



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

**Financial Statements
June 30, 2021**

**Submitted by
The Auditor
State of Hawaii**



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Department of Transportation
State of Hawaii
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June 30, 2021

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Report of Independent Auditors

The Auditor
State of Hawaii

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities and each major fund of the Highways Division, Department of Transportation, State of Hawaii (the "Highways Division") as of and for the year ended June 30, 2021, and the related notes to the financial statements, which collectively comprise the Highways Division's basic financial statements as listed in the index.

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider 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.

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Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of the Highways Division as of June 30, 2021, and the respective changes in financial position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

Financial Reporting Entity

As discussed in Note 1, the financial statements of the Highways Division are intended to present the financial position and the changes in financial position of only that portion of the governmental activities and each major fund of the State of Hawaii that is attributable to the transactions of the Highways Division. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2021, and the changes in its financial position for the 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.

Change in Accounting Principle

As discussed in Note 2 to the financial statements, effective July 1, 2020, the Highways Division adopted Governmental Accounting Standards Board Statement No. 84, *Fiduciary Activities*. 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 on pages 4 through 13 and schedule of revenues and expenditures – budget and actual (non-GAAP budgetary basis) – State Highway Fund on pages 46 through 48, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.



Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated February 3, 2022 on our consideration of the Highways Division’s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants agreements, and other matters. The purpose of that report is solely 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 Highways 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 Highways Division’s internal control over financial reporting and compliance.

Accuity LLP

Honolulu, Hawaii
February 3, 2022

Highways Division
Department of Transportation
State of Hawaii
Management’s Discussion and Analysis (Unaudited)
June 30, 2021

The following Management’s Discussion and Analysis (“MD&A”) of activities and financial performance of the Highways Division, Department of Transportation, State of Hawaii (the “Highways Division”) provides the reader with an introduction and overview to the financial statements of the Highways Division as of and for the year ended June 30, 2021. This discussion has been prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section.

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

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

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

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

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Highways Division’s financial statements. The Highways Division’s financial statements are comprised of government-wide financial statements, fund financial statements, and notes to the financial statements.

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Government-wide Financial Statements

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

- The *Statement of Net Position* presents all of the Highways Division's assets, deferred outflows of resources, liabilities, and deferred inflows of resources with the difference reported as net position. Over time, increases or decreases in the Highways Division's net position are an indicator of whether its financial health is improving or deteriorating.
- The *Statement of Activities* presents information showing how the Highways Division's net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods.

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

The government-wide financial statements can be found on pages 14 and 15 of this report.

Fund Financial Statements

A fund is a grouping of related self-balancing accounts, which is used to maintain control over resources that have been segregated for specific activities or objectives.

- *Governmental Funds* – Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental funds financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating the Highways Division's near-term financing and finance-related legal requirements.

Governmental funds financial statements are prepared using the current financial resources measurement focus and the modified-accrual basis of accounting. These statements provide a detailed short-term view of the Highways Division's finances that assist in determining whether there will be adequate financial resources available to meet the current needs of the Highways Division.

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Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities of the government-wide financial statements. By doing so, readers may better understand the long-term impact of the Highways Division's near-term financing decisions. Both the governmental funds balance sheet and the governmental funds statement of revenues, expenditures, and changes in fund balances provide reconciliations on pages 17 and 19, respectively, to facilitate this comparison between governmental funds financial statements and government-wide financial statements.

The Highways Division maintains three governmental funds – the State Highway Fund (“SHF”) (a special revenue fund), the Debt Service Fund, and the Capital Projects Fund – all of which are considered major funds for presentation purposes. Information is presented separately in the governmental funds balance sheet and in the governmental funds statement of revenues, expenditures, and changes in fund balances for each of these funds.

The governmental funds financial statements can be found on pages 16 through 19 of this report.

Notes to the Financial Statements

The notes to the financial statements provide additional information that is essential for a full understanding of the data provided in the government-wide and governmental funds financial statements. The notes to financial statements can be found in pages 20 through 45 of this report.

Required Supplementary Information Other Than MD&A

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

The budgetary comparison schedule compares the SHF's original budget, final budget, and actual amounts prepared on a budgetary basis. A reconciliation between the actual SHF revenues and expenditures compared to the SHF revenues and expenditures prepared for budgetary purposes is included in notes to the Schedule of Revenues and Expenditures – Budget and Actual (Non-GAAP Budgetary Basis). The Schedule of Revenues and Expenditures – Budget and Actual (Non-GAAP Budgetary Basis) – State Highway Fund can be found on page 46 of this report.

Financial Highlights

Government-wide Financial Statements

The assets and deferred outflows of resources of the Highways Division exceeded its liabilities at June 30, 2021 by \$4.7 billion. Of this amount, \$282 million is considered unrestricted and may be used to meet the Highways Division's ongoing obligations.

The Highways Division's net position decreased by \$31 million during the year ended June 30, 2021.

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Fund Financial Statements

At June 30, 2021, the Highways Division's governmental funds reported a combined ending fund balance of \$509 million. The combined fund balance increased by \$185 million from the prior year's ending fund balance.

The Highways Division's SHF, the major operating fund, reported an ending fund balance of \$313 million. There was a \$55 million increase in fund balance during the year ended June 30, 2021.

Government-wide Financial Analysis

Condensed Statements of Net Position

As noted earlier, net position may serve over time as a useful indicator of the Highways Division's financial position. The Highways Division's assets and deferred outflows of resources exceeded liabilities by \$4.7 billion and \$4.8 billion at June 30, 2021 and 2020, respectively.

Condensed Statements of Net Position
As of June 30, 2021 and 2020

| | 2021 | 2020 |
|---------------------------------------|-------------------------|-------------------------|
| Assets | | |
| Current and other assets | \$ 590,736,040 | \$ 423,698,330 |
| Capital assets, net | <u>4,951,071,001</u> | <u>5,007,050,155</u> |
| Total assets | <u>\$ 5,541,807,041</u> | <u>\$ 5,430,748,485</u> |
| Deferred outflows of resources | | |
| Deferred charge on refunding, net | <u>\$ 6,367,009</u> | <u>\$ 7,796,440</u> |
| Liabilities | | |
| Current liabilities | \$ 92,495,948 | \$ 100,839,974 |
| Long-term liabilities | <u>714,923,234</u> | <u>566,211,586</u> |
| Total liabilities | <u>\$ 807,419,182</u> | <u>\$ 667,051,560</u> |
| Net position | | |
| Net investment in capital assets | \$ 4,458,496,596 | \$ 4,543,496,295 |
| Unrestricted | <u>282,258,272</u> | <u>227,997,070</u> |
| Total net position | <u>\$ 4,740,754,868</u> | <u>\$ 4,771,493,365</u> |

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The largest portion of the Highways Division's net position (\$4.5 billion at June 30, 2021 and 2020) reflects its investment in capital assets (e.g., land and land improvements, buildings and improvements, vehicles and equipment, and infrastructure), net of accumulated depreciation, which is reduced by any related debt and other borrowings used to acquire those assets that is still outstanding and deferred charges on refunding net of accumulated amortization. The Highways Division uses these capital assets to provide services to citizens; therefore, these assets are not available for future spending. Although the Highways Division's net investment in capital assets is reported net of related debt and other borrowings, it should be noted that the resources needed to repay the debt and other borrowings must be provided from other sources, since capital assets themselves cannot be used to liquidate these liabilities.

The remaining net position (\$282 million and \$228 million at June 30, 2021 and 2020, respectively) is unrestricted and may be used to meet the Highways Division's on-going obligations to citizens and creditors.

Current and other assets increased by \$167 million or 39% from June 30, 2020 to June 30, 2021, due primarily to increases in cash and cash equivalents and restricted cash and cash equivalents of \$71 million and \$111 million, respectively.

Capital assets, net decreased by \$56 million from June 30, 2020 to June 30, 2021, primarily due to depreciation expense of \$211 million and disposals and impairments of \$38 million net of additions of \$193 million.

Current liabilities decreased by \$8 million or 8% from June 30, 2020 to June 30, 2021, primarily due to a \$16 million decrease in payables from restricted assets, offset by an increase in accounts payable of \$10 million.

Long-term liabilities increased by \$146 million or 26% from June 30, 2020 to June 30, 2021, primarily due to an increase in revenue bonds payable of \$143 million. Refer to "Long-Term Debt" section on pages 12 and 13 for discussion on the revenue bond issuance in June 2021.

A reconciliation on page 17 facilitates the comparison between governmental funds and governmental activities.

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Condensed Statements of Activities

The following condensed financial information reflects how the Highways Division's net position changed during the year ended June 30, 2021 and 2020.

Condensed Statements of Activities
For the Years Ended June 30, 2021 and 2020

| | 2021 | 2020 |
|-------------------------------------|------------------|------------------|
| Expenses | | |
| Depreciation expense | \$ 210,993,474 | \$ 209,237,344 |
| Operations and maintenance | 125,429,257 | 157,615,560 |
| Administration of Highways Division | 95,647,926 | 109,500,501 |
| Interest expense | 20,867,550 | 14,991,048 |
| Motor Vehicle Safety Office | 14,066,995 | 6,213,063 |
| Other | 57,883,393 | 24,373,377 |
| Total expenses | 524,888,595 | 521,930,893 |
| Revenues | | |
| Program revenues | | |
| Capital grants and contributions | 84,696,444 | 96,694,042 |
| Operating grants and contributions | 153,903,445 | 93,333,620 |
| Charges for services | 57,950,513 | 50,674,007 |
| Total program revenues | 296,550,402 | 240,701,669 |
| Net program expenses | (228,338,193) | (281,229,224) |
| General revenues | | |
| Taxes | 188,404,799 | 227,206,617 |
| Investment income and other | 9,194,897 | 22,726,148 |
| Total general revenues | 197,599,696 | 249,932,765 |
| Change in net position | (30,738,497) | (31,296,459) |
| Net position | | |
| Beginning of year | 4,771,493,365 | 4,802,789,824 |
| End of year | \$ 4,740,754,868 | \$ 4,771,493,365 |

Total expenses increased by \$3 million or 0.6% from \$522 million in fiscal year 2020 to \$525 million in fiscal year 2021. This increase is due primarily to the increase in interest expense of \$6 million, Motor Vehicle Safety Office of \$8 million, and other expenses of \$34 million. The increase in other expenses is primarily due to capital project fund expenditures. The increase is offset by decreases in operations and maintenance expenses and administration of Highways Division expenses of \$32 million and \$14 million respectively.

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Total revenues increased by \$4 million or 0.7% from \$491 million in fiscal year 2020 to \$494 million in fiscal year 2021, due primarily to an increase in program revenues of \$56 million or 23%, and a decrease in general revenues of \$52 million or 21%.

Program revenues, which comprise charges for services, as well as capital and operating grants, accounted for 60% and 49% of total revenues in fiscal years 2021 and 2020, respectively. The largest components of program revenues (80% for fiscal year 2021 and 79% for fiscal year 2020) resulted from capital and operating grants and contributions primarily from the Federal Highway Administration for the maintenance and construction of roads and other infrastructure. Capital and operating grants and contributions increased by \$49 million from \$190 million in fiscal year 2020 to \$239 million in fiscal year 2021 due primarily to grants and contributions received for the decreased costs associated with the statewide highway maintenance programs.

General revenues, which consist of taxes, including state fuel taxes, vehicle weight taxes and penalties, and rental motor and tour vehicle surcharge taxes, as well as investment income, accounted for 40% and 51% of total revenues in fiscal years 2021 and 2020, respectively.

The decrease in net position was \$31 million in fiscal year 2021 as compared to the decrease in net position of \$31 million in fiscal year 2020.

A reconciliation on page 19 facilitates the comparison between governmental funds and governmental activities.

Financial Analysis of the Highways Division's Governmental Funds

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

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

At June 30, 2021, the Highways Division's governmental funds reported combined ending fund balance of \$509 million, representing an increase of \$185 million from the prior year. \$313 million of the fund balance is classified as committed to indicate that amounts can only be used for specific purposes pursuant to formal action of the Legislature. \$196 million of the fund balance is classified as restricted to indicate that amounts are restricted for specific purposes imposed by external parties.

At June 30, 2020, the Highways Division's governmental funds reported combined ending fund balance of \$324 million, representing an increase of \$60 million from the prior year. \$258 million of the fund balance was classified as committed to indicate that amounts could only be used for specific purposes pursuant to formal action of the Legislature. \$67 million of the fund balance was classified as restricted to indicate that amounts were restricted to specific purposes imposed by external parties.

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

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

At June 30, 2021 and 2020, the total fund balance of the SHF was \$313 million and \$258 million, respectively. SHF's fund balance increased by \$55 million in the current year compared to a \$8 million increase in the prior year. The current year increase was mainly due to revenues over expenditures of \$124 million and net transfers out of \$69 million.

The Debt Service Fund ("DSF") is used to track the revenue bond debt service for the Highways Division. Debt service requirements are primarily transferred from the SHF. The debt service expenditures were \$51 million and \$53 million for fiscal years 2021 and 2020, respectively.

The Capital Projects Fund ("CPF") accounts for the Highways Division's capital improvements program. At June 30, 2021, the CPF had a total fund balance of \$196 million. The CPF fund balance increased by \$130 million in fiscal year 2021 as compared to a \$52 million increase in the prior year. The increase in the current year fund balance was mainly due to expenditures over revenues of \$69 million offset by net transfers in of \$18 million and \$181 million in other financing sources from revenue bond issuances.

State Highway Fund Budgetary Highlights

The final SHF budget had total revenues of \$209 million. The actual revenues on a budgetary basis were \$248 million or 18% more than the final budget, primarily due to higher than budgeted revenues for vehicle weight taxes, rental motor and tour vehicle surcharge taxes, vehicle registration fees, and other fees and penalties of \$23 million, \$11 million, \$7 million, and \$3 million, respectively, offset by lower than budgeted revenues for state fuel taxes of \$0.3 million and investment income of \$4 million.

Expenditures on the budgetary actual basis were \$215 million or 26% lower than the final budgeted amounts. Most of the difference was due to actual expenditures lower than final budgeted amounts for operations and maintenance and administration of the Highways Division of \$25 million and \$50 million, respectively. The lower-than-budgeted expenditures were primarily due to the deferral of several projects that had been budgeted for during the fiscal year and lower payroll expenditures due to staffing vacancies.

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Capital Asset and Debt Administration

Capital Assets

The Highways Division’s investment in capital assets as of June 30, 2021 amounted to \$12 billion and accumulated depreciation of \$7 billion, resulting in net investment in capital assets of \$5 billion. This investment in capital assets includes land and land improvements, buildings and building improvements, vehicles and equipment, infrastructure assets, and construction in progress. Infrastructure assets consist of land, roadways, tunnels and bridges, and miscellaneous roadway components.

During fiscal year 2021, the Highways Division had bid openings for 45 projects, with contract amounts totaling approximately \$200 million. There were 27 projects on Oahu, 8 projects on Maui, (includes Molokai and Lanai), 2 projects on Hawaii, and 4 projects on Kauai. In addition, there were 4 statewide projects.

During fiscal year 2020, the Highways Division had bid openings for 40 projects, with contract amounts totaling approximately \$61 million. There were 21 projects on Oahu, 5 projects on Maui, (includes Molokai and Lanai), 4 projects on Hawaii, 7 projects on Kauai, and 3 statewide projects.

During the year ended June 30, 2021, the Highways Division recognized impairment losses on capital assets of approximately \$12,605,000, which is reported as Administration expense in the statement of activities.

Additional information on the Highways Division’s capital assets can be found in Note 6 to the financial statements.

Long-Term Debt

As of June 30, 2021, outstanding State of Hawaii Highway Revenue Bonds amounted to \$538 million, compared to \$431 million as of June 30, 2020. These revenue bonds are payable solely from, and collateralized solely by, certain revenues held in the State Highway Fund. The proceeds of the revenue bonds are used to finance highway capital improvement projects and other related projects for the State Highways System.

| Series | Interest Rates | Final Maturity Date (July 1) | Original Amount of Issue | Outstanding Amount |
|---------------|-----------------------|-------------------------------------|---------------------------------|---------------------------|
| 2005B | 3.00 – 5.25 % | 2021 | \$ 123,915,000 | \$ 4,425,000 |
| 2011 | 2.00 – 5.00 % | 2032 | 117,365,000 | 37,430,000 |
| 2016 | 2.00 – 5.00 % | 2034 | 135,660,000 | 96,230,000 |
| 2014 | 1.26 – 5.00 % | 2036 | 204,485,000 | 180,870,000 |
| 2019 | 3.00 – 5.00 % | 2040 | 81,835,000 | 81,835,000 |
| 2021 | 5.00% | 2041 | 137,205,000 | 137,205,000 |
| | | | <u>\$ 800,465,000</u> | <u>\$ 537,995,000</u> |

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On June 9, 2021, the Highways Division issued \$137 million of State of Hawaii Revenue Bonds Series 2021 (the 2021 Bonds). The 2021 Bonds bear interest at 5.00% and mature in annual installments from 2027 through 2041. These bonds were issued at a premium of \$44 million.

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

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

See Notes 8 and 9 to the financial statements for additional information on the State of Hawaii Highway Revenue Bonds.

The Highways Division entered into an equipment lease purchase agreement to fund the acquisition and installation of energy conservation measures at selected Highways Division locations. Lease payments commenced on August 1, 2017 and will continue through August 1, 2031 at an interest rate of 2.63%. See Note 16 to the financial statements for further information on this capital lease obligation, which amounted to \$53 million and \$56 million at June 30, 2021 and 2020, respectively.

Additional information on the Highways Division's other long-term liabilities can be found in Note 8 to the financial statements.

Request for Information

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

Highways Division
Department of Transportation
State of Hawaii
Statement of Net Position – Governmental Activities
June 30, 2021

| | |
|--|-------------------------|
| Assets | |
| Equity in cash and cash equivalents and investments in State Treasury | \$ 302,815,749 |
| Receivables, net | |
| Due from U.S. government | 28,355,286 |
| Due from counties | 12,915,391 |
| Due from State of Hawaii | 1,376,369 |
| Other receivables | 547,362 |
| Restricted cash and cash equivalents and investments in State Treasury | |
| Capital projects | 230,393,750 |
| Security deposits | 13,721,828 |
| Other assets | 610,305 |
| Capital assets, net of accumulated depreciation | 4,951,071,001 |
| Total assets | <u>5,541,807,041</u> |
| Deferred Outflows of Resources | |
| Deferred charge on refunding, net | 6,367,009 |
| Liabilities | |
| Accounts payable | 40,490,594 |
| Accrued payroll | 5,652,495 |
| Accrued interest payable | 1,411,575 |
| Contracts payable | |
| Current portion | 16,327,419 |
| Retainage payable | 5,410,368 |
| Revenue bond interest payable | 9,481,669 |
| Security deposits | 13,721,828 |
| Long-term liabilities | |
| Due within one year | |
| Accrued vacation payable | 2,996,443 |
| Workers' compensation payable | 1,319,297 |
| Capital lease obligation | 2,851,146 |
| Revenue bonds payable | 27,980,000 |
| Due after one year | |
| Accrued vacation payable | 10,131,674 |
| Workers' compensation payable | 10,920,704 |
| Capital lease obligation | 50,608,975 |
| Revenue bonds payable | 608,114,995 |
| Total liabilities | <u>807,419,182</u> |
| Net Position | |
| Net investment in capital assets | 4,458,496,596 |
| Unrestricted | 282,258,272 |
| Total net position | <u>\$ 4,740,754,868</u> |

The accompanying notes are an integral part of these financial statements.

Highways Division
Department of Transportation
State of Hawaii
Statement of Activities – Governmental Activities
Year Ended June 30, 2021

Expenses

| | |
|---|--------------------|
| Operations and maintenance | |
| Oahu highways and services | \$ 61,195,319 |
| Kauai highways and services | 9,869,463 |
| Hawaii highways and services | 22,254,789 |
| Maui highways and services | 1,699,941 |
| Molokai highways and services | 1,238,019 |
| Lanai highways and services | 730,759 |
| Pass-through for county highways and services | 28,440,967 |
| Depreciation expense | 210,993,474 |
| Administration | 95,647,926 |
| Interest expense | 20,867,550 |
| Repairs and maintenance | 49,629,789 |
| Surcharge on gross receipts | 8,253,604 |
| Motor Vehicle Safety Office | 14,066,995 |
| Total expenses | <u>524,888,595</u> |

Program revenues

| | |
|------------------------------------|----------------------|
| Capital grants and contributions | 84,696,444 |
| Operating grants and contributions | 153,903,445 |
| Charges for services | |
| Vehicle registration fees | 49,615,863 |
| Penalties and fines | 4,688,485 |
| Other fees and permits | 2,268,857 |
| Rentals | 1,377,308 |
| Total program revenues | <u>296,550,402</u> |
| Net program expenses | <u>(228,338,193)</u> |

General revenues

| | |
|---|---------------------|
| Taxes | |
| Vehicle weight taxes | 88,529,327 |
| State fuel taxes | 67,674,476 |
| Rental motor and tour vehicle surcharge taxes | 32,200,996 |
| Investment income | 1,197,890 |
| Other revenues | 7,997,007 |
| Total general revenues | <u>197,599,696</u> |
| Change in net position | <u>(30,738,497)</u> |

Net position

| | |
|-------------------|-------------------------|
| Beginning of year | <u>4,771,493,365</u> |
| End of year | <u>\$ 4,740,754,868</u> |

The accompanying notes are an integral part of these financial statements.

Highways Division
Department of Transportation
State of Hawaii
Balance Sheet – Governmental Funds
June 30, 2021

| | State Highway Fund | Capital Projects Fund | Total |
|---|-----------------------|--------------------------|-----------------------|
| Assets | | | |
| Equity in cash and cash equivalents and investments in State Treasury | \$ 276,695,553 | \$ 26,120,196 | \$ 302,815,749 |
| Receivables | | | |
| Due from capital projects fund | 35,984,693 | - | 35,984,693 |
| Due from U.S. government | 13,264,947 | 15,090,339 | 28,355,286 |
| Due from counties | 12,915,391 | - | 12,915,391 |
| Due from State of Hawaii | 1,376,369 | - | 1,376,369 |
| Other receivables | - | 547,362 | 547,362 |
| Restricted cash and cash equivalents and investments in State Treasury | | | |
| Capital projects | - | 230,393,750 | 230,393,750 |
| Security deposits | 13,721,828 | - | 13,721,828 |
| Other assets | 587,738 | 22,567 | 610,305 |
| Total assets | <u>\$ 354,546,519</u> | <u>\$ 272,174,214</u> | <u>\$ 626,720,733</u> |
| Liabilities | | | |
| Accounts payable | \$ 15,167,653 | \$ 25,322,941 | \$ 40,490,594 |
| Accrued payroll | 5,652,495 | - | 5,652,495 |
| Contracts payable | | | |
| Current portion | 3,287,865 | 13,039,554 | 16,327,419 |
| Retainage payable | 3,992,815 | 1,417,553 | 5,410,368 |
| Security deposits | 13,721,828 | - | 13,721,828 |
| Due to State Highway Fund | - | 35,984,693 | 35,984,693 |
| Total liabilities | <u>41,822,656</u> | <u>75,764,741</u> | <u>117,587,397</u> |
| Fund Balances | | | |
| Restricted – Capital Projects Fund | - | 196,409,473 | 196,409,473 |
| Committed – State Highway Fund | 312,723,863 | - | 312,723,863 |
| Total fund balances | <u>312,723,863</u> | <u>196,409,473</u> | <u>509,133,336</u> |
| Total liabilities and fund balances | <u>\$ 354,546,519</u> | <u>\$ 272,174,214</u> | <u>\$ 626,720,733</u> |

The accompanying notes are an integral part of these financial statements.

Highways Division
Department of Transportation
State of Hawaii
Reconciliation of the Governmental Funds Balance Sheet
to the Statement of Net Position
June 30, 2021

| | | | |
|---|----|------------------------|-------------------------|
| Total fund balances – governmental funds | | \$ | 509,133,336 |
| Amounts reported for governmental activities in the statement of net position are different because | | | |
| Capital assets used in governmental activities are not current financial resources and therefore are not reported in the governmental funds financial statements. These assets consist of | | | |
| Governmental capital assets | \$ | 11,565,163,672 | |
| Less: Accumulated depreciation | | <u>(6,614,092,671)</u> | 4,951,071,001 |
| Deferred charges on refunding are recorded as expenditures in governmental funds financial statements when the corresponding debt is first issued. However, in government-wide financial statements, such amounts are recorded as a deferred outflow of resources and amortized over the term of the related bonds. | | | 6,367,009 |
| Accrued interest payable is not recognized in governmental funds | | | (10,893,244) |
| Long-term liabilities are not due and payable in the current period and therefore are not reported in the governmental funds financial statements | | | |
| Revenue bonds payable | | (636,094,995) | |
| Capital lease obligation | | (53,460,121) | |
| Accrued vacation payable | | (13,128,117) | |
| Workers' compensation payable | | <u>(12,240,001)</u> | <u>(714,923,234)</u> |
| Net position of governmental activities | | | <u>\$ 4,740,754,868</u> |

The accompanying notes are an integral part of these financial statements.

Highways Division
Department of Transportation
State of Hawaii

Statement of Revenues, Expenditures, and Changes in Fund Balances – Governmental Funds
Year Ended June 30, 2021

| | State Highway Fund | Debt Service Fund | Capital Projects Fund | Total |
|---|-----------------------|----------------------|--------------------------|-----------------------|
| Revenues | | | | |
| Charges for services | | | | |
| Vehicle registration fees | \$ 49,615,863 | \$ - | \$ - | \$ 49,615,863 |
| Penalties and fines | 4,688,485 | - | - | 4,688,485 |
| Other fees and permits | 2,268,857 | - | - | 2,268,857 |
| Rentals | 1,377,308 | - | - | 1,377,308 |
| Capital grants and contributions | - | - | 84,696,444 | 84,696,444 |
| Operating grants and contributions | 153,903,445 | - | - | 153,903,445 |
| Taxes | | | | |
| Vehicle weight taxes | 88,529,327 | - | - | 88,529,327 |
| State fuel taxes | 67,674,476 | - | - | 67,674,476 |
| Rental motor and tour vehicle surcharge taxes | 32,200,996 | - | - | 32,200,996 |
| Investment income | 1,197,890 | - | - | 1,197,890 |
| Other revenues | 7,543,923 | - | 453,085 | 7,997,008 |
| Total revenues | <u>409,000,570</u> | <u>-</u> | <u>85,149,529</u> | <u>494,150,099</u> |
| Expenditures | | | | |
| Operations and maintenance | | | | |
| Oahu highways and services | 80,451,307 | - | - | 80,451,307 |
| Hawaii highways and services | 32,847,757 | - | - | 32,847,757 |
| Kauai highways and services | 15,923,612 | - | - | 15,923,612 |
| Maui highways and services | 24,470,398 | - | - | 24,470,398 |
| Molokai highways and services | 1,313,935 | - | - | 1,313,935 |
| Lanai highways and services | 730,759 | - | - | 730,759 |
| Pass-through for county highways and services | 28,440,967 | - | - | 28,440,967 |
| Administration | 78,745,463 | - | - | 78,745,463 |
| Surcharge on gross receipts | 8,253,604 | - | - | 8,253,604 |
| Motor Vehicle Safety Office | 14,066,995 | - | - | 14,066,995 |
| Capital outlay | - | - | 154,144,605 | 154,144,605 |
| Debt service | | | | |
| Principal payments | - | 30,695,000 | - | 30,695,000 |
| Interest expense | - | 20,382,475 | - | 20,382,475 |
| Total expenditures | <u>285,244,797</u> | <u>51,077,475</u> | <u>154,144,605</u> | <u>490,466,877</u> |
| Revenues over (under) expenditures | 123,755,773 | (51,077,475) | (68,995,076) | 3,683,222 |
| Other financing sources (uses) | | | | |
| Transfers in | - | 51,077,475 | 17,597,327 | 68,674,802 |
| Transfers out | (68,674,802) | - | - | (68,674,802) |
| Premiums on revenue bonds | - | - | 43,908,934 | 43,908,934 |
| Issuance of revenue bonds | - | - | 137,205,000 | 137,205,000 |
| Total other financing sources (uses) | <u>(68,674,802)</u> | <u>51,077,475</u> | <u>198,711,261</u> | <u>181,113,934</u> |
| Net change in fund balances | 55,080,971 | - | 129,716,185 | 184,797,156 |
| Fund balances | | | | |
| Beginning of year | 257,642,892 | - | 66,693,288 | 324,336,180 |
| End of year | <u>\$ 312,723,863</u> | <u>\$ -</u> | <u>\$ 196,409,473</u> | <u>\$ 509,133,336</u> |

The accompanying notes are an integral part of these financial statements.

Highways Division
Department of Transportation
State of Hawaii
Reconciliation of the Governmental Funds Statement of Revenues, Expenditures, and
Changes in Fund Balances to the Statement of Activities
Year Ended June 30, 2021

| | | |
|---|----------------------|------------------------|
| Net change in fund balances – total governmental funds | | \$ 184,797,156 |
| Amounts reported for governmental activities in the statement of activities are different because | | |
| Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense | | |
| Expenditures for capital assets | \$ 193,071,094 | |
| Loss on impairment of capital assets | (12,604,804) | |
| Loss on disposals | (25,451,970) | |
| Less: Current fiscal year depreciation | <u>(210,993,474)</u> | (55,979,154) |
| Borrowings provide current financial resources to governmental funds; however, issuing debt increases long-term liabilities in the statement of net assets | | |
| Issuance of revenue bonds | (137,205,000) | |
| Premiums on revenue bonds | <u>(43,908,934)</u> | (181,113,934) |
| Repayment of long-term debt and capital lease is reported as expenditures in the governmental funds financial statements, but the repayment reduces long-term liabilities in the government-wide financial statements | | |
| Bond principal repayment | 30,695,000 | |
| Capital lease obligation | 2,543,062 | |
| Revenue bonds interest payable | (9,481,669) | |
| Change in debt service liability recognized in debt service fund | <u>(8,130,000)</u> | 15,626,393 |
| Governmental funds report the effect of original issue premium and deferred charge on refunding when the corresponding debt is first issued, whereas the amounts are amortized to expense over the remaining term of the related bond in the government-wide financial statements | | |
| Amortization of bond premiums | 7,226,733 | |
| Amortization of deferred charge on refunding | <u>(1,429,431)</u> | 5,797,302 |
| Other revenues and expenditures in the government-wide financial statements do not provide or use current financial resources and therefore are not reported as revenues and expenditures in governmental funds financial statements | | <u>133,740</u> |
| Change in net position – governmental activities | | <u>\$ (30,738,497)</u> |

The accompanying notes are an integral part of these financial statements.

Highways Division
Department of Transportation
State of Hawaii
Notes to Financial Statements
June 30, 2021

1. Financial Reporting Entity

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

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

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

The financial statements of the Highways Division are intended to present the financial position and the changes in financial position of only that portion of the governmental activities and governmental funds of the State of Hawaii that are attributable to the transactions of the Highways Division. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2021, and the changes in its financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America (“GAAP”). The State Comptroller maintains the central accounts for all State funds and publishes financial statements for the State annually, which includes the Highways Division’s financial activities.

2. Summary of Significant Accounting Policies

The Highways Division’s financial statements are prepared in accordance with GAAP, as prescribed by the Governmental Accounting Standards Board (“GASB”). The significant accounting policies used by the Highways Division are described below.

Measurement Focus, Basis of Accounting, and Financial Position

Government-wide Financial Statements

The Government-wide financial statements (the statement of net position and the statement of activities) report information of all the nonfiduciary activities of the Highways Division. Interfund activity has been removed from these government-wide statements. The economic resources measurement focus and the accrual basis of accounting are used to report the government-wide financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements have been met.

The statement of net position includes all capital assets and long-term liabilities that are excluded from the governmental funds financial statements. The net position is reported in three categories: net investment in capital assets, restricted for capital projects activity, and unrestricted. When both restricted and unrestricted resources are available for use, generally it is the Highways Division's policy to use restricted resources first, then unrestricted resources as they are needed. Additionally, the Highways Division would first use restricted, committed, then assigned, and finally unassigned amounts of unrestricted fund balances for expenditures.

The statement of activities demonstrates the degree to which the direct expenses of a given function, segment or component unit are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function, segment or component unit. Program revenues include charges paid by users and grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. Taxes and other items not included in program revenues are reported instead as general revenues.

Governmental Funds Financial Statements

Governmental funds are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized when they are measurable and available. The Highways Division considers all revenues reported in the governmental funds to be available if the revenues are collected within sixty days after year-end. Revenues susceptible to accrual include taxpayer-assessed tax revenues. Taxpayer-assessed tax revenues primarily consist of income and general excise taxes. The revenues of the Highways Division do not include any income or general excise taxes. Other revenues which are not considered susceptible to accrual and therefore are not accrued include fines, forfeitures and penalties, licenses, permits, and franchise taxes. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, claims and judgments, and compensated absences, which are recognized as expenditures when payment is due. General capital asset acquisitions are reported as expenditures in governmental funds. Proceeds of general long-term debt are reported as other financing sources.

Highways Division
Department of Transportation
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Notes to Financial Statements
June 30, 2021

The governmental funds accounts of the Highways Division are organized on the basis of funds, each of which is considered a separate accounting entity. Government resources are allocated to and accounted for in individual funds based upon the purposes for which they are to be spent and the means by which spending activities are controlled. For financial reporting purposes, the Highways Division includes all funds that are controlled by or dependent on the Highways Division's administrative head. Control by or dependence on the Division was determined on the basis of statutory authority and monies flowing through the Highways Division to each fund or account.

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

- **State Highway Fund** – The State Highway Fund, which generally accounts for revenues and expenditures for highway operations, maintenance and administration is a special revenue fund of the State established by Section 248-8, Hawaii Revised Statutes (“HRS”). All fuel taxes collected under Section 243-4, HRS except county fuel taxes, aviation fuel taxes, and taxes on fuel sold for use by small boats are deposited in the State Highway Fund. Section 248-9, HRS provides that monies in the State Highway Fund shall be expendable by the Department of Transportation for the design, construction, reconstruction, repair and maintenance, and for acquisition of rights-of-way for public highways included in the State Highway Fund established under Section 264-41, HRS.
- **Debt Service Fund** – The Debt Service Fund accounts for the Highways Division's financial resources obtained and used for the payment of principal and interest on State of Hawaii Highway Revenue Bonds.
- **Capital Projects Fund** – The Capital Projects Fund accounts for the Highways Division's construction projects and the related sources of financing.

The accompanying financial statements include highway projects authorized by legislative acts through June 30, 2021.

Equity in Cash and Cash Equivalents and Investments in State Treasury

Equity in cash and cash equivalents and investments in State Treasury consists of amounts held in State Treasury for governmental funds as discussed in Note 3.

Restricted Cash and Cash Equivalents

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

Highways Division
Department of Transportation
State of Hawaii
Notes to Financial Statements
June 30, 2021

Receivables

Receivables are reported at their gross value when earned and are reduced by the estimated portion that is expected to be uncollectible. The allowance for uncollectible accounts is based on collection history and current information regarding the creditworthiness of the tenants and others doing business with the Highways Division. When continued collection activity results in receipt of amounts previously written off, revenue is recognized for the amount collected.

Capital Assets

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

Capital assets are depreciated by the straight-line method over their useful lives estimated by management as follows:

| Class of Assets | Estimated Useful Life | Capitalization Threshold |
|------------------------|------------------------------|---------------------------------|
| Land improvements | 15 years | \$ 100,000 |
| Buildings | 30 years | 100,000 |
| Building improvements | 30 years | 100,000 |
| Vehicles and equipment | 5 – 7 years | 5,000 |
| Infrastructure | 28 – 75 years | 100,000 |

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

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

Deferred Outflows of Resources and Deferred Inflows of Resources

Deferred outflows of resources are a consumption of net position by a government that is applicable to a future reporting period and deferred inflows of resources are an acquisition of net position by a government that is applicable to a future reporting period. Both deferred outflows of resources and deferred inflows of resources are reported in the government-wide statement of net position but are not recognized in the financial statements as revenues and expenses until the period(s) to which they relate occur. Deferred outflows of resources of the Highways Division represent the deferred charge of refunding revenue bonds. As of June 30, 2021, the Highways Division did not have any deferred inflows of resources.

Highways Division
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Notes to Financial Statements
June 30, 2021

The difference between the reacquisition price of issued bonds 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. As of June 30, 2021, the deferred charge on refunding, net of accumulated amortization, amounted to approximately \$6,367,000.

Long-Term Obligations

In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities. Bond premiums are deferred and amortized over the life of the bonds using the effective interest method.

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

Bond Issuance Costs

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

Compensated Absences

It is the Highways Division's policy to permit employees to accumulate earned but unused vacation and sick leave benefits. There is no liability for unpaid accumulated sick leave since sick leave is not convertible to pay upon termination of employment. All vacation pay is accrued when incurred in the accompanying government-wide financial statements. A liability for these amounts is reported in the governmental funds financial statements only if they have matured, for example, as a result of employee resignations and retirements.

Fund Balances

The Highways Division classifies fund balances based primarily on the extent to which it is bound to follow constraints on how resources can be spent. Classifications include:

- **Nonspendable** – Balances that cannot be spent because they are either not in spendable form or they are legally or contractually required to be maintained intact.
- **Restricted** – Balances that are restricted to specific purposes by external parties such as creditors, grantors, or other governments, which are sources of externally enforceable legal restrictions.
- **Committed** – Balances that can only be used for specific purposes pursuant to formal action of the State Legislature, the highest level of decision-making authority. Legislation is required to modify or rescind a fund balance commitment.
- **Assigned** – Balances that are constrained by management for specific purposes as authorized by the Hawaii Revised Statutes, but are not restricted or committed.
- **Unassigned** – Residual balances that are not contained in the other classifications.

Highways Division
Department of Transportation
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Notes to Financial Statements
June 30, 2021

When an expenditure is incurred for which committed, assigned, or unassigned fund balances are available, Highways Division considers amounts to have been spent first out of committed funds, then assigned funds, and finally unassigned funds.

Risk Management

The Highways Division is exposed to various risks of loss from torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and injuries to employees. The State is self-insured for workers' compensation as discussed in Note 17. Liabilities related to these losses are reported when it is probable that the losses have occurred and the amount of those losses can be reasonably estimated.

Intrafund and Interfund Transactions

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

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the basic financial statements and accompanying notes. Actual results may differ from those estimates.

Recently Issued Accounting Pronouncements

GASB Statement No. 84

The GASB issued Statement No. 84, *Fiduciary Activities*. The objective of this Statement is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported. Upon implementation of this Statement, the Highways Division determined that resources and liabilities previously reported in an agency fund are assets and liabilities of the State Highway Fund and are also reported in the government-wide financial statements but did not result in restatements of net position or fund balance. As of July 1, 2020, such liabilities amounted to approximately \$1,436,000 that are now reported as security deposits payable from restricted assets.

GASB Statement No. 87

The GASB issued Statement No. 87, *Leases*. The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. The 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 provisions of the contract. The requirements of this Statement are effective for reporting periods beginning after June 15, 2021. The Highways Division is currently evaluating the impact that this Statement will have on its financial statements.

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GASB Statement No. 92

The GASB issued Statement No. 92, *Omnibus 2020*. The primary objectives of this Statement are to enhance comparability in accounting and financial reporting and to improve the consistency of authoritative literature by addressing practice issues that have been identified during implementation and application of certain GASB Statements. The requirements of this Statement are effective at multiple periods depending on when certain Statements are implemented. The Highways Division is currently evaluating the impact that this Statement will have on its financial statements.

GASB Statement No. 93

The GASB issued Statement No. 93, *Replacement of Interbank Offered Rates*. The primary objective of this Statement is to address those and other accounting and financial reporting implications that result from the replacement of an interbank offered rate. The removal of the London Interbank Offered Rate as an appropriate benchmark interest rate is effective for reporting periods ending after December 31, 2021. All other requirements of this Statement are effective for reporting periods beginning after June 15, 2021. The Highways Division is currently evaluating the impact that this Statement will have on its financial statements.

GASB Statement No. 94

The GASB issued Statement No. 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements*. The primary objective of this Statement is to improve financial reporting by addressing issues related to public-private and public-public partnership arrangements. The requirements of this Statement are effective for reporting periods beginning after June 15, 2022. The Highways Division is currently evaluating the impact that this Statement will have on its financial statements.

GASB Statement No. 96

The GASB issued Statement No. 96, *Subscription-Based Information Technology Arrangements*. This Statement provides guidance on the accounting and financial reporting for subscription-based information technology arrangements for government end users. The requirements of this Statement are effective for reporting periods beginning after June 15, 2022. The Highways Division is currently evaluating the impact that this Statement will have on its financial statements.

Highways Division
Department of Transportation
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Notes to Financial Statements
June 30, 2021

3. Equity in Cash and Cash Equivalents and Investments in State Treasury

Cash and cash equivalents at June 30, 2021 consisted of amounts held in State Treasury and are reflected in the accompanying financial statements at June 30, 2021 as follows:

| | |
|--------------------------------------|-----------------------|
| Cash and cash equivalents | \$ 302,815,749 |
| Restricted cash and cash equivalents | |
| Capital projects | 230,393,750 |
| Security deposits | 13,721,828 |
| Total cash and cash equivalents | <u>\$ 546,931,327</u> |

The State Director of Finance is responsible for the safekeeping of cash and investments 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. Cash is pooled with funds from other State agencies and departments and deposited into approved financial institutions or in the State Treasury investment pool. Funds in the investment pool accrue interest based on the average weighted cash balances of each account.

The State requires that depository banks pledge, as collateral, government securities held in the name of the State for deposits not covered by federal deposit insurance.

GAAP requires disclosures over common deposit and investment risks related to credit risk, interest rate risk, and foreign currency risk. Investments can be categorized by type, maturity and custodian to determine the level of interest rate, credit, and custodial risk assumed by the Highways Division. However, as the governmental funds are held in the State investment pool, the Highways Division does not manage these investments and the types of investments, and related interest rate, credit, and custodial risk are not determinable at the Highways Division level. The risk and fair value disclosures related to the State's investment pool are included in the State's Annual Comprehensive Financial Report ("ACFR"), which may be obtained from the Department of Accounting and General Services website: <https://ags.hawaii.gov/reports/financial-reports>.

Highways Division
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Notes to Financial Statements
June 30, 2021

4. Tax and Fee Revenues

State Fuel Tax

For fiscal year 2021, the tax on liquid motor vehicle fuel imposed on each gallon of fuel was as follows:

| | |
|-------------------------|-----------|
| Gasoline | 16 cents |
| Diesel fuel | |
| Non-highway use | 1 cent |
| Highway use | 16 cents |
| Liquefied petroleum gas | 5.2 cents |

Vehicle Weight Tax and Penalties

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

Rental Motor and Tour Vehicle Surcharge Taxes

The rental motor vehicle surcharge tax was \$5 a day that a rental motor vehicle is rented or leased.

The tour vehicle surcharge tax was \$66 a month for tour vehicles categorized by the Public Utilities Commission as an over 25-passenger carrier vehicle and \$16 a month for tour vehicles categorized as an 8 to 25-passenger carrier vehicle.

Vehicle Registration and Motor Carrier Safety Inspection Fees

The vehicle registration fee was \$45 per vehicle, of which \$5 is earmarked for deposit into the Emergency Medical Services (“EMS”) special fund. During the year ended June 30, 2021, the Highways Division collected approximately \$5,716,000 on behalf of the EMS special fund.

The motor carrier safety inspection fee was \$1.50 per vehicle.

5. Federal Grants-in-Aid

The Highways Division has projects in progress in which part of the funding is being provided by the Federal Highway Administration (“FHWA”) through grants-in-aid. Such projects are generally accounted for in the Capital Projects and State Highway Funds. At June 30, 2021, receivables totaling approximately \$28,355,000 from the U.S. government are comprised of billed costs, pending reimbursement, as well as unbilled costs, which are eligible for reimbursement.

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In addition, the MVSO has projects in progress in which part of the funding is being provided through federal grants-in-aid. The grants contain various compliance requirements, which must be met by the MVSO, including a matching of the grant amounts with state and local highway safety expenditures as defined in a formula. MVSO's matching requirement is met through the expenditures of the Division of Driver Education, The Judiciary, State of Hawaii. Cost reimbursement by the FHWA and National Highway Traffic Safety Administration ("NHTSA") are subject to final audit by federal agencies. In addition, FHWA and NHTSA reserve the right to examine the Highways Division for economy, efficiency, and program results. The Highways Division's management believes that any federal aid received as of June 30, 2021 that might be required to be repaid to the FHWA or NHTSA based on federal audits would not be material to the financial position of the various funds of the Highways Division at June 30, 2021, or the results of operations of such funds for the year then ended.

6. Capital Assets

The following is a summary of changes in capital assets during the year ended June 30, 2021:

| | Balance July 1, 2020 | Additions | Disposals | Transfers | Balance June 30, 2021 |
|--------------------------------|-------------------------|------------------------|------------------------|----------------------|--------------------------|
| Nondepreciable assets | | | | | |
| Land | \$ 1,267,214,299 | \$ 1,107,600 | \$ (18,648) | \$ - | \$ 1,268,303,251 |
| Construction in progress | 303,249,639 | 186,826,783 | (38,038,126) | (238,553,529) | 213,484,767 |
| Total nondepreciable assets | <u>1,570,463,938</u> | <u>187,934,383</u> | <u>(38,056,774)</u> | <u>(238,553,529)</u> | <u>1,481,788,018</u> |
| Depreciable assets | | | | | |
| Land improvements | 2,215,473 | - | - | - | 2,215,473 |
| Buildings and improvements | 61,216,658 | - | - | 148,476 | 61,365,134 |
| Vehicles and equipment | 90,197,719 | 5,136,711 | (1,359,218) | - | 93,975,212 |
| Infrastructure | 9,687,502,193 | - | (87,411) | 238,405,053 | 9,925,819,835 |
| Total depreciable assets | 9,841,132,043 | 5,136,711 | (1,446,629) | 238,553,529 | 10,083,375,654 |
| Less: Accumulated depreciation | <u>(6,404,545,826)</u> | <u>(210,993,474)</u> | 1,446,629 | - | <u>(6,614,092,671)</u> |
| Total depreciable assets, net | <u>3,436,586,217</u> | <u>(205,856,763)</u> | - | <u>238,553,529</u> | <u>3,469,282,983</u> |
| Total capital assets, net | <u>\$ 5,007,050,155</u> | <u>\$ (17,922,380)</u> | <u>\$ (38,056,774)</u> | <u>\$ -</u> | <u>\$ 4,951,071,001</u> |

During the year ended June 30, 2021, the Highways Division recognized impairment losses on capital assets that are no longer in use of approximately \$12,605,000. The related assets were derecognized at net carrying amount. The impairment loss is reported in Administration expenses in the government-wide statement of activities.

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7. Net Position

At June 30, 2021, net position consisted of the following:

| | | |
|---|--|--------------------------------|
| Net investment in capital assets | | |
| Net property, plant and equipment | | \$ 4,951,071,001 |
| Less: Revenue bonds payable | | (636,094,995) |
| Add: Unspent revenue bond proceeds | | 230,393,750 |
| Add: Deferred charge on refunding, net | | 6,367,009 |
| Less: Capital lease obligation, net of unused proceeds and financed interest cost | | (53,460,121) |
| Less: Capital-related accounts and contracts payable | | (39,780,048) |
| Total net investment in capital assets | | <u>4,458,496,596</u> |
| Unrestricted | | <u>282,258,272</u> |
| Total net position | | <u><u>\$ 4,740,754,868</u></u> |

8. General Long-Term Liabilities

Changes in general long-term liabilities during the year ended June 30, 2021 were as follows:

| | Balance July 1, 2020 | Additions | Reductions | Balance June 30, 2021 | Amount Due Within One Year |
|--|-------------------------|-----------------------|------------------------|--------------------------|----------------------------------|
| Accrued vacation payable | \$ 12,977,892 | \$ 5,141,293 | \$ (4,991,068) | \$ 13,128,117 | \$ 2,996,443 |
| Workers' compensation payable | 12,457,717 | 1,590,518 | (1,808,234) | 12,240,001 | 1,319,297 |
| Capital lease obligation | 56,003,183 | - | (2,543,062) | 53,460,121 | 2,851,146 |
| Revenue bonds payable | 431,485,000 | 137,205,000 | (30,695,000) | 537,995,000 | 27,980,000 |
| Revenue bonds payable – unamortized premium | <u>61,417,794</u> | <u>43,908,934</u> | <u>(7,226,733)</u> | <u>98,099,995</u> | <u>-</u> |
| Total governmental activities long-term liabilities | <u>\$ 574,341,586</u> | <u>\$ 187,845,745</u> | <u>\$ (47,264,097)</u> | <u>\$ 714,923,234</u> | <u>\$ 35,146,886</u> |

State Highway funds are used to settle the above other long-term liabilities.

9. Revenue Bonds

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

These revenue bonds are payable solely from, and collateralized solely by, the revenues held in the State Highway Fund consisting primarily of highway fuel taxes, vehicle registration fees, vehicle weight taxes, rental motor vehicle and tour vehicle surcharge taxes, and interest earnings on monies previously credited to the State Highway Fund. The proceeds of the

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revenue bonds are used to finance certain highway capital improvement projects and other related projects for the State Highways System.

On February 20, 2005, the Highways Division issued \$123,915,000 in State of Hawaii Revenue Bonds Series B ("2005B Bonds") with interest rates ranging from 3.0% to 5.25% and mature in annual installments through 2021. These bonds were issued at a premium of \$15,000,000, which will be amortized over the life of the bonds using the effective interest method.

On December 15, 2011, the Highways Division issued \$112,270,000 in State of Hawaii Revenue Bonds Series 2011A ("2011A Bonds"). The 2011A Bonds bear interest at rates ranging from 2.00% to 5.00% and mature in annual installments through 2032. These bonds were issued at a premium of approximately \$13,152,000, which will be amortized over the life of the bonds using the effective interest method.

On December 15, 2011, the Highways Division also issued \$5,095,000 in State of Hawaii Revenue Bonds Series 2011B ("2011B Bonds") with an interest rate of 4.00% and mature in annual installments through 2032. These bonds were issued at a premium of approximately \$467,000, which will be amortized over the life of the bonds using the effective interest method. The 2011B bonds were issued to provide funds for a current refunding of the outstanding 2001 Bonds. The payments for the current refunding of revenue bonds amounted to \$5,400,000.

On August 14, 2014, the Highways Division issued \$103,375,000 in State of Hawaii Revenue Bonds Series 2014A ("2014A Bonds"). The 2014A Bonds bear interest at rates ranging from 2.00% to 5.00% and mature in annual installments through 2034. These bonds were issued at a premium of approximately \$17,291,000, which will be amortized over the life of the bonds using the effective interest method.

On August 14, 2014, the Highways Division also issued \$32,285,000 in State of Hawaii Revenue Bonds Series 2014B ("2014B Bonds"). The 2014B Bonds bear interest at rates ranging from 3.00% to 5.00% and mature in annual installments through 2026. These bonds were issued at a premium of approximately \$5,865,000, which will be amortized over the life of the bonds using the effective interest method.

On September 8, 2016, the Highways Division issued \$103,395,000 in State of Hawaii Revenue Bonds Series 2016A ("2016A Bonds"). The 2016A Bonds bear interest at rates ranging from 2.00% to 5.00% and mature in annual installments through 2030. These bonds were issued at a premium of approximately \$17,107,000, which will be amortized over the life of the bonds using the effective interest method.

On September 8, 2016, the Highways Division also issued \$101,090,000 in State of Hawaii Revenue Bonds Series 2016B ("2016B Bonds"). The 2016B Bonds bear interest at rates ranging from 1.26% to 5.00% and mature in annual installments through 2036. These bonds were issued at a premium of approximately \$25,989,000, which will be amortized over the life of the

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bonds using the effective interest method. The Highways Division issued the bonds to advance refund \$111,590,000 of the outstanding callable series 2008 and 2011A bonds with interest rates ranging from 4.80% to 6.00%.

The net proceeds of approximately \$128,188,00 (after an additional contribution of \$2,019,000, payment of \$514,000 in underwriting fees, insurance, and other issuance costs, and payment of \$397,000 in accrued interest) were used to purchase U.S. Treasury securities. These securities were deposited in an irrevocable trust to provide for all future debt service on the refunded portion of the 2008 and 2011A series bonds. As a result, that portion of the 2008 and 2011A series bonds are considered defeased, and the Highways Division has removed the liability from its accounts.

On December 11, 2019, the Highways Division issued \$81,835,000 of State of Hawaii Revenue Bonds Series 2019A ("2019A Bonds"). The 2019A Bonds bear interest at rates ranging from 3.00% to 5.00% and mature in annual installments through 2040. These bonds were issued at a premium of approximately \$18,661,000. The 2019A Bonds maturing on and before January 1, 2029 are not subject to redemption prior to their respective maturity dates. The 2019A Bonds maturing on or after January 1, 2030 are subject to redemption prior to their respective maturity dates at the option of the State at 100% plus accrued interest.

On June 9, 2021, the Highways Division issued \$137,205,000 of State of Hawaii Revenue Bonds Series 2021 ("2021 Bonds"). The 2021 Bonds bear interest at 5.00% and mature in annual installments beginning in 2027 through 2041. These bonds were issued at a premium of approximately \$43,909,000. The 2021 Bonds, maturing on and before January 1, 2030, are not subject to redemption prior to their respective maturity dates. The 2021 Bonds, maturing on or after January 1, 2033, are subject to redemption prior to their respective maturity dates at the option of the State at 100% plus accrued interest.

The following is a summary of revenue bonds issued and outstanding at June 30, 2021:

| Series | Interest Rates | Final Maturity Date (July 1) | Original Amount of Issue | Outstanding Amount |
|---------------|-----------------------|-------------------------------------|---------------------------------|---------------------------|
| 2005B | 3.00 – 5.25 % | 2021 | \$ 123,915,000 | \$ 4,425,000 |
| 2011 | 2.00 – 5.00 % | 2032 | 117,365,000 | 37,430,000 |
| 2014 | 2.00 – 5.00 % | 2034 | 135,660,000 | 96,230,000 |
| 2016 | 1.26 – 5.00 % | 2036 | 204,485,000 | 180,870,000 |
| 2019 | 3.00 – 5.00 % | 2040 | 81,835,000 | 81,835,000 |
| 2021 | 5.00% | 2041 | 137,205,000 | 137,205,000 |
| | | | <u>\$ 800,465,000</u> | <u>537,995,000</u> |
| | | Add: Unamortized premium | | 98,099,995 |
| | | Less: Current portion | | (27,980,000) |
| | | Noncurrent portion | | <u>\$ 608,114,995</u> |

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During the year ended June 30, 2021, approximately \$51,077,000 was transferred from the State Highway Fund to the Debt Service Fund for repayment of revenue bonds principal of approximately \$8,130,000 and \$22,565,000 on July 1, 2020 and January 1, 2021, respectively, and interest of approximately \$10,408,000 and \$9,974,000 due on July 1, 2020 and January 1, 2021, respectively.

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

| Years ending June 30, | Principal | Interest | Total |
|------------------------------|-----------------------|-----------------------|-----------------------|
| 2022 | \$ 27,980,000 | \$ 22,697,000 | \$ 50,677,000 |
| 2023 | 27,615,000 | 24,545,000 | 52,160,000 |
| 2024 | 28,670,000 | 23,495,000 | 52,165,000 |
| 2025 | 29,710,000 | 22,107,000 | 51,817,000 |
| 2026 | 31,095,000 | 20,716,000 | 51,811,000 |
| 2027 – 2031 | 151,305,000 | 79,883,000 | 231,188,000 |
| 2032 – 2036 | 142,605,000 | 45,584,000 | 188,189,000 |
| 2037 – 2041 | 99,015,000 | 15,335,000 | 114,350,000 |
| Total | <u>\$ 537,995,000</u> | <u>\$ 254,362,000</u> | <u>\$ 792,357,000</u> |

A comparison of revenues pledged as collateral for debt service payments recognized for the year ended June 30, 2021 to the principal and interest requirements of the bonds for the period is as follows:

| | |
|-------------------------------------|----------------|
| Pledged user taxes | \$ 246,355,000 |
| Principal and interest requirements | 51,077,000 |

10. Transfers

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

| | State Highway Fund | Debt Service Fund | Capital Projects Fund |
|--|---------------------------|--------------------------|------------------------------|
| Funding of revenue bond and capital lease debt service | \$ (51,077,475) | \$ 51,077,475 | \$ - |
| Funding of highway capital projects | (17,597,327) | - | 17,597,327 |
| | <u>\$ (68,674,802)</u> | <u>\$ 51,077,475</u> | <u>\$ 17,597,327</u> |

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11. Pension Plan

Plan Description

Generally, all full-time employees of the State and counties, are required to be members of the Employees' Retirement System (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. The ERS issues publicly available annual financial reports that can be obtained at the ERS website: <https://ers.ehawaii.gov/resources/financials>.

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 2.25%) 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.

The following summarizes the provisions relevant to the largest employee groups of the respective membership class.

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 thirty years of credited service are eligible to retire at age 55.

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- *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 surviving 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/re-entry 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.
- *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.

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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 twelve 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.
- 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.

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 thirty 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.

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- *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 the monthly benefit. If there is no spouse/reciprocal beneficiary or surviving 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.
- *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 rate for fiscal year 2021 was 24% for general employees. Contributions to the pension plan from the Highways Division were approximately \$12,773,000 for the year ended June 30, 2021.

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Pursuant to Act 17, SLH 2017, employer contributions from the State and counties are expected to increase over four years beginning July 1, 2017. The rate for general employees increased to 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. Contributory members hired after June 30, 2012 are required to contribute 9.8% 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.

Measurement of the actuarial valuation is made for the State as a whole and is not separately computed for the individual state departments and agencies such as the Highways Division. It is the State's policy to recognize the proportionate share of the pension liability, pension expense, deferred inflows related to pensions, and deferred outflows related to pensions for only component units and proprietary funds that are reported separately in the State's ACFR. Therefore, the Highways Division's share of the net pension liability, pension expense, deferred inflows related to pensions, and deferred outflows related to pension are not included in the accompanying financial statements.

Detailed information about the pension plan's fiduciary net position is available in the separately-issued ERS financial report. The ERS complete financial statements are available at <https://ers.ehawaii.gov/resources/financials>.

Payables to the Pension Plan

The Highways Division's contribution payable to the ERS at June 30, 2021 approximated \$526,000.

Disclosures and Required Supplementary Information

The State's ACFR includes the required disclosures and required supplementary information on the State's pension plan.

12. Postemployment Healthcare and Life Insurance Benefits

Plan Description

The State provides certain health care and life insurance benefits to all qualified employees. Pursuant to Act 88, SLH 2001, the State contributes to the Hawaii Employer-Union Health Benefits Trust Fund ("EUTF"), an agent multiple-employer defined benefit plan that replaced the Hawaii Public Employees Health Fund effective July 1, 2003. The EUTF was established to provide a single delivery system of health benefits for state and county workers, retirees, and their dependents. The EUTF issues an annual financial report that is available to the public at <https://eutf.hawaii.gov/reports>.

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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 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 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.

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

Measurement of the actuarial valuation and the ARC are made for the State as a whole and are not separately computed for the individual state departments and agencies such as the Highways Division. The State has only computed the allocation of the other postemployment benefit (“OPEB”) liability, OPEB expense, deferred outflows of resources, and deferred inflows of resources related to OPEB to component units and proprietary funds that are reported separately in the State’s ACFR. Therefore, the OPEB costs for the Highways Division were not available and are not included in the financial statements.

Contributions

Contributions are governed by HRS Chapter 87A and may be amended through legislation. The employer is required to make all contributions for members.

The governor’s Fourteenth Supplementary (emergency) Proclamation, issued on October 13, 2020, suspended specific provisions of law. Included were Sections 87A-42(b) – (f), HRS, *other postemployment benefits trust*, 87A-43, HRS, *payment of public employer contributions to the other postemployment benefits trust*, and 237-31(3), HRS, *remittances*, related to the requirement for public employers to pay the annual required contribution to the EUTF in the

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fiscal years 2020–2021. Due to the governor’s proclamation, contributions to the OPEB plan from the Highways Division were approximately \$318,000 for the year ended June 30, 2021.

Detailed information about the OPEB plan’s fiduciary net position is available in the separately issued EUTF financial report. The EUTF’s complete financial statements are available at <https://eutf.hawaii.gov/reports/>.

Payables to the OPEB Plan

The Highways Division did not have any contribution payable to EUTF at June 30, 2021.

Disclosures and Required Supplementary Information

The State’s ACFR includes the required disclosures and required supplementary information on the State’s OPEB plan.

13. 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 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 basic financial statements.

14. Transactions with Other State Agencies

The State assesses a surcharge of 5% for central service expenses on all receipts of the State Highway Fund, after deducting any amounts pledged, charged or encumbered for the payment of bonds and interest during the year. During fiscal year 2021, the assessment amounted to approximately \$8,254,000, which is included as the caption surcharge on gross receipts expense/expenditures in the accompanying financial statements.

The Highways Division is also assessed a percentage of the cost of the general administration expenses of the Department of Transportation. During fiscal year 2021, assessments net of amounts refunded amounted to approximately \$5,325,000, which is included in administration expense/expenditures in the accompanying financial statements.

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15. Commitments and Contingencies

Construction Contracts

At June 30, 2021, construction contracts outstanding amounted to approximately \$112,854,000 for various infrastructure projects and approximately \$308,540,000 for operations and maintenance projects.

Condemnation Proceedings

The Highways Division occasionally finds it necessary to condemn property for construction of highways. These proceedings require the Highways Division to compensate existing property owners for the fair market value of their real property. Prior to the determination of fair value, the Highways Division is required to deposit funds in State courts for these proceedings. The amount of funds deposited in the State courts was approximately \$119,000 at June 30, 2021. Such funds deposited may not be sufficient to cover the full amount required for compensation purposes. Management, however, believes any additional compensation in excess of amounts deposited with State courts will not be material to the financial statements of the Highways Division. The funds deposited in the State courts are reflected in capital projects expenditures in the governmental fund statement of revenue, expenditures, and changes in fund balances and in capital assets on the government-wide statement of net position in the year in which the deposits were made.

Accumulated Sick Leave

Sick leave accumulates at the rate of one and three-quarters working days for each month of service without limit but may be taken only in the event of illness and is not convertible to pay upon termination of employment. However, an employee who retires or leaves government service in good standing with sixty days or more of unused sick leave is entitled to additional service credit in the ERS. At June 30, 2021, accumulated sick leave was approximately \$28,076,000.

Defeased Bonds

At various dates in prior years, the Highways Division has placed proceeds from bond issuances in irrevocable refunding escrow accounts for the purpose of providing sufficient funds to pay all principal and interest refunded bond issues and remaining payment dates (defeased bonds). The likelihood of the earnings and principal not being sufficient to pay the defeased bonds appears remote and accordingly the escrow accounts and defeased bonds are not included in the accompanying financial statements. Defeased bonds principal outstanding at June 30, 2021 was \$39,560,000.

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Litigation

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

Environmental Issues

The Highways Division is subject to laws and regulations relating to the protection of the environment. The Highways 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 Highways 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 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. As a result, it is not possible to reasonably estimate the amount of the potential cost to the IDPP and allocable share of the Highways Division, and if there would be a material impact to the Highways Division's financial statements. Accordingly, no estimate of loss has been recorded in the accompanying financial statements.

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Notes to Financial Statements
June 30, 2021

16. Lease Commitments

Capital Lease Obligation

On July 8, 2015, the Highways Division entered into an equipment lease purchase agreement for the acquisition and installation of energy conservation measures at selected Highways Division locations. Annual lease payments commenced on August 1, 2017 and will continue through August 1, 2031 at an interest rate of 2.63%. At June 30, 2021, the cost and accumulated amortization of assets under capital leases amounted to approximately \$60,286,000 and \$7,536,000, respectively. Amortization of equipment acquired under the agreement approximated \$2,153,000 and is included with depreciation expense for the year ended June 30, 2021.

Future minimum lease payments are as follows:

| | Principal | Interest | Total |
|------------------------------|----------------------|---------------------|----------------------|
| Years ending June 30, | | | |
| 2022 | \$ 2,851,000 | \$ 1,406,000 | \$ 4,257,000 |
| 2023 | 3,180,000 | 1,331,000 | 4,511,000 |
| 2024 | 3,520,000 | 1,247,000 | 4,767,000 |
| 2025 | 3,903,000 | 1,155,000 | 5,058,000 |
| 2026 | 4,301,000 | 1,052,000 | 5,353,000 |
| 2027 – 2031 | 28,427,000 | 3,329,000 | 31,756,000 |
| 2032 | <u>7,278,000</u> | <u>191,000</u> | <u>7,469,000</u> |
| Total | <u>\$ 53,460,000</u> | <u>\$ 9,711,000</u> | <u>\$ 63,171,000</u> |

Operating Leases – Rental Revenue

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

| | |
|------------------------------|---------------------|
| Years ending June 30, | |
| 2022 | \$ 302,000 |
| 2023 | 302,000 |
| 2024 | 302,000 |
| 2025 | 302,000 |
| 2026 | 302,000 |
| 2027 – 2031 | 646,000 |
| 2032 – 2036 | 402,000 |
| 2037 – 2041 | 360,000 |
| 2042 – 2044 | <u>216,000</u> |
| Total | <u>\$ 3,134,000</u> |

17. Risk Management

The State records a liability for risk financing and 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. A summary of the State's underwriting risks is as follows:

Property Insurance

The State has an insurance policy with various insurers for property coverage. The limit of loss per occurrence is \$200,000,000, except for terrorism losses, which have a \$100,000,000 per occurrence limit. There are two different types of deductibles for the property coverage. The deductible for losses such as hurricanes, floods and earthquakes are 3% of the replacement costs to the property subject to a \$1,000,000 per occurrence minimum. The deductible for all other perils such as a fire is \$1,000,000. The deductible for terrorism coverage is \$1,000,000.

Crime Insurance

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. Losses under the deductible amount are paid by the Risk Management Office of the Department of Accounting and General Services, and losses not covered by insurance are paid from the State's General Fund.

General Liability (Including Torts)

Liability (tort and automobile) claims up to \$25,000 are handled by the Risk Management Office. All other claims are handled by the Department of the Attorney General. The State has personal injury and property damage liability, including automobile and public errors and omissions, employment liability, and employee benefits liability insurance policy in force with a \$5,000,000 self-insured retention per occurrence. The annual per occurrence limit is \$7,500,000 for wrongful action and \$12,500,000 for Products/Completed Operations, Errors and Omissions, and Employee Benefits Liability, and for crime loss, \$10,000,000 with no aggregate limit. Losses under the deductible amount but over the Risk Management Office authority or over the aggregate limit are typically paid from legislative appropriations of the State's General Fund.

Cyber Liability Insurance

The State is insured for various types of cyber-related activities with a loss limit of \$50,000,000 with a deductible of \$1,000,000 per claim. This policy includes (with sub-limits) system failure business interruption, dependent business interruption, dependent business interruption system failure, and Payment Card Industry – Data Security Standard coverage.

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Notes to Financial Statements
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Self-Insured Risks

The State generally self-insures its automobile no-fault and workers' compensation losses. Automobile losses up to \$25,000 are administered by the State Risk Management Office.

Reserve for Losses and Loss Adjustment Costs

A liability for workers' compensation claims is established if information indicates that a loss has been incurred as of June 30, 2021, and the amount of the loss can be reasonably estimated. The liability also includes an estimate for amounts incurred but not reported. The amount of the estimated loss is recorded in the accompanying government-wide statement of net position, as those losses will be liquidated with future expendable resources. The estimated losses are generally paid from legislative appropriations of the State's General Fund.

18. Subsequent Events

As required by Section 251-2, HRS, *rental motor vehicle and tour vehicle surcharge tax*, effective January 1, 2022, and each subsequent January 1 through 2027, the rental motor vehicle surcharge tax shall increase by \$0.50 per day.

On October 7, 2021, the Division issued \$23,130,000 of State of Hawaii Highway Refunding Revenue Bonds Series 2019B (Forward Delivery) at 5% per annum payable semiannually each January 1 and July 1 commencing on January 1, 2022. The bonds, which mature on January 1, 2024 through 2032, were issued to provide refunding of Highway Revenue Bonds, Series 2011A that mature in 2023 through 2032.

**Required Supplementary Information
Other than Management's Discussion
and Analysis (Unaudited)**

Highways Division
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State Highway Fund
Schedule of Revenues and Expenditures – Budget and Actual (Non-GAAP Budgetary Basis)
Year Ended June 30, 2021

| | Original | Final | Actual on Budgetary Basis | Variance with Final Budget Positive (Negative) |
|--|------------------------|------------------------|--|---|
| Revenues | | | | |
| State fuel taxes | \$ 68,011,180 | \$ 68,011,180 | \$ 67,674,476 | \$ (336,704) |
| Vehicle weight taxes | 9,600,000 | 9,600,000 | 32,200,996 | 22,600,996 |
| Rental motor and tour vehicle surcharge taxes | 77,349,305 | 77,349,305 | 88,146,222 | 10,796,917 |
| Vehicle registration fees | 42,706,691 | 42,706,691 | 49,295,721 | 6,589,030 |
| Investment income | 5,106,000 | 5,106,000 | 1,182,492 | (3,923,508) |
| Other fees and penalties | 6,599,505 | 6,599,505 | 9,235,571 | 2,636,066 |
| Total revenues | <u>209,372,681</u> | <u>209,372,681</u> | <u>247,735,478</u> | <u>38,362,797</u> |
| Expenditures | | | | |
| Operations and maintenance | | | | |
| Oahu highways and services | 82,064,049 | 82,790,642 | 71,337,271 | 11,453,371 |
| Hawaii highways and services | 16,010,200 | 17,288,190 | 12,440,989 | 4,847,201 |
| Maui highways and services | 18,218,994 | 18,324,599 | 13,240,548 | 5,084,051 |
| Kauai highways and services | 9,610,883 | 9,726,385 | 6,172,874 | 3,553,511 |
| Molokai highways and services | 1,905,296 | 1,906,290 | 1,514,543 | 391,747 |
| Lanai highways and services | 458,106 | 458,825 | 317,912 | 140,913 |
| Administration including debt service | 139,822,316 | 141,272,208 | 91,350,167 | 49,922,041 |
| Surcharge on gross receipts | 11,743,298 | 9,124,274 | 10,038,090 | (913,816) |
| Motor Vehicle Safety Office | 9,581,991 | 9,636,093 | 8,891,041 | 745,052 |
| Total expenditures | <u>289,415,133</u> | <u>290,527,506</u> | <u>215,303,435</u> | <u>75,224,071</u> |
| Revenues over (under) expenditures and other uses | <u>\$ (80,042,452)</u> | <u>\$ (81,154,825)</u> | <u>\$ 32,432,043</u> | <u>\$ 113,586,868</u> |

**Highways Division
Department of Transportation
State of Hawaii
State Highway Fund
Note to Schedule of Revenues and Expenditures – Budget and Actual
(Non-GAAP Budgetary Basis)
Year Ended June 30, 2021**

Budget and Budgetary Accounting

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

In the case of expenditures, the original and amended budgeted amounts reflected on the schedule of revenues and expenditures – budget and actual (non-GAAP budgetary basis) for the State Highway Fund are derived primarily from acts of the State Legislature and from other authorizations contained in other specific appropriation acts in various Session Laws of Hawaii.

Allotments are made and expenditures are controlled at the program level for the State Highway Fund. Allotments for the State Highway Fund lapse at year-end.

Highways Division
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State Highway Fund
Note to Schedule of Revenues and Expenditures – Budget and Actual
(Non-GAAP Budgetary Basis)
Year Ended June 30, 2021

The table below reconciles the revenues over expenditures and other uses shown on the schedule of revenues and expenditures – budget and actual (non-GAAP budgetary basis) for the State Highway Fund to the revenues over expenditures, before other financing uses, on a GAAP basis shown on the statement of revenues, expenditures, and changes in fund balances for the State Highway Fund. The expenditures shown on the schedule of revenues and expenditures – budget and actual (non-GAAP budgetary basis) are based on the budgetary allotted expenditures while the expenditures shown on the statement of revenues, expenditures, and changes in fund balance are based on GAAP. Therefore, significant differences may exist between these two bases.

| | |
|---|-----------------------|
| Revenues over expenditures and other uses, non-GAAP budgetary basis | \$ 32,432,043 |
| Federal grants in aid – not included in budgeted revenues but included in GAAP basis revenues | 153,903,445 |
| Miscellaneous differences in revenues based on budgetary basis and GAAP basis | 7,361,647 |
| Pass-through expenditures for county projects not included in allotted expenditures on budgetary basis but included in GAAP basis expenditures | (28,440,967) |
| Debt service payments budgeted as part of Administration of Highways Division, but not shown as an expenditure in State Highway Fund | 51,077,475 |
| Differences in operations and maintenance expenditures between budgetary basis and on a GAAP basis | (50,713,631) |
| Differences in Highways Division administrative expenditures between allotted expenditures on budgetary basis and expenditures on GAAP basis (less budgeted debt service payment) | (38,472,771) |
| Differences in Motor Vehicle Safety Office expenditures and gross receipts surcharge between allotted expenditures on budgetary basis and expenditures on GAAP basis | <u>(3,391,468)</u> |
| Revenues over expenditures, before other financing uses, GAAP basis | <u>\$ 123,755,773</u> |