

State of Hawai'i Department of Hawaiian Home Lands

Financial and Compliance Audit

June 30, 2016

**Submitted by
The Auditor
State of Hawai'i**

State of Hawai‘i
Department of Hawaiian Home Lands
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June 30, 2016

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PART I
Financial Section

Report of Independent Auditors

The Auditor
State of Hawaii

The Hawaiian Homes Commission
Department of Hawaiian Home Lands

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the State of Hawai'i, Department of Hawaiian Home Lands (the "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 index.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express 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 auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the Department'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 Department'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, 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 the respective budgetary comparison for the General Fund and the Hawaiian Home Administration Account 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 1, the financial statements of the Department include only the governmental activities, each major fund, and the aggregate remaining fund information of the Department, and are not intended to present fairly the financial position of the State of Hawai'i (the "State") as of June 30, 2016, and the changes in its financial position 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 and budgeting comparison information on pages 4 through 11 and pages 18 through 19, respectively, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

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

The combining nonmajor fund financial statements and the schedule of expenditures of federal awards are the responsibility of management and were derived from and relate 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 combining nonmajor fund financial statements and the schedule of expenditures of federal awards are fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated December 21, 2016 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.

Accuity LLP

Honolulu, Hawai'i
December 21, 2016

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Management’s Discussion and Analysis (Unaudited)
June 30, 2016

The following Management’s Discussion and Analysis (“MD&A”) is designed to provide an overview of the financial performance of the State of Hawai‘i, Department of Hawaiian Home Lands (the “Department”) for the fiscal year ended June 30, 2016. Please read it in conjunction with the Department’s financial statements, which follow this section.

Financial Highlights for Fiscal Year 2016

- The Department’s net position, the amount of assets exceeding liabilities, totaled \$815.8 million. Of this amount, \$210.8 million is unrestricted, \$146.4 million is restricted, and \$458.6 million is net investment in capital assets.
- The Department’s net position increased \$13.5 million over the course of this year’s operations.
- In fiscal year 2016, the Department’s revenues exceeded expenses (before transfers) by \$13.5 million. In fiscal year 2015, the expenses exceeded revenues (before transfers) by \$3.8 million.
- The total revenues of the Department increased by \$12.0 million, or 21.2%.
- The total fund balance of the Department’s governmental funds increased by \$21.1 million.

Overview of the 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) department-wide financial statements, (2) fund financial statements, and (3) notes to the financial statements. This report also contains other supplementary information (combining financial statements – nonmajor governmental funds) in addition to the basic financial statements.

The first two statements are department-wide financial statements that provide both long-term and short-term information about the Department’s overall financial status and operations.

The fund financial statements focus on individual parts of the Department, reporting the Department’s status and operations in more detail than the department-wide financial statements. These statements detail how general departmental services were financed in the short-term as well as what remains for future spending.

The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data.

Department-Wide Financial Statements

The department-wide financial statements provide a broad view of the Department’s operations. The statements provide both short-term and long-term information about the Department’s financial position and activities, which assists in assessing the Department’s economic condition at the end of the fiscal year and operations for the year then ended. These statements are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. The department-wide financial statements include two statements:

- The statement of net position presents all of the Department’s assets and liabilities. The difference between the assets and liabilities is reported as net position.

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- The statement of activities presents information showing how the Department’s net position changed during the fiscal year. This statement presents a comparison between direct expenses and program revenues for each division of the Department.

The activities of the Department are mostly supported by state appropriation, rental income from commercial land leases, and intergovernmental revenues. The Department’s basic services fall under these types of activities.

Fund Financial Statements

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 legal requirements.

The fund financial statements provide more detailed information about the Department’s status and operations. Certain of the Department’s funds were established under State of Hawaii (“State”) Law or by bond covenants. Other funds of the Department are established by the Hawaiian Homes Commission Act. These funds manage money for particular purposes.

The Department only has governmental funds which finance the Department’s basic services. Governmental funds are used to account for essentially the same functions reported as governmental activities in the department-wide financial statements. However, unlike the department-wide financial statements, the fund financial statements focus on near-term inflows and outflows of spendable resources as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating the Department’s short-term financing requirements.

Because the focus of fund financial statements is narrower than that of the department-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the department-wide financial statements. By doing so, readers may better understand the long-term impact of the Department’s short-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The Department has 15 governmental funds, nine of which are separately disclosed as major funds for presentation purposes. Each major fund is presented in a separate column in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures and changes in fund balance. These funds are briefly described as follows:

- **General Fund** – The General Fund is authorized and appropriated by the State Legislature each year for planning, development, management and general support for the Hawaiian Homestead Program.
- **Hawaiian Home General Loan Fund** – Act 249, SLH 1986, amended this revolving loan fund and consolidated all loan funds other than the Hawaiian Home Loan Fund in 1986. The major source of receipts for this fund is through principal repayment. The Department can make loans from the revolving funds for the construction of homes, home repairs or additions, or for the development and operation of a farm, ranch or agriculture operation.

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- **Hawaiian Home Lands Trust Fund** – This fund was established by Act 14, Special Session 1995, which settles all claims made on behalf of the Hawaiian Home Land Trust against the State between August 21, 1959 and July 1988. It requires that the State make twenty annual deposits of \$30 million or their discounted equivalent into the Hawaiian Home Lands Trust Fund. Proceeds of the fund may be used by the Department for capital improvements and other purposes undertaken in furtherance of the Hawaiian Homes Commission Act of 1920, as amended.
- **Hawaiian Home Operating Fund** – This fund was established through a merger of the Hawaiian Home Development Fund and Hawaiian Home Operating Fund in 1986. Any interest or earnings arising out of investments from the Hawaiian Home Loan Fund are to be credited to and deposited into the Hawaiian Home Operating Fund. All monies received by the Department from any other source, other than those prescribed in other funds of the Hawaiian Homes Commission Act, are deposited into this fund. The Department uses the fund for the construction, operation and maintenance of revenue-producing activities that are intended to serve principally occupants on Hawaiian home lands. The fund is also used to finance improvements and developments necessary to serve present and future occupants of Hawaiian home lands.
- **Hawaiian Home Receipts Fund** – All interest monies from loans or investments received by the Department from any fund, except the Hawaiian Home Loan Fund, Hawaiian Home Administration Account, Native Hawaiian Rehabilitation Fund, Department of Hawaiian Home Lands Revenue Bond Special Fund and Hawaiian Home Lands Trust Fund, are deposited into this fund. This fund serves as a clearing fund at the end of each quarter. All monies in this fund are transferred to other funds as authorized by the Hawaiian Homes Commission Act.
- **Hawaiian Home Administration Account** – The revenue sources of this fund are the entire receipts from any leasing or other dispositions of “available lands” and any interest or other earnings arising out of investments from this fund. The Department expends the monies for salaries and all other administrative expenses of the Department, excluding capital improvements, in the absence of general funds appropriated for operating and administrative costs.
- **Federal Grants** – The Department is the recipient of an annual block grant under the Native American Housing Assistance and Self-Determination Act of 1996 (“NAHASDA”). The U.S. Department of Housing and Urban Development (“HUD”) is the cognizant entity of the NAHASDA grant in carrying out affordable housing activities for Native Hawaiian families qualified for this program.
- **Hawaiian Home Trust Fund** – Monies deposited into this fund are available for transfers into any other fund or account authorized by the Act or for any public purpose to further the purposes of the Act. Public purpose includes using the Hawaiian Home Trust Fund as a reserve for loans insured or guaranteed by the HUD Federal Housing Administration, Veteran Administration or any other federal agency authorized to insure or guarantee loans. A major portion in the Hawaiian Home Trust Fund is the reserve for loans insured by the HUD Federal Housing Administration.
- **Hawaiian Home Lands Bond Funds** – The bond funds are authorized and appropriated by the State Legislature each year for construction projects or grant in aid funds for projects or grants which benefit the trust’s beneficiaries or community organizations.

The accompanying notes to the financial statements are part of the financial statements. The notes provide additional information that is essential to gain a full understanding of the information provided in the department-wide and fund financial statements.

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In addition to the basic financial statements and accompanying notes, this report also presents other supplementary information consisting of the combining balance sheet and combining statement of revenues, expenditures and changes in fund balances in connection with nonmajor governmental funds and schedule of expenditures of federal awards.

Financial Analysis of the Department as a Whole

Net Position

The Department’s total net position increased by \$13.5 million to \$815.8 million between fiscal years 2016 and 2015, primarily due to the additional appropriation of general funds the Department received in the fourth quarter of fiscal year 2016 in accordance with Act 119, as amended by Act 124, SLH 2016.

A large portion of the Department’s net position (56%) reflects its investment in capital assets such as land, buildings, infrastructure, furniture and equipment, and construction-in-progress. The Department uses these capital assets to provide improvements on a special class of public lands, which are leased to native Hawaiians; consequently, these assets cannot be sold. Although the Department’s investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets cannot be used to liquidate these liabilities.

The following is a comparative statement of net position:

Summary of Statement of Net Position
(in millions)

	2016	2015	Increase (Decrease)
Current and other assets	\$ 428.6	\$ 402.0	\$ 26.6
Capital assets	523.1	535.1	(12.0)
Total assets	<u>951.7</u>	<u>937.1</u>	<u>14.6</u>
Long-term debt outstanding	62.1	65.4	(3.3)
Other liabilities	73.8	69.4	4.4
Total liabilities	<u>135.9</u>	<u>134.8</u>	<u>1.1</u>
Net position			
Net investment in capital assets	458.6	467.2	(8.6)
Restricted	146.4	141.2	5.2
Unrestricted	210.8	193.9	16.9
	<u>\$ 815.8</u>	<u>\$ 802.3</u>	<u>\$ 13.5</u>

Change in Net Position

The Department’s total program revenues decreased from \$45.8 million in fiscal year 2015 to \$40.9 million in fiscal year 2016 (see statement of activities). Approximately 33.5% of the Department’s program revenues came from interest income, 28.6% came from grants and contributions, 36.9% came from the general lease program, and 1.0% came from other sources. Total general revenues decreased by 31.1% to \$27.7 million due to the Department receiving the final installment of the Act 14, Special SLH 1995 at the end of fiscal year 2015, which was partially offset by the Department receiving

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additional general fund appropriations for construction projects and grants in aid funding for community organizations during fiscal year 2016.

Statement of Activities

The statement of activities presents how the Department’s net position changed during the current fiscal year. Revenues and expenses are reported as soon as the underlying event occurs, regardless of the timing of the related cash flows. As such, the statement includes information for some items that will result in cash flows in future fiscal periods (e.g., uncollected lease payments).

The following is a comparative summary of changes in net position:

	Summary of Changes in Net Position (in millions)		
	2016	2015	Increase (Decrease)
Revenues			
Program revenue			
Administration and support services	\$ 6.9	\$ 4.4	\$ 2.5
Homestead services	7.2	6.0	1.2
Land development	-	4.4	(4.4)
Home construction	-	0.4	(0.4)
Land management	15.1	15.8	(0.7)
Intergovernmental revenues	11.7	14.8	(3.1)
Appropriation, net of lapsed appropriations	27.7	10.8	16.9
Total revenues	<u>68.6</u>	<u>56.6</u>	<u>12.0</u>
Expenses			
Administration and support services	15.1	13.1	2.0
Homestead services	28.9	29.4	(0.5)
Land development	4.3	2.4	1.9
Home construction	3.2	3.9	(0.7)
Land management	3.6	4.0	(0.4)
Total expenses	<u>55.1</u>	<u>52.8</u>	<u>2.3</u>
Excess of revenues over expenses	13.5	3.8	9.7
Transfers, net	-	29.4	(29.4)
Change in net position	13.5	33.2	(19.7)
Net position			
Beginning of year	<u>802.3</u>	<u>769.1</u>	<u>33.2</u>
End of year	<u>\$ 815.8</u>	<u>\$ 802.3</u>	<u>\$ 13.5</u>

As noted, net position increased by \$13.5 million from operations, a 1.7% growth this year, compared to an increase of \$33.2 million, a 4.3% growth in fiscal year 2015. The fiscal year 2016 increase is primarily due to an increase in bonds funds received for construction projects and general funds, offset by a slight increase in expenses in fiscal year 2016.

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Financial Analysis of the Department’s Governmental Funds

Governmental Funds

The focus of the Department’s governmental funds is to provide information on short-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the Department’s financing requirements. In particular, unassigned fund balances may serve as a useful measure of a government’s net resources available for spending at the end of the fiscal year.

As of the end of fiscal year 2016, the Department’s governmental funds reported a combined increase in fund balance of \$21.1 million. The changes in fund balance for the governmental funds differ from the change in net position for governmental activities. The differences relate to certain financial resources and expenditures such as debt financing and capital outlays that are included in the changes in fund balances but are not reported in the changes in net position.

Comparison of Balance Sheet
(in millions)

	Assets			Liabilities			Fund Balances (Deficit)		
	2016	2015	Change	2016	2015	Change	2016	2015	Change
General Fund	\$ 0.9	\$ 0.7	\$ 0.2	\$ 0.8	\$ 0.1	\$ 0.7	\$ 0.1	\$ 0.6	\$ (0.5)
General Loan Fund	94.4	87.2	7.2	31.9	29.5	2.4	62.5	57.7	4.8
Land Trust Fund	159.7	168.3	(8.6)	1.2	2.6	(1.4)	158.5	165.7	(7.2)
Operating Fund	37.6	20.4	17.2	1.1	1.3	(0.2)	36.5	19.1	17.4
Receipts Fund	6.0	5.7	0.3	4.0	3.9	0.1	2.0	1.8	0.2
Administration									
Account	35.8	38.9	(3.1)	3.9	4.3	(0.4)	31.9	34.6	(2.7)
Federal Grants	38.8	35.6	3.2	29.7	27.2	2.5	9.1	8.4	0.7
Trust Fund	42.9	40.4	2.5	30.7	28.2	2.5	12.2	12.2	-
HHL Bond Funds	12.4	4.2	8.2	0.6	-	0.6	11.8	4.2	7.6
Other Funds	30.8	28.8	2.0	3.7	2.5	1.2	27.1	26.3	0.8
Total	\$ 459.3	\$ 430.2	\$ 29.1	\$ 107.6	\$ 99.6	\$ 8.0	\$ 351.7	\$ 330.6	\$ 21.1

Comparison of Statement of Revenues, Expenditures and Changes in Fund Balances
(in millions)

	Revenues			Expenditures			Other Financing Sources and Lapsed Appropriations			Net Changes in Fund Balances (Deficit)		
	2016	2015	Change	2016	2015	Change	2016	2015	Change	2016	2015	Change
General Fund	\$ 16.7	\$ 8.3	\$ 8.4	\$ 7.8	\$ 7.6	\$ 0.2	\$ (9.4)	\$ (1.7)	\$ (7.7)	\$ (0.5)	\$ (1.0)	\$ 0.5
General Loan Fund	0.9	-	0.9	0.1	0.5	(0.4)	4.0	2.6	1.4	4.8	2.1	2.7
Land Trust Fund	2.2	5.4	(3.2)	9.4	18.4	(9.0)	-	29.4	(29.4)	(7.2)	16.4	(23.6)
Operating Fund	1.0	0.9	0.1	4.1	4.0	0.1	20.5	6.0	14.5	17.4	2.9	14.5
Receipts Fund	4.2	5.1	(0.9)	-	-	-	(4.0)	(3.6)	(0.4)	0.2	1.5	(1.3)
Administration												
Account	15.4	15.8	(0.4)	6.8	7.5	(0.7)	(11.3)	(4.3)	(7.0)	(2.7)	4.0	(6.7)
Federal Grants	12.3	14.5	(2.2)	11.6	16.8	(5.2)	-	-	-	0.7	(2.3)	3.0
Trust Fund	-	-	-	-	-	-	-	0.9	(0.9)	-	0.9	(0.9)
HHL Bond Funds	11.3	2.4	8.9	3.7	0.4	3.3	-	-	-	7.6	2.0	5.6
Other Funds	3.7	3.7	0.0	2.9	3.8	(0.9)	-	-	-	0.8	(0.1)	0.9
Total	\$ 67.7	\$ 56.1	\$ 11.6	\$ 46.4	\$ 59.0	\$ (12.6)	\$ (0.2)	\$ 29.3	\$ (29.5)	\$ 21.1	\$ 26.4	\$ (5.3)

Overall, the assets for the Department increased by \$29.1 million, liabilities increased by \$8.0 million, and fund balance increased by \$21.1 million.

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Budgetary Highlights

In fiscal year 2016, the General Fund Account received appropriations amounting to \$16.7 million. This amount was expended according to the budget except \$184,454 was lapsed.

In the Hawaiian Home Administration Account, the actual revenue exceeded the budgeted amount by \$1.7 million and expenditures were \$6.8 million less than the budgeted amount. The overall favorable variance of \$8.5 million was created by expenditure control measures.

Capital Asset and Debt Administration

Capital Assets

At the end of fiscal year 2016, the Department had invested \$801.6 million in a broad range of capital assets, including land, building and improvements, furniture and equipment, and infrastructure. This amount represents a net increase (including additions, deductions and reclassifications) of \$11.3 million, or 1.4%, over last year.

Capital Assets
(in millions)

	2016	2015	Increase (Decrease)
Buildings and improvements	\$ 29.2	\$ 29.2	\$ -
Furniture and equipment	5.6	5.6	-
Motor vehicles	1.3	1.0	0.3
Infrastructure	<u>713.9</u>	<u>687.9</u>	<u>26.0</u>
Total depreciable assets	750.0	723.7	26.3
Less: Accumulated depreciation	<u>(278.5)</u>	<u>(255.2)</u>	<u>(23.3)</u>
Net depreciable assets	471.5	468.5	3.0
Land	41.8	41.8	-
Construction in progress	<u>9.8</u>	<u>24.8</u>	<u>(15.0)</u>
Total capital assets	<u>\$ 523.1</u>	<u>\$ 535.1</u>	<u>\$ (12.0)</u>

In fiscal year 2016, the Department expended \$26.3 million for various capital projects, including \$12.4 million for East Kapolei 2 (Increment II-B Development), \$11.1 million for Laiopua Village 4, Ph 1 (Akau Subdivision), and \$2.7 million for various other projects.

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Long-Term Debt

In 2009, the Department issued Revenue Bonds, Series 2009, to fund the planning, design and construction projects on the Hawaiian Home Lands. The Department also has a note payable to reimburse the Housing and Community Development Corporation of Hawai‘i for infrastructure costs over a 15-year period. The Department is also obligated to repay a portion of the State general obligation bonds issued on the Department’s behalf through reimbursable general obligation bonds.

Outstanding Debt
(in millions)

	2016	2015	Decrease
Notes payable	\$ 8.1	\$ 9.8	\$ (1.7)
Capital lease obligation	19.3	20.2	(0.9)
Bonds payable, net	37.1	37.9	(0.8)
Total	<u>\$ 64.5</u>	<u>\$ 67.9</u>	<u>\$ (3.4)</u>

Economic Factors and Next Year’s Budgets

Revenues generated from general leases, revocable permits, licenses and right of entry agreements are projected to total \$13.1 million. This represents an increase of 1.6% from the prior fiscal year projection. The increase is primarily due to scheduled increases in rents and fees.

Currently Known Facts or Decisions

As stewards of the Hawaiian Home Lands Trust, the Department remains focused on the core mission of returning native Hawaiians to the land, as envisioned by founder Prince Jonah Kuhio Kalaniana‘ole.

In the ongoing effort to effectively manage the trust, the Department spent much of the fiscal year laying the foundation for major changes that will have profound impacts on the future of the trust and the beneficiaries we serve.

At the top of the Department’s list of priorities is stabilizing department funding in light of the *Nelson v. Hawaiian Homes Commission* ruling and the end of the Act 14 settlement payments. This responsibility is a deliberate balancing act as the Department also strives to meet an ever growing beneficiary demand for homesteading opportunities.

Last year, the Department received its first appropriation of general funds since 2010. While the appropriation of \$9.6 million fell short of the \$25.7 million the Department determined to be sufficient to cover operating expenses, the Department and the Hawaiian Homes Commission looks forward to working with the State Legislature to ensure “sufficient sums,” as determined by the court, are available for the Department.

In addition to stabilizing department funding, the priorities for the fiscal year include improving service to beneficiaries by increasing affordability of the Department’s housing products, supporting the existing communities, reviving the agricultural homesteading program, and maximizing the management of natural resources including water and renewable energy resources.

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Statement of Net Position
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Assets

Equity in cash and cash equivalents and investments held in State Treasury	\$ 282,887,732
Receivables	
Due from State Treasury	13,258,098
Due from Federal Agency	1,567,967
Loans, net of allowance for losses of \$13,806,000	82,662,525
Accrued interest	5,742,517
General leases and licenses, net of allowance for losses of \$2,191,000	3,107,105
Other	3,834,162
Inventory of homes purchased from former lessees	4,347,486
Inventory of homes for sale and development	169,554
Restricted cash and short-term investments held outside of State Treasury	31,074,415
Capital assets, net	523,110,392
Total assets	<u>\$ 951,761,953</u>

Liabilities and Net Position

Liabilities

Vouchers and contracts payable	\$ 6,447,629
Accrued wages and employee benefits payable	43,083
Due to State Treasury	26,519,263
Due to Federal agency	160
Interest payable	685,050
Temporary deposits payable	30,664,409
Other liabilities	4,406,248
Unearned revenue	1,186,763
Due within one year	
Notes payable	1,700,000
Capital lease obligation	860,000
Bonds payable	865,097
Accrued vacation	459,070
Due in more than one year	
Notes payable	6,400,000
Capital lease obligation	18,475,000
Bonds payable, net of discount of \$396,000	36,258,577
Accrued vacation	1,000,149
Total liabilities	<u>135,970,498</u>

Commitments and contingencies

Net position

Net investment in capital assets	458,551,718
Restricted for	
Capital projects	51,893,444
Debt reserve agreements	9,337,295
Loans and loan commitments	82,662,525
Guaranteed and insured loans	2,500,000
Unrestricted	210,846,473
Total net position	<u>815,791,455</u>
Total liabilities and net position	<u>\$ 951,761,953</u>

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

State of Hawai‘i
Department of Hawaiian Home Lands
Statement of Activities
June 30, 2016

Functions / Programs	Program Expenses	Program Revenue		Net (Expense) Revenue and Changes in Net Position
		Charges for Services	Operating Grants and Contributions	
Administration and support services	\$ 15,066,273	\$ 6,852,056	\$ 4,765,110	\$ (3,449,107)
Homestead services	28,935,783	7,189,177	-	(21,746,606)
Land development	4,303,711	-	6,934,849	2,631,138
Home construction	3,185,230	-	-	(3,185,230)
Land management	3,642,360	15,126,822	-	11,484,462
Total governmental activities	<u>\$ 55,133,357</u>	<u>\$ 29,168,055</u>	<u>\$ 11,699,959</u>	(14,265,343)
General revenues				
State appropriations, net of lapsed appropriations of \$210,079				<u>27,777,695</u>
Total general revenues				<u>27,777,695</u>
Change in net position				13,512,352
Net position at July 1, 2015				<u>802,279,103</u>
Net position at June 30, 2016				<u>\$ 815,791,455</u>

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

State of Hawai‘i
Department of Hawaiian Home Lands
Balance Sheet
Governmental Funds
June 30, 2016

	General Fund	Hawaiian Home General Loan Fund	Hawaiian Home Lands Trust Fund	Hawaiian Home Operating Fund	Hawaiian Home Receipts Fund	Hawaiian Home Administration Account	Federal Grants	Hawaiian Home Trust Fund	Hawaiian Home Lands Bond Funds	Other Funds	Total
Assets											
Equity in cash and cash equivalents and investments held in State Treasury	\$ -	\$ 21,687,555	\$ 156,675,015	\$ 36,902,520	\$ 307,297	\$ 30,077,984	\$ 7,152	\$ 12,199,529	\$ -	\$ 25,030,680	\$ 282,887,732
Cash and short-term investments											
Receivables											
Due from other funds	-	-	-	-	-	-	-	30,664,410	-	-	30,664,410
Due from State	824,159	-	-	-	-	-	43,051	-	12,390,888	-	13,258,098
Due from Federal agency	-	1,567,967	-	-	-	-	-	-	-	-	1,567,967
Loans, net of allowance for losses of \$13,806,000	-	66,758,777	-	-	-	-	14,003,767	-	-	1,899,981	82,662,525
Accrued interest	-	-	-	24,735	5,644,034	-	73,748	-	-	-	5,742,517
General leases and licenses, net of allowance for losses of \$2,191,000	-	-	-	-	-	3,107,105	-	-	-	-	3,107,105
Other	-	150,214	2,873,877	721,697	-	70,378	17,996	-	-	-	3,834,162
Inventory of homes purchased from former lessees	-	4,254,486	-	-	-	-	-	-	-	93,000	4,347,486
Inventory of homes for sale and development	-	-	169,554	-	-	-	-	-	-	-	169,554
Restricted cash and short-term investments held outside of State Treasury	-	-	-	-	-	2,550,374	24,735,714	-	1,406	3,786,921	31,074,415
Total assets	\$ 824,159	\$ 94,418,999	\$ 159,718,446	\$ 37,648,952	\$ 5,951,331	\$ 35,805,841	\$ 38,881,428	\$ 42,863,939	\$ 12,392,294	\$ 30,810,582	\$ 459,315,971
Liabilities and Fund Balances											
Liabilities											
Vouchers and contracts payable	\$ 750,786	\$ -	\$ 1,207,026	\$ 279,580	\$ -	\$ 901,044	\$ 3,418,216	\$ -	\$ 597,744	\$ 764,117	\$ 7,918,513
Accrued wages and employee benefits payable	-	-	-	-	-	43,083	-	-	-	-	43,083
Due to other funds	-	30,455,949	-	208,461	-	-	-	-	-	-	30,664,410
Due to State Treasury	-	-	-	172,690	16,650	-	26,329,923	-	-	-	26,519,263
Due to Federal agency	-	-	-	160	-	-	-	-	-	-	160
Temporary deposits payable	-	-	-	-	-	-	-	30,664,409	-	-	30,664,409
Other liabilities	-	1,460,275	-	-	-	-	-	-	-	2,945,973	4,406,248
Unearned revenue	-	-	-	442,851	3,959,568	2,963,433	-	-	-	-	7,365,852
Total liabilities	750,786	31,916,224	1,207,026	1,103,742	3,976,218	3,907,560	29,748,139	30,664,409	597,744	3,710,090	107,581,938
Fund balances											
Restricted for											
Debt agreements	-	-	-	-	-	2,550,374	-	-	-	6,786,921	9,337,295
Guaranteed and insured loans	-	150,000	-	-	-	-	-	2,350,000	-	-	2,500,000
Federal loan programs	-	-	-	-	-	-	20,829,627	-	-	-	20,829,627
Assigned to											
Home loans and homestead services	-	67,638,333	-	-	1,975,113	-	-	9,849,530	-	4,719,767	84,182,743
Land management	814,192	-	-	36,545,210	-	29,347,907	-	-	-	-	66,707,309
Home construction and land development	-	-	158,511,420	-	-	-	-	-	12,392,294	15,593,804	186,497,518
Unassigned	(740,819)	(5,285,558)	-	-	-	-	(11,696,338)	-	(597,744)	-	(18,320,459)
Total fund balances	73,373	62,502,775	158,511,420	36,545,210	1,975,113	31,898,281	9,133,289	12,199,530	11,794,550	27,100,492	351,734,033
Total liabilities and fund balances	\$ 824,159	\$ 94,418,999	\$ 159,718,446	\$ 37,648,952	\$ 5,951,331	\$ 35,805,841	\$ 38,881,428	\$ 42,863,939	\$ 12,392,294	\$ 30,810,582	\$ 459,315,971

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

State of Hawai‘i
Department of Hawaiian Home Lands
Reconciliation of the Governmental Funds Balance Sheet
to the Statement of Net Position
June 30, 2016

Total fund balances – governmental funds \$ 351,734,033

Amounts reported for governmental activities in the statement of net position are different because

Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds.

These assets consists of

Infrastructure assets	\$ 713,885,932	
Land	41,824,231	
Building and improvements	29,188,835	
Construction in progress	9,784,521	
Other capital assets	6,884,933	
Accumulated depreciation	<u>(278,458,060)</u>	
		523,110,392

Certain revenues not collected within 60 days after the end of the year are deferred in the funds.	6,179,089
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Accrued interest payable is not recognized in governmental funds.	(685,050)
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Long-term debt payment accruals are included as an expenditure for governmental funds but are included in bonds payable and capital lease obligation in the statement of net position.	1,470,884
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Some long-term liabilities are not due and payable in the current period and therefore are not reported in the funds, including

Notes payable	(8,100,000)
Capital lease obligation	(19,335,000)
Bonds payable	(37,123,674)
Accrued vacation	<u>(1,459,219)</u>

Net position of governmental activities	<u>\$ 815,791,455</u>
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The accompanying notes are an integral part of the financial statements.

State of Hawai‘i
Department of Hawaiian Home Lands
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
Year Ended June 30, 2016

	General Fund	Hawaiian Home General Loan Fund	Hawaiian Home Lands Trust Fund	Hawaiian Home Operating Fund	Hawaiian Home Receipts Fund	Hawaiian Home Administration Account	Federal Grants	Hawaiian Home Trust Fund	Hawaiian Home Lands Bond Funds	Other Funds	Total
Revenues											
State appropriations	\$ 16,712,774	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 11,275,000	\$ -	\$ 27,987,774
General leases	-	-	-	-	-	10,922,208	-	-	-	-	10,922,208
Licenses and permits	-	-	-	-	-	3,808,120	-	-	-	-	3,808,120
Interest from loans and note receivable	-	-	-	33,742	3,899,060	-	261,643	-	-	-	4,194,445
Investment income	-	-	952,546	15,843	317,258	203,045	-	-	-	108,542	1,597,234
Intergovernmental revenues	-	-	141,096	-	-	-	11,699,959	-	-	3,000,000	14,841,055
Other	-	915,669	1,056,799	1,039,977	-	379,484	434,645	-	-	555,752	4,382,326
Total revenues	16,712,774	915,669	2,150,441	1,089,562	4,216,318	15,312,857	12,396,247	-	11,275,000	3,664,294	67,733,162
Expenditures											
Current											
Administration and support services	4,236,627	-	51,710	1,633,958	-	3,780,223	1,870,787	-	3,162,000	128,401	14,863,706
Homestead services	1,918,294	117,143	-	1,584,352	-	1,039,716	12,750	-	-	-	4,672,255
Land development	789,531	-	1,520,714	236,000	-	442,036	1,299,654	-	-	-	4,287,935
Land management	845,391	-	490,032	640,844	-	1,564,774	47,895	-	-	7,007	3,595,943
Capital outlay											
Home construction/capital projects	-	-	7,315,535	6,679	-	-	8,402,581	-	495,890	-	16,220,685
Debt service											
Principal	-	-	-	19,845	-	-	-	-	-	752,500	772,345
Interest	-	-	-	1,191	-	-	-	-	-	2,008,080	2,009,271
Total expenditures	7,789,843	117,143	9,377,991	4,122,869	-	6,826,749	11,633,667	-	3,657,890	2,895,988	46,422,140
Excess (deficiency) of revenues over (under) expenditures	8,922,931	798,526	(7,227,550)	(3,033,307)	4,216,318	8,486,108	762,580	-	7,617,110	768,306	21,311,022
Other financing sources (uses)											
Transfers in	-	3,980,000	-	20,500,000	-	-	-	-	-	-	24,480,000
Transfers out	(9,223,784)	-	-	-	(3,980,000)	(11,273,402)	-	-	-	(2,814)	(24,480,000)
Total other financing sources (uses)	(9,223,784)	3,980,000	-	20,500,000	(3,980,000)	(11,273,402)	-	-	-	(2,814)	-
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	(300,853)	4,778,526	(7,227,550)	17,466,693	236,318	(2,787,294)	762,580	-	7,617,110	765,492	21,311,022
Lapsed appropriations	(184,454)	-	-	-	-	-	-	-	(25,625)	-	(210,079)
Net change in fund balances	(485,307)	4,778,526	(7,227,550)	17,466,693	236,318	(2,787,294)	762,580	-	7,591,485	765,492	21,100,943
Fund balances at July 1, 2015	558,680	57,724,249	165,738,970	19,078,517	1,738,795	34,685,575	8,370,709	12,199,530	4,203,065	26,335,000	330,633,090
Fund balances at June 30, 2016	\$ 73,373	\$ 62,502,775	\$ 158,511,420	\$ 36,545,210	\$ 1,975,113	\$ 31,898,281	\$ 9,133,289	\$ 12,199,530	\$ 11,794,560	\$ 27,100,492	\$ 351,734,033

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

State of Hawai‘i
Department of Hawaiian Home Lands
Reconciliation of the Governmental Funds Statement of Revenues,
Expenditures and Changes in Fund Balances to the Statement of Activities
Year Ended June 30, 2016

Net change in fund balances – governmental funds \$ 21,100,943

Amounts reported for governmental activities in the statement of activities are different because

Capital outlays are reported as expenditures in governmental funds, however in the statement of activities, the cost of capital assets is allocated over their estimated useful lives as depreciation expense.

In the current period, these amounts are

Capital outlay	\$ 11,335,459
Depreciation expense	<u>(23,356,728)</u>

Excess of capital outlay over depreciation expense	(12,021,269)
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Repayment of note payable is reported as an expenditure in governmental funds, but the payment reduces note payable in the statement of net position.	1,700,000
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Repayment of bond principal is reported as an expenditure in governmental funds, but the repayment reduces bonds payable in the statement of net position.	812,495
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Repayment of capital lease obligation is reported as an expenditure in governmental funds, but the repayment reduces the capital lease obligation in the statement of net position.	830,000
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Revenues in the statement of activities that do not provide current financial resources are not reported as revenues and are deferred in the governmental funds.	1,122,624
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The net increase in accrued vacation is reported in the statement of activities and does not require the use of current financial resources and therefore is not reported as expenditures in governmental funds.	(62,441)
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Long-term debt payment accruals are included as an expenditure for governmental funds but are included in bonds payable and capital lease obligation in the statement of net position.	<u>30,000</u>
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Change in net position of governmental activities	<u>\$ 13,512,352</u>
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The accompanying notes are an integral part of the financial statements.

State of Hawai‘i
Department of Hawaiian Home Lands
Statement of Revenues and Expenditures – Budget and Actual (Budgetary Basis)
General Fund (Unaudited)
Year Ended June 30, 2016

	Budgeted Amounts	Actual	Variance
	Original and Final	(Budgetary Basis)	Over (Under)
State appropriations	<u>\$ 9,875,687</u>	<u>\$ 16,712,774</u>	<u>\$ 6,837,087</u>
Expenditures			
Administration and support services	8,802,309	3,188,412	(5,613,897)
Homestead services	549,378	1,650,606	1,101,228
Land development	88,700	563,246	474,546
Land management	<u>435,300</u>	<u>708,097</u>	<u>272,797</u>
Total expenditures	<u>9,875,687</u>	<u>6,110,361</u>	<u>(3,765,326)</u>
Excess of revenues over expenditures	<u>\$ -</u>	<u>\$ 10,602,413</u>	<u>\$ 10,602,413</u>

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

State of Hawai‘i
Department of Hawaiian Home Lands
Statement of Revenues and Expenditures – Budget and Actual (Budgetary Basis)
Hawaiian Home Administration Account (Unaudited)
Year Ended June 30, 2016

	Budgeted Amounts	Actual	Variance
	Original and Final	(Budgetary Basis)	Over (Under)
Revenues	<u>\$ 13,517,243</u>	<u>\$ 15,312,857</u>	<u>\$ 1,795,614</u>
Expenditures			
Administration and support services	5,014,120	3,978,428	(1,035,692)
Homestead services	3,398,870	1,159,933	(2,238,937)
Land development	1,863,687	497,946	(1,365,741)
Land management	<u>3,240,566</u>	<u>1,080,944</u>	<u>(2,159,622)</u>
Total expenditures	<u>13,517,243</u>	<u>6,717,251</u>	<u>(6,799,992)</u>
Excess of revenues over expenditures	<u>\$ -</u>	<u>\$ 8,595,606</u>	<u>\$ 8,595,606</u>

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

State of Hawai‘i
Department of Hawaiian Home Lands
Notes to Financial Statements
June 30, 2016

1. Organization and Summary of Significant Accounting Policies

Financial Reporting Entity

The State of Hawai‘i, Department of Hawaiian Home Lands (the “Department”), is headed by the Hawaiian Homes Commission (“HHC”). The Department was established by Section 24 of Act 1 (the Hawai‘i State Government Reorganization Act of 1959), Second Special Session Laws of Hawai‘i 1959, and is responsible for the administration of the Hawaiian Homes Commission Act of 1920 enacted by the United States Congress. The Hawaiian Homes Commission Act (“HHCA”) sets aside certain public lands as Hawaiian home lands to be utilized in the rehabilitation of native Hawaiians. The financial statements include the public trusts controlled by the HHC.

The Department is part of the executive branch of the State of Hawai‘i (the “State”). The Department’s financial statements are intended to present the financial position and the changes in financial position, of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State that is attributable to the transactions of the Department. The State Comptroller maintains the central accounts for all State funds and publishes financial statements for the State annually which includes the Department’s assets, liabilities, net position and financial activities.

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

Department-Wide Financial Statements

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

The statement of activities demonstrates the degree to which the direct expenses of a given function are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Program revenues include charges to customers who purchase, use or directly benefit from goods or services provided by a given function. Program revenues also include grants and contributions that are restricted to meeting the operational or capital requirements of a particular function.

Appropriations and other items not properly included among program revenues are reported instead as general revenues. Resources that are dedicated internally are reported as general revenues rather than as program revenues.

Net position is restricted when constraints placed on them are either externally imposed or are imposed by constitutional provisions or enabling legislation.

Governmental 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

State of Hawai‘i
Department of Hawaiian Home Lands
Notes to Financial Statements
June 30, 2016

are collected within 60 days of the end of the current fiscal year end. Principal revenue sources considered susceptible to accrual include lease payments, sales, federal grants and interest on loans and investments, and interest receivable. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditure, as well as expenditures related to compensated absences, are recorded only when payment is due.

As of June 30, 2016, fund balances of the governmental funds are classified as follows:

- **Nonspendable** – Amounts that cannot be spent because they are either in nonspendable form or they are legally or contractually required to be maintained intact.
- **Restricted** – Amounts that are restricted for specific purposes due to constitutional provisions or enabling legislation or constraints that are externally imposed by creditors, grantors, contributors, or laws or regulations of other governments.
- **Committed** – Amounts that can be used only for specific purposes determined by a formal action of the State Legislature. The State Legislature is the highest level of decision-making authority for the Department. Commitments may be established, modified or rescinded only through formal acts by the State Legislature.
- **Assigned** – Amounts that do not meet the criteria to be classified as restricted or committed but that are intended to be used for specific purposes. Under the Department’s adopted policy, only the HHC may assign amounts for specific purposes.
- **Unassigned** – All other spendable amounts.

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.

Fund Accounting

The accounts of the Department are organized on the basis of funds, each of which is considered a separate accounting entity. The financial activities of each fund are accounted for with a separate set of self-balancing accounts which represent each fund’s assets, liabilities, fund balance, revenues and expenditures.

The financial activities of the Department that are reported in the accompanying governmental fund financial statements have been classified into the following major governmental funds:

General Fund

The General Fund is used to account for all financial resources except those required to be accounted for in another fund. The annual operating budget as authorized by the State Legislature provides the basic framework within which the resources and obligations of the General Fund are accounted for.

State of Hawai‘i
Department of Hawaiian Home Lands
Notes to Financial Statements
June 30, 2016

Special Revenue Funds

Special revenue funds are used to account for proceeds of specific revenue sources that are restricted to expenditures for specified purposes. Revenues are primarily from general leases, licenses and permits granted for commercial, residential, agricultural and pastoral uses, and interest and investment income. The Department's major special revenue funds are as follows:

- **Hawaiian Home General Loan Fund** – The Hawaiian Home General Loan Fund is used to account for Department loans made to native Hawaiian homesteaders.
- **Hawaiian Home Lands Trust Fund** – The Hawaiian Home Lands Trust Fund accounts for funds from the State to be expended by the Department, as provided by law upon approval by the Commission and used for capital improvements and other purposes undertaken in furtherance of the Hawaiian Homes Commission Act of 1920.
- **Hawaiian Home Operating Fund** – The Hawaiian Home Operating Fund is used to account for operations of the Department and is funded by monies transferred from the Hawaiian Home Receipts Fund.
- **Hawaiian Home Receipts Fund** – The Hawaiian Home Receipts Fund is used to account for receipts of investment interest and loan interest payments from the Department loans to homesteaders.
- **Hawaiian Home Administration Account** – The Hawaiian Home Administration Account is used to account for commercial general leases, revocable permits and licenses of “available” lands as defined under the HHCA. Lease revenues are used to fund operations of the Department.
- **Federal Grants** – The Federal Grants fund is used to account for grants the Department has with the Federal Government.
- **Hawaiian Home Trust Fund** – The Hawaiian Home Trust Fund is used to account for the loan principal and interest payments the Department collects on assumed loans from the Department of Housing and Urban Development (“HUD”) as part of the mortgage loan insurance agreement. The amounts maintained in this fund provide for payment of any mortgage insurance claims and expenditures incurred by HUD in connection with the lessee borrowings.
- **Hawaiian Home Lands Bond Funds** – The Hawaiian Home Lands Bond Funds are authorized and appropriated by the State Legislature each year for construction projects or grant-in-aid funds for projects or grants which benefit the trust's beneficiaries or community organizations.

Appropriations

An authorization granted by the State Legislature permitting a State agency, within established fiscal and budgetary controls, to incur obligations and to make expenditures. Appropriations are allotted quarterly. The allotted appropriations lapse if not expended by or encumbered at the end of the fiscal year, except for allotted appropriations related to capital projects.

State of Hawai‘i
Department of Hawaiian Home Lands
Notes to Financial Statements
June 30, 2016

Encumbrances

Encumbrance accounting, under which purchase orders, contracts and other commitments for the expenditure of monies are recorded in order to reserve that portion of the applicable appropriation, is employed as an extension of formal budgetary integration in the governmental fund types. Encumbrances at June 30, 2016 for the Department’s governmental funds were as follows:

	Contracts	Claims
General Fund	\$ 333,000	\$ 481,000
Lands Trust Fund	14,514,000	833,000
Operating Fund	3,662,000	764,000
Administration Account	1,718,000	512,000
Federal Grants	16,344,000	4,486,000
Bond Funds	11,391,000	1,000,000
Other Funds	112,000	700,000
Total	<u>\$ 48,074,000</u>	<u>\$ 8,776,000</u>

Equity in Cash and Cash Equivalents and Investments Held in State Treasury

The State Director of Finance is responsible for the safekeeping of cash and investments in the State Treasury in accordance with State laws. The Director of Finance may invest any monies of the State, which in the Director’s judgment, are in excess of the amounts necessary for meeting the immediate requirements of the State. Cash is pooled with funds from other State agencies and departments and deposited into approved financial institutions or in the State Treasury Investment Pool 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 these funds are held in the State cash pool, the Department does not manage these 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 State’s Comprehensive Annual Financial Report (“CAFR”) for the fiscal year ended June 30, 2016. The State’s CAFR can be found at the Department of Accounting and General Services’ (“DAGS”) website: <http://ags.hawaii.gov/accounting/annual-financial-reports/>.

Investments held in the State Treasury are reported at fair value within the fair value hierarchy established by general accepted accounting principles. For more information on investment fair values, refer to the State’s CAFR.

Cash and short-term investments held outside of State Treasury are held in a financial institution outside of the State of Hawai‘i.

State of Hawai‘i
Department of Hawaiian Home Lands
Notes to Financial Statements
June 30, 2016

Restricted Cash and Investments

Cash held with an escrow agent and invested until the repayment of certain obligations have been classified as restricted assets.

The Department invests funds held by Wells Fargo related to the capital lease obligation in money market funds. The investments are carried at fair value and are valued at the last reported sale price on the last business day of the year or at the last bid price if no sale was reported on that date. Unrealized gains are considered investment income and the funds are restricted to funding future capital lease payments.

Fair Value Measurements

For financial assets reported at fair value, the Department defines fair value as the price that would be received to sell an asset in the principal or most advantageous market in an orderly transaction between market participants. The Department measures fair value using assumptions developed based on market data obtained from independent external sources and the reporting entity's own assumptions. The hierarchy is broken down into levels based on the reliability of the inputs as follows:

- **Level 1** – Quoted prices (unadjusted) in active markets for identical assets or liabilities.
- **Level 2** – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- **Level 3** – Unobservable inputs for an asset or liability reflecting management's own assumptions. Level 3 inputs are used to measure fair value to the extent that observable Level 1 or 2 inputs are not available.

Due from State

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 and ownership 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 in the accompanying fund and department-wide financial statements.

Inventory of Homes for Sale and Development

Inventory of homes for sale and development are stated at the lower of cost or estimated net realizable value and includes the costs of land development and home construction, capitalized interest, real estate taxes, and direct overhead costs incurred during development and home construction.

Intrafund and Interfund Transactions

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

All interfund transfers are reflected in the governmental fund financial statements but are eliminated in the departmental financial statements.

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Capital Assets

Capital assets, which include land, buildings, improvements, equipment and infrastructure assets, are reported in the departmental financial statements. The capitalization thresholds are \$5,000 for equipment, and \$100,000 for infrastructure, and buildings and improvements with estimated useful lives of greater than one year. Maintenance and repairs are charged to operations when incurred. Purchased and constructed capital assets are valued at historical cost or estimated historical cost. Donated fixed assets are recorded at their fair market value at the date of donation.

Capital assets are depreciated on the straight-line method over the assets' estimated useful life as follows:

Machinery and equipment	5 – 7 years
Vehicles	5 years
Buildings and improvements	15 – 40 years
Infrastructure	30 years

The Department also has land in various parts of the State, some of which were transferred to it at no cost or at nominal cost.

Temporary Deposits Payable

As part of the mortgage loan insurance agreement, the Department assumes delinquent mortgage loans from HUD. The temporary deposits payable balance represents the amount of loans assumed, less any payments made to HUD, for the payment of future mortgage insurance claims.

Accumulated Vacation and Sick Leave

Vacation pay is accrued as earned by employees. Vacation pay can accumulate at the rate of one and three-quarter 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.

Sick leave accumulates at a rate of one and three-quarter days for each month of service without limit, but may be taken only in the event of illness or other incapacitation and is not convertible to pay upon termination of employment. Accordingly, accumulated sick leave is not included in the Department's statement of net position or governmental fund balance sheet. However, an employee who retires or leaves government service in good standing with 60 days or more in unused sick leave is entitled to additional service credit in the Employees' Retirement System of the State of Hawai'i ("ERS"). Accumulated sick leave as of June 30, 2016 was approximately \$4,452,000.

Lease Rents and Interest Income

The Department's governmental fund financial statement recognizes lease rent and mortgage interest of its governmental funds as revenues when they are measurable and available. The available criterion is satisfied when revenues are collectible during the period or soon enough thereafter to pay liabilities of the current period. Amounts not collected within 60 days after the end of the year approximated \$6,179,000 as of June 30, 2016, and are recorded as deferred revenue in the governmental funds balance sheet. The departmental financial statements present lease rents and mortgage interest under the accrual method of accounting.

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Use of Estimates

In preparing financial statements in conformity with GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

New Accounting Pronouncements

The GASB issued Statement No. 72, *Fair Value Measurement and Application*. The Statement enhances 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 also enhances fair value application guidance and disclosure. The requirements of this Statement are effective for reporting periods beginning after June 15, 2015. Management adopted the new standard in fiscal year 2016.

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 reporting periods 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. Earlier adoption is encouraged. This Statement did not have a material effect on the Department's financial statements.

The GASB issued Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. The Statement replaces GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. The Statement addresses the financial reports of defined benefit other postemployment benefit plans that are administered through trusts that meet specified criteria. The requirements of this Statement are effective for reporting periods beginning after June 15, 2016. Management has not yet determined the effect this Statement will have on the Department'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*. The Statement will require governments to report a liability on the face of the financial statements for the other postemployment benefits that they provide. The requirements of this Statement are effective for reporting periods beginning after June 15, 2017. Management has not yet determined the effect this Statement will have on the Department'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 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. This Statement did not have a material effect on the Department's financial statements.

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The GASB issued Statement No. 77, *Tax Abatement Disclosures*. The Statement requires governments that enter into tax abatement agreements to disclose information about the nature and magnitude of the tax abatements. 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. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*. The Statement amends the scope and applicability of GASB Statement No. 68 to exclude pensions provided to employees of state or local governmental employers through a cost-sharing multiple-employer defined benefit pension that meet certain requirements. 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 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. 80, *Blending Requirements for Certain Component Units-An Amendment of GASB Statement No. 14*. This Statement amends the blending requirements in GASB Statement No. 14. The Statement amends the blending requirements for the financial statement presentation of component units of all state and local governments. The requirements of this Statement are effective for reporting periods beginning after June 15, 2016. Management has not yet determined the effect this Statement will have on the Department's financial statements.

The GASB issued Statement No. 81, *Irrevocable Split-Interest Agreements*. The objective of this Statement is to improve accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. The requirements of this Statement are effective for reporting periods beginning after December 15, 2016. Management has not yet determined the effect this Statement will have 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*. The objective of this Statement is to address certain issues that have been raised with respect to Statements No. 67, *Financial Reporting for Pension Plans*, No. 68, *Accounting and Financial Reporting for Pensions*, and No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*. The requirements of this Statement are effective for reporting periods beginning after June 15, 2016. Management has not yet determined the effect this Statement will have on the Department's financial statements.

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2. Budgeting and Budgetary Control

The Department's annual budget is prepared on the cash basis utilizing encumbrance accounting. Revenue estimates are provided to the State Legislature at the time of budget consideration and are revised and updated throughout the fiscal year. Amounts reflected by the Department as budgeted revenues are those estimates as compiled by the State Director of Finance. Budgeted expenditures for the Department's General Fund and the Hawaiian Homes Administration Account, a special revenue fund, are provided to the Department of Budget and Finance, State of Hawai‘i, for accumulation with budgeted amounts of the other State agencies and included in the Governor's executive budget that is subject to legislative approval. In addition, the budget for all expenditures of the Department's funds is also presented annually to the HHC for approval.

To the extent not expended or encumbered, General Fund appropriations generally lapse at the end of the fiscal year for which the appropriations were made. The State Legislature specifies the lapse date and any other particular conditions which may terminate the authorization for other appropriations.

For purposes of budgeting, the Department's budgetary fund structure and accounting principles differ from those utilized to present the financial statements in conformity with GAAP.

Since the budgetary basis differs from GAAP, budget and actual amounts in the statements of revenues and expenditures – budget and actual – general fund and the Hawaiian Home Administration Account, are presented on the budgetary basis. A reconciliation of the General Fund and the Hawaiian Home Administration Account revenues in excess of expenditures on a budgetary basis for the year ended June 30, 2016, to revenues in excess of expenditures presented in conformity with accounting principles generally accepted in the United States of America, is set forth below.

Under Hawai‘i Revised Statutes (“HRS”) Section 78-13, staff salaries and wages amounting to approximately \$43,000 in the Hawaiian Home Administration Account, for the period from June 16, 2016 through June 30, 2016, are to be funded with monies budgeted for fiscal year 2017. Accordingly, these amounts are excluded from the statements of revenues and expenditures – budget and actual of the Hawaiian Home Administration Account, but are included in the departmental and governmental fund financial statements in accordance with GAAP.

Salaries and wages amounting to approximately \$394,000 in the Hawaiian Home Administration Account, for the period from June 16, 2015 to June 30, 2015, were funded with monies budgeted for fiscal year 2016. Accordingly, these amounts are included in the statements of revenues and expenditures – budget and actual of the Hawaiian Home Administration Account, for the year ended June 30, 2016.

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The following schedule reconciles the budgetary amounts of the General Fund and the Hawaiian Home Administration Account to the amounts presented in accordance with GAAP:

	General Fund	Hawaiian Home Administration Account
Excess of revenues over expenditures – actual on budgetary basis	\$ 10,602,413	\$ 8,595,606
Current year’s appropriations encumbered at June 30, 2016	(597,076)	1,692,640
Current year’s encumbrances included in vouchers payable	(217,621)	(183,377)
Expenditures for liquidation of prior year’s encumbrances	(331,601)	(1,969,551)
Fiscal 2015 expenditures funded by fiscal 2016 budget	-	393,873
Fiscal 2016 expenditures funded by fiscal 2017 budget under Section 78-13 HRS	(533,184)	(43,083)
Excess of revenues over expenditures – GAAP basis	<u>\$ 8,922,931</u>	<u>\$ 8,486,108</u>

3. Cash and Investments

Equity in cash and cash equivalents and investments include monies in the State Treasury. For financial statement reporting purposes, cash and cash equivalents and investments consist of cash, time certificates of deposit, repurchase agreements, and U.S. government securities.

Restricted investments held outside of the State Treasury consist of money market funds held at a financial institution outside of the State of Hawai‘i. At June 30, 2016, the fair value of these investments was approximately \$6,339,000 and was determined using Level 1 inputs.

4. Loans Receivable

Loans receivable consist of approximately 1,300 loans made to native Hawaiian lessees for the purposes specified in the HHCA. Loans are for a maximum amount of approximately \$354,000 and for a maximum term of 30 years. Loan payments expected to be collected within the next fiscal year approximates \$2,612,000. Interest rates on outstanding loans range up to 10%. The Department’s loan portfolio consists of loans that the Department has originated and that generally are collateralized by improvements on the leased properties located in the State. Loan commitments as of June 30, 2016 were approximately \$880,000. The Department has provided an allowance for loan losses of approximately \$13,806,000 as of June 30, 2016. The allowance for loan losses is a valuation reserve, which has been provided through charges to operations in the department-wide financial statements. The reserve is based on management’s assessment of loan balances deemed uncollectible as of June 30, 2016.

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5. Inventory of Homes Purchased from Former Lessees

Through June 30, 2016, the Department constructed and sold a total of 583 homes to native Hawaiians in various locations throughout Hawai‘i.

Under certain circumstances, the Department purchases homes from former lessees due to voluntary and involuntary cancellations of land leases. The homes are subsequently resold to qualified lessees. As of June 30, 2016, the Department purchased homes from former lessees with costs aggregating approximately \$4,347,000.

6. Capital Assets

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

	Balance July 1, 2015	Additions	Disposals / Transfers	Balance June 30, 2016
Capital assets, not being depreciated				
Land	\$ 41,824,231	\$ -	\$ -	\$ 41,824,231
Works of art, historical treasures	29,426	-	-	29,426
Construction in progress	24,765,665	10,974,594	(25,955,738)	9,784,521
Total capital assets, not being depreciated	<u>66,619,322</u>	<u>10,974,594</u>	<u>(25,955,738)</u>	<u>51,638,178</u>
Capital assets, being depreciated				
Buildings and improvements	29,188,835	-	-	29,188,835
Infrastructure	687,930,194	25,955,738	-	713,885,932
Furniture and equipment	5,585,078	110,749	(127,251)	5,568,576
Motor vehicles	1,000,712	253,729	32,490	1,286,931
Total capital assets, being depreciated	<u>723,704,819</u>	<u>26,320,216</u>	<u>(94,761)</u>	<u>749,930,274</u>
Less: Accumulated depreciation for				
Buildings and improvements	(10,087,972)	(929,845)	-	(11,017,817)
Infrastructure	(238,923,833)	(22,297,950)	-	(261,221,783)
Furniture and equipment	(5,311,652)	(67,594)	123,634	(5,255,612)
Motor vehicles	(869,019)	(61,339)	(32,490)	(962,848)
Total accumulated depreciation	<u>(255,192,476)</u>	<u>(23,356,728)</u>	<u>91,144</u>	<u>(278,458,060)</u>
Total capital assets, being depreciated, net	<u>468,512,343</u>	<u>2,963,488</u>	<u>(3,617)</u>	<u>471,472,214</u>
Capital assets, net	<u>\$ 535,131,665</u>	<u>\$ 13,938,082</u>	<u>\$ (25,959,355)</u>	<u>\$ 523,110,392</u>

Depreciation expense for the year ended June 30, 2016 was charged to functions of the Department as follows:

Administration and support services	\$ 1,024,664
Homestead services	22,297,951
Land development	2,603
Land management	31,510
Total depreciation	<u>\$ 23,356,728</u>

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7. Long-Term Obligations

For the year ended June 30, 2016, changes in long-term obligations were as follows:

	Notes Payable	Capital Lease Obligation	Bonds Payable, Net	Accrued Vacation
Balances at July 1, 2015	\$ 9,800,000	\$ 20,165,000	\$ 37,936,169	\$ 1,396,778
Increase	-	-	-	518,322
Decrease	<u>(1,700,000)</u>	<u>(830,000)</u>	<u>(812,495)</u>	<u>(455,881)</u>
Balances at June 30, 2016	<u>\$ 8,100,000</u>	<u>\$ 19,335,000</u>	<u>\$ 37,123,674</u>	<u>\$ 1,459,219</u>

Obligations for accrued vacation are generally liquidated by the General Fund, the Hawaiian Home Operating Fund, and the Hawaiian Home Administration Account.

8. Notes Payable

Land Acquisition / Purchase Note Payable

In December 2004, the Department entered into a transfer agreement with the Housing and Community Development Corporation of Hawai‘i (“HCDCH”), State of Hawai‘i, in connection with the acquisition of approximately 1,800 acres of land consisting of four properties on three islands by the Department. A portion of the land is partially developed and is intended to be utilized for 3,500 homes for native Hawaiians.

As part of the transfer agreement, the Department must pay \$2.2 million a year for 15 years, for a total of \$33 million, in the form of a note, to reimburse the HCDCH, for infrastructure costs at three of the properties. This note is noninterest bearing. At June 30, 2016, the Department owed \$8,100,000 to HCDCH. The note will be repaid with monies in the Department’s Hawaiian Home Land Trust Fund. In July 2013, the Department executed an amendment that reduces the annual payments to \$1.7 million through 2020 and the final payment totaling \$1.3 million is due in 2021.

The annual payment requirements of the notes are as follows:

Year ending June 30,	Purchase Note Payable
2017	\$ 1,700,000
2018	1,700,000
2019	1,700,000
2020	1,700,000
2021	<u>1,300,000</u>
	<u>\$ 8,100,000</u>

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9. Capital Lease Obligation

In December 2006, the Department entered into a 25-year facility lease agreement with Wells Fargo Bank, National Association (the “lessor”), to lease an office facility, which was constructed and completed in April 2008. The Department was required to make semi-annual interest-only payments through May 2009 and annual principal and interest payments beginning November 2009. Interest on the outstanding balance accrues at various rates throughout the term of the lease. At June 30, 2016, the interest rate was 2.23%. Upon expiration of the lease, the title of the facility will be transferred from the lessor to the Department. The following is a schedule by years of future minimum lease payments related to this agreement:

Year ending June 30,	
2017	\$ 1,710,000
2018	1,712,000
2019	1,712,000
2020	1,714,000
2021	1,709,000
Thereafter	<u>18,826,000</u>
Total minimum lease payments	27,383,000
Amount representing interest	<u>8,048,000</u>
Present value of minimum lease payments	19,335,000
Less: Current portion	<u>860,000</u>
Long-term portion	<u>\$ 18,475,000</u>

The cost basis and accumulated depreciation of the leased assets at June 30, 2016 was as follows:

Cost	\$ 25,513,266
Less: Accumulated depreciation	<u>(10,152,614)</u>
	<u>\$ 15,360,652</u>

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10. Bonds Payable

The following are the revenue bonds issued by the Department and portions of the State general obligation bonds allocated to the Department under acts of various Session Laws of Hawai‘i. The revenue bonds are payable from and collateralized by the Department’s revenues generated from certain capital improvement projects. The general obligation bonds are backed by the full faith, credit and taxing power of the State. Repayments of allocated bond debts are made to the State General Fund. Details of the Department’s revenue and allocated general obligation bonds as of June 30, 2016 are as follows:

\$42,500,000 revenue bonds dated March 18, 2009; due in annual principal installments of \$640,000 to \$2,840,000 from October 1, 2009 through October 1, 2039; interest at 2.00% to 6.00% payable semi-annually.	\$ 37,490,000
\$7,415 Series DB refunding bonds dated September 16, 2003; due in annual principal installments of \$675 to \$1,000 from September 1, 2008 through September 1, 2016; interest at 5.00% to 5.25% payable semi-annually. The last principal installment was paid in October 2016.	1,001
\$110,109 Series DG refunding bonds dated June 15, 2005; due in annual principal installments of \$9,933 to \$14,820 from July 1, 2009 through July 1, 2017; interest at 5.00% payable semi-annually. The last principal installment was paid in October 2016.	28,916
	<u>37,519,917</u>
Less: Unamortized discount on revenue bonds	(396,243)
	<u>\$ 37,123,674</u>

The annual requirements of the general obligation and revenue bonds are as follows:

Year ending June 30,	Interest	Principal	Total
2017	\$ 2,164,000	\$ 865,000	\$ 3,029,000
2018	2,121,000	905,000	3,026,000
2019	2,077,000	935,000	3,012,000
2020	2,031,000	1,000,000	3,031,000
2021	1,976,000	1,025,000	3,001,000
2022 – 2026	8,988,000	6,070,000	15,058,000
2027 – 2031	7,039,000	8,010,000	15,049,000
2032 – 2036	4,392,000	10,660,000	15,052,000
2037 – 2039	985,000	8,050,000	9,035,000
	<u>\$ 31,773,000</u>	<u>\$ 37,520,000</u>	<u>\$ 69,293,000</u>

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11. Employee Benefit Plans

Substantially all employees of the Department participate in the State's various employee benefit plans, including the Employees' Retirement System ("ERS") of the State of Hawai'i, postemployment healthcare and life insurance plan, and a deferred compensation plan. For more information on the State's benefit plans, refer to the State of Hawai'i and ERS' CAFR. The State's CAFR can be found at the DAGS website: <http://ags.hawaii.gov/accounting/annual-financial-reports/>. The ERS CAFR can be found at the ERS website: <http://ers.ehawaii.gov/resources/financials>.

Employees' Retirement System

The ERS is a cost-sharing, multiple-employer defined benefit public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits. All contributions, benefits and eligibility requirements are established by HRS Chapter 88 and can be amended by legislative action.

- **State Policy** – The actuarial valuation of the ERS does not provide pension information by department or agency. Accordingly, the State's policy on the accounting and reporting for pension benefits is to allocate a portion of the net pension liability, pension expense, and deferred inflows and outflows of resources required under GASB Statement No. 68 only 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 number of covered employees for each component unit and proprietary fund for pension benefits.
- **Contributions** – Contributions are established by HRS Chapter 88 and may be amended through legislation. The employer rate is set by statute based on the recommendations of the ERS actuary resulting from an experience study conducted every five years. Contributions by the Department to the pension plan were approximately \$2,249,000 for the year ended June 30, 2016.
- **Required Supplementary Information and Disclosures** – The State's CAFR includes the required footnote disclosures and supplementary information on the State's pension plan.

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.

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Postemployment Healthcare and Life Insurance Benefits

The State contributes to the Hawai‘i 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 other postemployment benefits (“OPEB”) information by department or agency. Accordingly, the State’s policy on the accounting and reporting for OPEB is to only 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 number of covered employees for each component unit and proprietary fund.
- **Contributions** – Contributions are financed on a pay-as-you-go basis. Contributions by the Department to the EUTF for the years ended June 30, 2016, 2015 and 2014 were approximately \$1,138,000, \$1,194,000 and \$1,076,000, respectively.
- **Required Supplementary Information and Disclosures** – The State’s CAFR includes the required footnote disclosures and supplementary information on the State’s OPEB plan.

12. General Leases and Licenses

The Department’s general leasing operations (Section 204 of Hawaiian Homes Commission Act of 1920, as amended) consist principally of the leasing of its Hawaiian home lands. The general leases have varying terms extending through July 2086.

The future minimum lease income from general leases as of June 30, 2016 is as follows:

Year ending June 30,	
2017	\$ 13,141,000
2018	12,847,000
2019	12,420,000
2020	12,612,000
2021	13,081,000
2022 – 2026	64,541,000
2027 – 2031	69,666,000
2032 – 2036	68,721,000
2037 – 2041	68,488,000
2042 – 2046	65,349,000
2047 – 2051	64,342,000
2052 – 2056	65,451,000
2057 – 2061	58,071,000
2062 – 2066	57,769,000
2067 – 2071	50,817,000
2072 – 2076	37,853,000
2077 – 2081	26,591,000
2082 – 2086	1,435,000
	<u>\$ 763,195,000</u>

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13. Commitments and Contingencies

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.

For purposes of securing information about the Hawaiian Home Lands Trust Individual Claims discussed as a separate note in prior audits of the Department, please see the discussion about Individual Claims and the lawsuits relating to them, including the claims against the State and the Department in *Kalima v. State of Hawai‘i*, Civil No. 99-4771-12, in the State's CAFR on the DAGS website.

Insurance

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 an estimated loss 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 liability was not material at June 30, 2016.

Guaranteed and Insured Loans

As of June 30, 2016, the Department was contingently liable for approximately \$43,178,000 in loans originated primarily by the U.S. Department of Agriculture Rural Development for which the Department has guaranteed repayment. Approximately \$7,541,000 of these loans have been reported delinquent as of June 30, 2016.

The Department is also a party to a mortgage loan insurance agreement with the HUD. The agreement provides that HUD will perform underwriting processing for the insurance program and will administer an insurance fund for mortgages originated and held by HUD-approved lenders. The Department will maintain and provide the necessary and proper funds for payment of any mortgage insurance claims and expenditures incurred by HUD in connection with the lessee borrowers. The Department has reserved cash of approximately \$12,200,000 in the trust fund and has deposited \$150,000 with HUD. As of June 30, 2016, loans outstanding totaled approximately \$417,363,000 under this agreement, of which approximately \$31,835,000 has been reported as delinquent.

The Department is also a party to a Native Hawaiian Home Loan Guarantee Program (HUD Section 184) agreement with HUD. The agreement provides that HUD will guarantee certain loans in which homestead leases issued by the Department pursuant to the Hawaiian Homes Commission Act is used as collateral for the loan. As of June 30, 2016, loans outstanding totaled approximately \$91,609,000 under this agreement, of which approximately \$5,021,000 has been reported as delinquent.

State of Hawai‘i
Department of Hawaiian Home Lands
Notes to Financial Statements
June 30, 2016

As of June 30, 2016, the Department was also contingently liable for approximately \$4,649,000 in loans originated by financial institutions and other lenders for which it had guaranteed repayment. Approximately \$1,730,000 of these loans has been reported delinquent as of June 30, 2016.

As of June 30, 2016, the Department paid approximately \$7,478,000 for delinquent mortgage loan payments of lessees. These payments are carried as loans receivable from lessees and bear similar terms as stipulated in the lessees' mortgage notes with the lenders.

The Department has certain loans for which the collateral for the loans is not covered by casualty insurance. The number of such loans was not known as of June 30, 2016.

Other

In December 2008, the Department entered into a collaborative financing arrangement with the Office of Hawaiian Affairs, State of Hawai‘i (“OHA”) in which OHA will provide funds for the Department's use in the planning, design and construction of infrastructure for homesteads for native Hawaiians on properties owned and controlled by the Department. Under the agreement, OHA will pay the Department on an annual basis the lesser of \$3,000,000 or the debt service of the revenue bonds issued by the Department in 2009. As of June 30, 2016, the Department received \$24,000,000 from OHA.

14. Assessments for Central Service and Administrative Expenses

The State of Hawai‘i has asserted that the Department is liable for its pro rata share of central service and administrative expenses incurred by the State in accordance with Sections 36-27 and 36-30, Hawai‘i Revised Statutes. Pursuant to Section 36-31, Hawai‘i Revised Statutes, the Department maintains that their funds are trust funds and are not subject to the special fund assessments. Accordingly, no provision for any liability has been made in the accompanying financial statements.

Effective July 1, 1998, Act 27, SLH 1998 amended Section 213 of the Hawaiian Homes Commissions Act and reclassified certain special funds as trust funds.

As of June 30, 2016, the Department's estimate of the accumulated asserted assessments since the inception of the aforementioned law approximated \$24,217,000.

Supplemental Information

State of Hawai'i
Department of Hawaiian Home Lands
Combining Balance Sheet
Nonmajor Governmental Funds
June 30, 2016

Supplemental Information

	Hawaiian Home Loan Fund	Department of Hawaiian Home Lands Revenue Bond Special Fund	Native Hawaiian Rehabilitation Fund	Protocol Funds	Temporary Deposits	East West Collector Road Fund	Total Other Governmental Funds
Assets							
Equity in cash and cash equivalents and investments held in State Treasury	\$ 2,732,907	\$ 13,093,713	\$ 6,261,838	\$ 1,966	\$ 2,937,906	\$ 2,350	\$ 25,030,680
Loans, net of allowance for losses	1,899,981	-	-	-	-	-	1,899,981
Inventory of homes purchased from former lessees	93,000	-	-	-	-	-	93,000
Restricted cash and short-term investments held outside of State Treasury	-	3,786,921	-	-	-	-	3,786,921
Total assets	<u>\$ 4,725,888</u>	<u>\$ 16,880,634</u>	<u>\$ 6,261,838</u>	<u>\$ 1,966</u>	<u>\$ 2,937,906</u>	<u>\$ 2,350</u>	<u>\$ 30,810,582</u>
Liabilities and Fund Balances							
Liabilities							
Vouchers and contracts payable	\$ -	\$ 753,220	\$ 10,877	\$ 20	\$ -	\$ -	\$ 764,117
Other liabilities	8,067	-	-	-	2,937,906	-	2,945,973
Total liabilities	<u>8,067</u>	<u>753,220</u>	<u>10,877</u>	<u>20</u>	<u>2,937,906</u>	<u>-</u>	<u>3,710,090</u>
Fund balances							
Restricted for							
Debt agreements	-	6,786,921	-	-	-	-	6,786,921
Assigned to							
Home loans and homestead services	4,717,821	-	-	1,946	-	-	4,719,767
Home construction and land development	-	9,340,493	6,250,961	-	-	2,350	15,593,804
Total fund balances	<u>4,717,821</u>	<u>16,127,414</u>	<u>6,250,961</u>	<u>1,946</u>	<u>-</u>	<u>2,350</u>	<u>27,100,492</u>
Total liabilities and fund balances	<u>\$ 4,725,888</u>	<u>\$ 16,880,634</u>	<u>\$ 6,261,838</u>	<u>\$ 1,966</u>	<u>\$ 2,937,906</u>	<u>\$ 2,350</u>	<u>\$ 30,810,582</u>

State of Hawai‘i
Department of Hawaiian Home Lands
Combining Statement of Revenues, Expenditures and Changes in Fund Balances
Nonmajor Governmental Funds
Year Ended June 30, 2016

Supplemental Information

	Hawaiian Home Loan Fund	Department of Hawaiian Home Lands Revenue Bond Special Fund	Native Hawaiian Rehabilitation Fund	Protocol Funds	Temporary Deposits	East West Collector Road Fund	Total Other Governmental Funds
Revenues							
Investment income	\$ -	\$ 72,597	\$ 35,945	\$ -	\$ -	\$ -	\$ 108,542
Intergovernmental revenues	-	3,000,000	-	-	-	-	3,000,000
Other	140,737	-	415,015	-	-	-	555,752
Total revenues	140,737	3,072,597	450,960	-	-	-	3,664,294
Expenditures							
Current							
Administration and support services	-	-	127,847	554	-	-	128,401
Land management	-	-	7,007	-	-	-	7,007
Debt service							
Principal	-	752,500	-	-	-	-	752,500
Interest	-	2,008,080	-	-	-	-	2,008,080
Total expenditures	-	2,760,580	134,854	554	-	-	2,895,988
Excess (deficiency) of revenues over (under) expenditures	140,737	312,017	316,106	(554)	-	-	768,306
Other financing sources							
Transfers out	-	-	-	(2,814)	-	-	(2,814)
Total other financing sources	-	-	-	(2,814)	-	-	(2,814)
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	140,737	312,017	316,106	(3,368)	-	-	765,492
Net change in fund balances	140,737	312,017	316,106	(3,368)	-	-	765,492
Fund balances at July 1, 2015	4,577,084	15,815,397	5,934,855	5,314	-	2,350	26,335,000
Fund balances at June 30, 2016	\$ 4,717,821	\$ 16,127,414	\$ 6,250,961	\$ 1,946	\$ -	\$ 2,350	\$ 27,100,492

Schedule of Expenditures of Federal Awards

State of Hawai‘i
Department of Hawaiian Home Lands
Schedule of Expenditures of Federal Awards
Year Ended June 30, 2016

Federal Program / Pass Through Entity	CFDA Number	Identifying Number	Expenditures
U.S. Department of Housing and Urban Development			
Native Hawaiian Housing Block Grant, Year 9	14.873	10HBGHI0001	\$ 5,113,587
Native Hawaiian Housing Block Grant, Year 10	14.873	11HBGHI0001	<u>7,342,280</u>
Total expenditures			<u>\$ 12,455,867</u>

See notes to the schedule of expenditures of federal awards.

State of Hawai‘i
Department of Hawaiian Home Lands
Notes to the Schedule of Expenditures of Federal Awards
June 30, 2016

1. Basis of Presentation

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Department and is presented on the cash basis of accounting. The information on this schedule is presented in accordance with the requirements of the Uniform Guidance. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

2. Loans Outstanding

The Department had the following loan balances outstanding as of June 30, 2016. Loans made during the year are included in the federal expenditures presented in the schedule.

Program Title	CFDA Number	Amount Outstanding
U.S. Department of Housing and Urban Development		
Native Hawaiian Housing Block Grant	14.873	<u>\$ 14,270,994</u>

3. Subrecipients

Of the federal expenditures presented in the schedule of expenditures of federal awards, the Department provided federal awards to subrecipients as follows:

Program Title / Subrecipient	CFDA Number	Amount Provided to Subrecipients
U.S. Department of Housing and Urban Development		
Native Hawaiian Housing Block Grant, Year 9 Nanakuli Housing Corporation	14.873	<u>\$ 64,417</u> 64,417
Native Hawaiian Housing Block Grant, Year 10 Nanakuli Housing Corporation	14.873	<u>78,521</u> 78,521 <u>\$ 142,938</u>

4. Indirect Costs

The Department has elected not to use the 10% de minimis indirect cost rate allowed under the Uniform Guidance.

PART II

Government Auditing Standards



CERTIFIED PUBLIC ACCOUNTANTS

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

The Auditor
State of Hawaii

The Hawaiian Homes Commission
Department of Hawaiian Home Lands

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, each major fund, and the aggregate remaining fund information of the State of Hawai'i, Department of Hawaiian Home Lands (the "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, and have issued our report thereon dated December 21, 2016.

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 Department'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 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*.

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 Department'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 Department's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

The image shows a handwritten signature in black ink that reads "Accuity LLP". The signature is written in a cursive, flowing style.

Honolulu, Hawai'i
December 21, 2016

**Report of Independent Auditors on Compliance for
Each Major Program and on Internal Control Over Compliance
Required by the Uniform Guidance**

The Auditor
State of Hawaii

The Hawaiian Homes Commission
Department of Hawaiian Home Lands

Report on Compliance for Each Major Federal Program

We have audited the State of Hawai'i, Department of Hawaiian Home Lands' (the "Department") compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on the Department's major federal program for the year ended June 30, 2016. The Department's major federal program is identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts and grants applicable to its federal program.

Auditors' 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 audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (the "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.

Opinion on Each Major Federal Program

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 its major federal program for the year ended June 30, 2016.

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.

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. Accordingly, this report is not suitable for any other purpose.

Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance

We have audited the governmental activities, each major fund, and the aggregate remaining fund information of the financial statements of the 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. We have issued our report thereon dated December 21, 2016, which contained unmodified opinions on those financial statements. Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the Uniform Guidance and is not a required part of the basic financial statements. Such 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. The 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 expenditure of federal awards is fairly stated in all material respects in relation to the basic financial statements as a whole.

Accuity LLP

Honolulu, Hawai'i
December 21, 2016

PART III

Schedule of Findings and Questioned Costs

State of Hawai‘i
Department of Hawaiian Home Lands
Schedule of Findings and Questioned Costs
Year Ended June 30, 2016

Section I – Summary of Auditors’ Results

Financial Statements

Type of auditors’ report issued	Unmodified	
Internal control over financial reporting		
• Material weaknesses identified?	<u> </u> yes	<u> X </u> no
• Significant deficiencies identified?	<u> </u> yes	<u> X </u> none reported
Noncompliance material to financial statements noted?	<u> </u> yes	<u> X </u> no

Federal Awards

Internal control over major programs		
• Material weaknesses identified?	<u> </u> yes	<u> X </u> no
• Significant deficiencies identified?	<u> </u> yes	<u> X </u> none reported
Type of auditors’ report issued on compliance for major programs	Unmodified	
Any audit findings disclosed that are required to be reported in accordance with the Uniform Guidance?	<u> </u> yes	<u> X </u> no
Identification of major program		

CFDA

Number	Name of Federal Program or Cluster
14.873	Native Hawaiian Housing Block Grant

Dollar threshold used to distinguish between type A and type B programs	\$750,000
Auditee qualified as low-risk auditee?	<u> X </u> yes <u> </u> no

State of Hawai‘i
Department of Hawaiian Home Lands
Schedule of Findings and Questioned Costs
Year Ended June 30, 2016

Section II – Financial Statement Findings

None noted.

Section III – Federal Award Findings and Questioned Costs

None noted.

Section IV – Status of Prior Year Findings and Questioned Costs

None noted.