STATE OF HAWAI'I
OFFICE OF THE AUDITOR
465 S. King Street, Room 500
Honolulu, Hawai'i 96813-2917

LESLIE H. KONDO
State Auditor

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lao.auditors@hawaii.gov

DEPT. COMM. NO. 352

April 10, 2017

HAND DELIVER

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

Re: Audits of the State of Hawai'i's Department of Health

Dear President Kouchi:

We are enclosing copies of: (1) the financial audit and single audit report of the Department of Health for the fiscal year ending June 30, 2016; (2) the financial audit report of the Department of Health's Drinking Water Treatment Revolving Fund for the fiscal year ending June 30, 2016; and (3) Water Pollution Control Revolving Funds for the fiscal year ending June 30, 2016.

The financial audit and single audit report of the Department of Health was issued on March 27, 2017, and financial audit reports of the Drinking Water Treatment Revolving Fund and Water Pollution Control Revolving Funds were issued on December 9, 2016. The Office of the Auditor retained N&K CPAs, Inc. to perform the audits.

You may view the Auditor's Summary and reports electronically on our website at:
http://files.hawaii.gov/auditor/Reports/2016_Audit/DOH_Summary_2016.pdf,
http://files.hawaii.gov/auditor/Reports/2016_Audit/DOH2016.pdf,
http://files.hawaii.gov/auditor/Reports/2016_Audit/DOH_DWTRLF_2016, and
http://files.hawaii.gov/auditor/Reports/2016_Audit/DOH_WPCRF_2016.

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

Very truly yours,

Leslie H. Kondo
State Auditor

LHK:RTS:lfs

Attachments

ORIGINAL

DEPT. COMM. NO. 352

Auditor's Summary

Financial Audit of the Department of Health

Financial Statements, Fiscal Year Ended June 30, 2016

PHOTO: OFFICE OF THE AUDITOR

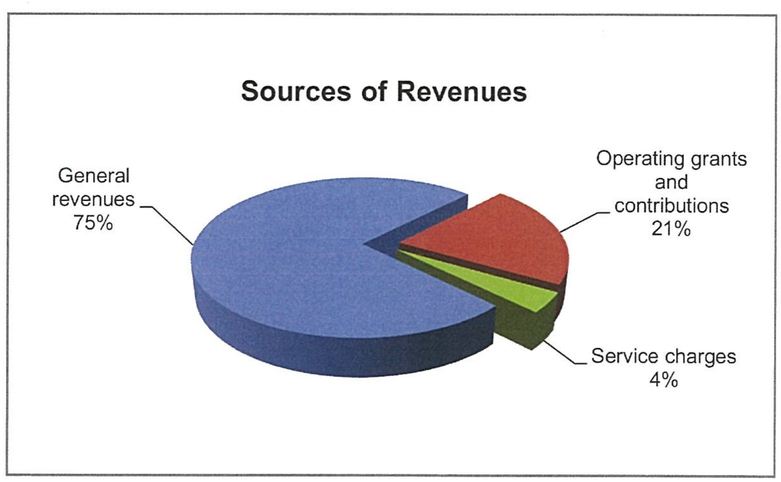
THE PRIMARY PURPOSE *of the audit was to form an opinion on the fairness of the presentation of the financial statements for the Department of Health (DOH), as of and for the fiscal year ended June 30, 2016, and to comply with the requirements of Title 2 U.S. Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance), which established audit requirements for state and local governmental units that receive federal awards. The audit was conducted by N&K CPAs, Inc.*

About the Department

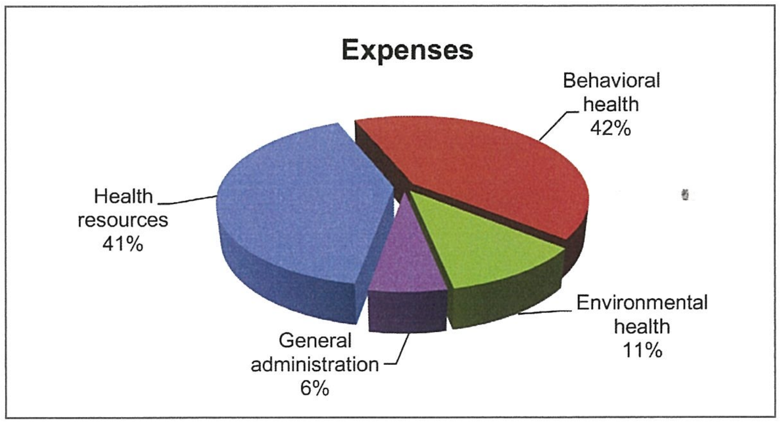
DOH administers and oversees statewide personal health services, health promotion and disease prevention, mental health programs, monitoring of the environment, and the enforcement of environmental health laws. DOH also administers federal grants to support the State's health services and programs. DOH 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, 2016, DOH reported total revenues of $775 million and total expenses of $711 million, resulting in a change in net position of $64 million. Revenues consisted of $578 million from general revenues, $166 million from operating grants and contributions, and $31 million from service charges.



Expenses consisted of $292 million for health resources, $301 million for behavioral health, $77 million for environmental health, and $41 million for general administration.



As of June 30, 2016, DOH's total assets and deferred outflows of resources exceeded total liabilities and deferred inflows of resources by $967 million. Total assets and deferred outflows of resources of $1.102 billion were comprised of cash of $407 million, receivables of $136 million, loans receivable of $486 million, deferred outflows of resources of $1 million, and net capital assets of $72 million. Total liabilities and deferred inflows of resources totaled $135 million. DOH's net position of $967 million were comprised of a restricted amount of $743 million, of which $688 million were for loans, an unrestricted amount of $152 million, and net investment of capital assets of $72 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 WAS ONE SIGNIFICANT DEFICIENCY and no material weaknesses in internal control over financial reporting that are required to be reported under *Government Auditing Standards*.

Significant Deficiency

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

THERE WAS ONE MATERIAL WEAKNESS AND ONE SIGNIFICANT DEFICIENCY in internal control over compliance in accordance with the *Uniform Guidance*.

Material Weakness

- Federal funds were not disbursed in a timely manner to comply with federal regulations.

Significant Deficiency

- Federal funds used to pay for terminated employees' accrued leave were charged as direct program costs.

For the complete report and financial statements visit our website at:
http://files.hawaii.gov/auditor/Reports/2016_Audit/DOH2016.pdf

ORIGINAL

DEPT. COMM. NO. 352

FINANCIAL AUDIT OF THE DEPARTMENT OF HEALTH STATE OF HAWAII

For the Fiscal Year Ended June 30, 2016

Submitted by
The Auditor
State of Hawaii

N&K CPAs, Inc.
ACCOUNTANTS | CONSULTANTS

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March 27, 2017

Mr. Leslie H. 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 (DOH) as of and for the fiscal year ended June 30, 2016. Our audit was conducted in accordance with the terms of our contract with the Office of the Auditor, 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).

OBJECTIVES OF THE AUDIT

The primary purpose of our audit was to form opinions on the fairness of the presentation of the DOH's basic financial statements as of and for the fiscal year ended June 30, 2016, and to comply with the requirements of the Uniform Guidance, which establishes audit requirements for state and local governments that receive federal financial assistance. More specifically, the objectives of the audit were as follows:

1. To provide a basis for opinions on the fairness of the DOH's basic financial statements and the schedule of expenditures of federal awards as of and for the fiscal year ended June 30, 2016.

2. To consider the DOH'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 of the DOH'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 DOH'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 opinions on the DOH's compliance with applicable laws, regulations, contracts, and grants that could have a direct and material effect on each major federal program.

SCOPE OF THE AUDIT

Our audit was conducted 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 Uniform Guidance. The scope of our audit included an examination of the transactions and accounting records of the DOH for the fiscal year ended June 30, 2016.

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 DOH as of and for the fiscal year ended June 30, 2016, and our opinion on the basic financial statements and supplementary information.
- 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 DOH.

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

Sincerely,

N&K CPAs, Inc.

N&K CPAs, INC.

Dwayne Takeno
Principal

DEPARTMENT OF HEALTH
STATE OF HAWAII

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DEPARTMENT OF HEALTH
STATE OF HAWAII

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PART I

FINANCIAL SECTION

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INDEPENDENT AUDITOR'S REPORT

To 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 State of Hawaii, Department of Health (Department), as of and for the year ended June 30, 2016, 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.

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, 2016, and the respective changes in financial position and, where applicable, cash flows thereof and the respective 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 Matter

As discussed in Note A, the financial statements of the Department are intended to present the financial position, the changes in the financial position and, where applicable, 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, 2016, the changes in its 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.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 10 through 20 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.

Supplementary 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 Title 2 U.S. *Code of Federal Regulations (CFR) Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards,* is presented for purposes of additional analysis and 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 27, 2017 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 to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Department's internal control over financial reporting and compliance.

N&K CPAs, INC.

Honolulu, Hawaii
March 27, 2017

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, 2016. 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 $903.5 million as of June 30, 2015 to $967.3 million as of June 30, 2016, or by approximately $63.8 million. The total increase in net position was attributed to increases in the Department's governmental activities net position of $19.4 million and business-type activities' net position of $44.4 million during the year.

- The Department's governmental activities reported an aggregate increase in net position of approximately $19.4 million during the year totaling $278.7 million at June 30, 2016. Note that this is based on the net position at June 30, 2015 of $259.3 million.

- The Department's proprietary funds, consisting of two revolving loan funds, reported an increase in net position of $44.4 million for FY 2016. Total net position was $688.6 million at June 30, 2016 compared to $644.2 million at June 30, 2015.

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	
	2016	2015	2016	2015	2016	2015
Current assets	$ 334,496	$ 321,948	$ 246,846	$ 227,488	$ 581,342	$ 549,436
Capital assets	71,528	63,488	723	920	72,251	64,408
ARRA advances	--	--	--	7,438	--	7,438
Loans receivable, noncurrent	--	--	448,362	415,522	448,362	415,522
Total assets	406,024	385,436	695,931	651,368	1,101,955	1,036,804
Deferred outflows of resources related to pensions	--	--	786	537	786	537
Current liabilities	108,543	109,248	587	686	109,130	109,934
Long term liabilities	18,772	16,905	6,823	6,252	25,595	23,157
Total liabilities	127,315	126,153	7,410	6,938	134,725	133,091
Deferred inflows of resources related to pensions	--	--	660	712	660	712
Net position						
Net investment in capital assets	71,528	63,488	723	920	72,251	64,408
Restricted	55,012	54,493	687,924	643,335	742,936	697,828
Unrestricted	152,169	141,302	--	--	152,169	141,302
Total net position	$ 278,709	$ 259,283	$ 688,647	$ 644,255	$ 967,356	$ 903,538

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, 2016, the Department's total net position was approximately $967.3 million.

At June 30, 2016, in addition to equity in cash and cash equivalents in the state treasury approximating $406.9 million, the Department had total loans receivable from county governments in the amount of $486.5 million arising from its two revolving loan funds. The Department had total liabilities of $134.7 million at June 30, 2016 of which $12.9 million relates to accrued wages and employee benefits payable. Approximately $48.7 million in liabilities relate to vouchers and contracts payable. At June 30, 2016, restricted net position was $742.9 million. The restrictions arise from legal and contractual agreements.

Condensed Statement of Activities
Fiscal Years Ended June 30,
($000)

	Governmental Activities		Business-Type Activities		Total	
	2016	2015	2016	2015	2016	2015
Revenue						
Program revenues						
Charges for services	$ 25,488	$ 24,771	$ 5,904	$ 5,805	$ 31,392	$ 30,576
Operating grants and contributions	116,489	110,986	49,588	30,426	166,077	141,412
General revenues						
State appropriated funds	443,142	413,282	--	--	443,142	413,282
Non-imposed fringe benefits	59,826	53,972	--	--	59,826	53,972
Hawaii tobacco settlement special fund	48,917	46,879	--	--	48,917	46,879
Environmental fees and taxes	50,586	58,652	--	--	50,586	58,652
Total revenues	744,448	708,542	55,492	36,231	799,940	744,773
Expenses						
General administration	41,058	41,757	--	--	41,058	41,757
Environmental health administration	62,047	59,601	15,041	16,806	77,088	76,407
Behavioral health administration	301,078	309,306	--	--	301,078	309,306
Health resources administration	291,795	264,751	--	--	291,795	264,751
Total expenses	695,978	675,415	15,041	16,806	711,019	692,221
Excess before transfers	48,470	33,127	40,451	19,425	88,921	52,552
Transfers	(29,044)	(28,996)	3,941	4,025	(25,103)	(24,971)
Change in net position	19,426	4,131	44,392	23,450	63,818	27,581
Net position						
Beginning of year	259,283	255,152	644,255	620,805	903,538	875,957
End of year	$ 278,709	$ 259,283	$ 688,647	$ 644,255	$ 967,356	$ 903,538

Governmental activities increased the Department's net position by $19.4 million in FY 2016, which was a 7.4% increase from FY 2015. The overall increase in governmental activities is the result of higher revenues from the several areas: General revenues of state appropriated funds ($29.9M), non-imposed fringe benefits ($5.9M), and Hawaii tax tobacco settlement special fund ($2.0M).

Revenues of the Department's business-type activities, which increased by $19.3 million from 2015, 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, 2016, business-type activities increased the Department's net position by $44.4 million to $688.6 million as compared to the fiscal year ending June 30, 2015.

Total government-wide expenses for FY 2016 were $711.0 million of which $696.0 million was for governmental activities. As compared to FY 2015, total government-wide expenses were $692.2 million of which $675.4 million was for governmental activities. Overall, the Department is organized into four major administrations.

The Department's Behavioral Health Services Administration expended 42.3% or $301.1 million of departmental funds with a decrease of $8.2 million compared to FY 2015. 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; and

- 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 41.0 percent of department funds. FY 2016 expenses for this Administration increased $27.0 million compared to FY 2015. 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 10.8 percent of the departmental funds with an increase of $681 thousand expended versus FY 2015 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 5.8 percent of the departmental funds.

Governmental Funds Financial Analysis

The following table presents revenues and expenditures of the governmental funds for FY 2016 and FY 2015 ($000):

	2016	2015
Revenues		
State general fund allotments	$ 443,142	$ 413,282
Intergovernmental	113,908	110,331
Hawaii tobacco settlement special fund	48,919	46,879
Deposit beverage container deposit special fund	23,504	26,758
Non-imposed fringe benefits	59,826	53,972
Taxes, fees, fines and other	57,289	57,568
Investment income	974	454
Total revenues	747,562	709,244
Expenditures		
General administration	40,330	41,302
Environmental health	62,132	60,959
Behavioral health	298,879	307,429
Health resources	290,345	263,844
Total expenditures	691,686	673,534
Excess of revenues over expenditures before transfers	$ 55,876	$ 35,710

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, 2016, general fund revenues were $493.4 million, including $59.7 million for fringe benefits paid directly from the State general fund. General fund expenditures were $428.8 million.

In FY 2016, the DBCDSF earned revenues of $23.6 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 $47.5 million in deposits from distributors and repaid $35.2 million in deposits to consumers during FY 2016.

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 2016, WPCRF received $23.1 million and $2.2 million of federal and state funds, respectively. WPCRF also disbursed $44.1 million in loan proceeds and collected $28.2 million in principal repayments in 2016. As compared to 2015, the fund collected $10.4 million and $2.2 million in federal and state contributions, and disbursed $26.7 million in loan proceeds and collected $27.0 million in principal payments.

The DWTRLF accounts for federal and state match 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 2016, DWTRLF received $25.3 million and $1.8 million of federal and state funds, respectively. DWTRLF also disbursed $30.5 million in loan proceeds and collected $8.3 million in principal repayments in 2016. As compared to 2015, the DWTRLF collected $19.2 million and $1.8 million in federal and state contributions, and disbursed $48.4 million in loan proceeds and collected $6.5 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 2016:

	Budgeted Amounts ($000)		Actual on a Budgetary Basis ($000)
	Original	Final	
General fund			
Revenues	$ 442,419	$ 444,313	$ 439,675
Expenditures			
General administration	24,637	27,052	26,373
Environmental health	20,436	21,427	20,851
Behavioral health	268,459	266,659	264,544
Health resources	128,887	129,174	127,906
Deposit beverage container deposit special fund			
Revenues	84,590	84,597	58,397
Expenditures	84,590	84,597	65,104
Mental health substance abuse fund			
Revenues	15,913	15,913	5,509
Expenditures	15,913	15,913	4,402

The deposit beverage container program recognized revenues on a budgetary basis of $58.4 million, which is based on the actual number of containers sold. In fiscal year 2015, there were 958.6 million containers sold. The amount of containers sold decreased to 949.2 million in fiscal year 2016.

For the mental health substance abuse fund, the actual revenues received of $5.5 million in FY 2016 were $1.1 million more than the actual expenditures.

Capital Assets

As of June 30, 2016, the Department's governmental activities had invested approximately $71.5 million (net of accumulated depreciation) in a broad range of capital assets. See Note D to the Department's basic financial statements for a description of capital assets activities for the fiscal year ended June 30, 2016.

Capital Assets
Governmental Activities
June 30, 2016
($000)

	2016	2015
Land	$ 1,018	$ 1,018
Land improvements	3,305	3,305
Buildings and building improvements	177,859	165,197
Furniture and equipment	24,850	23,696
Total	207,032	193,216
Accumulated depreciation	135,504	129,728
Total capital assets, net	$ 71,528	$ 63,488

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 2016, AMHD serviced 7,828 clients as compared to the 8,282 clients serviced in FY 2015. AMHD's Access Line continues to provide the community with a resource site for information as well as a referral point for possible clients.

In the developmental disabilities program, the number of clients increased by 212 clients in FY 2016. In FY 2016, the program served 2,873 clients in the home and community-based waiver program as compared to 2,661 clients served in FY 2015.

Further, the Federal Medical Assistance Percentage ("FMAP") increased from 51.85 percent to 52.23 percent for the period October 2014 to September 2015. The FMAP increased from 52.23 percent to 53.98 percent effective October 2015 to September 2016.

And lastly, the WPCRF executed a total of four loan agreements for $43.8 million during FY 2016. DWTRLF executed a total of 13 loan agreements for $53.2 million during FY 2016. Further, the WPCRF expects to execute a total of ten loan agreements in the amount of $43.3 million while the DWTRLF expects to execute a total of four loan agreements for $46.8 million in FY 2017.

Department of Health
State of Hawaii
STATEMENT OF NET POSITION
June 30, 2016

	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	$ 200,125,996	$ 206,785,770	$ 406,911,766
Receivables			
Due from State Treasury	100,680,836	48,637	100,729,473
Due from other State agencies	813,000	--	813,000
Accrued interest and loan fees	216,641	1,780,645	1,997,286
Accounts receivable	1,836,079	2,160	1,838,239
Due from federal government	5,523,100	114,589	5,637,689
Tobacco settlement receivable	25,300,000	--	25,300,000
Current maturities of loans receivable	--	38,114,325	38,114,325
	134,369,656	40,060,356	174,430,012
Total current assets	334,495,652	246,846,126	581,341,778
Loans receivable, net of current maturities	--	448,362,119	448,362,119
Capital assets, net of accumulated depreciation	71,528,488	722,608	72,251,096
Total assets	406,024,140	695,930,853	1,101,954,993
Deferred outlfows of resources related to pensions	--	786,298	786,298
Total assets and deferred outflows of resources	$ 406,024,140	$ 696,717,151	$ 1,102,741,291

See accompanying notes to the basic financial statements.

Department of Health
State of Hawaii
STATEMENT OF NET POSITION (Continued)
June 30, 2016

	Governmental Activities	Business-Type Activities	Total
LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION			
Current liabilities			
Vouchers and contracts payable	$ 48,573,567	$ 96,841	$ 48,670,408
Accrued wages and employee benefits payable	12,552,199	357,785	12,909,984
Unearned revenue	3,324,913	--	3,324,913
Accrued vacation, current portion	9,594,143	132,112	9,726,255
Workers' compensation liability	1,032,325	--	1,032,325
Due to other State agencies	31,860,413	--	31,860,413
Beverage container deposits	1,606,002	--	1,606,002
Total current liabilities	108,543,562	586,738	109,130,300
Accrued vacation, net of current portion	18,771,936	371,666	19,143,602
Net pension liability	--	4,034,098	4,034,098
Other postemployment benefits	--	2,417,932	2,417,932
Total liabilities	127,315,498	7,410,434	134,725,932
Deferred inflows of resources related to pensions	--	659,535	659,535
Net position			
Net investment in capital assets	71,528,488	722,608	72,251,096
Restricted for			
Loans	--	687,924,574	687,924,574
Trust fund programs	4,015,370	--	4,015,370
Medicaid programs	50,996,240	--	50,996,240
Unrestricted	152,168,544	--	152,168,544
Total net position	278,708,642	688,647,182	967,355,824
Total liabilities, deferred inflows of resources, and net position	$ 406,024,140	$ 696,717,151	$ 1,102,741,291

See accompanying notes to the basic financial statements.

Department of Health
State of Hawaii
STATEMENT OF ACTIVITIES
Fiscal Year Ended June 30, 2016

		Program Revenues		Net (Expense) Revenue and Changes in Net Position — Primary Government		
Functions/Programs	Expenses	Charges for Services	Operating Grants and Contributions	Governmental Activities	Business-Type Activities	Total
Primary government						
Governmental activities						
General administration	$ 41,058,324	$ 2,437,839	$ 8,121,756	$ (30,498,729)	$ --	$ (30,498,729)
Environmental health administration	62,047,123	8,095,493	7,263,399	(46,688,231)	--	(46,688,231)
Behavioral health services administration	301,077,579	1,343,525	15,829,188	(283,904,866)	--	(283,904,866)
Health resources administration	291,795,453	13,610,740	85,274,951	(192,909,762)	--	(192,909,762)
Total governmental activities	695,978,479	25,487,597	116,489,294	(554,001,588)	--	(554,001,588)
Business-type activities						
Environmental health loan program	15,040,771	5,904,030	49,588,234	--	40,451,493	40,451,493
Total business-type activities	15,040,771	5,904,030	49,588,234	--	40,451,493	40,451,493
Total primary government	$ 711,019,250	$ 31,391,627	$ 166,077,528	(554,001,588)	40,451,493	(513,550,095)
General revenues						
State general fund allotments, net				443,141,973	--	443,141,973
Non-imposed employee fringe benefits				59,825,997	--	59,825,997
Environmental response tax				1,287,966	--	1,287,966
Deposit beverage container fee				23,504,004	--	23,504,004
Advance glass disposal fee				795,188	--	795,188
Tobacco tax				25,000,000	--	25,000,000
Hawaii tobacco settlement special fund				48,916,823	--	48,916,823
Transfers				(29,044,353)	3,941,000	(25,103,353)
Total general revenues and transfers				573,427,598	3,941,000	577,368,598
Change in net position				19,426,010	44,392,493	63,818,503
Net position at July 1, 2015				259,282,632	644,254,689	903,537,321
Net position at June 30, 2016				$ 278,708,642	$ 688,647,182	$ 967,355,824

See accompanying notes to the basic financial statements.

Department of Health
State of Hawaii
BALANCE SHEET - GOVERNMENTAL FUNDS
June 30, 2016

	General	Deposit Beverage Container Deposit	Mental Health Substance Abuse	Other Funds	Total Governmental
ASSETS					
Equity in cash and cash equivalents and investments in State Treasury	$ --	$ 29,675,959	$ 44,682,080	$ 125,767,957	$ 200,125,996
Due from State Treasury	89,875,619	--	--	10,805,217	100,680,836
Due from other State agencies	--	--	191,200	621,800	813,000
Accrued interest receivable	--	13,134	68,936	134,571	216,641
Accounts receivable	--	1,638,079	--	198,000	1,836,079
Due from Federal government	--	--	--	5,523,100	5,523,100
Total assets	$ 89,875,619	$ 31,327,172	$ 44,942,216	$ 143,050,645	$ 309,195,652
LIABILITIES AND FUND BALANCES					
Liabilities					
Vouchers and contracts payable	$ 29,206,788	$ 2,666,602	$ 104,870	$ 16,595,307	$ 48,573,567
Accrued wages and employee benefits	9,850,101	41,176	--	2,660,922	12,552,199
Unearned revenue	--	--	191,200	3,941,713	4,132,913
Due to other State agencies	--	--	--	6,560,413	6,560,413
Beverage container deposits	--	1,606,002	--	--	1,606,002
Total liabilities	39,056,889	4,313,780	296,070	29,758,355	73,425,094
Fund balances					
Restricted to					
Medicaid programs	--	--	44,646,146	5,542,094	50,188,240
Trust fund programs	--	--	--	4,015,370	4,015,370
Committed to					
Behavioral health administration	--	--	--	2,916,412	2,916,412
Environmental health administration	--	--	--	30,450,963	30,450,963
General administration	--	--	--	2,712,304	2,712,304
Health resources administration	--	--	--	45,756,585	45,756,585
Capital projects activities	--	--	--	9,810,753	9,810,753
Deposit beverage container program	--	27,013,392	--	--	27,013,392
Tobacco settlement program	--	--	--	12,849,142	12,849,142
Assigned to					
Behavioral health administration	23,461,141	--	--	--	23,461,141
Environmental health administration	2,211,013	--	--	--	2,211,013
General administration	11,527,163	--	--	--	11,527,163
Health resources administration	13,619,413	--	--	--	13,619,413
Unassigned	--	--	--	(761,333)	(761,333)
Total fund balance	50,818,730	27,013,392	44,646,146	113,292,290	235,770,558
Total liabilities and fund balance	$ 89,875,619	$ 31,327,172	$ 44,942,216	$ 143,050,645	$ 309,195,652

See accompanying notes to the basic financial statements.

Department of Health
State of Hawaii
RECONCILIATION OF THE GOVERNMENTAL FUNDS FUND BALANCE TO THE STATEMENT OF NET POSITION
June 30, 2016

Total fund balance - governmental funds	$	235,770,558
Amounts reported for governmental activities in the statement of net assets are different because:		
Capital assets used in governmental activities are not financial resources and therefore not reported as an asset in the governmental funds.		71,528,488
Compensated absences reported in the statement of net position do not require the use of current financial resources and therefore are not not reported as liabilities in the governmental funds.		(28,366,079)
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.		(1,032,325)
Revenues not collected within 60 days and therefore not available for current financial resources are reported as unavailable revenues in the governmental funds.		808,000
Net position of governmental activities	$	278,708,642

See accompanying notes to the basic financial statements.

Department of Health
State of Hawaii
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE OF GOVERNMENTAL FUNDS
Fiscal Year Ended June 30, 2016

	General	Deposit Beverage Container Deposit	Mental Health Substance Abuse	Other Funds	Total Governmental
REVENUES					
State allotment, net	$ 433,711,924	$ --	$ --	$ 9,430,049	$ 443,141,973
Intergovernmental	--	--	--	113,907,995	113,907,995
Hawaii tobacco settlement	--	--	--	48,918,708	48,918,708
Deposit beverage container deposit	--	23,504,004	--	--	23,504,004
Non-imposed employee fringe benefits	59,718,821	5,552	--	101,624	59,825,997
Taxes, fees, fines and other	--	--	207,652	57,082,088	57,289,740
Investment income	--	84,309	285,259	604,464	974,032
Total revenues	493,430,745	23,593,865	492,911	230,044,928	747,562,449
EXPENDITURES					
General administration	29,366,537	--	--	10,963,916	40,330,453
Environmental health	25,597,666	19,497,212	--	17,037,219	62,132,097
Behavioral health services	281,324,562	--	571,975	16,982,037	298,878,574
Health resources	146,531,046	--	--	143,813,848	290,344,894
Total expenditures	482,819,811	19,497,212	571,975	188,797,020	691,686,018
Excess (deficiency) of revenues over expenditures	10,610,934	4,096,653	(79,064)	41,247,908	55,876,431
OTHER FINANCING SOURCES (USES)					
Transfers in	--	--	37,695,337	35,418,769	73,114,106
Transfers out	(5,332,850)	--	(37,301,625)	(70,559,549)	(113,194,024)
Total other financing sources (uses)	(5,332,850)	--	393,712	(35,140,780)	(40,079,918)
Net change in fund balance	5,278,084	4,096,653	314,648	6,107,128	15,796,513
Fund balance at July 1, 2015	45,540,646	22,916,739	44,331,498	107,185,162	219,974,045
Fund balance at June 30, 2016	$ 50,818,730	$ 27,013,392	$ 44,646,146	$ 113,292,290	$ 235,770,558

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 BALANCE OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
Fiscal Year Ended June 30, 2016

Net change in fund balance - total governmental funds	$	15,796,513
Amounts reported for governmental activities in the statement of activities are different because:		
Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which capital outlays less dispositions exceeded depreciation for the year.		8,040,701
Increase in compensated absences reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds.		(1,671,130)
Increase 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 an expenditure in the governmental funds.		(155,244)
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.		(2,584,830)
Change in net position of governmental activities	$	19,426,010

See accompanying notes to the basic financial statements.

Department of Health
State of Hawaii
GENERAL FUND - BUDGETARY COMPARISON STATEMENT
Fiscal Year Ended June 30, 2016

	Budgeted Amounts		Actual Amounts
	Original	Final	(Budgetary Basis)
REVENUES			
Current-year appropriations	$ 442,419,195	$ 444,312,531	$ 439,674,696
EXPENDITURES			
General administration	24,637,216	27,051,703	26,372,997
Environmental health	20,436,226	21,427,232	20,851,218
Behavioral health services	268,458,562	266,659,220	264,544,101
Health resources	128,887,191	129,174,376	127,906,380
Total expenditures	442,419,195	444,312,531	439,674,696
Excess of revenues over expenditures	$ --	$ --	$ --

See accompanying notes to the basic financial statements.

Department of Health
State of Hawaii
DEPOSIT BEVERAGE CONTAINER DEPOSIT SPECIAL FUND -
BUDGETARY COMPARISON STATEMENT
Fiscal Year Ended June 30, 2016

	Budgeted Amounts		Actual Amounts
	Original	Final	(Budgetary Basis)
REVENUES			
Current-year funds	$ 84,589,786	$ 84,596,793	$ 58,396,621
EXPENDITURES			
Environmental health	84,589,786	84,596,793	65,104,386
Total expenditures	84,589,786	84,596,793	65,104,386
Excess of expenditures over revenues	$ --	$ --	$ (6,707,765)

See accompanying notes to the basic financial statements.

Department of Health
State of Hawaii
MENTAL HEALTH SUBSTANCE ABUSE SPECIAL FUND - BUDGETARY COMPARISON STATEMENT
Fiscal Year Ended June 30, 2016

	Budgeted Amounts		Actual Amounts
	Original	Final	(Budgetary Basis)
REVENUES			
Current-year funds	$ 15,913,421	$ 15,913,421	$ 5,508,684
EXPENDITURES			
Environmental health	15,913,421	15,913,421	4,402,276
Total expenditures	15,913,421	15,913,421	4,402,276
Excess of expenditures over revenues	$ --	$ --	$ 1,106,408

See accompanying notes to the basic financial statements.

Department of Health
State of Hawaii
STATEMENT OF NET POSITION - PROPRIETARY FUNDS
June 30, 2016

	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	$ 154,394,787	$ 52,390,983	$ 206,785,770
Loan fees receivable	328,021	657,038	985,059
Accrued interest receivable	387,824	95,468	483,292
Other accrued interest	229,871	82,423	312,294
Due from State Treasury	30,265	18,372	48,637
Due from Federal Government	--	114,589	114,589
Accounts receivable	--	2,160	2,160
Current portion of loans receivable	29,233,656	8,880,669	38,114,325
Total current assets	184,604,424	62,241,702	246,846,126
Loans receivable, net of current portion	321,251,818	127,110,301	448,362,119
Capital assets, net of accumulated depreciation	2,629	719,979	722,608
Total assets	505,858,871	190,071,982	695,930,853
Deferred outflows of resources related to pensions	445,645	340,653	786,298
Total assets and deferred outflows of resources	$ 506,304,516	$ 190,412,635	$ 696,717,151

See accompanying notes to the basic financial statements.

Department of Health
State of Hawaii
STATEMENT OF NET POSITION - PROPRIETARY FUNDS (Continued)
June 30, 2016

	Water Pollution Control Revolving Fund	Drinking Water Treatment Revolving Loan Fund	Total
LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION			
Current liabilities			
Accounts payable and other accrued liabilities	$ 207,868	$ 378,870	$ 586,738
Total current liabilities	207,868	378,870	586,738
Accrued vacation, net of current portion	210,655	161,011	371,666
Net pension liability	2,552,978	1,481,120	4,034,098
Other postemployment benefits	1,526,838	891,094	2,417,932
Total liabilities	4,498,339	2,912,095	7,410,434
Deferred inflows of resources related to pensions	84,727	574,808	659,535
Net position			
Net investment in capital assets	2,629	719,979	722,608
Restricted - expendable	501,718,821	186,205,753	687,924,574
Total net position	501,721,450	186,925,732	688,647,182
Total liabilities, deferred inflows of resources, and net position	$ 506,304,516	$ 190,412,635	$ 696,717,151

See accompanying notes to the basic financial statements.

Department of Health
State of Hawaii
STATEMENT OF REVENUES, EXPENSES
AND CHANGES IN FUND NET POSITION - PROPRIETARY FUNDS
Fiscal Year Ended June 30, 2016

	Water Pollution Control Revolving Fund	Drinking Water Treatment Revolving Loan Fund	Total
OPERATING REVENUES			
Interest income from loans	$ 1,542,935	$ 390,359	$ 1,933,294
Administrative loan fees	1,585,917	2,384,819	3,970,736
Total revenues	3,128,852	2,775,178	5,904,030
EXPENSES			
Administrative	2,343,537	1,331,275	3,674,812
State program management	--	887,637	887,637
Water protection	--	786,602	786,602
Principal forgiveness for ARRA	7,438,075	--	7,438,075
Principal forgiveness for SRF	10,102	2,243,543	2,253,645
Total expenses	9,791,714	5,249,057	15,040,771
Operating loss	(6,662,862)	(2,473,879)	(9,136,741)
NONOPERATING REVENUES AND EXPENSES			
State contributions	2,172,000	1,769,000	3,941,000
Federal contributions	23,058,155	25,287,251	48,345,406
Other interest income	928,511	314,317	1,242,828
Total nonoperating revenues and expenses	26,158,666	27,370,568	53,529,234
Change in net position	19,495,804	24,896,689	44,392,493
NET POSITION			
Beginning of year	482,225,646	162,029,043	644,254,689
End of year	$ 501,721,450	$ 186,925,732	$ 688,647,182

See accompanying notes to the basic financial statements.

Department of Health
State of Hawaii
STATEMENT OF CASH FLOWS - PROPRIETARY FUNDS
Fiscal Year Ended June 30, 2016

	Water Pollution Control Revolving Fund	Drinking Water Treatment Revolving Loan Fund	Total
Cash flows from operating activities			
Payments to employees	$ (1,736,976)	$ (1,400,720)	$ (3,137,696)
Payments to vendors	(326,143)	(1,105,307)	(1,431,450)
Net cash used in operating activities	(2,063,119)	(2,506,027)	(4,569,146)
Cash flows from noncapital financing activities			
State contributions	2,172,000	1,769,000	3,941,000
Federal contributions	22,878,236	25,262,865	48,141,101
Net cash provided by noncapital financing activities	25,050,236	27,031,865	52,082,101
Cash flows from investing activities			
Principal repayments on loans	28,162,154	8,251,499	36,413,653
Disbursement of loan proceeds	(44,100,102)	(30,460,917)	(74,561,019)
Interest income from loans	1,574,845	385,827	1,960,672
Administrative loan fees	1,521,942	2,417,690	3,939,632
Other interest income	864,139	289,073	1,153,212
Net cash used in investing activities	(11,977,022)	(19,116,828)	(31,093,850)
Net increase in cash	11,010,095	5,409,010	16,419,105
Equity in cash and cash equivalents and investments in State Treasury			
Beginning of year	143,384,692	46,981,973	190,366,665
End of year	$ 154,394,787	$ 52,390,983	$ 206,785,770

See accompanying notes to the basic financial statements.

Department of Health
State of Hawaii
STATEMENT OF CASH FLOWS - PROPRIETARY FUNDS (Continued)
Fiscal Year Ended June 30, 2016

	Water Pollution Control Revolving Fund	Drinking Water Treatment Revolving Loan Fund	Total
Reconciliation of operating loss to net cash provided by operating activities			
Operating loss	$ (6,662,862)	$ (2,473,879)	$ (9,136,741)
Adjustments to reconcile operating loss to net cash used in operating activities			
Depreciation expense	8,752	188,384	197,136
Principal forgiveness for ARRA	7,438,075	--	7,438,075
Principal forgiveness for SRF	10,102	2,243,543	2,253,645
Interest income from loans	(1,542,935)	(390,359)	(1,933,294)
Administrative loan fees	(1,585,917)	(2,384,819)	(3,970,736)
Pension expense	259,163	207,062	466,225
In-kind contribution from the Enivonrmental Protection Agency	195,664	195,663	391,327
Change in assets, deferred outflows, liabilities, and deferred inflows			
Due from State Treasury	(2,152)	2,087	(65)
Accounts receivable	--	(2,160)	(2,160)
Accounts payable and other accrued liabilities	(47,702)	(20,420)	(68,122)
Net deferred outflows/inflows of resources related to pensions	(253,006)	(217,362)	(470,368)
Other postemployment benefits	119,699	146,233	265,932
Net cash used in operating activities	$ (2,063,119)	$ (2,506,027)	$ (4,569,146)
Disclosure of noncash investing, capital, and financing activities			
In-kind contribution from the Environmental Protection Agency	$ 195,664	$ 195,663	$ 391,327

See accompanying notes to the basic financial statements.

Department of Health
State of Hawaii
STATEMENT OF FIDUCIARY NET POSITION - AGENCY FUNDS
June 30, 2016

ASSETS		
Cash and cash equivalents	$	481,169
Total assets		481,169
LIABILITIES		
Due to others		481,169
Total liabilities		481,169
NET POSITION	$	--

See accompanying notes to the basic financial statements.

NOTE A - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(1) ***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, 2016, 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.

(2) ***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

NOTE A - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

(3) ***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 to be available if they are collected within 60 days of the end of the current fiscal year end. 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:

Governmental Funds (Governmental Activities)

- *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.

NOTE A - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

- *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.

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.

NOTE A - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Propriety 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.

(4) ***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/.

(5) ***Due from State Treasury*** - The State Director of Finance is responsible for the safekeeping of all cash in the State Treasury in accordance with State laws. Currently, separate accounts are not maintained in the State Treasury for the Department's general operating and capital appropriations. Although these appropriations are available to the Department to expend, custody of the funds remains with the State. Unspent general and capital appropriations that continue to be available to the Department for expenditure at the end of the fiscal year are reported as Due from State Treasury in the accompanying fund and government-wide financial statements.

NOTE A - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(6) ***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 $813 thousand 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.

(7) ***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 $48.9 million in tobacco settlement revenues during the year ended June 30, 2016. 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, 2016 through June 30, 2016.

(8) ***ARRA Advances*** - The proprietary funds received American Recovery and Reinvestment Act ("ARRA") stimulus money that was used to provide construction grants with no interest or loan fees and 100 percent principal forgiveness upon completion of approved projects. The proprietary funds are allowed to use a portion of the ARRA funds for specified purposes as set forth in the grant. ARRA funds provided to counties have been classified as "ARRA Advances" on the statement of net position upon disbursement. As of June 30, 2016, the ARRA advances have been completely forgiven and expensed as all the conditions and compliance requirements have been satisfied by the counties.

NOTE A - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(9) ***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. Beginning with federal fiscal year 2010, the capitalization grants allow for portions of loans to be forgiven upon satisfaction of certain requirements.

(10) ***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.

(11) ***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:

Land	All capitalized
Land improvements	$100,000
Building and building improvements	$100,000
Furniture and equipment	$5,000

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	Not applicable
Building and building improvements	30	Not applicable
Furniture and equipment	5 - 7	5 - 7

NOTE A - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(12) ***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, 2016 consisted primarily of Federal grant funds for which all requirements had not yet been met.

(13) ***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 $31.9 million.

(14) ***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. 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 $0.015 are made by the distributors to the DBCDSF for each qualifying container as a handling fee. Effective September 1, 2015, the handling fee has been reduced to $0.01 for each qualifying container.

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.

(15) ***Deferred Outflows/Inflows of Resources*** - Deferred outflows of resources represents a consumption of net position that applies to a future period and will not be recognized as an outflow of resources (expense or expenditure) until that time. The Department reports the deferred outflows of resources related to pensions on the statement of net position.

Deferred inflows of resources represents an acquisition of net position that applies to a future period and will not be recognized as an inflow of resources (revenue) until that time. The Department reports deferred inflows of resources related to pensions on the statement of net position.

NOTE A - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(16) ***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.

(17) ***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, 2016, accumulated sick leave was approximately $76.2 million.

(18) ***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.

(19) ***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.

(20) ***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, 2016 for the Department's governmental funds were approximately:

General	$	50,819,000
Deposit beverage container deposit special fund		13,263,000
Mental health substance abuse		1,573,000
Other funds		10,799,000
Total	$	76,454,000

NOTE A - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(21) ***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.

(22) ***Nonmonetary Transactions*** - The Department receives noncash awards for one of its federally funded programs. The Department expended approximately $14,701,000 in vaccines in fiscal year 2016.

(23) ***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.

(24) ***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.

(25) ***New Accounting Pronouncements*** - The Government Accounting Standards Board (the "GASB") issued Statement No. 72, Fair Value Measurement and Application. The Statement will enhance comparability of financial statements among governments by requiring measurement of certain assets and liabilities at fair value using a consistent and more detailed definition of fair value and accepted valuation techniques. The Statement will also enhance fair value application guidance and disclosure. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2015. Management has adopted this Statement as presented in the Department's financial statements.

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 Department's financial statements.

NOTE A - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 Fund's financial statements.

The GASB issued Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. The Statement reduces the generally accepted accounting principles ("GAAP") to two categories of authoritative GAAP. The first category of authoritative GAAP consists of GASB Statements of Governmental Accounting Standards. The second category includes GASB Implementation Guides, GASB Technical Bulletins, and guidance from the American Institute of Certified Public Accountants that is cleared by the GASB. The requirements of this Statement are effective for reporting periods beginning after June 15, 2015. Management has adopted the applicable requirements of this Statement as presented in the Department's financial statements.

The GASB issued Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*. The Statement amends the scope and applicability of Statement No. 68 to exclude certain pensions provided to employees of state or local governmental employers through a cost-sharing multiple-employer defined benefit pension. The requirements of this Statement are effective for reporting periods beginning after December 15, 2015. Management has not yet determined the effect this Statement will have on the Department's financial statements.

The GASB issued Statement No. 79, *Certain External Investment Pools and Pool Participants*. The Statement addresses how certain state and local government external investment pools - and participants in those pools - may measure and report their investments. The requirements of this Statement are effective for reporting periods beginning after June 15, 2015, except for certain provisions, which are effective for reporting periods beginning after December 15, 2015. Management has determined that this Statement does not have a material effect on the Department's financial statements.

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)

NOTE A - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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. Management has not yet determined the effect this Statement will have on the Department's financial statements.

NOTE B - 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.

- *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.

NOTE B - BUDGETING AND BUDGETARY CONTROL (Continued)

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, 2015, to excess of revenues over expenditures presented in conformity with GAAP follows:

	General	Deposit Beverage Container Deposit	Mental Health Substance Abuse
Excess of revenues over expenditures (expenditures over revenues) - actual on a budgetary basis	$ --	$ (6,707,765)	$ 1,106,408
Reserve for encumbrances at year end	50,818,730	13,262,593	1,573,491
Expenditures for liquidation of prior year's encumbrances	(47,590,908)	(6,276,751)	(3,075,171)
Accruals and other adjustments	7,383,112	3,818,576	316,208
Excess of revenues over expenditures (expenditures over revenues) - GAAP basis	$ 10,610,934	$ 4,096,653	$ (79,064)

NOTE C - LOANS RECEIVABLE

At June 30, 2016, 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 percent to 3.02 percent, 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 2016, $9,691,720 in loans were forgiven. All loans and advances forgiven were in accordance with required conditions. Accrued interest receivable on the loans amounted to approximately $483,000 at June 30, 2016.

NOTE C - LOANS RECEIVABLE (Continued)

The following is a schedule of principal payments due on loans for projects completed or in progress as of June 30, 2016:

Year ending June 30,		
2017	$	38,114,325
2018		37,053,957
2019		36,389,788
2020		34,951,378
2021		34,631,196
Thereafter		305,335,800
	$	486,476,444

NOTE D - CAPITAL ASSETS

Capital asset activity for governmental and business-type activities for the year ended June 30, 2016 was as follows:

	Beginning Balance	Additions	Dispositions	Ending Balance
Governmental activities				
Capital assets, not being depreciated				
Land	$ 1,018,080	$ --	$ --	$ 1,018,080
Total capital assets not being depreciated	1,018,080	--	--	1,018,080
Capital assets, being depreciated				
Land improvements	3,304,766	--	--	3,304,766
Building and building improvements	165,196,647	12,662,565	--	177,859,212
Furniture and equipment	23,696,635	1,431,483	(277,759)	24,850,359
Total capital assets being depreciated	192,198,048	14,094,048	(277,759)	206,014,337
Less: Accumulated depreciation				
Land improvements	2,212,302	96,122	--	2,308,424
Building and building improvements	107,459,011	4,679,643	--	112,138,654
Furniture and equipment	20,057,028	1,277,582	(277,759)	21,056,851
Total accumulated depreciation	129,728,341	6,053,347	(277,759)	135,503,929
Governmental activities capital assets, net	$ 63,487,787	$ 8,040,701	$ --	$ 71,528,488
Business-type activities				
Capital assets being depreciated				
Furniture and equipment	$ 2,493,251	$ --	$ --	$ 2,493,251
Total capital assets being depreciated				
Less: Accumulated depreciation	1,573,507	197,136	--	1,770,643
Total accumulated depreciation	1,573,507	197,136	--	1,770,643
Business-type activities capital assets, net	$ 919,744	$ (197,136)	$ --	$ 722,608

NOTE D - CAPITAL ASSETS (Continued)

Current period depreciation expense was charged to functions as follows:

Governmental activities	
General administration	$ 756,199
Environmental health	578,715
Behavioral health services	2,276,605
Health resources	2,441,828
Total depreciation expense - governmental activities	$ 6,053,347
Business-type activities	
Environmental health	$ 197,136
Total depreciation expense - business-type activities	$ 197,136

NOTE E - ACCRUED VACATION

The changes to the accrued vacation liability during 2016 were as follows:

	Governmental Activities	Business-Type Activities
Balance at July 1, 2015	$ 26,694,949	$ 497,309
Increase	13,244,593	170,746
Decrease	(11,573,463)	(164,277)
Balance at June 30, 2016	28,366,079	503,778
Less: Current portion	9,594,143	132,112
Noncurrent portion	$ 18,771,936	$ 371,666

NOTE F - BEVERAGE CONTAINER DEPOSITS

The changes to the beverage container deposit liability during 2016 were as follows:

Balance at July 1, 2015	$ 1,817,994
Increase: Deposits received from distributors	47,460,689
Decrease: Payments made to redemption centers, net of refunds	(35,192,539)
Decrease: Unredeemed deposits recognized as revenue	(12,480,142)
Balance at June 30, 2016	$ 1,606,002

NOTE G - 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, 2016, were as follows:

	Balance July 1, 2015	Additions	Deductions	Balance June 30, 2016
Assets				
Cash and cash equivalents	$ 432,614	$ 218,097	$ 169,542	$ 481,169
Liabilities				
Due to others	$ 432,614	$ 218,097	$ 169,542	$ 481,169

NOTE H - 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 $59.8 million for the fiscal year ended June 30, 2016, 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.

NOTE I - 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 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

NOTE I - EMPLOYEE BENEFIT PLANS (Continued)

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.

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 I - EMPLOYEE BENEFIT PLANS (Continued)

Contributory 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 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.

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 officers and firefighters with ten years of credited service are

NOTE I - EMPLOYEE BENEFIT PLANS (Continued)

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 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.

NOTE I - EMPLOYEE BENEFIT PLANS (Continued)

<u>*Hybrid Plan for Employees Hired After June 30, 2012*</u>

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 2016 were 25.00% for police officers and firefighters and 17.00% for all other employees. Contributions to the pension plan from the Department were $470,369 for the fiscal year ended June 30, 2016.

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, 2016, the Department reported a liability of $4,034,098 for its proportionate share of net pension liability of the State. The net pension liability was measured as of June 30, 2015, 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, 2015, the Department's proportion was 0.0900% which decreased from its proportion measured as of June 30, 2014 of 0.1300%.

NOTE I - EMPLOYEE BENEFIT PLANS (Continued)

There were no changes in other assumptions and inputs that affected the measurement of the total pension liability since the prior measurement date other than the investment return assumption. Fiscal year 2016 was the first year of the three-year phase-in of the investment return assumption. The investment return rate decreased beginning in fiscal year 2016 to 7.65% and will continue to decrease to 7.55% in fiscal year 2017 and to 7.50% in fiscal year 2018, and will remain at 7.50% thereafter. There were no other changes between the measurement date, June 30, 2015, and the reporting date, June 30, 2016, that are expected to have a significant effect on the proportionate share of the net pension liability.

For the year ended June 30, 2016, the Department recognized pension expense of $466,225. At June 30, 2016, the Department 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	$ 66,970	$ (126,005)
Changes of assumptions	106,456	--
Net difference between projected and actual earnings on pension plan investments	133,019	(505,569)
Changes in proportion and difference between Department contributions and proportionate share of contributions	9,484	(27,961)
Department contributions subsequent to the measurement date	470,369	--
	$ 786,298	$ (659,535)

The $470,369 reported as deferred outflows of resources related to pensions resulting from State 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,	Amount
2017	$ (150,584)
2018	(150,584)
2019	(150,584)
2020	119,521
2021	(11,375)
Total	$ (343,606)

NOTE I - EMPLOYEE BENEFIT PLANS (Continued)

Actuarial Assumptions - The total pension liability in the June 30, 2015 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.00%
Payroll growth rate	3.50%
Investment rate of return	7.65% per year, compounded annual including inflation

The same rates were applied to all periods. There were no changes to ad hoc postemployment benefits including COLA.

Post-retirement mortality rates are based on Client Specific Tables and the 1994 US Group Annuity Mortality Static Tables. Pre-retirement mortality rates are based on custom tables with RP-2000 rates.

The actuarial assumptions used in the June 30, 2015 valuation were based on the most recent experience study dated December 20, 2010. Between experience studies, the Board of Trustees of the Employees' Retirement System of the State of Hawaii elected to lower the investment return assumption effective with the June 30, 2015 valuation.

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 arithmetic real rates of return for each major asset class are summarized in the following table:

Asset Class	Target Allocation	Long-Term Expected Arithmetic Rate of Return
Domestic equity	30.0%	8.5%
Non-U.S. equity	26.0%	9.0%
Total Fixed income	20.0%	3.1%
Real estate	7.0% *	9.2%
Private equity	7.0% *	11.9%
Real return	5.0% *	6.7%
Covered calls	5.0%	7.7%
	100.0%	

* The real estate, private equity and real return targets will be the percentage actually invested up to 7.0%, 7.0% and 5.0%, respectively, of the total fund. Changes in the real estate, private equity and real return targets will be offset by an equal percentage change in the large cap domestic equity target.

NOTE I - EMPLOYEE BENEFIT PLANS (Continued)

Discount Rate - The discount rate used to measure the net pension liability was 7.65%, a decrease from the 7.75% 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.

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 7.65%, 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 (6.65%) or 1-percentage point higher (8.65%) than the current rate:

	1% Decrease (6.65%)	Discount Rate (7.65%)	1% Increase (8.65%)
Department's proportionate share of the net pension liability	$ 5,080,696	$ 4,034,098	$ 2,987,497

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.

Payables to the Pension Plan - At June 30, 2016, the amount payable to the ERS was approximately $30,000.

(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.

NOTE I - EMPLOYEE BENEFIT PLANS (Continued)

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 Healthcare and Life Insurance Benefits*

The State contributes to the Hawaii Employer-Union Health Benefits Trust Fund ("EUTF"), an agent multiple-employer defined benefit plan. The EUTF was established to provide a single delivery system of health benefits for state and county workers, retirees, and their dependents. The eligibility requirements for retiree health benefits are based on date of hire.

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 the State's total covered employee headcount 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 Department's proprietary funds' financial statements. The following table shows the allocated annual OPEB cost that has been allocated to the Department's proprietary funds for the year ended June 30, 2016:

	Water Pollution Control Revolving Fund	Drinking Water Treatment Revolving Loan Fund	Total
Annual OPEB cost	$ 258,123	$ 258,123	$ 516,246
Less: Contributions made	(138,424)	(111,890)	(250,314)
Increase in net OPEB obligation	119,699	146,233	265,932
Net OPEB obligation, beginning of year	1,407,139	744,861	2,152,000
Net OPEB obligation, end of year	$ 1,526,838	$ 891,094	$ 2,417,932

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, 2016, 2015, and 2014 were approximately $3.5 million, $3.3 million, and $3.4 million.

Required Supplementary Information and Disclosures

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

NOTE J - COMMITMENTS AND CONTINGENCIES

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, 2016:

Year ending June 30,	Amount
2017	$ 239,000
2018	235,000
2019	226,000
2020	226,000
2021	97,000
Thereafter	142,000
	$ 1,165,000

Rental expenditures for the fiscal year ended June 30, 2016 approximated $2,074,000.

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, 2016, 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, 2016 were approximately $530,000 and $28,000 for the general fund and other funds, respectively.

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.

NOTE J - COMMITMENTS AND CONTINGENCIES (Continued)

Ceded Lands

The Office of Hawaiian Affairs ("OHA") and the State are involved in litigation regarding the State's alleged failure to properly account for and pay to OHA monies due to OHA under the provisions of the Hawaii State Constitution and Chapter 10 of the Hawaii Revised Statutes for use by the State of certain ceded lands. The ultimate outcome of this matter is still unknown. Full discussion of this matter and other legal matters between OHA and the State are disclosed in the State's CAFR.

SUPPLEMENTARY INFORMATION

Department of Health
State of Hawaii
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Fiscal Year Ended June 30, 2016

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	$ 303,956	$ --
VSCP Special Projects	285	200-2012-50811	176,531	--
Special Programs for the Aging - Title VII Chapter 2	468	93.042	95,273	--
Special Programs for the Aging - Title III Part D	401	93.043	79,704	79,704
Aging Cluster				
Special Programs for the Aging - Title III Part B - Grants for Supportive Services and Senior Centers	401	93.044	2,079,600	2,042,416
Special Programs for the Aging - Title III Part C - Nutrition Services	401	93.045	3,275,464	2,811,176
Nutrition Services Incentive Program	406	93.053	689,758	689,758
Subtotal Aging Cluster			6,044,822 *	5,543,350
Special Programs for the Aging - Title IV and Title II - Discretionary Projects	various	93.048	287,502	21,847
National Family Caregiver Support, Title III, Part E	401	93.052	725,608	725,608
Public Health Emergency Preparedness	various	93.069	5,437,733 *	--
Environmental Public Health and Emergency Response	444	93.070	530,635	200,346
Lifespan Respite Care Program	627	93.072	13,349	--
Affordable Care Act Personal Responsibility Education Program	613	93.092	159,561	54,756
Comprehensive Community Mental Health Services for Children with Serious Emotional Disturbances (SED)	589	93.104	815,075	--
Maternal and Child Health Federal Consolidated Programs	257, 307, 466	93.110	796,567	518,037
Project Grants and Cooperative Agreements for Tuberculosis Control Programs	247	93.116	889,708	--
Cooperative Agreements to States/Territories for the Coordination and Development of Primary Care Offices	298	93.130	152,056	--
Injury Prevention and Control Research and State and Community Based Programs	278, 343, 749	93.136	333,358	83,340
Projects for Assistance in Transition from Homelessness	26208	93.150	11,333	11,333
Hansen's Disease National Ambulatory Care Program	264	93.215	910,374	--
Family Planning - Services	239	93.217	2,283,181	1,832,456
Affordable Care Act Abstinence Education Program	273	93.235	102,406	102,406
State Rural Hospital Flexibility Program	415	93.241	252,452	--
Substance Abuse and Mental Health Services - Projects of Regional and National Significance	various	93.243	2,280,261 *	970,443
Universal Newborn Hearing Screening	416	93.251	123,403	--
Immunization Cooperative Agreements	457	93.268	17,393,324 *	--

* Denotes Major Federal Program

The accompanying notes are an integral part of this schedule.

Department of Health
State of Hawaii
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)
Fiscal Year Ended June 30, 2016

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	$ 82,947	$ --
Centers for Disease Control and Prevention - Investigations and Technical Assistance	various	93.283	154,207	--
Small Rural Hospital Improvement Grant Program	454	93.301	62,226	--
National State Based Tobacco Control Programs	744	93.305	830,844	254,275
Epidemiology and Laboratory Capacity for Infectious Diseases	700	93.323	468,426	--
State Health Insurance Assistance Program	403	93.324	221,869	--
Behavioral Risk Factor Surveillance System	747	93.336	232,420	135,727
Food Safety and Security Monitoring Project	580	93.448	200,445	--
Affordable Care Act - Maternal, Infant, and Early Childhood Home Visiting Program	602, 753	93.505	2,989,178	2,611,839
ACA Nationwide Program for National and State Background Checks for Direct Patient Access Employees of Long Term Care Facilities and Providers	644	93.506	231,506	--
PPHF National Public Health Improvement Initiative	615	93.507	139,584	--
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	565,118	--
PPHF Capacity Building Assistance to Strengthen Public Health Immunization Infrastructure and Performance - financed in part by Prevention and Public Health Funds	624	93.539	30,298	--
Community-Based Child Abuse Prevention Grants	270	93.590	343,265	200,539
Developmental Disabilities Basic Support and Advocacy Grants	240	93.630	469,400	--
Capacity Building Assistance to Strengthen Health Immunization Infrastructure and Performance - financed in part by the Prevention and Public Health Fund	746	93.733	219,187	--
State Public Health Approaches for Ensuring Quitline Capacity - funded in part by Prevention and Public Health Funds	701	93.735	39,452	--
Surveillance for Diseases Among Immigrants and Refugees - financed in part by Prevention and Public Health Funds	657	93.755	57,338	28,819
State and Local Public Health Actions to Prevent Obesity, Diabetes, Heart Disease and Stroke	655, 702	93.757	1,306,900	1,291,943
Preventive Health and Health Services Block Grant funded solely with Prevention and Public Health Funds	33203, 34203	93.758	1,163,671	280,128
State Survey and Certification of Health Care Providers and Suppliers (Title XVIII) Medicare	221, 380, 387	93.777	2,001,736	--

* Denotes Major Federal Program

The accompanying notes are an integral part of this schedule.

Department of Health
State of Hawaii
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)
Fiscal Year Ended June 30, 2016

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	$ 305,874	$ --
Domestic Ebola Supplement to the Epidemiology and Laboratory Capacity for Infectious Diseases	751	93.815	15,730	--
Hospital Preparedness Program (HPP) Ebola Preparedness and Response Activities	754	93.817	677,745	--
National Bioterrorism Hospital Preparedness Program	435	93.889	1,172,302	915,893
Grants to States for Operation of Offices of Rural Health	299	93.913	166,818	--
HIV Care Formula Grants	293	93.917	2,542,699	2,492,376
Cooperative Agreements for State-Based Comprehensive Breast and Cervical Early Detection Programs	448	93.919	1,091,130	763,133
Healthy Start Initiative	286	93.926	6,655	--
HIV Prevention Activities - Health Department Based	266	93.940	1,286,616	363,884
HIV / AIDS Surveillance	272	93.944	200,814	24,345
Assistance Programs for Chronic Disease Prevention and Control	various	93.945	318,249	42,996
Cooperative Agreements to Support State-Based Safe Motherhood and Infant Health Initiative Programs	319	93.946	170,794	--
Block Grants for Community Mental Health Services	33202, 34202	93.958	2,417,857	1,040,574
Block Grants for Prevention and Treatment of Substance Abuse	33204, 34204	93.959	8,068,698 *	7,503,243
Preventive Health Services - Sexually Transmitted Diseases Control Grants	268	93.977	292,706	--
Maternal and Child Health Services Block Grant to the States	34201, 35201	93.994	1,806,614	22,701
Hawaii State Mental Health Data Infrastructure Grants for Quality Improvement	318	93.UNKNOWN	94,461	74,682
Hawaii Tobacco State Enforcement Contract	633	93.FAR 52.217-9	194,910	103,057
Subtotal Direct Programs			72,838,861	28,293,780
Total Department of Health and Human Services Programs			$ 72,838,861	$ 28,293,780
Department of Agriculture				
Direct Programs				
Food Safety Cooperative Agreements	203	10.479	99,619	--
Special Supplemental Nutrition Program for Women, Infants and Children	275, 295	10.557	32,328,150	2,630,017
WIC Grants To States (WGS)	740	10.578	1,600,900	--
Subtotal Direct Programs			$ 34,028,669	$ 2,630,017

* Denotes Major Federal Program

The accompanying notes are an integral part of this schedule.

Department of Health
State of Hawaii
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)
Fiscal Year Ended June 30, 2016

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	$ 141,123		$ 141,123
Subtotal Pass-through Program			141,123		141,123
Total Department of Agriculture Programs			$ 34,169,792		$ 2,771,140
Environmental Protection Agency					
Direct Programs					
Air Pollution Control Program Support	233	66.001	692,582		--
Surveys, Studies, Research, Investigations, Demonstrations and Special Purpose Activities Relating to the Clean Air Act	294	66.034	116,607		--
Water Pollution Control State, Interstate, and Tribal Program Support	231, 237, 601	66.419	1,784,354		14,365
State Public Water System Supervision	232	66.432	469,345		--
Water Quality Management Planning	16284	66.454	105,740		--
Capitalization Grants for Clean Water State Revolving Funds	various	66.458	12,288,553	*	12,240,659
Nonpoint Source Implementation Grants	9290	66.460	1,616,789		1,254,195
Capitalization Grants for Drinking Water State Revolving Funds	various	66.468	19,373,073	*	18,800,471
Beach Monitoring and Notification Program Implementation Grants	8291	66.472	240,547		--
Environmental Information Exchange Network Grant Program and Related Assistance	570	66.608	42,443		--
Toxic Substances Compliance Monitoring Cooperative Agreements	243	66.701	57,646		--
TSCA Title IV State Lead Grants Certification of Lead-Based Paint Professionals	330	66.707	226,477		--
Hazardous Waste Management State Program Support	230	66.801	566,691		--
Superfund State, Political Subdivision, and Indian Tribe Site-Specific Cooperative Agreements	394	66.802	207,999		--
Underground Storage Tanks Prevention, Detection and Compliance Program	339	66.804	203,811		--
Leaking Underground Storage Tank Trust Fund Corrective Action Program	258	66.805	606,301		--
State and Tribal Response Program Grants	360	66.817	1,039,477		--
Total Environmental Protection Agency Programs			$ 39,638,435		$ 32,309,690

* Denotes Major Federal Program

** Pass-through Entity Indentifying Number

The accompanying notes are an integral part of this schedule.

Department of Health
State of Hawaii
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)
Fiscal Year Ended June 30, 2016

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	84.181A	$ 2,022,452	$ 109,801
Total Department of Education Programs			2,022,452	109,801
Department of Defense				
Direct Program				
State Memorandum of Agreement Program for the Reimbursement of Technical Services	245	12.113	235,430	--
Total Department of Defense Programs			235,430	--
Department of Transportation				
Direct Program				
Interagency Hazardous Materials Public Sector Training and Planning Grants	641	20.703	144,480	--
Subtotal Direct Program			144,480	--
Pass-through from the State Department of Transportation				
State and Community Highway Safety	581**	20.600	63,643	63,643
Subtotal Pass-through Program			63,643	63,643
Total Department of Transportation Programs			208,123	63,643
Total Expenditures of Federal Awards			$ 149,113,093	$ 63,548,054

* Denotes Major Federal Program

** Pass-through Entity Indentifying Number

The accompanying notes are an integral part of this schedule.

Department of Health
State of Hawaii
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Fiscal Year Ended June 30, 2016

NOTE A - 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, 2016. 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.

NOTE B - 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.

NOTE C - LOANS OUTSTANDING

The Department had the following loan balances outstanding at June 30, 2016. 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	$ 31,974,768
Capitalization Grants for Drinking Water State Revolving Funds	66.468	$ 50,308,816

NOTE D - NONCASH AWARDS

The Department also receives noncash awards for the Immunization Cooperative Agreements Program. The Department expended approximately $14,701,000 in vaccines for the Immunization Cooperative Agreements Program for the fiscal year ended June 30, 2016.

NOTE E - 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

N&K CPAs, Inc.
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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 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, 2016, 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 27, 2017.

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.

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 and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and questioned costs as Finding No. 2016-001 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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.

N&K CPAs, INC.

Honolulu, Hawaii
March 27, 2017

PART III

REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE

N&K CPAs, Inc.
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REPORT ON COMPLIANCE FOR EACH MAJOR 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 Each Major Federal Program

We have audited the State of Hawaii, Department of Health's (Department) 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, 2016. 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.

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

As described in Finding No. 2016-002 in the accompanying schedule of findings and questioned costs, the Department did not comply with requirements regarding:

CFDA Number	Name of Federal Program	Compliance Requirement	Ref. No.
93.044 93.045 93.053	Aging Cluster	Cash Management	2016-002
93.069	Public Health Emergency Preparedness	Cash Management	2016-002
93.243	Substance Abuse and Mental Health Services - Projects of Regional and National Significance	Cash Management	2016-002
93.268	Immunization Cooperative Agreements	Cash Management	2016-002
93.959	Block Grants for Prevention and Treatment of Substance Abuse	Cash Management	2016-002

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 our opinion, except for the noncompliance described in the Basis for Qualified Opinion on Major Federal Programs 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 on Major Federal Programs paragraph for the fiscal year ended June 30, 2016.

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, 2016.

Other Matters

The results of our auditing procedures disclosed other instances of noncompliance, which are required to be reported in accordance with the Uniform Guidance and which are described in the accompanying schedule of findings and questioned costs as Finding No. 2016-002 to 2016-004. Our opinion on each major federal program is not modified with respect to these 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. 2016-002 to be a material weakness.

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 deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as Finding No. 2016-003 to 2016-004 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.

N&K CPAs, Inc.

Honolulu, Hawaii
March 27, 2017

PART IV

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Department of Health
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Fiscal Year Ended June 30, 2016

SECTION I - SUMMARY OF AUDITOR'S RESULTS

Financial Statements

Type of report the auditor issued on whether the financial statements audited were prepared in accordance with GAAP:	Unmodified	
Internal control over financial reporting:		
Material weakness(es) identified?	__ yes	✓ no
Significant deficiency(ies) identified?	✓ yes	__ none reported
Noncompliance material to the financial statements noted?	__ yes	✓ no

Federal Awards

Internal control over major federal 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 except for CFDA No: 66.458 and 66.468	
Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)?	✓ yes	__ no

Identification of major federal programs:

CFDA 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
93.243	Substance Abuse and Mental Health Services - Projects of Regional and National Significance
93.268	Immunization Cooperative Agreements
93.959	Block Grants for Prevention and Treatment of Substance Abuse
	Environmental Protection Agency
66.458	Capitalization Grants for Clean Water State Revolving Funds
66.468	Capitalization Grants for Drinking Water State Revolving Funds

SECTION I - SUMMARY OF AUDITOR'S RESULTS (Continued)

Dollar threshold used to distinguish between Type A and Type B programs:	$3,000,000	
Auditee qualified as a low-risk auditee?	__ yes	✓ no

SECTION II - FINANCIAL STATEMENT FINDINGS

Ref. No. **Internal Control Findings**

2016-001 Reliance on Third Party Certifications (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.

Condition, Cause and Effect: 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. Overreliance

SECTION II - FINANCIAL STATEMENT FINDINGS (Continued)

Ref. No.	Internal Control Findings (Continued)
2016-001	Reliance on Third Party Certifications (Significant Deficiency)

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 2015-002 included in the Summary Schedule of Prior Audit Findings.

Recommendation: 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.

Views of Responsible Officials and Planned Corrective Action: The Department agrees with the finding and recommendation. See Part VI Correction Action Plan.

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Ref. No.	Compliance and Internal Control Findings	Questioned Costs
2016-002	**Cash Management (Material Weakness)**	

Federal agency: Department of Health and Human Services (DHHS)

CFDA No.: 93.044, 93.045, 93.053, 93.069, 93.243, 93.268 and 93.959

Programs:
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;
Substance Abuse and Mental Health Services - Projects of Regional and National Significance
Immunization Cooperative Agreements;
Block Grants for Prevention and Treatment of Substance Abuse

Federal award no. and Year:

15AAHINSIP	10/01/2014 - 09/30/2015
15AAHIT3SS	10/01/2014 - 09/30/2015
15AAHIT3CM	10/01/2014 - 09/30/2015
15AAHIT3HD	10/01/2014 - 09/30/2015
16AAHINSIP	10/01/2015 - 09/30/2016
16AAHIT3SS	10/01/2015 - 09/30/2016
16AAHIT3CM	10/01/2015 - 09/30/2016
16AAHIT3HD	10/01/2015 - 09/30/2016
3U90TP000513-03	04/01/2015 - 09/30/2016
5U90TP000513-03	07/01/2015 - 06/30/2016
3H79TI025340-02	09/30/2014 - 09/29/2015
5H79TI025340-03	09/30/2015 - 09/29/2016
5U79SP020167-02	09/30/2014 - 09/29/2015
5U79SP020167-03	09/30/2015 - 09/29/2016
5U79SM061226-03	09/30/2014 - 09/29/2015
5U79SM061226-04	09/30/2015 - 09/29/2017

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS (Continued)

Ref. No.	Compliance and Internal Control Findings (Continued)	Questioned Costs

2016-002 Cash Management (Material Weakness) (Continued)

Federal award no. and Year		
	5H23IP000721-03	01/01/2015 - 12/31/2015
	6NH23IP000721-04	01/01/2016 - 03/31/2017
	2B08TI010015-14	10/01/2013 - 09/30/2015
	2B08TI010015-15	10/01/2014 - 09/30/2016
	3B08TI010015-14	10/01/2013 - 09/30/2015
	3B08TI010015-15	10/01/2014 - 09/30/2016

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).

During the fiscal year ended June 30, 2016, the Department expended the following amounts under the following major programs as reported in the schedule of expenditures on pages 63 - 67:

CFDA 93.044, 93.045, and 93.053	$ 6,044,822
CFDA 93.069	$ 5,437,733
CFDA 93.243	$ 2,280,261
CFDA 93.268 (excluding non-cash expenditures)	$ 2,692,498
CFDA 93.959	$ 8,068,698
	$ 24,524,012

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS (Continued)

Ref. No.	Compliance and Internal Control Findings (Continued)	Questioned Costs
2016-002	**Cash Management (Material Weakness) (Continued)**	
	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.	$ --
	Identification as a Repeat Finding, if applicable: See finding 2015-003 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: The Department agrees with the finding and recommendation. See Part VI Correction Action Plan.	

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS (Continued)

Ref. No.	Compliance and Internal Control Findings (Continued)	Questioned Costs

2016-003 Allowable Costs/Cost Principles - Accrued Vacation and Vacation Payout (Significant Deficiency)

Federal agency: Department of Health and Human Services (DHHS)
Department of Agriculture

CFDA No.: 93.243, and 93.268

Program: Substance Abuse and Mental Health Services - Projects of Regional and National Significance
Immunization Cooperative Agreements

Federal award no. and Year:

1H79TI025340-02	09/30/2014 - 09/29/2015
5H79TI025340-03	09/30/2015 - 09/29/2016
5U79SP020167-02	09/30/2014 - 09/29/2015
5U79SP020167-03	09/30/2015 - 09/29/2016
5U79SM061226-03	09/30/2014 - 09/29/2015
5U79SM061226-04	09/30/2015 - 09/29/2017
5H79SM060159-05	09/30/2014 - 09/29/2016
1H79SM060956-01	09/30/2014 - 09/29/2018
5H23IP000721-03	01/01/2015 - 12/31/2015
6NH23IP000721-04	01/01/2016 - 03/31/2017

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 our testing of payroll for a major federal program in fiscal years 2014 and 2015, we 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, Substance Abuse and Mental Health Services - Projects of Regional and National Significance and Immunization Cooperative Agreement programs.

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS (Continued)

Ref. No.	Compliance and Internal Control Findings (Continued)	Questioned Costs
2016-003	**Allowable Costs/Cost Principles - Accrued Vacation and Vacation Payout (Significant Deficiency) (Continued)**	

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 were charged to major federal programs as follows:

CFDA No. 93.243	$ 11,221
CFDA No. 93.268	16,116
Other non-major federal programs	182,873
	$ 210,210

Identification as a Repeat Finding, if applicable: See finding 2015-004 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: The Department agrees with the finding and recommendation. See Part VI Correction Action Plan.

PART V

PRIOR YEAR FINDINGS AND QUESTIONED COSTS

Department of Health
State of Hawaii
STATUS OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS
Fiscal Year Ended June 30, 2016

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 7, 2016.

SECTION II - FINANCIAL STATEMENT FINDINGS

	Recommendations	Status
2015-001	**Department of Human Service Transactions** (page 83)	
	The Department should continue to work on becoming current on billings to DHS. It should also work with DHS to ensure that DHS completes reconciliations of Medicaid payments and communicates over and underpayments in a timely manner.	Accomplished. AMHD is current on billings to DHS. On a regular basis, denied claims are resubmitted to DHS in order to obtain payments for consumers who may have been determined to retroactively be Medicaid eligible. Claims can be submitted up to one year after the date of services were provided.
2015-002	**Reliance on Third Party Certifications** (pages 84 - 85)	
	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 2016-001.

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

	Recommendations	Status
2015-003	**Cash Management** (pages 86 - 88)	
	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 2016-002.
2015-004	**Allowable Costs/Cost Principles - Fringe Benefits** (pages 89 - 90)	
	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 2016-003.
2015-005	**Matching, Level of Effort, Earmarking** (page 91)	
	PHEP personnel should develop policies and procedures to ensure the match is calculated properly and records are maintained. PHEP should also consider having a secondary review to ensure in-kind matching for volunteer service is calculated correctly.	Accomplished. The PHEP program has developed policies and procedures and has developed a written policy dated May 5, 2015 has been distributed to all employees involved in the PHEP project.

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS (Continued)

	Recommendations	Status
2015-006	**Special Tests** (pages 92 - 93)	
	We recommend that the Department develop written policies and protocols for overseeing program-enrolled providers. In developing their written policies and protocols, the Department should use the 2015 Vaccines for Children Operations Guide by the Center for Disease Control as a resource.	Accomplished. The Immunization program has developed written policies and protocols for overseeing program-enrolled providers.
2015-007	**Subrecipient Monitoring** (pages 94 - 95)	
	We recommend that the Department develop formal oversight procedures to ensure that all steps of the subrecipient monitoring process are fully completed and are performed on a timely manner.	Accomplished. During our testing of current year subrecipient monitoring procedures performed by the Department, we noted no instances of incomplete or untimely monitoring.

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/17-031

March 17, 2017

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, 2016"

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, MD
Director of Health

Attachment

SUBJECT: FINANCIAL AUDIT OF THE DEPARTMENT OF HEALTH, STATE OF HAWAII, FOR THE FISCAL YEAR ENDED JUNE 30, 2016

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, Section II – Financial Statement Findings" and "Part IV – Schedule of Findings and Questioned Costs, Section III – Federal Award Findings and Questioned Costs" portions of the report.

- Reference No. 2016-001 Reliance on Third Party Certifications (Significant Deficiency)

The audit finds that there is an overreliance on self-reporting of distributors and redemption centers for the beverage redemption fees program administered by the DOH. The Program is making every effort towards establishing a systematic process for verifying the contents of reports and claims submitted by distributors and certified redemption centers. However, the Program has a fifty-percent staff vacancy rate, including most of the Accountant and Account Clerk positions, the Engineer position, and the Planner position which is responsible for contract management tasks. Due to the numerous vacancies, the Program has made only incremental progress to implement an internal process to audit the reporting records of distributors and redemption centers.

Two new accountants and an account clerk position were authorized for the Office of Solid Waste Management (OSWM) under Act 122/SLH 2014 and the positions were established in 2015. The Program has been actively recruiting for these positions but continue to struggle with filling these new as well as existing accounting positions. We continue to draw low number of interested candidates applying for these positions and for those applicants that do apply, most candidates have either withdrawn from consideration or turned down offers of employment from the Program. While efforts continue to fill these positions on a permanent basis, the Program has recruited two 89-day hire employees. An added challenge is the high turnover rate. When the positions have been filled, the incumbents have not remained long, instead opting for promotional opportunities within the civil service system or for higher paying positions in the federal or private sector. Given these challenges, we will look at new approaches to resolve this issue such as (1) incentivizing potential applicants by recruitment above the minimum salary range by taking advantage of the "Recruitment Above Minimum/Hiring Above Minimum (RAM/HAM)" provided for by the State Civil Service system, (2) exploring the option of outsourcing the Program's auditing function through a multi-year contract, and (3) reviewing the current organizational structure of the Deposit Beverage Container Program (DBCP) and other solid waste management functions to enable the DBCP to function more independently and provide a better structure conducive to attracting and retaining employees in these positions.

Person Responsible: Darren Park, Solid Waste Management Coordinator, OSWM, Solid and Hazardous Waste Branch.

Anticipated Date of Completion: June 30, 2018

- Reference No. 2016-002 Cash Management (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 Audit of the Department of Health, State of Hawaii, For the Fiscal Year Ending June 30, 2015, Reference No. 2015-003, Cash Management (Material Weakness), the State's requirement for 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 Financial Accounting Management and Information System (FAMIS) and is looking at the policies and processes currently in place to determine what types of modifications are needed for improvements.

  Person Responsible: Administrative Services Office and DAGS

  Anticipated Date of Completion: Unknown

- Reference No. 2016-003 Allowable Costs/Cost Principles – Accrued Vacation and Vacation Payout (Significant Deficiency)

  The issue of vacation payouts to employees who are federally funded is a Statewide issue and policies and procedures must be developed in collaboration with B&F and all State agencies. DOH has brought this to the attention of B&F and they will be addressing this issue for the State. 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 must be transferred to a non-federal account within 90 days or prior to the submission of the final Federal Financial Report (FFR), whichever is sooner. DOH will work closely with the programs who receive federal funds to ensure that the vacation payouts to employees paid on these federal funds are transferred timely.

  Person Responsible: Janis Morita, Chief, Administrative Services Office and Ebru Yilmaz-Pedro, Fiscal Officer, Administrative Services Office

  Anticipated Date of Completion: Ongoing

ORIGINAL

DEPT. COMM. NO. 352

FINANCIAL AUDIT OF THE
STATE OF HAWAII
DEPARTMENT OF HEALTH
DRINKING WATER TREATMENT REVOLVING LOAN FUND

Fiscal Year Ended June 30, 2016

Submitted by
The Auditor
State of Hawaii

N&K CPAs, Inc.
ACCOUNTANTS | CONSULTANTS

AMERICAN SAVINGS BANK TOWER | 1001 BISHOP STREET, SUITE 1700 | HONOLULU, HAWAII 96813-3696
T (808) 524-2255 **F** (808) 523-2090 | nkcpa.com

STATE OF HAWAII
DEPARTMENT OF HEALTH
DRINKING WATER TREATMENT REVOLVING LOAN FUND

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STATE OF HAWAII
DEPARTMENT OF HEALTH
DRINKING WATER TREATMENT REVOLVING LOAN FUND

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PART I

FINANCIAL SECTION

N&K CPAs, Inc.
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AMERICAN SAVINGS BANK TOWER
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T (808) 524-2255 F (808) 523-2090

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 (the "Fund"), as of and for the fiscal year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the Fund'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 an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the 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 reasonable basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of June 30, 2016, and the changes in its financial position and its cash flows for the fiscal 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 the Fund, 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 the Fund. 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, 2016, 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 the 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.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the Fund's basic financial statements. The supplementary information on pages 31 through 35 is presented for purposes of additional analysis and is 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 December 9, 2016 on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Fund's internal control over financial reporting and compliance.

N&K CPAs, INC.

Honolulu, Hawaii
December 9, 2016

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
STATEMENT OF NET POSITION
June 30, 2016

ASSETS AND DEFERRED OUTFLOWS OF RESOURCES

Current assets		
Equity in cash and cash equivalents and investments in State Treasury	$	52,390,983
Loan fees receivable		657,038
Accrued interest on loans		95,468
Other accrued interest		82,423
Due from federal government		114,589
Due from State Treasury		18,372
Accounts receivable		2,160
Current maturities of loans receivable		8,880,669
Total current assets		62,241,702
Loans receivable, net of current maturities		127,110,301
Capital assets, net of accumulated depreciation		719,979
Total assets		190,071,982
Deferred outflows of resources related to pensions		340,653
Total assets and deferred outflows of resources	$	190,412,635

See accompanying notes to the financial statements.

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
STATEMENT OF NET POSITION (Continued)
June 30, 2016

LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION

Current liabilities	
Accounts payable and other accrued liabilities	$ 378,870
Total current liabilities	378,870
Accrued vacation, net of current portion	161,011
Net pension liability	1,481,120
Other postemployment benefits	891,094
Total liabilities	2,912,095
Deferred inflows of resources related to pensions	574,808
Net position	
Net investment in capital assets	719,979
Restricted - expendable	186,205,753
Total net position	186,925,732
Total liabilities, deferred inflows of resources, and net position	$ 190,412,635

See accompanying notes to the financial statements.

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION
Fiscal Year Ended June 30, 2016

OPERATING REVENUES		
Interest income from loans	$	390,359
Administrative loan fees		2,384,819
Total operating revenues		2,775,178
OPERATING EXPENSES		
Administrative		1,331,275
State program management		866,284
Water protection		786,602
Principal forgiveness for SRF		2,243,543
Small systems technical assistance		21,353
Total operating expenses		5,249,057
Operating loss		(2,473,879)
NONOPERATING REVENUES		
State contributions		1,769,000
Federal contributions		25,287,251
Other interest income		314,317
Total nonoperating revenues		27,370,568
Change in net position		24,896,689
NET POSITION		
Beginning of fiscal year		162,029,043
End of fiscal year	$	186,925,732

See accompanying notes to the financial statements.

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
STATEMENT OF CASH FLOWS
Fiscal Year Ended June 30, 2016

CASH FLOWS FROM OPERATING ACTIVITIES	
Payments to employees	$ (1,400,720)
Payments to vendors	(1,105,307)
Net cash used in operating activities	(2,506,027)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
State contributions	1,769,000
Federal contributions	25,262,865
Net cash provided by noncapital financing activities	27,031,865
CASH FLOWS FROM INVESTING ACTIVITIES	
Principal repayment on loans	8,251,499
Disbursement of loans proceeds	(30,460,917)
Interest income from loans	385,827
Administrative loan fees	2,417,690
Other interest income	289,073
Net cash used in investing activities	(19,116,828)
Net increase in cash	5,409,010
EQUITY IN CASH AND CASH EQUIVALENTS AND INVESTMENTS IN STATE TREASURY	
Beginning of fiscal year	46,981,973
End of fiscal year	$ 52,390,983

See accompanying notes to the financial statements.

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
STATEMENT OF CASH FLOWS (Continued)
Fiscal Year Ended June 30, 2016

Reconciliation of operating loss to net cash used in operating activities		
Operating loss	$	(2,473,879)
Adjustments to reconcile operating loss to net cash used in operating activities		
Depreciation expense		188,384
Principal forgiveness for SRF		2,243,543
Interest income from loans		(390,359)
Administrative loan fees		(2,384,819)
Pension expense		207,062
In-kind contributions from the Environmental Protection Agency		195,663
Change in assets, deferred outflows of resources, liabilities, and deferred inflows of resources		
Due from SRF		23,837
Due from State Treasury		2,088
Accounts receivable		(2,160)
Accounts payable and other accrued liabilities		(44,258)
Net deferred outflows/inflows of resources related to pensions		(217,362)
Other postemployment benefits		146,233
Net cash used in operating activities	$	(2,506,027)

Disclosure of noncash investing, capital, and financing activities

In-kind contribution from the Environmental Protection Agency	$	195,663

See accompanying notes to the financial statements.

NOTE A - ESTABLISHMENT AND PURPOSE OF THE FUND

The 1996 Amendments to the Safe Drinking Water Act (the "Act") provide for the U.S. Environmental Protection Agency ("EPA") to make capitalization grants to states for the purpose of providing loans and other types of financial assistance to public water systems for drinking water infrastructure, including construction of public drinking water systems.

In 1997, the State of Hawaii ("State") Legislature established the Drinking Water Treatment Revolving Loan Fund (the "Fund") to receive federal capitalization grants from the EPA. The Fund is administered by the Safe Drinking Water Branch, Environmental Management Division of the State of Hawaii, Department of Health (the "Department"). The Fund's primary purpose is to provide loans in perpetuity to public drinking water systems for the 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.

NOTE B - SIGNIFICANT ACCOUNTING POLICIES

(1) ***Basis of 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 Department that is attributable to the transactions of the Fund and do not purport to present the financial position, results of operations or cash flows of the State or Department.

The financial statements of the Fund are presented using the economic resources measurement focus and the accrual basis of accounting in accordance with accounting principles prescribed by the Governmental Accounting Standards Board ("GASB") for proprietary funds.

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 nonoperating items. Operating revenues and expenses generally result from providing services or 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 Fund 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 is reported as operating expenses.

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

(2) ***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.

(3) ***Equity in Cash and Cash Equivalents and Investments in State Treasury*** - All monies of the Fund 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 in the State Treasury Investment Pool System. Funds in the investment pool accrue interest based on the average weighted cash balances of each account.

At June 30, 2016, 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. Cash deposits with the State Treasury are either federally insured or collateralized with obligations of the State or the United States of America. All securities pledged as collateral are held either by the State Treasury or by the State's fiscal agents in the name of the State.

(4) ***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 2014 allow for portions of loans to be forgiven upon satisfaction of certain requirements.

(5) ***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 - SIGNIFICANT ACCOUNTING POLICIES (Continued)

(6) ***Capital Assets*** - Capital assets are defined as those assets with estimated useful lives greater than one year and with an acquisition cost greater than $5,000. Such assets are recorded at cost or, if donated, at fair value at the date of donation. Depreciation of capital assets is provided for on a straight-line basis over the estimated useful lives (5 - 7 years) of the respective assets.

(7) ***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. The current portion of the accrued vacation balance is included in the accounts payable and other accrued liabilities balance.

(8) ***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 Employees' Retirement System of the State of Hawaii ("ERS"). At June 30, 2016, accumulated sick leave was approximately $529,500.

(9) ***Net Position*** - The Fund'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.

(10) ***Administrative Costs*** - The accompanying financial statements do not reflect certain administrative costs, which are paid for by other sources of funding from the Department. These costs include the Department's and State's overhead costs which the Department does not assess to the Fund, since they are not practical to determine.

(11) ***Fund Accounts*** - The Fund 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.

(12) ***Expenses*** - The statement of revenues, expenses and changes in fund net position presents expenses on a functional basis. The natural classifications of expenses are presented in the supplementary schedule of operating expenses.

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

(13) ***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.

(14) ***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.

(15) ***New Accounting Pronouncements*** - The Government Accounting Standards Board (the "GASB") issued Statement No. 72, *Fair Value Measurement and Application*. The Statement will enhance comparability of financial statements among governments by requiring measurement of certain assets and liabilities at fair value using a consistent and more detailed definition of fair value and accepted valuation techniques. The Statement will also enhance fair value application guidance and disclosure. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2015. Management has adopted the new standard as presented in the Fund's financial statements.

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

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 Fund's financial statements, but anticipates that it will materially impact the Fund's financial statements.

The GASB issued Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. The Statement reduces the generally accepted accounting principles ("GAAP") to two categories of authoritative GAAP. The first category of authoritative GAAP consists of GASB Statements of Governmental Accounting Standards. The second category includes GASB Implementation Guides, GASB Technical Bulletins, and guidance from the American Institute of Certified Public Accountants that is cleared by the GASB. The requirements of this Statement are effective for reporting periods beginning after June 15, 2015. Management has adopted the applicable requirements of this Statement as presented in the Fund's financial statements.

The GASB issued Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*. The Statement amends the scope and applicability of Statement No. 68 to exclude certain pensions provided to employees of state or local governmental employers through a cost-sharing multiple-employer defined benefit pension. The requirements of this Statement are effective for reporting periods beginning after December 15, 2015. Management has not yet determined the effect this Statement will have on the Fund's financial statements.

The GASB issued Statement No. 79, *Certain External Investment Pools and Pool Participants*. The Statement addresses how certain state and local government external investment pools - and participants in those pools - may measure and report their investments. The requirements of this Statement are effective for reporting periods beginning after June 15, 2015, except for certain provisions, which are effective for reporting periods beginning after December 15, 2015. Management has determined that this Statement does not have a material effect on the Fund's financial statements.

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

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

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. Management has not yet determined the effect this Statement will have on the Fund's financial statements.

NOTE C - LOANS RECEIVABLE

At June 30, 2016, loans receivable were as follows:

Twenty-one loans receivable from the City & County of Honolulu, Board of Water Supply, due in semi-annual 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.	$ 63,847,206
Seventeen loans receivable from the County of Hawaii, Department of Water Supply, due in semi-annual 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.	25,803,244
Fifteen loans receivable from the County of Maui, Department of Water Supply, due in semi-annual 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.	22,259,557
Fifteen loans receivable from the County of Kauai, Department of Water due in semi-annual 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.	24,080,963
	135,990,970
Less: current maturities	(8,880,669)
	$ 127,110,301

NOTE C - LOANS RECEIVABLE (Continued)

Loans are expected to mature at various dates through 2035. The scheduled principal payments on loans maturing in subsequent years are as follows:

Fiscal Years Ending,	Amount
2017	$ 8,880,669
2018	8,067,058
2019	8,405,036
2020	8,440,810
2021	8,440,638
Thereafter	93,756,759
	$ 135,990,970

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 2016, $2,243,543 in loans were forgiven. All loans and advances were forgiven in accordance with the required conditions.

At June 30, 2016, $37,881,833, $9,500,000 and $21,500,000 were committed to be loaned to the City and County of Honolulu, County of Hawaii, and County of Maui, respectively, under existing loan agreements.

NOTE D - CONTRIBUTED CAPITAL

The Fund is capitalized by grants from the EPA and matching funds from the State. The following summarizes the EPA capitalization grants and ARRA funds awarded, amounts drawn on each grant, and the balances available for future loans at June 30, 2016:

Budget Period	Amount	Total Draws at June 30, 2015	EPA Draws	Total 2016 Cash Draws	Funds Available
07/01/07 - 06/30/17	$ 8,229,300	$ 8,156,653	$ --	$ 72,647	$ --
03/01/08 - 06/30/17	8,229,000	8,118,618	--	110,382	--
03/01/09 - 06/30/18	8,146,000	7,487,781	--	658,219	--
01/01/10 - 06/30/19	8,146,000	6,273,615	--	1,523,454	348,931
04/01/11 - 06/30/17	13,573,000	8,857,486	--	4,415,334	300,180
09/30/11 - 06/30/18	9,268,000	6,052,564	--	3,023,838	191,598
09/28/12 - 06/30/19	9,125,000	6,972,081	--	2,152,919	--
09/30/13 - 06/30/20	8,421,000	4,297,739	--	4,020,417	102,844
12/01/14 - 06/30/21	8,787,058	2,467,937	--	6,072,017	247,104
10/01/15 - 06/30/19	8,787,000	--	586,000	3,213,638	4,987,362
	$ 90,711,358	$ 58,684,474	$ 586,000	$ 25,262,865	$ 6,178,019

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, 2016, the Fund was in compliance with the 20 percent State matching requirement. The required State match through June 30, 2016 approximated $33.2 million, of which the entire amount has been utilized.

NOTE E - CAPITAL ASSETS

Capital asset activity for the fiscal year ended June 30, 2016, was as follows:

	Balance at June 30, 2015	Additions	Retirements/ Disposals	Balance at June 30, 2016
Equipment	$ 2,408,734	$ --	$ --	$ 2,408,734
Accumulated depreciation	(1,500,371)	(188,384)	--	(1,688,755)
	$ 908,363	$ (188,384)	$ --	$ 719,979

NOTE F - ACCRUED VACATION

The changes to the accrued vacation liability during 2016 were as follows:

Balance at July 1, 2015	$ 201,869
Increase	69,936
Decrease	(58,882)
Balance at June 30, 2016	212,923
Less: Current portion	(51,912)
Noncurrent portion	$ 161,011

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 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

NOTE G - EMPLOYEE BENEFIT PLANS (Continued)

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.

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.

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

NOTE G - EMPLOYEE BENEFIT PLANS (Continued)

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 2016 were 25.00% for police officers and firefighters and 17.00% for all other employees. Contributions to the pension plan from the Fund were $217,362 for the fiscal year ended June 30, 2016.

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.

NOTE G - EMPLOYEE BENEFIT PLANS (Continued)

Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions - At June 30, 2016, the Fund reported a liability of $1,481,120 for its proportionate share of the net pension liability of the State. The net pension liability was measured as of June 30, 2015, 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, 2015, the Fund's proportion was 0.0400% which decreased from its proportion measured as of June 30, 2014 of 0.1200%.

There were no changes in other assumptions and inputs that affected the measurement of the total pension liability since the prior measurement date other than the investment return assumption. Fiscal year 2016 was the first year of the three-year phase-in of the investment return assumption. The investment return rate decreased beginning in fiscal year 2016 to 7.65% and will continue to decrease to 7.55% in fiscal year 2017 and to 7.50% in fiscal year 2018, and will remain at 7.50% thereafter. There were no other changes between the measurement date, June 30, 2015, and the reporting date, June 30, 2016, that are expected to have a significant effect on the proportionate share of the net pension liability.

For the year ended June 30, 2016, the Fund recognized pension expense of $207,062. At June 30, 2016, the Fund 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	$ 66,493	$ (56,830)
Changes of assumptions	47,314	--
Net difference between projected and actual earnings on pension plan investments	--	(505,569)
Changes in proportion and difference between Fund contributions and proportionate share of contributions	9,484	(12,409)
Fund contributions subsequent to the measurement date	217,362	--
	$ 340,653	$ (574,808)

NOTE G - EMPLOYEE BENEFIT PLANS (Continued)

The $217,362 reported as deferred outflows of resources related to pensions resulting from Fund contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the 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,	Amount
2017	$ (197,875)
2018	(197,875)
2019	(197,875)
2020	157,057
2021	(14,949)
Total	$ (451,517)

Actuarial Assumptions - The total pension liability in the June 30, 2015 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.00%
Payroll growth rate	3.50%
Investment rate of return	7.65% per year, compounded annual including inflation

The same rates were applied to all periods. There were no changes to ad hoc postemployment benefits including COLA.

Post-retirement mortality rates are based on Client Specific Tables and the 1994 US Group Annuity Mortality Static Tables. Pre-retirement mortality rates are based on custom tables with RP-2000 rates.

The actuarial assumptions used in the June 30, 2015 valuation were based on the most recent experience study dated December 20, 2010. Between experience studies, the Board of Trustees of the Employees' Retirement System of the State of Hawaii elected to lower the investment return assumption effective with the June 30, 2015 valuation.

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

NOTE G - EMPLOYEE BENEFIT PLANS (Continued)

are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

Asset Class	Target Allocation	Long-term Expected Real Rate of Return
Domestic equity	30.0%	8.5%
International equity	26.0%	9.3%
Total fixed income	20.0%	3.1%
Real estate	7.0% *	9.2%
Private equity	7.0% *	11.9%
Real return	5.0% *	6.7%
Covered calls	5.0%	7.7%
	100.0%	

* The real estate, private equity and real return targets will be the percentage actually invested up to 7.0%, 7.0% and 5.0%, respectively, of the total fund. Changes in the real estate, private equity and real return targets will be offset by an equal percentage change in the large cap domestic equity target.

Discount Rate - The discount rate used to measure the net pension liability was 7.65%, a decrease from the 7.75% 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 Fund's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate - The following presents the Fund's proportionate share of the net pension liability calculated using the discount rate of 7.65%, as well as what the Fund's proportionate share of the net pension liability would be if it were calculated using a discount rate that is one percentage point lower (6.65%) or one percentage point higher (8.65%) than the current rate:

	1% Decrease (6.65%)	Discount Rate (7.65%)	1% Increase (8.65%)
Fund's proportionate share of the net pension liability	$ 1,865,378	$ 1,481,120	$ 1,096,860

NOTE G - EMPLOYEE BENEFIT PLANS (Continued)

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' complete financial statements are available at: http://www.ers.ehawaii.gov.

Payables to the Pension Plan - At June 30, 2016, the amount payable to the ERS was approximately $13,000.

(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 Healthcare and Life Insurance Benefits*

The State contributes to the Hawaii Employer-Union Health Benefits Trust Fund ("EUTF"), an agent multiple-employer defined benefit plan. The EUTF was established to provide a single delivery system of health benefits for state and county workers, retirees, and their dependents. The eligibility requirements for retiree health benefits are based on date of hire.

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,

NOTE G - EMPLOYEE BENEFIT PLANS (Continued)

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 the State's total covered employee headcount 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 Fund's financial statements. The following table shows the allocated annual OPEB cost that has been allocated to the Fund for the year ended June 30, 2016:

Annual OPEB cost	$ 258,123
Less: contributions made	(111,890)
Increase in net OPEB obligation	146,233
Net OPEB obligation	
Beginning of year	744,861
End of year	$ 891,094

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, 2016, 2015, and 2014 approximated $112,000, $92,000, and $69,000, 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.

The Department is covered by the State's self-insured workers' compensation program for medical expenses of injured Department employees. However, the Department is required to pay temporary total and temporary partial disability benefits as long as the employee is on the Department's payroll. Because actual claims 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. Claims 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

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
SCHEDULE OF CASH RECEIPTS, DISBURSEMENTS AND CASH BALANCE
Fiscal Year Ended June 30, 2016

RECEIPTS		
Principal repayment on loans	$	8,251,499
Interest income from loans		385,827
State contributions		1,769,000
Federal contributions		25,262,865
Administrative loan fees		2,417,690
Other interest income		289,073
Total receipts		38,375,954
DISBURSEMENTS		
Disbursement of loan proceeds		30,460,917
Administrative		2,506,027
Total disbursements		32,966,944
Excess of receipts over disbursements		5,409,010
EQUITY IN CASH AND CASH EQUIVALENTS AND INVESTMENTS IN STATE TREASURY		
Beginning of fiscal year		46,981,973
End of fiscal year	$	52,390,983

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
COMBINING STATEMENT OF NET POSITION
June 30, 2016

	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	$ 48,839,552	$ 3,551,431	$ 52,390,983
Loan fees receivable	--	657,038	657,038
Accrued interest on loans	95,468	--	95,468
Other accrued interest	82,423	--	82,423
Due from federal government	--	114,589	114,589
Due from State Treasury	--	18,372	18,372
Accounts receivable	--	2,160	2,160
Current maturities of loans receivable	8,880,669	--	8,880,669
Total current assets	57,898,112	4,343,590	62,241,702
Loans receivable, net of current maturities	127,110,301	--	127,110,301
Capital assets, net of accumulated depreciation	--	719,979	719,979
Total assets	185,008,413	5,063,569	190,071,982
Deferred outflows of resources related to pensions	--	340,653	340,653
Total assets and deferred outflows of resources	$ 185,008,413	$ 5,404,222	$ 190,412,635

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
COMBINING STATEMENT OF NET POSITION (Continued)
June 30, 2016

	State Revolving Fund Activity	Non-SRF Activity	Total
LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION			
Current liabilities			
Accounts payable and other accrued liabilities	$ --	$ 378,870	$ 378,870
Total current liabilities	--	378,870	378,870
Accrued vacation, net of current portion	--	161,011	161,011
Net pension liability	--	1,481,120	1,481,120
Other postemployment benefits	--	891,094	891,094
Total liabilities	--	2,912,095	2,912,095
Deferred inflows of resources related to pensions	--	574,808	574,808
Net position			
Net investment in capital assets	--	719,979	719,979
Restricted - expendable	185,008,413	1,197,340	186,205,753
Total net position	185,008,413	1,917,319	186,925,732
Total liabilities, deferred inflows of resources, and net position	$ 185,008,413	$ 5,404,222	$ 190,412,635

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
COMBINING STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION
Fiscal Year Ended June 30, 2016

	State Revolving Fund Activity	Non-SRF Activity	Total
OPERATING REVENUES			
Interest income from loans	$ 390,359	$ --	$ 390,359
Administrative loan fees	--	2,384,819	2,384,819
Total operating revenues	390,359	2,384,819	2,775,178
OPERATING EXPENSES			
Administrative	--	1,331,275	1,331,275
State program management	--	866,284	866,284
Water protection	--	786,602	786,602
Principal forgiveness for SRF	2,243,543	--	2,243,543
Small systems technical assistance	--	21,353	21,353
Total operating expenses	2,243,543	3,005,514	5,249,057
Operating loss	(1,853,184)	(620,695)	(2,473,879)
NONOPERATING REVENUES			
State contributions	1,769,000	--	1,769,000
Federal contributions	23,382,539	1,904,712	25,287,251
Other interest income	314,317	--	314,317
Total nonoperating revenues	25,465,856	1,904,712	27,370,568
Interfund transfers	981,538	(981,538)	--
Change in net position	24,594,210	302,479	24,896,689
NET POSITION			
Beginning of fiscal year	160,414,203	1,614,840	162,029,043
End of fiscal year	$ 185,008,413	$ 1,917,319	$ 186,925,732

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
SCHEDULE OF OPERATING EXPENSES
Fiscal Year Ended June 30, 2016

	State Revolving Fund Activity	Non-SRF Activity	Total
Principal forgiveness for SRF	$ 2,243,543	$ --	$ 2,243,543
Personnel	--	1,333,140	1,333,140
Professional services	--	468,376	468,376
Services rendered by other State agencies	--	343,861	343,861
Pension expense	--	207,062	207,062
Intergovernmental personnel agreement expenses	--	195,663	195,663
Depreciation	--	188,384	188,384
Travel	--	80,502	80,502
Training	--	56,984	56,984
Repairs and maintenance	--	50,396	50,396
Office and other supplies	--	26,718	26,718
Rental	--	6,028	6,028
Telephone	--	940	940
Miscellaneous	--	47,460	47,460
Total operating expenses	$ 2,243,543	$ 3,005,514	$ 5,249,057

PART II

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS

N&K CPAs, Inc.
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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 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 State of Hawaii, Drinking Water Treatment Revolving Loan Fund (the "Fund"), as of and for the fiscal year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the Fund's basic financial statements and have issued our report thereon dated December 9, 2016.

Internal Control Over Financial Reporting

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

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

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

Compliance and Other Matters

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

N&K CPAs, INC.

Honolulu, Hawaii
December 9, 2016

PART III

REPORT ON COMPLIANCE FOR A FEDERAL PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE

N&K CPAs, Inc.
ACCOUNTANTS | CONSULTANTS

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REPORT ON COMPLIANCE FOR A FEDERAL PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE WHEN USING THE PROGRAM-SPECIFIC AUDIT OPTION TO SATISFY THE 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, Department of Health, Drinking Water Treatment Revolving Fund's (the "Fund") 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 Drinking Water State Revolving Funds Program (the "Program") for the fiscal year ended June 30, 2016.

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 Fund'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 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 Fund'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 Fund's Program. However, our audit does not provide a legal determination of the Fund's compliance.

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

In our opinion, the Fund complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its Program for the fiscal year ended June 30, 2016.

Report on Internal Control Over Compliance

Management of the Fund 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 Fund'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 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 Fund'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.

N&K CPAs, Inc.

Honolulu, Hawaii
December 9, 2016

PART IV

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

State of Hawaii
Department of Health
Drinking Water Control Revolving Loan Fund
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
Fiscal Year Ended June 30, 2016

Ref. No.	**Financial Statement Findings**
2015-001	**Prior Period Adjustment**

Criteria: Capital assets are defined as those assets with estimated useful lives greater than one year and with an acquisition cost greater than $5,000.

Finding and Cause and Effect: Management brought to our attention during our audit that $623,714 of equipment purchased during fiscal year 2012 was erroneously expensed. Calculated accumulated depreciation on this equipment as of June 30, 2014 totaled $200,479. The effect of properly recording this equipment and accumulated depreciation is an increase in net position of $423,234 as of June 30, 2014.

Status

Resolved. No similar instances noted.

ORIGINAL

DEPT. COMM. NO. 352

FINANCIAL AUDIT OF THE STATE OF HAWAII DEPARTMENT OF HEALTH WATER POLLUTION CONTROL REVOLVING FUND

Fiscal Year Ended June 30, 2016

Submitted by
The Auditor
State of Hawaii

N&K CPAs, Inc.
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STATE OF HAWAII
DEPARTMENT OF HEALTH
DRINKING WATER TREATMENT REVOLVING LOAN FUND

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STATE OF HAWAII
DEPARTMENT OF HEALTH
DRINKING WATER TREATMENT REVOLVING LOAN FUND

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PART I

FINANCIAL SECTION

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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 (the "Fund"), as of and for the fiscal year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the Fund'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 an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the 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 reasonable basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of June 30, 2016, and the changes in its financial position and its cash flows for the fiscal 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 the Fund, 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 the Fund. 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, 2016, 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 the 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.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the Fund's basic financial statements. The supplementary information on pages 31 through 35 is presented for purposes of additional analysis and is 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 December 9, 2016 on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Fund's internal control over financial reporting and compliance.

N&K CPAs, INC.

Honolulu, Hawaii
December 9, 2016

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
STATEMENT OF NET POSITION
June 30, 2016

ASSETS AND DEFERRED OUTFLOWS OF RESOURCES

Current assets		
Equity in cash and cash equivalents and investments in State Treasury	$	52,390,983
Loan fees receivable		657,038
Accrued interest on loans		95,468
Other accrued interest		82,423
Due from federal government		114,589
Due from State Treasury		18,372
Accounts receivable		2,160
Current maturities of loans receivable		8,880,669
Total current assets		62,241,702
Loans receivable, net of current maturities		127,110,301
Capital assets, net of accumulated depreciation		719,979
Total assets		190,071,982
Deferred outflows of resources related to pensions		340,653
Total assets and deferred outflows of resources	$	190,412,635

See accompanying notes to the financial statements.

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
STATEMENT OF NET POSITION (Continued)
June 30, 2016

LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION

Current liabilities	
Accounts payable and other accrued liabilities	$ 378,870
Total current liabilities	378,870
Accrued vacation, net of current portion	161,011
Net pension liability	1,481,120
Other postemployment benefits	891,094
Total liabilities	2,912,095
Deferred inflows of resources related to pensions	574,808
Net position	
Net investment in capital assets	719,979
Restricted - expendable	186,205,753
Total net position	186,925,732
Total liabilities, deferred inflows of resources, and net position	$ 190,412,635

See accompanying notes to the financial statements.

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION
Fiscal Year Ended June 30, 2016

OPERATING REVENUES		
Interest income from loans	$	390,359
Administrative loan fees		2,384,819
Total operating revenues		2,775,178
OPERATING EXPENSES		
Administrative		1,331,275
State program management		866,284
Water protection		786,602
Principal forgiveness for SRF		2,243,543
Small systems technical assistance		21,353
Total operating expenses		5,249,057
Operating loss		(2,473,879)
NONOPERATING REVENUES		
State contributions		1,769,000
Federal contributions		25,287,251
Other interest income		314,317
Total nonoperating revenues		27,370,568
Change in net position		24,896,689
NET POSITION		
Beginning of fiscal year		162,029,043
End of fiscal year	$	186,925,732

See accompanying notes to the financial statements.

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
STATEMENT OF CASH FLOWS
Fiscal Year Ended June 30, 2016

CASH FLOWS FROM OPERATING ACTIVITIES	
Payments to employees	$ (1,400,720)
Payments to vendors	(1,105,307)
Net cash used in operating activities	(2,506,027)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
State contributions	1,769,000
Federal contributions	25,262,865
Net cash provided by noncapital financing activities	27,031,865
CASH FLOWS FROM INVESTING ACTIVITIES	
Principal repayment on loans	8,251,499
Disbursement of loans proceeds	(30,460,917)
Interest income from loans	385,827
Administrative loan fees	2,417,690
Other interest income	289,073
Net cash used in investing activities	(19,116,828)
Net increase in cash	5,409,010
EQUITY IN CASH AND CASH EQUIVALENTS AND INVESTMENTS IN STATE TREASURY	
Beginning of fiscal year	46,981,973
End of fiscal year	$ 52,390,983

See accompanying notes to the financial statements.

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
STATEMENT OF CASH FLOWS (Continued)
Fiscal Year Ended June 30, 2016

Reconciliation of operating loss to net cash used in operating activities		
Operating loss	$	(2,473,879)
Adjustments to reconcile operating loss to net cash used in operating activities		
Depreciation expense		188,384
Principal forgiveness for SRF		2,243,543
Interest income from loans		(390,359)
Administrative loan fees		(2,384,819)
Pension expense		207,062
In-kind contributions from the Environmental Protection Agency		195,663
Change in assets, deferred outflows of resources, liabilities, and deferred inflows of resources		
Due from SRF		23,837
Due from State Treasury		2,088
Accounts receivable		(2,160)
Accounts payable and other accrued liabilities		(44,258)
Net deferred outflows/inflows of resources related to pensions		(217,362)
Other postemployment benefits		146,233
Net cash used in operating activities	$	(2,506,027)

Disclosure of noncash investing, capital, and financing activities

In-kind contribution from the Environmental Protection Agency	$	195,663

See accompanying notes to the financial statements.

NOTE A - ESTABLISHMENT AND PURPOSE OF THE FUND

The 1996 Amendments to the Safe Drinking Water Act (the "Act") provide for the U.S. Environmental Protection Agency ("EPA") to make capitalization grants to states for the purpose of providing loans and other types of financial assistance to public water systems for drinking water infrastructure, including construction of public drinking water systems.

In 1997, the State of Hawaii ("State") Legislature established the Drinking Water Treatment Revolving Loan Fund (the "Fund") to receive federal capitalization grants from the EPA. The Fund is administered by the Safe Drinking Water Branch, Environmental Management Division of the State of Hawaii, Department of Health (the "Department"). The Fund's primary purpose is to provide loans in perpetuity to public drinking water systems for the 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.

NOTE B - SIGNIFICANT ACCOUNTING POLICIES

(1) ***Basis of 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 Department that is attributable to the transactions of the Fund and do not purport to present the financial position, results of operations or cash flows of the State or Department.

The financial statements of the Fund are presented using the economic resources measurement focus and the accrual basis of accounting in accordance with accounting principles prescribed by the Governmental Accounting Standards Board ("GASB") for proprietary funds.

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 nonoperating items. Operating revenues and expenses generally result from providing services or 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 Fund 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 is reported as operating expenses.

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

(2) ***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.

(3) ***Equity in Cash and Cash Equivalents and Investments in State Treasury*** - All monies of the Fund 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 in the State Treasury Investment Pool System. Funds in the investment pool accrue interest based on the average weighted cash balances of each account.

At June 30, 2016, 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. Cash deposits with the State Treasury are either federally insured or collateralized with obligations of the State or the United States of America. All securities pledged as collateral are held either by the State Treasury or by the State's fiscal agents in the name of the State.

(4) ***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 2014 allow for portions of loans to be forgiven upon satisfaction of certain requirements.

(5) ***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 - SIGNIFICANT ACCOUNTING POLICIES (Continued)

(6) ***Capital Assets*** - Capital assets are defined as those assets with estimated useful lives greater than one year and with an acquisition cost greater than $5,000. Such assets are recorded at cost or, if donated, at fair value at the date of donation. Depreciation of capital assets is provided for on a straight-line basis over the estimated useful lives (5 - 7 years) of the respective assets.

(7) ***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. The current portion of the accrued vacation balance is included in the accounts payable and other accrued liabilities balance.

(8) ***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 Employees' Retirement System of the State of Hawaii ("ERS"). At June 30, 2016, accumulated sick leave was approximately $529,500.

(9) ***Net Position*** - The Fund'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.

(10) ***Administrative Costs*** - The accompanying financial statements do not reflect certain administrative costs, which are paid for by other sources of funding from the Department. These costs include the Department's and State's overhead costs which the Department does not assess to the Fund, since they are not practical to determine.

(11) ***Fund Accounts*** - The Fund 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.

(12) ***Expenses*** - The statement of revenues, expenses and changes in fund net position presents expenses on a functional basis. The natural classifications of expenses are presented in the supplementary schedule of operating expenses.

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

(13) ***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.

(14) ***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.

(15) ***New Accounting Pronouncements*** - The Government Accounting Standards Board (the "GASB") issued Statement No. 72, *Fair Value Measurement and Application*. The Statement will enhance comparability of financial statements among governments by requiring measurement of certain assets and liabilities at fair value using a consistent and more detailed definition of fair value and accepted valuation techniques. The Statement will also enhance fair value application guidance and disclosure. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2015. Management has adopted the new standard as presented in the Fund's financial statements.

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

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 Fund's financial statements, but anticipates that it will materially impact the Fund's financial statements.

The GASB issued Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. The Statement reduces the generally accepted accounting principles ("GAAP") to two categories of authoritative GAAP. The first category of authoritative GAAP consists of GASB Statements of Governmental Accounting Standards. The second category includes GASB Implementation Guides, GASB Technical Bulletins, and guidance from the American Institute of Certified Public Accountants that is cleared by the GASB. The requirements of this Statement are effective for reporting periods beginning after June 15, 2015. Management has adopted the applicable requirements of this Statement as presented in the Fund's financial statements.

The GASB issued Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*. The Statement amends the scope and applicability of Statement No. 68 to exclude certain pensions provided to employees of state or local governmental employers through a cost-sharing multiple-employer defined benefit pension. The requirements of this Statement are effective for reporting periods beginning after December 15, 2015. Management has not yet determined the effect this Statement will have on the Fund's financial statements.

The GASB issued Statement No. 79, *Certain External Investment Pools and Pool Participants*. The Statement addresses how certain state and local government external investment pools - and participants in those pools - may measure and report their investments. The requirements of this Statement are effective for reporting periods beginning after June 15, 2015, except for certain provisions, which are effective for reporting periods beginning after December 15, 2015. Management has determined that this Statement does not have a material effect on the Fund's financial statements.

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

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

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. Management has not yet determined the effect this Statement will have on the Fund's financial statements.

NOTE C - LOANS RECEIVABLE

At June 30, 2016, loans receivable were as follows:

Twenty-one loans receivable from the City & County of Honolulu, Board of Water Supply, due in semi-annual 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.	$ 63,847,206
Seventeen loans receivable from the County of Hawaii, Department of Water Supply, due in semi-annual 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.	25,803,244
Fifteen loans receivable from the County of Maui, Department of Water Supply, due in semi-annual 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.	22,259,557
Fifteen loans receivable from the County of Kauai, Department of Water due in semi-annual 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.	24,080,963
	135,990,970
Less: current maturities	(8,880,669)
	$ 127,110,301

NOTE C - LOANS RECEIVABLE (Continued)

Loans are expected to mature at various dates through 2035. The scheduled principal payments on loans maturing in subsequent years are as follows:

Fiscal Years Ending,	Amount
2017	$ 8,880,669
2018	8,067,058
2019	8,405,036
2020	8,440,810
2021	8,440,638
Thereafter	93,756,759
	$ 135,990,970

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 2016, $2,243,543 in loans were forgiven. All loans and advances were forgiven in accordance with the required conditions.

At June 30, 2016, $37,881,833, $9,500,000 and $21,500,000 were committed to be loaned to the City and County of Honolulu, County of Hawaii, and County of Maui, respectively, under existing loan agreements.

NOTE D - CONTRIBUTED CAPITAL

The Fund is capitalized by grants from the EPA and matching funds from the State. The following summarizes the EPA capitalization grants and ARRA funds awarded, amounts drawn on each grant, and the balances available for future loans at June 30, 2016:

Budget Period	Amount	Total Draws at June 30, 2015	EPA Draws	Total 2016 Cash Draws	Funds Available
07/01/07 - 06/30/17	$ 8,229,300	$ 8,156,653	$ --	$ 72,647	$ --
03/01/08 - 06/30/17	8,229,000	8,118,618	--	110,382	--
03/01/09 - 06/30/18	8,146,000	7,487,781	--	658,219	--
01/01/10 - 06/30/19	8,146,000	6,273,615	--	1,523,454	348,931
04/01/11 - 06/30/17	13,573,000	8,857,486	--	4,415,334	300,180
09/30/11 - 06/30/18	9,268,000	6,052,564	--	3,023,838	191,598
09/28/12 - 06/30/19	9,125,000	6,972,081	--	2,152,919	--
09/30/13 - 06/30/20	8,421,000	4,297,739	--	4,020,417	102,844
12/01/14 - 06/30/21	8,787,058	2,467,937	--	6,072,017	247,104
10/01/15 - 06/30/19	8,787,000	--	586,000	3,213,638	4,987,362
	$ 90,711,358	$ 58,684,474	$ 586,000	$ 25,262,865	$ 6,178,019

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, 2016, the Fund was in compliance with the 20 percent State matching requirement. The required State match through June 30, 2016 approximated $33.2 million, of which the entire amount has been utilized.

NOTE E - CAPITAL ASSETS

Capital asset activity for the fiscal year ended June 30, 2016, was as follows:

	Balance at June 30, 2015	Additions	Retirements/ Disposals	Balance at June 30, 2016
Equipment	$ 2,408,734	$ --	$ --	$ 2,408,734
Accumulated depreciation	(1,500,371)	(188,384)	--	(1,688,755)
	$ 908,363	$ (188,384)	$ --	$ 719,979

NOTE F - ACCRUED VACATION

The changes to the accrued vacation liability during 2016 were as follows:

Balance at July 1, 2015	$ 201,869
Increase	69,936
Decrease	(58,882)
Balance at June 30, 2016	212,923
Less: Current portion	(51,912)
Noncurrent portion	$ 161,011

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 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

NOTE G - EMPLOYEE BENEFIT PLANS (Continued)

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.

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.

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

NOTE G - EMPLOYEE BENEFIT PLANS (Continued)

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 2016 were 25.00% for police officers and firefighters and 17.00% for all other employees. Contributions to the pension plan from the Fund were $217,362 for the fiscal year ended June 30, 2016.

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.

NOTE G - EMPLOYEE BENEFIT PLANS (Continued)

Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions - At June 30, 2016, the Fund reported a liability of $1,481,120 for its proportionate share of the net pension liability of the State. The net pension liability was measured as of June 30, 2015, 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, 2015, the Fund's proportion was 0.0400% which decreased from its proportion measured as of June 30, 2014 of 0.1200%.

There were no changes in other assumptions and inputs that affected the measurement of the total pension liability since the prior measurement date other than the investment return assumption. Fiscal year 2016 was the first year of the three-year phase-in of the investment return assumption. The investment return rate decreased beginning in fiscal year 2016 to 7.65% and will continue to decrease to 7.55% in fiscal year 2017 and to 7.50% in fiscal year 2018, and will remain at 7.50% thereafter. There were no other changes between the measurement date, June 30, 2015, and the reporting date, June 30, 2016, that are expected to have a significant effect on the proportionate share of the net pension liability.

For the year ended June 30, 2016, the Fund recognized pension expense of $207,062. At June 30, 2016, the Fund 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	$ 66,493	$ (56,830)
Changes of assumptions	47,314	--
Net difference between projected and actual earnings on pension plan investments	--	(505,569)
Changes in proportion and difference between Fund contributions and proportionate share of contributions	9,484	(12,409)
Fund contributions subsequent to the measurement date	217,362	--
	$ 340,653	$ (574,808)

NOTE G - EMPLOYEE BENEFIT PLANS (Continued)

The $217,362 reported as deferred outflows of resources related to pensions resulting from Fund contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the 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,		Amount
2017	$	(197,875)
2018		(197,875)
2019		(197,875)
2020		157,057
2021		(14,949)
Total	$	(451,517)

Actuarial Assumptions - The total pension liability in the June 30, 2015 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.00%
Payroll growth rate	3.50%
Investment rate of return	7.65% per year, compounded annual including inflation

The same rates were applied to all periods. There were no changes to ad hoc postemployment benefits including COLA.

Post-retirement mortality rates are based on Client Specific Tables and the 1994 US Group Annuity Mortality Static Tables. Pre-retirement mortality rates are based on custom tables with RP-2000 rates.

The actuarial assumptions used in the June 30, 2015 valuation were based on the most recent experience study dated December 20, 2010. Between experience studies, the Board of Trustees of the Employees' Retirement System of the State of Hawaii elected to lower the investment return assumption effective with the June 30, 2015 valuation.

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

NOTE G - EMPLOYEE BENEFIT PLANS (Continued)

are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

Asset Class	Target Allocation	Long-term Expected Real Rate of Return
Domestic equity	30.0%	8.5%
International equity	26.0%	9.3%
Total fixed income	20.0%	3.1%
Real estate	7.0% *	9.2%
Private equity	7.0% *	11.9%
Real return	5.0% *	6.7%
Covered calls	5.0%	7.7%
	100.0%	

* The real estate, private equity and real return targets will be the percentage actually invested up to 7.0%, 7.0% and 5.0%, respectively, of the total fund. Changes in the real estate, private equity and real return targets will be offset by an equal percentage change in the large cap domestic equity target.

Discount Rate - The discount rate used to measure the net pension liability was 7.65%, a decrease from the 7.75% 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 Fund's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate - The following presents the Fund's proportionate share of the net pension liability calculated using the discount rate of 7.65%, as well as what the Fund's proportionate share of the net pension liability would be if it were calculated using a discount rate that is one percentage point lower (6.65%) or one percentage point higher (8.65%) than the current rate:

	1% Decrease (6.65%)	Discount Rate (7.65%)	1% Increase (8.65%)
Fund's proportionate share of the net pension liability	$ 1,865,378	$ 1,481,120	$ 1,096,860

NOTE G - EMPLOYEE BENEFIT PLANS (Continued)

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' complete financial statements are available at: http://www.ers.ehawaii.gov.

Payables to the Pension Plan - At June 30, 2016, the amount payable to the ERS was approximately $13,000.

(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 Healthcare and Life Insurance Benefits*

The State contributes to the Hawaii Employer-Union Health Benefits Trust Fund ("EUTF"), an agent multiple-employer defined benefit plan. The EUTF was established to provide a single delivery system of health benefits for state and county workers, retirees, and their dependents. The eligibility requirements for retiree health benefits are based on date of hire.

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,

NOTE G - EMPLOYEE BENEFIT PLANS (Continued)

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 the State's total covered employee headcount 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 Fund's financial statements. The following table shows the allocated annual OPEB cost that has been allocated to the Fund for the year ended June 30, 2016:

Annual OPEB cost	$ 258,123
Less: contributions made	(111,890)
Increase in net OPEB obligation	146,233
Net OPEB obligation	
Beginning of year	744,861
End of year	$ 891,094

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, 2016, 2015, and 2014 approximated $112,000, $92,000, and $69,000, 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.

The Department is covered by the State's self-insured workers' compensation program for medical expenses of injured Department employees. However, the Department is required to pay temporary total and temporary partial disability benefits as long as the employee is on the Department's payroll. Because actual claims 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. Claims 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

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
SCHEDULE OF CASH RECEIPTS, DISBURSEMENTS AND CASH BALANCE
Fiscal Year Ended June 30, 2016

RECEIPTS		
Principal repayment on loans	$	8,251,499
Interest income from loans		385,827
State contributions		1,769,000
Federal contributions		25,262,865
Administrative loan fees		2,417,690
Other interest income		289,073
Total receipts		38,375,954
DISBURSEMENTS		
Disbursement of loan proceeds		30,460,917
Administrative		2,506,027
Total disbursements		32,966,944
Excess of receipts over disbursements		5,409,010
EQUITY IN CASH AND CASH EQUIVALENTS AND INVESTMENTS IN STATE TREASURY		
Beginning of fiscal year		46,981,973
End of fiscal year	$	52,390,983

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
COMBINING STATEMENT OF NET POSITION
June 30, 2016

	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	$ 48,839,552	$ 3,551,431	$ 52,390,983
Loan fees receivable	--	657,038	657,038
Accrued interest on loans	95,468	--	95,468
Other accrued interest	82,423	--	82,423
Due from federal government	--	114,589	114,589
Due from State Treasury	--	18,372	18,372
Accounts receivable	--	2,160	2,160
Current maturities of loans receivable	8,880,669	--	8,880,669
Total current assets	57,898,112	4,343,590	62,241,702
Loans receivable, net of current maturities	127,110,301	--	127,110,301
Capital assets, net of accumulated depreciation	--	719,979	719,979
Total assets	185,008,413	5,063,569	190,071,982
Deferred outflows of resources related to pensions	--	340,653	340,653
Total assets and deferred outflows of resources	$ 185,008,413	$ 5,404,222	$ 190,412,635

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
COMBINING STATEMENT OF NET POSITION (Continued)
June 30, 2016

	State Revolving Fund Activity	Non-SRF Activity	Total
LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION			
Current liabilities			
Accounts payable and other accrued liabilities	$ --	$ 378,870	$ 378,870
Total current liabilities	--	378,870	378,870
Accrued vacation, net of current portion	--	161,011	161,011
Net pension liability	--	1,481,120	1,481,120
Other postemployment benefits	--	891,094	891,094
Total liabilities	--	2,912,095	2,912,095
Deferred inflows of resources related to pensions	--	574,808	574,808
Net position			
Net investment in capital assets	--	719,979	719,979
Restricted - expendable	185,008,413	1,197,340	186,205,753
Total net position	185,008,413	1,917,319	186,925,732
Total liabilities, deferred inflows of resources, and net position	$ 185,008,413	$ 5,404,222	$ 190,412,635

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
COMBINING STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION
Fiscal Year Ended June 30, 2016

	State Revolving Fund Activity	Non-SRF Activity	Total
OPERATING REVENUES			
Interest income from loans	$ 390,359	$ --	$ 390,359
Administrative loan fees	--	2,384,819	2,384,819
Total operating revenues	390,359	2,384,819	2,775,178
OPERATING EXPENSES			
Administrative	--	1,331,275	1,331,275
State program management	--	866,284	866,284
Water protection	--	786,602	786,602
Principal forgiveness for SRF	2,243,543	--	2,243,543
Small systems technical assistance	--	21,353	21,353
Total operating expenses	2,243,543	3,005,514	5,249,057
Operating loss	(1,853,184)	(620,695)	(2,473,879)
NONOPERATING REVENUES			
State contributions	1,769,000	--	1,769,000
Federal contributions	23,382,539	1,904,712	25,287,251
Other interest income	314,317	--	314,317
Total nonoperating revenues	25,465,856	1,904,712	27,370,568
Interfund transfers	981,538	(981,538)	--
Change in net position	24,594,210	302,479	24,896,689
NET POSITION			
Beginning of fiscal year	160,414,203	1,614,840	162,029,043
End of fiscal year	$ 185,008,413	$ 1,917,319	$ 186,925,732

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
SCHEDULE OF OPERATING EXPENSES
Fiscal Year Ended June 30, 2016

	State Revolving Fund Activity	Non-SRF Activity	Total
Principal forgiveness for SRF	$ 2,243,543	$ --	$ 2,243,543
Personnel	--	1,333,140	1,333,140
Professional services	--	468,376	468,376
Services rendered by other State agencies	--	343,861	343,861
Pension expense	--	207,062	207,062
Intergovernmental personnel agreement expenses	--	195,663	195,663
Depreciation	--	188,384	188,384
Travel	--	80,502	80,502
Training	--	56,984	56,984
Repairs and maintenance	--	50,396	50,396
Office and other supplies	--	26,718	26,718
Rental	--	6,028	6,028
Telephone	--	940	940
Miscellaneous	--	47,460	47,460
Total operating expenses	$ 2,243,543	$ 3,005,514	$ 5,249,057

PART II

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS

N&K CPAs, Inc.
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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 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 State of Hawaii, Drinking Water Treatment Revolving Loan Fund (the "Fund"), as of and for the fiscal year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the Fund's basic financial statements and have issued our report thereon dated December 9, 2016.

Internal Control Over Financial Reporting

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

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

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

Compliance and Other Matters

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

N&K CPAs, INC.

Honolulu, Hawaii
December 9, 2016

PART III

REPORT ON COMPLIANCE FOR A FEDERAL PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE

N&K CPAs, Inc.
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REPORT ON COMPLIANCE FOR A FEDERAL PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE WHEN USING THE PROGRAM-SPECIFIC AUDIT OPTION TO SATISFY THE 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, Department of Health, Drinking Water Treatment Revolving Fund's (the "Fund") 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 Drinking Water State Revolving Funds Program (the "Program") for the fiscal year ended June 30, 2016.

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 Fund'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 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 Fund'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 Fund's Program. However, our audit does not provide a legal determination of the Fund's compliance.

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

In our opinion, the Fund complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its Program for the fiscal year ended June 30, 2016.

Report on Internal Control Over Compliance

Management of the Fund 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 Fund'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 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 Fund'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.

N&K CPAs, Inc.

Honolulu, Hawaii
December 9, 2016

PART IV

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

Ref. No.	Financial Statement Findings
2015-001	**Prior Period Adjustment**

Criteria: Capital assets are defined as those assets with estimated useful lives greater than one year and with an acquisition cost greater than $5,000.

Finding and Cause and Effect: Management brought to our attention during our audit that $623,714 of equipment purchased during fiscal year 2012 was erroneously expensed. Calculated accumulated depreciation on this equipment as of June 30, 2014 totaled $200,479. The effect of properly recording this equipment and accumulated depreciation is an increase in net position of $423,234 as of June 30, 2014.

Status

Resolved. No similar instances noted.