,747,651 |

See accompanying notes to the financial statements.

**Department of Health**
**Water Pollution Control Revolving Fund**
**State of Hawaii**

Statement of Cash Flows
For the Year Ended June 30, 2018

| | |
|---|---|
| Cash Flows from Operating Activities: | |
| Payments to employees | $ (1,788,859) |
| Payments to vendors | (128,055) |
| Net cash used in operating activities | (1,916,914) |
| Cash Flows from Noncapital Financing Activity: | |
| State Contributions | 2,070,000 |
| Cash Flows from Investing Activities: | |
| Principal repayments on loans | 32,891,401 |
| Disbursement of loan proceeds | (19,170,189) |
| Interest income from loans | 1,354,879 |
| Administrative loan fees | 1,725,348 |
| Other interest income | 981,059 |
| Net cash provided by investing activities | 17,782,498 |
| Net increase in cash | 17,935,584 |
| Equity in Cash and Cash Equivalents and Investments in State Treasury: | |
| Beginning of fiscal year | 152,457,917 |
| End of fiscal year | $ 170,393,501 |

See accompanying notes to the financial statements.

**Department of Health**
**Water Pollution Control Revolving Fund**
**State of Hawaii**

Statement of Cash Flows (continued)
For the Year Ended June 30, 2018

| | |
|---|---|
| Reconciliation of operating income to net cash used in operating activities: | |
| Operating income | $ 604,916 |
| Adjustment to reconcile operating income to net cash used in operating activities | |
| Depreciation | 1,237 |
| Interest income from loans | (1,317,117) |
| Administrative loan fees | (1,721,338) |
| In-kind contribution from Environmental Protection Agency | 208,306 |
| Non-imposed fringe benefits | 15,320 |
| Change in assets, deferred outflows of resources, liabilities, and deferred inflows of resources: | |
| Due from State Treasury | (3,830) |
| Accounts payable and other accrued liabilities | (16,121) |
| Net deferred outflows/inflows of resources related to pensions | 359,507 |
| Net pension liability | (92,775) |
| Other postemployment benefits | 44,981 |
| Net cash used in operating activities | $ (1,916,914) |

See accompanying notes to the financial statements.

## NOTE A - ESTABLISHMENT AND PURPOSE OF THE FUND

In accordance with the Clean Water Act of 1987 (the Act), the U.S. Environmental Protection Agency's (EPA) direct grants for the construction of wastewater treatment works ended in 1990. The Act provides for the creation of a State Revolving Fund (SRF) loan program to be capitalized in part by federal funds. The Act authorizes states to make loans for construction of publicly owned wastewater treatment works, for implementation of a non-point source pollution control management program and for implementation of an estuary conservation and management program. The SRF serves as the major federal funding source for future wastewater construction projects. Under the Act, from 1989 to 1994, the State of Hawaii (State) received more than $72 million in SRF capitalization grants. The Act expired on September 30, 1995, however the state continues to receive SRF capitalization grants annually from the U.S. EPA and to date, has been awarded over $304.6 million.

In 1988, the Hawaii State Legislature established the State Water Pollution Control Revolving Fund (WPCRF or Fund) to initiate the federal loan program. The purpose of the WPCRF is to provide loans in perpetuity to county and state agencies for the construction of wastewater treatment facilities and for non-point source projects. Such loans may be at or below market interest rates and be fully amortized for a period not to exceed twenty years. Prior to July 1, 2015, the first repayment of principal and interest occurs no later than one year after the notice to proceed for construction or the final agreement date, whichever is later. Beginning July 1, 2015, the first repayment of principal and interest occurs no later than one year after the final loan disbursement, one year after the project completion date or three years after the final agreement date, whichever is earliest. The Fund is administered by the Wastewater Branch, Environmental Management Division of the Department of Health (DOH), State of Hawaii.

## NOTE B - SIGNIFICANT ACCOUNTING POLICIES

### 1. Financial Statement Presentation

The accompanying financial statements are intended to present the financial position, results of operations and cash flows of only that portion of the State and DOH that is attributable to the transactions of WPCRF and do not purport to present the financial position, results of operation or cash flows of the State or DOH.

The accompanying financial statements of the WPCRF have been prepared in conformity with accounting principles generally accepted in the United States of America prescribed by the Governmental Accounting Standards Board (GASB).

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES (continued)**

**2. Measurement Focus and Basis of Accounting**

The accompanying financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are reported when earned and expenses are reported when a liability is incurred, regardless of the timing of the related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services or goods in connection with a proprietary fund's principal ongoing operation. Revenues and expenses not meeting this definition are reported as non-operating revenues and expenses. The principal operating revenues of the WPCRF are interest income and administrative loan fees on loans made to county governments. Federal grants, state matching funds, and interest income from investments are reported as non-operating revenue. Principal forgiveness for loans is reported as operating expenses.

**3. Use of Estimates**

In preparing financial statements in conformity with accounting principles generally accepted in the United States, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. These estimates, among others, include the allowance for uncollectible accounts, depreciable lives of capital assets, and the pensions and other postemployment benefits (OPEB) liability.

**4. Equity in Cash and Cash Equivalents and investments in State Treasury**

All monies of the WPCRF are deposited into the state treasury. The state Director of Finance is responsible for the safekeeping of cash in the state treasury in accordance with state laws. The Director of Finance may invest any monies of the state, which in the Director's judgment are in excess of the amounts necessary for meeting the immediate requirements of the state.

Effective August 1, 1999, cash was pooled with funds from other state agencies and departments and deposited into approved financial institutions or participates in the State Treasury Investment Pool System. Cash accounts that participate in the investment pool accrue interest based on the average weighted cash balances of each account. At June 30, 2018, information relating to the

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES (continued)**

types, insurance, collateral, and related interest rate, credit and custodial risks of funds deposited with the State Treasury was not available since such information is determined on a statewide basis and not for individual departments. The State requires that the depository banks pledge, as collateral, government securities held in the name of the state for deposits not covered by federal deposit insurance.

**5. Loans Receivable**

Loans made to the counties are funded by federal capitalization grants, State matching funds, repayments and investment interest income. Loan funds are disbursed to local agencies as they expend for the purposes of the loan, and request reimbursement from the Fund. Interest is calculated from the date that loan funds are disbursed, and after the final disbursement has been made, the payment schedule identified in the loan agreement is adjusted for the actual amounts disbursed, and interest accrued during the project period. The capitalization grants for federal fiscal years 2010 through 2017 allow for portions of loans to be forgiven upon satisfaction of certain requirements.

**6. Administrative Loan Fees**

The administrative loan fee program pays for the Fund’s administration, including employee salaries and benefits. The program applies an administrative loan fee to all loans as provided for in Chapter 11-65 of the Hawaii Administrative Rules.

**7. Capital Assets**

Management capitalizes an asset if the cost is in excess of $5,000 and the useful life exceeds one year. Purchased capital assets are valued at cost. Donated assets are recorded at their fair market value at the date of donation.

Depreciation expense is recorded in the financial statements. The straight-line method is utilized over the asset’s estimated useful life. Generally, the useful life is three to seven years.

**8. Accrued Vacation**

Employees earn vacation leave at a rate of 14 hours for each month of service. Vacation leave can be accumulated up to a maximum of 720 hours at the end of the calendar year and is convertible to pay upon termination of service.

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES (continued)**

Included in accrued vacation is compensatory time off (CTO). Employees may elect to take CTO in lieu of cash payment for overtime worked. CTO can be accumulated up to 240 hours.

**9. Accumulated Sick Leave**

Sick leave accumulates at a rate of 14 hours for each month of service without limit, but may be taken only in the event of an illness and is not convertible to pay upon termination of employment. However, an employee who leaves government service in good standing with 60 days or more of unused sick leave is entitled to additional service credit in the Employees' Retirement System (ERS). At June 30, 2018, accumulated sick leave was approximately $862,500.

**10. Net Position**

Net position are restricted when constraints placed on them are either externally imposed or imposed by constitutional provisions or enabling legislation. Internally imposed designations of resources are not presented as restricted net position. When both restricted and unrestricted resources are available for use, generally, it is management's policy to use restricted resources first, then unrestricted resources as they are needed.

WPCRF's net position is classified into two net position categories.

*Net investment in capital assets* consists of capital assets, net of accumulated depreciation and outstanding debt attributable to the acquisition, construction or improvement of those assets.

*Restricted-expendable* consists of restricted assets less liabilities whose use by WPCRF are subject to externally-imposed stipulations that can be fulfilled by actions of WPCRF pursuant to those stipulations or that expire by the passage of time.

**11. Administration Costs**

The accompanying financial statements do not reflect certain administrative costs incurred which are paid for by other sources of funding from DOH. These costs include the DOH and State's overhead costs which DOH does not assess to WPCRF, since they are not practical to determine.

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES (continued)**

**12. Fund Accounts**

The WPCRF consists of the SRF and state activity. The SRF consists of the state match, federal capitalization grant loans, federal set-aside funds, Water Resources Reform and Development Act (WRRDA) administrative funds, principal loan repayments, and interest from loans and investments. The State activity consists of administration loan fees and state loan funds.

**13. Expenses**

The statement of revenues, expenses and changes in net position presents expenses on a functional basis. The natural classifications of expenses are presented in the supplementary schedule of operating expenses.

**14. Deferred Outflows of Resources and Deferred Inflows of Resources**

Deferred outflows of resources represent a consumption of net position that applies to a future period and will not be recognized as an outflow of resources (expense) until that time. Deferred inflows of resources represent an acquisition of net position that applies to a future period and will not be recognized as an inflow of resources (revenue) until that time. The following is a breakdown of deferred outflows of resources and deferred inflows of resources as of June 30, 2018:

| | Deferred Outflows of Resources | Deferred Inflows of Resources |
|---|---|---|
| Related to Pensions | $ 1,013,110 | $ (47,105) |
| Related to Other Postemployment Benefits | 219,542 | (4,631) |
| | $ 1,232,652 | $ (51,736) |

**15. Pensions**

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the 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. Investments are reported at their fair value.

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES (continued)**

**16. Other Post-employment Benefits**

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

**17. Due from State Treasury**

Due from State Treasury includes amounts due from other State departments and agencies, which were not received at the end of the fiscal year.

**18. New Accounting Pronouncements**

During fiscal year 2018, the WPCRF implemented GASB Statement No. 75 (GASB 75), *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. The Statement replaces GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions,* and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*. The Statement required the liability of employers for defined benefit OPEB to be measured as the portion of the present value of projected benefit payments to be provided to current active and inactive employees that is attributed to those employees' past periods of service, less the amount of the OPEB plan's fiduciary net position.

Adoption of GASB 75 has resulted in the restatement of the WPCRF's fiscal year 2017 financial statements to reflect the reporting of a net OPEB liability and deferred outflows of resources related to OPEB in accordance with the provisions of GASB 75. As of July 1, 2017, the WPCRF recorded a net OPEB liability and deferred outflows of resources related to OPEB of $3,661,488 and $184,246, respectively. The impact of the restatement to beginning net position is as follows:

| | 2017 (As Previously Reported) | Restatement Adjustment | 2017 (As Restated) |
|---|---|---|---|
| Net position at beginning of year | $ 515,096,701 | $(1,861,850) | $ 513,234,851 |

## NOTE C - LOANS RECEIVABLE

At June 30, 2018, the WPCRF had loans receivable from the following government entities:

| | |
|---|---|
| Fifteen loans with the City & County of Honolulu; due in annual or semiannual payments, including interest ranging from 0.00% to 2.96%, commencing not later than one year after project completion, notice to proceed, final loan disbursement or three years after loan agreement date. Final payment is due not later than twenty years after project completion date. | $ 230,299,155 |
| Eight loans with the County of Hawaii; due in annual or semiannual payments, including interest ranging from 0.25% to 0.50%, commencing not later than one year after project completion, notice to proceed, final loan disbursement or three years after loan agreement date. Final payment is due not later than twenty years after project completion date. | 35,647,870 |
| Twenty-eight loans with the County of Maui; due in annual or semiannual payments, including interest ranging from 0.25% to 0.50%, commencing not later than one year after project completion, notice to proceed, final loan disbursement or three years after loan agreement date. Final payment is due not later than twenty years after project completion date | 62,121,823 |
| Ten loans with the County of Kauai; due in semiannual or quarterly payments, including interest ranging from 0.25% to 2.13%, commencing not later than one year after project completion, notice to proceed, final loan disbursement or three years after loan agreement date. Final payment is due not later than twenty years after project completion date. | 24,156,811 |
| | 352,225,659 |
| Less: current maturities | (31,059,585) |
| | $ 321,166,074 |

**NOTE C - LOANS RECEIVABLE (continued)**

Loans are expected to mature at various dates through 2039. The scheduled principal payments on loans maturing in subsequent years are as follows:

| Fiscal Years Ending, | Amount |
|---|---|
| 2019 | $ 31,059,585 |
| 2020 | 29,952,400 |
| 2021 | 29,852,115 |
| 2022 | 29,798,719 |
| 2023 | 29,067,322 |
| 2024-2028 | 131,840,464 |
| 2029-2033 | 59,118,413 |
| 2034-2039 | 11,524,029 |
| 2040 | 12,612 |
| | $ 352,225,659 |

Management believes that all loans will be repaid according to the loan terms or portions will be forgiven upon satisfaction of certain requirements; accordingly, no provision for uncollectible amounts has been recorded.

In fiscal year 2018, no loans were forgiven. Loans and advances forgiven are performed in accordance with the required conditions.

As of June 30, 2018, the WPCRF were committed under existing loan agreements to the following counties:

| | |
|---|---|
| City & County of Honolulu | $ 32,333,482 |
| County of Hawaii | 15,282,850 |
| County of Maui | 17,260,684 |
| County of Kauai | 3,700,000 |
| | $ 68,577,016 |

## NOTE D – CONTRIBUTED CAPITAL

The WPCRF is capitalized by grants from EPA and matching funds from the State. The following summarizes the EPA capitalization grants, amounts drawn on each grant, and the balances available for future loans at June 30, 2018:

| Budget Period | Amount | Total Draws at June 30, 2017 | EPA Draws | Total 2018 Cash Draws | Funds Available |
|---|---|---|---|---|---|
| 10/01/16-06/30/20 | $ 10,348,000 | $ 10,348,000 | $ - | $ - | $ - |
| 10/01/17-06/30/21 | 10,268,000 | - | 850,000 | - | 9,418,000 |
| | $ 20,616,000 | $ 10,348,000 | $ 850,000 | $ - | $ 9,418,000 |

The State is required to match 20 percent of the estimated amount of the grant from the EPA and does so in the year that the capitalization grant is awarded. Through June 30, 2018, the Fund was in compliance with the 20 percent State matching requirement. The required State match through June 30, 2018 approximated $60.9 million, of which the entire amount has been utilized.

## NOTE E – CAPITAL ASSETS

Capital asset activity for the fiscal year ended June 30, 2018 was as follows:

| | Balance at July 1, 2017 | Additions | Retirements/ Disposals | Balance at June 30, 2018 |
|---|---|---|---|---|
| Equipment | $ 84,518 | $ 8,898 | $ (32,452) | $ 60,964 |
| Accumulated Depreciation | (83,467) | (1,237) | 32,452 | (52,252) |
| | $ 1,051 | $ 7,661 | $ - | $ 8,712 |

## NOTE F – ACCRUED VACATION

The changes to the accrued vacation liability during 2018 were as follows:

| | |
|---|---|
| Balance at July 1, 2017 | $ 255,063 |
| Increase | 86,009 |
| Decrease | (76,247) |
| Balance at June 30, 2018 | 264,825 |
| Less: Current portion | (70,495) |
| Noncurrent portion | $ 194,330 |

## NOTE G - EMPLOYEE BENEFIT PLANS

### 1. Employees' Retirement System

***Plan Description***

Generally, all full-time employees of the State and counties 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 Hawaii Revised Statutes (HRS) Chapter 88 and can be amended through legislation. The ERS issues publicly available annual financial reports that can be obtained at ERS' website: http://www.ers.ehawaii.gov.

***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 members 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.

**NOTE G - EMPLOYEE BENEFIT PLANS (continued)**

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

*Noncontributory Class*

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

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

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

  Ordinary death benefits are available to employees who were active at 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 the 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.

**NOTE G - EMPLOYEE BENEFIT PLANS (continued)**

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.

**NOTE G - EMPLOYEE BENEFIT PLANS (continued)**

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

- Disability and Death Benefits - Members are eligible for service-related disability benefits regardless of length of service and receive a lifetime pension of 50% of their average final compensation plus refund of contributions and accrued interest. Ten years of credited service is required for ordinary disability. Ordinary disability benefits are 3% of average final compensation for each year of service for judges and elected officers and 1.75% of average final compensation for each year of service for police officers and firefighters and are payable immediately, without an actuarial reduction, at a minimum of 30% of average final compensation.

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

*Hybrid Class for Members Hired Prior to July 1, 2012*

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

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

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

**NOTE G - EMPLOYEE BENEFIT PLANS (continued)**

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 governed 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 year 2018 were 25.00% for police and firefighters and 17.00% for all other employees. Contributions to the pension plan from the Fund were $194,777 for the fiscal year ended June 30, 2018.

**NOTE G - EMPLOYEE BENEFIT PLANS (continued)**

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 all employees, except for police officers and firefighters, increases to 18.00% on July 1, 2017; 19.00% on July 1, 2018; 22.00% on July 1, 2019; and 24.00% 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 Pensions***

At June 30, 2018, the WPCRF reported a liability of $3,757,650 for its proportionate share of net pension liability of the State. The net pension liability was measured as of June 30, 2017, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The State's proportion of the net pension liability was based on a projection of the State's long-term share of contributions to the pension plan relative to projected contributions of all participants, actuarially determined. The WPCRF's proportion of the net pension liability was based on an allocation of the State's net pension liability based on the proportionate share of qualified payroll. At June 30, 2017 and 2016, the WPCRF's proportion of the State's share was 0.05%.

There was no change in actuarial assumptions as of June 30, 2016 to June 30, 2017. There were no changes in assumptions between the measurement date, June 30, 2017, and the reporting date, June 30, 2018, that are expected to have a significant effect on the proportionate share of the net pension liability.

**NOTE G - EMPLOYEE BENEFIT PLANS (continued)**

For the year ended June 30, 2018, the WPCRF recognized pension expense of $492,174. At June 30, 2018, the WPCRF reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

| | Deferred Outflows of Resources | Deferred Inflows of Resources |
|---|---|---|
| Differences between expected and actual experience | $ 37,354 | $ (38,474) |
| Changes in assumptions | 560,741 | - |
| Net difference between projected and actual earnings on pension plan investments | 207,683 | - |
| Changes in proportion and difference between WPCRF contributions and proportionate share of contributions | 12,555 | (8,631) |
| WPCRF contributions subsequent to the measurement date | 194,777 | - |
| | $ 1,013,110 | $ (47,105) |

The $194,777 reported as deferred outflows of resources related to pensions resulting from WPCRF contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the fiscal year ended June 30, 2019. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

| Fiscal Year Ending June 30, | Amount |
|---|---|
| 2019 | $ 583,962 |
| 2020 | 86,000 |
| 2021 | 72,331 |
| 2022 | 28,351 |
| 2023 | 584 |
| Total | $ 771,228 |

**NOTE G - EMPLOYEE BENEFIT PLANS (continued)**

***Actuarial Assumptions***

The total pension liability in the June 30, 2017 actuarial valuation was determined using the following actuarial assumptions adopted by the Board of Trustees of the Employees' Retirement System of the State of Hawaii, on December 12, 2016, based on the most recent experience study dated July 5, 2016:

| | |
|---|---|
| Inflation | 2.50% |
| Payroll growth rate | 3.50% |
| Investment rate of return | 7.00% per year, compounded annual including inflation |

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

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.

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.

**NOTE G - EMPLOYEE BENEFIT PLANS (continued)**

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 Real Rate of Return |
|---|---|---|
| Broad growth | 63.0% | 5.8% |
| Principal protection | 7.0% | 0.2% |
| Real return | 10.0% | 3.6% |
| Crisis risk offset | 20.0% | 3.1% |
| | 100.0% | |

***Discount Rate***

The discount rate used to measure the net pension liability was 7.00%, the same 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 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.

**NOTE G - EMPLOYEE BENEFIT PLANS (continued)**

***Sensitivity of the WPCRF's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate***

The following presents the WPCRF's proportionate share of the net pension liability calculated using the discount rate of 7.00%, as well as what the WPCRF's proportionate share of the 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%) |
|---|---|---|---|
| WPCRF's proportionate share of the net pension liability | $ 4,751,492 | $ 3,757,650 | $ 2,769,876 |

***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 accounting 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.

The State's comprehensive annual financial report contains further disclosures related to the State's proportionate share of the net pension liability and employer pension contributions.

***Payables to the Pension Plan***

At June 30, 2018, there was no payable to the ERS.

## NOTE G - EMPLOYEE BENEFIT PLANS (continued)

### 2. Deferred Compensation Plan

The State offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all State employees, permits employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or an 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 has the duty of due care that would be required of an ordinary prudent investor.

### 3. Post-Employment Health Care and Life Insurance Benefits

***Plan Description***

The state provides certain health care and life insurance benefits to all qualified employees. Pursuant to Act 88, Session Laws of Hawaii (SLH) of 2001, the state contributes to the Hawaii Employer-Union Health Benefits Trust Fund (EUTF), an agent multiple-employer defined benefit plan, effective July 1, 2003. The EUTF was established to provide a single delivery system of health benefits for state and county workers, retirees, and their dependents.

***State Policy***

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

***Contributions***

Contributions are governed by HRS Chapter 87A and may be amended through legislation. Contributions to the OPEB plan from the WPCRF was approximately $220,000 for the fiscal year ended June 30, 2018. The employer is required to make all contributions for members.

**NOTE G - EMPLOYEE BENEFIT PLANS (continued)**

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

At June 30, 2018, the WPCRF reported a liability of $3,706,469 for its proportionate share of net OPEB liability of the State. The net OPEB liability was measured as of June 30, 2017, and the total OPEB liability used to calculate the net OPEB liability was determined by an actuarial valuation as of that date. The State's proportion of the net OPEB liability was based on a projection of the State's long-term share of contributions to the EUTF relative to projected contributions of all participants, actuarially determined. The WPCRF's proportion of the net OPEB liability was based on an allocation of the State's net OPEB liability based on the proportionate share of qualified payroll. At June 30, 2017 and 2016, the WPCRF's proportion of the State's share was 0.04%.

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

For the year ended June 30, 2018, the WPCRF recognized OPEB expense of $233,858. At June 30, 2018, the WPCRF reported deferred outflows of resources and deferred inflows of resources related to OPEB from the following sources:

| | Deferred Outflows of Resources | Deferred Inflows of Resources |
|---|---|---|
| Differences between expected and actual experience | $ - | $ - |
| Changes in assumptions | - | - |
| Net difference between projected and actual earnings on investments | - | (4,631) |
| WPCRF contributions subsequent to the measurement date | 219,542 | - |
| | $ 219,542 | $ (4,631) |

**NOTE G - EMPLOYEE BENEFIT PLANS (continued)**

The $219,542 reported as deferred outflows of resources related to OPEB resulting from WPCRF contributions subsequent to the measurement date will be recognized as a reduction of the net OPEB liability in the fiscal year ended June 30, 2019. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to OPEB will be recognized in OPEB expense as follows:

| Fiscal Years Ending June 30, | Amount |
|---|---|
| 2019 | $ (926) |
| 2020 | (926) |
| 2021 | (926) |
| 2022 | (926) |
| 2023 | (927) |
| Total | $ (4,631) |

**NOTE G - EMPLOYEE BENEFIT PLANS (continued)**

***Actuarial Assumptions***

The total OPEB liability in the June 30, 2017 actuarial valuation was determined using the following actuarial methods and assumptions, applied to all periods included in the measurement, unless otherwise specified:

| | |
|---|---|
| Actuarial cost method | Entry age normal |
| Discount rate | 7.00% |
| Inflation | 2.50% |
| Salary increases | 3.50% to 7.00%, including inflation |
| Investment rate of return | 7.00%, net of investment expenses, including inflation |
| Demographic assumptions | Based on the experience study covering the five year period ended June 30, 2015, as conducted for the ERS |
| Mortality | System-specific mortality tables utilizing scale BB to project generational mortality improvement |
| Healthcare trend rates: | |
| PPO* | Initial rates of 6.60%, 6.60%, and 9.00%; declining to a rate of 4.86% after 14 years |
| HMO* | Initial rate of 9.00%; declining to a rate of 4.86% after 14 years |
| Part B & BMC | Initial rates of 2.00% and 5.00%; declining to a rate of 4.70% after 14 years |
| Dental | 3.50% |
| Vision | 2.50% |
| Life insurance | 0.00% |

* Blended rates for medical and prescription drug.

**NOTE G - EMPLOYEE BENEFIT PLANS (continued)**

The long-term expected rate of return on EUTF's investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

| Asset Class | Target Allocation | Long-term Expected Rate of Return |
|---|---|---|
| U.S. equity | 19.00% | 5.50% |
| International equity | 19.00% | 7.00% |
| U.S. microcap | 7.00% | 7.00% |
| Private equity | 10.00% | 9.25% |
| REITs | 6.00% | 5.85% |
| Core real estate | 10.00% | 3.80% |
| Global options | 7.00% | 5.50% |
| Core bonds | 3.00% | 0.55% |
| Long treasuries | 7.00% | 1.90% |
| Trend following | 7.00% | 1.75% |
| TIPS | 5.00% | 0.50% |
| | 100.0% | |

***Discount Rate***

Projected benefits payments are required to be discounted to their actual present values using a single discount rate that reflects (1) a long-term expected rate of return on the EUTF's investments (to the extent that the plan's fiduciary net position is projected to be sufficient to pay benefits), and (2) tax-exempt municipal bond rate based on an index of 20-year general obligation bonds with an average AA credit rating as of the measurement date (to the extent that the contributions for use with the long-term expected rate of return are not met).

**NOTE G - EMPLOYEE BENEFIT PLANS (continued)**

A single discount rate of 7.00% was used to measure the total OPEB liability. This discount rate was based on the expected rate of return on the EUTF's investments of 7.00%. Beginning with the fiscal year 2019 contributions, the State's funding policy is to pay the recommended actuarially determined contributions, which is based on layered, closed amortization periods. As a result, the EUTF's fiduciary net position is expected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on EUTF's investments was applied to all periods of projected benefit payments to determine the total OPEB liability.

***Changes in Net OPEB Liability***

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

| | Total OPEB Liability | Plan Fiduciary Net Position | Net OPEB Liability |
|---|---|---|---|
| Beginning Balance | $ 3,853,739 | $ 192,251 | $ 3,661,488 |
| Service cost | 61,715 | - | 61,715 |
| Interest on the total OPEB liability | 187,393 | - | 187,393 |
| Changes of benefit terms | - | - | - |
| Difference between expected and actual experience | - | - | - |
| Changes of assumptions | - | - | - |
| Employer contributions | - | 184,246 | (184,246) |
| Net investment income | - | 18,447 | (18,447) |
| Benefit payments | (92,650) | (92,650) | - |
| Administrative expense | - | (47) | 47 |
| Other | - | 1,481 | (1,481) |
| Net changes | 156,458 | 111,477 | 44,981 |
| Ending balance | $ 4,010,197 | $ 303,728 | $ 3,706,469 |

## NOTE G - EMPLOYEE BENEFIT PLANS (continued)

***Sensitivity of the WPCRF's Proportionate Share of the Net OPEB Liability to Changes in the Discount Rate***

The following presents the WPCRF's proportionate share of the net OPEB liability calculated using the discount rate of 7.00%, as well as what the WPCRF's proportionate share of the net OPEB 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%) |
|---|---|---|---|
| WPCRF's proportionate share of the net OPEB liability | $ 4,350,218 | $ 3,706,469 | $ 3,185,542 |

***Sensitivity of the WPCRF's Proportionate Share of the Net OPEB Liability to Changes in the Healthcare Cost Trend Rate***

The following presents the WPCRF's proportionate share of the net OPEB liability calculated using current healthcare cost trend rates, as well as what the WPCRF's proportionate share of the net OPEB liability would be if it were calculated using a healthcare cost trend rate that is one percentage point lower or one percentage point higher than the current rate:

| | 1% Decrease | Current Healthcare Cost Trend Rate | 1% Increase |
|---|---|---|---|
| WPCRF's proportionate share of the net OPEB liability | $ 3,155,548 | $ 3,706,469 | $ 4,401,793 |

## NOTE G - EMPLOYEE BENEFIT PLANS (continued)

### *OPEB Plan Fiduciary Net Position*

The OPEB plan's fiduciary net position is determined on the same basis used by the OPEB plan. The EUTF's financial statements are prepared using the accrual basis of accounting under which revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. Employer contributions are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan. Investment purchases and sales are recorded 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 EUTF financial report. EUTF's complete financial statements are available at http://eutf.hawaii.gov.

### *Required Supplementary Information and Disclosures*

The State's CAFR includes the required footnote disclosures and supplementary information on the State's OPEB plan.

## NOTE H - INSURANCE COVERAGE

Insurance coverage is maintained at the State level. The State is self-insured for substantially all perils including workers' compensation. Expenditures for workers' compensation and other insurance claims are appropriated annually from the State's general fund.

DOH is covered by the State's self-insured workers' compensation program for medical expenses of injured Department employees. However, DOH is required to pay temporary total and temporary partial disability benefits as long as the employee is on DOH's payroll. Because actual claim liabilities depend on such complex factors as inflation, changes in legal doctrines, and damage awards, the process used in computing claims liability does not necessarily result in an exact amount. Claim liabilities may be re-evaluated periodically to take into consideration recently settled claims, the frequency of claims, and other economic and social factors.

Workers' compensation benefit claims reported as well as incurred but not reported were reviewed at year end. The estimated losses from these claims were not material.

## SUPPLEMENTARY INFORMATION

**Department of Health**
**Water Pollution Control Revolving Fund**
**State of Hawaii**

Schedule of Cash Receipts, Disbursements and Cash Balance
For the Year Ended June 30, 2018

| | |
|---|---|
| Receipts: | |
| Principal repayment on loans | $ 32,891,401 |
| Interest income from loans | 1,354,879 |
| State contributions | 2,070,000 |
| Administrative loan fees | 1,725,348 |
| Other interest income | 981,059 |
| Total receipts | 39,022,687 |
| Disbursements: | |
| Disbursement of loan proceeds | 19,170,189 |
| Administrative | 1,916,914 |
| Total disbursements | 21,087,103 |
| Excess of receipts over disbursements | 17,935,584 |
| Equity in Cash and Cash Equivalents and Investments in State Treasury: | |
| Beginning of fiscal year | 152,457,917 |
| End of fiscal year | $ 170,393,501 |

**Department of Health**
**Water Pollution Control Revolving Fund**
**State of Hawaii**

Combining Statement of Net Position
June 30, 2018

| | State Revolving Fund Activity | State Activity | Total |
|---|---|---|---|
| **Assets and Deferred Outflows of Resources** | | | |
| Current Assets: | | | |
| Equity in cash and cash equivalents and investments in State Treasury | $ 166,889,031 | $ 3,504,470 | $ 170,393,501 |
| Loan fees receivable | - | 353,923 | 353,923 |
| Accrued interest on loans | 325,841 | - | 325,841 |
| Other accrued interest | 31,780 | - | 31,780 |
| Due from State Treasury | 1,097,892 | 3,830 | 1,101,722 |
| Current maturities of loans receivable | 31,059,585 | - | 31,059,585 |
| Total current assets | 199,404,129 | 3,862,223 | 203,266,352 |
| Loans Receivable, net of current maturities | 321,166,074 | - | 321,166,074 |
| Capital Assets, net of accumulated depreciation | - | 8,712 | 8,712 |
| Total assets | 520,570,203 | 3,870,935 | 524,441,138 |
| Deferred Outflows of Resources Related to Pensions | - | 1,232,652 | 1,232,652 |
| Total assets and deferred outflows of resources | $ 520,570,203 | $ 5,103,587 | $ 525,673,790 |
| **Liabilities, Deferred Inflows of Resources, and Net Position** | | | |
| Current Liabilities-- | | | |
| Accounts Payable and Other Accrued Liabilities | $ 73,829 | $ 142,125 | $ 215,954 |
| Accrued Vacation, net of current portion | 75,227 | 119,103 | 194,330 |
| Net Pension Liability | - | 3,757,650 | 3,757,650 |
| Other Postemployment Benefits | - | 3,706,469 | 3,706,469 |
| Total liabilities | 149,056 | 7,725,347 | 7,874,403 |
| Deferred Inflows of Resources Related to Pensions | - | 51,736 | 51,736 |
| Net Position: | | | |
| Net investment in capital assets | - | 8,712 | 8,712 |
| Restricted - expendable | 520,424,977 | (2,686,038) | 517,738,939 |
| Total net position | 520,424,977 | (2,677,326) | 517,747,651 |
| Total liabilities, deferred inflows of resources, and net position | $ 520,574,033 | $ 5,099,757 | $ 525,673,790 |

## Department of Health
## Water Pollution Control Revolving Fund
## State of Hawaii

Combining Statement of Revenues, Expenses and Changes in Net Position
For the Year Ended June 30, 2018

| | State Revolving Fund Activity | State Activity | Total |
|---|---|---|---|
| Operating Revenues: | | | |
| Interest income from loans | $ 1,317,117 | $ - | $ 1,317,117 |
| Administrative loan fees | - | 1,721,338 | 1,721,338 |
| Total operating revenue | 1,317,117 | 1,721,338 | 3,038,455 |
| Operating Expenses-- | | | |
| Administrative | 856,986 | 1,576,553 | 2,433,539 |
| Operating income | 460,131 | 144,785 | 604,916 |
| Nonoperating Revenues: | | | |
| State contributions | 2,070,000 | - | 2,070,000 |
| Federal contributions | 208,306 | - | 208,306 |
| Other interest income | 1,614,257 | - | 1,614,257 |
| Other income | 4,719 | 10,602 | 15,321 |
| Total nonoperating revenues | 3,897,282 | 10,602 | 3,907,884 |
| Change in net position | 4,357,413 | 155,387 | 4,512,800 |
| Net Position: | | | |
| Beginning of fiscal year, as previously reported | 515,648,794 | (552,093) | 515,096,701 |
| Restatement due to change in accounting principle | - | (1,861,850) | (1,861,850) |
| Beginning of fiscal year, as restated | 515,648,794 | (2,413,943) | 513,234,851 |
| Transfer from State Activity to SRF Activity | 418,770 | (418,770) | - |
| End of fiscal year | $ 520,424,977 | $ (2,677,326) | $ 517,747,651 |

# Department of Health
# Water Pollution Control Revolving Fund
# State of Hawaii

Schedule of Operating Expenses
For the Year Ended June 30, 2018

| | State Revolving Fund Activity | State Activity | Total |
|---|---|---|---|
| Personnel | $ 622,645 | $ 746,906 | $ 1,369,551 |
| Pension Expense | - | 492,174 | 492,174 |
| OPEB Expense | - | 233,858 | 233,858 |
| Intergovernmental Personnel Agreement Expenses | 208,306 | - | 208,306 |
| Travel | 11,429 | 25,714 | 37,143 |
| Professional Services | - | 23,100 | 23,100 |
| Services rendered by other State agencies | 6,093 | 29,472 | 35,565 |
| Telephone | 2,718 | 7,428 | 10,146 |
| Rental | 3,065 | 3,677 | 6,742 |
| Office and Other Supplies | 1,361 | 2,093 | 3,454 |
| Training | 705 | 3,510 | 4,215 |
| Depreciation | - | 1,237 | 1,237 |
| Miscellaneous | 664 | 7,384 | 8,048 |
| Total operating expenses | $ 856,986 | $ 1,576,553 | $ 2,433,539 |

# Department of Health
# Water Pollution Control Revolving Fund
# State of Hawaii

Schedule of Expenditures of Federal Awards
June 30, 2018

| Federal Grantor / Program Title | Federal CFDA Number | Project Number | Total Federal Expenditures | Passed through to Subrecipients |
|---|---|---|---|---|
| Environmental Protection Agency-- Capitalization Grants for Clean Water State Revolving Funds | 66.458 | various | $ 7,759,837 | $ 7,759,837 |
| Total | | | $ 7,759,837 | $ 7,759,837 |

Notes to Schedule of Expenditures of Federal Awards
June 30, 2018

## 1. Basis of Presentation

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Water Pollution Control Revolving Fund (WPCRF) and is presented on the cash basis of accounting. The information in this schedule is presented in accordance with the audit requirements of OMB Circular A-133. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements. This schedule is incorporated in the Department of Health's schedule of federal expenditures as of June 30, 2018.

## 2. Loan Receivable Outstanding

At June 30, 2018, WPCRF had a loan receivable balance outstanding of $25,931,599 related to loans made during the year. Loans made during the year are included in the federal expenditures presented in the schedule of expenditures of federal awards.

## 3. Indirect Cost Rate

WPCRF has elected not to use the 10-percent de minimus indirect cost rate allowed under the Uniform Guidance.

## PART II

## 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

# Report On Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit Of Financial Statements Performed In Accordance With Government Auditing Standards

## Independent Auditor's Report

To 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 financial statements of State of Hawaii, Water Pollution Control Revolving Fund (WPCRF) as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise the WPCRF's basic financial statements, and have issued our report thereon dated November 30, 2018.

### Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the WPCRF'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 opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the WPCRF's internal control. Accordingly, we do not express an opinion on the effectiveness of the WPCRF's internal control.

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

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



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**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the WPCRF'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.

KMH LLP

KMH LLP

Honolulu, Hawaii
November 30, 2018

## PART III

## REPORT ON COMPLIANCE FOR A FEDERAL PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY UNIFORM GUIDANCE

# Report On Compliance for a Federal Program and on Internal Control Over Compliance Required by Uniform Guidance

## Independent Auditor's Report

To the Auditor
State of Hawaii

### Report on Compliance for Capitalization Grants for Clean Water State Revolving Funds Program

We have audited the State of Hawaii, Water Pollution Control Revolving Fund's (WPCRF) compliance with the types of compliance requirements described in the *OMB Compliance Supplement* and the *Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs* that could have a direct and material effect on its Capitalization grants for the Clean Water State Revolving Funds Program (Program) for the year ended June 30, 2018.

### Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to the Program.

### Auditor's Responsibility

Our responsibility is to express an opinion on compliance for the WPCRF's Program based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on the program occurred. An audit includes examining, on a test basis, evidence about the WPCRF's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for the WPCRF's program. However, our audit does not provide a legal determination of the WPCRF's compliance.



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### Opinion on Compliance for Capitalization Grants for Clean Water State Revolving Funds

In our opinion, the WPCRF complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its program for the year ended June 30, 2018.

### Report on Internal Control Over Compliance

Management of the WPCRF is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the WPCRF's internal control over compliance with the types of requirements that could have a direct and material effect on its Program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for its Program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the WPCRF's internal control over compliance.

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

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

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance and the *Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund* Programs. Accordingly, this report is not suitable for any other purpose.

KMH LLP

KMH LLP

Honolulu, Hawaii
November 30, 2018