

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

Financial Statements

June 30, 2001 and 2000

Report of Independent Accountants

To the Board of Water Supply
City and County of Honolulu

In our opinion, the accompanying balance sheet as of June 30, 2001 and the related statements of income and retained earnings and cash flows present fairly, in all material respects, the financial position of the Board of Water Supply (the Board), City and County of Honolulu, at June 30, 2001, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Board's management; our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion. The financial statements of the Board, before restatement, as of June 30, 2000 and for the year then ended were audited by other independent accountants whose report dated December 8, 2000 expressed an unqualified opinion on those statements.

As discussed in Note 2 to the financial statements, on July 1, 2000 the Board changed its method of accounting for contributions in aid of construction and has restated all prior years presented. We also audited the adjustments in Note 2 that were applied to restate the fiscal year 2000 financial statements. In our opinion, such adjustments are appropriate and have been properly applied.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental schedules of property, plant and equipment, long-term debt, and net revenue requirements are presented for purposes of additional analysis and are not a required part of the basic financial statements. This information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

PricewaterhouseCoopers LLP

Honolulu, Hawaii
September 18, 2001

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

**Balance Sheets
June 30, 2001 and 2000**

	Assets	
	2001	2000
Current Assets:		
Cash and cash equivalents	\$ 54,998,153	\$ 20,152,661
Investments –		
Mutual funds	6,041,584	-
Government agency securities	697,946	22,336,937
Bank repurchase agreements	-	121,300,000
Time certificates of deposit	-	8,600,000
Interest receivable	230,988	3,832,078
Customer receivables –		
Billed, less allowance for uncollectible accounts of \$1,260,000 in 2001 and \$1,318,000 in 2000	5,936,527	6,630,557
Unbilled	8,031,419	7,239,594
Other receivables	774,603	548,904
Materials and supplies	3,866,973	3,302,046
Prepaid expenses	107,147	16,996
Total current assets	<u>80,685,340</u>	<u>193,959,773</u>
Restricted Assets:		
Cash and cash equivalents	90,691,873	2,823,952
Investments –		
Bank repurchase agreements	10,000,000	45,400,000
Time certificates of deposit	-	3,000,000
Government agency discount notes	280,116	32,723,754
Other receivables, less allowance for uncollectible accounts of \$1,332,000 in 2001 and 2000	1,172,328	1,174,025
Interest receivable	1,587,557	2,221,234
Total restricted assets	<u>103,731,874</u>	<u>87,342,965</u>
Other Assets	<u>2,643,272</u>	<u>547,359</u>
Property, Plant and Equipment:		
Utility plant in service	1,137,216,817	1,009,314,906
Construction work in progress	107,168,370	71,337,815
	<u>1,244,385,187</u>	<u>1,080,652,721</u>
Accumulated depreciation	<u>(384,284,725)</u>	<u>(361,175,758)</u>
Property, plant and equipment, net	<u>860,100,462</u>	<u>719,476,963</u>
Total assets	<u>\$ 1,047,160,948</u>	<u>\$ 1,001,327,060</u>

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

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

**Balance Sheets (continued)
June 30, 2001 and 2000**

	Liabilities and Fund Equity	
	2001	2000
Current Liabilities:		
Payable from current assets –		
Contracts payable, including retainages	\$ 9,838,518	\$ 7,312,730
Accounts payable	4,965,607	3,509,244
Current portion of general obligation water bonds	-	2,185,000
Accrued CASE fees	-	8,412,654
Accrued interest payable	430,559	663,759
	<u>15,234,684</u>	<u>22,083,387</u>
Payable from restricted assets –		
Contracts payable, including retainages	6,263,774	2,424,070
Current portion of water system revenue bonds	-	425,000
Other	6,032	6,032
	<u>6,269,806</u>	<u>2,855,102</u>
Total current liabilities	<u>21,504,490</u>	<u>24,938,489</u>
Other Liabilities:		
Customer advances for plant construction	41,659,652	48,606,810
Accrued vacation and compensatory pay	6,773,421	7,127,231
Accrued workers' compensation	1,634,281	1,382,768
Other	984,980	984,434
Total other liabilities	<u>51,052,334</u>	<u>58,101,243</u>
Long-Term Debt, net of current portion	<u>66,600,000</u>	<u>50,260,000</u>
Commitments and Contingencies		
Fund Equity:		
Retained earnings	<u>908,004,124</u>	<u>868,027,328</u>
Total liabilities and fund equity	<u>\$ 1,047,160,948</u>	<u>\$ 1,001,327,060</u>

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

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

**Statements of Income and Retained Earnings
For the Years Ended June 30, 2001 and 2000**

	2001	2000
Operating Revenues:		
Water sales	\$ 102,412,818	\$ 99,260,105
Other, principally contract and service fees (net of expenses of \$595,000 in 2001 and \$604,000 in 2000)	696,216	484,764
Total operating revenues	<u>103,109,034</u>	<u>99,744,869</u>
Operating Expenses:		
Depreciation	26,536,891	24,443,156
Administrative and general	19,062,211	18,717,007
Maintenance	17,069,431	14,765,091
Power and pumping	13,745,784	12,281,709
Transmission and distribution	6,488,584	5,665,174
CASE fees	4,785,514	8,412,654
Customers' accounting and collection	3,461,071	3,642,724
Water reclamation	1,542,279	-
Water treatment	177,097	171,403
Source of supply	136,810	14,540
Total operating expenses	<u>93,005,672</u>	<u>88,113,458</u>
Operating income	<u>10,103,362</u>	<u>11,631,411</u>
Nonoperating Revenues (Expenses):		
Interest	11,055,047	14,392,767
Interest expense, net of interest capitalized of \$1,300,000 in 2001 and \$2,200,000 in 2000	(284,668)	(999,322)
Other	(1,891,831)	175,043
Total nonoperating revenue	<u>8,878,548</u>	<u>13,568,488</u>
Contributions in aid of construction	<u>20,994,886</u>	<u>30,068,665</u>
Net income	39,976,796	55,268,564
Retained Earnings, beginning of year	<u>868,027,328</u>	<u>812,758,764</u>
Retained Earnings, end of year	<u>\$ 908,004,124</u>	<u>\$ 868,027,328</u>

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

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

**Statements of Cash Flows
For the Years Ended June 30, 2001 and 2000**

	2001	2000
Cash Flows from Operating Activities:		
Cash received from customers	\$ 103,381,848	\$ 99,429,752
Cash payments to suppliers for goods and services	(50,043,908)	(30,376,900)
Cash payments to employees for services	(24,732,604)	(28,545,631)
Other revenues	236,459	175,043
Net cash provided by operating activities	<u>28,841,795</u>	<u>40,682,264</u>
Cash Flows from Investing Activities:		
Purchase of investments	(276,602,115)	(395,087,673)
Proceeds from maturity of investments	492,943,160	421,524,070
Interest on investments	15,289,814	13,984,040
Net cash provided by investing activities	<u>231,630,859</u>	<u>40,420,437</u>
Cash Flows from Capital and Related Financing Activities:		
Acquisition and construction of capital assets, net of contributions in aid of construction	(150,760,566)	(68,674,692)
Proceeds from issuance of bonds, net of discount	64,504,086	-
Repayments on bonds	(54,998,290)	(3,260,000)
Interest paid on bonds	(1,837,413)	(3,182,021)
Customer advances for capital projects	5,332,942	4,804,227
Net cash used for capital and related financing activities	<u>(137,759,241)</u>	<u>(70,312,486)</u>
Net Increase in Cash and Cash Equivalents	122,713,413	10,790,215
Cash and Cash Equivalents, beginning of year	<u>22,976,613</u>	<u>12,186,398</u>
Cash and Cash Equivalents, end of year (including \$90,691,873 and \$2,823,952 in restricted accounts in 2001 and 2000, respectively)	<u><u>\$ 145,690,026</u></u>	<u><u>\$ 22,976,613</u></u>

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

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

**Statements of Cash Flows (continued)
For the Years Ended June 30, 2001 and 2000**

	2001	2000
Reconciliation of Operating Income to Net Cash		
Provided by Operating Activities:		
Operating income	\$ 10,103,362	\$ 11,631,411
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation expense	26,536,891	24,443,156
Other revenues (expenses)	236,459	175,043
(Increase) decrease in assets:		
Customer receivables	(97,795)	(919,048)
Materials and supplies	(564,927)	(445,140)
Other receivables	(224,002)	-
Prepaid expenses	(90,151)	111,490
Other assets	-	(6,064)
Increase (decrease) in liabilities:		
Accounts payable	1,456,363	851,537
Accrued CASE fees	(8,412,654)	8,412,654
Accrued vacation	(353,810)	(22,229)
Accrued workers' compensation	251,513	430,926
Other liabilities	546	(3,981,472)
Total adjustments	18,738,433	29,050,853
Net cash provided by operating activities	\$ 28,841,795	\$ 40,682,264

Supplemental Disclosure of Noncash Capital and Related Financing Activities:

The Board received approximately \$8,715,000 and \$19,312,000 in contributions of property, plant and equipment from government agencies, developers and customers which are recorded as contributions in aid of construction at their cost or estimated cost at June 30, 2001 and 2000, respectively.

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

Board of Water Supply City and County of Honolulu

Notes to Financial Statements

1. Summary of Significant Accounting Policies

Operations

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

Financial Statement Presentation

The Board is a component unit of the City (the primary government).

The accompanying financial statements present only the activities of the Board and do not include other organizations, activities and functions of the City. Accordingly, the accompanying financial statements are not intended to present fairly the financial position and the results of operations and cash flows of the City's discretely presented component unit.

The Board follows Governmental Accounting Standards Board (GASB) Statement No. 20, *"Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting."* Under GASB No. 20, the Board applies all applicable Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board Opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. The Board does not apply FASB Statements and Interpretations issued after November 30, 1989.

Basis of Accounting

The accompanying financial statements are prepared on the accrual basis of accounting, whereby revenues and expenses are recognized in the period earned or incurred. The measurement focus is on the determination of revenues, expenses, financial position and cash flows.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles 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. Actual results could differ from those estimates.

Regulation and Water Rates

Article VII of the Revised Charter of the City and County of Honolulu (the City Charter) states that the Board's seven-member board has the authority to establish and adjust water rates and charges so that the revenues derived shall be sufficient to make the Board self-supporting. The Board 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

Cash and Cash Equivalents

The Board 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.

Materials and Supplies

Materials and supplies are stated at the lower of average cost (which approximates the first-in, first-out method) or market.

Property, Plant and Equipment

Property, plant and equipment are stated at cost and include contributions by governmental agencies, private subdividers and customers at their cost or estimated cost of new construction.

Major replacements, renewals and betterments are capitalized. Interest costs are capitalized during the construction period of major capital projects. The Board 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.

Depreciation is computed over the estimated useful lives of the various asset groups using the straight-line method applied to the beginning-of-the-year costs. Depreciation on both purchased and contributed assets is charged against operations.

The ranges of estimated economic useful lives of plant and equipment are as follows:

Source of Supply Plant	20 to 100 years
Pumping Plant	20 to 50 years
Water Treatment Plant	20 to 30 years
Transmission and Distribution Plant	13-1/3 to 50 years
General Plant	8 to 50 years

Water System Facilities Charge

A water system facilities charge is levied against all new developments requiring water from the Board'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 recorded as customer advances and are used to construct water facilities. Upon completion of construction, the amounts collected are reclassified to contributions in aid of construction.

Board of Water Supply City and County of Honolulu

Notes to Financial Statements

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.

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

Risk Management

The Board 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, (5) employee health, dental and accident benefits, and (6) miscellaneous others. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims in excess of this commercial coverage was not significant in any of the three preceding years. The Board is partially self-insured for workers' compensation claims and judgements as discussed in Note 9.

Revenue Recognition

The Board's policy is to bill customers on a cyclical monthly or bi-monthly basis for water usage. The accrual for unbilled water revenues 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 received by the Board for constructing utility plant and other activities are recognized as income when all applicable eligibility requirements, including time requirements, are met.

Pension Expense

Pension costs are based upon actuarial computations and include current service costs and amortization of prior service costs. The Board's policy is to fund pension costs accrued.

2. Accounting Changes

On July 1, 2000, the Board adopted GASB Statement No. 33 (GASB 33), "*Accounting and Financial Reporting for Nonexchange Transactions*." This statement establishes accounting and financial reporting standards over the recording of nonexchange transactions involving cash and financial and capital resources. As a result of the adoption of GASB 33, contributions in aid of construction is included as a separate line item in the income statement. Prior to the adoption of GASB 33, contributions in aid of construction were recorded as equity transactions.

The Board restated prior year financial statements to retroactively apply GASB 33. The adoption of GASB 33 as of July 1, 1999 resulted in the combination of two equity accounts, contributions in aid of construction and retained earnings. The cumulative effect of adoption of GASB 33 resulted in a \$474 million increase to retained earnings effective July 1, 1999.

Board of Water Supply City and County of Honolulu

Notes to Financial Statements

The adoption of GASB 33 resulted in a restatement of prior year net income as follows:

	2000
Net income, as previously reported	\$ 25,199,899
Contributions in aid of construction	<u>30,068,665</u>
Net income, as restated	55,268,564
Retained earnings:	
Beginning of year, as previously reported	338,798,865
Adjustments	<u>473,959,899</u>
End of year, as restated	<u>\$ 868,027,328</u>

3. Deposits and Investments

Cash collected by the Board is deposited in separate accounts maintained 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 HRS authorize the Board to invest, with certain restrictions, in obligations of the State of Hawaii or the United States, in federally-insured savings accounts, time certificates of deposit, and bank repurchase agreements with federally-insured financial institutions authorized to do business in the State of Hawaii.

At June 30, 2001 and 2000, cash, bank repurchase agreements, time certificates of deposit, and government agency discount notes of approximately \$156,668,000 and \$256,337,000 respectively, were held by the City on behalf of the Board. The original maturity of these investments are less than one-year therefore the Board accounts for these investments at cost. The carrying value of these investments as of June 30, 2001 and 2000, respectively, approximated their market value.

Effective September 25, 2000, the Board entered into an investment management agreement with Pacific Century Trust (Pacific Century). At June 30, 2001, the Board's funds were in the process of being transferred from the City to Pacific Century. As current investments held by the City mature, the funds will be reinvested by Pacific Century. Investments managed by Pacific Century consist mainly of mutual funds, which are recorded at fair value based on quoted market prices. At June 30, 2001, the mutual funds managed by Pacific Century had a cost of \$6,000,000 and a fair value of \$6,041,584.

These balances were fully insured or collateralized with securities held by Pacific Century or the City's agent in the City's name.

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

Notes to Financial Statements

4. Restricted Assets

At June 30, 2001 and 2000, restricted assets were held for the following purposes:

	2001	2000
Construction	\$ 101,299,650	\$ 84,449,791
Renewals and replacements	2,001,613	2,002,965
Bond interest and redemption	430,611	890,209
	<u> </u>	<u> </u>
Total	<u>\$ 103,731,874</u>	<u>\$ 87,342,965</u>

5. Long-Term Debt

At June 30, 2001 and 2000, long-term debt consisted of the following:

	2001	2000
Water System Revenue Bonds, 3.50 % to 5.50 %	\$ 66,600,000	\$ 16,820,000
General Obligation Water Bonds, 4.75 % to 9.50 %	-	36,050,000
	<u>66,600,000</u>	<u>52,870,000</u>
Current portion	-	(2,610,000)
	<u> </u>	<u> </u>
Noncurrent portion	<u>\$ 66,600,000</u>	<u>\$ 50,260,000</u>

Principal and interest payments on water system revenue bonds are to be paid from the Board's revenue. Water system revenue bonds are subject to redemption on and after specific dates prior to maturity at the option of the Board at prices ranging from 100 to 101 percent of face value.

Board of Water Supply City and County of Honolulu

Notes to Financial Statements

Future bond principal and interest payments are as follows:

	Principal	Interest	Total
Year Ending June 30,			
2002	\$ -	\$ 2,115,000	\$ 2,115,000
2003	780,000	3,354,000	4,134,000
2004	1,090,000	3,317,000	4,407,000
2005	1,135,000	3,272,000	4,407,000
2006	1,180,000	3,221,000	4,401,000
Thereafter	62,415,000	51,170,000	113,585,000
	<u>\$ 66,600,000</u>	<u>\$ 66,449,000</u>	<u>\$ 133,049,000</u>

In February 2001, the Board created an irrevocable trust with an escrow agent to retire \$365,000, \$1,560,000, and \$32,460,000 of the Board's outstanding 1976, 1978, and 1992 general obligation water bonds, respectively. The escrow agent will pay all future debt service payments on the 1976, 1978, and 1992 Series bonds out of the irrevocable trust. Consequently, the 1976, 1978, and 1992 Series bonds were considered to be defeased and the liabilities for those bonds were removed from the Board's financial statements in 2001. At June 30, 2001, the outstanding defeased bonds amounted to \$365,000, \$1,040,000, and \$32,460,000 for the 1976, 1978, and 1992 Series bonds, respectively.

In May 2001, the Board issued \$66,600,000 in water system revenue bonds to retire \$16,395,000 of the Board's outstanding 1996 Series bonds with the remainder to fund the Board's capital improvement projects. An irrevocable trust with an escrow agent was funded to provide for all future debt service payments on the 1996 Series bonds. Consequently, the 1996 Series bonds were considered to be defeased and the liabilities for those bonds were removed from the Board's financial statements in 2001. At June 30, 2001, the outstanding 1996 Series defeased bonds amounted to \$16,395,000.

These transactions resulted in a loss of approximately \$2 million in fiscal 2001.

6. Related Party Transactions

Billing and Collection Services

The Board has an agreement with the Department of Environmental Services, City and County of Honolulu to provide certain services through June 30, 2004, relating to the billing and collection of sewer service charges. Fees related to these services were negotiated at approximately \$100,000 per year through fiscal 2003. The fees for fiscal 2004 are subject to negotiation. The revenues related to these fees are included in other operating revenues in the accompanying statements of income and retained earnings.

Board of Water Supply City and County of Honolulu

Notes to Financial Statements

Central Administrative Services Expense Fee

On June 30, 2000, the Board entered into 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 Board on an on-going basis. The CASE fee was calculated as 3% of the Board's total operating budget less budgeted transfers to the capital improvement, renewal and replacement, and other Board funds for fiscal 2000.

For fiscal 2001, the CASE fee increased to 4% of the above computation less actual fees billed by the City for specified services. The CASE fees for fiscal years subsequent to 2001 are subject to negotiation between the Board and the City. Either the Board or the City may terminate this agreement at any time with six months prior written notice.

The Board's Charter allows for a CASE fee to the extent that it represents a reasonable charge for services necessary for the Board to perform its duties. Although the Board and management have preliminarily concluded as to the reasonableness of the CASE fee, they intend to conduct a formal study of the cost of the services provided by the City. The Board and management do not believe that the results of this study will have a material adverse affect on the accompanying financial statements.

Ewa Villages Water System Facilities Charge

Based upon negotiations with the City, the Board has agreed to deviate from its standard policies regarding a developer's responsibility to construct the related water system infrastructure for the City's low-income housing development known as Ewa Villages. The size of the development required the City to build a specified water system and convey it to the Board. The City began construction of the water system infrastructure, however, the Board subsequently agreed to complete the unfinished phases of the work.

The Board agreed to negotiate a water system facility charge with the City to consider only the portion of the total infrastructure costs that will benefit the Ewa Villages project. The Board estimated the total cost of the existing and proposed infrastructure as approximately \$28.9 million, of which the City's share is approximately \$7.6 million. Although both the Board and the City agree with this amount, the two parties are determining the extent the City satisfied this obligation through costs it incurred in its initial phase of construction.

The Board has recorded a receivable and related allowance for uncollectible accounts of approximately \$1.3 million related to this water system facility charge to the City. In the opinion of management, the amount recorded net of reserves for resolution of this amount will not have a material adverse affect on the financial statements.

Waipio Soccer Park

During October 1998, the Board and the City entered into an agreement to build a non-potable water facility to provide for the irrigation needs of the City's Waipio Soccer Park, the City's Ted Makalena golf course and, if adequate supply exists, the U.S. Navy's surrounding agricultural land. The project was completed in fiscal 2001 at a cost of approximately \$2 million.

Board of Water Supply City and County of Honolulu

Notes to Financial Statements

Honouliuli Reclamation Facility

In July 2000, the Board entered into a Water Reclamation Facility Sale Agreement and Assignment of Water Reclamation Facility Agreement (the Sale Agreement) with a third-party contractor and the City for the purchase of a water reclamation plant. The total cost of the acquisition is estimated at \$51.6 million, including the initial purchase price of \$48.1 million for the plant and \$3.5 million for certain components of the distribution system. Of the initial price, \$44 million was paid as of June 30, 2001 and the remaining balance of \$4.1 million is to be paid when the facility meets certain performance standards specified in the Sale Agreement and is included in contracts payable from restricted assets at June 30, 2001.

In conjunction with the acquisition, the Board also executed a 20-year service contract with the same third-party contractor to provide design, engineering, operations and maintenance services for the facility. The Board is planning to provide for separate financing of the acquisition through a tax-free bond offering in fiscal 2002.

The Board acquired the facility for the opportunities that management believes exist for the sale of reclaimed water as well as the benefits related to the conservation of the fresh water supply. The Board has capitalized all costs incurred to place the facility into service. Realization of this asset is dependent upon management's ability to execute its marketing plans and to generate revenues at least to the extent of operating costs and depreciation. The total cost of the facility and its distribution system is considered realizable. However, the carrying value could be reduced in the near term if either rate or consumption estimates are reduced.

7. Employee Benefit Plans

Defined Benefit Pension Plan

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

Prior to June 30, 1984, the plan consisted of only a contributory option. Effective July 1, 1984, legislation was enacted to create a new noncontributory option for members of the ERS. Eligible employees hired for the first time or those returning to service after June 30, 1984 without vested benefit status automatically become participants of the noncontributory retirement option. Members of the ERS who were in service on June 30, 1984 had the option to elect the new noncontributory retirement option. Benefits vest after five and ten years of credited service under the contributory and noncontributory options, respectively.

Both options 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 is based on the three highest paid years of service, excluding the vacation payment.

Board of Water Supply City and County of Honolulu

Notes to Financial Statements

Most covered employees of the contributory option are required to contribute 7.8% of their salary. The funding method used to calculate the total employer contribution requirement is the Entry Age Normal Actuarial Cost Method. Under this method, employer contributions to the ERS are comprised of normal cost plus level annual payments required to liquidate the unfunded actuarial liability over the remaining period of 18 years from July 1, 1998.

The Board's policy is to fund its required contribution annually. The payroll for employees of the Board covered by the ERS for the years ended June 30, 2001, 2000 and 1999 was approximately \$24,699,000, \$28,636,000 and \$24,846,000, respectively; the Board's total payroll was approximately \$24,733,000, \$28,804,000 and \$25,119,000, respectively. The contribution requirement for the years ended June 30, 2001, 2000 and 1999 were approximately \$71,700, \$71,700 and \$1,560,000, respectively, which represented approximately 0.1%, 0.1% and 6.3% of the Board's covered payroll for these fiscal years, respectively. The Board's contribution requirement for these fiscal years represented approximately 1% of the total contribution requirement for all employers.

ERS issues a Comprehensive Annual Financial Report (CAFR) that includes financial statements and required supplementary information, which may be obtained from the following address:

Employees' Retirement System of the State of Hawaii
201 Merchant Street, Suite 400
Honolulu, Hawaii 96813

The following data was obtained from the disclosures contained in the CAFR for the year ended June 30, 2000, the most recent available.

The number of employers as of March 31, 2000 was:

State	1
Counties	<u>4</u>
Total employers	<u><u>5</u></u>

Basis of Accounting

The financial statements of the ERS are prepared using the accrual basis of accounting. Employer and member contributions are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

Method Used to Value Investments

Plan investments are reported at fair value. Where appropriate, the fair value includes disposition costs. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Mortgages are valued on the basis of future principal and interest payments, and are discounted

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at prevailing interest rates for similar instruments. The fair value of real estate investments and real estate owned are based on independent appraisals and estimated values.

Early Retirement Incentive

Act 212 of the 1994 regular session of the State Legislature authorized an early retirement incentive to state and county employees with at least 25 years of service as of December 31, 1994. Qualifying employees received two additional years of service credits for purposes of calculating their retirement benefits.

Act 216 of the 2000 State Legislative Session lowered the employer contributions to the System by extending the payment schedule for the actuarial present value cost of the early retirement incentive bonus from 5 to 19 years beginning with System payments for the year ended June 30, 2001. The retirement contribution liability related to this program as of June 30, 2001 and 2000 was approximately \$717,000 and \$759,000, respectively.

Post-Retirement Health Care and Life Insurance Benefits

In addition to providing pension benefits, the State of Hawaii Public Employees Health Fund provides certain health care and life insurance benefits, in accordance with State statutes, to all employees who retire from the Board on or after attaining age 62 with at least 10 years of service or age 55 with at least 30 years of service under the noncontributory plan and age 55 with at least 5 years of service under the contributory plan. Currently, 543 Board retirees and surviving dependents are eligible to receive health care benefits and 426 Board retirees are eligible to receive life insurance benefits. Retirees credited with at least 10 years of service excluding sick leave credit qualify for free medical insurance premiums. However, retirees with less than 10 years must assume a portion of the monthly premiums. All disabled retirees who retire after June 30, 1984, with less than 10 years of service also qualify for free medical insurance premiums. Free life insurance coverage and dental coverage for dependents under age 19 are also available. Retirees covered by the medical portion of Medicare are eligible to receive a reimbursement of the basic medical coverage premiums. Contributions are based upon negotiated collective bargaining agreements and are funded by the Board as accrued. The amounts allocated to the Board for years ended June 30, 2001 and 2000 aggregated approximately \$2,420,000 and \$2,469,000, respectively, and are included as expenses in the accompanying financial statements.

Deferred Compensation Plan

All full-time employees are eligible to participate in the City and County of Honolulu's Public Employees' Deferred Compensation Plan (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 (annuity contract) 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 Board has excluded the Plan's assets and liabilities from the financial statements

Board of Water Supply City and County of Honolulu

Notes to Financial Statements

because the Board and City do not have significant administrative involvement in the Plan or perform the investment function for the Plan.

8. Commitments

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. At June 30, 2001, accumulated sick leave aggregated approximately \$18,100,000.

Other commitments, primarily for utility plant construction approximated \$155,969,000 at June 30, 2001.

9. Contingencies

Workers' Compensation Self-Insurance Liability

The Board is self-insured for workers' compensation and disability claims below \$300,000 and in excess of \$1,000,000. Such claims are reported to and managed by the City's Workers' Compensation Division (the Division). The Board provides reserves for claims not covered by insurance that in the opinion of the Division will result in probable judgement against the Board.

The liability for losses and loss adjustment expenses is comprised of two components, case reserves and incurred but not reported loss reserves (IBNR). Case or outstanding loss reserves, represent estimates of ultimate costs to settle reported claims. These estimates are determined on a case-by-case basis by the Division. IBNR is usually based upon recommendations from an independent actuary on an annual basis.

The Board believes that all claims have been reported at June 30, 2001. The Board did not obtain an actuarial valuation report to determine the adequacy of the loss and loss adjustment expenses. Accordingly, for the year ended June 30, 2001, no provision was made for IBNR. Management believes the final resolution of incurred losses and IBNR losses will not significantly impact the Board's financial position or results of operations.

The aggregate case reserves as of June 30, 2001 for the Board's workers' compensation claims total \$2.849 million. Included in that amount is approximately \$1.738 million in permanent total disability (PTD) payments that have been discounted (at an annual rate of 5%) to a present value of approximately \$702,000. Anticipated excess insurance (above the Board's \$300,000 self-retention) recoveries on one of the PTD claims reduces the case reserves by \$178,250. Therefore, the total case reserves recorded by the Board is \$1.634 million at June 30, 2001.

Safe Drinking Water

The Board 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 United States

Board of Water Supply City and County of Honolulu

Notes to Financial Statements

Environmental Protection Agency. Management indicated that the Board 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 Board's customer service area.

Other Legal Matters

The Board 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 a material adverse affect on the Board's financial position or results of operations.

Credit Risk

Financial instruments, which potentially expose the Board to concentrations of credit risk, consist primarily of accounts receivable from retail customers. The Board's customer base is concentrated among commercial, industrial, residential and governmental customers located within the City. Although the Board is directly affected by the City's economy, management does not believe significant credit risk exists at June 30, 2001, except as provided in the allowance for uncollectible accounts. The Board manages its credit exposure through procedures designed to identify and monitor credit risk.

10. New Accounting Pronouncements

In June 1999, GASB issued Statement No. 34, "*Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*," which establishes a new financial reporting model for state and local governments. The statement requires the Board to implement the new accounting pronouncement in conjunction with the City's implementation deadlines. As a government with total annual revenues of \$100 million or more, the City falls under the Phase 1 criteria and is required to implement GASB 34 for the period beginning after June 15, 2001. Additionally for purposes of the retroactive reporting of major networks and subsystems of general infrastructure assets, GASB 34 sets the implementation of Phase 1 governments for years beginning after June 15, 2005.

In June 2001, the GASB issued Statement No. 37, "*Basic Financial Statement – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*", and No. 38, "*Certain Financial Statement Note Disclosures*," to be implemented simultaneously with GASB 34. GASB 37 amends GASB 34, which includes management's discussion and analysis requirements, adoption of the modified approach for previously depreciated infrastructure assets and program revenue classifications. GASB 38 also modifies GASB 34 by establishing and modifying disclosure requirements related to the summary of significant accounting policies, actions taken to address violations of significant finance-related legal and contractual provisions, debt and lease obligations, short-term debt and disaggregation of receivable and payable balances.

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City and County of Honolulu**

Notes to Financial Statements

The Board will implement GASB 34, 37 and 38 in conjunction with the City's implementation in fiscal year ending June 30, 2002. Management does not anticipate that the implementation of these Statements will have a material impact on the Board's financial statements.

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

**Supplemental Schedule of Property, Plant and Equipment
For the Year Ended June 30, 2001
(Excluding construction work in progress)**

Assets				
	Balance July 1, 2000	Additions	Retirements	Balance June 30, 2001
Property, excluding land and land rights:				
Source of supply	\$ 32,384,947	\$ 2,137,040	\$ -	\$ 34,521,987
Pumping	130,182,304	4,455,284	365,806	134,271,782
Water treatment	30,111,701	797,392	-	30,909,093
Transmission and distribution	751,993,162	54,235,820	3,730,728	802,498,254
Water reclamation	-	48,100,000	-	48,100,000
General	49,647,223	8,222,083	515,807	57,353,499
	<u>994,319,337</u>	<u>117,947,619</u>	<u>4,612,341</u>	<u>1,107,654,615</u>
Land and Land Rights:				
Source of supply	6,149,062	13,500,000	-	19,649,062
Pumping	540,269	1,052,300	-	1,592,569
Water treatment	65	5,288	-	5,353
Transmission and distribution	473,400	9,045	-	482,445
General	7,832,773	-	-	7,832,773
	<u>14,995,569</u>	<u>14,566,633</u>	<u>-</u>	<u>29,562,202</u>
	<u>\$ 1,009,314,906</u>	<u>\$ 132,514,252</u>	<u>\$ 4,612,341</u>	<u>\$ 1,137,216,817</u>
Obtained From:				
Operating fund		\$ 111,519,366		
Special expendable fund		12,280,099		
Contributions in aid:				
Government		4,254,882		
Other		4,459,905		
		<u>\$ 132,514,252</u>		

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

**Supplemental Schedule of Property, Plant and Equipment (continued)
For the Year Ended June 30, 2001
(Excluding construction work in progress)**

	Accumulated Depreciation			Balance June 30, 2001
	Balance July 1, 2000	Additions	Retirements	
Property, excluding land and land rights:				
Source of supply	\$ 16,630,378	\$ 997,456	\$ -	\$ 17,627,834
Pumping	57,319,921	4,987,903	365,806	61,942,018
Water treatment	7,536,036	1,439,397	-	8,975,433
Transmission and distribution	258,319,876	17,104,865	3,677,297	271,747,444
General	21,369,547	3,071,757	449,308	23,991,996
	<u>\$ 361,175,758</u>	<u>\$ 27,601,378</u>	<u>\$ 4,492,411</u>	<u>\$ 384,284,725</u>
Less amounts charged to jobbing contract work		<u>1,064,487</u>		
Depreciation Expense		<u><u>\$ 26,536,891</u></u>		

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

**Supplemental Schedule for Long-Term Debt
For the Year Ended June 30, 2001**

		Last Installment	Interest Rate	Bond Dated	Maturing Serially From	Call Dates (1)	Outstanding June 30, 2001
Water System Revenue							
Bonds:							
Series	2001	2003	4.000	05-15-2001	07-01-2002	(2)	\$ 780,000
	2001	2004	4.000	05-15-2001	07-01-2003	(2)	1,090,000
	2001	2005	4.000	05-15-2001	07-01-2004	(2)	1,035,000
	2001	2005	3.500	05-15-2001	07-01-2004	(2)	100,000
	2001	2006	5.000	05-15-2001	07-01-2005	(2)	1,130,000
	2001	2006	3.700	05-15-2001	07-01-2005	(2)	50,000
	2001	2007	3.875	05-15-2001	07-01-2006	(2)	1,240,000
	2001	2008	4.000	05-15-2001	07-01-2007	(2)	1,285,000
	2001	2009	5.000	05-15-2001	07-01-2008	(2)	1,165,000
	2001	2009	4.125	05-15-2001	07-01-2008	(2)	175,000
	2001	2010	5.000	05-15-2001	07-01-2009	(2)	1,105,000
	2001	2010	4.250	05-15-2001	07-01-2009	(2)	300,000
	2001	2011	5.000	05-15-2001	07-01-2010	(2)	250,000
	2001	2011	4.375	05-15-2001	07-01-2010	(2)	1,220,000
	2001	2012	5.000	05-15-2001	07-01-2011	(2)	200,000
	2001	2012	4.500	05-15-2001	07-01-2011	(2)	1,335,000
	2001	2013	5.375	05-15-2001	07-01-2012	07-01-2011	535,000
	2001	2013	4.600	05-15-2001	07-01-2012	07-01-2011	1,075,000
	2001	2014	4.700	05-15-2001	07-01-2013	07-01-2011	1,685,000
	2001	2015	5.500	05-15-2001	07-01-2014	07-01-2011	1,765,000
	2001	2016	5.500	05-15-2001	07-01-2015	07-01-2011	1,860,000
	2001	2017	5.500	05-15-2001	07-01-2016	07-01-2011	1,735,000
	2001	2017	5.000	05-15-2001	07-01-2016	07-01-2011	230,000
	2001	2018	5.000	05-15-2001	07-01-2017	07-01-2011	2,070,000
	2001	2019	5.125	05-15-2001	07-01-2018	07-01-2011	2,175,000
	2001	2020	5.125	05-15-2001	07-01-2019	07-01-2011	2,285,000
	2001	2021	5.125	05-15-2001	07-01-2020	07-01-2011	2,405,000
	2001	2022	5.125	05-15-2001	07-01-2021	07-01-2011	2,525,000
	2001	2023	5.250	05-15-2001	07-01-2022	07-01-2011	2,655,000
	2001	2024	5.250	05-15-2001	07-01-2023	07-01-2011	2,795,000
	2001	2025	5.250	05-15-2001	07-01-2024	07-01-2011	2,940,000
	2001	2026	5.250	05-15-2001	07-01-2025	07-01-2011	3,095,000
	2001	2027	5.250	05-15-2001	07-01-2026	07-01-2011	3,260,000
	2001	2028	5.250	05-15-2001	07-01-2027	07-01-2011	3,430,000
	2001	2029	5.250	05-15-2001	07-01-2028	07-01-2011	3,610,000
	2001	2030	5.250	05-15-2001	07-01-2029	07-01-2011	3,800,000
	2001	2031	5.250	05-15-2001	07-01-2030	07-01-2011	4,000,000
	2001	2032	5.250	05-15-2001	07-01-2031	07-01-2011	4,210,000
Total Long-Term Debt							\$ 66,600,000

(1) Call dates indicated are optional.

(2) Noncallable.

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

**Supplemental Schedule of Net Revenue Requirements
For the Year Ended June 30, 2001**

Revenues:	
Water sales	\$ 102,412,818
Other, principally contract and service fees (net of expenses of \$595,000)	696,216
Interest	<u>11,055,047</u>
Total revenues	114,164,081

Deductions:	
Operating expenses	93,005,672
Less depreciation expense	<u>(26,536,891)</u>
Total deductions	<u>66,468,781</u>
Net revenues	<u><u>\$ 47,695,300</u></u>

Net Revenue Requirement

Greater of –	
1 Maximum aggregate debt service	\$ 4,432,676
Aggregate debt service for 2001	1,356,294
Required deposits:	
Reimbursable obligation fund	<u>-</u>
	<u>5,788,970</u>
2 Maximum aggregate debt service	4,432,676
Aggregate debt service for 2001	<u>1,356,294</u>
	<u>5,788,970</u>
	x 1.20
	<u>6,946,764</u>
Net revenue requirement	<u><u>\$ 6,946,764</u></u>