STATE OF HAWAI'I
OFFICE OF THE AUDITOR
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LESLIE H. KONDO
State Auditor

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DEPT. COMM. NO. 380

April 27, 2018

VIA HAND DELIVERY

The Honorable Ronald D. Kouchi
Senate President
415 South Beretania Street
State Capitol, Room 409
Honolulu, Hawai'i 96813

RE: Financial and Compliance Audits of the Department of Health

Dear President Kouchi:

We are enclosing copies of : (1) the financial and compliance audit report of the Department of Health for the fiscal year ended June 30, 2017 issued on March 28, 2018; (2) the financial and compliance audit report of the Department of Health's Drinking Water Treatment Revolving Fund for the fiscal year ended June 30, 2017, issued on November 30, 2017; and (3) the financial and compliance audit report of the Department of Health's Water Pollution Control Revolving Fund for the fiscal year ended June 30, 2017, issued on November 30, 2017. The Office of the Auditor retained KMH LLP to perform the audits.

You may view the Auditor's Summary and reports on our website at:

http://files.hawaii.gov/auditor/Reports/2017_Audit/DOH2017.pdf

http://files.hawaii.gov/auditor/Reports/2017_Audit/DOH_Summary_2017.pdf

http://files.hawaii.gov/auditor/Reports/2017_Audit/DOH_DWTRLF_2017.pdf

http://files.hawaii.gov/auditor/Reports/2017_Audit/DOH_WPCRF_2017.pdf

If you have any questions about the report, please contact me.

Very truly yours,

Leslie H. Kondo
State Auditor

LHK:RTS:emo

Enclosures

Department of Health
State of Hawaii

Financial Statements
June 30, 2017
Together with Independent Auditor's Report

Submitted by

THE AUDITOR
STATE OF HAWAII

KMHLLP

A Hawaii Limited Liability Partnership

March 28, 2018

Mr. Leslie Kondo, State Auditor
Office of the Auditor
State of Hawaii

Dear Mr. Kondo:

This is our report on the financial audit of the Department of Health of the State of Hawaii (Department) as of and for the fiscal year ended June 30, 2017. Our audit was performed in accordance with the terms of our contract with the State of Hawaii and with the requirements of Title 2 U.S. Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance) and Government Auditing Standards, Audits of States, Local Governments, and Non-Profit Organizations.

OBJECTIVES OF THE AUDIT

The primary purpose of our audit was to form opinions on the fairness of the presentation of the Department's basic financial statements as of and for the fiscal year ended June 30, 2017, and to comply with the requirements of the Uniform Guidance. The objectives of the audit were as follows:

1. To provide a basis for an opinion on the fairness of the presentation of the Department's basic financial statements, including whether the schedule of expenditures of federal awards is fairly stated in relation to the financial statements.

2. To consider the Department's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the basic financial statements.

3. To perform tests on the Department's compliance with laws, regulations, contracts, and grants, including applicable provisions of the Hawaii Public Procurement Code (Chapter 103D and 103F, Hawaii Revised Statutes), that could have a direct and material effect on the determination of financial statement amounts.

4. To consider the Department's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinions on compliance and to test and report on internal control over compliance.

5. To provide a basis for opinions on the Department's compliance with applicable laws, regulations, contracts, and grants that could have a direct and material effect on each major federal program.

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SCOPE OF THE AUDIT

Our audit was performed in accordance with auditing standards generally accepted in the United States of America as prescribed by the American Institute of Certified Public Accountants; *Government Auditing Standards,* issued by the Comptroller General of the United States; and the provisions of the Uniform Guidance. The scope of our audit included an examination of the transactions and accounting records of the Department for the fiscal year ended June 30, 2017.

ORGANIZATION OF THE REPORT

This report is presented in six parts as follows:

- Part I – The basic financial statements and related notes to the financial statements of the Department as of and for the fiscal year ended June 30, 2017, and our opinion on the basic financial statements.
- Part II – Our report on internal control over financial reporting and on compliance and other matters.
- Part III – Our report on compliance for each major program and internal control over compliance.
- Part IV – The schedule of findings and questioned costs.
- Part V – The summary schedule of prior audit findings.
- Part VI – Corrective action plan as provided by the Department.

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

Sincerely,

Wilcox Choy

Wilcox Choy
Partner

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PART I

FINANCIAL SECTION

Independent Auditor's Report

Office of the Auditor
State of Hawaii

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Department of Health (Department), as of and for the fiscal year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the Department's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

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Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Department, as of June 30, 2017, and the respective changes in financial position, and, where applicable, its cash flows, and budgetary comparisons for each major fund for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As discussed in Note 1, the financial statements of the Department are intended to present the financial position, the changes in financial position, and, where applicable, its cash flows and budgetary comparisons, of only that portion of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the State of Hawaii that is attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2017, the changes in financial position, or, where applicable, its cash flows and budgetary comparisons, for the year then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

As discussed in Note 1 to the basic financials statements, in 2017 the Department adopted Government Accounting Standards Board (GASB) Statement No. 82 (GASB 82), *Pension Issues – an amendment of GASB statements No. 67, No. 68, and No. 73*. As a result of adopting this standard, the Department has restated beginning net position for the fiscal year ended June 30, 2016. Our opinions are not modified with respect to this matter.

As discussed in Note 11 to the basic financial statements, the 2016 financial statements have been restated to correct misstatements and the result of implementing GASB Statement No. 82. We also audited the adjustments described in Note 11 that were applied to restate the 2016 financial statements. In our opinion, such adjustments are appropriate and have been properly applied. Our opinions are not modified with respect to this matter.

Other Matters

2016 Financial Statements

The financial statements of the Department, as of and for the year ended June 30, 2016, before they were restated for the matter discussed in Note 11 to the financial statements, were audited by other auditors, whose report, dated March 27, 2017, expressed an unmodified opinion on those statements.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 11 through 22 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 Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Department's basic financial statements. The schedule of expenditures of federal awards, as required by the Office of Management and Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance), is not a required part of the basic financial statements.

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

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated March 28, 2018 on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is 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 Department'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 Department's internal control over financial reporting and compliance.

KMH LLP

KMH LLP

Honolulu, Hawaii
March 28, 2018

This Management's Discussion and Analysis ("MD&A") presents a narrative overview and analysis of the financial activities and performance of the State of Hawaii, Department of Health (the "Department") during the fiscal year that ended on June 30, 2017. Please read it in conjunction with the Department's financial statements and the related notes to the basic financial statements (which follow this section). The following is a brief description of the contents of those three sections:

Overview of the Basic Financial Statements

This MD&A serves as an introduction to the Department's basic financial statements. The basic financial statements are comprised of three components: (1) government- wide financial statements; (2) fund financial statements; and (3) notes to the basic financial statements.

Government-Wide Financial Statements

The government-wide financial statements provide information about the Department's overall financial position and results of operations. These statements, which are presented on an accrual basis of accounting, consists of the statement of net position and the statement of activities.

The government-wide statements report information about the Department as a whole using accounting methods similar to those used by private sector companies. The statement of net position provides both short-term and long-term information about the Department's financial position, which assists in assessing the Department's economic condition at the end of the fiscal year. All of the current year revenues and expenses are accounted for in the statement of activities regardless of when cash is received or paid. The government-wide financial statements include two statements:

- The *Statement of Net Position* presents all of the Department's assets, deferred outflows, liabilities and deferred inflows, with the difference reported as "net position." Over time, increases and decreases in the Department's net position may serve as a useful indicator of whether the financial position of the Department is improving or deteriorating.
- The *Statement of Activities* presents information showing how the Department's net position changed during the most recent fiscal year.

The government-wide financial statements of the Department are further divided into two categories:

- *Governmental activities* - The activities in this section are primarily supported by State of Hawaii appropriations, funds from the tobacco settlement, beverage container deposit administrative fees, federal grants, taxes, and other fees.
- *Business-type activities* - These functions normally are intended to recover all or a significant portion of their costs through user's fees and charges to external users. These activities include the Department's two revolving loan funds.

Fund Financial Statements

The fund financial statements include the Department's: (1) governmental funds, for which activities are funded primarily from appropriations from the State of Hawaii, beverage container deposit program collections, mental health and substance abuse, and federal grants; (2) proprietary funds, which consist of revolving loan funds and are reported similar to business activities; and (3) fiduciary funds. The governmental funds are presented on the modified accrual basis of accounting. The proprietary and the fiduciary funds are presented on the accrual basis of accounting.

The fund financial statements provide more detailed information about the Department's most significant funds and not the Department as a whole. In these statements, the financial activities of the Department are recorded in individual funds. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Department uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. Funds are reported as a major fund or a non-major (other) fund. The Governmental Accounting Standards Board ("GASB") issued Statement 34, *Basic Financial Statements - Management's Discussion and Analysis - for State and Local Governments*, which sets forth the minimum criteria for the determination of major funds. The non-major funds are combined in a column in the fund financial statements.

The fund financial statements also include the budgetary comparison statements, which include reconciliations for the general fund, Hawaii tobacco settlement special fund, deposit beverage container deposit special fund and mental health substance abuse special fund, comparing the excess of revenues over expenditures presented on a budgetary basis to the excess (deficiency) of revenues over expenditures presented in conformity with U.S. generally accepted accounting principles ("GAAP") as presented in the governmental fund financial statements.

To reiterate, the Department has three types of funds:

- *Governmental funds* - Governmental funds are used to account for essentially the same functions reported in the governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of expendable resources as well as on the balances of expendable resources available at the end of the fiscal year.

  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 in the government-wide financial statements. Both the governmental fund balance sheet and statement of revenues, expenditures, and changes in fund balance provide a reconciliation to facilitate comparison between governmental funds and governmental activities in the government-wide financial statements.

- *Proprietary funds* - Proprietary funds are used to report activities that operate more like those of commercial enterprises. They are known as enterprise funds because they charge fees for services provided to outsiders. They are used to report the same functions presented as business-type activities in the government-wide financial statements. The Department uses enterprise funds to account for the operations of its two revolving loan funds each of which are considered to be major funds of the Department.
- *Fiduciary funds* - The fiduciary funds account for net position held in a trustee or agent capacity for others. These funds are not reflected in the government-wide financial statements since these resources are not available to support the Department's programs.

Notes to the Basic Financial Statements

The Notes to Basic Financial Statements section provides additional information that is essential to a full understanding of the data provided in the basic financial statements. The notes to the basic financial statements follow the basic financial statements.

Government-wide Financial Highlights

The Department's total net position increased from $961.2 million (as restated) as of June 30, 2016 to $1,024.5 million as of June 30, 2017, or by approximately $63.3 million. The total increase in net position was attributed to increases in the Department's governmental activities net position of $39.0 million and business-type activities' net position of $24.3 million during the year.

The Department's governmental activities reported an aggregate increase in net position of approximately $39.0 million during the year totaling $311.6 million at June 30, 2017. Note that this is based on the net position at June 30, 2016 of $272.6 million (as restated).

The Department's proprietary funds, consisting of two revolving loan funds, reported an increase in net position of $24.3 million for FY 2017. Total net position was $688.5 million (as restated) at June 30, 2016 compared to $712.8 million at June 30, 2017.

Government-Wide Financial Analysis

This section includes condensed government-wide financial information and analysis.

Condensed Statement of Net Position
June 30,
($000)

	Governmental Activities		Business-Type Activities		Total	
	2017	2016	2017	2016	2017	2016
Current assets	$ 366,384	$ 334,496	$ 237,005	$ 246,846	$ 603,389	$ 581,342
Capital assets	84,682	71,528	633	723	85,315	72,251
Loans receivable, noncurrent	-	-	483,277	448,362	483,277	448,362
Total assets	451,066	406,024	720,915	695,931	1,171,981	1,101,955
Deferred outflows of resources related to pensions	-	-	2,287	786	2,287	786
Current liabilities	120,991	108,543	699	587	121,690	109,130
Long term liabilities	18,389	18,772	9,302	6,823	27,691	25,595
Total liabilities	139,380	127,315	10,001	7,410	149,381	134,725
Deferred inflows of resources related to pensions	-	-	372	660	372	660
Net position						
Net investment in capital assets	84,682	71,528	633	723	85,315	72.251
Restricted	59,500	55,012	712,197	687,924	771,697	742,936
Unrestricted	167,504	152,169	-	-	167,504	152,169
Total net position	$ 311,686	$ 278,709	$ 712,830	$ 688,647	$1,024,516	$ 967,356

As noted earlier, changes in net position may serve over time as a useful indicator of the Department's financial position. As of June 30, 2017, the Department's total net position was approximately $1,024.5 million.

Department of Health
State of Hawaii

Management Discussion and Analysis
June 30, 2017

At June 30, 2017, in addition to equity in cash and cash equivalents in the state treasury approximating $520.4 million, the Department had total loans receivable from county governments in the amount of $522.8 million arising from its two revolving loan funds. The Department had total liabilities of $149.4 million at June 30, 2017 of which $13.7 million relates to accrued wages and employee benefits payable. Approximately $59.2 million in liabilities relate to vouchers and contracts payable. At June 30, 2017, restricted net position was $771.7 million. The restrictions arise from legal and contractual agreements.

Condensed Statement of Activities
June 30,
($000)

	Governmental Activities		Business-Type Activities		Total	
	2017	2016	2017	2016	2017	2016
Revenue:						
Program revenues:						
Charges for services	$ 32,224	$ 25,488	$ 5,787	$ 5,904	$ 38,011	$ 31,392
Operating grants and contributions	122,884	116,489	25,296	49,588	148,180	166,077
General revenues:						
State appropriated funds	459,877	443,142	-	-	459,877	433,142
Non-imposed fringe benefits	68,703	59,826	-	-	68,703	59,826
Hawaii tobacco settlement special fund	48,400	48,917	-	-	48,400	48,917
Environmental fees and taxes	50,682	50,586	-	-	50,682	50,586
Total revenues	782,770	744,448	31,083	55,492	813,853	789,940
Expenditures:						
General administration	45,862	41,058	-	-	45,862	41,058
Environmental health administration	79,157	62,047	10,738	15,041	89,895	77,088
Behavioral health administration	314,113	301,078	-	-	314,113	301,078
Health resources administration	289,076	291,795	-	-	289,076	291,795
Total expenditures	728,208	695,978	10,738	15,041	738,946	711,019
Excess before transfers	54,562	48,470	20,345	40,451	74,907	78,921
Transfers	(15,502)	(29,044)	3,941	3,941	(11,561)	(25,103)
Change in net position	39,060	19,426	24,286	44,392	63,346	53,818
Net position:						
Restatement adjustments	(6,083)	-	(103)	-	(6,186)	-
Beginning of year	278,709	259,283	688,647	644,255	967,356	903,538
End of year	$ 311,686	$ 278,709	$ 712,830	$ 688,647	$1,024,516	$ 957,356

Governmental activities increased the Department's net position by $39.0 million in FY 2017, which was a 14.3% increase from FY 2016 (as restated). The overall increase in governmental activities is the result of higher revenues from the several areas: General revenues of state appropriated funds ($26.7M) and non-imposed fringe benefits ($8.9M).

Revenues of the Department's business-type activities, which decreased by $24.4 million from 2016, consist of the Department's environmental loan programs - one for water pollution control and the other for drinking water treatment - were generated from charges for services, program investment income, and federal assistance program funds as well as state matching funds. Charges for services consist primarily of administration loan fees and interest income on loans related to the Department's two revolving loan programs. The majority of the programs' investment income is from the Department's participation in the State Treasury Investment Pool System.

For the fiscal year ended June 30, 2017, business-type activities increased the Department's net position by $24.3 million to $712.8 million as compared to the fiscal year ended June 30, 2016.

Total government-wide expenditures for FY 2017 were $738.9 million of which $728.2 million was for governmental activities. As compared to FY 2016, total government-wide expenditures were $711.0 million of which $696.0 million was for governmental activities. Overall, the Department is organized into four major administrations.

The Department’s Behavioral Health Services Administration expended 42.5% or $314.1 million of departmental funds with an increase of $13.0 million compared to FY 2016. This administration is responsible for providing available and coordinated mental health and substance abuse treatment and prevention programs. Programs within this administration are:

- Adult Mental Health Division ("AMHD") that includes the Hawaii State Hospital and Community Mental Health Center Branches;
- Child and Adolescent Mental Health Division ("CAMHD") which includes seven Family Guidance Centers and the Family Court Liaison Branches;
- Alcohol and Drug Abuse Division ("ADAD") which plans for and purchases substance abuse prevention and treatment services for adolescents and adults; and
- Developmental Disabilities Division ("DDD") that services disabled clients in Hawaii while addressing the conditions of the Makin Settlement.

The Department's Health Resources Administration expended approximately 39.1% of Department funds. FY 2017 expenses for this Administration decreased $2.7 million compared to FY 2016. Major programs in this administration include:

- Family Health Services Division ("FHSD") that administers the State's Early Intervention program for children zero to three in compliance with the Federal Individual with Disabilities Education Act, Part C as well as serving children, youth and families through its three branches, namely, Children with Special Health Needs, Maternal and Child Health, and Women, Infants and Children;
- Emergency Medical Services and Injury Prevention System Branch ("EMSIPSB") that includes the State's mandated Emergency Medical Services, which operates the State's emergency ambulance service in the four major counties, and the injury prevention program;
- Communicable Disease and Public Health Nursing Division ("CDPHND") which strives to reduce morbidity and mortality from communicable diseases in Hawaii, to improve the health of individuals and communities, and to support the Medical Marijuana Registry program;
- Disease Outbreak Control Division which provides immunization and disease investigation services as well as provides emergency response to disease outbreaks and potential acts of bioterrorism;
- Office of Health Care Assurance ("OHCA") which manages the state licensing and Federal certification of medical and health care facilities, agencies, and services provided throughout the State in order to ensure acceptable standards of care provided and to ensure compliance with State and Federal requirements. OHCA is also responsible for the rollout and management of the Medical Marijuana Dispensaries.

The Department's Environmental Health Administration is responsible for the management of the clean air, clean water, solid and hazardous waste, public health sanitation, vector control, and purity of food and drugs. It expended approximately 12.2% of the departmental funds with an increase of $12.8 million expended versus FY 2016 on a government-wide basis. This administration also manages both the Water Pollution Control Revolving and the Drinking Water Treatment Revolving Loan Funds.

Finally, the Department's General Administration provides the overall leadership and oversight for the Department. It includes administrative support staff, three district health offices, and five administratively attached agencies. This administration expended approximately 6.2% of the departmental funds.

Governmental Funds Financial Analysis

The following table presents revenues and expenditures of the governmental funds for FY2017 and FY 2016 ($000):

	2017	2016
Revenues:		
State general fund allotments	$ 459,877	$ 443,142
Intergovernmental	122,959	113,908
Hawaii tobacco settlement special fund	48,400	48,919
Deposit beverage container deposit special fund	23,642	23,504
Non-imposed fringe benefits	68,703	59,826
Taxes, fees, fines and other	59,892	57,289
Investment income	1,338	974
Total revenues	784,811	747,562
Expenditures:		
General administration	44,336	40,330
Environmental health	77,908	62,132
Behavioral health	313,639	298,879
Health resources	288,011	290,345
Total expenditures	723,894	691,686
Excess of revenues over expenditures before transfers	$ 60,917	$ 55,876

The governmental funds revenue consist of the Department's general fund, Hawaii tobacco settlement special fund ("HTSSF"), deposit beverage container deposit special fund ("DBCDSF"), intergovernmental (federal) funds, taxes, fees, fines and investment income.

During the fiscal year ended June 30, 2017, general fund revenues were $517.5 million, including $68.6 million for fringe benefits paid directly from the State general fund. General fund expenditures were $507.3 million.

In FY 2017, the DBCDSF earned revenues of $23.8 million from beverage container deposit administrative fees and unredeemed containers income. Of this amount received, $19.5 million in expenditures were paid to redemption centers or utilized to fund the program. The fund collected $47.9 million in deposits from distributors and repaid $33.8 million in deposits to consumers during FY 2017.

The proprietary funds consist of two funds: Water Pollution Control Revolving Fund ("WPCRF") and Drinking Water Treatment Revolving Loan Fund ("DWTRLF") and are reported in the government-wide statement of net position and statement of activities as business-type activities.

The WPCRF accounts for federal and state funds used to provide loans to county governments for the construction of wastewater treatment facilities and the repayment of principal, interest and fees from such loans and investment of such monies. During FY 2017, WPCRF received $10.0 million and $2.2 million of federal and state funds, respectively. WPCRF also disbursed $46.6 million in loan proceeds and collected $30.1 million in principal repayments in 2017. As compared to 2016, the fund collected $23.1 million and $2.2 million in federal and state contributions, respectively, and disbursed $44.1 million in loan proceeds and collected $28.2 million in principal payments.

The DWTRLF accounts for federal and state funds used to provide loans and other types of financial assistance to public water systems for drinking water infrastructure and the repayment of principal interest and fees from such loans and the investment of such monies. During FY 2017, DWTRLF received $12.8 million and $1.8 million of federal and state funds, respectively. DWTRLF also disbursed $49.1 million in loan proceeds and collected $24.0 million in principal repayments in 2016. As compared to 2016, the DWTRLF collected $25.3 million and $1.8 million in federal and state contributions, respectively, and disbursed $30.5 million in loan proceeds and collected $8.3 million in principal payments.

The Department accounts for funds held as an agent and/or trustee for certain individuals in the fiduciary funds.

Budgetary Analysis

The following budget information relates to the general fund, deposit beverage container deposit special fund and mental health substance abuse special fund for 2017:

	Budgeted Amounts ($000)		Actual on a Budgetary Basis ($000)
	Original	Final	
General fund			
Revenues	$ 468,649	$ 472,480	$ 455,093
Expenditures			
General administration	32,269	32,580	31,963
Environmental health	23,782	23,897	21,209
Behavioral health	277,780	279,622	268,664
Health resources	134,818	136,381	133,257
Deposit beverage container deposit special fund			
Revenues	71,148	71,162	57,395
Expenditures	71,148	71,162	63,438
Mental health substance abuse fund			
Revenues	11,610	11,610	5,056
Expenditures	11,610	11,610	8,662

The deposit beverage container program recognized revenues on a budgetary basis of $57.4 million, which is based on the actual number of containers sold. In fiscal year 2016, there were 949.2 million containers sold. The amount of containers sold increased to 966.5 million in fiscal year 2017.

For the mental health substance abuse fund, the actual revenues received of $5.1 million in FY 2017 were $3.6 million less than the actual expenditures.

Capital Assets

As of June 30, 2017, the Department's governmental activities had invested approximately $84.7 million (net of accumulated depreciation) in a broad range of capital assets. See Note 4 to the Department's basic financial statements for a description of capital assets activities for the fiscal year ended June 30, 2017.

Capital Assets Governmental Activities June 30,
($000)

	2017	2016
Land	$ 1,018	$ 1,018
Land improvements	3,305	3,305
Buildings and building improvements	194,613	177,859
Furniture and equipment	25,868	24,850
Total	224,804	207,032
Accumulated depreciation	140,122	135,504
Total capital assets, net	$ 84,682	$ 71,528

Currently Known Facts, Decisions, or Conditions

Although the State's economy improved since last fiscal year, the State continued its cautious approach regarding expenditures. Therefore, the Department has continued to evaluate and monitor the statewide service delivery system of the adult mental health program in order to improve service delivery and to contain operational costs.

In FY 2017, AMHD serviced 9,925 clients as compared to the 7,828 clients serviced in FY 2016. AMHD's Crisis Line of Hawaii (formerly known as Access Line) continues to provide short term confidential counseling, information about available help, and mobile support services in a crisis.

In the developmental disabilities program, the number of clients decreased by 27 clients in FY 2017. In FY 2017, the program served 2,846 clients in the home and community-based waiver program as compared to 2,873 clients served in FY 2016.

Further, the Federal Medical Assistance Percentage ("FMAP") increased from 52.23 percent to 53.98 percent for the period October 2015 to September 2016. The FMAP increased from 53.98 percent to 54.93 percent effective October 2016 to September 2017.

And lastly, the WPCRF executed a total of six loan agreements for $32.2 million during FY 2017. DWTRLF executed a total of four loan agreements for $46.9 million during FY 2017. Further, the WPCRF expects to execute a total of six loan agreements in the amount of $52.7 million while the DWTRLF expects to execute a total of two loan agreements for $21.0 million in FY 2018.

Department of Health
State of Hawaii

Statement of Net Position
June 30, 2017

	Governmental Activities	Business-Type Activities	Total
Assets and Deferred Outflows of Resources			
Current Assets:			
Equity in Cash and Cash Equivalents and Investments in State Treasury	$ 325,323,491	$ 195,129,700	$ 520,453,191
Receivables:			
Due from State Treasury	-	429,537	429,537
Due from other State agencies	3,710,145	-	3,710,145
Accrued interest and loan fees	401,858	1,847,263	2,249,121
Accounts receivable	121,019	3,467	124,486
Due from federal government	11,527,435	72,021	11,599,456
Tobacco settlement receivable	25,300,000	-	25,300,000
Current maturities of loans receivable	-	39,523,194	39,523,194
Total current assets	366,383,948	237,005,182	603,389,130
Loans Receivable, net of current maturities	-	483,276,400	483,276,400
Capital Assets, net of accumulated depreciation	84,682,320	633,137	85,315,457
Total assets	451,066,268	720,914,719	1,171,980,987
Deferred Outflows of Resources Related to Pensions	-	2,287,468	2,287,468
Total assets and deferred outflows of resources	$ 451,066,268	$ 723,202,187	$ 1,174,268,455
Liabilities, Deferred Inflows of Resources, and Net Position			
Current Liabilities:			
Vouchers payable	$ 59,038,517	$ 129,525	$ 59,168,042
Accrued wages and employee benefits payable	13,221,496	438,037	13,659,533
Unearned revenue	3,074,078	-	3,074,078
Accrued vacation, current portion	10,621,466	131,674	10,753,140
Workers' compensation liability	786,381	-	786,381
Due to other State agencies	32,550,399	-	32,550,399
Beverage container deposits	1,698,494	-	1,698,494
Total current liabilities	120,990,831	699,236	121,690,067
Accrued Vacation, net of current portion	18,389,359	342,392	18,731,751
Net Pension Liability	-	6,367,104	6,367,104
Other Postemployment Benefits	-	2,591,967	2,591,967
Total liabilities	139,380,190	10,000,699	149,380,889
Deferred Inflows of Resources Related to Pensions	-	371,875	371,875
Net Position:			
Net investment in capital assets	84,682,320	633,137	85,315,457
Restricted for:			
Loans	-	712,196,476	712,196,476
Trust fund programs	5,854,579	-	5,854,579
Medicaid programs	53,645,465	-	53,645,465
Unrestricted	167,503,714	-	167,503,714
Total net position	311,686,078	712,829,613	1,024,515,691
Total liabilities, deferred inflows of resources, and net position	$ 451,066,268	$ 723,202,187	$ 1,174,268,455

See accompanying notes to the basic financial statements.

Department of Health
State of Hawaii

Statement of Activities
For the Fiscal Year Ended June 30, 2017

		Program Revenues		Net (Expenses) Revenue and Changes in Net Position		
Functions/Programs	**Expenses**	**Charges for Services**	**Operating Grants and Contributions**	**Governmental Activities**	**Business-Type Activities**	**Total**
Governmental Activities:						
General administration	$ 45,861,975	$ 1,614,536	$ 7,882,946	$ (36,364,493)	$ -	$ (36,364,493)
Environmental health administration	79,157,002	12,661,209	8,989,606	(57,506,187)	-	(57,506,187)
Behavioral health services administration	314,112,997	1,178,600	14,747,382	(298,187,015)	-	(298,187,015)
Health resources administration	289,075,720	16,769,564	91,264,413	(181,041,743)	-	(181,041,743)
Total governmental activities	728,207,694	32,223,909	122,884,347	(573,099,438)	-	(573,099,438)
Business-type Activities --						
Environmental Health Loan Programs	10,737,760	5,786,229	25,295,913	-	20,344,382	20,344,382
Total Department	$ 738,945,454	$ 38,010,138	$ 148,180,260	(573,099,438)	20,344,382	(552,755,056)
General Revenues:						
State general fund allotments, net				459,876,958	-	459,876,958
Nonimposed employee fringe benefits				68,702,588	-	68,702,588
Hawaii tobacco settlement special fund				48,399,839	-	48,399,839
Tobacco tax				25,000,000	-	25,000,000
Deposit beverage container fee				23,642,248	-	23,642,248
Environmental response tax				1,266,898	-	1,266,898
Advance glass disposal fee				772,991	-	772,991
Total general revenues				627,661,522	-	627,661,522
Transfers				(15,501,750)	3,941,000	(11,560,750)
Change in net position				39,060,334	24,285,382	63,345,716
Net Position at July 1, 2016, as previously reported				278,708,642	688,647,182	967,355,824
Restatement Adjustments				(6,082,898)	(102,951)	(6,185,849)
Net Position at July 1, 2016, as restated				272,625,744	688,544,231	961,169,975
Net Position at June 30, 2017				$ 311,686,078	$ 712,829,613	$ 1,024,515,691

See accompanying notes to the basic financial statements.

Department of Health
State of Hawaii

Balance Sheet – Governmental Funds
June 30, 2017

	General	Deposit Beverage Container Deposit	Mental Health Substance Abuse	Other Governmental Funds	Total Governmental Funds
Assets:					
Equity in cash and cash equivalents and investments in State Treasury	$ 95,008,858	$ 36,041,595	$ 45,506,531	$ 148,766,507	$ 325,323,491
Due from other State agencies	-	-	1,214,011	2,496,134	3,710,145
Accrued interest receivable	-	33,934	97,378	270,546	401,858
Accounts receivable	-	121,019	-	-	121,019
Due from Federal government	-	-	-	11,527,435	11,527,435
Total assets	$ 95,008,858	$ 36,196,548	$ 46,817,920	$ 163,060,622	$ 341,083,948
Liabilities and Fund Balances					
Liabilities:					
Vouchers and contracts payable	$ 29,666,937	$ 3,850,960	$ 218,799	$ 25,301,821	$ 59,038,517
Accrued wages and					-
employee benefits payable	10,460,180	39,706	-	2,721,610	13,221,496
Unearned revenue	-	-	1,214,011	5,556,129	6,770,140
Due to other State agencies	-	-	-	7,250,399	7,250,399
Beverage container deposits	-	1,698,494	-	-	1,698,494
Total liabilities	40,127,117	5,589,160	1,432,810	40,829,959	87,979,046
Fund Balances:					
Restricted:					
Medicaid programs	-	-	45,385,110	8,260,355	53,645,465
Trust fund programs	-	-	-	5,854,579	5,854,579
Committed:					-
Behavioral health administration	-	-	-	6,527,852	6,527,852
Enviornmental health administration	-	-	-	22,289,708	22,289,708
General administration	-	-	-	4,184,614	4,184,614
Health resources administration	-	-	-	53,587,737	53,587,737
Capital projects activities	-	-	-	10,033,087	10,033,087
Deposit beverage container program	-	30,607,388	-	-	30,607,388
Tobacco settlement program	-	-	-	11,786,736	11,786,736
Assigned:					
Behavioral health administration	23,542,849	-	-	-	23,542,849
Environmental health administration	1,782,792	-	-	-	1,782,792
General administration	12,751,875	-	-	-	12,751,875
Health resources administration	16,804,225	-	-	-	16,804,225
Unassigned	-	-	-	(294,005)	(294,005)
Total fund balances	54,881,741	30,607,388	45,385,110	122,230,663	253,104,902
Total liabilities and fund balances	$ 95,008,858	$ 36,196,548	$ 46,817,920	$ 163,060,622	$ 341,083,948

See accompanying notes to the basic financial statements.

Department of Health
State of Hawaii

Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Position
June 30, 2017

Total Fund Balances - Governmental Funds	$ 253,104,902
Amounts Reported for Governmental Activities in the Statement of Net Position are Different Because:	
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the governmental funds	84,682,320
Compensated absences reported in the statement of net position do not require the use of current financial resources and therefore are not reported as liabilities in the governmental funds	(29,010,825)
Workers' compensation liability reported in the statement of net position does not require the use of current financial resources and therefore is not reported as a liability in the governmental funds	(786,381)
Revenues not collected within 60 days and therefore not available for current financial resources are reported as unavailable revenues in the governmental funds.	3,696,062
Net Position of Governmental Activitie	$ 311,686,078

See accompanying notes to the basic financial statements.

Department of Health
State of Hawaii

Statement of Revenues, Expenditures, and Changes in Fund Balances – Governmental Funds
For the Fiscal Year Ended June 30, 2017

	General	Deposit Beverage Container Deposit	Mental Health Substance Abuse	Other Governmental Funds	Total Governmental Funds
Revenues:					
State-alloted appropriations	$ 448,937,958	$ -	$ -	$ 10,939,000	$ 459,876,958
Intergovernmental	-	-	-	122,958,973	122,958,973
Nonimposed employee fringe benefits	68,586,202	5,559	-	110,827	68,702,588
Taxes, fees, fines and other	-	-	139,674	59,752,371	59,892,045
Investment income	-	111,062	371,272	855,431	1,337,765
Hawaii tobacco settlement	-	-	-	48,399,839	48,399,839
Deposit beverage container deposit	-	23,642,248	-	-	23,642,248
Total revenues	517,524,160	23,758,869	510,946	243,016,441	784,810,416
Expenditures:					
General administration	35,455,235	-	-	8,881,081	44,336,316
Environmental health	29,794,766	19,524,261	-	28,588,545	77,907,572
Behavioral health services	295,126,669	-	718,325	17,794,056	313,639,050
Health resources	146,902,941	-	-	141,107,619	288,010,560
Total expenditures	507,279,611	19,524,261	718,325	196,371,301	723,893,498
Excess (deficiency) of revenues over (under) expenditures	10,244,549	4,234,608	(207,379)	46,645,140	60,916,918
Other Financing Sources (Uses):					
Transfers in	-	-	46,972,590	81,743,614	128,716,204
Transfers out	(6,181,538)	(4,301)	(46,026,247)	(114,003,794)	(166,215,880)
Total other financing sources (uses)	(6,181,538)	(4,301)	946,343	(32,260,180)	(37,499,676)
Net change in fund balances	4,063,011	4,230,307	738,964	14,384,960	23,417,242
Fund Balances at July 1, 2016, as previous reported	50,818,730	27,013,392	44,646,146	113,292,290	235,770,558
Restatement Adjustments	-	(636,311)	-	(5,446,587)	(6,082,898)
Fund Balances at July 1, 2016, as restated	50,818,730	26,377,081	44,646,146	107,845,703	229,687,660
Fund Balances at June 30, 2017	$ 54,881,741	$ 30,607,388	$ 45,385,110	$ 122,230,663	$ 253,104,902

See accompanying notes to the basic financial statements.

Department of Health
State of Hawaii

Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balances to the Statement of Activities
For the Fiscal Year Ended June 30, 2017

Net Change in Fund Balances - Total Governmental Funds	$	23,417,242
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 are allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which capital outlays less dispositions exceeded depreciation for the year.		13,153,832
Increase in compensated absences reported in the statement of activities do not require the use of current financial resources and therefore not reported as expenditures in the governmental funds.		(644,746)
Decrease in workers' compensation liability reported in the statement of activities do not require the use of current financial resources and therefore is not reported as expenditures in the governmental funds.		245,944
Transfers reported on the statement of activities that do not provide or use current financial resources are not reported as transfers for the governmental funds		2,888,062
Change in Net Position - Governmental Activities	$	39,060,334

See accompanying notes to the basic financial statements.

Department of Health
State of Hawaii

General Fund
Statement of Revenues and Expenditures - Budget and Actual
For the Fiscal Year Ended June 30, 2017

	Original	Final	Actual on Budgetary Basis	Variance Favorable (Unfavorable)
Revenues --				
State allotments	$ 468,649,394	$ 472,479,799	$ 455,092,717	$ (17,387,082)
Expenditures:				
General administration	32,269,360	32,579,507	31,962,868	616,639
Environmental health	23,781,687	23,897,021	21,208,642	2,688,379
Behavioral health services	277,780,076	279,622,430	268,664,162	10,958,268
Health resources	134,818,271	136,380,841	133,257,045	3,123,796
	468,649,394	472,479,799	455,092,717	17,387,082
Excess of revenues over expenditures	$ -	$ -	$ -	$ -

See accompanying notes to the basic financial statements.

Department of Health
State of Hawaii

Special Revenue Funds
Statement of Revenues and Expenditures - Budget and Actual
For the Fiscal Year Ended June 30, 2017

			Actual on Budgetary Basis		
	Original	**Final**	**Deposit Beverage Container Deposit Special Revenue Fund**	**Mental Health Substance Abuse**	**Variance Favorable (Unfavorable)**
Revenues --					
Intergovernmental revenues:					
Deposit beverage container deposit	$ 71,147,889	$ 71,161,909	$ 57,395,107	$ -	$ (13,766,802)
Mental health substance abuse	11,610,000	11,610,000	-	5,055,541	(6,554,459)
	82,757,889	82,771,909	57,395,107	5,055,541	(20,321,261)
Expenditures:					
Environmental health					
Deposit beverage container deposit	71,147,889	71,161,909	63,438,260	-	7,723,649
Mental health substance abuse	11,610,000	11,610,000	-	8,661,665	2,948,335
	82,757,889	82,771,909	63,438,260	8,661,665	10,671,984
Deficiency of revenues under expenditures	$ -	$ -	$ (6,043,153)	$ (3,606,124)	$ (9,649,277)

See accompanying notes to the basic financial statements.

Department of Health
State of Hawaii

Statement of Net Position - Proprietary Funds
June 30, 2017

	Business-type Activities - Enterprise Fund		
	Water Pollution Control Revolving Fund	Drinking Water Treatment Revolving Loan Fund	Total
Assets and Deferred Outflows of Resources:			
Current assets:			
Equity in cash and cash equivalents and investments in State Treasury	$ 152,457,917	$ 42,671,783	$ 195,129,700
Loan fees receivable	357,933	566,577	924,510
Accrued interest receivable	363,603	115,892	479,495
Other accrued interest	320,271	122,987	443,258
Due from State Treasury	176,202	253,335	429,537
Due from Federal Government	-	72,021	72,021
Accounts receivable	-	3,467	3,467
Current portion of loans receivable	31,568,631	7,954,563	39,523,194
Total current assets	185,244,557	51,760,625	237,005,182
Loan receivable, net of current portion	334,378,240	148,898,160	483,276,400
Capital assets, net of accumulated depreciation	1,051	632,086	633,137
Total assets	519,623,848	201,290,871	720,914,719
Deferred outflows of resources related to pensions	1,422,191	865,277	2,287,468
Total assets and deferred outflows of resources	$ 521,046,039	$ 202,156,148	$ 723,202,187
Liabilities, Deferred Inflows of Resources, and Net Position:			
Current liabilities--			
Accounts payable and other accrued liabilities	$ 234,915	$ 464,321	$ 699,236
Accrued vacation, net of current portion	182,592	159,800	342,392
Net pension liability	3,850,425	2,516,679	6,367,104
Other postemployment benefits	1,615,392	976,575	2,591,967
Total liabilities	5,883,324	4,117,375	10,000,699
Deferred inflows of resources related to pensions	66,014	305,861	371,875
Net Position:			
Net investment in capital assets	1,051	632,086	633,137
Restricted - expendable	515,095,650	197,100,826	712,196,476
Total net position	515,096,701	197,732,912	712,829,613
Total liabilities, deferred inflows of resources, and net position	$ 521,046,039	$ 202,156,148	$ 723,202,187

See accompanying notes to the basic financial statements.

Department of Health
State of Hawaii

Statement of Revenues, Expenses and Changes in Net Position - Proprietary Funds
For the Fiscal Year Ended June 30, 2017

	Business-type Activities-Enterprise Fund		
	Water Pollution Control Revolving Fund	**Drinking Water Treatment Revolving Loan Fund**	**Total**
Operating Revenues:			
Interest income from loans	$ 1,419,075	$ 482,655	$ 1,901,730
Administrative loan fees	1,659,465	2,225,034	3,884,499
Total revenues	3,078,540	2,707,689	5,786,229
Expenses:			
Administrative	2,429,915	1,597,367	4,027,282
State program management	-	1,125,889	1,125,889.00
Water protection	-	286,314	286,314.00
Small system technical assistance	-	17,595	17,595
Principal forgiveness for SRF	1,034,800	4,245,880	5,280,680
Total expenses	3,464,715	7,273,045	10,737,760
Operating loss	(386,175)	(4,565,356)	(4,951,531)
Nonoperating Revenues and Expenses:			
State contributions	2,172,000	1,769,000	3,941,000
Federal contributions	10,189,000	13,084,934	23,273,934
Other interest income	1,432,761	556,160	1,988,921
Other income	17,882	15,176	33,058
Total nonoperating revenues and expenses	13,811,643	15,425,270	29,236,913
Change in net position	13,425,468	10,859,914	24,285,382
Net Position:			
Beginning of year, as previously reported	501,721,450	186,925,732	688,647,182
Restatement due to change in accounting principle	(50,217)	(52,734)	(102,951)
Beginning of year, as restated	501,671,233	186,872,998	688,544,231
End of year	$ 515,096,701	$ 197,732,912	$ 712,829,613

See accompanying notes to the basic financial statements.

Department of Health
State of Hawaii

Statement of Cash Flows - Proprietary Funds
For the Fiscal Year Ended June 30, 2017

	Business-type Activities - Enterprise Fund		
	Water Pollution Control Revolving Fund	Drinking Water Treatment Revolving Loan Fund	Total
Cash Flows from Operating Activities:			
Payments to employees	$ (1,750,383)	$ (1,512,953)	$ (3,263,336)
Payments to vendors	(134,299)	(784,915)	(919,214)
Net cash used in operating activities	(1,884,682)	(2,297,868)	(4,182,550)
Cash Flows from Noncapital Financing Activities:			
State contributions	2,172,000	1,769,000	3,941,000
Federal contributions	10,033,000	12,805,156	22,838,156
Net cash provided by noncapital financing activities	12,205,000	14,574,156	26,779,156
Cash Flows from Capital and Related Financing Activities--			
Purchase of equipment	-	(109,156)	(109,156)
Cash Flows from Investing Activities:			
Principal repayments on loans	30,067,153	23,993,473	54,060,626
Disbursement of loan proceeds	(46,563,350)	(49,101,105)	(95,664,455)
Interest income from loans	1,443,296	462,230	1,905,526
Administrative loan fees	1,629,553	2,315,495	3,945,048
Other interest income	1,166,160	443,575	1,609,735
Net cash used in investing activities	(12,257,188)	(21,886,332)	(34,143,520)
Net decrease in cash	(1,936,870)	(9,719,200)	(11,656,070)
Equity in Cash and Cash Equivalents and Investments in State Treasury:			
Beginning of year	154,394,787	52,390,983	206,785,770
End of year	$ 152,457,917	$ 42,671,783	$ 195,129,700
Reconciliation of Operating Loss to Net Cash Provided by Operating Activities:			
Operating loss	$ (386,175)	$ (4,565,356)	$ (4,951,531)
Adjustments to reconcile operating loss to net cash used in operating activities:			
Depreciation expense	1,578	197,049	198,627
Principal forgiveness for SRF	1,034,800	4,245,880	5,280,680
Interest income from loans	(1,419,075)	(482,655)	(1,901,730)
Administrative loan fees	(1,659,466)	(2,225,034)	(3,884,500)
In-kind contribution from the Environmental Protection Agency	156,000	141,032	297,032
Non-imposed fringe benefits	17,882	15,176	33,058
Change in assets, deferred outflows, liabilities, and deferred inflows:			
Due from State Treasury	30,265	18,372	48,637
Accounts receivable	-	(1,307)	(1,307)
Accounts payable and other accrued liabilities	(1,016)	84,240	83,224
Net deferred outflows/inflows of resources related to pensions	(1,045,476)	(846,305)	(1,891,781)
Net pension liability	1,297,447	1,035,559	2,333,006
Other postemployment benefits	88,554	85,481	174,035
Net cash used in operating activities	$ (1,884,682)	$ (2,297,868)	$ (4,182,550)

See accompanying notes to the basic financial statements.

Department of Health
State of Hawaii

Fiduciary Funds
Statement of Fiduciary Net Position - Agency Funds
June 30, 2017

Assets --	
Cash and cash equivalents	$ 437,041
Total assets	437,041
Liabilities --	
Due to others	437,041
Total liabilities	437,041
Net Position	$ -

See accompanying notes to the basic financial statements.

1. Organization and Summary of Significant Accounting Policies

a. Financial Reporting Entity

The State of Hawaii, Department of Health (the “Department”), administers and oversees statewide personal health services, health promotion and disease prevention, mental health programs, monitoring of the environment, and the enforcement of environmental health laws. Federal grants received to support the State’s health services and programs are administered by the Department.

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

The Department is part of the executive branch of the State of Hawaii (“State”). The financial statements of the Department are intended to present the financial position and the changes in financial position and cash flows, where applicable, of only that portion of the governmental activities, business-type activities, each major fund, and the aggregate remaining fund information of the State that is attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State as of June 30, 2017, and the changes in its financial position and cash flows, and budgetary comparisons, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America. The State Comptroller maintains the central accounts for all State funds and publishes the State’s Comprehensive Annual Financial Report (“CAFR”), which includes the Department’s financial activities.

Act 262, Session Laws of Hawaii of 1996, established the Hawaii Health Systems Corporation (“HHSC”) as a public body corporate and politic and an instrumentality and agency of the State. HHSC consists of the state hospitals and was created to provide quality health care for all of the people in the State. HHSC commenced operations on July 1, 1996 and is administratively attached to the Department. However, HHSC is a component unit of the State and not the Department. HHSC’s stand-alone financial statements are included in the State’s CAFR but are not included in the Department’s basic financial statements.

1. Organization and Summary of Significant Accounting Policies (continued)

b. Government-wide Financial Statements

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

Certain eliminations have been made as prescribed by GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, related to interfund activities, receivables, and payables. All internal balances have been eliminated except those representing balances between governmental and business-type activities, which are presented as internal balances and eliminated in the total department column when applicable. In the statement of activities, those transactions between governmental and business-type activities have not been eliminated. In addition, the fiduciary funds account for net position held in a trustee or agent capacity for others. These funds are not reflected in the government- wide financial statements since these resources are not available to support the Department's programs.

c. Fund Financial Statements

The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Department considers revenues other than federal grants and assistance awards to be available if they are collected within 60 days of the end of the current fiscal year end.

Federal grants and assistance awards made on the basis of entitlement periods are recorded as revenue when available and entitlement occurs which is generally within 12 months of the end of the current fiscal year. All other federal reimbursement-type grants are recorded as intergovernmental receivables and revenues when the related expenditure or expenses are incurred as of fiscal year-end and funds are available.

1. Organization and Summary of Significant Accounting Policies (continued)

c. Fund Financial Statements (continued)

Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, expenditures related to compensated absences and claims and judgments are recorded only when payment is due.

The proprietary and fiduciary fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, similar to the government-wide financial statements described above.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. Revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses. The principal operating revenues of the proprietary funds are interest income and administrative loan fees on loans made to county governments. Federal grants, state matching funds and interest income from sources other than loans are reported as nonoperating revenues. Principal forgiveness for loans and ARRA advances are reported as operating expenses.

A description of the funds administered by the Department is as follows:

***General Fund* -** The General Fund is the general operating fund of the Department. It is used to account for all financial resources except those required to be accounted for in another fund. The General Fund presented is a part of the State's General Fund and is limited to only those appropriations and obligations of the Department.

***Special Revenue Funds* -** Special revenue funds are used to account for the proceeds of specific revenue sources (other than major capital projects) that are legally restricted to expenditures for specified purposes.

***Capital Projects Funds* -** Capital projects funds are used to account for financial resources to be used for the acquisition or construction of major capital facilities (other than those financed by proprietary funds) and are included in Other Funds in the fund financial statements.

1. Organization and Summary of Significant Accounting Policies (continued)

c. Fund Financial Statements (continued)

The Department accounts for governmental fund balances in accordance with GASB Statement No. 54 (“GASBS 54”), *Fund Balance Reporting and Governmental Fund Type Definitions*. GASBS 54’s hierarchical fund balance classification structure is based primarily on the extent to which a government is bound to follow constraints on how resources can be spent. Classifications include:

Nonspendable fund balance **-** amounts that are not in spendable form (such as inventory) or are required to be maintained in tact;

Restricted - amounts constrained to specific purposes by their providers (such as creditors, grantors or other governments) through constitutional provisions, or by enabling legislation;

Committed - amounts constrained to specific purposes by a government itself, using its highest level of decision-making authority; to be reported as committed, amounts cannot be used for any other purpose unless the government takes the same highest level of action to remove or change the constraint;

Assigned **-** amounts a government intends to use for a specific purpose; intent can be expressed by the governing body or by an official or body to which the government delegates the authority;

Unassigned **-** amounts that are available for any purpose; positive amounts are reported only in the general fund.

When both restricted and unrestricted balances are available for use, it is the Department’s policy to use restricted fund balance first, then unrestricted fund balance. Furthermore, committed fund balances are reduced first, followed by assigned amounts, and then unassigned amounts when expenditures are incurred for purposes for which amounts in any of those unrestricted classifications can be used.

1. Organization and Summary of Significant Accounting Policies (continued)

c. Fund Financial Statements (continued)

Proprietary Funds (Business-Type Activities)

Enterprise Funds - Enterprise funds are used to account for the activities for which the intent of management is to recover, primarily through user charges, the cost of providing goods or services to customers or where sound financial management dictates that periodic determination of results of operations are appropriate.

Fiduciary Funds

Agency Funds - Agency funds are used to account for cash collected and disbursed by the Department in a custodial capacity.

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

The State Director of Finance is responsible for the safekeeping of cash in the State Treasury in accordance with State laws. The Director of Finance may invest any monies of the State which, in the Director's judgment, are in excess of the amounts necessary for meeting the immediate requirements of the State. Cash is pooled with funds from other State agencies and departments and deposited into approved financial institutions or in the State Treasury Investment Pool System. 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.

GASB Statement No. 40, Deposit and Investment Risk Disclosures, 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 Department. However, as all of the Department's monies are held in the State cash pool, the Department does not manage its own investments and the types of investments and related interest rate, credit and custodial risks are not determinable at the department level. The risk disclosures of the State's cash pool are included in the CAFR which may be obtained from the Department of Accounting and General Services' ("DAGS") website: http://ags.hawaii.gov/accounting/annual-financial-reports/.

1. Organization and Summary of Significant Accounting Policies (continued)

e. Due from Other State Agencies

Receivables due from other State agencies consist of reimbursements from the Department of Human Services ("DHS") for Medicaid payments that the Department makes to providers of health services. The Department is responsible to pay the State portion of the Medicaid claims, and DHS reimburses the Department for the Federal portion of the claims. The receivable of $3.7 million is comprised of various Medicaid rehabilitation option claims.

Payments made to providers and received from DHS for the Federal portion of the Medicaid claims are classified as expenditures and transfers in, respectively, for financial statement purposes.

f. Tobacco Settlement

In November 1998, the State settled its tobacco lawsuit as part of a nationwide settlement involving 46 other states and various tobacco industry defendants. Under the settlement, those tobacco companies that have joined in the Master Settlement Agreement will pay the State approximately $1.3 billion over a 25 year period. The Department is responsible for administering the Hawaii Tobacco Settlement Special Fund ("HTSSF"). The Department receives all tobacco settlement monies and then allocates and appropriates 100 percent of the funds to other State agencies and other entities in accordance with Act 118, SLH 2015. The Department receives annual payments on April 15 of each year for tobacco settlements earned for the preceding calendar year.

The Department recognized approximately $48.4 million in tobacco settlement revenues during the year ended June 30, 2017. In accordance with GASB Technical Bulletin No. 2004-1, *Tobacco Settlement Recognition and Financial Reporting Entity Issues*, the Department has recorded a tobacco settlement receivable for $25.3 million in the statement of net position representing tobacco settlements earned for the period January 1, 2017 through June 30, 2017.

1. Organization and Summary of Significant Accounting Policies (continued)

g. Loans Receivable

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

h. Administrative Loan Fees

The Department has implemented an administrative loan fee program to pay for the proprietary fund's administration, including employee salaries and benefits. The proprietary funds apply an administrative fee to all loans as provided for in Chapter 11-65 of the Hawaii Administrative Rules.

i. Capital Assets

Capital assets, which include buildings, furniture, and equipment, are reported in the applicable governmental or business-type activities in the government- wide financial statements and in the proprietary funds' financial statements. Capital assets are defined by the Department as those assets with estimated useful lives greater than one year and with an acquisition cost greater than:

	Minimum Capitalization Amount
Land	All
Land improvements	$ 100,000
Buildings and improvements	100,000
Furniture and equipment	5,000
Motor Vehicles	5,000

1. Organization and Summary of Significant Accounting Policies (continued)

i. Capital Assets (continued)

Such assets are recorded at historical cost if purchased or constructed. Donated assets are recorded at estimated fair value at the time received. Depreciation expense is recorded in the government-wide and proprietary funds' financial statements using the straight-line method over the estimated useful lives of the assets. Generally, the useful lives (in years) are as follows:

	Governmental-Type Activities	Business-Type Activities
Land improvements	15 years	5-100 years
Buildings and improvements	30 years	5-100 years
Furniture and equipment	7 years	1-25 years
Motor Vehicles	5 years	5-10 years

j. Unearned Revenue

Unearned revenues at the government-wide level and fund level arise when the Department receives resources before it has a legal claim to them. In subsequent periods, when the revenue recognition criteria is met, or when the Department has a legal claim to the resources, the liability for unearned revenue is removed from the statement of net position and balance sheet, and revenue is recognized. Unearned revenues at June 30, 2017 consisted primarily of Federal grant funds for which all requirements had not yet been met.

k. Due to Other State Agencies

Payables to other State agencies consist of funds allocated to other State agencies in accordance with the HTSSF. The amount allocated to other funds in accordance with the HTSSF is $32.6 million.

l. Beverage Container Deposits and Container Fees

Deposits of $0.05 are made by distributors to the deposit beverage container deposit special fund ("DBCDSF") for each qualifying container sold. The DBCDSF maintains all deposits until the redemption centers claim reimbursement for the deposits paid to consumers. The DBCDSF maintains the deposits that are expected to be redeemed. In addition, deposits of $0.01 are made by the distributors to the DBCDSF for each qualifying container as a handling fee.

1. Organization and Summary of Significant Accounting Policies (continued)

l. Beverage Container Deposits and Container Fees (continued)

Amounts paid to consumers are based on containers redeemed or a predetermined weight per type of container redeemed (i.e., aluminum, mixed plastics, etc.). These weights are determined based on the mix of containers redeemed and are reviewed when necessary. Management adjusts the deposit liability balance and unredeemed deposit revenue recognized based on the amount of deposits refunded in the first three months of the subsequent fiscal year related to deposits collected prior to year end. Deposits not refunded within the first three months of the subsequent fiscal year are recognized as revenue for the previous year.

According to HRS 342G-104, any funds that accumulate in the DBCDSF shall be retained by the fund unless determined to be in excess by the Legislature.

m. Deferred Outflows and Inflows of Resources

Deferred outflows of resources represent a consumption of net position that applies to a future period and will not be recognized as an outflow of resources (expense) until that time. Deferred inflows of resources represent an acquisition of net position that applies to a future period and will not be recognized as an inflow of resources (revenue) until that time.

n. Accrued Vacation

Vacation pay is accrued as earned by employees. Vacation pay can accumulate at the rate of one and three-quarters working days for each month of service up to 720 hours at calendar year-end and is convertible to pay upon termination of employment. As accrued vacation does not require the use of current financial resources, it is not reported in the governmental funds balance sheet.

o. 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, a State employee who retires or leaves government service in good standing with 60 days or more of unused sick leave is entitled to additional service credit in the State's Employees' Retirement System ("ERS"). At June 30, 2017, accumulated sick leave was approximately $77.3 million.

1. Organization and Summary of Significant Accounting Policies (continued)

p. 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 are recorded as operating transfers in the basic financial statements.

q. Use of Estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

r. Encumbrances

Encumbrance accounting, under which purchase orders and contractual commitments for the expenditure of funds are recorded in order to reserve that portion of the applicable appropriation, is employed in the governmental funds. Although appropriations generally lapse at year end, open encumbrances are reported as reservations of fund balances because the commitments will be honored when the goods or services are received. Encumbrances do not constitute expenditures or liabilities. Encumbrances at June 30, 2017 for the Department's governmental funds were approximately:

	Governmental Activities
General	$ 52,392,000
Deposit beverage container deposit special fund	12,829,000
Mental health substance abuse	5,622,000
Other funds	14,951,000
	$ 85,794,000

1. Organization and Summary of Significant Accounting Policies (continued)

s. Use of Restricted and Unrestricted Net Position

When an expense is incurred for which both restricted and unrestricted net position is available, the Department's policy is to apply restricted net position first.

t. Nonmonetary Transactions

The Department receives noncash awards for one of its federally funded programs. The Department expended approximately $15,905,000 in vaccines in fiscal year 2017.

u. Administrative Costs

DAGS assesses the Department's special funds centralized and administrative service fees, which are recorded as direct expenditures in the Department's funds. The Deposit Beverage Container Deposit Special Fund is exempt from paying the central service fee assessed by DAGS under ACT 228, SLH 2013.

v. Pensions

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

w. New Accounting Pronouncements

The GASB issued Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*. The Statement establishes accounting and financial reporting requirements by employers and governmental nonemployer contributing entities for pensions that are not within the scope of Statement No. 68, and for the assets accumulated for purposes of providing those pensions. This Statement has no impact on the Department's financial statements.

1. Organization and Summary of Significant Accounting Policies (continued)

w. New Accounting Pronouncements (continued)

The GASB issued Statement No. 82, *Pension Issues an amendment of GASB Statements No. 67, No. 68, and No. 73*. This Statement addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. The requirements of this Statement are effective for reporting periods beginning after June 15, 2016, except for the requirements of this Statement for the selection of assumptions in a circumstance in which an employer's pension liability is measured as of a date other than the employer's most recent fiscal year-end. In that circumstance, the requirements for the selection of assumptions are effective for that employer in the first reporting period in which the measurement date of the pension liability is on or after June 15, 2017. The adoption of Statement No. 82 had no impact on the Department’s governmental fund financial statements, which continue to report expenditures using the modified-accrual basis of accounting. However, adoption has resulted in the restatement of the Department’s fiscal year 2016 government-wide financial statements to reflect the new calculation of deferred outflows of resources in accordance with the provisions of Statement No. 82. Refer to the State CAFR for more information regarding the State’s pension.

The GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. The Statement replaces GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*. The Statement will require the liability of employers for defined benefit OPEB to be measured as the portion of the present value of projected benefit payments to be provided to current active and inactive employees that is attributed to those employees' past periods of service, less the amount of the OPEB plan's fiduciary net position. The requirements of this Statement are effective for fiscal years beginning after June 15, 2017. Management has not yet determined the effect this Statement will have on the Department’s financial statements, but anticipates that it will materially impact the Department’s financial statements.

1. Organization and Summary of Significant Accounting Policies (continued)

w. New Accounting Pronouncements (continued)

In June 2017, GASB issued Statement No. 87, *Leases*. The objective of this Statement is to establish a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thus enhancing the relevance and consistency of information reported about the government's leasing activities. The provisions of this Statement are effective for the period beginning after December 15, 2019. The Department has not yet determined the effect this statement will have on its financial statements.

2. Budgeting and Budgetary Control

The Department follows these procedures in establishing the budgetary data reflected in the basic financial statements:

The Budget **-** Not less than 20 days before the State Legislature convenes in every odd- numbered year, the Governor submits to the State Legislature, and to each member thereof, a budget which contains the program and budget recommendation of the Governor for the succeeding biennium. The budget in general contains: the State program structure; statements of statewide objectives; financial requirements for the next biennium to carry out the recommended programs; a summary of State receipts and revenues in the last completed fiscal year; a revised estimate for the fiscal year in progress; and an estimate for the succeeding biennium.

Legislative Review **-** The State Legislature considers the Governor's proposed program and financial plan and budget, evaluates alternatives to the Governor's recommendations, adopts programs, and determines the State budget. It may, from time to time, request the Department of Budget and Finance and any agency to conduct such analysis of programs and finances as will assist in determining the State's program and financial plan and budget.

2. Budgeting and Budgetary Control (continued)

Program Execution - Except as limited by policy decisions of the Governor, appropriations by the State Legislature, and other provisions of law, the agencies responsible for the programs administer the programs and are responsible for their proper management. The appropriations by the State Legislature for a biennium are allocated between the two fiscal years of the biennium in the manner provided in the budget or appropriations act and as further prescribed by the Director of Finance. No appropriation transfers or changes between programs or agencies can be made without legislative authorization. Authorized transfers or changes, when made, should be reported to the State Legislature.

Budgetary control is maintained at the appropriation line item level established in the appropriation acts. Budgets are adopted for the Department's funds and are prepared on the cash basis of accounting, except for the encumbrance of purchase orders and contract obligations (basis difference), which is a basis of accounting other than GAAP.

Since budgetary basis differs from GAAP, budget and actual amounts in the budgetary comparison statements are presented on the budgetary basis. A reconciliation of revenues over expenditures (expenditures over revenues) on a budgetary basis at June 30, 2017, to excess of revenues over expenditures presented in conformity with GAAP follows:

	General	Deposit Beverage Container Deposit	Mental Health Substance Abuse	Total
Excess of revenues over expenditures (expenditures over revenues) - actual on a budgetary basis	$ -	$(6,043,153)	$ (3,606,124)	$(9,649,277)
Reserve for encumbrances at year end	52,392,210	12,829,313	5,621,821	70,843,344
Expenditures for liquidation of prior year's encumbrances	(51,564,977)	(5,352,056)	(898,518)	(57,815,551)
Accruals and other adjustments	9,417,316	2,800,504	(1,324,558)	10,893,262
Total change in fund balances	$ 10,244,549	$ 4,234,608	$ (207,379)	$14,271,778

3. Loans Receivable

At June 30, 2017, the proprietary funds loans receivable consisted of loans to county governmental units for the water pollution control and drinking water treatment programs. The loans require annual, semi-annual or quarterly payments, including interest at 0.00%to 3.02%, commencing not later than one year after project completion, notice to proceed, final loan disbursement, or three years after loan agreement date. Final payment is due not later than twenty years after project completion. In fiscal year 2017, $5,280,680 in loans was forgiven. All loans and advances forgiven were in accordance with required conditions. Accrued interest receivable on the loans amounted to approximately $479,000 at June 30, 2017.

The following is a schedule of principal payments due on loans for projects completed or in progress as of June 30, 2017:

Year ending June 30,	
2018	$ 39,523,194
2019	39,688,921
2020	38,879,800
2021	38,937,778
2022	38,840,804
2023-2027	184,800,765
2028-2032	107,806,669
2033-2037	31,456,136
2038-2039	2,865,527
	$ 522,799,594

As of June 30, 2017, the Department's proprietary funds were committed under existing loan agreements to the following counties:

	Water Pollution Control Revolving Loan Fund	Drinking Water Treatment Revolving Loan Fund	Total
City & County of Honolulu	$ 32,333,482	$ -	$ 32,333,482
County of Hawaii	41,264,760	-	41,264,760
County of Maui	23,760,684	5,000,000	28,760,684
County of Kauai	21,850,000	-	21,850,000
	$ 119,208,926	$ 5,000,000	$ 124,208,926

4. Capital Assets

Capital asset activity for governmental and business-type activities for the year ended June 30, 2017 was as follows:

	Balance July 1, 2016	Additions	Disposals	Balance June 30, 2017
Governmental Type Activities:				
Depreciable Assets:				
Land improvements	$ 3,304,766	$ -	$ -	$ 3,304,766
Building and improvements	177,859,212	19,106,830	(2,352,504)	194,613,538
Furniture and equipment	24,850,359	1,788,019	(770,199)	25,868,179
Total depreciable assets	206,014,337	20,894,849	(3,122,703)	223,786,483
Less Accumulated Depreciation:				
Land improvements	(2,308,424)	(96,123)	-	(2,404,547)
Building and improvements	(112,138,654)	(5,648,231)	2,006,088	(115,780,797)
Furniture and equipment	(21,056,851)	(1,528,228)	648,180	(21,936,899)
Total accumulated depreciation	(135,503,929)	(7,272,582)	2,654,268	(140,122,243)
Non-Depreciable Assets -- Land	1,018,080	-	-	1,018,080
Governmental activities capital assets, net	$ 71,528,488	$ 13,622,267	$ (468,435)	$ 84,682,320
Business-Type Activities				
Depreciable Assets -- Furniture and Equipment	$ 2,493,252	$ 109,156	$ (7,024)	$ 2,595,384
Less Accumulated Depreciation -- Furniture and Equipment	(1,770,644)	(198,627)	7,024	(1,962,247)
Business-type activities capital assets, net	$ 722,608	$ (89,471)	$ -	$ 633,137
Total Department capital assets, net	$ 72,251,096	$ 13,532,796	$ (468,435)	$ 85,315,457

4. Capital Assets (continued)

Current period depreciation expense was charged to functions as follows:

	Governmental Activities	Business-Type Activities	Total
General administration	$ 1,849,289	$ -	$ 1,849,289
Environmental health	2,076,064	198,627	2,274,691
Behavioral health services	2,329,708	-	2,329,708
Health resources	1,017,521	-	1,017,521
Total	$ 7,272,582	$ 198,627	$ 7,471,209

5. Accrued Vacation

The changes to the accrued vacation liability during 2017 were as follows:

	Governmental Activities	Business-Type Activities	Total
Balance at July 1, 2016	$ 28,869,857	$ 503,778	$ 28,869,857
Increase	14,196,072	184,517	14,380,589
Decrease	(13,551,326)	(214,229)	(13,765,555)
Balance at June 30, 2017	29,010,825	474,066	29,484,891
Less: Current portion	10,621,466	131,674	10,753,140
Noncurrent portion	$ 18,389,359	$ 342,392	$ 18,731,751

6. Beverage Container Deposits

The changes to the beverage container deposit liability during 2017 were as follows:

Balance at July 1, 2016	$ 1,606,002
Increase: Deposits received from distributors	47,920,682
Decrease: Payments made to redemption centers, net of refunds	(33,765,166)
Decrease: Unredeemed deposits recognized as revenue	(14,063,024)
Balance at June 30, 2017	$ 1,698,494

7. Changes in Assets and Liabilities of the Agency Funds

The agency funds are purely custodial (assets equal liabilities) and thus do not involve the measurement of results of operations. The changes in assets and liabilities of the agency funds for the fiscal year ended June 30, 2017, were as follows:

	Balance July 1, 2016	Additions	Deductions	Balance June 30, 2017
Assets --				
Cash	$ 481,169	$ 175,505	$ 219,633	$ 437,041
Liabilities --				
Due to others	$ 481,169	$ 175,505	$ 219,633	$ 437,041

8. Non-imposed Employee Fringe Benefits

Non-imposed employee fringe benefits related to general and State special fund salaries are funded by the State. These costs, totaling approximately $68.7 million for the fiscal year ended June 30, 2017, have been reported as revenues and expenditures of the Department's general and State special revenue funds.

Payroll fringe benefit costs related to Federally-funded salaries are not funded by the State and are recorded as expenditures in the Federal special revenue funds.

9. Employee Benefit Plans

a. Employees' Retirement System

i. Plan Description

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

9. Employee Benefit Plans (continued)

a. Employees' Retirement System (continued)

ii. Benefits Provided

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

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

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

<u>Noncontributory Class</u>

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

9. Employee Benefit Plans (continued)

a. Employees' Retirement System (continued)

ii. Benefits Provided (continued)

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

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

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

<u>*Contributory Plan for Employees Hired Prior to July 1, 2012*</u>

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

9. Employee Benefit Plans (continued)

a. Employees' Retirement System (continued)

ii. Benefits Provided (continued)

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

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

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

Contributory Plan for Employees 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. Police officers and firefighters' retirement benefits are determined using the benefit multiplier of 2.25% for qualified service, up to a maximum of 80% of average final compensation. Police

9. Employee Benefit Plans (continued)

a. Employees' Retirement System (continued)

ii. Benefits Provided (continued)

officers and firefighters with ten years of credited service are eligible to retire at age 60. Police officers and firefighters with five years of credited service are eligible to retire at age 55. Police officers and fire fighters with 25 years of credited service are eligible to retire at any age, provided the last five years is service credited in these occupations.

Disability and Death Benefits - Members are eligible for service-related disability benefits regardless of length of service and receive a lifetime pension of 50% of their average final compensation plus refund of contributions and accrued interest. Ten years of credited service is required for ordinary disability. Ordinary disability benefits are 3% of average final compensation for each year of service for judges and elected officers and 1.75% of average final compensation for each year of service for police officers and firefighters and are payable immediately, without an actuarial reduction, at a minimum of 30% of average final compensation. Death benefits for contributory members hired after June 30, 2012 are generally the same as those for contributory members hired June 30, 2012 and prior.

Hybrid Plan for Employees Hired Prior to July 1, 2012

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

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

Death Benefits - For service-connected deaths, the designated surviving spouse/reciprocal beneficiary receives a lump sum payment of the member's contributions and accrued

9. Employee Benefit Plans (continued)

a. Employees' Retirement System (continued)

ii. Benefits Provided (continued)

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 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 Plan for Employees Hired After June 30, 2012

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

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

9. Employee Benefit Plans (continued)

a. Employees' Retirement System (continued)

iii. Contributions

Contributions are governed by HRS Chapter 88 and may be amended through legislation. The employer rate is set by statute based on the recommendations of the ERS actuary resulting from an experience study conducted every five years. Since July 1, 2005, the employer contribution rate is a fixed percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liabilities. The contribution rates for fiscal year 2017 were 25.00% for police officers and firefighters and 17.00% for all other employees. Contributions to the pension plan from the Department were $667,605 for the fiscal year ended June 30, 2017.

On May 18, 2017, the Governor signed into law Act 17 SLH 2017. Per Act 17, future employer contributions from the State and counties are expected to increase pursuant to a phased-in contribution rate increase over four years beginning July 1, 2017. The rate for all employees, except for police officers and firefighters, increases to 18.00% on July 1, 2017; 19.00% on July 1, 2018; 22.00% on July 1, 2019; and 24.00% on July 1, 2020.

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

9. Employee Benefit Plans (continued)

a. Employees' Retirement System (continued)

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

At June 30, 2017, the Department reported a liability of $6,367,104 for its proportionate share of net pension liability of the State. The net pension liability was measured as of June 30, 2016, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The State's proportion of the net pension liability was based on a projection of the State's long-term share of contributions to the pension plan relative to projected contributions of all participants, actuarially determined. At June 30, 2016, the Department's proportion was 0.09% which is the same from its proportion measured as of June 30, 2015.

There were significant changes in actuarial assumptions effective June 30, 2016 based on the Five-Year Experience Study report dated July 5, 2016 that resulted in a significant increase in the measurement of the total pension liability. Primary drivers for the increase include a decrease in the investment return assumption and discount rate from 7.65% as of June 30, 2015 to 7.00% as of June 30, 2016; and a decrease in the mortality assumptions for longer life expectancy and an explicit assumption for continued future mortality improvement (generational approach). There were no other changes in assumptions between the measurement date, June 30, 2016, and the reporting date, June 30, 2017, that are expected to have a significant effect on the proportionate share of the net pension liability.

For the year ended June 30, 2017, the Department recognized pension expense of $808,572. At June 30, 2017, the Department reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

9. Employee Benefit Plans (continued)

a. Employees' Retirement System (continued)

iv. Pension Liabilities, Pension Expense, and Deferred Outflows and Inflows of Resources, Related to Pensions (continued)

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	$ 161,740	$ (98,589)
Changes in assumptions	1,281,549	-
Net difference between projected and actual earnings on pension plan investments	450,532	(251,560)
Changes in proportion and difference between Department contributions and proportionate share of contributions	26,301	(21,726)
Department contributions subsequent to the measurement date	367,346	-
	$ 2,287,468	$ (371,875)

The $367,346 reported as deferred outflows of resources related to pensions resulting from Department contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the fiscal year ended June 30, 2017. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Fiscal Year Ending June 30,	
2018	$ 299,610
2019	299,610
2020	406,113
2021	354,492
2022	188,422
Total	$ 1,548,247

9. Employee Benefit Plans (continued)

a. Employees' Retirement System (continued)

iv. Pension Liabilities, Pension Expense, and Deferred Outflows and Inflows of Resources, Related to Pensions (continued)

See Note 11 for discussion on the impact of implementing GASB 82.

v. Actuarial Assumptions

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

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

There were no changes to ad hoc postemployment benefits including COLA.

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

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

9. Employee Benefit Plans (continued)

a. Employees' Retirement System (continued)

v. Actuarial Assumptions (continued)

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

Strategic Allocation (risk-based classes)	Target Allocation	Long-term Expected Geometric Rate of Return
Broad growth	63.0%	8.35%
Principal protection	7.0%	2.20%
Real return	10.0%	6.15%
Crisis risk offset	20.0%	5.50%
	100.0%	

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

Sensitivity of the Department's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate - The following presents the Department's proportionate share of the net pension liability calculated using the discount rate of 7.00%, as well as what the Department's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage point lower (6.00%) or 1-percentage point higher (8.00%) than the current rate:

9. Employee Benefit Plans (continued)

a. Employees' Retirement System (continued)

v. Actuarial Assumptions (continued)

	1% Decrease (6.00%)	Discount Rate (7.00%)	1% Increase (8.00%)
Department's proportionate share of the net pension liability	$ 8,143,952	$ 6,367,104	$ 4,896,821

vi. Pension Plan Fiduciary Net Position

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

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

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

vii. Payables to the Pension Plan

At June 30, 2017, there was no payable to the ERS.

9. Employee Benefit Plans (continued)

b. Deferred Compensation Plan

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

All plan assets are held in a trust fund to protect them from claims of general creditors. The State has no responsibility for loss due to the investment or failure of investment of funds and assets in the plan, but has the duty of due care that would be required of an ordinary prudent investor.

c. Post-Employment Healthcare and Life Insurance Benefits

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

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

9. Employee Benefit Plans (continued)

c. Post-Employment Healthcare and Life Insurance Benefits (continued)

Annual OPEB Cost - The following table shows the components of the annual OPEB cost that have been allocated to the Department's proprietary funds for the year ended June 30, 2017:

	Drinking Water Treatment Revolving Loan Fund	Water Pollution Control Revolving Loan Fund	Total
Annual OPEB cost	$ 244,083	$ 272,800	$ 516,883
Contributions made	(158,602)	(184,246)	(342,848)
Increase in net OPEB obligation	85,481	88,554	174,035
Net OPEB obligation, beginning of year	891,094	1,526,838	2,417,932
Net OPEB obligation, end of year	$ 976,575	$ 1,615,392	$ 2,591,967

Amount of Contributions Made

Contributions are financed on a pay-as-you-go basis and the Department's contributions for the years ended June 30, 2017, 2016, and 2015 were approximately $343,000, $250,000, and $216,000, respectively.

Required Supplementary Information and Disclosures

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

10. Commitments and Contingencies

a. Operating Leases

The Department leases various office facilities and equipment through fiscal year 2023 on a long-term basis as provided for in the lease agreements. The following is a schedule of minimum future rent payments on noncancelable operating leases at June 30, 2017:

Year ending June 30,	Amount
2018	$ 216,473
2019	191,217
2020	192,695
2021	128,669
2022	81,525
Thereafter	5,353
Total	$ 815,932

Rental expenditures for the fiscal year ended June 30, 2017 approximated $3,386,000.

b. Insurance Coverage

The State maintains certain insurance coverage to satisfy bond indenture agreements as well as for other purposes, but is substantially self-insured for all other perils including workers' compensation. The State records a liability for risk financing and insurance related losses, including incurred but not reported, 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. At June 30, 2017, the State recorded estimated losses for workers' compensation, automobile, and general liability claims as long- term liabilities as the losses will not be liquidated with currently expendable available financial resources. The estimated losses will be paid from legislative appropriations of the State's General Fund.

The Department's portion of the State's workers' compensation expenditures for the year ended June 30, 2017 were approximately $509,000 and $16,000 for the general fund and other funds, respectively.

c. Litigation

The Department is a party to various legal proceedings, the outcome of which, in the opinion of management, will not have a material adverse effect on the Department's financial position. Losses, if any, are either covered by insurance or will be paid from legislative appropriations of the State's General Fund.

11. Restatements

During the current year, the following restatement adjustments were identified:

- Expenditures related to cigarette tax revenues were overstated at June 30, 2016. As a result, health resource administration expenditures were restated resulting in an adjustment of approximately $5.4 million to the July 1, 2016 net position and fund balance.
- Receivables related to the Deposit Beverage Container Deposit Fund (DBCDF) were overstated at June 30, 2016. As a result, the receivable balance was restated resulting in an adjustment of approximately $636,000 to the July 1, 2016 net position and fund balance.
- Expenditures related to pension were overstated at June 30, 2016, as a result of the implementation of GASB 82. The resulting adjustment was in the amount of approximately $50,000 and $53,000 to the July 1, 2016 net position for the Water Pollution Control Revolving Fund (WPCRF) and Drinking Water Treatment Revolving Loan Fund (DWTRLF), respectively.

The results of these adjustments have the following impact on the June 30, 2016 financial statements:

	DBCDF	Other Governmental Funds	Total Governmental Funds
Fund balance, as previously reported	$ 27,013,392	$ 113,292,290	$ 235,770,558
Restatement adjustments	(636,311)	(5,446,587)	(6,082,898)
Fund balance, as restated	$ 26,377,081	$ 107,845,703	$ 229,687,660

	WPCRF	DWTRLF	Business-Type Activities
Net position, as previously reported	$ 501,721,450	$ 186,925,732	$ 688,647,182
Restatement adjustments	(50,217)	(52,734)	(102,951)
Net position, as restated	$ 501,671,233	$ 186,872,998	$ 688,544,231

SUPPLEMENTARY INFORMATION

Department of Health
State of Hawaii
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Fiscal Year Ended June 30, 2017

Federal Grantor/Pass-through Grantor/Program or Cluster Title	Project Number	Federal CFDA Number	Total Federal Expenditures	Passed through to Subrecipients
Department of Health and Human Services				
Direct Programs:				
TB Epidemiological Studies Consortium	626	200-2011-41277	$ 325,414	$ --
Special Programs for the Aging - Title VII Chapter 2	468	93.041	102,249	--
Special Programs for the Aging - Title III Part D	401	93.043	78,054	78,054
Aging Cluster:				
Special Programs for the Aging - Title III Part B - Grants for Supportive Services and Senior Centers	401	93.044	2,111,064	2,066,223
Special Programs for the Aging - Title III Part C - Nutrition Services	401	93.045	2,815,980	2,367,517
Nutrition Services Incentive Program	406	93.053	402,130	402,130
Subtotal Aging Cluster			5,329,174 *	4,835,870
Special Programs for the Aging - Title IV and Title II - Discretionary Projects	405, 757	93.048	981,063	515,177
National Family Caregiver Support, Title III, Part E	401	93.052	587,760	587,760
Public Health Emergency Preparedness	760, 1297	93.069	5,023,485 *	--
Environmental Public Health and Emergency Response	444	93.070	276,763	123,563
Hawaii Birth Defects Surveilance and Intervention for Zika Virus	761	93.073	41,221	--
HPP and PHEP Cooperative Agreements	752	93.074	391,426	--
Affordable Care Act Personal Responsibility Education Program	613	93.092	150,544	24,981
Comprehensive Community Mental Health Services for Children with Serious Emotional Disturbances (SED)	589	93.104	366,995	--
Maternal and Child Health Federal Consolidated Programs	257, 307, 466	93.110	713,035	491,466
Project Grants and Cooperative Agreements for Tuberculosis Control Programs	247	93.116	1,089,296	--
Cooperative Agreements to States/Territories for the Coordination and Development of Primary Care Offices	298	93.130	182,645	41,999
Injury Prevention and Control Research and State and Community Based Programs	various	93.136	594,211	138,499
Projects for Assistance in Transition from Homelessness	26208	93.150	79,188	77,249
Hansen's Disease National Ambulatory Care Program	264	93.215	973,625	--
Family Planning - Services	239	93.217	2,330,776	1,819,001
Affordable Care Act Abstinence Education Program	273	93.235	125,682	116,343
State Rural Hospital Flexibility Program	415	93.241	381,338	183,715
Substance Abuse and Mental Health Services - Projects of Regional and National Significance	various	93.243	2,666,803	1,562,826
Universal Newborn Hearing Screening	416	93.251	170,903	18,742
Immunization Cooperative Agreements	457	93.268	18,065,579 *	--

* Denotes Major Federal Program

Department of Health
State of Hawaii
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Fiscal Year Ended June 30, 2017

Federal Grantor/Pass-through Grantor/Program or Cluster Title	Project Number	Federal CFDA Number	Total Federal Expenditures		Passed through to Subrecipients
Department of Health and Human Services (Continued)					
Adult Viral Hepatitis Prevention and Control	397	93.270	$ 81,428		$ --
Centers for Disease Control and Prevention - Investigations and Technical Assistance	649, 448	93.283	514,526		280,441
Small Rural Hospital Improvement Grant Program	454	93.301	67,172		38,384
National State Based Tobacco Control Programs	744	93.305	712,421		200,000
Epidemiology and Laboratory Capacity for Infectious Diseases	700	93.323	1,429,395		--
State Health Insurance Assistance Program	403	93.324	180,714		--
Behavioral Risk Factor Surveillance System - Zika	762	93.336	20,000		20,000
Food Safety and Security Monitoring Project	580	93.448	265,915		--
Affordable Care Act - Maternal, Infant, and Early Childhood Home Visiting Program	602, 753	93.505	4,546,281	*	4,055,973
ACA Nationwide Program for National and State Background Checks for Direct Patient Access Employees of Long Term Care Facilities and Providers	644	93.506	170,074		--
ACA Building Epidemiology, Laboratory, and Health Information Systems Capacity in the Epidemiology and Laboratory Capacity for Infectious Disease and Emerging Infections Program Cooperative Agreements	607	93.521	600,812		--
PPHF Capacity Building Assistance to Strengthen Public Health Immunization Infrastructure and Performance - financed in part by Prevention and Public Health Funds	624, 758	93.539	933,072		--
Community-Based Child Abuse Prevention Grants	270	93.590	255,854		162,705
Developmental Disabilities Basic Support and Advocacy Grants	240	93.630	443,613		--
Capacity Building Assistance to Strengthen Health Immunization Infrastructure and Performance - financed in part by the Prevention and Public Health Fund	746	93.733	206,322		--
State Public Health Approaches for Ensuring Quitline Capacity - funded in part by Prevention and Public Health Funds	701	93.735	29,851		--
Behavioral Risk Factor Surveillance System	747	93.745	132,574		--
Surveillance for Diseases Among Immigrants and Refugees - financed in part by Prevention and Public Health Funds	657	93.755	215,532		171,343
State and Local Public Health Actions to Prevent Obesity, Diabetes, Heart Disease and Stroke	655, 702	93.757	3,448,432	*	2,879,870
Preventive Health and Health Services Block Grant funded solely with Prevention and Public Health Funds	various	93.758	891,163		37,612
State Survey and Certification of Health Care Providers and Suppliers (Title XVIII) Medicare	221, 380, 387	93.777	1,920,219		--

* Denotes Major Federal Program

Federal Grantor/Pass-through Grantor/Program or Cluster Title	Project Number	Federal CFDA Number	Total Federal Expenditures		Passed through to Subrecipients
Department of Health and Human Services (Continued)					
Medical Assistance Program	662	93.778	$ 342,869		$ --
Domestic Ebola Supplement to the Epidemiology and Laboratory Capacity for Infectious Diseases	751	93.815	173,974		--
Hospital Preparedness Program (HPP) Ebola Preparedness and Response Activities	754	93.817	13,016		--
National Bioterrorism Hospital Preparedness Program	435	93.889	1,111,846		939,991
Grants to States for Operation of Offices of Rural Health	299	93.913	189,789		49,385
HIV Care Formula Grants	293	93.917	2,258,775		1,279,427
Cooperative Agreements for State-Based Comprehensive Breast and Cervical Early Detection Programs	448	93.919	533,457		347,703
HIV Prevention Activities - Health Department Based	266	93.940	892,573		249,344
HIV / AIDS Surveillance	272	93.944	236,998		--
Assistance Programs for Chronic Disease Prevention and Control	647, 661	93.945	502,295		125,975
Cooperative Agreements to Support State-Based Safe Motherhood and Infant Health Initiative Programs	319	93.946	159,250		--
Block Grants for Community Mental Health Services	various	93.958	2,083,486		841,784
Block Grants for Prevention and Treatment of Substance Abuse	34204, 35204	93.959	7,565,743	*	7,239,136
Preventive Health Services - Sexually Transmitted Diseases Control Grants	268	93.977	384,504		--
Preventive Health Services	034203	93.944	26,004		--
Maternal and Child Health Services Block Grant to the States	various	93.994	1,884,785		22,701
Hawaii State Mental Health Data Infrastructure Grants for Quality Improvement	318	93.UNKNOWN	85,610		28,413
Hawaii Tobacco State Enforcement Contract	633	93.FAR 52.217-9	363,330		261,814
Electronic Death Registration	208	93.UNKNOWN	40,619		--
Vital Statistics Cooperative Program (VSCP) Special Project	285	93.UNKNOWN	198,536		--
Total Department of Health and Human Services Programs			77,140,058		29,847,246
Department of Agriculture					
Direct Programs:					
Food Safety Cooperative Agreements	203	10.479	68,608		--
Special Supplemental Nutrition Program for Women, Infants and Children	275, 295	10.557	29,147,028	*	2,538,976
WIC Grants To States (WGS)	740, 741, 756	10.578	1,013,712		869,157
Subtotal Direct Programs			30,229,348		3,408,133

* Denotes Major Federal Program

Department of Health
State of Hawaii

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Fiscal Year Ended June 30, 2017

Federal Grantor/Pass-through Grantor/Program or Cluster Title	Project Number	Federal CFDA Number	Total Federal Expenditures		Passed through to Subrecipients
Department of Agriculture (Continued)					
Pass-through from the State Department of Human Services					
State Administrative Matching Grants for the Supplemental Nutrition Assistance Program	OTSP01**	10.561	$ 385,256		$ 385,256
Subtotal Pass-through Program			385,256		385,256
Total Department of Agriculture Programs			30,614,604		3,793,389
Environmental Protection Agency					
Direct Programs:					
Air Pollution Control Program Support	233	66.001	788,883		--
Surveys, Studies, Research, Investigations, Demonstrations and Special Purpose Activities Relating to the Clean Air Act	294	66.034	170,501		--
Water Pollution Control State, Interstate, and Tribal Program Support	231, 237, 601	66.419	1,735,777		--
State Public Water System Supervision	232	66.432	477,874		--
Water Quality Management Planning	16284	66.454	126,818		--
Capitalization Grants for Clean Water State Revolving Funds	various	66.458	10,574,000	*	10,574,000
Nonpoint Source Implementation Grants	9290	66.460	1,372,894		887,939
Capitalization Grants for Drinking Water State Revolving Funds	various	66.468	15,170,408	*	15,120,852
Beach Monitoring and Notification Program Implementation Grants	8291	66.472	323,005		--
Environmental Information Exchange Network Grant Program and Related Assistance	570	66.608	124,029		--
Toxic Substances Compliance Monitoring Cooperative Agreements	243	66.701	42,814		--
TSCA Title IV State Lead Grants Certification of Lead-Based Paint Professionals	330	66.707	185,785		--
Hazardous Waste Management State Program Support	230	66.801	555,391		--
Superfund State, Political Subdivision, and Indian Tribe Site-Specific Cooperative Agreements	394	66.802	289,925		--
Underground Storage Tanks Prevention, Detection and Compliance Program	339	66.804	140,697		--
Leaking Underground Storage Tank Trust Fund Corrective Action Program	258	66.805	502,736		--
State and Tribal Response Program Grants	360	66.817	1,002,271		--
Total Environmental Protection Agency Programs			33,583,808		26,582,791

* Denotes Major Federal Program

** Pass-through Entity Indentifying Number

Department of Health
State of Hawaii
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Fiscal Year Ended June 30, 2017

Federal Grantor/Pass-through Grantor/Program or Cluster Title	Project Number	Federal CFDA Number	Total Federal Expenditures	Passed through to Subrecipients
Department of Education				
Direct Program--				
Special Education - Grants for Infants and Families	213	84.181	$ 2,453,060	$ 550,524
Total Department of Education Programs			2,453,060	550,524
Department of Defense				
Direct Program--				
State Memorandum of Agreement Program for the Reimbursement of Technical Services	245	12.113	196,642	--
Total Department of Defense Programs			196,642	--
Department of Transportation				
Direct Program--				
Interagency Hazardous Materials Public Sector Training and Planning Grants	641	20.703	98,194	--
Total Department of Transportation Programs			98,194	--
Total Expenditures of Federal Awards			$ 144,086,366	$ 60,773,950

* Denotes Major Federal Program

Notes to Schedule of Expenditures of Federal Awards
Fiscal Year Ended June 30, 2017

1. Basis of Presentation

The accompanying schedule of expenditures of federal awards (the Schedule) includes the federal grant activity of the State of Hawaii, Department of Health (the "Department") under programs of the federal government for the fiscal year ended June 30, 2017. The information in this Schedule is presented in accordance with the requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Because the Schedule presents only a selected portion of the operations of the Department, it is not intended to and does not present the financial position, change in net position, or cash flows of the Department.

2. Summary of Significant Accounting Policies

Expenditures reported on the Schedule are reported on the cash basis of accounting which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. Such expenditures are recognized following, as applicable, either the cost principles contained in Office of Management and Budget Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments,* or the cost principles contained in the Uniform Guidance wherein certain types of expenditures are not allowable or are limited as to reimbursement.

3. Loans Outstanding

The Department had the following loan balances outstanding at June 30, 2017. Loans made during the year are included in the federal expenditures presented in the schedule of expenditures of federal awards.

Program Title	CFDA Number	Amount Outstanding
Capitalization Grants for Clean Water State Revolving Funds	66.458	$ 33,645,457
Capitalization Grants for Drinking Water State Revolving Funds	66.468	$ 35,399,416

4. Noncash Awards

The Department also receives noncash awards for the Immunization Cooperative Agreements Program. The Department expended approximately $15,905,000 in vaccines for the Immunization Cooperative Agreements Program for the fiscal year ended June 30, 2017.

5. Indirect Cost Rate

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

PART II

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

Independent Auditor's Report

Office of the Auditor
State of Hawaii

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the State of Hawaii, Department of Health (Department), as of and for the fiscal year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the Department's basic financial statements, and have issued our report thereon dated March 28, 2018.

Internal Control Over Financial Reporting

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

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and questioned costs as Finding No. 2017-001 and 2017-002 to be material weaknesses.

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A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying schedule of findings and questions costs as Finding No. 2017-003 that we consider to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as items 2017-004 through 2017-008.

Department's Response to Findings

The Department's response to the findings identified in our audit is described in the accompanying corrective action plan. The Department's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

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

KMH LLP

KMH LLP

Honolulu, Hawaii
March 28, 2018

PART III

REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY THE UNIFORM GUIDANCE

Report on Compliance for Each Major Federal Program and on Internal Control over Compliance Required by Uniform Guidance

Independent Auditor's Report

Office of the Auditor
State of Hawaii

Report on Compliance for Each Major Federal Program

We have audited the State of Hawaii, Department of Health's (Department's) compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of the Department's major federal programs for the fiscal year ended June 30, 2017. The Department's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

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

Auditor's Responsibility

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

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

Basis for Qualified Opinion on Major Federal Programs in the Table Below

As described in the accompanying schedule of findings and questioned costs, the Department did not comply with requirements regarding:

<table>
<tr><th>CFDA Number</th><th>Name of Federal Program</th><th>Compliance Requirement</th><th>Ref. No.</th></tr>
<tr><td>93.959</td><td>Block Grants for Prevention and Treatment of Substance Abuse</td><td>Reporting</td><td>2017-004</td></tr>
<tr><td>93.959</td><td>Block Grants for Prevention and Treatment of Substance Abuse</td><td>Subrecipient Monitoring</td><td>2017-005</td></tr>
<tr><td>93.505</td><td>Affordable Care Act - Maternal, Infant, and Early Childhood Home Visiting Program</td><td>Reporting</td><td>2017-006</td></tr>
<tr><td>93.044
93.045
93.053</td><td>Aging Cluster</td><td rowspan="7">Cash Management</td><td rowspan="7">2017-007</td></tr>
<tr><td>93.069</td><td>Public Health Emergency Preparedness</td></tr>
<tr><td>93.268</td><td>Immunization Cooperative Agreements</td></tr>
<tr><td>93.505
93.870</td><td>Maternal, Infant, and Early Childhood Home Visiting Cluster</td></tr>
<tr><td>93.757</td><td>State and Local Public Health Actions to Prevent Obesity, Diabetes, Heart Disease and Stroke</td></tr>
<tr><td>93.959</td><td>Block Grants for Prevention and Treatment of Substance Abuse</td></tr>
<tr><td>93.757</td><td>State and Local Public Health Actions to Prevent Obesity, Diabetes, Heart Disease and Stroke</td><td>Reporting</td><td>2017-008</td></tr>
</table>

Compliance with such requirements is necessary, in our opinion, for the Department to comply with the requirements applicable to those programs.

Qualified Opinion on the Major Federal Programs in the Table Above

In our opinion, except for the noncompliance described in the Basis for Qualified Opinion paragraph, the Department complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on the major federal programs identified in the Basis for Qualified Opinion paragraph for the fiscal year ended June 30, 2017.

Unmodified Opinion on Each of the Other Major Federal Programs

In our opinion, the Department complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its other major federal programs identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs for the fiscal year ended June 30, 2017.

Other Matters

The Department's response to the noncompliance findings identified in our audit are described in the accompanying corrective action plan. The Department's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

Report on Internal Control Over Compliance

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

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses and significant deficiencies.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as Finding No. 2017-004 through 2017-009 to be material weaknesses.

A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We consider the deficiency in internal control over compliance described in the accompanying schedule of findings and questioned costs as Finding No. 2017-010 through 2017-013 to be significant deficiencies.

The Department's response to the internal control over compliance findings identified in our audit is described in the accompanying corrective action plan. The Department's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

KMH LLP

KMH LLP

Honolulu, Hawaii
March 28, 2018

PART IV

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Department of Health
State of Hawaii

Schedule of Findings and Questioned Costs
June 30, 2017

Section I – Summary of Auditor's Results

Financial Statements

Type of auditor's report issued: Unmodified

Internal control over financial reporting:

- Material weakness(es) identified? _√_ Yes ____No

- Significant deficiency(ies) identified that are not considered to be material weaknesses? _√_ Yes ____None reported

Noncompliance material to financial statements noted? ___Yes _√_ No

Federal Awards

Internal control over major programs:

- Material weakness(es) identified? _√_ Yes ____No

- Significant deficiency(ies) identified? _√_ Yes None reported

Type of auditor's report issued on compliance for major federal programs: Qualified

Any audit findings disclosed that are required to be reported in accordance with section 2 CFR 200.516(a)? √ Yes No

Section I – Summary of Auditor's Results (continued)

Identification of major federal programs:

CDFA Number	Name of Federal Program
	Department of Health & Human Services
	Aging Cluster:
93.044	Special Programs for Aging – Title III Part B – Grants for Supportive Services and Senior Centers
93.045	Special Programs for Aging – Title III Part C – Nutrition Services
93.053	Nutrition Services Incentive Program
93.069	Public Health Emergency Preparedness
93.268	Immunization Cooperative Agreements
93.505	Affordable Care Act - Maternal, Infant, and Early Childhood Home Visiting Program
93.757	State and Local Public Health Actions to Prevent Obesity, Diabetes, Heart Disease and Stroke
93.959	Block Grants for Prevention and Treatment of Substance Abuse
	Department of Agriculture
10.557	Special Supplemental Nutrition Program for Women, Infants and Children
	Environmental Protection Agency
66.458	Capitalization Grants for Clean Water State Revolving Funds
66.468	Capitalization Grants for Drinking Water State Revolving Funds

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

Auditee qualified as low-risk auditee? ___Yes _√_No

Section II – Financial Statement Findings

Finding No.: 2017-001 Financial Statement Reporting
Type of Finding: Material Weakness
Criteria: In accordance with Governmental Accounting Standards Board (GASB) Statement No. 34, fund financial statements should be prepared using the current financial resources measurement focus and the modified accrual basis of accounting. Under this focus/basis, revenues are recognized only to the extent that they are susceptible to accrual and liabilities are required to be recorded only to the extent that their repayment will require the use of expendable available financial resources. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

Condition: During our audit, we proposed and management accepted the following audit adjustments:

- Restatement adjustment related to cigarette tax revenues for approximately $5.4 million.
- Restatement adjustment related to the deposit beverage container deposit fund receivable for approximately $636,000.

The adjustments above were recorded in beginning net position as of July 1, 2016 in the Department's financial statements as of June 30, 2017.

Context: Due to staffing constraints, the Department annually contracts with its auditors to assist in compiling the Department's financial statements. The errors noted above, were detected during the audit because of unusual variances or patterns noted in the related financial statement balances.

For the cigarette tax revenues adjustment, SB 1297 requires cigarette tax revenues in excess of $7.4 million related to the Trauma System Special Fund should be transferred by the Department and become a realization of the general fund on June 30th of each year. SB 1297 was passed in the 2015 legislative session and effective as of June 30, 2016. The Department properly recorded a journal voucher to comply with SB 1297 in December 2016, but did not properly accrue for the transfer as of June 30, 2016.

For the deposit beverage adjustment, an incorrect formula on a spreadsheet, prepared by the previous auditors, resulted in an overaccrual of receivables related to the administrative fee portion of the beverage deposits.

Section II – Financial Statement Findings (continued)

Cause: Management is responsible for its financial statements and it is an important reminder that auditors, even when assisting in the compilation of the financial statements, are not part of management's internal controls. Appropriate review by management is required.

Effect: Ineffective reviews of the financial statements increases the risk of material misstatements as illustrated by the results of the fiscal year 2017 audit.

Identification as a Repeat Finding, if applicable: Not applicable

Recommendations: Management should revisit its process in reviewing its financial statements. For example, management should ensure that the review process includes the consideration and investigation of material variances from prior years or material changes in the Department's business environment (e.g., new laws, agreements, etc.) that may impact the financial statements.

Views of Responsible Officials and Planned Corrective Action: See Part VI Correction Action Plan.

Section II – Financial Statement Findings (continued)

Finding No.: 2017-002 Vouchers Payable

Type of Finding: Material Weakness

Criteria: In accordance with Governmental Accounting Standards Board (GASB) Statement No. 34, fund financial statements should be prepared using the current financial resources measurement focus and the modified accrual basis of accounting. Under this focus/basis, revenues are recognized only to the extent that they are susceptible to accrual and liabilities are required to be recorded only to the extent that their repayment will require the use of expendable available financial resources. The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

Condition: During our audit, we proposed and management accepted audit adjustments related to vouchers payable for an under accrual of approximately $7.4 million.

Context: Management is responsible to review various reports (e.g., disbursements, open purchase orders, etc.) and identify the amounts that should be accrued as of June 30, 2017. An initial vouchers payable detail listing was provided. During our audit testing, we noted numerous errors and expanded our testing. We did note that this was the fiscal officer's first audit with the Department. She was supported by the Administrative Services Office Chief and the Accountant IV that both participated in previous financial statement audits.

Cause: Management's process in identifying vouchers payable accruals did not adequately capture the correct accrual balances. Based on our discussion with management, the accrued amounts were determined based on the invoice date, rather than by the date of service or goods received.

Effect: The ineffective voucher payable accrual process resulted in the initial management prepared financial information being materially misstated.

Identification as a Repeat Finding, if applicable: Not applicable

Recommendations: We recommend the Department of Health revisit their process to identify vouchers payable that should be accrued. Due to the diverse nature of the Department's activities, it is important to work with the respective divisions and programs to obtain timely and accurate information.

Views of Responsible Officials and Planned Corrective Action: See Part VI Correction Action Plan.

Section II – Financial Statement Findings (continued)

Finding No.: 2017-003 Reliance on Third Party Certifications

Type of Finding: Significant Deficiency

Criteria: Section 342G-1 05, Hawaii Revised Statutes (HRS), states that payment of the deposit beverage container fee and deposits shall be made monthly, based on inventory reports of the deposit beverage distributors. All deposit beverage distributors shall submit to the Department documentation in sufficient detail that identifies the net number of deposit beverage containers sold, donated, or transferred, by container size and type.

In addition, Section 342G-110, HRS, specifies that the deposit on each filled deposit beverage container shall be paid by the beverage distributor, who manufactures or imports beverages in deposit beverage containers. Beverage distributors shall also pay a deposit beverage container fee and register with the State.

Section 342G-1 19, HRS, specifies that the Department shall pay certified redemption centers handling fees and deposit refunds based on collection reports submitted by the redemption centers. The redemption reports include the number or weight of deposit beverage containers of each material type accepted at the redemption center for the reporting period; the amount of refunds paid out by material type; the number or weight of deposit beverage containers of each material type transported out of state or to a permitted recycling facility; and copies of out-of-state transport and weight receipts or acceptance receipts from permitted recycling facilities. Additionally, Section 11-282-47, Hawaii Administrative Rules (HAR), states that the Department shall pay certified redemption centers handling fees and refund values based on reports submitted by the redemption centers to the Department.

Section 342G-103, HRS, requires all beverage distributors operating within the State to register with the Department and maintain records reflecting the manufacture of their beverages in deposit beverage containers as well as the importation and exportation of deposit beverage containers. The records shall be made available, upon request, for inspection by the Department.

Similarly Section 342 G-1 21, HRS, requires distributors and redemption centers to make their records available upon request by the Department, a duly authorized agent of the Department, or the Office of the Auditor.

Section II – Financial Statement Findings (continued)

Condition: The Deposit Beverage Container Program (Program) receives beverage container deposits and container fees from distributors and refunds deposits and pays handling fees to redemption centers based on certified information. The Program relies on certifications from distributors to support deposits and container fees received. The Program also relies on certifications from redemption centers to support deposit refunds and handling fees paid.

Context and Cause: As noted below, this is a recurring finding. The Department's still has not been able to recruit or retain the personnel needed to monitor the distributors and the certified redemption centers.

Effect: Overreliance on the self-reporting by distributors and redemption centers may result in underpayments on deposits and the related container fees received by the Department to administer the program, overpayments of deposit refunds and handling fees to redemption centers, and an overstated redemption rate. An overstated redemption rate could result in a misstatement in the Department's financial statements, as well as higher container fees for consumers to support the program.

The Program could mitigate the risk of fraud (underpayments by distributors and overpayments to redemption centers) by implementing a systematic process for monitoring the activities of and reports submitted by distributors and redemption centers. However, due to insufficient staff positions and turnover, management has been unable to establish a systematic monitoring process.

Identification as a Repeat Finding, if applicable: See finding 2016-001 included in the Summary Schedule of Prior Audit Findings.

Recommendation: We recommend that the Program implement a systematic process and direct Department personnel to oversee distributors and redemption centers, including conducting regular audits of reports submitted and payments made by distributors and reports submitted for deposit refund and handling fee requests from redemption centers.

Views of Responsible Officials and Planned Corrective Action: See Part VI Correction Action Plan

Section III – Federal Award Findings and Questioned Costs

Finding No.: 2017-004	**Timely Submission of Federal Financial Report**
Federal Agency:	Department of Health and Human Services (DHHS)
CFDA No.:	93.959
Requirement:	Reporting
Type of Finding:	Material Noncompliance and Material Weakness
Program:	Block Grants for Prevention and Treatment of Substance Abuse
Federal award no. and year:	3B08TI010015-15S2 10/01/2014 – 09/30/2016

Criteria: 2 CFR section 200.327 states that "[financial] information must be collected with the frequency required by the terms and conditions of the Federal award, but no less frequently than annually nor more frequently than quarterly except in unusual circumstances." Under the reporting requirements of the Substance Abuse Prevention and Treatment Block Grant (SABG), the program must submit a closing Federal Financial Report (FFR) within 90 days after the end of the obligation and expenditure period of the grant.

Condition: Reporting requirements for one FFR was not met.

Context: SABG was required to submit one closing FFR during FY 2017. During the audit, we noted that the FFR was submitted 175 days after the end of the obligation and expenditure period of the grant.

Cause: Based on further inquiry with Department personnel, we noted the delay in submission was caused by changes in funding sources for certain personnel and the length of time to close out all provider contracts at the end of each grant period.

Effect: Failure to submit reports results in noncompliance with the reporting requirement.

Questioned Costs: None

Identification as a Repeat Finding, if applicable: Not applicable

Recommendation: We recommend program management be more diligent in following its procedures and internal controls related to contract close-outs and the de-obligation of funds in order to ensure compliance with Federal requirements.

Views of Responsible Officials and Planned Corrective Action: See Part VI Correction Action Plan.

Section III – Federal Award Findings and Questioned Costs

Finding No.: 2017-005	**Monitoring Procedures and Risk Assessment Process**
Federal Agency:	Department of Health and Human Services (DHHS)
CFDA No.:	93.959
Requirement:	Subrecipient Monitoring
Type of Finding:	Material Noncompliance and Material Weakness
Program:	Block Grants for Prevention and Treatment of Substance Abuse
Federal award no. and year:	3B08TI010015-15S2 10/01/2014 – 09/30/2016

Criteria: In accordance with 2 CFR section 200.331, all pass-through entities must monitor the activities of the subrecipient as necessary to ensure that the subaward is used for authorized purposes, in compliance with Federal statutes, regulations, and the terms and conditions of the subaward; and that subaward performance goals are achieved. In addition, all pass-through entities must evaluate each subrecipient's risk of noncompliance with Federal statutes, regulations, and the terms and conditions of the subaward for purposes of determining the appropriate subrecipient monitoring.

Condition: The program did not comply with its documented monitoring procedures consistently. Also, from a control standpoint, the program does not have a formal, documented risk assessment policy. In addition, through discussions with program personnel, we noted that contracts are chosen for on-site visits on an ad hoc basis, rather than based on a formal risk assessment policy.

Context: Of a total of 51 contracts, we selected five contracts based on a non-statistical sample. We noted that three of the five contracts were not monitored based on the program’s documented procedures.

Cause: There was a lack of diligence in following documented monitoring procedures.

Effect: Failure to have and follow a subrecipient monitoring policy that meets the requirements in 2 CFR section 200.331 results in noncompliance with the subrecipient monitoring requirement.

Questioned Costs: None

Identification as a Repeat Finding, if applicable: Not applicable

Recommendation: We recommend that management establish a formal, documented risk assessment policy in order to support which subrecipients are chosen and how they are monitored. We also recommend that management follow its documented monitoring procedures.

Views of Responsible Officials and Planned Corrective Action: See Part VI Correction Action Plan.

Section III – Federal Award Findings and Questioned Costs (continued)

Finding No.: 2017-006	**Timely Submission of Federal Financial Report**	
Federal Agency:	Department of Health and Human Services (DHHS)	
CFDA No.:	93.505	
Requirement:	Reporting	
Type of Finding:	Material Noncompliance and Material Weakness	
Program:	Affordable Care Act - Maternal, Infant, and Early Childhood Home Visiting Program	
Federal award no. and year:	X02MC27398	08/01/2014 – 09/30/2016
	X02MC28216	03/01/2015 – 09/30/2017
	D89MC28280	03/01/2015 – 09/30/2017
	X10MC29466	04/01/2016 – 09/30/2018

Criteria: 2 CFR section 200.327 states that "[financial] information must be collected with the frequency required by the terms and conditions of the Federal award, but no less frequently than annually nor more frequently than quarterly except in unusual circumstances." Under the reporting requirements of the Maternal, Infant, and Early Childhood Home Visiting Cluster, the program must submit annual and closing Federal Financial Reports (FFRs) by the deadlines listed in the respective notices of award, unless revised deadlines were subsequently communicated to the program.

Condition: Reporting requirements for the FFR were not met.
Context: Deadlines vary based on budget periods. The FFRs were submitted between 45 and 50 days after the deadline for all four grant awards for which FFRs were due during FY 2017.

Cause: FFRs were not submitted by the deadline due to lack of diligence.

Effect: Failure to submit reports results in noncompliance with the reporting requirement.

Questioned Costs: None

Identification as a Repeat Finding, if applicable: Not applicable

Recommendation: We recommend program management be more diligent in following Federal deadlines in order to ensure compliance with Federal requirements.

Views of Responsible Officials and Planned Corrective Action: See Part VI Correction Action Plan.

Section III – Federal Award Findings and Questions Costs (continued)

Finding No.: 2017-007 **Cash Management**
Federal Agency: Department of Health and Human Services (DHHS)
CFDA No.: 10.557, 93.044, 93.045, 93.053, 93.069, 93.268, 93.959, and 93.505
Program: Aging Cluster:
Special Programs for Aging – Title III Part B – Grants for Supportive Services and Senior Centers
Special Programs for Aging – Title III Part C – Nutrition Services
Nutrition Services Incentive Program
Public Health Emergency Preparedness
Immunization Cooperative Agreements
Block Grants for Prevention and Treatment of Substance Abuse
Special Supplemental Nutrition Program for Women, Infants and Children
Affordable Care Act - Maternal, Infant, and Early Childhood Home Visiting Program
State and Local Public Health Actions to Prevent Obesity, Diabetes, Heart Disease and Stroke
Requirement: Cash Management
Type of Finding: Material Noncompliance and Material Weakness
Federal award no. and year:

14AAHIT3SS	10/01/2013 - 09/30/2014	6U90TP000513-	07/01/2016 - 06/30/2018
15AAHIT3SS	10/01/2014 - 09/30/2015	6NH23IP000721-	01/01/2016 - 03/31/2017
16AAHIT3SS	10/01/2015 - 09/30/2016	5NH23IP000721-	04/01/2017 - 06/30/2018
17AAHIT3SS	10/01/2016 - 09/30/2017	2B08TI010015-15	10/01/2014 - 09/30/2016
14AAHIT3CM	10/01/2013 - 09/30/2014	2B08TI010015-16	10/01/2015 - 09/30/2017
15AAHIT3CM	10/01/2014 - 09/30/2015	3B08TI010015-15	10/01/2014 - 09/30/2016
16AAHIT3CM	10/01/2015 - 09/30/2016	3B08TI010015-16	10/01/2015 - 09/30/2017
17AAHIT3CM	10/01/2016 - 09/30/2017	7HI700HI7	10/01/2013 – 09/30/2017
14AAHIT3HD	10/01/2013 - 09/30/2014	X02MC27398	08/01/2014 – 09/30/2016
15AAHIT3HD	10/01/2014 - 09/30/2015	X02MC28216	03/01/2015 – 09/30/2017
16AAHIT3HD	10/01/2015 - 09/30/2016	D89MC28280	03/01/2015 – 09/30/2017
17AAHIT3HD	10/01/2016 - 09/30/2017	X10MC29466	04/01/2016 – 09/30/2018
5U90TP000513-05	07/01/2016 - 06/30/2017		

Section III – Federal Award Findings and Questions Costs (continued)

Criteria: The federal award programs noted above are not subject to the Treasury-State Agreement and, as such, are subject to 2 CFR 200.305(b), which states:

"The timing and amount of advance payments must be as close as is administratively feasible to the actual disbursements by the non-Federal entity for direct program or project costs and the proportionate share of any allowable indirect costs. The non-Federal entity must make timely payment to contractors in accordance with the contract provisions..."

Condition: Systemic problem. During our testing of the Department's cash management procedures, we could not verify whether the State of Hawaii, Department of Accounting and General Services (DAGS) disbursed funds from federal sources as close as administratively feasible to the Department's disbursements for the federal award programs identified above after the Department drew down the funds, in accordance with 2 CFR 200.305(b).

Context: During the fiscal year ended June 30, 2017, the Department expended the following amounts under the following major programs as reported in the schedule of expenditures on pages 68 - 73:

CFDA 93.044, 93.045, and 93.053	$	5,329,174
CFDA 93.069		5,023,485
CFDA 93.268 (excluding non-cash expenditures)		2,160,749
CFDA 93.959		7,565,743
CFDA 10.557 (excluding food expenditures)		10,933,085
CFDA 93.505		4,546,281
CFDA 93.757		3,448,432
	$	39,006,949

Cause: The Department draws down federal funds that it estimates will be needed based on the vouchers processed daily. However, since deposits must be posted prior to the processing of payments or disbursing of the funds, it is difficult for the Department to disburse federal funds in accordance with 2 CFR 200.305(b), and we could not verify compliance with 2 CFR 200.305(b).

Effect: Noncompliance with federal regulations could result in a loss of funding that may jeopardize the operations of the Department's federally funded programs.

Questioned Costs: None

Section III – Federal Award Findings and Questions Costs (continued)

Identification as a Repeat Finding, if applicable: See finding 2016-002 included in the Summary Schedule of Prior Audit Findings.

Recommendation: We recommend that the Department work with DAGS and the Department of Budget and Finance to ensure timely disbursement of federal funds in accordance with 2 CFR 200.305(b).

Views of Responsible Officials and Planned Corrective Action: See Part VI Correction Action Plan.

Section III – Federal Award Findings and Questioned Costs (continued)

Finding No.: 2017-008	**Timely Submission of Federal Financial Report**
Federal Agency:	Department of Health and Human Services (DHHS)
CFDA No.:	93.757
Requirement:	Reporting
Type of Finding:	Material Noncompliance and Material Weakness
Program:	State and Local Public Health Actions to Prevent Obesity, Diabetes, Heart Disease and Stroke
Federal award no. and year:	U58DP005502 09/30/2014 – 09/30/2018

Criteria: 2 CFR section 200.327 states that "[financial] information must be collected with the frequency required by the terms and conditions of the Federal award, but no less frequently than annually nor more frequently than quarterly except in unusual circumstances." Under the reporting requirements of the State and Local Public Health Actions to Prevent Obesity, Diabetes, Heart Disease and Stroke, the program must submit annual Federal Financial Report (FFR) by the deadline listed in the respective notice of award, unless a revised deadline was subsequently communicated to the program.

Condition: Reporting requirement for the FFR was not met due to untimely submission.
Context: The FFR for budget period ended September 29, 2016 was submitted 57 days after the deadline. At the time of the submittal, the person responsible was new to the program and was not aware of the deadline until receiving an email indicating the program was late.

Cause: The FFR was not submitted by the deadline due to a lack of documented policies and procedures and an insufficient understanding of the requirements provided in the notice of awards and relevant federal regulations.

Effect: Failure to submit reports resulted in noncompliance with the reporting requirement.

Questioned Costs: None

Identification as a Repeat Finding, if applicable: Not applicable

Recommendation: We recommend program management review its notice of award documentation and relevant federal regulations and develop formal policies and procedures to ensure compliance with Federal requirements.

Views of Responsible Officials and Planned Corrective Action: See Part VI Correction Action Plan.

Section III – Federal Award Findings and Questioned Costs (continued)

Finding No.: 2017-009	**Obtaining Single Audit Reports**
Federal Agency:	Department of Health and Human Services (DHHS)
CFDA No.:	93.757
Requirement:	Subrecipient Monitoring
Type of Finding:	Material Weakness
Program:	State and Local Public Health Actions to Prevent Obesity, Diabetes, Heart Disease and Stroke
Federal award no. and year:	U58DP005502 09/30/2014 – 09/30/2018

Criteria: 2 CFR section 200.331 states that the Department should "verify that every subrecipient is audited as required by Subpart F – Audit Requirements" and "consider whether the results of the subrecipient's audits…indicate conditions that necessitate adjustment to the [Department's] own records." Under the subrecipient monitoring requirements of the State and Local Public Health Actions to Prevent Obesity, Diabetes, Heart Disease and Stroke, the program must obtain Single Audit reports for the subrecipients that meet the Single Audit threshold and review for control deficiencies and instances of non-compliance.

Condition: The Department includes all federal requirements, including the Single Audit requirement, in its contracts with subrecipients. However, Single Audit reports are not being obtained by program management to ensure subrecipient compliance with federal requirements.

Context: We obtained the reports for the two largest subrecipients noting that a Single Audit report was timely completed for the most recent fiscal year. In FY 2017, these two subrecipients had combined expenditures of approximately $2.7 million, which is approximately 95 percent of subrecipient expenditures. We did note findings in one of the two reports, but these are required to be tracked in FY 2018.

Cause: Lack of documented policies and procedures contributed to Single Audit reports not being requested until we conducted our audit.

Effect: Failure to obtain reports may result in the Department not detecting that a subrecipient has not obtained a Single Audit on a timely basis and therefore result in non-compliance with the federal requirements.

Questioned Costs: None

Identification as a Repeat Finding, if applicable: Not applicable

Section III – Federal Award Findings and Questioned Costs (continued)

Recommendation: We recommend program management develop formal policies and procedures to ensure compliance with Federal requirements.

Views of Responsible Officials and Planned Corrective Action: See Part VI Correction Action Plan.

Section III – Federal Award Findings and Questioned Costs (continued)

Finding No.: 2017-010	**Maintenance of State Funding Levels**	
Federal Agency:	Department of Health and Human Services (DHHS)	
CFDA No.:	93.505	
Requirement:	Matching, Level of Effort, and Earmarking	
Type of Finding:	Significant Deficiency	
Program:	Affordable Care Act - Maternal, Infant, and Early Childhood Home Visiting Program	
Federal award no. and year:	X02MC27398	08/01/2014 – 09/30/2016
	X02MC28216	03/01/2015 – 09/30/2017
	D89MC28280	03/01/2015 – 09/30/2017
	X10MC29466	04/01/2016 – 09/30/2018

Criteria: In accordance with section 511(f) of the Social Security Act, Funds provided to an eligible entity receiving a grant under this section shall supplement, and not supplant, funds from other sources for early childhood home visitation programs or initiatives. Under the level of effort requirements of the cluster, the program was required to maintain non-Federal funding for grant activities at a level which is not less than expenditures for such activities as the program's most recently completed fiscal year.

Condition: The program does not have a control in place to ensure that it obtains the required amount of non-Federal funding to meet the level of effort requirement.

Context: During our audit, we noted that management budgeted for the program to meet its level of effort requirement. However, there were no controls in place to ensure that the final non-Federal expenditures for the federal fiscal year met the minimum requirement.

***Cause*:** There was a lack of diligence in monitoring the level of non-Federal funding against required amounts.

Effect: Failure to identify a deficient level of effort could result in the disallowance of federal funding in the proportion of the actual to required non-Federal funding deficiency.

Section III – Federal Award Findings and Questioned Costs (continued)

Questioned Costs: None

Identification as a Repeat Finding, if applicable: Not applicable

Recommendation: We recommend program management establish monitoring procedures to ensure that final non-Federal funding meets the level of effort requirement.

Views of Responsible Officials and Planned Corrective Action: See Part VI Correction Action Plan.

Section III – Federal Award Findings and Questioned Costs (continued)

Finding No.: 2017-011	**Accrued Vacation**	
Federal Agency:	Department of Health and Human Services (DHHS)	
CFDA No.:	93.268	
Requirement:	Allowable Costs/Cost Principles	
Type of Finding:	Significant Deficiency	
Program:	Immunization Cooperative Agreement	
Federal award no. and year:	6NH23IP000721-04	01/01/2016 - 03/31/2017
	5NH23IP000721-05	04/01/2017 - 06/30/2018

Criteria: In accordance with the Frequently Asked Questions for the Office of Management and Budget's Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards at 2 CFR 200, any state government "using the cash basis of accounting should allocate payments for unused leave, when an employee retires or terminates employment in the year of payment as a general administrative expense to all activities of the governmental unit or component or, with the approval of the cognizant agency for indirect costs, the costs can be included in fringe benefit rates."

Condition: Systemic Problem. During the previous auditor's testing of payroll for a major federal program in fiscal years 2014 and 2015, they noted the payouts for an employee's leave that had accrued through their termination was charged entirely to the federal award. We noted similar findings in the current year where federal funds were used to pay out accrued leave for Immunization Cooperative Agreement program.

Context: Based on our discussion with management, steps were taken to correct this issue but will not fully take effect until fiscal year 2018. As a result, this finding remains applicable.

Cause: Based on further inquiry with Department personnel, we noted that payments for accrued leave for terminated employees are charged as direct costs to the employees' respective program(s).

Effect: Unallowable costs may be charged to major federal programs.

Questioned Costs: None

Section III – Federal Award Findings and Questioned Costs (continued)

Identification as a Repeat Finding, if applicable: See finding 2016-003 included in the Summary Schedule of Prior Audit Findings.

Recommendation: The Department should review and correct its payout process for accrued leave to prevent future errors.

Views of Responsible Officials and Planned Corrective Action: See Part VI Correction Action Plan.

Section III – Federal Award Findings and Questioned Costs (continued)

Finding No.: 2017-012	**Excluded Parties Listing Search (EPLS)**	
Federal Agency:	Department of Health and Human Services (DHHS)	
CFDA No.:	93.505	
Requirement:	Procurement/Suspension and Debarment	
Type of Finding:	Significant Deficiency	
Program:	Affordable Care Act - Maternal, Infant, and Early Childhood Home Visiting Program	
Federal award no. and year:	X02MC27398	08/01/2014 – 09/30/2016
	X02MC28216	03/01/2015 – 09/30/2017
	D89MC28280	03/01/2015 – 09/30/2017
	X10MC29466	04/01/2016 – 09/30/2018

Criteria: In accordance with 2 CFR 200.213, the regulations set forth in 2 CFR 180 restrict awards, subawards, and contracts with certain parties that are debarred, suspended, or otherwise excluded from or ineligible for participation in Federal assistance programs or activities.

Condition: The EPLS check was not performed prior to the execution of a contract with a vendor.

Context: Of the four new contracts procured during FY 2017, we selected two for testing, based on a non-statistical sample. For one of the two contracts tested, we noted no documentation that an EPLS check was performed prior to the execution of the vendor agreement. We also re-performed the EPLS check for the contracts tested and noted the vendor was not debarred, suspended or otherwise excluded from or ineligible for participation in Federal assistance programs or activities.

Cause: Management indicated the check was performed; however, documentation was not maintained.

Effect: Failure to perform EPLS checks could result in noncompliance with the procurement requirement.

Questioned Costs: None

Identification as a Repeat Finding, if applicable: Not applicable

Recommendation: We recommend program management establish procedures to perform and retain EPLS check documentation prior to executing a vendor agreement to ensure the parties are not debarred, suspended, or otherwise excluded from or ineligible for Federal assistance programs or activities.

Views of Responsible Officials and Planned Corrective Action: See Part VI Correction Action Plan.

Section III – Federal Award Findings and Questioned Costs (continued)

Finding No.: 2017-013	**Schedule of Expenditures of Federal Awards (SEFA) Preparation**
Federal Agency:	Department of Health and Human Services (DHHS) Department of Agriculture
CFDA No.:	93.044, 93.045, 93.053, 93.268, and 10.557
Type of Finding:	Significant Deficiency
Program:	Aging Cluster Immunization Cooperative Agreements Special Supplemental Nutrition Program for Women, Infants and Children

Criteria: The Office of Management and Budget (OMB) issued Uniform Guidance, which requires non-federal entities that expend $750,000 or more in federal awards a year to have a Single Audit conducted on its federal award programs and SEFA. 2 CFR 200.510(b) states "the auditee must also prepare a schedule of expenditures of Federal awards for the period covered by the auditee's financial statements which must include the total Federal awards expended…"

Condition: During the audit, we noted the following differences between the original SEFA and final federal expenditures according to the programs and related financial support:

CFDA No.	Program Name	Difference
93.044, 93.045, 93.053	Aging Cluster	$ (4,927,043)
93.268	Immunization Cooperative Agreements	(15,904,830)
10.557	Special Supplemental Nutrition Program for Women, Infants and Children	(2,773,832)
Various	Other non-major federal programs	7,534,758

Context: Due to the diversity and number of federal programs, the Administrative Services Office ("ASO") relies on program heads to properly identify and classify federal expenditures by the program codes. We did note that this was the fiscal officer's first audit with the Department. She was supported by the Administrative Services Office Chief and the Accountant IV that both participated in previous financial statement audits.

Cause: Incorrect amounts in the SEFA were primarily caused by a lack of verification of final program expenditure amounts between the programs and the ASO. The fiscal officer inquired with the respective divisions/branches to provide the program codes that should be included in the SEFA schedule. However, based on discussion with the programs, ASO did not verify the final amounts in the SEFA, which were incomplete.

Section III – Federal Award Findings and Questioned Costs (continued)

Effect: The lack of verification resulted in inaccurate expenditure amounts being reported in the SEFA.

Recommendation: We recommend the Department of Health revisit their process of compiling the Schedule of Expenditures and Federal Awards.

Views of Responsible Officials and Planned Corrective Action: See Part VI Correction Action Plan.

PRIOR YEAR FINDINGS AND QUESTIONED COSTS

Department of Health
State of Hawaii

Summary Schedule of Prior Audit
June 30, 2017

STATUS REPORT

This section contains the current status of prior audit recommendations. The recommendations are referenced to the pages of the previous audit report for the fiscal year ended June 30, 2016, dated March 27, 2017.

Recommendations	Status
Part II – Financial Statement Findings	
2016-001 Reliance on Third Party Certifications	
We recommend that the Program implement a systematic process and direct a Department personnel to oversee distributors and redemption centers, including conducting regular audits of reports submitted and payments made by distributors and reports submitted for deposit refund and handling fee requests from redemption centers.	Positions have been established in the program (two account clerk positions and an accountant position), however these positions are currently vacant. In addition, the program is working to implement an internal process to audit the reporting records of distributors and redemption centers. Not accomplished. Refer to finding 2017- 003.
Part III – Federal Award Findings and Questioned Costs	
2016-002 Cash Management	
We recommend that the Department work with DAGS and B&F to ensure timely disbursement of federal funds in accordance with 31 CFR 205.	The State has been looking at its processes for managing federal awards and is taking steps towards addressing the issues relating to cash management. This affects all State agencies in the Executive Branch that receive Federal awards and DOH is waiting for the State to provide guidance and changes to process. Once guidance and processes are received from the State Office of Budget and Finance (B&F), DOH will work to comply with the requirements. Not accomplished. Refer to finding 2017- 008.

Recommendations	Status
Part III – Federal Award Findings and Questioned Costs (continued)	
2016-003 Allowable Costs/Cost Principles – Accrued Vacation and Vacation Payout	
The Department should review and correct its payout process for accrued leave to prevent future errors.	This issue affects all State agencies and B&F is aware of the issue and is looking at the possible alternatives to resolve this issue of vacation payouts for federally funded employees who terminate from State services. To resolve this issue in the short term, all State departments are being advised to utilize non-Federal funds to payout the accrued vacation to employees funded by Federal projects at the time of termination/separation from service. Partially accomplished. Refer to finding 2017-009.

PART VI

CORRECTIVE ACTION PLAN

DAVID Y. IGE
GOVERNOR OF HAWAII

VIRGINIA PRESSLER, M.D.
DIRECTOR OF HEALTH

STATE OF HAWAII
DEPARTMENT OF HEALTH
P. O. BOX 3378
HONOLULU, HI 96801-3378

In reply, please refer to:
A/18-013

March 29, 2018

Mr. Leslie H. Kondo, State Auditor
Office of the Auditor, State of Hawaii
465 S. King Street, Room 500
Honolulu, Hawaii 96813

Subject: Response to Draft Report "Financial Audit of the Department of Health, State of Hawaii, for the Fiscal Year Ended June 30, 2017"

Dear Mr. Kondo:

Attached are the Department of Health's comments of the audit findings for the above-mentioned audit of the Department of Health.

We appreciate the opportunity to comment on the report.

Sincerely,

Virginia Pressler

Virginia Pressler, M.D.
Director of Health

Attachment

SUBJECT: **FINANCIAL AUDIT OF THE DEPARTMENT OF HEATLH, STATE OF HAWAII, FOR THE FISCAL YEAR ENDED JUNE 30, 2017**

The Department of Health (DOH) appreciates the opportunity to comment on the subject report. We realize that audit findings and recommendations from the auditor is a management tool to assist DOH in making ongoing improvements to our existing processes in order to better manage and monitor these sources of funding.

We would like to comment on "Part IV - Schedule of Findings and Questioned Costs" portion of the report. Please note that we are responding to the Draft Report "Financial Audit of the Department of Health, State of Hawaii, for the Fiscal Year Ended June 30, 2016"

Reference No. 2017-001 Financial Statement Reporting (Material Weakness)

We agree that DOH has a responsibility for the review of the financial data that is prepared by the auditor but we would like to note that the financial information prepared by the auditors is based on the data that DOH provides to the auditors. DOH staff takes every effort to ensure that the data submitted to the auditors for the preparation of the financial report are complete and accurate. Given the short review time given to DOH by the auditors, DOH accounting staff reviews the major components of the financial statements and the supporting documentation related to those major components.

For future audits of the DOH, the departmental accounting staff will develop procedures to review prior year financial statements and determine whether variances and other material changes to the financial statements of the year being audited need further review based on rule changes, new laws or the State's overall business climate that may contribute to the variances and materials changes.

Person Responsible: Ebru Yilmaz-Pedro, Fiscal Officer, Administrative Services Office
Anticipated Date of Completion: Next Financial Audit for the Period Ending June 30, 2018 for the Department of Health

Reference No. 2017-002 Vouchers Payable (Material Weakness)

The DOH recognizes that the process for identifying vouchers payable was different from prior years as information was gathered by the DOH accounting staff and did not include input from the DOH programs as was done in previous audits.

For future audits, procedures are being developed to obtain information from the program on vouchers payable that require DOH programs to submit information for all payables that cannot be paid in the fiscal year that it was received/incurred. These reports from the DOH programs will be requested for the months of June, July, and August and reviewed by the DOH accounting staff and compared with the documents that are currently held by the DOH accounting office and Datamart reports.

Person Responsible: Ebru Yilmaz-Pedro, Fiscal Officer, Administrative Services Office
Anticipated Date of Completion: Next Financial Audit for the Period Ending June 30, 2018 for the Department of Health

Finding No.: 2017-003 Reliance on Third Party Certifications (Significant Deficiency)

The DOH recognizes that the Deposit Beverage Container Program (DBCP) recognizes the potential risk of fraud if a comprehensive auditing function is not implemented. The Office of Solid Waste Management (OSWM) that has oversight over the DBCP and other recycling programs has witnessed an increase in vacancies over time. There are currently nine out of seventeen positions vacant in the OSWM. In response, the OSWM is taking a different approach to help insulate the development, implementation, and maintenance of the DBCP auditing function from position vacancies. The OSWM will outsource the auditing duties to an independent public accounting firm on a "as needed" basis that is dependent on OSWM staffing levels. The procurement of this accounting service is highly dependent on recruitment of a Planner IV since there is currently insufficient resources to solicit and manage this contract.

As mentioned in a prior audit, the DBCP is making an effort to utilize different approaches to recruit and fill positions within the program in addition to outsourcing the auditing function. The approaches being considered to recruit and fill positions are (1) incentivizing potential applicants by recruitment above the minimum salary range by taking advantage of the "Recruitment Above the Minimum/Hiring Above Minimum" (RAM/HAM) provided for by the State of Civil Service system and (2) reviewing the current organizational structure of the DBCP and other solid waste management functions to enable the DBCP to function more independently and provide a better structure that will attract and retain employees in these positions.

Person Responsible: Darren Park, Office of Solid Waste Management Coordinator, Solid and Hazardous Waste Branch
Anticipated Date of Completion: Unknown

Reference No. 2017-004 Timely Submission of Federal Financial Report (Material Noncompliance and Material Weakness

The program recognizes that the Federal Financial Report was not submitted within 90 days after the end of the obligation and expenditure period of the grant.

The program has already taken action towards a solution that will ensure that the Federal Financial Report will be submitted timely. Three months prior to the end of each contract year, letters notifying providers and contractors of invoice deadlines and time submittal of invoices will be issued. Alcohol and Drug Abuse Division intends to submit the Federal Financial Report directly to Substance Abuse and Mental Health Services Administration.

Person Responsible: Edward Mersereau, Division Chief, Alcohol and Drug Abuse Division (ADAD)
Melanie Muraoka, Administrative Officer V, Alcohol and Drug Abuse Division (ADAD)
Anticipated Date of Completion: Next Financial Audit for the Period Ending June 30, 2018 for the Department of Health

Reference No. 2017-005 Monitoring Procedures and Risk Assessment Process (Material Noncompliance and Material Weakness)

The program recognizes that a formal risk assessment policy was not in place and the sub-recipient monitoring was not performed consistently.

The program has already taken action towards a solution that includes implementing a risk assessment policy and as suggested by the auditors, revising the control narrative to allow for desk-top audits rather than only face-to-face audits.

Person Responsible: Edward Mersereau, Division Chief, Alcohol and Drug Abuse Division (ADAD)
Melanie Muraoka, Administrative Officer V , Alcohol and Drug Abuse Division (ADAD)
Anticipated Date of Completion: Next Financial Audit for the Period Ending June 30, 2018 for the Department of Health

Reference No. 2017-006 Timely Submission of Federal Financial Report (Material Noncompliance and Material Weakness)

The DOH, Home Visiting Services Unit (HVSU) recognizes that the home visiting program is required to submit annual and closing Federal Financial Reports (FFRs) by the deadlines listed in the respective notices of award. It is the responsibility of the HVSU Accountant to complete and submit the FFR for review and approval to Maternal and Child Health Branch Accountant, Family Health Services Division Accountant, and Administrative Services Office Accountant. The Home Visiting Services Unit ensures ASO receives our FFRs to meet the reporting deadlines. The program will continue to work with the appropriate DOH ASO Accountant to meet the FFR reporting deadlines.

Person Responsible: Kimberly Arakaki, Division Chief, Maternal and Child Health Branch
Allison Mikuni, Administrative Officer, Maternal and Child Health Branch
Anticipated Date of Completion: Ongoing

Reference No. 2017-007 Cash Management (Material Noncompliance and Material Weakness)

The audit finds that the drawdown of funds for federal awards are not in compliance with 2 CFR 200.305(b) that requires disbursement of federal funds as close as administratively possible to DOH's disbursement for the federal award programs. As mentioned in the previous financial audits of the Department of Health, State of Hawaii, For the Fiscal Years Ending June 30, 2015 and June 30, 2016, disbursing the drawdown of funds is a very cumbersome process. The State Department of Budget and Finance (B&F) validates the deposits recorded in the State's Financial Accounting Management and Information System (FAMIS) done by the State Department of Accounting and General Services (DAGS). The processes for obtaining validation and posting to the FAMIS take approximately 5 to 10 days and it is only when these processes are secured, can DOH disburse the funds to vendors. This process affects all State agencies that receive federal funding. DAGS and B&F are reviewing the State's FAMIS and is looking at the policies and processes currently in place to determine what types of modifications are needed for improvements.

Person Responsible: State of Hawaii Budget & Finance (B&F), State of Hawaii Department of Accounting and General Services (DAGS)
Anticipated Date of Completion: Unknown

Reference No. 2017-008 Timely Submission of Federal Financial Report (Material Noncompliance and Material Weakness)

The Department will implement procedures to ensure that the Chronic Disease Prevention and Health Promotion Division (CDPHPD) will comply with the timely submission of Federal Financial Reports (FFR). CDPHPD now has a streamline process that utilizes Microsoft SharePoint to efficiently share data between employees. The project managers for federal grants will maintain a timeline of all federal requirements deadlines that will be recorded on SharePoint. Additionally, the division accountant is currently keeping a record of all FFR deadlines.

Person Responsible: Owen Tamanaha, Administrative Officer
Anticipated Date of Completion: May 2018

Reference No. 2017-009 Obtaining Single Audit Reports (Material Weakness)

The Department will implement procedures to ensure that the Chronic Disease Prevention and Health Promotion Division (CDPHPD) will obtain the Single Audit Report from applicable contractors. Nonprofit organizations that will expend $500,000 or more in a year in federal funds, are required to conduct a Single Audit. When the organization completes the Single Audit, they will be required to send a copy to their respective CDPHPD project manager. This language will be added to the "Special Conditions" in applicable contracts going forward.

Person Responsible: Owen Tamanaha, Administrative Officer
Anticipated Date of Completion: October 2018

Reference No. 2017-010 Maintenance of State Funding Levels (Significant Deficiency)

During the audit, the DOH, Home Visiting Services Unit (HVSU) provided the auditor with documentation showing all General Fund expenditures for Federal Fiscal Year 2017. This includes payments made from appropriations G 16 376 & G 17 376 in the total amount of $3,128,334.41 which exceeds the programs Maintenance of Effort (MOE). The auditor reported to the HVSU Supervisor they could use the previously provided documentation to verify compliance with the requirement. The auditor downgraded this draft finding from "Material Noncompliance and Material Weakness" to a "Significant Deficiency" with no compliance issues.

The DOH, Home Visiting Services Unit (HVSU) recognizes that the home visiting program is required to maintain non-federal funding for grant activities at a level which is not less than expenditures for such activities as the programs most recently completed fiscal year. It is the responsibility of the Home Visiting Services Unit Accountant to track and verify that the Maintenance of Effort (MOE) requirements are met on an annual basis.

Person Responsible: Zachary Riehemann, Home Visiting Services Unit Accountant
Anticipated Date of Completion: June 30, 2018 and annually thereafter.

Reference No. 2017-011 Accrued Vacation (Significant Deficiency)

This vacation payout has already been resolved. DOH has outlined a process where once an individual paid on federal funds separates from service, the program reviews the expenditures made to the account and identifies the vacation payout amount charged to the federal fund. The vacation payout is then transferred to a non-federal fund account within 90 days or prior to the submission of the final Federal Financial Report (FFR), whichever is sooner. DOH continues to work closely with the programs who receive federal funds to identify vacation payout amounts that need to be transferred timely.

Person Responsible: Janis Morita, Chief, Administrative Services Office
Ebru Yilmaz-Pedro, Fiscal Officer, Administrative Services Office
Anticipated Date of Completion: Ongoing

Reference No. 2017-012 Excluded Parties Listing Search (EPLS) (Significant Deficiency)

The DOH, Home Visiting Services Unit (HVSU) recognizes that the home visiting program is required to restrict awards, sub-awards, and contracts with certain parties that are debarred, suspended, or otherwise excluded from or ineligible for participation in Federal assistance programs or activities. The HVSU acknowledges an oversight in maintaining documentation that an EPLS check was performed prior to the execution of the vendor agreement. The Home Visiting Services Unit, Supervisor will establish policies and procedure requiring the Contract Specialist to review the contract checklist, perform and retain EPLS check documentation to ensure that no awards, sub-awards, and contracts are issued to any parties that are debarred, suspended or otherwise excluded from or ineligible for participation in Federal assistance programs or activities and save documentation in the contract file.

Person Responsible: Tod Robertson, Home Visiting Services Unit Supervisor
Anticipated Date of Completion: June 30, 2018.

Reference 2017-013 Schedule of Expenditures and Federal Awards (SEFA) Preparation (Significant Deficiency)

The DOH acknowledges that improvements are needed in compiling data for the SEFA. The DOH-ASO is developing a procedure to assist DOH programs in compiling their expenditure data and is currently working on training materials and a training session on how to gather the data. DOH-ASO will also work to start the process of data gathering prior to the ending of the fiscal year in order to allow for additional review and discussion with the DOH programs and their data gathering efforts.

Person Responsible: Ebru Yilmaz-Pedro, Fiscal Officer, Administrative Services Office
Anticipated Date of Completion: Commencing with the next financial audit cycle for the period ending June 30, 2018 (will be ongoing)

Auditor’s Summary

Financial and Compliance Audit of the Department of Health

Financial Statements, Fiscal Year Ended June 30, 2017

PHOTO: OFFICE OF THE AUDITOR

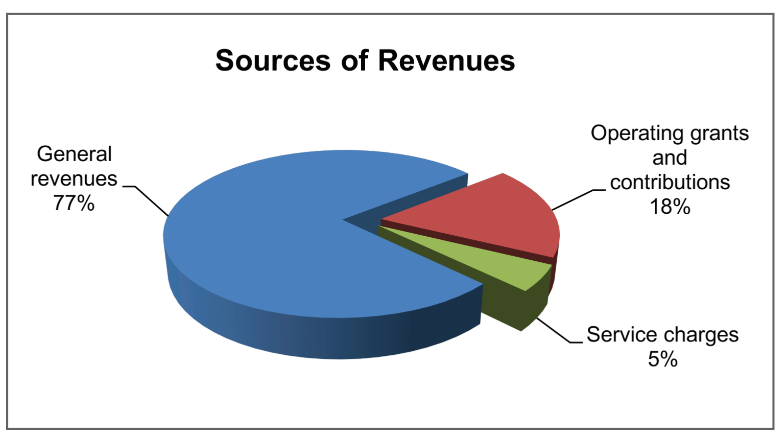
THE PRIMARY PURPOSE *of the audit was to form an opinion on the fairness of the presentation of the financial statements for the Department of Health (DOH), as of and for the fiscal year ended June 30, 2017, and to comply with the requirements of Code of Federal Regulations, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, Title 2, Part 200 (Uniform Guidance), which established audit requirements for state and local governmental units that receive federal awards. The audit was conducted by KMH LLP.*

About the Department

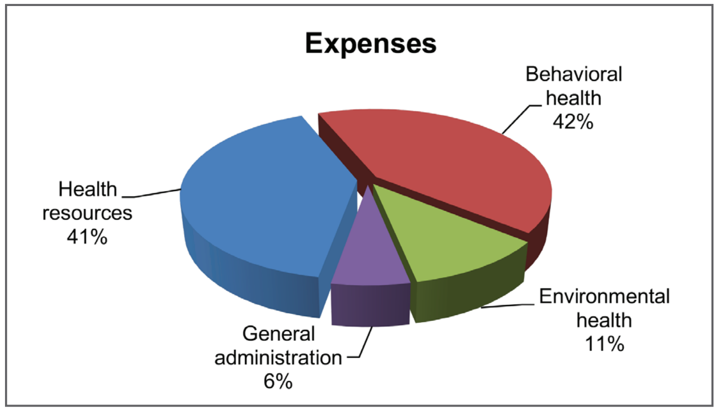
DOH administers and oversees statewide personal health services, health promotion and disease prevention, mental health programs, monitoring of the environment, and the enforcement of environmental health laws. DOH administers federal grants to support the State’s health services and programs. DOH is organized into four major administrations: Behavioral Health Services, Health Resources, Environmental Health, and General Administration.

Financial Highlights

FOR THE FISCAL YEAR ended June 30, 2017, DOH reported total revenues of $802 million and total expenses of $739 million, resulting in a change in net position of $63 million. Revenues consisted of $616 million from general revenues, $148 million from operating grants and contributions, and $38 million from service charges.



Total expenses of $739 million consisted of $289 million for health resources, $314 million for behavioral health, $90 million for environmental health, and $46 million for general administration.



As of June 30, 2017, total assets and deferred outflows of resources exceeded total liabilities and deferred inflows of resources by $1.02 billion. Total assets and deferred outflows of resources of $1.17 billion were comprised of cash of $520 million, receivables of $85 million, loans receivable of $482 million, deferred outflows of resources of $2 million, and net capital assets of $85 million. Total liabilities and deferred inflows of resources totaled $150 million. DOH's net position of $1.02 billion was comprised of a restricted amount of $772 million, of which $712 million was for loans, an unrestricted amount of $168 million, and net investment of capital assets of $85 million.

Auditors' Opinions

DOH RECEIVED AN UNMODIFIED OPINION that the financial statements were presented fairly, in all material respects, in accordance with generally accepted accounting principles. DOH received a qualified opinion on its compliance with major federal programs in accordance with the *Uniform Guidance*.

Findings

THERE WERE TWO MATERIAL WEAKNESSES and one significant deficiency in internal control over financial reporting that are required to be reported under *Government Auditing Standards*.

Material Weaknesses (2)

- Audit adjustments were recorded to beginning net position related to cigarette tax revenues and the deposit beverage receivable because of ineffective management review.
- Audit adjustments made to record additional vouchers payable were not identified by management.

Significant Deficiency

- The Deposit Beverage Container Program is susceptible to fraud because of an overreliance on self-reporting by distributors and redemption centers.

THERE WERE SIX MATERIAL WEAKNESSES and four significant deficiencies in internal control over compliance in accordance with the *Uniform Guidance*.

Material Weaknesses (6)

- Failure to submit federal financial reports timely (3).
- Failure to follow subrecipient monitoring policy to ensure subrecipient compliance with federal requirements (2).
- Federal funds were not disbursed in a timely manner to comply with federal regulations.

Significant Deficiencies (4)

- Lack of monitoring the level of non-Federal funding to meet the level of effort requirement.
- Federal funds used to pay terminated employees' accrued leave were charged as direct program costs.
- Lack of documentation of the Excluded Parties Listing Search to ensure vendor eligibility.
- Inaccurate expenditure amounts reported in the Schedule of Expenditures and Federal Awards.

For the complete report and financial statements visit our website at:
http://files.hawaii.gov/auditor/Reports/2017_Audit/DOH2017.pdf

Department of Health
Drinking Water Treatment Revolving Loan Fund
State of Hawaii

Financial Statements
June 30, 2017
Together with Independent Auditor's Report

Submitted by

THE AUDITOR
STATE OF HAWAII

Table of Contents

PART I

FINANCIAL SECTION

Independent Auditor's Report

To the Auditor
State of Hawaii

Report on the Financial Statements

We have audited the accompanying financial statements of the State of Hawaii, Drinking Water Treatment Revolving Loan Fund ("DWTRLF") as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the DWTRLF's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

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Opinion

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

Emphasis of Matter

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

Other Matters

Required Supplementary Information

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

Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the DWTRLF's basic financial statements. The supplementary information on pages 35 to 38 are presented for purposes of additional analysis and are not a required part of the basic financial statements.

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

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated November 30, 2017 on our consideration of the DWTRLF's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the DWTRLF'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 DWTRLF's internal control over financial reporting and compliance.

KMH LLP

KMH LLP

Honolulu, Hawaii
November 30, 2017

Department of Health
Drinking Water Treatment Revolving Loan Fund
State of Hawaii

Statement of Net Position
June 30, 2017

Assets and Deferred Outflows of Resources

Current Assets:	
Equity in cash and cash equivalents and investments in State Treasury	$ 42,671,783
Loan fees receivable	566,577
Accrued interest on loans	115,892
Other accrued interest	122,987
Due from federal government	253,335
Due from State Treasury	72,021
Accounts receivable	3,467
Current maturities of loans receivable	7,954,563
Total current assets	51,760,625
Loans Receivable, net of current maturities	148,898,160
Capital Assets, net of accumulated depreciation	632,086
Total assets	201,290,871
Deferred Outflows of Resources Related to Pensions	865,277
Total assets and deferred outflows of resources	$ 202,156,148

Liabilities, Deferred Inflows of Resources, and Net Position

Current Liabilities--	
Accounts Payable and Other Accrued Liabilities	$ 464,321
Total current liabilities	464,321
Accrued Vacation, net of current portion	159,800
Net Pension Liability	2,516,679
Other Postemployment Benefits	976,575
Total liabilities	4,117,375
Deferred Inflows of Resources Related to Pensions	305,861
Net Position:	
Net investment in capital assets	632,086
Restricted - expendable	197,100,826
Total net position	197,732,912
Total liabilities, deferred inflows of resources, and net position	$ 202,156,148

See accompanying notes to the financial statements.

Department of Health
Drinking Water Treatment Revolving Loan Fund
State of Hawaii

Statement of Revenues, Expenses and Changes in Net Position
For the Year Ended June 30, 2017

Operating Revenues:	
Interest income from loans	$ 482,655
Administrative loan fees	2,225,034
Total operating revenue	2,707,689
Operating Expenses:	
Administrative	1,597,367
State program management	1,125,889
Water protection	286,314
Principal forgiveness	4,245,880
Small systems technical assistance	17,595
Total operating expenses	7,273,045
Operating loss	(4,565,356)
Nonoperating Revenues:	
State contributions	1,769,000
Federal contributions	13,084,934
Other interest income	556,160
Other income	15,176
Total nonoperating revenues	15,425,270
Change in net position	10,859,914
Net Position:	
Beginning of fiscal year, as previously reported	186,925,732
Restatement due to change in accounting principle	(52,734)
Beginning of fiscal year, as restated	186,872,998
End of fiscal year	$ 197,732,912

See accompanying notes to the financial statements.

Department of Health
Drinking Water Treatment Revolving Loan Fund
State of Hawaii

Statement of Cash Flows
For the Year Ended June 30, 2017

Cash Flows from Operating Activities:	
Payments to employees	$ (1,512,953)
Payments to vendors	(784,915)
Net cash used in operating activities	(2,297,868)
Cash Flows from Noncapital Financing Activities:	
State contributions	1,769,000
Federal contributions	12,805,156
Net cash provided by noncapital financing activities	14,574,156
Cash Flows from Capital and Related Financing Activities --	
Purchase of Equipment	(109,156)
Net cash used in capital and related financing activities	(109,156)
Cash Flows from Investing Activities:	
Principal repayments on loans	23,993,473
Disbursement of loan proceeds	(49,101,106)
Interest income from loans	462,230
Administrative loan fees	2,315,495
Other interest income	443,576
Net cash used in investing activities	(21,886,332)
Net decrease in cash	(9,719,200)
Equity in Cash and Cash Equivalents and Investments in State Treasury:	
Beginning of fiscal year	52,390,983
End of fiscal year	$ 42,671,783

See accompanying notes to the financial statements.

Department of Health
Drinking Water Treatment Revolving Loan Fund
State of Hawaii

Statement of Cash Flows (continued)
For the Year Ended June 30, 2017

Reconciliation of Operating Loss to Net Cash Used in Operating Activities:		
Operating loss	$	(4,565,356)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation expense		197,049
Principal forgiveness		4,245,880
Interest income from loans		(482,655)
Administrative loan fees		(2,225,034)
In-kind contributions from Environmental Protection Agency		141,032
Non-imposed fringe benefits		15,176
Change in assets, deferred outflows of resources, liabilities, and deferred inflows of resources:		
Due from State Treasury		18,372
Accounts receivable		(1,307)
Accounts payable and other accrued liabilities		84,240
Net deferred outflows/inflows of resources related to pensions		(846,305)
Net pension liability		1,035,559
Other postemployment benefits		85,481
Net cash used in operating activities	$	(2,297,868)

See accompanying notes to the financial statements.

NOTE A - ESTABLISHMENT AND PURPOSE OF THE FUND

The Safe Drinking Water Act Amendments (“SDWA”) of 1996 (the “Act”) authorized the Environmental Protection Agency (“EPA”) to make capitalization grants to the states for the purpose of providing loans and other types of financial assistance to public water supply systems for drinking water infrastructure.

The Act also authorized the states to set aside funding for prevention programs and administration of the Fund, provided that the amount of funding did not exceed thirty-one percent (31%) of the annual capitalization grant as follows:

1. Up to fifteen percent (15%) may be used to provide local assistance and other state programs.

2. Up to four percent (4%) may be used to cover the costs of program administration.

3. Up to ten percent (10%) may be used for Public Water System Supervision (“PWSS”) program activities and other initiatives of the SDWA.

4. Finally, up to two percent (2%) may be used to support small systems technical assistance activities.

To receive the federal capitalization grants, the 1997 State of Hawaii (“State”) Legislature established the Drinking Water Treatment Revolving Loan Fund (“DWTRLF” or “Fund”) to receive federal capitalization grants from EPA. The DWTRLF is intended to provide loans in perpetuity to public drinking water systems for construction of drinking water treatment facilities. Such loans may be at or below market interest rates and must be fully amortized within twenty years. Prior to July 1, 2015, the first repayment of principal and interest occurs no later than one year after the notice to proceed for construction or the final agreement date, whichever is later. Beginning July 1, 2015, the first repayment of principal and interest occurs no later than one year after the final loan disbursement, one year after the project completion date or three years after the final agreement date, whichever is earliest. The Fund is administered by the Safe Drinking Water Branch, Environmental Management Division of the Department of Health (“DOH”), State of Hawaii.

NOTE B – SIGNIFICANT ACCOUNTING POLICIES

1. Financial Statement Presentation

The accompanying financial statements are intended to present the financial position, results of operations and cash flows of only that portion of the State and DOH that is attributable to the

NOTE B - ACCOUNTING POLICIES (continued)

transactions of DWTRLF and do not purport to present the financial position , results of operation or cash flows of the State or DOH.

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

2. Measurement Focus and Basis of Accounting

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

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

3. Use of Estimates

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

NOTE B - ACCOUNTING POLICIES (continued)

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

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

Effective August 1, 1999, cash is pooled with funds from other state agencies and departments and deposited into approved financial institutions or participates in the State Treasury Investment Pool System. Cash accounts that participate in the investment pool accrue interest based on the average weighted cash balances of each account. At June 30, 2017, information relating to the types, insurance, collateral, and related interest rate, credit and custodial risks of funds deposited with the State Treasury was not available since such information is determined on a statewide basis and not for individual departments. The State requires that the depository banks pledge, as collateral, government securities held in the name of the state for deposits not covered by federal deposit insurance.

5. Loans Receivable

Loans made to the counties are funded by federal capitalization grants, State matching funds, repayments and investment interest income. Loan funds are disbursed to local agencies as they expend for the purposes of the loan, and request reimbursement from the Fund. Interest is calculated from the date that loan funds are disbursed, and after the final disbursement has been made, the payment schedule identified in the loan agreement is adjusted for the actual amounts disbursed, and interest accrued during the project period. The capitalization grants for federal fiscal years 2010 through 2016 allow for portions of loans to be forgiven upon satisfaction of certain requirements.

6. Administrative Loan Fees

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

NOTE B - ACCOUNTING POLICIES (continued)

7. Capital Assets

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

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

8. Accrued Vacation

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

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

9. Accumulated Sick Leave

Sick leave accumulates at a rate of 14 hours for each month of service without limit, but may be taken only in the event of an illness and is not convertible to pay upon termination of employment. However, an employee who leaves government service in good standing with 60 days or more of unused sick leave is entitled to additional service credit in the Employees' Retirement System ("ERS"). At June 30, 2017, accumulated sick leave was approximately $588,600.

10. Net Position

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

NOTE B - ACCOUNTING POLICIES (continued)

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

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

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

11. Administrative Costs

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

12. Fund Accounts

The DWTRLF consists of the State Revolving Fund ("SRF") and non-SRF activity. The SRF activity consists exclusively of federal capitalization grant loans, state matching contributions, principal loan repayments, and interest from loans and other earning assets. Non-SRF activity consists of administrative loan fees and federal set aside funds.

13. Expenses

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

14. Deferred Outflows of Resources and Deferred Inflows of Resources

Deferred outflows of resources represent a consumption of net position that applies to a future period and will not be recognized as an outflow of resources (expense) until that time. Deferred inflows of resources represent an acquisition of net position that applies to a future period and will not be recognized as an inflow of resources (revenue) until that time.

NOTE B - ACCOUNTING POLICIES (continued)

15. Pensions

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

16. Other Post-employment Benefits

The state provides post-retirement health care and life insurance benefits to qualified retirees classified as OPEB. OPEB costs are measured and disclosed using the accrual basis of accounting. From an accrual accounting perspective, the cost of OPEB should be associated with the periods in which the exchange of salaries and benefits for employee services occur, rather than with the periods when benefits are paid or provided.

GASB 45 requires state and local government employers to move from accounting for OPEB costs from a pay-as-you-go basis to an accrual basis for the actuarially determined annual OPEB cost. The OPEB liability is the long-term financial obligation allocated to the DWTRLF.

17. Indirect Cost

The state charges the DWTRLF federal grants an indirect cost on direct salaries and wages, including all fringe benefits. It is determined based on a negotiated Federal indirect rate.

18. Due from State Treasury

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

NOTE B - ACCOUNTING POLICIES (continued)

19. New Accounting Pronouncements

The GASB issued Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets* that are not within the Scope of *GASB Statement 68*, and *Amendments to Certain Provisions of GASB Statements 67 and 68*. The Statement establishes accounting and financial reporting requirements by employers and governmental nonemployer contributing entities for pensions that are not within the scope of Statement No. 68. The requirements of this Statement are effective for fiscal years beginning after June 15, 2015, except those provisions that address employers and governmental nonemployer contributing entities for pensions that are not within the scope of Statement No. 68, which are effective for fiscal years beginning after June 15, 2016. Management has adopted the applicable requirements of this statement as presented in the Fund's financial statements.

The GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. The Statement replaces GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions,* and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*. The Statement will require the liability of employers for defined benefit OPEB to be measured as the portion of the present value of projected benefit payments to be provided to current active and inactive employees that is attributed to those employees' past periods of service, less the amount of the OPEB plan's fiduciary net position. The requirements of this Statement are effective for fiscal years beginning after June 15, 2017. Management has determined that Statement No. 75 will have a material effect in the Fund's financial statements.

NOTE C - LOANS RECEIVABLE

At June 30, 2017, the DWTRLF had outstanding loan receivables with the following government entities:

Fourteen loans with the City & County of Honolulu, Board of Water Supply; due in semiannual payments, including interest ranging from 0.00% to 1.00%, commencing not later than one year after project completion, notice to proceed, final loan disbursement or three years after loan agreement date. Final payment is due not later than twenty years after project completion.	$ 71,763,807
Eighteen loans with the County of Hawaii, Water Board; due in semiannual payments, including interest ranging from 0.00% to 1.37%, commencing not later than one year after project completion, notice to proceed, final loan disbursement or three years after loan agreement date. Final payment is due not later than twenty years after project completion.	33,756,825
Twenty loans with the County of Maui, Board of Water Supply; due in semiannual payments, including interest ranging from 0.00% to 1.00%, commencing not later than one year after project completion, notice to proceed, final loan disbursement or three years after loan agreement date. Final payment is due not later than twenty years after project completion.	29,168,424
Fifteen loans with the County of Kauai, Board of Water Supply; due in semiannual payments, including interest ranging from 0.16% to 1.37%, commencing not later than one year after project completion, notice to proceed, final loan disbursement or three years after loan agreement date. Final payment is due not later than twenty years after project completion.	22,163,667
	156,852,723
Less: current maturities	(7,954,563)
	$ 148,898,160

NOTE C - LOANS RECEIVABLE (continued)

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

Fiscal Years Ending,	Amount
2018	$ 7,954,563
2019	9,000,742
2020	9,528,579
2021	9,894,637
2022	9,858,374
2023-2027	46,234,822
2028-2032	40,740,417
2033-2037	21,067,094
2038-2039	2,573,495
	$ 156,852,723

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

In fiscal year 2017, $4,245,880 in loans were forgiven. All loans and advances were forgiven in accordance with the required conditions.

At June 30, 2017, $5,000,000 was committed to be loaned to the County of Maui under existing loan agreements.

NOTE D – CONTRIBUTED CAPITAL

The DWTRLF is capitalized by grants from EPA and matching funds from the State. The following summarizes the EPA capitalization grants, amounts drawn on each grant, and the balances available for future loans at June 30, 2017:

Budget Period	Amount	Total Draws at June 30, 2016	EPA Draws	Total 2017 Cash Draws	Funds Available
01/01/10-06/30/19	$ 8,146,000	$ 7,797,067	$ -	$ 348,933	$ -
04/01/11-06/30/17	13,573,000	13,272,820	-	300,180	-
09/30/11-06/30/18	9,268,000	9,076,400	-	191,600	-
09/30/13-06/30/20	8,421,000	8,318,157	-	102,843	-
12/01/14-06/30/21	8,787,058	8,539,954	-	247,104	-
10/01/15-06/30/19	8,787,000	3,799,638	-	4,900,347	87,015
10/01/16-06/30/20	8,312,000	-	315,000	6,714,149	1,282,851
	$ 65,294,058	$ 50,804,036	$ 315,000	$ 12,805,156	$ 1,369,866

The State is required to match 20 percent of the estimated amount of the grant from the EPA and does so in the year that the capitalization grant is awarded. Through June 30, 2017, the Fund was in compliance with the 20 percent State matching requirement. The required State match through June 30, 2017 approximated $34.9 million, of which the entire amount has been utilized.

NOTE E – CAPITAL ASSETS

Capital asset activity for the fiscal year ended June 30, 2017 was as follows:

	Balance at July 1, 2016	Additions	Retirements/ Disposals	Balance at June 30, 2017
Equipment	$ 2,408,734	$ 109,156	$ (7,024)	$ 2,510,866
Accumulated Depreciation	(1,688,755)	(197,049)	7,024	(1,878,780)
	$ 719,979	$ (87,893)	$ -	$ 632,086

NOTE F – ACCRUED VACATION

The changes to the accrued vacation liability during 2017 were as follows:

Balance at July 1, 2016	$ 212,923
Increase	63,517
Decrease	(57,437)
Balance at June 30, 2017	219,003
Less: Current portion	(59,203)
Noncurrent portion	$ 159,800

NOTE G - EMPLOYEE BENEFIT PLANS

1. Pension Plan

Plan Description

Generally, all full-time employees of the State and counties are required to be members of the ERS, a cost-sharing multiple-employer defined benefit pension plan that administers the State's pension benefits program. Benefits, eligibility, and contribution requirements are governed by Hawaii Revised Statutes ("HRS") Chapter 88 and can be amended through legislation. The ERS issues publicly available annual financial reports that can be obtained at ERS' website: http://www.ers.ehawaii.gov.

Benefits Provided

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

NOTE G - EMPLOYEE BENEFIT PLANS (continued)

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

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

Noncontributory Class

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

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

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

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

NOTE G - EMPLOYEE BENEFIT PLANS (continued)

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.

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

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

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

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

NOTE G - EMPLOYEE BENEFIT PLANS (continued)

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.

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

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

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

Hybrid Class for Members Hired Prior to July 1, 2012

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

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

NOTE G - EMPLOYEE BENEFIT PLANS (continued)

- 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 dependent children/parents, the ordinary death benefit is payable to the designated beneficiary.

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

Hybrid Class for Members Hired After June 30, 2012

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

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

NOTE G - EMPLOYEE BENEFIT PLANS (continued)

Contributions

Contributions are governed by HRS Chapter 88 and may be amended through legislation. The employer rate is set by statute based on the recommendations of the ERS actuary resulting from an experience study conducted every five years. Since July 1, 2005, the employer contribution rate is a fixed percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liabilities. The contribution rates for fiscal year 2017 were 25.00% for police and firefighters and 17.00% for all other employees. Contributions to the pension plan from the DWTRLF were $170,110 for the fiscal year ended June 30, 2017.

On May 18, 2017, the Governor signed into law Act 17 SLH 2017. Per Act 17, future employer contributions from the State and counties are expected to increase pursuant to a phased-in contribution rate increase over four years beginning July 1, 2017. The rate for all employees, except for police officers and firefighters, increases to 18.00% on July 1, 2017; 19.00% on July 1, 2018; 22.00% on July 1, 2019; and 24.00% on July 1, 2020.

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

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

At June 30, 2017, the DWTRLF reported a liability of $2,516,679 for its proportionate share of net pension liability of the State. The net pension liability was measured as of June 30, 2016, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The State’s proportion of the net pension liability was based on a projection of the State’s long-term share of contributions to the pension plan relative to projected contributions of all participants, actuarially determined. The DWTRLF’s proportion of the net pension liability was based on an allocation of the State’s net pension liability based on the proportionate share of qualified payroll. At June 30, 2016 and 2015, the DWTRLF’s proportion of the State’s share was 0.04%.

NOTE G - EMPLOYEE BENEFIT PLANS (continued)

There were significant changes in actuarial assumptions effective June 30, 2016 based on the Five-Year Experience Study report dated July 5, 2016 that resulted in a significant increase in the measurement of the total pension liability. Primary drivers for the increase include a decrease in the investment return assumption and discount rate from 7.65% as of June 30, 2015 to 7.00% as of June 30, 2016; and a decrease in the mortality assumptions for longer life expectancy and an explicit assumption for continued future mortality improvement (generational approach). There were no other changes in assumptions between the measurement date, June 30, 2016, and the reporting date, June 30, 2017, that are expected to have a significant effect on the proportionate share of the net pension liability.

For the year ended June 30, 2017, the DWTRLF recognized pension expense of $359,365. At June 30, 2017, the DWTRLF reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	$ 108,613	$ (44,645)
Changes in assumptions	569,577	-
Net difference between projected and actual earnings on pension plan investments	-	(251,560)
Changes in proportion and difference between DWTRLF contributions and proportionate share of contributions	16,977	(9,656)
DWTRLF contributions subsequent to the measurement date	170,110	-
	$ 865,277	$ (305,861)

NOTE G - EMPLOYEE BENEFIT PLANS (continued)

The $170,110 reported as deferred outflows of resources related to pensions resulting from DWTRLF contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the fiscal year ended June 30, 2017. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Fiscal Years Ending June 30,	Amount
2018	$ 75,337
2019	75,337
2020	102,117
2021	89,137
2022	47,378
Total	$ 389,306

Actuarial Assumptions

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

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

There were no changes to ad hoc postemployment benefits including COLA.

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

NOTE G - EMPLOYEE BENEFIT PLANS (continued)

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

Strategic Allocation (risk-based classes)	Target Allocation	Long-term Expected Geometric Rate of Return
Broad growth	63.0%	8.35%
Principal protection	7.0%	2.20%
Real return	10.0%	6.15%
Crisis risk offset	20.0%	5.50%
	100.0%	

Discount Rate

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

NOTE G - EMPLOYEE BENEFIT PLANS (continued)

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

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

	1% Decrease (6.00%)	Discount Rate (7.00%)	1% Increase (8.00%)
DWTRLF's proportionate share of the net pension liability	$ 3,219,001	$ 2,516,679	$ 1,935,531

Pension Plan Fiduciary Net Position

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

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

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

Payables to the Pension Plan

At June 30, 2017, there was no payable to the ERS.

NOTE G - EMPLOYEE BENEFIT PLANS (continued)

New Pronouncement for Financial Reporting – Pension

In March 2016, GASB issued Statement No. 82 (GASB 82), *Pension Issues – An Amendment of GASB Statements No. 67, No. 68, and No. 73*. GASB 82 addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. The Fund implemented the provisions of GASB 82 as of June 30, 2017, which resulted in the restatement of the Fund's beginning net position as follows:

	2016 (As Previously Reported)	Restatement Adjustment	2016 (As Restated)
Net position at beginning of year	$ 186,925,732	$ (52,734)	$ 186,872,998

2. Deferred Compensation Plan

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

All plan assets are held in a trust fund to protect them from claims of general creditors. The State has no responsibility for loss due to the investment or failure of investment of funds and assets in the plan, but has the duty of due care that would be required of an ordinary prudent investor.

3. Post-Employment Health Care and Life Insurance Benefits

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

NOTE G - EMPLOYEE BENEFIT PLANS (continued)

State Policy

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

Annual OPEB Cost

The components of the allocated annual OPEB cost (annual required contribution, interest on net OPEB obligation, and adjustment to annual required contribution) are insignificant to the DWTRLF's financial statements. The following table shows the allocated annual OPEB cost that has been allocated to DWTRLF for the year ended June 30, 2017:

Annual OPEB cost	$ 244,083
Less: Contributions made	(158,602)
Increase in net OPEB obligation	85,481
Net OPEB obligation, beginning of year	891,094
Net OPEB obligation, end of year	$ 976,575

Amount of Contributions Made

Contributions are financed on a pay-as-you-go basis and DWTRLF's contributions for the fiscal years ended June 30, 2017, 2016, and 2015 approximated $159,000, $112,000 and $92,000, respectively.

Required Supplementary Information and Disclosures

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

NOTE H - INSURANCE COVERAGE

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

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

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

SUPPLEMENTARY INFORMATION

Department of Health
Drinking Water Treatment Revolving Loan Fund
State of Hawaii

Schedule of Cash Receipts, Disbursements and Cash Balance
For the Year Ended June 30, 2017

Receipts:	
Principal repayment on loans	$ 23,993,473
Interest income from loans	462,230
State contributions	1,769,000
Federal contributions	12,805,156
Administrative loan fees	2,315,495
Other interest income	443,576
Total receipts	41,788,930
Disbursements:	
Disbursement of loan proceeds	49,101,106
Purchase of equipment	109,156
Administrative	2,297,868
Total disbursements	51,508,130
Excess of disbursements over receipts	(9,719,200)
Equity in Cash and Cash Equivalents and Investments in State Treasury:	
Beginning of fiscal year	52,390,983
End of fiscal year	$ 42,671,783

Department of Health
Drinking Water Treatment Revolving Loan Fund
State of Hawaii

Combining Statement of Net Position
June 30, 2017

	State Revolving Fund Activity	Non-SRF Activity	Total
Assets and Deferred Outflows of Resources			
Current Assets:			
Equity in cash and cash equivalents and investments in State Treasury	$ 39,468,281	$ 3,203,502	$ 42,671,783
Loan fees receivable	-	566,577	566,577
Accrued interest on loans	115,892	-	115,892
Other accrued interest	122,987	-	122,987
Due from federal government	-	253,335	253,335
Due from State Treasury	72,021	-	72,021
Accounts receivable	-	3,467	3,467
Current maturities of loans receivable	7,954,563	-	7,954,563
Total current assets	47,733,744	4,026,881	51,760,625
Loans Receivable, net of current maturities	148,898,160	-	148,898,160
Capital Assets, net of accumulated depreciation	-	632,086	632,086
Total assets	196,631,904	4,658,967	201,290,871
Deferred Outflows of Resources Related to Pensions	-	865,277	865,277
Total assets and deferred outflows of resources	$ 196,631,904	$ 5,524,244	$ 202,156,148
Liabilities, Deferred Inflows of Resources, and Net Position			
Current Liabilities--			
Accounts Payable and Other Accrued Liabilities	$ -	$ 464,321	$ 464,321
Total current liabilities	-	464,321	464,321
Accrued Vacation, net of current portion	-	159,800	159,800
Net Pension Liability	-	2,516,679	2,516,679
Other Postemployment Benefits	-	976,575	976,575
Total liabilities	-	4,117,375	4,117,375
Deferred Inflows of Resources Related to Pensions	-	305,861	305,861
Net Position:			
Net investment in capital assets	-	632,086	632,086
Restricted - expendable	196,631,904	468,922	197,100,826
Total net position	196,631,904	1,101,008	197,732,912
Total liabilities, deferred inflows of resources, and net position	$ 196,631,904	$ 5,524,244	$ 202,156,148

Department of Health
Drinking Water Treatment Revolving Loan Fund
State of Hawaii

Combining Statement of Revenues, Expenses and Changes in Net Position
For the Year Ended June 30, 2017

	State Revolving Fund Activity	Non-SRF Activity	Total
Operating Revenues:			
Interest income from loans	$ 482,655	$ -	$ 482,655
Administrative loan fees	-	2,225,034	2,225,034
Total operating revenue	482,655	2,225,034	2,707,689
Operating Expenses:			
Administrative	-	1,597,367	1,597,367
State program management	-	1,125,889	1,125,889
Water protection	-	286,314	286,314
Principal forgiveness	4,245,880	-	4,245,880
Small systems technical assistance	-	17,595	17,595
Total operating expenses	4,245,880	3,027,165	7,273,045
Operating loss	(3,763,225)	(802,131)	(4,565,356)
Nonoperating Revenues:			
State contributions	1,769,000	-	1,769,000
Federal contributions	11,471,723	1,613,211	13,084,934
Other interest income	556,160	-	556,160
Other income	-	15,176	15,176
Total nonoperating revenues	13,796,883	1,628,387	15,425,270
Change in net position	10,033,658	826,256	10,859,914
Net Position:			
Beginning of fiscal year, as previously reported	185,008,414	1,917,318	186,925,732
Restatement due to change in accounting principle	-	(52,734)	(52,734)
Beginning of fiscal year, as restated	185,008,414	1,864,584	186,872,998
Transfer from Non-SRF Activity to SRF Activity	1,589,832	(1,589,832)	-
End of fiscal year	$ 196,631,905	$ 1,101,007	$ 197,732,912

Department of Health
Drinking Water Treatment Revolving Loan Fund
State of Hawaii

Schedule of Operating Expenses
For the Year Ended June 30, 2017

	State Revolving Fund Activity	Non-SRF Activity	Total
Principal Forgiveness	$ 4,245,880	$ -	$ 4,245,880
Personnel	-	1,472,835	1,472,835
Professional Services	-	314,720	314,720
Pension Expense	-	359,365	359,365
Depreciation	-	197,049	197,049
Services Rendered by Other State Agencies	-	174,961	174,961
Intergovernmental Personnel Agreement Expenses	-	141,032	141,032
Repairs and Maintenance	-	127,238	127,238
Travel	-	94,234	94,234
Training	-	61,351	61,351
Office and Other Supplies	-	32,667	32,667
Rental	-	4,383	4,383
Telephone	-	2,080	2,080
Miscellaneous	-	45,250	45,250
Total operating expenses	$ 4,245,880	$ 3,027,165	$ 7,273,045

PART II

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

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

Independent Auditor's Report

To the Auditor
State of Hawaii

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States, the financial statements of State of Hawaii, Drinking Water Treatment Revolving Loan Fund ("DWTRLF") as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the DWTRLF's basic financial statements, and have issued our report thereon dated November 30, 2017.

Internal Control over Financial Reporting

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

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

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

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Compliance and Other Matters

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

Purpose of this Report

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

KMH LLP

KMH LLP

Honolulu, Hawaii
November 30, 2017

PART III

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

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

Independent Auditor's Report

To the Auditor
State of Hawaii

Report on Compliance for Capitalization Grants for Drinking Water State Revolving Funds Program

We have audited the State of Hawaii, Drinking Water Treatment Revolving Loan Fund's ("DWTRLF") compliance with the types of compliance requirements described in the *OMB Compliance Supplement* and the *Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs* that could have a direct and material effect on its Capitalization grants for the Drinking Water State Revolving Funds Program ("Program") for the year ended June 30, 2017.

Management's Responsibility

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

Auditor's Responsibility

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

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

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Opinion on Compliance for Capitalization Grants for Drinking Water State Revolving Funds

In our opinion, the DWTRLF complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its Program for the year ended June 30, 2017.

Report on Internal Control Over Compliance

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

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

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

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

KMH LLP

KMH LLP

Honolulu, Hawaii
November 30, 2017

Department of Health
Water Pollution Control Revolving Fund
State of Hawaii

Financial Statements
June 30, 2017
Together with Independent Auditor's Report

Submitted by

THE AUDITOR
STATE OF HAWAII

Table of Contents

PART I

FINANCIAL SECTION

Independent Auditor's Report

To the Auditor
State of Hawaii

Report on the Financial Statements

We have audited the accompanying financial statements of the State of Hawaii, Water Pollution Control Revolving Fund ("WPCRF") as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the WPCRF's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

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Opinion

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

Emphasis of Matter

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

Other Matters

Required Supplementary Information

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

Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the WPCRF's basic financial statements. The supplementary information on pages 34 to 37 are presented for purposes of additional analysis and are not a required part of the basic financial statements.

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

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated November 30, 2017 on our consideration of the WPCRF's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the WPCRF's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the WPCRF's internal control over financial reporting and compliance.

KMH LLP

KMH LLP

Honolulu, Hawaii
November 30, 2017

Department of Health
Water Pollution Control Revolving Fund
State of Hawaii

Statement of Net Position
June 30, 2017

Assets and Deferred Outflows of Resources

Current Assets:	
Equity in cash and cash equivalents and investments in State Treasury	$ 152,457,917
Loan fees receivable	357,933
Accrued interest on loans	363,603
Other accrued interest	320,271
Due from State Treasury	176,202
Current maturities of loans receivable	31,568,631
Total current assets	185,244,557
Loans Receivable, net of current maturities	334,378,240
Capital Assets, net of accumulated depreciation	1,051
Total assets	519,623,848
Deferred Outflows of Resources Related to Pensions	1,422,191
Total assets and deferred outflows of resources	$ 521,046,039

Liabilities, Deferred Inflows of Resources, and Net Position

Current Liabilites--	
Accounts Payable and Other Accrued Liabilities	$ 234,915
Total current liabilities	234,915
Accrued Vacation, net of current portion	182,592
Net Pension Liability	3,850,425
Other Postemployment Benefits	1,615,392
Total liabilities	5,883,324
Deferred Inflows of Resources Related to Pensions	66,014
Net Position:	
Net investment in capital assets	1,051
Restricted - expendable	515,095,650
Total net position	515,096,701
Total liabilities, deferred inflows of resources, and net position	$ 521,046,039

See accompanying notes to the financial statements.

Department of Health
Water Pollution Control Revolving Fund
State of Hawaii

Statement of Revenues, Expenses and Changes in Net Position
For the Year Ended June 30, 2017

Operating Revenues:	
Interest income from loans	$ 1,419,075
Administrative loan fees	1,659,465
Total operating revenue	3,078,540
Operating Expenses:	
Administrative	2,429,915
Principal forgiveness	1,034,800
Total operating expenses	3,464,715
Operating loss	(386,175)
Nonoperating Revenues:	
State contributions	2,172,000
Federal contributions	10,189,000
Other interest income	1,432,761
Other income	17,882
Total nonoperating revenues	13,811,643
Change in net position	13,425,468
Net Position:	
Beginning of fiscal year, as previously reported	501,721,450
Restatement due to change in accounting principle	(50,217)
Beginning of fiscal year, as restated	501,671,233
End of fiscal year	$ 515,096,701

See accompanying notes to the financial statements.

Department of Health
Water Pollution Control Revolving Fund
State of Hawaii

Statement of Cash Flows
For the Year Ended June 30, 2017

Cash Flows from Operating Activities:	
Payments to employees	$ (1,750,383)
Payments to vendors	(134,299)
Net cash used in operating activities	(1,884,682)
Cash Flows from Noncapital Financing Activities:	
State contributions	2,172,000
Federal contributions	10,033,000
Net cash provided by noncapital financing activities	12,205,000
Cash Flows from Investing Activities:	
Principal repayments on loans	30,067,153
Disbursement of loan proceeds	(46,563,350)
Interest income from loans	1,443,296
Administrative loan fees	1,629,553
Other interest income	1,166,160
Net cash used in investing activities	(12,257,188)
Net decrease in cash	(1,936,870)
Equity in Cash and Cash Equivalents and Investments in State Treasury:	
Beginning of fiscal year	154,394,787
End of fiscal year	$ 152,457,917

See accompanying notes to the financial statements.

Department of Health
Water Pollution Control Revolving Fund
State of Hawaii

Statement of Cash Flows (continued)
For the Year Ended June 30, 2017

Reconciliation of operating loss to net cash used in operating activities:	
Operating loss	$ (386,175)
Adjustment to reconcile operating loss to net cash used in operating activities	
Depreciation	1,578
Principal forgiveness	1,034,800
Interest income from loans	(1,419,075)
Administrative loan fees	(1,659,465)
In-kind contribution from Environmental Protection Agency	156,000
Non-imposed fringe benefits	17,882
Change in assets, deferred outflows of resources, liabilities, and deferred inflows of resources:	
Due from State Treasury	30,265
Accounts payable and other accrued liabilities	(1,017)
Net deferred outflows/inflows of resources related to pensions	(1,045,476)
Net pension liability	1,297,447
Other postemployment benefits	88,554
Net cash used in operating activities	$ (1,884,682)

See accompanying notes to the financial statements.

NOTE A - ESTABLISHMENT AND PURPOSE OF THE FUND

In accordance with the Clean Water Act of 1987 (the "Act"), the U.S. Environmental Protection Agency's ("EPA") direct grants for the construction of wastewater treatment works ended in 1990. The Act provides for the creation of a State Revolving Fund ("SRF") loan program to be capitalized in part by federal funds. The Act authorizes states to make loans for construction of publicly owned wastewater treatment works, for implementation of a non-point source pollution control management program and for implementation of an estuary conservation and management program. The SRF serves as the major federal funding source for future wastewater construction projects. Under the Act, from 1989 to 1994, the State of Hawaii ("State") received more than $72 million in SRF capitalization grants. The Act expired on September 30, 1995, however the state continues to receive SRF capitalization grants annually from the U.S. EPA and to date, has been awarded over $294.4 million.

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

NOTE B - SIGNIFICANT ACCOUNTING POLICIES

1. Financial Statement Presentation

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

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

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (continued)

2. Measurement Focus and Basis of Accounting

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

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

3. Use of Estimates

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

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

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

Effective August 1, 1999, cash was pooled with funds from other state agencies and departments and deposited into approved financial institutions or participates in the State Treasury Investment Pool System. Cash accounts that participate in the investment pool accrue interest based on the average weighted cash balances of each account. At June 30, 2017, information relating to the

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (continued)

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

5. Loans Receivable

Loans made to the counties are funded by federal capitalization grants, State matching funds, repayments and investment interest income. Loan funds are disbursed to local agencies as they expend for the purposes of the loan, and request reimbursement from the Fund. Interest is calculated from the date that loan funds are disbursed, and after the final disbursement has been made, the payment schedule identified in the loan agreement is adjusted for the actual amounts disbursed, and interest accrued during the project period. The capitalization grants for federal fiscal years 2010 through 2016 allow for portions of loans to be forgiven upon satisfaction of certain requirements.

6. Administrative Loan Fees

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

7. Capital Assets

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

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

8. Accrued Vacation

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

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (continued)

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

9. Accumulated Sick Leave

Sick leave accumulates at a rate of 14 hours for each month of service without limit, but may be taken only in the event of an illness and is not convertible to pay upon termination of employment. However, an employee who leaves government service in good standing with 60 days or more of unused sick leave is entitled to additional service credit in the Employees' Retirement System (“ERS”). At June 30, 2017, accumulated sick leave was approximately $811,300.

10. Net Position

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

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

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

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

11. Administration Costs

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

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (continued)

12. Fund Accounts

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

13. Expenses

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

14. Deferred Outflows of Resources and Deferred Inflows of Resources

Deferred outflows of resources represent a consumption of net position that applies to a future period and will not be recognized as an outflow of resources (expense) until that time. Deferred inflows of resources represent an acquisition of net position that applies to a future period and will not be recognized as an inflow of resources (revenue) until that time.

15. Pensions

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

16. Other Post-employment Benefits

The state provides post-retirement health care and life insurance benefits to qualified retirees classified as OPEB. OPEB costs are measured and disclosed using the accrual basis of accounting. From an accrual accounting perspective, the cost of OPEB should be associated with the periods in which the exchange of salaries and benefits for employee services occur, rather than with the periods when benefits are paid or provided.

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (continued)

GASB 45 requires state and local government employers to move from accounting for OPEB costs from a pay-as-you-go basis to an accrual basis for the actuarially determined annual OPEB cost. The OPEB liability is the long-term financial obligation allocated to the WPCRF.

17. Due from State Treasury

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

18. New Accounting Pronouncements

The GASB issued Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets* that are not within the Scope of *GASB Statement 68*, and *Amendments to Certain Provisions of GASB Statements 67 and 68*. The Statement establishes accounting and financial reporting requirements by employers and governmental nonemployer contributing entities for pensions that are not within the scope of Statement No. 68. The requirements of this Statement are effective for fiscal years beginning after June 15, 2015, except those provisions that address employers and governmental nonemployer contributing entities for pensions that are not within the scope of Statement No. 68, which are effective for fiscal years beginning after June 15, 2016. Management has adopted the applicable requirements of this statement as presented in the Fund’s financial statements.

The GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. The Statement replaces GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions,* and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*. The Statement will require the liability of employers for defined benefit OPEB to be measured as the portion of the present value of projected benefit payments to be provided to current active and inactive employees that is attributed to those employees' past periods of service, less the amount of the OPEB plan's fiduciary net position. The requirements of this Statement are effective for fiscal years beginning after June 15, 2017. Management has determined that Statement No. 75 will have a material effect in the Fund’s financial statements.

NOTE C - LOANS RECEIVABLE

At June 30, 2017, the WPCRF had loans receivable from the following government entities:

Twenty-one loans with the City & County of Honolulu; due in annual or semiannual payments, including interest ranging from 0.00% to 3.02%, commencing not later than one year after project completion, notice to proceed, final loan disbursement or three years after loan agreement date. Final payment is due not later than twenty years after project completion date.	$ 253,907,322
Seven loans with the County of Hawaii; due in annual or semiannual payments, including interest ranging from 0.25% to 0.50%, commencing not later than one year after project completion, notice to proceed, final loan disbursement or three years after loan agreement date. Final payment is due not later than twenty years after project completion date.	32,625,279
Twenty-five loans with the County of Maui; due in annual or semiannual payments, including interest ranging from 0.25% to 2.60%, commencing not later than one year after project completion, notice to proceed, final loan disbursement or three years after loan agreement date. Final payment is due not later than twenty years after project completion date	54,136,638
Ten loans with the County of Kauai; due in semiannual or quarterly payments, including interest ranging from 0.25% to 2.13%, commencing not later than one year after project completion, notice to proceed, final loan disbursement or three years after loan agreement date. Final payment is due not later than twenty years after project completion date.	25,277,632
	365,946,871
Less: current maturities	(31,568,631)
	$ 334,378,240

NOTE C - LOANS RECEIVABLE (continued)

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

Fiscal Years Ending,	Amount
2018	$ 31,568,631
2019	30,688,179
2020	29,351,221
2021	29,043,141
2022	28,982,430
2023-2027	138,565,943
2028-2032	67,066,252
2033-2037	10,389,042
2038-2039	292,032
	$ 365,946,871

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

In fiscal year 2017, $1,034,800 in loans were forgiven. All loans and advances were forgiven in accordance with the required conditions.

As of June 30, 2017, the WPCRF were committed under existing loan agreements to the following counties:

City & County of Honolulu	$ 32,333,482
County of Hawaii	41,264,760
County of Maui	23,760,684
County of Kauai	21,850,000
	$ 119,208,926

NOTE D – CONTRIBUTED CAPITAL

The WPCRF is capitalized by grants from EPA and matching funds from the State. The following summarizes the EPA capitalization grants, amounts drawn on each grant, and the balances available for future loans at June 30, 2017:

Budget Period	Amount	Total Draws at June 30, 2016	EPA Draws	Total 2017 Cash Draws	Funds Available
10/01/16-06/30/20	$ 10,348,000	$ -	$ 315,000	$ 10,033,000	$ -

The State is required to match 20 percent of the estimated amount of the grant from the EPA and does so in the year that the capitalization grant is awarded. Through June 30, 2017, the Fund was in compliance with the 20 percent State matching requirement. The required State match through June 30, 2017 approximated $58.9 million, of which the entire amount has been utilized.

NOTE E – CAPITAL ASSETS

Capital asset activity for the fiscal year ended June 30, 2017 was as follows:

	Balance at July 1, 2016	Additions	Retirements/ Disposals	Balance at June 30, 2017
Equipment	$ 84,518	$ -	$ -	$ 84,518
Accumulated Depreciation	(81,889)	(1,578)	-	(83,467)
	$ 2,629	$ (1,578)	$ -	$ 1,051

NOTE F – ACCRUED VACATION

The changes to the accrued vacation liability during 2017 were as follows:

Balance at July 1, 2016	$ 290,855
Increase	44,114
Decrease	(79,906)
Balance at June 30, 2017	255,063
Less: Current portion	(72,471)
Noncurrent portion	$ 182,592

NOTE G - EMPLOYEE BENEFIT PLANS

1. Employees' Retirement System

Plan Description

Generally, all full-time employees of the State and counties are required to be members of the ERS, a cost-sharing multiple-employer defined benefit pension plan that administers the State's pension benefits program. Benefits, eligibility, and contribution requirements are governed by Hawaii Revised Statutes ("HRS") Chapter 88 and can be amended through legislation. The ERS issues publicly available annual financial reports that can be obtained at ERS' website: http://www.ers.ehawaii.gov.

Benefits Provided

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

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

NOTE G - EMPLOYEE BENEFIT PLANS (continued)

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

Noncontributory Class

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

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

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

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

Contributory Class for Members Hired Prior to July 1, 2012

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

NOTE G - EMPLOYEE BENEFIT PLANS (continued)

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

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

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

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

Contributory Class for Members Hired After June 30, 2012

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

NOTE G - EMPLOYEE BENEFIT PLANS (continued)

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

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

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

Hybrid Class for Members Hired Prior to July 1, 2012

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

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

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

NOTE G - EMPLOYEE BENEFIT PLANS (continued)

the monthly benefit. If there is no spouse/reciprocal beneficiary or dependent children/parents, the ordinary death benefit is payable to the designated beneficiary.

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

Hybrid Class for Members Hired After June 30, 2012

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

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

Contributions

Contributions are governed by HRS Chapter 88 and may be amended through legislation. The employer rate is set by statute based on the recommendations of the ERS actuary resulting from an experience study conducted every five years. Since July 1, 2005, the employer contribution rate is a fixed percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liabilities. The contribution rates for fiscal year 2017 were 25.00% for police and firefighters and 17.00% for all other employees. Contributions to the pension plan from the Fund were $197,236 for the fiscal year ended June 30, 2017.

NOTE G - EMPLOYEE BENEFIT PLANS (continued)

On May 18, 2017, the Governor signed into law Act 17 SLH 2017. Per Act 17, future employer contributions from the State and counties are expected to increase pursuant to a phased-in contribution rate increase over four years beginning July 1, 2017. The rate for all employees, except for police officers and firefighters, increases to 18.00% on July 1, 2017; 19.00% on July 1, 2018; 22.00% on July 1, 2019; and 24.00% on July 1, 2020.

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

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

At June 30, 2017, the WPCRF reported a liability of $3,850,425 for its proportionate share of net pension liability of the State. The net pension liability was measured as of June 30, 2016, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The State's proportion of the net pension liability was based on a projection of the State's long-term share of contributions to the pension plan relative to projected contributions of all participants, actuarially determined. The WPCRF's proportion of the net pension liability was based on an allocation of the State's net pension liability based on the proportionate share of qualified payroll. At June 30, 2016 and 2015, the WPCRF's proportion of the State's share was 0.05%.

There were significant changes in actuarial assumptions effective June 30, 2016 based on the Five-Year Experience Study report dated July 5, 2016 that resulted in a significant increase in the measurement of the total pension liability. Primary drivers for the increase include a decrease in the investment return assumption and discount rate from 7.65% as of June 30, 2015 to 7.00% as of June 30, 2016; and a decrease in the mortality assumptions for longer life expectancy and an explicit assumption for continued future mortality improvement (generational approach). There were no other changes in assumptions between the measurement date, June 30, 2016, and the reporting date, June 30, 2017, that are expected to have a significant effect on the proportionate share of the net pension liability.

NOTE G - EMPLOYEE BENEFIT PLANS (continued)

For the year ended June 30, 2017, the WPCRF recognized pension expense of $449,207. At June 30, 2017, the WPCRF reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	$ 53,127	$ (53,944)
Changes in assumptions	711,972	-
Net difference between projected and actual earnings on pension plan investments	450,532	-
Changes in proportion and difference between WPCRF contributions and proportionate share of contributions	9,324	(12,070)
WPCRF contributions subsequent to the measurement date	197,236	-
	$ 1,422,191	$ (66,014)

The $197,236 reported as deferred outflows of resources related to pensions resulting from WPCRF contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the fiscal year ended June 30, 2018. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Fiscal Year Ending June 30,	Amount
2018	$ 224,273
2019	224,273
2020	303,996
2021	265,355
2022	141,044
Total	$ 1,158,941

NOTE G - EMPLOYEE BENEFIT PLANS (continued)

Actuarial Assumptions

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

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

There were no changes to ad hoc postemployment benefits including COLA.

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

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

NOTE G - EMPLOYEE BENEFIT PLANS (continued)

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

Strategic Allocation (risk-based classes)	Target Allocation	Long-term Expected Geometric Rate of Return
Broad growth	63.0%	8.35%
Principal protection	7.0%	2.20%
Real return	10.0%	6.15%
Crisis risk offset	20.0%	5.50%
	100.0%	

Discount Rate

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

NOTE G - EMPLOYEE BENEFIT PLANS (continued)

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

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

	1% Decrease (6.00%)	Discount Rate (7.00%)	1% Increase (8.00%)
WPCRF's proportionate share of the net pension liability	$ 4,924,951	$ 3,850,425	$ 2,961,290

Pension Plan Fiduciary Net Position

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

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

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

Payables to the Pension Plan

At June 30, 2017, there was no payable to the ERS.

NOTE G - EMPLOYEE BENEFIT PLANS (continued)

New Pronouncement for Financial Reporting – Pension

In March 2016, GASB issued Statement No. 82 (GASB 82), *Pension Issues – An Amendment of GASB Statements No. 67, No. 68, and No. 73*. GASB 82 addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. The Fund implemented the provisions of GASB 82 as of June 30, 2017, which resulted in the restatement of the Fund's beginning net position as follows:

	2016 (As Previously Reported)	Restatement Adjustment	2016 (As Restated)
Net position at beginning of year	$ 501,721,450	$ (50,217)	$ 501,671,233

2. Deferred Compensation Plan

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

All plan assets are held in a trust fund to protect them from claims of general creditors. The State has no responsibility for loss due to the investment or failure of investment of funds and assets in the plan, but has the duty of due care that would be required of an ordinary prudent investor.

3. Post-Employment Health Care and Life Insurance Benefits

Plan Description

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

NOTE G - EMPLOYEE BENEFIT PLANS (continued)

State Policy

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

Annual OPEB Cost

The following table shows the components of the annual OPEB cost that have been allocated to the WPCRF for the years ended June 30th:

Annual OPEB cost	$ 272,800
Contributions made	(184,246)
Increase in net OPEB obligation	88,553
Net OPEB obligation, beginning of year	1,526,838
Net OPEB obligation, end of year	$ 1,615,392

Amount of Contributions Made

Contributions are financed on a pay-as-you-go basis and the Fund's contributions for the fiscal years ended June 30, 2017, 2016, and 2015 approximated $184,000, $138,000 and $124,000, respectively.

Required Supplementary Information and Disclosures

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

NOTE H - INSURANCE COVERAGE

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

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

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

SUPPLEMENTARY INFORMATION

Department of Health
Water Pollution Control Revolving Fund
State of Hawaii

Schedule of Cash Receipts, Disbursements and Cash Balance
For the Year Ended June 30, 2017

Receipts:	
Principal repayment on loans	$ 30,067,153
Interest income from loans	1,443,296
State contributions	2,172,000
Federal contributions	10,033,000
Administrative loan fees	1,629,553
Other interest income	1,166,160
Total receipts	46,511,162
Disbursements:	
Disbursement of loan proceeds	46,563,350
Administrative	1,884,682
Total disbursements	48,448,032
Excess of disbursements over receipts	(1,936,870)
Equity in Cash and Cash Equivalents and Investments in State Treasury:	
Beginning of fiscal year	154,394,787
End of fiscal year	$ 152,457,917

Department of Health
Water Pollution Control Revolving Fund
State of Hawaii

Combining Statement of Net Position
June 30, 2017

	State Revolving Fund Activity	State Activity	Total
Assets and Deferred Outflows of Resources			
Current Assets:			
Equity in cash and cash equivalents and investments in State Treasury	$ 149,014,177	$ 3,443,740	$ 152,457,917
Loan fees receivable	-	357,933	357,933
Accrued interest on loans	363,603	-	363,603
Other accrued interest	320,271	-	320,271
Due from State Treasury	176,202	-	176,202
Current maturities of loans receivable	31,568,631	-	31,568,631
Total current assets	181,442,884	3,801,673	185,244,557
Loans Receivable, net of current maturities	334,378,240	-	334,378,240
Capital Assets, net of accumulated depreciation	-	1,051	1,051
Total assets	515,821,124	3,802,724	519,623,848
Deferred Outflows of Resources Related to Pensions	-	1,422,191	1,422,191
Total assets and deferred outflows of resources	$ 515,821,124	$ 5,224,915	$ 521,046,039
Liabilities, Deferred Inflows of Resources, and Net Position			
Current Liabilities:			
Accounts Payable and Other Accrued Liabilities	$ 83,252	$ 151,663	$ 234,915
Total current liabilities	83,252	151,663	234,915
Accrued Vacation, net of current portion	89,078	93,514	182,592
Net Pension Liability	-	3,850,425	3,850,425
Other Postemployment Benefits	-	1,615,392	1,615,392
Total liabilities	172,330	5,710,994	5,883,324
Deferred Inflows of Resources Related to Pensions	-	66,014	66,014
Net Position:			
Net investment in capital assets	-	1,051	1,051
Restricted - expendable	515,648,794	(553,144)	515,095,650
Total net position	515,648,794	(552,093)	515,096,701
Total liabilities, deferred inflows of resources, and net position	$ 515,821,124	$ 5,224,915	$ 521,046,039

Department of Health
Water Pollution Control Revolving Fund
State of Hawaii

Combining Statement of Revenues, Expenses and Changes in Net Position
For the Year Ended June 30, 2017

	State Revolving Fund Activity	State Activity	Total
Operating Revenues:			
Interest income from loans	$ 1,419,075	$ -	$ 1,419,075
Administrative loan fees	-	1,659,465	1,659,465
Total operating revenue	1,419,075	1,659,465	3,078,540
Operating Expenses:			
Administrative	868,725	1,561,190	2,429,915
Principal forgiveness	1,034,800	-	1,034,800
Total operating expenses	1,903,525	1,561,190	3,464,715
Operating loss	(484,450)	98,275	(386,175)
Nonoperating Revenues:			
State contributions	2,172,000	-	2,172,000
Federal contributions	10,189,000	-	10,189,000
Other interest income	1,432,761	-	1,432,761
Other income	5,292.00	12,590	17,882
Total nonoperating revenues	13,799,053	12,590	13,811,643
Change in net position	13,314,603	110,865	13,425,468
Net Position:			
Beginning of fiscal year, as previously reported	502,334,190	(612,740)	501,721,450
Restatement due to change in accounting principle	-	(50,217)	(50,217)
Beginning of fiscal year, as restated	502,334,190	(662,957)	501,671,233
End of fiscal year	$ 515,648,793	$ (552,092)	$ 515,096,701

Department of Health
Water Pollution Control Revolving Fund
State of Hawaii

Schedule of Operating Expenses
For the Year Ended June 30, 2017

	State Revolving Fund Activity	State Activity	Total
Personnel	$ 676,828	$ 1,014,147	$ 1,690,975
Principal Forgiveness	1,034,800	-	1,034,800
Pension Expense	-	449,207	449,207
Intergovernmental Personnel Agreement Expenses	156,000	-	156,000
Travel	17,772	24,194	41,966
Professional Services	-	29,767	29,767
Services rendered by other State agencies	5,505	17,994	23,499
Telephone	3,333	7,896	11,229
Rental	3,802	5,441	9,243
Office and Other Supplies	2,559	2,359	4,918
Training	2,050	2,410	4,460
Depreciation	-	1,578	1,578
Dues and Subscription	-	1,000	1,000
Miscellaneous	876	5,197	6,073
Total operating expenses	$ 1,903,525	$ 1,561,190	$ 3,464,715

PART II

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

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

Independent Auditor's Report

To the Auditor
State of Hawaii

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States, the financial statements of State of Hawaii, Water Pollution Control Revolving Fund ("WPCRF") as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the WPCRF's basic financial statements, and have issued our report thereon dated November 30, 2017.

Internal Control over Financial Reporting

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

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

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

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Compliance and Other Matters

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

Purpose of this Report

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

KMH LLP

KMH LLP

Honolulu, Hawaii
November 30, 2017

PART III

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

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

Independent Auditor's Report

To the Auditor
State of Hawaii

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

We have audited the State of Hawaii, Water Pollution Control Revolving Fund's ("WPCRF") compliance with the types of compliance requirements described in the *OMB Compliance Supplement* and the *Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs* that could have a direct and material effect on its Capitalization grants for the Clean Water State Revolving Funds Program ("Program") for the year ended June 30, 2017.

Management's Responsibility

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

Auditor's Responsibility

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

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

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

In our opinion, the WPCRF complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its program for the year ended June 30, 2017.

Report on Internal Control Over Compliance

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

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

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

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

KMH LLP

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Honolulu, Hawaii
November 30, 2017