

**Board of Water Supply
City and County of Honolulu**
Financial Statements and Supplementary Information
June 30, 2013 and 2012

**Board of Water Supply
City and County of Honolulu
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Introduction

Board of Water Supply

City and County of Honolulu

Introduction

June 30, 2013 and 2012

The Board of Water Supply of the City and County of Honolulu (the “BWS”) is pleased to present its Annual Financial Report for the fiscal year 2013. This introduction provides an overview of the mission, organization and operations of the BWS. The following management’s discussion and analysis is intended to provide the reader with an easily understandable analysis of the BWS’s financial performance and all aspects of its financial position. Financial statements presenting the financial position and changes in financial position of the BWS is in conformity with accounting principles generally accepted in the United States of America, accompanied by the independent auditors’ report.

Organization and Business

The BWS is a semi-autonomous agency of the City and County of Honolulu (“City”). Pursuant to the City Revised Charter, the BWS has full control of all municipal water systems of the City, together with all materials, supplies and equipment, and all real and personal property used or useful in connection with such water systems. The BWS was established in 1929.

The Mayor of the City appoints five of the seven members of the Board of Directors. The other two are ex-officio members, the Director and Chief Engineer of the Department of Facility Maintenance, City and County of Honolulu, and the Director of the Department of Transportation of the State of Hawaii.

The BWS consists of 15 Divisions and Support Offices – Water Quality Division, Capital Projects, Communications, Customer Care, Executive Support Office, Finance, Human Resources, Information Technology, Legal, Field Operations, Water System Operations, Water Resources, Land, Security, and the Office of the Manager and Chief Engineer. All are under the direction of the Manager and Chief Engineer (“Manager”) who is appointed by the Board of Directors, and the Deputy Manager and Chief Engineer.

The Board of Directors has the power to set and adjust rates and charges for the furnishing of water services so that the revenues derived shall be sufficient to make the water system self-supporting. Rates and charges are determined on the basis of a recommendation by the Manager, subject to a public hearing to receive public testimony regarding any proposed rate increase, and final approval by the Board of Directors.

The BWS receives no revenues from taxation and depends solely upon revenues derived from its rates and charges to pay for its operations and debt service. The BWS may also receive funds from the federal, state or county governments for capital improvement and other projects.

The BWS services 175,921 accounts and a residential population of 976,372. The service area covers the island of Oahu and is 596.7 square miles. The customer base includes the residential population, businesses and industries, and agriculture. Of the total accounts, 160,312 are residential (91.1%), representing 60.1% of the total amount received from water sales in fiscal year 2013; 14,589 are commercial and industrial (8.3%), representing 39.3% of the total amount received from water sales in fiscal year 2013; and 1,020 are agricultural (0.6%).

The BWS provides potable quality water at reasonable rates, while managing the long-term viability of Oahu’s water resources and protecting the environment. In addition to providing potable water of 145 million gallons per day (“mgd”), the BWS is capable of delivering approximately 10 mgd of recycled water for irrigation of various golf courses, landscaped areas in Ewa, and for industrial processing in Campbell Industrial Park.

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Mission

The mission of the BWS is to provide a safe and dependable water supply that is affordable to its customers, now and into the future.

Three main strategic objectives emanate from this mission: resource, economic and organizational sustainability.

- **Resource sustainability** ensures that natural groundwater supplies are protected and managed efficiently.
- **Economic sustainability** calls for a sound financial strategy to support the BWS's operating and capital needs, while keeping water rates affordable.
- **Organizational sustainability** calls for a sound, well structured, efficient organization with the tools and skills necessary to provide exceptional value to the BWS's customers and the community.

Looking Ahead

BWS employees continue to concentrate their efforts in support of the BWS's mission with a focus on the following strategic objectives:

1. **Resource Sustainability**

This strategic objective ensures that natural groundwater supplies are protected and managed efficiently. The BWS plans for diversified strategies and projects in conservation, potable groundwater, and alternative water supplies, including brackish, recycled and desalinated water to meet future demands. Efforts also focus on protecting the natural environment, important watersheds, and water sources by monitoring Oahu's rainfall and aquifer water levels and salinity, and taking appropriate precautions to ensure the sustainability of the island's potable water supplies in a climate change future.

The BWS's comprehensive water conservation program continues to foster effective water management policies and practices that reduce per capita use of potable water to encourage sustainable behaviors to all users on Oahu. Resource and demand-side management, alternative water supplies, water system optimization, consumer education, and collaboration with other utilities on industry best practices, combine to form a holistic approach to this growing and expanding program.

- The BWS continues its successful leak detection and repair program, proactively identifying and repairing leaks before they become an emergency main break. The BWS Leak Detection Team surveys approximately 25 to 50 miles of pipelines per month to find leaks in the distribution system. This has resulted in an estimated savings of approximately 3.3 mgd or about 1.2 billion gallons per year.
- Private development reviews and water master plans have increased island wide with a growing economy, especially in Kakaako and Ewa. Water master plans are or have been reviewed for West Kapolei, Harborside, Makaiwa Hills, University of Hawaii ("UH") West Oahu, Ho'opili, Koa Ridge and Kakaako. Water system infrastructure continues to expand in concert with these developments. Water supply is available within the City's planning horizon to 2035.

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- Recycled water is an important component of a host of conservation and drought mitigation strategies to reduce potable water consumption. The BWS continues to support the use of recycled water in the Ewa area as an appropriate and more efficient source of water for irrigation and industrial purposes. Recycled water production averaged 8.5 mgd in fiscal year 2013, which was approximately the same as the previous fiscal year. In fiscal year 2014, the BWS is anticipating the addition of the State Department of Hawaiian Home Lands' administrative complex along Kapolei Parkway, the City of Kapolei, and the Oneula and Ocean Pointe District as R-1 recycled water users. Additionally, the H-Power Plant is closer to begin using reverse osmosis demineralized recycled water for its industrial processes instead of potable water.
- The BWS continues to make progress on the regional Watershed Management Plans ("WMP") for Oahu's water resources. The Koolaupoko WMP was adopted in fiscal year 2013, while plans for North Shore, Ewa and Central Oahu WMPs are ongoing. The Waianae and Koolauloa WMPs were adopted in fiscal year 2011. These plans are the regional component of long-range strategic water plans for the City that is concurrent with the City's development and sustainable communities plan for Oahu. The WMPs provide strategic framework for watershed protection projects and water use and development for the BWS's long-range capital improvement program, ensuring that adequate water supplies and water system infrastructure will meet Oahu's future water demands.
- To analyze the possible long-term effects of climate change on Oahu's water resources, the BWS has contracted with the UH and the U.S. Geological Survey to conduct hydro-geological research to assess Oahu's diminishing rainfall trends and provide numerical groundwater modeling capability for the Pearl Harbor aquifer in a climate change future.

The BWS placed two new potable water source stations in service:

- Waimanalo Wells III – This new well source station is capable of producing 0.5 mgd of water to serve East Waimanalo.
- Opana Wells – This new well source station is capable of producing 1 mgd of water to serve the North Shore.
- The BWS implemented and expanded on a wide array of public information and education programs that support and reinforce efforts to educate customers about the importance of conserving water throughout the years and about other BWS programs.
- The BWS continues to ensure that the community's potable water supply complies with all Federal and State safe drinking water standards by monitoring changes in safe drinking water regulations and installing new and replacement water treatment facilities as needed.

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2. Economic Sustainability

The second strategic objective calls for a sound financial strategy to support the BWS's operating and capital needs. While operation and construction costs steadily increase, the BWS continues to focus its efforts on improving its core services by addressing aging infrastructure and ensuring the reliability and quality of water provided to all customers in the City.

- The BWS initiated work on a long-term, comprehensive Water Master Plan. The plan will result in the creation of a 30-year Capital Improvement Program to expand capacity of and systematically repair and replace aging water infrastructure. The Water Master Plan applies new technology and best practices in planning and engineering tools. Once created, it will guide the update of the BWS's financial plan to ensure sufficient funding for infrastructure needs while keeping water rates affordable.
- The BWS issued a Request for Proposals to develop its six-acre Beretania Street property. The project was initiated at the suggestion of the Honolulu City Council to allow the BWS to explore and evaluate alternative sources of revenue to reduce its reliance on ratepayer-generated funds.
- More than \$26.5 million in capital program contracts and more than \$5.5 million in professional services contracts were awarded as of June 30, 2013. The repair, replacement and improvement projects proactively address the needs of the BWS's aging infrastructure to ensure continuity of core services.
- According to the American Water Works Association, water utilities nationwide should strive for roughly 25-30 main breaks per 100 miles of pipeline. The BWS ratio was better than the national average. In fiscal year 2013, the BWS's employees responded to a total of 350 main breaks or about 17 breaks per 100 miles of pipeline.
- The BWS completed the replacement of its 15-year-old customer information and billing system with a state-of-the-art Customer Information System ("CIS"). The move to the new Customer Care & Billing ("CC&B") system offered the opportunity for the BWS to convert to a monthly billing schedule. As a result, in January 2013, the BWS launched CC&B and monthly billing. These changes presented a number of challenges, including converting residential customer accounts from bi-monthly to monthly billing, preparations involved in converting to the new system, and addressing deferred maintenance on the Automatic Meter Reading system. The BWS also completed efforts to enable customers to go online to request to initiate and terminate service, change account information, as well as view and pay their bills. The BWS hopes to implement a full service online customer portal in fiscal year 2014.
- The BWS has initiated the upgrade of its Financial Management System with a target completion of Phase I by the second quarter of fiscal year 2014. Planning for Phase II enhancements will take place concurrently with Phase I.
- In preparation for a much needed upgrade, the BWS completed an assessment of its current utilization of the Computerized Maintenance Management System. Planning for this major system upgrade project is underway, with active engagement beginning in the second quarter of fiscal year 2014 and lasting well into fiscal year 2015.

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- The BWS's nationally recognized Geographic Information System ("GIS") database and applications continues to be upgraded for best in class industry functionality and performance. This system gives BWS users access to GIS layers and updated imagery, and integrates map service sharing with other City departments. Enhancements for mobile data gathering and data sharing in the cloud are underway.
- The BWS's Hydraulic Model Program effort has trained other departmental users on how to use new modeling software. In conjunction with the Water Master Plan project, the hydraulic modeling methodology for calibration is being updated, improved, and accelerated. Major calibration work will be taking place in fiscal year 2014.
- The BWS completed a pilot Project Information Management System project, which is designed to track the entire life cycle of BWS capital projects and Replacement and Facilities Improvement projects, as well as private projects. The resulting system is in place for a small group of users and valuable information and user requirements were gathered. This information will be utilized to plan, design and implement a Project Information Management System which improve internal controls over project management and provide broad access to a meaningful set of project status measures and supporting data.
- The BWS has brought up a second data center for new business requirements. The new data center is utilizing an existing BWS facility and resources that were previously allocated solely for disaster recovery purposes. This initiative allows the BWS to meet new business requirements with minimal investment.
- The BWS's Wireless Network Project continues deployment of site connectivity to provide high speed backbone links. A majority of the BWS sites will be connected by the end of fiscal year 2014, providing a foundation for potential migration of BWS's existing process control systems to internet protocol transport.

3. Organizational Sustainability

The BWS's third objective calls for a sound, well structured, efficient organization with the tools and skills necessary to provide exceptional value for customers and the community. Maintaining a strong, flexible organization that is able to resolve economic, regulatory and service challenges requires that the BWS use aggressive as well as time-tested strategies to meet the third BWS objective of organizational sustainability.

- The BWS successfully processed more than 128,000 customer calls and inquiries regarding bill payments and delinquent bills during the fiscal year. In July 2012, the BWS also implemented a callback feature where customers can leave their phone number and would receive a callback in the order calls are received.
- With the launch of the new billing system, the BWS contracted payment services to First Hawaiian Bank who will process all payments made via mail as well as accept payments from BWS customers at their bank branches.
- On March 1, 2013, the BWS began offering customers the option to pay their bill online using a credit card with BWS ePay.

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- Employee development continues to be a top priority for the BWS. Opportunities for employees to learn more about their field and to enhance their leadership and team-building skills are readily available.
- To ensure a continuing pool of qualified employees for specialized jobs, the BWS continues to offer Trades Apprentice Programs for Plant Electrical/Electronic Equipment Repairer and Pipefitter positions in the organization. Trades apprentices learn the needed skills through on-the-job training and evening classes at Honolulu Community College. Currently, the successful Pipefitter Trades Apprenticeship program graduates sufficient journey worker pipefitters to maintain staffing levels.
- Open communication with public employee union shop stewards of the Hawaii Government Employees Association and the United Public Workers continues to foster improved labor-managerial relationships. The meetings provide a forum where stewards are able to obtain clarification and guidance on personnel-related questions and concerns. These sessions also encourage open dialogue to address issues before they become problematic.
- The BWS continually works with the City Department of Emergency Management and Hawaii State Civil Defense to ensure it has plans and procedures in place to respond effectively to emergency situations such as a tropical cyclone, an island wide power outage, pandemic flu, tsunami, or other major events.
- Employee recognition programs are a key element to foster employee morale and encourage continuing performance excellence. These programs continue to be an important priority for BWS management.

Report of Independent Auditors

To the Board of Directors
Board of Water Supply
City and County of Honolulu

Report on the Financial Statements

We have audited the accompanying statement of net position of the Board of Water Supply (the "BWS"), a component unit of the City and County of Honolulu (the "City"), as of June 30, 2013, and the related statements of revenues, expenses and change in net position and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the BWS as of June 30, 2013, and the respective changes in its financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 2, the financial statements referred to above include only the financial activities of the BWS, and are not intended to present fairly the financial position, changes in its financial position, or cash flows of the City, in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters**Required Supplementary Information**

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 10 through 15 and schedule of funding progress on page 39 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 an opinion on the basic financial statements of the BWS. The introductory section and supplementary information are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The supplementary information 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 supplementary information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

The introductory section has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and, accordingly, we do not express an opinion or provide any assurance on them.

Other Auditors

The basic financial statements of the Board of Water Supply as of June 30, 2012 and for the year then ended, were audited by other auditors whose report dated October 23, 2012 expressed an unmodified opinion on those statements.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 25, 2013 on our consideration of the Board of Water Supply'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 BWS's internal control over financial reporting and compliance.

Accuity LLP

Honolulu, Hawaii
October 25, 2013

Management's Discussion and Analysis

Board of Water Supply

City and County of Honolulu

Management's Discussion and Analysis

June 30, 2013 and 2012

This section presents the management's discussion and analysis of the BWS's financial condition and activities for the fiscal year ended June 30, 2013. This information should be read in conjunction with the financial statements.

Financial Highlights

The BWS implemented the second of five scheduled rate increases in July 2012 to meet the rising costs of delivering water to customers and to continue its infrastructure repair and replacement programs. Water rates increased by 9.65%, which equates to more than \$4 of monthly water charges for an average single-family residential customer effective July 1, 2012.

The BWS still maintains a relatively strong financial performance with a manageable capital program. Meanwhile, management continues to carefully evaluate the BWS's finances to ensure optimum performance. In addition to meeting all debt covenants, outstanding debt and cash reserves were kept at levels appropriate for maintaining favorable bond ratings. Key financial highlights are listed below:

- Net position increased \$19.9 million in fiscal year 2013 compared to the \$19.4 million increase in fiscal year 2012.
- Total assets were \$1.4 billion, which exceeded liabilities by \$1.0 billion at June 30, 2013 and 2012.
- The BWS's unrestricted current assets at June 30, 2013 were 3.3 times its related current liabilities compared to 7.6 times at June 30, 2012.
- The BWS's debt to equity ratio was 29.0% and 30.5% at June 30, 2013 and 2012, respectively, indicating the continuance of capacity to issue additional debt.

Overview of Financial Report

The BWS is a semi-autonomous agency of the City. The financial statements are presented using the economic resources measurement focus and the accrual basis of accounting, whereby revenues and expenses are recognized in the period earned or incurred.

Management's discussion and analysis ("MD&A") represents management's analysis and comments on the BWS's financial condition and performance. Summary financial data, key financial and operational indicators used in the BWS's annual report, budget, bond resolutions, and other management tools were used for this analysis.

The basic financial statements include statements of net position, statements of revenues, expenses and change in net position, statements of cash flows, and notes to the financial statements. The statements of net position present the resources and obligations of the BWS at June 30, 2013 and 2012. The statements of revenues, expenses and change in net position presents the changes in net position for the fiscal years then ended, and the resultant ending net position balances.

The statements of cash flows present changes in cash and cash equivalents (short-term investments with original maturities of three months or less from the date of acquisition), resulting from operating, investing, capital and related financing activities, and non-capital financing activities.

The notes to the financial statements provide required disclosures and other information necessary for the fair presentation of the financial statements. The notes detail information about the BWS's significant accounting policies, significant account balances, related party transactions, employee benefit plans,

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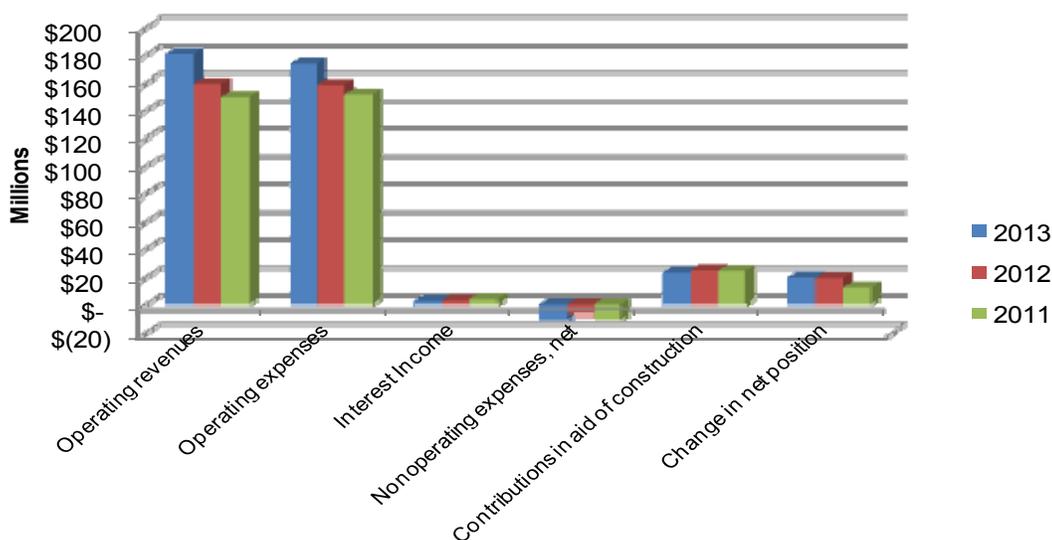
commitments, contingencies, and other significant events. Required supplementary information on post-employment benefits other than pensions and supplementary information for outstanding bonds and net revenue requirements are also included.

Results of Operations

Condensed Statements of Revenues, Expenses and Change in Net Position

| | 2013 | 2012 | 2011 |
|--------------------------------------|------------------|------------------|------------------|
| | (in thousands) | | |
| Operating revenues | \$ 180,505 | \$ 159,508 | \$ 149,894 |
| Operating expenses | | | |
| Administrative and general | 43,409 | 39,392 | 42,137 |
| Depreciation | 41,775 | 42,376 | 41,247 |
| Power and pumping | 39,248 | 33,202 | 28,631 |
| Other operating expenses | 49,060 | 43,754 | 39,818 |
| Total operating expenses | <u>173,492</u> | <u>158,724</u> | <u>151,833</u> |
| Operating income (loss) | <u>7,013</u> | <u>784</u> | <u>(1,939)</u> |
| Nonoperating revenues (expenses) | | | |
| Interest income | 2,529 | 2,903 | 3,929 |
| Others | (13,196) | (9,499) | (14,434) |
| Total nonoperating expenses | <u>(10,667)</u> | <u>(6,596)</u> | <u>(10,505)</u> |
| Contributions in aid of construction | <u>23,527</u> | <u>25,198</u> | <u>24,838</u> |
| Change in net position | <u>\$ 19,873</u> | <u>\$ 19,386</u> | <u>\$ 12,394</u> |

Statements of Revenues, Expenses and Change in Net Position



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Management's Discussion and Analysis

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The increase in net position for the year ended June 30, 2013 was \$19.9 million, compared to an increase of \$19.4 million for the year ended June 30, 2012.

Operating revenues for the year ended June 30, 2013 were \$180.5 million, an increase of \$21.0 million or 13.2% from the year ended June 30, 2012 revenues, due to water rate increases that were implemented on July 1, 2012. Operating revenues for the year ended June 30, 2012 totaled \$159.5 million which represented an increase of \$9.6 million or 6.4% from the year ended June 30, 2011. This increase was attributable to water rate increases that were implemented effective January 1, 2012.

Total operating expenses increased by \$14.8 million and \$6.9 million in fiscal years 2013 and 2012, respectively. Factors contributing to this change are explained below:

- Administrative and general expenses increased by \$4.0 million in fiscal year 2013, mainly due to an increase in project costs expensed and other contractual services. In fiscal year 2012, administrative and general expenses decreased by \$2.7 million due to a reduction in professional services, gasoline, motor vehicle parts and accessories, and other contractual services.
- Power and pumping expenses increased \$6.0 million during fiscal year 2013. This was primarily due to an increase in electricity costs of \$4.6 million and an increase in the repair and maintenance of equipment. Power and pumping expenses increased by \$4.6 million during fiscal year 2012, primarily due to an increase in electricity costs.
- Other operating expenses increased by \$5.3 million during fiscal year 2013, due to an increase in other contractual services for transmission expenditures to replace automated meter reading batteries. Maintenance expenses increased mainly due to an increase in project costs expensed for ocean cooling, pumping station, transmission and water treatment maintenance expenditures. Other operating expenses increased by \$3.9 million during fiscal year 2012 due to an increase in non-potable water treatment.
- For the year ended June 30, 2013, non-operating expenses increased by \$4.1 million due primarily to a decrease in interest expenses that were capitalized. Non-operating expenses decreased by \$3.9 million for the year ended June 30, 2012, due to a decrease in interest expense and losses from disposition of property.
- Contributions in aid of construction result from water system facilities charges that are levied against all new developments and residential properties requiring water from the BWS's systems, except those developments that have paid for and installed a complete water system, including sources, transmission, and daily storage facilities. In addition, contributions of capital assets from governmental agencies, developers and customers are recorded as contributions in aid of construction at their cost. The BWS realized contributions in aid of construction of \$23.5 million in fiscal year 2013 compared to \$25.2 million in fiscal year 2012. The decrease in contributions in aid of \$1.7 million was due to a decrease in projects completed by governmental funds of \$2.3 million, an increase in the Water Service Facilities Charge revenue ("WSFC") of \$2.7 million offset by a decrease in private development contributions of \$2.1 million. During the year ended June 30, 2013, the major developments completed were the University of Hawaii West and Oceanpointe-Area IVA-Phase 2.

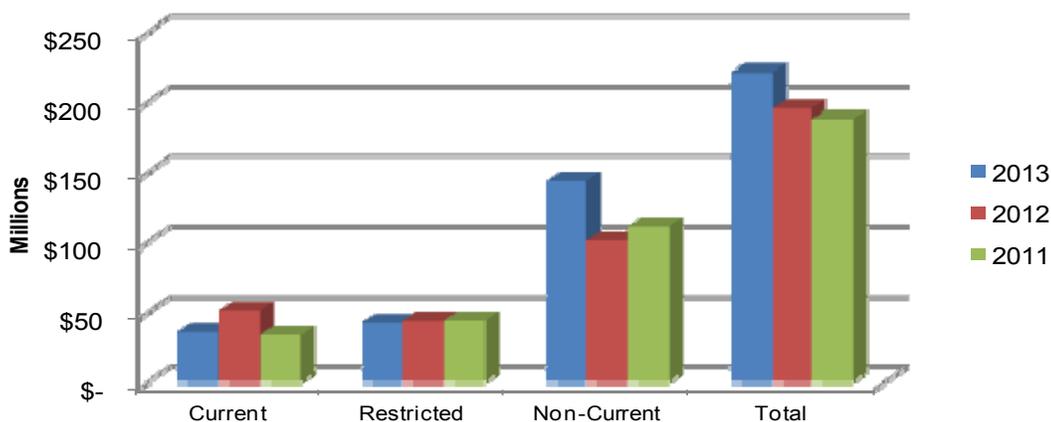
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June 30, 2013 and 2012**

Financial Condition

Condensed Statements of Net Position

| | 2013 | 2012 | 2011 |
|--|---------------------|---------------------|---------------------|
| | (in thousands) | | |
| Current assets | | | |
| Cash and cash equivalents | \$ 20,404 | \$ 14,354 | \$ 7,159 |
| Investments | 14,908 | 36,653 | 26,034 |
| Other current assets | 27,166 | 27,269 | 26,658 |
| Restricted assets | | | |
| Cash and cash equivalents | 15,197 | 15,682 | 14,975 |
| Investments | 26,686 | 27,681 | 28,532 |
| Due from broker | 1,330 | - | - |
| Investments | 143,688 | 100,659 | 110,862 |
| Bond issues costs | 2,173 | 2,294 | 2,805 |
| Capital assets, net | <u>1,138,464</u> | <u>1,146,384</u> | <u>1,157,677</u> |
| Total assets | <u>\$ 1,390,016</u> | <u>\$ 1,370,976</u> | <u>\$ 1,374,702</u> |
| Current liabilities, payable from current assets | \$ 19,065 | \$ 10,326 | \$ 11,750 |
| Other liabilities and payables from restricted assets | 47,108 | 48,860 | 61,786 |
| Bonds payable, noncurrent | <u>275,050</u> | <u>282,870</u> | <u>291,632</u> |
| Total liabilities | <u>341,223</u> | <u>342,056</u> | <u>365,168</u> |
| Net position | | | |
| Invested in capital assets, net of related debt | 843,770 | 842,391 | 834,243 |
| Restricted for capital activity and debt service | 26,635 | 26,410 | 25,609 |
| Unrestricted | <u>178,388</u> | <u>160,119</u> | <u>249,683</u> |
| Total net position | <u>1,048,793</u> | <u>1,028,920</u> | <u>1,009,534</u> |
| Total liabilities and net position | <u>\$ 1,390,016</u> | <u>\$ 1,370,976</u> | <u>\$ 1,374,702</u> |

Cash and Investments



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The BWS's unrestricted current assets were 3.3, 7.6, and 5.1 times its related current liabilities, payable from current assets, as of June 30, 2013, 2012 and 2011, respectively. The ratio decrease at June 30, 2013 was due to the \$21.7 million decrease in unrestricted current investments as the BWS's investment portfolio mix shifted to investment holdings with maturity dates that exceeded one year. The change in the investment mix also resulted in the \$43.0 million increase in the BWS's unrestricted noncurrent investments. The net increase in the BWS's unrestricted investments is primarily due to the \$19.9 million increase in net position as of June 30, 2013. The unrestricted current asset to current liabilities, payable from current assets, ratio increased from 5.1 to 7.6 at June 30, 2012 due to a shift in the investment portfolio mix to debt security holdings with maturity dates due within one year. This shift at June 30, 2012 resulted in a \$10.2 million decrease in unrestricted noncurrent investments.

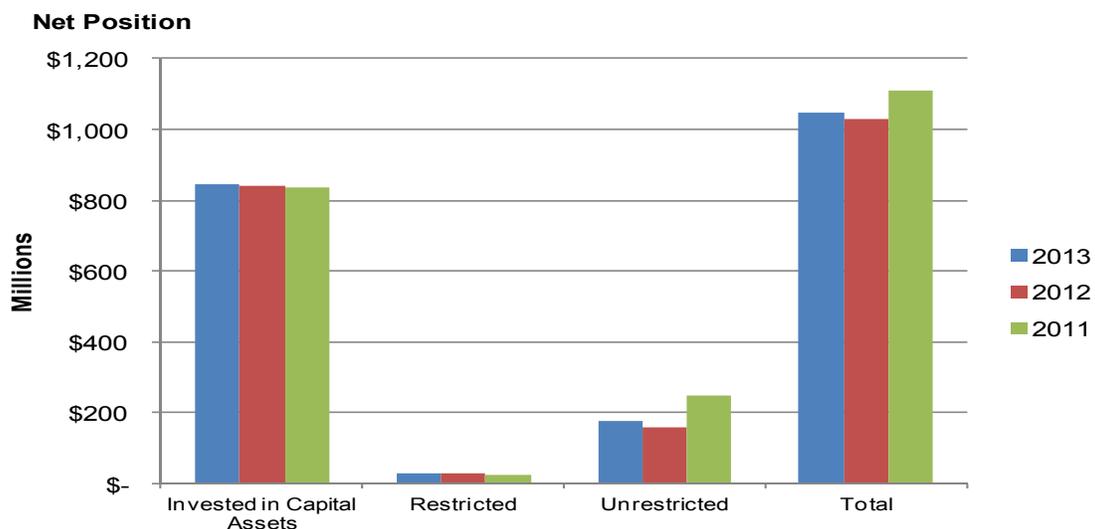
As of June 30, 2013 and 2012, capital assets, net decreased by \$7.9 million and \$11.3 million, respectively. The decreases in fiscal year 2013 and 2012 were due to construction work in progress charge-offs and depreciation charges exceeding acquisitions.

As of June 30, 2013, current liabilities payable from current assets increased by \$8.7 million or 84.6%. This increase is primarily due to the timing of payments on the BWS's trade accounts payable.

Other liabilities and payables from restricted assets decreased by \$12.9 million during fiscal year 2012. The decrease is due to principal payments made on the BWS note payables during 2012.

The BWS's noncurrent bonds payable decreased by \$7.8 million and \$8.8 million as of June 30, 2013 and 2012, respectively. These decreases represent the current bonds payable due within one year as of June 30, 2013 and 2012.

Net position increased by \$19.9 million and \$19.4 million as of June 30, 2013 and 2012, respectively. The increases were primarily due to an increase in operating revenue.



**Board of Water Supply
City and County of Honolulu
Management's Discussion and Analysis
June 30, 2013 and 2012**

Capital Assets and Long-Term Debt

During fiscal years 2013 and 2012, the BWS capitalized \$70.4 million and \$31.0 million, respectively, to its utility plant in service. Major assets added in fiscal year 2013 were Farrington Highway, Part I, \$23.0 million; Customer Information System, \$14.2 million; University of Hawaii West Oahu Offsite 440' water improvements, \$7.1 million; emergency power transformer replacements, \$3.7 million; Waimanalo Well III, \$3.6 million; and Mokulua Drive 8 inch main, and Part II, \$3.0 million. Major assets added in fiscal year 2012 were Waipahu Wells III, \$6.2 million; East Kapolei Transmission Main, \$4.2 million; Kamehameha Highway Sunset Beach water system improvements, \$3.6 million; and Kamehameha Highway 8 inch Main (Kaneohe), \$2.5 million.

The BWS issues long-term bonds to finance part of its capital improvement program. The BWS's debt to equity ratio has remained fairly constant at 29.0%, 30.5% and 32.9% for fiscal years 2013, 2012 and 2011, respectively.

The BWS issued \$85,195,000 of Board of Water Supply Water System Revenue Bonds, series 2012A bonds on March 14, 2012.

All outstanding debt has been assigned underlying ratings of Aa2 from Moody's Investors Service and AA+ from Fitch Ratings.

Rate Covenant

The BWS is required under its bond indenture, among other things, to fix, charge and collect such rates and other charges in each fiscal year to meet the net revenue requirement for such fiscal year. The net revenue requirement is the greater of 1) the sum of the aggregate debt service and all deposits required by bond resolution to be made, or 2) 1.20 times the aggregate debt service. The BWS met the net revenue requirements for the fiscal years ended June 30, 2013 and 2012.

Currently Known Facts, Decisions or Conditions

Effective July 1, 2012, the BWS increased its water rates by approximately 9.65%. Three additional annual water rate increases have been approved.

Request for Information

This financial report is designed to provide a general overview of the BWS's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Board of Water Supply, City and County of Honolulu, 630 S. Beretania Street, Honolulu, Hawaii 96813.

Financial Statements

**Board of Water Supply
City and County of Honolulu
Statements of Net Position
June 30, 2013 and 2012**

| | 2013 | 2012 |
|--|-------------------------|-------------------------|
| Assets | | |
| Currents assets | | |
| Cash and cash equivalents | \$ 20,404,063 | \$ 14,354,299 |
| Investments | 14,907,797 | 36,652,935 |
| Interest receivable | 550,550 | 868,151 |
| Customer receivables | | |
| Billed, less allowance for uncollectible accounts of \$1,993,416 and \$1,522,304 in 2013 and 2012, respectively | 6,462,403 | 7,640,511 |
| Unbilled | 11,017,915 | 11,776,533 |
| Other receivables, less allowance for uncollectible accounts of \$510,868 in 2013 and 2012 | 2,494,096 | 1,788,407 |
| Materials and supplies | 6,460,259 | 4,942,267 |
| Prepaid expenses | 181,093 | 252,738 |
| Total current assets | <u>62,478,176</u> | <u>78,275,841</u> |
| Restricted assets | | |
| Cash and cash equivalents | 15,197,057 | 15,682,582 |
| Investments | 26,685,751 | 27,680,574 |
| Due from broker | 1,330,000 | - |
| Total restricted assets | <u>43,212,808</u> | <u>43,363,156</u> |
| Investments | <u>143,688,323</u> | <u>100,659,263</u> |
| Bond issue costs | | |
| Net of accumulated amortization of \$1,569,695 and \$1,448,697 in 2013 and 2012, respectively | <u>2,172,821</u> | <u>2,293,819</u> |
| Capital assets | | |
| Infrastructure | 1,365,850,204 | 1,323,318,170 |
| Building and improvements | 152,197,864 | 149,119,056 |
| Equipment and machinery | 266,854,387 | 243,497,917 |
| | <u>1,784,902,455</u> | <u>1,715,935,143</u> |
| Less: Accumulated depreciation | <u>808,738,703</u> | <u>766,708,010</u> |
| | 976,163,752 | 949,227,133 |
| Land | 32,373,064 | 32,373,064 |
| Construction work in progress | <u>129,927,360</u> | <u>164,784,029</u> |
| Net capital assets | <u>1,138,464,176</u> | <u>1,146,384,226</u> |
| Total assets | <u>\$ 1,390,016,304</u> | <u>\$ 1,370,976,305</u> |

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

**Board of Water Supply
City and County of Honolulu
Statements of Net Position
June 30, 2013 and 2012**

| | 2013 | 2012 |
|--|-------------------------|-------------------------|
| Liabilities | | |
| Current liabilities | | |
| Payable from current assets | | |
| Accounts payable | \$ 10,790,929 | \$ 4,962,834 |
| Contracts payable, including retainages | 3,871,504 | 3,737,463 |
| Accrued vacation, current | 1,464,290 | 1,611,211 |
| Other | 2,938,049 | 14,948 |
| Total payable from current assets | <u>19,064,772</u> | <u>10,326,456</u> |
| Payable from restricted assets | | |
| Contracts payable, including retainages | 937,401 | 1,172,195 |
| Accrued interest payable | 6,750,422 | 5,955,485 |
| Bonds payable, current | 7,335,000 | 7,985,000 |
| Notes payable, current | 1,554,435 | 1,540,637 |
| Other | - | 300,160 |
| Total payable from restricted assets | <u>16,577,258</u> | <u>16,953,477</u> |
| Total current liabilities | <u>35,642,030</u> | <u>27,279,933</u> |
| Other liabilities | | |
| Customer advances | 894,125 | 1,387,908 |
| Accrued vacation, noncurrent | 5,042,067 | 4,610,403 |
| Accrued workers' compensation | 2,305,822 | 2,393,549 |
| Other postemployment benefits | 460,450 | 12,000 |
| Notes payable, noncurrent | 19,643,962 | 21,123,227 |
| Accrued arbitrage rebate | 48,873 | 48,873 |
| Other | 2,134,881 | 2,330,845 |
| Total other liabilities | <u>30,530,180</u> | <u>31,906,805</u> |
| Bonds payable, noncurrent | <u>275,050,393</u> | <u>282,869,112</u> |
| Total liabilities | <u>341,222,603</u> | <u>342,055,850</u> |
| Commitments and contingencies | | |
| Net Position | | |
| Invested in capital assets – net of related debt | 843,769,821 | 842,391,887 |
| Restricted for capital activity and debt service | 26,635,550 | 26,409,679 |
| Unrestricted | 178,388,330 | 160,118,889 |
| Total net position | <u>1,048,793,701</u> | <u>1,028,920,455</u> |
| Total liabilities and net position | <u>\$ 1,390,016,304</u> | <u>\$ 1,370,976,305</u> |

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

Board of Water Supply
City and County of Honolulu
Statements of Revenues, Expenses and Change in Net Position
Years Ended June 30, 2013 and 2012

| | 2013 | 2012 |
|---|-------------------------|-------------------------|
| Operating revenues | | |
| Water sales | \$ 177,316,132 | \$ 155,819,396 |
| Other, principally contract and service fees | <u>3,189,204</u> | <u>3,688,333</u> |
| Total operating revenues | 180,505,336 | 159,507,729 |
| Operating expenses | | |
| Administrative and general | 43,408,706 | 39,392,068 |
| Depreciation | 41,774,826 | 42,376,263 |
| Power and pumping | 39,248,278 | 33,202,387 |
| Transmission and distribution | 18,245,127 | 13,741,862 |
| Maintenance | 18,156,287 | 17,286,240 |
| Water reclamation | 4,908,661 | 6,318,530 |
| Customers' accounting and collection | 4,408,308 | 2,838,379 |
| Central administrative services expense fees | 3,300,000 | 3,300,000 |
| Source of supply | <u>41,265</u> | <u>267,921</u> |
| Total operating expenses | <u>173,491,458</u> | <u>158,723,650</u> |
| Operating income | <u>7,013,878</u> | <u>784,079</u> |
| Nonoperating revenues (expenses) | | |
| Interest income | 2,528,333 | 2,902,587 |
| Interest expense, net of interest capitalized and amortization of bond premiums of \$1,415,891 and \$4,187,825 in 2013 and 2012, respectively | (11,865,437) | (8,671,709) |
| Loss from disposal of capital assets | (254,503) | (359,250) |
| Realized and unrealized losses on investments | (2,414,961) | (916,009) |
| Other | <u>1,338,780</u> | <u>448,169</u> |
| Total nonoperating expenses | <u>(10,667,788)</u> | <u>(6,596,212)</u> |
| Contributions in aid of construction | <u>23,527,156</u> | <u>25,198,240</u> |
| Change in net position | 19,873,246 | 19,386,107 |
| Net position | | |
| Beginning of year | <u>1,028,920,455</u> | <u>1,009,534,348</u> |
| End of year | <u>\$ 1,048,793,701</u> | <u>\$ 1,028,920,455</u> |

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

Board of Water Supply
City and County of Honolulu
Statements of Cash Flows
Years Ended June 30, 2013 and 2012

| | 2013 | 2012 |
|--|----------------------|----------------------|
| Cash flows from operating activities | | |
| Cash received from customers | \$ 184,544,815 | \$ 159,137,904 |
| Cash payments to suppliers for goods and services | (83,091,063) | (68,910,138) |
| Cash payments to employees for services | (43,099,841) | (46,520,944) |
| Other income (expenses), net | 1,338,780 | (423,681) |
| Net cash provided by operating activities | <u>59,692,691</u> | <u>43,283,141</u> |
| Cash flows from capital and related financing activities | | |
| Acquisition and construction of capital assets, net of contributions in aid of construction | (18,911,159) | (20,436,212) |
| Proceeds from sale of capital assets | 9,665 | 53,643 |
| Customer payments for capital projects | 8,771,917 | 5,901,365 |
| Principal paid on bonds | (7,985,000) | (6,710,000) |
| Interest paid on bonds | (12,361,416) | (14,070,711) |
| Payments on arbitrage liability | - | (905,540) |
| Proceeds from notes payable | 85,061 | 11,492 |
| Interest paid on notes payable | (124,975) | (130,639) |
| Principal paid on notes payable | (1,550,528) | (1,543,469) |
| Net cash used in capital and related financing activities | <u>(32,066,435)</u> | <u>(37,830,071)</u> |
| Cash flows from investing activities | | |
| Purchase of investments | (144,688,330) | (139,097,887) |
| Proceeds from maturities of investments | 119,814,269 | 138,617,661 |
| Interest on investments | 2,812,044 | 2,929,369 |
| Net cash provided by (used in) investing activities | <u>(22,062,017)</u> | <u>2,449,143</u> |
| Net increase in cash and cash equivalents | 5,564,239 | 7,902,213 |
| Cash and cash equivalents | | |
| Beginning of year | <u>30,036,881</u> | <u>22,134,668</u> |
| End of year (including \$15,197,057 and \$15,682,582 in restricted assets in 2013 and 2012, respectively) | <u>\$ 35,601,120</u> | <u>\$ 30,036,881</u> |

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

**Board of Water Supply
City and County of Honolulu
Statements of Cash Flows
Years Ended June 30, 2013 and 2012**

| | 2013 | 2012 |
|--|----------------------|----------------------|
| Reconciliation of operating income to net cash provided by operating activities | | |
| Operating income | \$ 7,013,878 | \$ 784,079 |
| Depreciation | 43,399,565 | 43,966,589 |
| Provision for doubtful accounts | (646,148) | (538,635) |
| Other revenues | 1,338,780 | 448,169 |
| Changes in assets and liabilities | | |
| Customer receivables | 1,936,726 | (1,737,555) |
| Materials and supplies | (1,517,992) | (433,667) |
| Other receivables | (705,689) | 1,906,365 |
| Prepaid expenses and other | 71,645 | 165,236 |
| Accounts and contracts payable | 5,727,342 | 101,798 |
| Accrued vacation | 284,743 | 372,420 |
| Other postemployment benefits | 448,450 | (996,000) |
| Other liabilities | 2,341,391 | (755,658) |
| Net cash provided by operating activities | <u>\$ 59,692,691</u> | <u>\$ 43,283,141</u> |
| Noncash capital and related financing activities | | |
| Contributions of capital assets from government agencies, developers and customers that are recorded as contributions in aid of construction | \$ 14,755,239 | \$ 10,002,536 |
| Amortization of bond issue costs | 120,997 | 134,603 |
| Amortization of bond premium, net | (1,022,366) | (621,684) |
| Amortization of deferred loss on refunding | 538,647 | 220,494 |
| Bond proceeds deposited directly with escrow agent for refunding of previously issued debt | - | 97,821,826 |
| Bond proceeds used for bond issuance costs | - | 687,342 |
| Forgiveness of principal due on notes payable | - | 9,140,265 |

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

Board of Water Supply

City and County of Honolulu

Notes to Financial Statements

June 30, 2013 and 2012

1. Operations

The Revised Charter of the City and County of Honolulu provides for the operation of the Board of Water Supply (the "BWS") as a semi-autonomous body of the City and County of Honolulu government (the "City"). The BWS has full and complete authority to manage, control and operate the City's water system and related properties.

2. Summary of Significant Accounting Policies

Financial Statement Presentation, Measurement Focus and Basis of Accounting

The BWS is a component unit of the City (the "primary government"). The accompanying financial statements present only the activities of the BWS and do not include other organizations, activities and functions of the City.

The accounting policies of the BWS conform to U.S. generally accepted accounting principles as applicable to enterprise activities of governmental units as promulgated by the Governmental Accounting Standards Board ("GASB"). The accompanying financial statements are presented using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

The BWS distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services in connection with the BWS's principal ongoing water operations. The principal operating revenues are from charges for water usage, while operating expenses include cost of services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

The BWS applies all applicable GASB pronouncements, including the adoption of GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB (Financial Accounting Standards Board) and AICPA (American Institute of Certified Public Accountants) Pronouncements*, in the year ended June 30, 2013.

Use of Estimates

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant items subject to such estimates and assumptions include the carrying amount of capital assets, valuation allowances for receivables, accrued workers' compensation, and postretirement benefits. Actual results could differ from those estimates.

Regulation and Water Rates

Article VII of the Revised Charter of the City and County of Honolulu ("City Charter") states that the BWS's seven-member Board of Directors has the authority to establish and adjust water rates and charges so that the revenues derived shall be sufficient to make the BWS self-supporting. The Board of Directors is required to follow certain procedures that include holding public hearings before implementing changes in the water rate schedules.

**Board of Water Supply
City and County of Honolulu
Notes to Financial Statements
June 30, 2013 and 2012**

Cash and Cash Equivalents

The BWS considers all cash on hand, demand deposits, and short-term investments including restricted assets with original maturities of three months or less from the date of acquisition to be cash and cash equivalents.

Investments

Investments are stated at fair value, which are based on quoted market prices. The cost of securities sold is generally determined by the weighted average method.

Receivables

Receivables are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is the BWS's best estimate of the amount of probable credit losses in the BWS's existing receivables. The BWS determines the allowance based on historical write-off experience. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote.

Materials and Supplies

Materials and supplies are stated at the lower of weighted average cost or market. The weighted average cost method approximates the first-in, first-out method. The cost of materials and supplies are recorded as expenses when consumed rather than when purchased.

Restricted Assets

Restricted assets are comprised of cash and cash equivalents and investments maintained in accordance with bond resolutions and other agreements for the purpose of funding certain debt service payments, construction, improvements, and renewal and replacements of the water system. When both restricted and unrestricted assets are available for use, it is the BWS's policy to use restricted assets first, then unrestricted assets as they are needed. Restricted assets comprise the following:

- The debt service account accumulates transfers from the operating account throughout the fiscal year to make principal and interest payments on the outstanding water revenue bonds and other notes payable.
- The renewal and replacement account provides funding for improvements, reconstruction, emergency or extraordinary repairs, and renewals or replacements of the water system.
- The improvement account holds the proceeds of the series bond issuance pursuant to the series resolution or series certificates. These proceeds are only applied to costs specified in the applicable series resolution or series certificates.
- The extramural account holds reimbursements received from any governmental agency or private entity, pursuant to negotiated agreements, contracts and/or grants.

Capital Assets

Capital assets include those assets in excess of \$5,000 for buildings, structures, infrastructure, and equipment and machinery with a useful life of more than one year. Capital assets are stated at cost and include contributions by governmental agencies, private subdividers, and customers at their cost or estimated cost of new construction.

**Board of Water Supply
City and County of Honolulu
Notes to Financial Statements
June 30, 2013 and 2012**

Major replacements, renewals, and betterments are capitalized. Interest costs are capitalized during the construction period of major capital projects. Interest costs incurred in the years ended June 30, 2013 and 2012 totaled \$13,281,328 and \$12,859,534, respectively. Capitalized interest costs totaled \$1,053,169 and \$3,921,239 for the years ended June 30, 2013 and 2012, respectively. The BWS also capitalizes certain indirect costs to construction work based upon actual construction direct labor. Maintenance, repairs and replacements that do not improve or extend the lives of the assets are charged to expense.

Assets are depreciated over the individual assets' estimated useful lives using the straight-line method. Depreciation on both purchased and contributed assets is charged against operations.

The estimated useful lives of capital assets are as follows:

| | |
|-------------------------------------|------------------------------|
| Source of supply | 20 to 100 years |
| Pumping plant | 20 to 50 years |
| Water treatment plant | 20 to 30 years |
| Transmission and distribution plant | 13 $\frac{1}{3}$ to 50 years |
| General plant | 5 to 50 years |

Gains or losses resulting from the sale, retirement or disposal of capital assets in service are charged or credited to operations.

Bond Issue Costs, Original Issue Discount or Premium, and Deferred Loss on Refundings

Bond issue costs are deferred and are amortized over the life of the respective issue on a straight-line basis. Original issue discount or premium and deferred loss on refundings are also amortized using the straight-line method over the terms of the respective issues and are added to or offset against the bonds payable in the statements of net position.

Accrued Vacation and Compensatory Pay

Vacation is earned at the rate of one and three-quarters working days for each month of service. Vacation days may be accumulated to a maximum of ninety days as of the end of the calendar year and are convertible to pay upon termination.

The BWS accrues a liability for compensated absences and additional amounts for certain salary-related payments including payroll taxes and fringe benefits.

As of June 30, 2013 and 2012, accumulated sick leave aggregated approximately \$17,430,000 and \$17,840,000, respectively. Sick leave accumulates at the rate of one and three-quarters working days for each month of service without limit, but can be taken only in the event of illness and is not convertible to pay upon termination of employment. However, an employee who retires or leaves government service in good standing with 60 or more unused sick days is entitled to additional service credit in the State of Hawaii's Employees' Retirement System.

Water System Facilities Charge

A water system facilities charge is levied against all new developments and residential properties requiring water from the BWS's systems, except those developments that have paid for and installed a complete water system, including source, transmission, and daily storage facilities. The amounts collected are initially recorded as customer advances and are recognized as contributions in aid of construction when water service is made available to the customer. The use of these funds is designated for the construction of water facilities.

**Board of Water Supply
City and County of Honolulu
Notes to Financial Statements
June 30, 2013 and 2012**

Net Position

Net position comprises the various net earnings from operating and nonoperating revenues, expenses, and contributions in aid of construction. Net position is classified in the following three components: invested in capital assets, net of related debt; restricted for capital activity and debt service; and unrestricted net position. Invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation and reduced by outstanding debt that is attributable to the acquisition, construction, or improvement of those assets. Debt related to unspent proceeds or other restricted cash and investments at year-end is not included in the calculation of invested in capital assets, net of related debt. Restricted for capital activity and debt service consists of net position for which constraints are placed thereon by external parties, such as lenders, grantors, contributors, laws, regulations and enabling legislation. Unrestricted consists of all other net assets not included in the above categories.

Revenue Recognition

The BWS's policy is to bill customers on a cyclical monthly or bi-monthly basis for water usage. Beginning in January 2013, the BWS bills all customers on a cyclical monthly basis. The accrual for unbilled water revenues and related receivables reflected in the accompanying financial statements is based on estimated usage from the latest meter reading date to the end of the fiscal period.

Contributions in Aid of Construction

Contributions in aid of construction represent cash or capital assets received by the BWS to aid in the construction of infrastructure assets. Contributions in aid of construction are recognized when they are accepted by the BWS and when all applicable eligibility requirements have been met.

Pension Expense

The BWS's contributions to the Employees' Retirement System of the State of Hawaii are based upon actuarial computations and include current service costs and amortization of prior service costs. The BWS's policy is to fund pension costs accrued.

Deferred Compensation Plan

All full-time employees are eligible to participate in the City and County of Honolulu's Public Employees' Deferred Compensation Plan (the "Plan"), adopted pursuant to Internal Revenue Code Section 457. The Plan permits eligible employees to defer a portion of their salary until future years. The deferred compensation amounts are not available to employees until termination, retirement, death or unforeseeable emergency.

A trust fund was established to protect plan assets from claims of general creditors and from diversion to any uses other than paying benefits to participants and beneficiaries. Accordingly, the BWS has excluded the Plan's assets and liabilities from the financial statements because the BWS and the City do not have significant administrative involvement in the Plan or perform the investment function for the Plan.

Risk Management

The BWS is exposed to various risks of loss from: (1) torts, (2) theft of, damage to, and destruction of assets, (3) employee injuries and illnesses, (4) natural disasters, and (5) employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters.

**Board of Water Supply
City and County of Honolulu
Notes to Financial Statements
June 30, 2013 and 2012**

The ranges of insurance limits and deductibles are as follows:

| Policy | Limits (Millions) | Deductibles |
|------------------------------|----------------------|-------------|
| Property | \$ 60 | \$ 50,000 |
| Public Entity Liability | 15 | 500,000 |
| Excess Workers' Compensation | 25 | 600,000 |
| Employment Practices | 5 | 75,000 |
| Storage Tank Liability | 2 | 10,000 |
| Pollution Legal Liability | 5 | 250,000 |
| Crime | 5 | 25,000 |

New Accounting Pronouncements

In April 2012, the GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*. The objective of this Statement is to clarify the appropriate reporting of deferred outflows and deferred inflows of resources to ensure consistency in financial reporting. The requirements of this Statement are effective for reporting periods beginning after December 15, 2012. Management has not yet determined the effect this Statement will have on the BWS's financial statements.

In April 2012, the GASB issued Statement No. 66, *Technical Corrections – 2012*. The objective of this Statement is to enhance usefulness of financial reports by resolving conflicting accounting and financial reporting guidance that could diminish the consistency of financial reporting. The requirements of this Statement are effective for reporting periods beginning after December 15, 2012. Management does not expect that this Statement will have a material effect on the BWS's financial statements.

In June 2012, the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions*. The Statement revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. The requirements of this Statement are effective for reporting periods beginning after June 15, 2014. Management has not yet determined the effect this Statement will have on the BWS's financial statements.

In April 2013, the GASB issued Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*. The objective of this Statement is to improve accounting and financial reporting by state and local governments that extend and receive nonexchange financial guarantees. The requirements of this Statement are effective for reporting periods beginning after June 15, 2013. Management has not yet determined the effect this Statement will have on the BWS's financial statements.

3. Cash and Investments

Cash deposited with the City is maintained in separate accounts by the Department of Budget and Fiscal Services of the City. The Hawaii Revised Statutes ("HRS") provide for the City's Director of Finance to deposit the cash with any national or state bank or federally insured financial institution authorized to do business in the State of Hawaii, provided that all deposits are fully insured or collateralized. The City's demand deposits are fully insured or collateralized with securities held by the City or its agents in the City's name. The HRS authorizes the BWS to invest, with certain restrictions, in obligations of the State of Hawaii or the United States, in federally insured savings

**Board of Water Supply
City and County of Honolulu
Notes to Financial Statements
June 30, 2013 and 2012**

accounts, time certificates of deposit, and bank repurchase agreements with federally insured financial institutions authorized to do business in the State of Hawaii.

The BWS's portfolio is managed by various investment managers. These investments consist of U.S. government securities. Investments and securities issued by U.S. government-sponsored enterprises are recorded at fair value based on quoted market prices.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Generally, the longer the term of an investment, the greater the sensitivity of its fair value to changes in market interest rates. As a means of limiting its exposure to fair value losses, the BWS invests operating funds primarily in shorter-term securities, money market mutual funds, or similar investment pools.

Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. U.S. government securities or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk exposure. Because the BWS invests primarily in obligations of the U.S. government or U.S. government-sponsored enterprises, it is not exposed to significant credit risk.

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty to a transaction, the BWS will not be able to recover the value of investments or collateral securities that are in the possession of an outside party. All investments are registered in the name of the BWS and are held in the possession of a broker-dealer firm. At June 30, 2013, approximately \$6,876,108 in cash and cash equivalents and all investments were held by a broker-dealer firm. Cash, cash equivalents and investments held by the broker-dealer firm are insured up to \$500,000, of which up to \$250,000 may be uninvested cash, by the Securities Investor Protection Corporation. Excess coverage purchased from a private insurer by the broker-dealer firm is designed to provide additional protection up to the full net equity value of each account.

Concentration of Credit Risk

Concentration of credit risk is the risk of a loss attributed to the magnitude of a government's investment in a single issuer. The BWS's concentration of credit risk related to investments in debt securities has been mitigated by limiting such investments to only debt obligations of the U.S. government and U.S. government-sponsored enterprises.

The historical cost and estimated fair value of investments at June 30, 2013 and 2012 consisted of the following:

| | 2013 | | 2012 | |
|---------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| | Cost | Fair Value | Cost | Fair Value |
| U.S. Treasury obligations | \$ 130,259,846 | \$ 129,492,270 | \$ 67,996,413 | \$ 67,918,397 |
| U.S. Government agencies | 56,553,861 | 55,789,601 | 98,003,118 | 97,074,375 |
| | <u>\$ 186,813,707</u> | <u>\$ 185,281,871</u> | <u>\$ 165,999,531</u> | <u>\$ 164,992,772</u> |

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At June 30, 2013, each investment had a credit quality rating of Aaa. The credit exposure as a percentage of total investments was as follows:

| | Percent of Total | Fair Value |
|--|-----------------------------|-----------------------|
| U.S. Treasury obligations | 70% | \$ 129,492,270 |
| U.S. Government agencies | | |
| Federal National Mortgage Association | 15% | 27,225,332 |
| Federal Home Loan Mortgage Corporation | 13% | 24,839,075 |
| Federal Home Loan Bank | 2% | 3,725,194 |
| | <u>100%</u> | <u>\$ 185,281,871</u> |

The fair value of investments at June 30, 2013 by contractual maturity is shown below:

| | Investment Maturities (In Years) | | |
|---------------------------|---|----------------------|-----------------------|
| | Fair Value | Less Than 1 | 1 – 5 |
| U.S. Treasury obligations | \$ 129,492,270 | \$ 16,585,939 | \$ 112,906,331 |
| U.S. Government agencies | 55,789,601 | 3,682,001 | 52,107,600 |
| | <u>\$ 185,281,871</u> | <u>\$ 20,267,940</u> | <u>\$ 165,013,931</u> |

4. Restricted Assets

At June 30, 2013 and 2012, the BWS's restricted assets were comprised of cash and cash equivalents, debt securities, and due from broker receivables and were held for the following purposes:

| | 2013 | 2012 |
|--|----------------------|----------------------|
| Construction, renewals, and replacements | \$ 2,801,286 | \$ 2,895,470 |
| Debt service | 40,411,522 | 40,467,686 |
| | <u>\$ 43,212,808</u> | <u>\$ 43,363,156</u> |

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5. Capital Assets

Capital assets activity during the years ended June 30, 2013 and 2012 were as follows:

| | Balance July 1, 2012 | Additions | Transfers | Retirements | Balance June 30, 2013 |
|--------------------------------|---------------------------------|------------------|------------------|--------------------|----------------------------------|
| Depreciable assets | | | | | |
| Infrastructure | \$ 1,323,318,170 | \$ 12,759,768 | \$ 30,259,390 | \$ (487,124) | \$ 1,365,850,204 |
| Buildings and improvements | 149,119,056 | 922,294 | 2,156,514 | - | 152,197,864 |
| Equipment and machinery | 243,497,917 | 3,649,601 | 20,852,790 | (1,145,921) | 266,854,387 |
| Total depreciable assets | 1,715,935,143 | 17,331,663 | 53,268,694 | (1,633,045) | 1,784,902,455 |
| Less: Accumulated depreciation | (766,708,010) | (43,399,565) | - | 1,368,872 | (808,738,703) |
| Total depreciable assets, net | 949,227,133 | (26,067,902) | 53,268,694 | (264,173) | 976,163,752 |
| Land | 32,373,064 | - | - | - | 32,373,064 |
| Construction work in progress | 164,784,029 | 38,364,014 | (73,220,683) | - | 129,927,360 |
| Net capital assets | \$ 1,146,384,226 | \$ 12,296,112 | \$ (19,951,989) | \$ (264,173) | \$ 1,138,464,176 |
| | Balance July 1, 2011 | Additions | Transfers | Retirements | Balance June 30, 2012 |
| Depreciable assets | | | | | |
| Infrastructure | \$ 1,303,009,505 | \$ 10,096,793 | \$ 11,010,691 | \$ (798,819) | \$ 1,323,318,170 |
| Buildings and improvements | 148,085,176 | - | 1,142,608 | (108,728) | 149,119,056 |
| Equipment and machinery | 237,113,104 | 2,405,327 | 6,384,183 | (2,404,697) | 243,497,917 |
| Total depreciable assets | 1,688,207,785 | 12,502,120 | 18,537,482 | (3,312,244) | 1,715,935,143 |
| Less: Accumulated depreciation | (725,640,773) | (43,966,589) | - | 2,899,352 | (766,708,010) |
| Total depreciable assets, net | 962,567,012 | (31,464,469) | 18,537,482 | (412,892) | 949,227,133 |
| Land | 32,373,064 | - | - | - | 32,373,064 |
| Construction work in progress | 162,737,147 | 30,778,855 | (28,731,973) | - | 164,784,029 |
| Net capital assets | \$ 1,157,677,223 | \$ (685,614) | \$ (10,194,491) | \$ (412,892) | \$ 1,146,384,226 |

Depreciation charges allocated to various functions for the years ended June 30, 2013 and 2012 totaled \$1,624,739 and \$1,590,326, respectively.

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6. Bonds Payable

At June 30, 2013 and 2012, bonds payable consisted of the following:

| | 2013 | 2012 |
|--|-----------------------|-----------------------|
| Water System Revenue Bonds, Series 2004, annual principal due ranging from \$2,280,000 to \$2,465,000 through July 1, 2014, with interest ranging from 3.50% to 4.00% | \$ 4,830,000 | \$ 7,110,000 |
| Water System Revenue Bonds, Series 2006A, annual principal due commencing July 1, 2012, ranging from \$975,000 to \$11,965,000 through July 1, 2036, with interest ranging from 4.00% to 5.00% | 156,745,000 | 157,720,000 |
| Water System Revenue Bonds, Series 2006B, annual principal due ranging from \$2,335,000 to \$4,455,000 through July 1, 2021, with interest ranging from 5.00% to 5.25% | 32,200,000 | 35,140,000 |
| Water System Revenue Bonds, Series 2012A, annual principal due commencing July 1, 2012, ranging from \$860,000 to \$8,535,000 through July 1, 2033, with interest ranging from 2.00% to 5.00% | <u>83,405,000</u> | <u>85,195,000</u> |
| | 277,180,000 | 285,165,000 |
| Add: Unamortized premium | 14,504,001 | 15,526,367 |
| Less: Deferred loss on refunding | <u>(9,298,608)</u> | <u>(9,837,255)</u> |
| | 282,385,393 | 290,854,112 |
| Less: Current portion | <u>(7,335,000)</u> | <u>(7,985,000)</u> |
| Noncurrent portion | <u>\$ 275,050,393</u> | <u>\$ 282,869,112</u> |

Principal and interest payments on water system revenue bonds are to be paid from the BWS revenue. Water system revenue bonds are subject to redemption on and after specific dates prior to maturity at the option of the BWS. The redemption amount equals the outstanding principal amount plus accrued interest without premium on the date of redemption.

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Bonds payable activity during 2013 and 2012, were as follows:

| | Balance July 1, 2012 | Additions | Reductions | Balance June 30, 2013 | Due Within One Year |
|-----------------------------------|---------------------------------|----------------------|------------------------|----------------------------------|--------------------------------|
| Water System Revenue Bonds | | | | | |
| Series 2004 | \$ 7,110,000 | \$ - | \$ (2,280,000) | \$ 4,830,000 | \$ 2,365,000 |
| Series 2006A | 157,720,000 | - | (975,000) | 156,745,000 | 1,015,000 |
| Series 2006B | 35,140,000 | - | (2,940,000) | 32,200,000 | 3,095,000 |
| Series 2012A | 85,195,000 | - | (1,790,000) | 83,405,000 | 860,000 |
| | <u>\$ 285,165,000</u> | <u>\$ -</u> | <u>\$ (7,985,000)</u> | <u>\$ 277,180,000</u> | <u>\$ 7,335,000</u> |
| | | | | | |
| | Balance July 1, 2011 | Additions | Reductions | Balance June 30, 2012 | Due Within One Year |
| Water System Revenue Bonds | | | | | |
| Series 2001 | \$ 11,780,000 | \$ - | \$ (11,780,000) | \$ - | \$ - |
| Series 2004 | 79,875,000 | - | (72,765,000) | 7,110,000 | 2,280,000 |
| Series 2006A | 165,195,000 | - | (7,475,000) | 157,720,000 | 975,000 |
| Series 2006B | 38,110,000 | - | (2,970,000) | 35,140,000 | 2,940,000 |
| Series 2012A | - | 85,195,000 | - | 85,195,000 | 1,790,000 |
| | <u>\$ 294,960,000</u> | <u>\$ 85,195,000</u> | <u>\$ (94,990,000)</u> | <u>\$ 285,165,000</u> | <u>\$ 7,985,000</u> |

At June 30, 2013, future bond principal and interest payments are as follows:

| | Principal | Interest | Total |
|-----------------------------|-----------------------|-----------------------|-----------------------|
| Year Ending June 30, | | | |
| 2014 | \$ 7,335,000 | \$ 13,011,000 | \$ 20,346,000 |
| 2015 | 7,660,000 | 12,688,000 | 20,348,000 |
| 2016 | 8,005,000 | 12,346,000 | 20,351,000 |
| 2017 | 8,365,000 | 11,983,000 | 20,348,000 |
| 2018 | 8,745,000 | 11,604,000 | 20,349,000 |
| 2019–2023 | 50,640,000 | 51,287,000 | 101,927,000 |
| 2024–2028 | 65,175,000 | 37,447,000 | 102,622,000 |
| 2029–2033 | 78,120,000 | 20,163,000 | 98,283,000 |
| 2034–2037 | 43,135,000 | 3,993,000 | 47,128,000 |
| | <u>\$ 277,180,000</u> | <u>\$ 174,522,000</u> | <u>\$ 451,702,000</u> |
| Total | | | |

In February 2001, the BWS created an irrevocable trust with an escrow agent to retire \$32,460,000 of the BWS's outstanding 1992 general obligation water bonds. The escrow agent will pay all future debt service payments on the 1992 Series bonds out of the irrevocable trust. Consequently, the 1992 Series bonds were considered to be defeased and the liability for the bonds was removed from the BWS's financial statements in 2001. At June 30, 2013 and 2012, the outstanding 1992 Series defeased bonds amounted to \$8,885,000 and \$11,520,000, respectively.

In July 2006, the BWS issued \$213,805,000 in water system revenue bonds which consisted of \$165,195,000 of Series 2006A and \$48,610,000 of Series 2006B bonds. A portion of the proceeds of the issuance were used to refund, on a current basis, all of the BWS's outstanding Series 2002 bonds and to advance refund a portion of the outstanding 2001 Series and 2004 Series bonds. Consequently, a portion of the 2001 Series and 2004 Series bonds were considered to be defeased and were removed from the BWS's financial statements in 2007.

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In March 2012, the BWS issued \$85,195,000 in Series 2012A water system revenue bonds. The proceeds of the issuance were used to refund, on a current basis, all of the BWS's outstanding Series 2001 bonds and to advance refund a portion of the outstanding 2004 Series and 2006A Series bonds. Consequently, a portion of the 2004 Series and 2006A Series bonds were considered defeased and were removed from the BWS's financial statements in 2012. This refunding was undertaken to reduce total debt service payments by \$9,512,024 and resulted in an economic gain of approximately \$7,152,000. At June 30, 2013 and 2012, the outstanding 2004 Series defeased bonds totaled \$78,665,000. The outstanding 2006A Series defeased bonds totaled \$7,475,000 as of June 30, 2013 and 2012.

The debt refunding that occurred during 2007 and 2012 resulted in a difference between the reacquisition price and the net carrying amount of the old debt of approximately \$2,464,000 and \$8,238,000, respectively. These differences reported in the accompanying financial statements as a deduction from bonds payable, are being charged to operations through the year 2031 using the straight-line method.

7. Notes Payable

At June 30, 2013 and 2012, notes payable consisted of the following:

| | 2013 | 2012 |
|--|----------------------|----------------------|
| Notes payable to Department of Health | | |
| Note payable in semi-annual installments of approximately \$60,100, including interest at .10%, due June 2025 | \$ 1,434,323 | \$ 1,460,973 |
| Note payable in semi-annual installments of approximately \$104,400, including interest at .31%, due November 2025 | 2,559,105 | 2,759,596 |
| Note payable in semi-annual installments of approximately \$10,200, including interest at .10%, due January 2027 | 274,238 | 294,411 |
| Note payable in semi-annual installments of approximately \$302,500, including interest at .10%, due February 2026 | 7,813,086 | 8,409,892 |
| Non-interest bearing note payable in semi-annual installments of approximately \$75,000, due September 2025 | 1,873,828 | 2,023,734 |
| Note payable in semi-annual installments of approximately \$32,500, including interest at .01%, due March 2028 | 974,477 | 1,039,390 |
| Note payable in semi-annual installments of approximately \$70,200, including interest at .01%, due August 2027 | 2,035,004 | 2,175,245 |
| Note payable in semi-annual installments of approximately \$49,700, including interest at .01%, due March 2028 | 1,490,058 | 1,589,316 |
| Note payable in semi-annual installments of approximately \$36,100, including interest at .36%, due June 2028 | 1,051,902 | 1,120,118 |
| Notes payable to other lenders | | |
| Note payable in monthly installments of approximately \$15,700, including interest at 5%, due September 2025 | 1,692,376 | 1,791,189 |
| | <u>21,198,397</u> | <u>22,663,864</u> |
| Less: Current portion | 1,554,435 | 1,540,637 |
| Noncurrent portion | <u>\$ 19,643,962</u> | <u>\$ 21,123,227</u> |

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The notes payable to the Department of Health are state revolving fund loans and are collateralized by net revenues of the BWS.

At June 30, 2013, future principal and interest payments for notes payable are as follows:

| | Principal | Interest | Total |
|-----------------------------|----------------------|-------------------|----------------------|
| Year Ending June 30, | | | |
| 2014 | \$ 1,554,000 | \$ 106,000 | \$ 1,660,000 |
| 2015 | 1,571,000 | 99,000 | 1,670,000 |
| 2016 | 1,578,000 | 92,000 | 1,670,000 |
| 2017 | 1,586,000 | 85,000 | 1,671,000 |
| 2018 | 1,593,000 | 77,000 | 1,670,000 |
| 2019–2023 | 8,093,000 | 258,000 | 8,351,000 |
| 2024–2028 | 5,223,000 | 42,000 | 5,265,000 |
| Total | <u>\$ 21,198,000</u> | <u>\$ 759,000</u> | <u>\$ 21,957,000</u> |

8. Other Long-Term Liabilities

The following is a summary of changes in other long-term liabilities for the years ended June 30, 2013 and 2012:

| | Balance July 1, 2012 | Additions | Reductions | Balance June 30, 2013 | Due Within One Year |
|------------------------------------|---------------------------------|----------------------|------------------------|----------------------------------|--------------------------------|
| Customer advances | \$ 1,387,908 | \$ - | \$ (493,783) | \$ 894,125 | \$ - |
| Accrued vacation | 6,221,614 | 1,749,033 | (1,464,290) | 6,506,357 | 1,464,290 |
| Accrued workers' compensation | 2,393,549 | 1,211,800 | (1,299,527) | 2,305,822 | - |
| Other postemployment benefits | 12,000 | 8,681,000 | (8,232,550) | 460,450 | - |
| Accrued arbitrage rebate liability | 48,873 | - | - | 48,873 | - |
| Other | 2,330,845 | 134,034 | (329,998) | 2,134,881 | - |
| | <u>\$ 12,394,789</u> | <u>\$ 11,775,867</u> | <u>\$ (11,820,148)</u> | <u>\$ 12,350,508</u> | <u>\$ 1,464,290</u> |
| | Balance July 1, 2011 | Additions | Reductions | Balance June 30, 2012 | Due Within One Year |
| Customer advances | \$ 2,210,966 | \$ 6,055,440 | \$ (6,878,498) | \$ 1,387,908 | \$ - |
| Accrued vacation | 5,849,194 | 1,983,631 | (1,611,211) | 6,221,614 | 1,611,211 |
| Accrued workers' compensation | 2,235,157 | 1,140,112 | (981,720) | 2,393,549 | - |
| Other postemployment benefits | 1,008,000 | 10,759,000 | (11,755,000) | 12,000 | - |
| Accrued arbitrage rebate liability | 954,413 | - | (905,540) | 48,873 | - |
| Other | 1,704,062 | 1,216,123 | (589,340) | 2,330,845 | - |
| | <u>\$ 13,961,792</u> | <u>\$ 21,154,306</u> | <u>\$ (22,721,309)</u> | <u>\$ 12,394,789</u> | <u>\$ 1,611,211</u> |

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9. Net Position

The BWS's net position consisted of the following as of June 30, 2013 and 2012:

| | 2013 | 2012 |
|--|-------------------------|-------------------------|
| Invested in capital assets, net of related debt | | |
| Capital assets, net | \$ 1,138,464,176 | \$ 1,146,384,226 |
| Less: Noncurrent portion of water system revenue bonds payable | (275,050,393) | (282,869,112) |
| Less: Notes payable | <u>(19,643,962)</u> | <u>(21,123,227)</u> |
| Total invested in capital assets, net of related debt | <u>843,769,821</u> | <u>842,391,887</u> |
| Restricted for capital activity and debt service | | |
| Restricted cash and cash equivalents | 15,197,057 | 15,682,582 |
| Restricted investments | 26,685,751 | 27,680,574 |
| Restricted other receivables | 1,330,000 | - |
| Less: Contracts payable, including retainages | (937,401) | (1,172,195) |
| Less: Accrued interest payable | (6,750,422) | (5,955,485) |
| Less: Current portion of bonds payable | (7,335,000) | (7,985,000) |
| Less: Current portion of notes payable | (1,554,435) | (1,540,637) |
| Less: Other payables from restricted assets | <u>-</u> | <u>(300,160)</u> |
| Total restricted for capital activity and debt service | 26,635,550 | 26,409,679 |
| Unrestricted | <u>178,388,330</u> | <u>160,118,889</u> |
| Total net position | <u>\$ 1,048,793,701</u> | <u>\$ 1,028,920,455</u> |

10. Leases

The BWS leases certain properties to other users, primarily utility and telecommunications companies, under multi-year license agreements. The terms of these agreements range from 5 to 30 years. The agreements are generally based on fixed annual amounts, with provisions for increases.

The BWS also leases space for its deep seawater cooling project on Oahu under an operating lease that extends through September 2025. The lease is subject to early cancellation contingent on mutual agreement between BWS and the lessor.

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The future minimum rental payments and sublease income from these operating leases at June 30, 2013 were as follows:

| | Future Minimal Rental Payments | Less Sublease Income | Net Minimum Future Rental (Income) Expense |
|-----------------------------|---|-------------------------------------|---|
| Year Ending June 30, | | | |
| 2014 | \$ 159,000 | \$ 208,000 | \$ (49,000) |
| 2015 | 159,000 | 205,000 | (46,000) |
| 2016 | 159,000 | 198,000 | (39,000) |
| 2017 | 159,000 | 176,000 | (17,000) |
| 2018 | 159,000 | 123,000 | 36,000 |
| 2019–2023 | 793,000 | 500,000 | 293,000 |
| 2024–2028 | 350,000 | 500,000 | (150,000) |
| 2029–2031 | - | 300,000 | (300,000) |
| | <u>\$ 1,938,000</u> | <u>\$ 2,210,000</u> | <u>\$ (272,000)</u> |

11. Related Party Transactions

The BWS has an agreement with the Department of Environmental Services, City and County of Honolulu to provide certain services relating to the billing and collection of sewer service charges. Fees related to these services were negotiated at approximately \$1,424,900 and \$1,422,300 for the years ended June 30, 2013 and 2012, respectively.

The BWS has an agreement with the City to pay a Central Administrative Services Expense (“CASE”) fee for treasury, personnel, purchasing and other services that the City provides to the BWS on an on-going basis. The BWS’s Charter allows for CASE fees to the extent that it represents a reasonable charge for services necessary for the BWS to perform its duties. CASE fees incurred during the years ended June 30, 2013 and 2012 totaled \$3,300,000.

There were no amounts due from the City as of June 30, 2013. Amounts due from the City totaled \$423,860 as of June 30, 2012 and was included in other receivables.

The BWS has entered into agreements with the City for joint capital projects. The City advanced to the BWS \$928,325 during the years ended June 30, 2013 and 2012. The advanced amounts represent the City’s share of total project expenses. Unexpended advanced funds totaled \$861,723 and \$1,161,883 as of June 30, 2013 and 2012, respectively, and are included in other liabilities.

12. Employee Benefit Plans

Defined Benefit Pension Plan

Substantially all eligible employees of the BWS are members of the Employees’ Retirement System of the State of Hawaii (“ERS”), a cost-sharing multiple-employer defined benefit public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits and is governed by a Board of Trustees. All contributions, benefits, and eligibility requirements are established by HRS Chapter 88 and can be amended by legislative action.

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The ERS is comprised of a contributory, noncontributory and hybrid contributory retirement plan. Prior to June 30, 1984, the plan consisted of only a contributory option. Effective July 1, 1984, legislation was enacted to create a noncontributory plan for members of the ERS who are also covered under social security. Persons employed in positions not covered by social security are precluded from the noncontributory plan. The noncontributory plan provides for reduced benefits and covers most eligible employees hired after June 30, 1984. Employees hired before that date were allowed to continue under the contributory plan or to elect the noncontributory plan and receive a refund of employee contributions.

The plans provide a monthly retirement allowance based on the employee's age, years of credited service, and average final compensation ("AFC"). The AFC is the average salary earned during the five highest paid years of service, including the vacation payment, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after that date and prior to January 1, 2003 is based on the three highest paid years of service, excluding the vacation payment. Effective January 1, 2003, the AFC is the highest three calendar years or highest five calendar year plus lump sum vacation payment, or last 36 credited months or last 60 credited months plus lump sum vacation payment.

Employees under the contributory and hybrid contributory plans hired prior to July 1, 2012 are entitled to a benefit multiplier of 2.0% of average final compensation. Employees who joined the contributory and hybrid contributory plans subsequent to June 30, 2012 receive a benefit multiplier of 1.75%. Members of the noncontributory plan receive a benefit multiplier of 1.25%.

Effective July 1, 2006, most general employees are required to become members of the hybrid contributory plan. Employees under the hybrid contributory plan that became members prior to July 1, 2012 are required to contribute 6.0% of their salary and fully vest upon receiving 5 years of credited service. Employees under the hybrid contributory plan that became members subsequent to June 30, 2012 are required to contribute 8.0% of their salary and fully vest upon receiving 10 years of credited service.

Most covered employees under the contributory plan that are covered by Social Security that became members prior to July 1, 2012 are required to contribute 7.8% of their salary and are fully vested for benefits upon receiving 5 years of credited service. General employees that became members subsequent to June 30, 2012 are required to contribute 9.8% of their salary and become fully vested with 10 years of credited service.

Prior to July 1, 2005, the funding method used to calculate the total employer contribution requirement was the Entry Age Normal Actuarial Cost Method. Under this method, employer contributions to the ERS were comprised of normal cost plus level annual payments required to liquidate the unfunded actuarial liability over the remaining period of 29 years from July 1, 2000. Effective July 1, 2008, employer contribution rates are a fixed percentage of compensation, generally 15.0% for most covered employees. The BWS's contributions to the ERS for the years ended June 30, 2013, 2012 and 2011, were approximately \$4,604,000, \$4,405,000 and \$4,540,000, respectively, which represented approximately 15% of the BWS's covered payroll for the fiscal years ended June 30, 2013, 2012 and 2011.

ERS issues a Comprehensive Annual Financial Report that includes financial statements and required supplementary information, which may be obtained at the following address: Employees' Retirement System of the State of Hawaii, 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813.

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Post-Retirement Health Care and Life Insurance Benefits

In addition to providing pension benefits, the State of Hawaii Employer-Union Health Benefits Trust Fund ("EUTF"), an agent multiple-employer plan provides certain health care (medical, prescription, vision and dental) and life insurance benefits for retired BWS employees. Act 88 established the EUTF during the 2001 legislative session and is codified in HRS 87A. Contributions are based on negotiated collective bargaining agreements and are limited by State statute to the actual cost of benefit coverage.

For employees hired before July 1, 1996, the BWS pays 100% of the monthly health care premium for employees retiring with 10 or more years of credited service, and 50% of the monthly premium for employees retiring with fewer than ten years of credited service.

For employees hired after June 30, 1996 and retiring with 25 years or more of service, the BWS pays the entire health care premium. For employees retiring with at least 15 years but fewer than 25 years of service, the BWS pays 75% of the monthly Medicare or non-Medicare premium. For those retiring with at least 10 years but fewer than 15 years of service, the BWS pays 50% of the retired employees' monthly Medicare or non-Medicare premium. For those retiring with fewer than 10 years of service, the BWS makes no contributions.

For employees hired after June 30, 2001 and retiring with over 25 years of service, the BWS pays 100% of the monthly premium based on the self plan. For those who retire with at least 15 years but fewer than 25 years of service, the BWS pays 75% of the retired employees' monthly Medicare or non-Medicare premium based on the self plan. For those retiring with at least ten years but fewer than 15 years of service, the BWS pays 50% of the retired employees' monthly Medicare or non-Medicare premium based on the self plan. For those retiring with fewer than 10 years of service, the BWS makes no contributions.

The BWS also reimburses 100% of Medicare premium costs for retirees and qualified dependents (through the State of Hawaii), who are at least 65 years of age and have at least 10 years of service.

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

**Board of Water Supply
City and County of Honolulu
Notes to Financial Statements
June 30, 2013 and 2012**

For the fiscal years ended June 30, 2013, 2012 and 2011, the components of the BWS's annual OPEB costs, the amounts contributed to the plan and the changes to the BWS's net OPEB obligation are summarized as follows:

| | 2013 | 2012 | 2011 |
|--|--------------------|---------------------|---------------------|
| Annual required contribution | \$ 8,674,000 | \$ 10,750,000 | \$ 10,387,000 |
| Interest on net OPEB obligation | 54,000 | 53,000 | 191,000 |
| Adjustment to annual required contribution | <u>(47,000)</u> | <u>(44,000)</u> | <u>(152,000)</u> |
| Annual OPEB cost | 8,681,000 | 10,759,000 | 10,426,000 |
| Contributions made | <u>(8,232,550)</u> | <u>(11,755,000)</u> | <u>(12,339,000)</u> |
| Increase (decrease) in net OPEB obligation | 448,450 | (996,000) | (1,913,000) |
| Net OPEB obligation | | | |
| Beginning of year | <u>12,000</u> | <u>1,008,000</u> | <u>2,921,000</u> |
| End of year | <u>\$ 460,450</u> | <u>\$ 12,000</u> | <u>\$ 1,008,000</u> |
| Percentage of annual OPEB cost contributed | <u>95%</u> | <u>109%</u> | <u>118%</u> |

The funded status of the plan as of the most recent valuation date is as follows:

| Actuarial Valuation Date | Actuarial Value of Assets | Actuarial Accrued Liability ("AAL") | Actuarial AAL ("UAAL") | Funded Ratio | Covered Payroll | Percentage of Covered Payroll |
|---|--|--|---------------------------------------|-------------------------|----------------------------|--|
| July 1, 2011 | \$ 14,557,000 | \$ 127,154,000 | \$ 112,597,000 | 11% | \$ 29,900,000 | 377% |
| July 1, 2009 | 5,244,000 | 143,333,000 | 138,089,000 | 4% | 33,104,000 | 417% |

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Projections of benefits for financial reporting purposes are based on the substantive plan and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the July 1, 2011, actuarial valuation, the entry age normal actuarial cost method was used. The actuarial assumptions included a discount rate of 7.0%, projected salary increases of 3.5%, and an annual health cost trend rate of 8.0%, reduced by decrements to an ultimate rate of 6.0% after 8 years. The unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll amounts over a thirty-year closed period ending June 30, 2037.

**Board of Water Supply
City and County of Honolulu
Notes to Financial Statements
June 30, 2013 and 2012**

The EUTF issues a stand-alone financial report that includes financial statements and required supplementary information, which may be obtained at the following address: State of Hawaii Employer-Union Health Benefits Trust Fund, P.O. Box 2121, Honolulu, Hawaii 96805.

13. Commitments

Commitments, primarily for utility plant construction, approximated \$116,900,000 and \$89,590,000 as of June 30, 2013 and 2012, respectively. Such amounts are to be funded by operating revenues, contributed capital, cash and investments on hand.

14. Contingencies

Workers' Compensation Self-Insurance Liability

The BWS is self-insured for workers' compensation and disability claims up to \$600,000 and in excess of \$25,000,000. The BWS has obtained excess insurance coverage for claims that are not self-insured. All claims are reported to and managed by the City's Workers' Compensation Division (the "Division"). The BWS provides reserves for claims not covered by insurance that in the opinion of the Division will result in probable judgment against the BWS.

The liability for losses and loss adjustment expenses is comprised of case reserves and incurred but not reported loss reserves ("IBNR"). Case or outstanding loss reserves represent estimates of ultimate costs to settle reported claims. The estimated liability is presented at its net present value using a discount rate of 3%.

Determination of a reserve account for workers' compensation is a significant estimate. It is reasonably possible that one or more future events could result in a material change in the estimated claims loss in the near term.

Arbitrage

The BWS is required to annually calculate rebates to the U.S. Treasury on revenue bond issues. In accordance with the requirements of Section 148 of the Internal Revenue Code of 1986, as amended, rebates are calculated by bond series based on the amounts by which the cumulative amount of investment income exceeds the amount that would have been earned had funds been invested at the bond yield. As of June 30, 2013 and 2012, the arbitrage rebate and yield restriction liability totaled \$48,873.

Safe Drinking Water

The BWS is subject to the requirements of the Safe Drinking Water Act (the "Act"), which is administered by the State of Hawaii Department of Health on behalf of the U.S. Environmental Protection Agency. Management believes that the BWS is in full compliance with the requirements of the Act and is not aware of any matters under the Act that may materially affect the BWS's customer service area.

Other Legal Matters

The BWS is party to various legal proceedings arising in the normal course of business. The outcome of individual matters is not predictable. However, management believes that the ultimate resolution of all such matters, after considering insurance coverage, will not have material adverse effect on the BWS's financial position, results of operations, or liquidity.

**Required
Supplementary Information**

**Board of Water Supply
City and County of Honolulu
Schedule of Funding Progress
June 30, 2013**

| Actuarial Valuation Date | Actuarial Value of Assets (a) | Actuarial Accrued Liability ("AAL") (b) | Unfunded Actuarial Accrued Liability ("UAAL") (b-a) | Funded Ratio (a/b) | Annual Covered Payroll (c) | UAAL as a Percentage of Annual Covered Payroll ((b-a)/c) |
|---|--|--|--|-----------------------------------|---|---|
| July 1, 2011 | \$ 14,557,000 | \$ 127,154,000 | \$ 112,597,000 | 11% | \$ 29,900,000 | 377% |
| July 1, 2009 | 5,244,000 | 143,333,000 | 138,089,000 | 4% | 33,104,000 | 417% |
| July 1, 2007 | - | 94,188,000 | 94,188,000 | 0% | 29,115,000 | 323% |

Supplementary Information

**Board of Water Supply
City and County of Honolulu
Schedule of Bonds Payable
June 30, 2013**

| Description of Bonds Payable | Interest Rate | Bond Dated | Maturing Serially From | Call Dates (A) | Outstanding June 30, 2013 |
|--|---------------|------------|------------------------|----------------|---------------------------|
| Water System Revenue Bonds Series 2004 | | | | | |
| Insured Serial Bonds | 4.000% | 1/28/2004 | 7/1/2013 | (B) | \$ 2,365,000 |
| Insured Serial Bonds | 4.000% | 1/28/2004 | 7/1/2014 | (B) | 2,465,000 |
| | | | | | <u>4,830,000</u> |
| Water System Revenue Bonds Series 2006A (Non-AMT) | | | | | |
| Insured Serial Bonds | 4.000% | 7/7/2006 | 7/1/2013 | (B) | 1,015,000 |
| Insured Serial Bonds | 4.000% | 7/7/2006 | 7/1/2014 | (B) | 1,050,000 |
| Insured Serial Bonds | 4.250% | 7/7/2006 | 7/1/2015 | (B) | 3,660,000 |
| Insured Serial Bonds | 4.250% | 7/7/2006 | 7/1/2016 | (B) | 3,820,000 |
| Insured Serial Bonds | 4.000% | 7/7/2006 | 7/1/2017 | (B) | 3,000,000 |
| Insured Serial Bonds | 4.125% | 7/7/2006 | 7/1/2017 | (B) | 975,000 |
| Insured Serial Bonds | 4.200% | 7/7/2006 | 7/1/2018 | (B) | 1,185,000 |
| Insured Serial Bonds | 5.000% | 7/7/2006 | 7/1/2019 | 7/1/2016 | 595,000 |
| Insured Serial Bonds | 4.125% | 7/7/2006 | 7/1/2019 | (B) | 645,000 |
| Insured Serial Bonds | 4.125% | 7/7/2006 | 7/1/2020 | (B) | 1,290,000 |
| Insured Serial Bonds | 5.000% | 7/7/2006 | 7/1/2021 | 7/1/2016 | 960,000 |
| Insured Serial Bonds | 4.300% | 7/7/2006 | 7/1/2021 | (B) | 390,000 |
| Insured Serial Bonds | 4.500% | 7/7/2006 | 7/1/2022 | (B) | 2,740,000 |
| Insured Serial Bonds | 4.500% | 7/7/2006 | 7/1/2023 | (B) | 8,225,000 |
| Insured Serial Bonds | 4.500% | 7/7/2006 | 7/1/2024 | (B) | 8,595,000 |
| Insured Serial Bonds | 5.000% | 7/7/2006 | 7/1/2025 | 7/1/2016 | 9,010,000 |
| Insured Serial Bonds | 5.000% | 7/7/2006 | 7/1/2026 | 7/1/2016 | 9,470,000 |
| Insured Serial Bonds | 4.500% | 7/7/2006 | 7/1/2027 | (B) | 9,925,000 |
| Insured Term Bonds | 4.750% | 7/7/2006 | 7/1/2028 | 7/1/2016 | 10,390,000 |
| Insured Term Bonds | 4.750% | 7/7/2006 | 7/1/2029 | 7/1/2016 | 10,890,000 |
| Insured Term Bonds | 4.750% | 7/7/2006 | 7/1/2030 | 7/1/2016 | 11,420,000 |
| Insured Term Bonds | 4.750% | 7/7/2006 | 7/1/2031 | 7/1/2016 | 11,965,000 |
| Insured Term Bonds | 5.000% | 7/7/2006 | 7/1/2032 | 7/1/2016 | 8,220,000 |
| Insured Term Bonds | 5.000% | 7/7/2006 | 7/1/2033 | 7/1/2016 | 8,640,000 |
| Insured Term Bonds | 5.000% | 7/7/2006 | 7/1/2034 | 7/1/2016 | 9,080,000 |
| Insured Term Bonds | 5.000% | 7/7/2006 | 7/1/2035 | 7/1/2016 | 9,550,000 |
| Insured Term Bonds | 5.000% | 7/7/2006 | 7/1/2036 | 7/1/2016 | <u>10,040,000</u> |
| | | | | | 156,745,000 |

(A) Call dates indicated are optional.

(B) Noncallable.

**Board of Water Supply
City and County of Honolulu
Schedule of Bonds Payable
June 30, 2013**

| Description of Bonds Payable | Interest Rate | Bond Dated | Maturing Serially From | Call Dates (A) | Outstanding June 30, 2013 |
|--|---------------|------------|------------------------|----------------|---------------------------|
| Water System Revenue Bonds Series 2006B (AMT) | | | | | |
| Insured Serial Bonds | 5.000% | 7/7/2006 | 7/1/2013 | (B) | 3,095,000 |
| Insured Serial Bonds | 5.000% | 7/7/2006 | 7/1/2014 | (B) | 3,255,000 |
| Insured Serial Bonds | 5.000% | 7/7/2006 | 7/1/2015 | (B) | 3,430,000 |
| Insured Serial Bonds | 5.000% | 7/7/2006 | 7/1/2016 | (B) | 3,605,000 |
| Insured Serial Bonds | 5.250% | 7/7/2006 | 7/1/2017 | 7/1/2016 | 3,800,000 |
| Insured Serial Bonds | 5.250% | 7/7/2006 | 7/1/2018 | 7/1/2016 | 4,005,000 |
| Insured Serial Bonds | 5.250% | 7/7/2006 | 7/1/2019 | 7/1/2016 | 4,220,000 |
| Insured Serial Bonds | 5.250% | 7/7/2006 | 7/1/2020 | 7/1/2016 | 4,455,000 |
| Insured Serial Bonds | 5.250% | 7/7/2006 | 7/1/2021 | 7/1/2016 | 2,335,000 |
| | | | | | 32,200,000 |
| Water System Revenue Bonds Series 2012A (Non-AMT) | | | | | |
| Insured Serial Bonds | 3.00% | 3/29/2012 | 7/1/2013 | (B) | 860,000 |
| Insured Serial Bonds | 3.00% | 3/29/2012 | 7/1/2014 | (B) | 890,000 |
| Insured Serial Bonds | 3.00% | 3/29/2012 | 7/1/2015 | (B) | 915,000 |
| Insured Serial Bonds | 3.00% | 3/29/2012 | 7/1/2016 | (B) | 940,000 |
| Insured Serial Bonds | 3.00% | 3/29/2012 | 7/1/2017 | (B) | 970,000 |
| Insured Serial Bonds | 4.00% | 3/29/2012 | 7/1/2018 | (B) | 3,960,000 |
| Insured Serial Bonds | 5.00% | 3/29/2012 | 7/1/2019 | (B) | 4,140,000 |
| Insured Serial Bonds | 5.00% | 3/29/2012 | 7/1/2020 | (B) | 2,320,000 |
| Insured Serial Bonds | 5.00% | 3/29/2012 | 7/1/2021 | (B) | 6,865,000 |
| Insured Serial Bonds | 5.00% | 3/29/2012 | 7/1/2022 | (B) | 8,535,000 |
| Insured Serial Bonds | 5.00% | 3/29/2012 | 7/1/2023 | 7/1/2022 | 3,605,000 |
| Insured Serial Bonds | 5.00% | 3/29/2012 | 7/1/2024 | 7/1/2022 | 3,790,000 |
| Insured Serial Bonds | 5.00% | 3/29/2012 | 7/1/2025 | 7/1/2022 | 3,980,000 |
| Insured Serial Bonds | 5.00% | 3/29/2012 | 7/1/2026 | 7/1/2022 | 4,185,000 |
| Insured Serial Bonds | 4.50% | 3/29/2012 | 7/1/2027 | 7/1/2022 | 4,390,000 |
| Insured Serial Bonds | 4.50% | 3/29/2012 | 7/1/2028 | 7/1/2022 | 4,595,000 |
| Insured Serial Bonds | 4.50% | 3/29/2012 | 7/1/2029 | 7/1/2022 | 4,805,000 |
| Insured Serial Bonds | 4.50% | 3/29/2012 | 7/1/2030 | 7/1/2022 | 5,025,000 |
| Insured Serial Bonds | 5.00% | 3/29/2012 | 7/1/2031 | 7/1/2022 | 5,270,000 |
| Insured Serial Bonds | 5.00% | 3/29/2012 | 7/1/2032 | 7/1/2022 | 5,540,000 |
| Insured Serial Bonds | 5.00% | 3/29/2012 | 7/1/2033 | 7/1/2022 | 5,825,000 |
| Bifurcated Serial Bonds | 2.00% | 3/29/2012 | 7/1/2020 | (B) | 2,000,000 |
| | | | | | 83,405,000 |
| | | | | | \$ 277,180,000 |

(A) Call dates indicated are optional.

(B) Noncallable.

**Board of Water Supply
City and County of Honolulu
Schedule of Net Revenue Requirement
Years Ended June 30, 2013 and 2012**

| | 2013 | 2012 |
|---|----------------------|----------------------|
| Revenues | | |
| Water sales | \$ 177,316,132 | \$ 155,819,396 |
| Interest | 2,528,333 | 2,902,587 |
| Other | 4,527,984 | 4,136,502 |
| Total revenues | <u>184,372,449</u> | <u>162,858,485</u> |
| Deductions | | |
| Operating expenses | 173,491,458 | 158,723,650 |
| Less: Depreciation expense | (41,774,826) | (42,376,263) |
| Less: Allocated depreciation charges | (1,624,739) | (1,590,326) |
| Total deductions | <u>130,091,893</u> | <u>114,757,061</u> |
| Net revenues | <u>\$ 54,280,556</u> | <u>\$ 48,101,424</u> |
| Net Revenue Requirement | | |
| Greater of | | |
| 1) Aggregate debt service | \$ 20,504,052 | \$ 20,726,065 |
| Required deposits | - | - |
| | <u>20,504,052</u> | <u>20,726,065</u> |
| 2) Aggregate debt service | 20,504,052 | 20,726,065 |
| Minimum required debt service ratio | x 1.20 | x 1.20 |
| Net revenue requirement | <u>\$ 24,604,862</u> | <u>\$ 24,871,278</u> |
| Net revenue to aggregate debt service ratio | <u>2.65</u> | <u>2.32</u> |