

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

**Financial Statements**

**June 30, 2002 and 2001**

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

**Index of Financial Statements and Supplemental Schedules**

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

## **Introduction June 30, 2002**

The Board of Water Supply, City and County of Honolulu (Board), is pleased to present this financial report developed in compliance with Governmental Accounting Standards Board No. 34, entitled “*Basic Financial Statements – Management’s Discussion and Analysis – For State and Local Governments*,” (GASB 34), and related standards. GASB 34 is perhaps the most significant pronouncement for the public sector from the standpoint of financial reporting. It established new financial reporting requirements for state and local government, which will make financial reports more comprehensive and easier to understand. The management’s discussion and analysis is intended to provide the reader with an easily understandable analysis of a government’s financial performance and to enable the reader to assess all aspects of the government’s financial position. New proprietary fund statements include a statement of net assets and a statement of revenues, expenses and changes in fund net assets.

### **Mission**

The mission of the Board is to improve the quality of life in our community by providing world-class water services. The mission serves as the foundation for the Board’s vision to share its water management expertise and provide services statewide and throughout the Pacific: to benefit our global communities, to benefit our community by maintaining reasonable rates, to provide professional development opportunities for its staff, and to support the growth of Hawaii’s economy.

The Board’s Strategic Business Plan includes six major goals:

- Provide World-Class Customer Service
- Establish a Performance Culture at all Levels
- Develop Our Staff and Renew the Board’s Ohana
- Expand Water Resources and Assure Long-Term Viability
- Improve Infrastructure Reliability
- Identify Growth Opportunities

These goals are further supported by specific business initiatives executed by the Board’s six operating unit leaders and their staff.

### **Organization and Business**

The Board of Water Supply is a semi-autonomous municipal agency created pursuant to the Revised Charter of the City and County of Honolulu (City). The Board has full control of all water systems of the City, including water rights and water sources, together with all materials, supplies and equipment and all real and personal property used or useful in connection with such water systems. The Board has full and

complete authority to manage, control and operate the water systems and properties used or useful in connection with such water systems. The Board has been in existence since 1929.

The Mayor of the City and County of Honolulu appoints five of the seven members of the Board of Directors. The other two members, the chief engineer of the department of facility maintenance of the City and the director of transportation of the State of Hawaii, are members ex-officio of the Board.

The Board consists of six operating units – Business Development, Business Services, Customer Care, Maintenance, Operations and Water Resources, all under the direction of the Manager and Chief Engineer, who is appointed by the Board of Directors, and the Deputy Manager and Chief Engineer.

The Board of Directors has the power to fix and adjust rates and charges for the furnishing of water and water services so that the revenues derived therefrom 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 approval of the Board of Directors. Such rates are not subject to regulation by any other governmental body or authority.

The Board receives no revenues from taxation and depends solely upon revenues derived from its activities to pay for its operations and liquidation of indebtedness. The Board may receive funds from the federal, state, or county governments for capital improvement projects.

The Board services 159,362 accounts and a residential population of 877,740. The service area covers the island of Oahu and is 606 square miles. The customer base includes the residential population, businesses and industries, and agriculture. Of the total accounts, 147,673 are residential (92.7%), representing 60.6% of the total amount received from water sales in Fiscal Year 2002; 10,880 are commercial and industrial (6.8%), representing 38.3% of the total amount received from water sales in Fiscal Year 2002; and 809 are agricultural (0.5%), representing 1.1% of the total amount received from water sales in fiscal year (FY) 2002.

The Board provides high quality water at reasonable rates, while protecting the long-term viability of Oahu's water resources and enhancing the environment. In addition to providing potable water of 157 million gallons per day (mgd), the Board delivers approximately 6.8 mgd of recycled water to Ewa and Campbell Industrial Park users in west Oahu.

### **Looking Ahead**

The Board has adopted a strategic plan that commits itself to become a world-class organization. In 1999, the Board entered into a 5-year reengineering program to transform itself into a highly competitive, world-class provider of water utility related services. This program called QUEST (Quality Utility Employees Succeeding Together), seeks to improve customer service and achieve greater operational efficiencies and effectiveness. The Board has begun to realize the benefits of this program. At the outset of this program staffing was at 658 positions. At the end of FY 2002, there were 591 positions, a decrease of 10%, with no layoffs. Even with the decrease in staffing, the Board has been able to support a 1% water system annual growth, as well as to take on significant projects to modernize its business systems and change its work practices.

It is anticipated that significant costs and personnel resources will be required in the next two to three years before costs savings are fully realized. Specifically, the Board will be engaged in the implementation of major computerized information systems – the Financial Accounting System, the Computerized Maintenance Management System and the Customer Information System. The

success of these technology programs is vital to the Board realizing efficiencies and effectiveness in its business and core operations. In addition, a multi-skilled worker pilot is anticipated to begin in FY 2003, which will demonstrate operational and technological improvements and leading work practices in field operations.

The Board is also looking to expand its core business by responding to opportunities to own and operate military water systems. Additionally, the Board is sharing its expertise with developing water utilities in the Asia Pacific region. It recently conducted a water system assessment and provided emergency water testing services to Pohnpei Utilities in the Federated States of Micronesia. Projects such as this will help to build the Board's presence and to build relationships in the Asia Pacific region. These initiatives are expected to bring in new revenues and will provide opportunities for our staff to acquire and develop new skills and to venture into new career paths.

The Board's Research and Facility Improvement Program (RFIP) and Capital Improvement Program (CIP) are manageable at approximately \$436 million over the next five years. The Board's continuing effort will be the repair and replacement of pipelines to ensure reliability of service and the adequacy of water supply for future generations. To ensure this priority, approximately \$221 million or 75% of the Board's RFIP is budgeted for the repair and replacement of pipelines. Major CIP projects include the Kalaeloa Desalination Facility, a 5 mgd alternative water source for the Ewa area, \$40 million; a deep ocean water application facility to be constructed in conjunction with the Desalination Facility to provide potable water and business development benefits, \$16 million; Honolulu 42-inch and 24-inch transmission main from Liliha to Waahila Reservoir, to provide capacity and reliability to the Honolulu 180 East system, \$43 million; Ewa shaft granulated activated carbon units to remove volatile organic compounds, \$13 million; and the Beretania low service line booster station to supplement transmission capacity to East Honolulu, \$13 million.

The Board is well positioned financially to support ongoing and future reengineering efforts and the execution of its capital program and strategic plan. Its annual revenues, at an average of \$100.6 million over the past five years, have been relatively stable due to the large residential accounts that make up its customer base. Its high cash reserves provide flexibility for funding future capital improvement projects. Its low debt service affords the Board ample capacity to issue bonds. For the sixth year in a row, the Board has not found it necessary to raise its water rates due to prudent financial management.

In its efforts to support its innovative and forward thinking initiatives, the Board, together with its employees, is engaged in a historic reengineering program aimed at maximizing its resources for the benefit of its customers and community.

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

## **Management's Discussion and Analysis June 30, 2002**

This section presents management's discussion and analysis of the Board's financial condition and activities for the year ended June 30, 2002. This information should be read in conjunction with the financial statements.

### **Financial Highlights**

Management believes the Board's financial condition is very strong. While water rates and charges remained the same for the sixth year in a row, the Board continues to exhibit strong financial performance and a manageable capital improvements program. Outstanding debt is low, cash reserves are high, and all debt covenants were exceeded. Key financial highlights follow:

- Total cash and investments were \$180.7 million at June 30, 2002, an increase of \$18.0 million from \$162.7 million at June 30, 2001.
- Total assets at year-end were \$1,139.5 million and exceeded liabilities by \$977.5 million.
- The Board's liquidity ratio is 2.2 for fiscal year (FY) 2002 and 3.8 for FY 2001.
- The Board's debt to equity ratio is 12.4% and 7.0% for FY 2002 and FY 2001 respectively, indicating a large capacity to issue additional bonds.
- The Board received a \$20 million settlement (\$14.1 million net of expenses) from a two-year lawsuit against six petroleum-chemical companies and pineapple growers for contamination of water supplies in central and west Oahu.
- Operating revenues for FY 2002 was \$101.2 million, down 1.8% from revenues of \$103.1 million in FY 2001. This decrease was primarily attributable to the tragic events of September 11, which resulted in a 2.3% drop in consumption for hotels and commercial customers.
- Operating expenses before depreciation increased by \$7.2 million, primarily due to increases in reengineering and water reclamation expenses.
- Net assets increased by \$29.9 million in FY 2002 as compared to a \$32.7 million increase in FY 2001.
- The Board issued \$54.4 million in revenue bonds in FY 2002 to reimburse itself for the acquisition of the Honouliuli Water Reclamation Facility and construction of the recycled water distribution system.

- The Board acquired 21.952 acres for \$13.5 million from the Trustees under the Will and of the Estate of James Campbell, Deceased, by Eminent Domain for the Ewa Shaft, which will provide 15 million gallons per day (mgd) to meet future and existing demand in the Ewa and Waianae areas.
- Due to the events of September 11, the Board implemented special security precautions to safeguard the water supply round the clock. A \$1.5 million emergency contract was awarded to install closed-circuit security cameras at critical Board facilities.

### **Overview of Financial Report**

The Board is a component unit of the City and County of Honolulu. 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 Board's financial condition and performance. Summary financial statement data, key financial and operational indicators used in the Board's strategic plan, annual report, budget, operating fund analysis, bond resolutions and other management tools were used for this analysis.

The basic financial statements include a statement of net assets, a statement of revenues, expenses and changes in fund net assets, a statement of cash flows, and notes to the financial statements. The statement of net assets presents the resources and obligations of the Board at June 30. The statement of revenues, expenses and changes in fund net assets presents the results of operations for the year and the resultant ending net assets balance.

The statement of cash flows presents 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, and capital and related financing activities.

The notes to the financial statements provide required disclosures and other information necessary for a fair presentation of the statements. The notes detail information about the Board's significant accounting policies, significant account balances, related party transactions, employee benefit plans, commitments, contingencies, and other significant events. Supplementary information on property, plant and equipment, outstanding bonds and net revenue requirement are also included.

## Financial Analysis

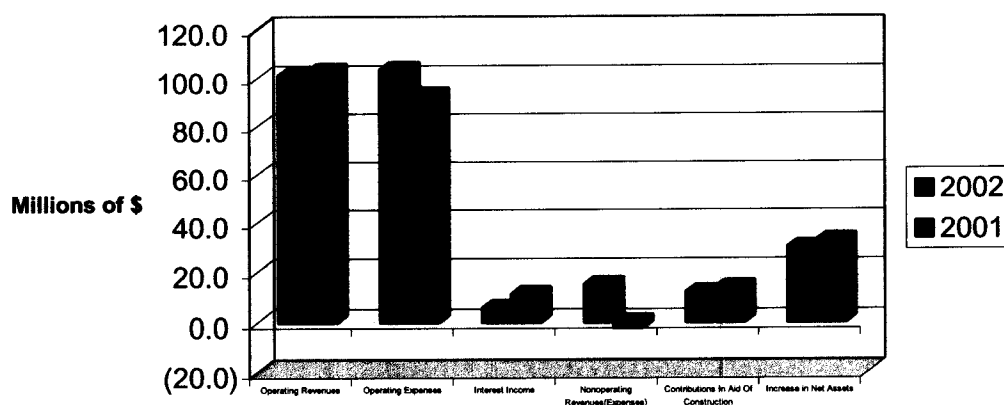
### Results of Operations

#### CONDENSED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS

	JUNE 30,		
	2002	2001	%
		(as restated)	VARIANCE
	(in thousands)		
Operating Revenues	\$ 101,235	\$ 103,109	-1.8%
Operating Expenses:			
Depreciation	30,003	26,537	13.1%
Administrative and general	25,694	19,062	34.8%
Water reclamation	3,679	1,542	138.6%
Other operating expenses	44,326	45,865	-3.4%
Total operating expenses	103,702	93,006	11.5%
Operating Income (Loss)	(2,467)	10,103	-124.4%
Nonoperating Revenues (Expenses):			
Interest income	5,554	11,055	-49.8%
Litigation settlement, net	14,145	0	100.0%
Others	818	(2,176)	-137.6%
Contributions in aid of construction	11,857	13,711	-13.5%
Increase in net assets	\$ 29,907	\$ 32,693	-8.5%

The increase in net assets for the fiscal year ended June 30, 2002 amounted to \$29.9 million, which is 8.5% lower than last year's increase of \$32.7 million. This increase may be analyzed by the components of the increase as presented above and further described below.

#### Statements of Revenues, Expenses and Changes in Fund Net Assets





Operating revenues for FY 2002 was \$101.2 million, 1.8% lower than FY 2001. Water revenues were primarily affected by a decrease in water consumption by hotel and commercial water customers brought on by the events of September 11. The combined water consumption of these customers decreased by 2.3%. For the sixth year in a row, water rates and charges remained unchanged.

Total operating expenses increased to \$103.7 million in FY 2002 from \$93.0 million in FY 2001, an increase of \$10.7 million or 11.5%. Factors contributing to this increase are explained below.

Depreciation expense increased by \$3.5 million from FY 2001. This was attributable to \$132.5 million in capitalized assets, including purchase of the Honouliuli Water Reclamation Facility being added to property, plant and equipment last year.

Administrative and general expenses increased \$6.6 million due primarily to costs of the Board's reengineering program. The Board is undergoing a significant reengineering effort to transform the organization into a world-class organization. Specialized services were retained and other costs were incurred to help the Board in this effort. Major accomplishments include a reorganization of the Board into six operating units, reorganizing the information technology section and working with staff to implement leading practices, directing major technology projects such as the financial accounting system project, designing and implementing a geographic information system, designing a multi-skilled worker pilot program for field workers, designing a learning academy, developing a water system expansion program, and developing a consumer education and outreach program. In addition, an increase in contributions of \$1.6 million was required from the state's Employees Retirement System.

The Board's water sales include revenues from its Honouliuli Recycled Water Facility, which is in its second year of operation. With the addition of recycled water customers, Coral Creek Golf Course, Hawaii Prince Golf Course, AES, Citizens Gas Co. and Tesoro Hawaii Corporation, total consumption reached 2.1 billion gallons for the year, with related revenues of \$3.0 million. This compares to consumption of 1.2 million gallons and revenues of \$1.7 million from inception of the program, September 2000 to June 30, 2001. Included in water reclamation expenses is \$1.8 million related to the operation and maintenance expenses of the Facility. With additional capital costs of \$812,000, revenues exceeded expenses and capital costs by approximately \$400,000. Over the next three years, total revenues from recycled water are expected to be \$13.4 million. Associated operations and maintenance costs and capital costs are estimated at \$6.1 million, resulting in projected net revenues of \$7.3 million over the same time period.

The Board's investment income has also been affected by the economy. Interest income decreased 49.8% from \$11.1 million in FY 2001 to \$5.6 million in FY 2002, due to decreased interest rates.

In FY 2002, a litigation settlement, net of litigation costs, of \$14.1 million contributed to the increase in net assets. The settlement was the culmination of a lawsuit filed by the Board to recover expenses associated with removing pesticides from the groundwater under the pineapple fields in central Oahu. This is a one-time increase to net assets this year.

In FY 2001, the Board adopted GASB Statement No. 33, "*Accounting and Financial Reporting for Nonexchange Transactions*." As a result, contributions in aid of construction are included as income. The contribution in aid of construction for FY 2002 is \$11.8 million, accounting for 39.6% of the \$29.9 million increase in net assets.

## ***Financial Condition***

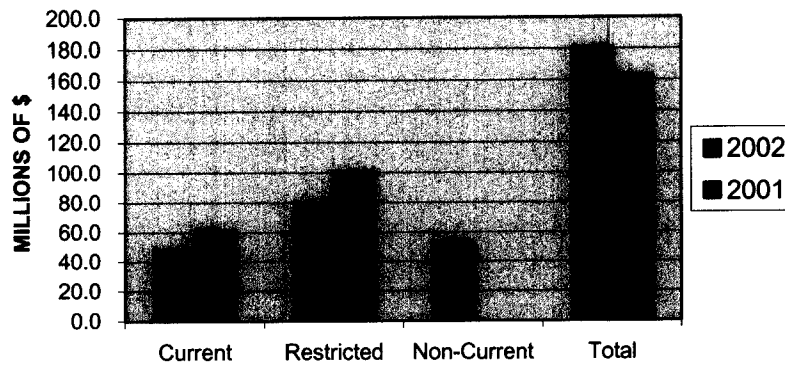
### **CONDENSED STATEMENTS OF NET ASSETS**

	<b>JUNE 30,</b>		<b>% VARIANCE</b>
	<b>2002</b>	<b>2001 (as restated)</b>	
	<b>(in thousands)</b>		
<b>Current Assets</b>			
Cash and Investments	\$ 47,689	\$ 61,738	-22.8%
Other current	19,452	18,948	2.7%
<b>Restricted Assets</b>			
Cash and Investments	80,071	100,972	-20.7%
Other restricted	848	2,760	-69.3%
<b>Investments</b>	52,981	0	100.0%
<b>Other Assets</b>	3,028	2,643	14.6%
<b>Property, Plant &amp; Equipment net of accumulated depreciation</b>	<u>935,409</u>	<u>860,100</u>	<u>8.8%</u>
<b>Total Assets</b>	<u><u>1,139,478</u></u>	<u><u>1,047,161</u></u>	<u><u>8.8%</u></u>
<b>Current Liabilities</b>	29,936	21,505	39.2%
<b>Other Liabilities</b>	11,781	11,423	3.1%
<b>Bonds Payable, Noncurrent</b>	<u>120,220</u>	<u>66,600</u>	<u>80.5%</u>
<b>Total Liabilities</b>	<u>161,937</u>	<u>99,528</u>	<u>62.7%</u>
<b>Net Assets:</b>			
Invested in capital assets, net of related debt	838,461	829,341	1.1%
Restricted for capital activity and debt service	43,487	59,591	-27.0%
Unrestricted	<u>95,593</u>	<u>58,701</u>	<u>62.8%</u>
<b>Total Net Assets</b>	<u>977,541</u>	<u>947,633</u>	<u>3.2%</u>
<b>Total Liabilities and Net Assets</b>	<u><u>\$ 1,139,478</u></u>	<u><u>\$ 1,047,161</u></u>	<u><u>8.8%</u></u>

The Board's financial condition remains strong at the year-end.

Cash position is strong and liquidity is high. Total cash and investments increased \$18.0 million from \$162.7 million at June 30, 2001 to \$180.7 million at June 30, 2002.

### CASH AND INVESTMENTS



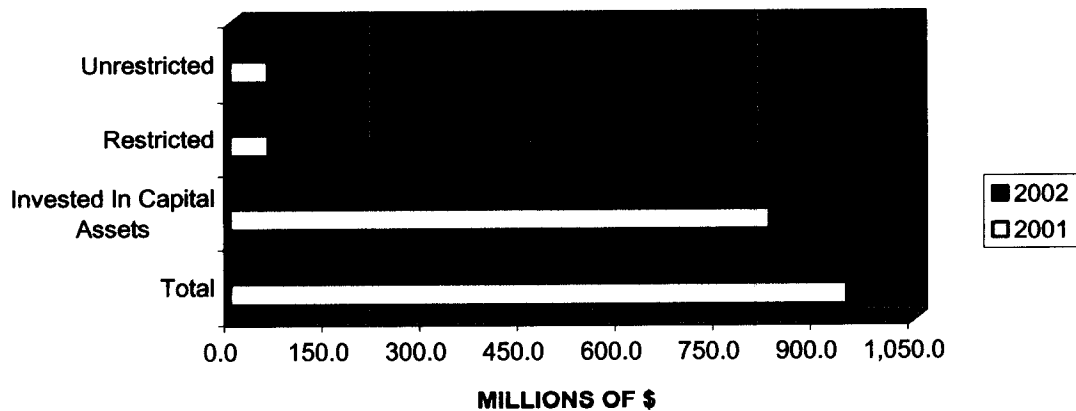
The Board's liquidity ratio (current assets divided by current liabilities) is 2.2 and 3.8 for June 30, 2002 and 2001, respectively.

The Board, which issues long term bonds to finance part of its capital improvement program, has a low debt to equity ratio. The ratio is 12.4% and 7.0% for June 30, 2002 and 2001, respectively. The Board issued \$54.4 million in bonds in FY 2002 (see Capital Assets and Long Term Debt).

For FY 2002, the Board budgeted a total capital improvement program of \$130.5 million. The program was funded with revenue bonds, 58.2%; revenues, 22.4%; and water system facilities charges, 19.4%.

Net assets increased 3.2% from \$947.6 million in FY 2001 to \$977.5 million in FY 2002. The unrestricted portion increased to \$95.6 million from \$58.7 million. Due to a prior period adjustment identified in 2002 relating to the recognition of income from water system facilities charges, 2001 beginning net assets increased by \$46.9 million and the 2001 increase in net assets decreased by \$7.3 million from amounts previously reported.

### NET ASSETS



### ***Capital Assets and Long Term Debt***

During the year, the Board capitalized \$87.3 million to its utility plant in service. Major assets added included automatic meter reading components, \$11.0 million, Kamehameha Highway transmission main, \$8.5 million, Makaha 242 Reservoir No. 2, \$6.0 million, Dillingham Boulevard transmission main, \$4.0 million, Kunia 228 Reservoir No. 2, \$3.1 million, and various transmission and distribution mains, \$10.6 million, primarily in the Honolulu District.

On March 5, 2002, the Board issued \$54.4 million revenue bonds to reimburse itself for the acquisition of the Honouliuli Water Reclamation Facility, purchased in July 2000 and construction of its distribution system. The issue involved the use of auction rate certificates, a variable rate vehicle. This issue increased the Board's outstanding bonds payable to \$121.0 million as of June 30, 2002.

The outstanding debt has been assigned ratings of Aa3 from Moody's Investors Service, AA from Standard and Poor's and AA from Fitch.

### **Rate Covenant**

The Board is required by its bond resolution, 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, which is reflected in the Supplemental Schedule of Net Revenue Requirement, is the greater of the sum of the aggregated debt service and required deposits for the year or 1.20 times the aggregate debt service for the year and 1.00 times the support facility reimbursement obligations outstanding as of the end of the fiscal year (which the Board had none). The Board's net revenue for 2002 is more than 8.8 times the requirement.

### **Requests for Information**

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

## Report of Independent Accountants

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

In our opinion, the accompanying statements of net assets and the related statements of revenues, expenses and changes in fund net assets and of 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, 2002 and 2001, and the results of its operations and its cash flows for the years 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 audits. We conducted our audits 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 audits provide a reasonable basis for our opinion.

As discussed in Note 12 to the financial statements, the Board restated its 2001 financial statements to correct its accounting for customer advances.

As described in Note 1 to the financial statements, the Board has implemented a new financial reporting model as required by the provisions of Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, effective July 1, 2001.

The management's discussion and analysis on pages 4 through 10 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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, bonds payable, and net revenue requirement 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.

*Priscilla H. Cooper CPA*

Honolulu, Hawaii  
January 10, 2003

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

**Statements of Net Assets  
June 30, 2002 and 2001**

	<b>Assets</b>	<b>2002</b>	<b>2001 (as restated)</b>
<b>Current Assets:</b>			
Cash and cash equivalents	\$	16,738,336	\$ 54,998,153
Investments		30,950,642	6,739,530
Interest receivable		249,314	230,988
Customer receivables –			
Billed, less allowance for uncollectible accounts of \$1,300,000 in 2002 and \$1,260,000 in 2001		6,354,040	5,936,527
Unbilled		7,902,753	8,031,419
Other receivables		683,350	774,603
Materials and supplies		4,145,283	3,866,973
Prepaid expenses		117,667	107,147
Total current assets		<u>67,141,385</u>	<u>80,685,340</u>
<b>Restricted Assets:</b>			
Cash and cash equivalents		8,653,752	90,691,873
Investments		71,416,920	10,280,116
Other receivables, less allowance for uncollectible accounts of \$2,203,000 in 2002 and \$1,332,000 in 2001		716,786	1,172,328
Interest receivable		131,501	1,587,557
Total restricted assets		<u>80,918,959</u>	<u>103,731,874</u>
<b>Investments</b>		52,980,643	-
<b>Other Assets</b>		3,028,012	2,643,272
<b>Property, Plant and Equipment:</b>			
Utility plant in service		1,217,602,734	1,137,216,817
Construction work in progress		126,958,999	107,168,370
		<u>1,344,561,733</u>	<u>1,244,385,187</u>
Accumulated depreciation		<u>(409,152,644)</u>	<u>(384,284,725)</u>
Property, plant and equipment, net		<u>935,409,089</u>	<u>860,100,462</u>
<b>Total assets</b>		<u><u>\$ 1,139,478,088</u></u>	<u><u>\$ 1,047,160,948</u></u>

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

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

**Statements of Net Assets (continued)  
June 30, 2002 and 2001**

	<b>Liabilities and Net Assets</b>	
	<b>2002</b>	<b>2001 (as restated)</b>
<b>Current Liabilities:</b>		
Payable from current assets –		
Contracts payable, including retainages	\$ 8,481,760	\$ 9,838,518
Accounts payable	7,560,186	4,965,607
Accrued interest payable	1,758,320	430,559
	<u>17,800,266</u>	<u>15,234,684</u>
Payable from restricted assets –		
Contracts payable, including retainages	11,350,051	6,263,774
Bonds payable, current	780,000	-
Other	6,032	6,032
	<u>12,136,083</u>	<u>6,269,806</u>
Total current liabilities	<u>29,936,349</u>	<u>21,504,490</u>
<b>Other Liabilities:</b>		
Customer advances	2,024,491	2,030,278
Accrued vacation and compensatory pay	6,631,646	6,773,421
Accrued workers' compensation	2,223,314	1,634,281
Other	901,479	984,980
Total other liabilities	<u>11,780,930</u>	<u>11,422,960</u>
<b>Bonds Payable, Noncurrent</b>	<u>120,220,000</u>	<u>66,600,000</u>
Total liabilities	<u>161,937,279</u>	<u>99,527,450</u>
<b>Commitments and Contingencies</b>		
<b>Net Assets:</b>		
Invested in capital assets, net of related debt	838,460,596	829,340,855
Restricted for capital activity and debt service	43,486,878	59,591,397
Unrestricted	95,593,335	58,701,246
Total net assets	<u>\$ 977,540,809</u>	<u>\$ 947,633,498</u>

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



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

**Statements of Revenues, Expenses and Changes in Fund Net Assets  
For the Years Ended June 30, 2002 and 2001**

	2002	2001 (as restated)
<b>Operating Revenues:</b>		
Water sales	\$ 100,695,638	\$ 102,412,818
Other, principally contract and service fees (net of expenses of \$671,000 in 2002 and \$595,000 in 2001)	539,054	696,216
Total operating revenues	<u>101,234,692</u>	<u>103,109,034</u>
<b>Operating Expenses:</b>		
Depreciation	30,003,211	26,536,891
Administrative and general	25,693,972	19,062,211
Maintenance	17,092,603	17,069,431
Power and pumping	12,815,018	13,745,784
Transmission and distribution	7,220,782	6,488,584
Water reclamation	3,679,036	1,542,279
Customers' accounting and collection	3,570,777	3,461,071
CASE fees	3,325,671	4,785,514
Water treatment	199,442	177,097
Source of supply	101,792	136,810
Total operating expenses	<u>103,702,304</u>	<u>93,005,672</u>
Operating income (loss)	<u>(2,467,612)</u>	<u>10,103,362</u>
<b>Nonoperating Revenues (Expenses):</b>		
Interest income	5,554,251	11,055,047
Interest expense, net of interest capitalized of \$3,000,000 in 2002 and \$1,300,000 in 2001	(975,522)	(284,668)
Litigation settlement, net	14,145,091	-
Other	1,793,968	(1,891,831)
Total nonoperating revenue	<u>20,517,788</u>	<u>8,878,548</u>
<b>Contributions in aid of construction</b>	<u>11,857,135</u>	<u>13,711,178</u>
Increase in net assets	<u>29,907,311</u>	<u>32,693,088</u>
<b>Net Assets at Beginning of Year, as previously reported</b>	947,633,498	868,027,328
Prior period adjustment	-	46,913,082
<b>Net Assets at Beginning of Year, as restated</b>	<u>947,633,498</u>	<u>914,940,410</u>
<b>Net Assets at End of Year</b>	<u>\$ 977,540,809</u>	<u>\$ 947,633,498</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, 2002 and 2001**

	2002	2001 (as restated)
<b>Cash Flows from Operating Activities:</b>		
Cash received from customers	\$ 101,620,339	\$ 103,381,848
Cash payments to suppliers for goods and services	(46,765,513)	(50,043,908)
Cash payments to employees for services	(24,679,248)	(24,732,604)
Other revenues	373,845	236,459
Net cash provided by operating activities	<u>30,549,423</u>	<u>28,841,795</u>
<b>Cash Flows from Noncapital Financing Activities:</b>		
Proceeds from litigation settlement, net	<u>14,145,091</u>	<u>-</u>
<b>Cash Flows from Investing Activities:</b>		
Purchase of investments	(252,739,151)	(276,602,115)
Proceeds from maturity of investments	115,830,717	492,943,160
Interest on investments	6,991,982	15,289,814
Net cash provided by (used in) investing activities	<u>(129,916,452)</u>	<u>231,630,859</u>
<b>Cash Flows from Capital and Related Financing Activities:</b>		
Acquisition and construction of capital assets, net of contributions in aid of construction	(90,983,945)	(150,760,566)
Proceeds from issuance of bonds, net of discount	53,701,930	64,504,086
Repayments on bonds	-	(54,998,290)
Interest paid on bonds	(2,293,035)	(1,837,413)
Customer advances for capital projects	4,499,050	5,332,942
Net cash used for capital and related financing activities	<u>(35,076,000)</u>	<u>(137,759,241)</u>
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<u>(120,297,938)</u>	<u>122,713,413</u>
<b>Cash and Cash Equivalents, beginning of year</b>	<u>145,690,026</u>	<u>22,976,613</u>
<b>Cash and Cash Equivalents, end of year (including \$8,653,752 and \$90,691,873 in restricted accounts in 2002 and 2001, respectively)</b>	<u><u>\$ 25,392,088</u></u>	<u><u>\$ 145,690,026</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, 2002 and 2001**

	2002	2001 (as restated)
<b>Reconciliation of Operating Income (Loss) to Net Cash Provided by Operating Activities:</b>		
Operating income (loss)	\$ (2,467,612)	\$ 10,103,362
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:		
Depreciation expense	30,003,211	26,536,891
Other revenues	373,845	236,459
(Increase) decrease in assets:		
Customer receivables	(288,847)	(97,795)
Materials and supplies	(278,310)	(564,927)
Other receivables	-	(224,002)
Prepaid expenses and other	(6,634)	(90,151)
Increase (decrease) in liabilities:		
Accounts payable	(475,658)	1,456,363
Accrued CASE fees	3,325,671	(8,412,654)
Accrued vacation	(141,775)	(353,810)
Accrued workers' compensation	589,033	251,513
Other liabilities	(83,501)	546
Total adjustments	33,017,035	18,738,433
Net cash provided by operating activities	\$ 30,549,423	\$ 28,841,795

**Supplemental Disclosure of Noncash Capital and Related Financing Activities:**

The Board received approximately \$7,644,000 and \$8,715,000 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, 2002 and 2001, 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 June 30, 2002 and 2001**

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### **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 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.

Effective July 1, 2001, the Board adopted GASB Statement No. 34, *"Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments,"* GASB Statement No. 37, *"Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus – an amendment of GASB Statements No. 21 and No. 34,"* and GASB Statement No. 38, *"Certain Financial Statement Note Disclosures."* These Statements establish new financial reporting requirements for state and local governments. The implementation of these Statements resulted in a presentation of net assets and a management discussion and analysis section for the Board.

#### **Basis of Accounting**

The accompanying 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.

The Board distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services in connection with the Board'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.

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

## **Notes to Financial Statements June 30, 2002 and 2001**

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### **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.

### **Restricted Assets**

Restricted assets are comprised of cash and cash equivalents, investments and receivables maintained in accordance with bond resolutions, agreements and formal actions of the Board for the purpose of funding certain debt service payments, construction, improvements, and renewal and replacements of the water system. 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.

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 certificate. These proceeds are only applied to costs specified in the applicable series resolution or series certificate.

The special expendable account collects customer deposits from the assessment of water system facilities charges and negotiated agreements. Disbursements from the account are restricted to the construction of water source, storage and transmission facilities, including the related land, engineering and design work.

### **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.

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

## **Notes to Financial Statements June 30, 2002 and 2001**

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### **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 and residential properties 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 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 restricted to the construction of water facilities.

### **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 and (5) employee health, dental and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. The Board is partially self-insured for workers' compensation claims and judgements as discussed in Note 10.

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

## **Notes to Financial Statements June 30, 2002 and 2001**

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### **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.

### **Net Assets**

Net assets comprise the various net earnings from operating and nonoperating revenues, expenses and contributions in aid of construction. Net assets are classified in the following three components: invested in capital assets, net of related debt; restricted for capital activity and debt service; and unrestricted net assets. 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 are not included in the calculation of invested in capital assets, net of related debt. Restricted for capital activity and debt service consists of net assets for which constraints are placed thereon by external parties, such as lenders, grantors, contributors, laws, regulations and enabling legislation, including self-imposed legal mandates. Unrestricted consists of all other net assets not included in the above categories.

### **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. Cash and Investments**

At June 30, 2002 and 2001, cash, bank repurchase agreements, and government agency discount notes of approximately \$4,539,000 and \$156,668,000, respectively, were held by the City on behalf of the Board. These investments were accounted for at cost, which approximated fair value, at June 30, 2002 and 2001.

Effective in fiscal 2001, the Board entered into an investment management agreement with a trust company. As current investments held by the City matured, the funds were reinvested by the trust company. Effective in fiscal 2002, the Board's portfolio was diversified and managed by various investment managers. These investments consist mainly of mutual funds and U.S. government securities, which are recorded at fair value based on quoted market prices.

# Board of Water Supply City and County of Honolulu

## Notes to Financial Statements June 30, 2002 and 2001

At June 30, 2002 and 2001, investments were comprised of the following:

	2002		2001	
	Cost	Fair Value	Cost	Fair Value
Mutual funds	\$ 54,373,970	\$ 54,565,320	\$ 6,000,000	\$ 6,041,584
U.S. government treasury obligations	41,986,950	44,160,928	-	-
U.S. government agencies	58,075,214	56,621,957	978,062	978,062
Bank repurchase agreements	-	-	10,000,000	10,000,000
Total	<u>\$ 154,436,134</u>	<u>\$ 155,348,205</u>	<u>\$ 16,978,062</u>	<u>\$ 17,019,646</u>

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 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.

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

### 3. Restricted Assets

At June 30, 2002 and 2001, restricted assets were held for the following purposes:

	2002	2001
Construction	\$ 76,420,565	\$ 101,299,650
Renewals and replacements	2,019,196	2,001,613
Bond interest and redemption	<u>2,479,198</u>	<u>430,611</u>
Total	<u>\$ 80,918,959</u>	<u>\$ 103,731,874</u>



# Board of Water Supply City and County of Honolulu

## Notes to Financial Statements June 30, 2002 and 2001

### 4. Property, Plant and Equipment

Property, plant and equipment activity during 2002 and 2001 was as follows:

	Balance, July 1, 2001	Additions	Retirements / Transfers	Balance, June 30, 2002
Utility plant in service	\$1,137,216,817	\$ 87,277,945	\$ 6,892,028	\$1,217,602,734
Construction work in progress	107,168,370	120,377,403	100,586,774	126,958,999
	1,244,385,187	207,655,348	107,478,802	1,344,561,733
Accumulated depreciation	(384,284,725)	(31,156,468)	(6,288,549)	(409,152,644)
	<u>\$ 860,100,462</u>	<u>\$ 176,498,880</u>	<u>\$ 101,190,253</u>	<u>\$ 935,409,089</u>
	Balance, July 1, 2000	Additions	Retirements / Transfers	Balance, June 30, 2001
Utility plant in service	\$1,009,314,906	\$ 132,514,252	\$ 4,612,341	\$1,137,216,817
Construction work in progress	71,337,815	106,988,694	71,158,139	107,168,370
	1,080,652,721	239,502,946	75,770,480	1,244,385,187
Accumulated depreciation	(361,175,758)	(27,601,378)	(4,492,411)	(384,284,725)
	<u>\$ 719,476,963</u>	<u>\$ 211,901,568</u>	<u>\$ 71,278,069</u>	<u>\$ 860,100,462</u>

### 5. Bonds Payable

At June 30, 2002 and 2001, bonds payable consisted of the following:

	2002	2001
Water System Revenue Bonds, Series 2001, annual principal due ranging from \$780,000 to \$4,210,000 through July 1, 2032, with interest ranging from 3.50% to 5.50% (4.00% at June 30, 2002).	\$ 66,600,000	\$ 66,600,000
Water System Revenue Bonds, Series 2002, annual principal due commencing July 1, 2003, ranging from \$950,000 to \$3,300,000 through July 1, 2031, with interest at the monthly auction rates (1.45% to 1.55% at June 30, 2002).	54,400,000	-
	121,000,000	66,600,000
Current portion	780,000	-
Noncurrent portion	<u>\$ 120,220,000</u>	<u>\$ 66,600,000</u>

# Board of Water Supply City and County of Honolulu

## Notes to Financial Statements June 30, 2002 and 2001

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 100 percent of the principal amount plus accrued interest without premium.

Bonds payable activity during 2002 and 2001 was as follows:

	Balance, July 1, 2001	Additions	Reductions	Balance, June 30, 2002	Current Portion
Water System Revenue Bonds:					
2001 Series	\$ 66,600,000	\$ -	\$ -	\$ 66,600,000	\$ 780,000
2002 Series	-	54,400,000	-	54,400,000	-
	<u>\$ 66,600,000</u>	<u>\$ 54,400,000</u>	<u>\$ -</u>	<u>\$ 121,000,000</u>	<u>\$ 780,000</u>
	Balance, July 1, 2000	Additions	Reductions	Balance, June 30, 2001	Current Portion
Water System Revenue Bonds:					
1996 Series	\$ 16,820,000	\$ -	\$ (16,820,000)	\$ -	\$ -
2001 Series	-	66,600,000	-	66,600,000	-
General Obligation Water Bonds	<u>36,050,000</u>	<u>-</u>	<u>(36,050,000)</u>	<u>-</u>	<u>-</u>
	<u>\$ 52,870,000</u>	<u>\$ 66,600,000</u>	<u>\$ (52,870,000)</u>	<u>\$ 66,600,000</u>	<u>\$ -</u>

Future bond principal and interest payments are as follows:

	Principal	Interest	Total
Year ending June 30,			
2003	\$ 780,000	\$ 4,167,000	\$ 4,947,000
2004	2,040,000	4,116,000	6,156,000
2005	2,135,000	4,056,000	6,191,000
2006	2,180,000	3,990,000	6,170,000
2007	2,290,000	3,921,000	6,211,000
Thereafter	<u>111,575,000</u>	<u>60,890,000</u>	<u>172,465,000</u>
	<u>\$ 121,000,000</u>	<u>\$ 81,140,000</u>	<u>\$ 202,140,000</u>

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

## **Notes to Financial Statements June 30, 2002 and 2001**

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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, these 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, 2002, the outstanding defeased bonds amounted to \$520,000, and \$31,025,000 for the 1978 and 1992 Series bonds, respectively. As of June 30, 2002, the 1976 defeased bonds were paid off.

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, 2002, the outstanding 1996 Series defeased bonds amounted to \$15,950,000.

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

In March 2002, the Board issued \$54,400,000 in water system revenue bonds, which consisted of \$30,000,000 of Series 2002A and \$24,400,000 of Series 2002B bonds. Proceeds of the issuance were primarily used to fund the acquisition of a water reclamation facility.

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

## **Notes to Financial Statements June 30, 2002 and 2001**

### **6. Net Assets**

At June 30, 2002 and 2001, net assets consisted of the following:

	2002	2001
<b>Invested in Capital Assets, Net of Related Debt:</b>		
Net property, plant and equipment	\$ 935,409,089	\$ 860,100,462
Less: Water system revenue bonds payable	(121,000,000)	(66,600,000)
Add: Unspent debt proceeds	24,051,507	35,840,393
	<u>838,460,596</u>	<u>829,340,855</u>
<b>Restricted for Capital Activity and Debt Service:</b>		
Restricted cash and cash equivalents	8,653,752	90,691,873
Restricted investments	71,416,920	10,280,116
Restricted interest receivable	131,501	1,587,557
Restricted other receivables	716,786	1,172,328
Less:		
Unspent debt proceeds	(24,051,507)	(35,840,393)
Contracts payable, including retainages	(11,350,051)	(6,263,774)
Customer advances	(2,024,491)	(2,030,278)
Other payable from restricted assets	(6,032)	(6,032)
	<u>43,486,878</u>	<u>59,591,397</u>
<b>Unrestricted</b>	<u>95,593,335</u>	<u>58,701,246</u>
<b>Total net assets</b>	<u><u>\$ 977,540,809</u></u>	<u><u>\$ 947,633,498</u></u>

### **7. 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 revenues, expenses and changes in fund net assets.

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

## **Notes to Financial Statements June 30, 2002 and 2001**

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### **Central Administrative Services Expense Fee**

During fiscal year 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. For fiscal year 2001, the CASE fee was calculated as 4% of the Board's total operating budget less budgeted transfers to the capital improvement, renewal and replacement, and other Board funds. 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 CASE fees for fiscal years subsequent to 2001 are currently being negotiated between the Board and the City, the Board accrued their best estimate of approximately \$3,326,000 for fiscal year 2002.

### **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 was approximately \$28.9 million, of which the City's share was 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. As of June 30, 2002 and 2001, the Board has recorded a receivable and related allowance for uncollectible accounts of approximately \$1.9 million and \$1.3 million, respectively, related to this water system facility charge to the City.

### **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 was 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, 2002 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, 2002.

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 provided for separate financing of the acquisition through a bond offering in fiscal 2002.

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

## **Notes to Financial Statements June 30, 2002 and 2001**

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### **8. 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.

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, 2002, 2001 and 2000 was approximately \$24,994,000, \$24,699,000 and \$28,636,000, respectively; the Board's total payroll was approximately \$25,127,000, \$24,733,000 and \$28,804,000, respectively. The contribution requirement for the years ended June 30, 2002, 2001 and 2000 was approximately \$1,622,600, \$71,700 and \$71,700, respectively, which represented approximately 6.4%, 0.1% and 0.1% 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

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

## **Notes to Financial Statements June 30, 2002 and 2001**

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### **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, 2002 and 2001 was approximately \$675,000 and \$717,000, 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, 532 Board retirees and surviving dependents are eligible to receive health care benefits and 417 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, 2002 and 2001 aggregated approximately \$2,800,000 and \$2,420,000, 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 because the Board and City do not have significant administrative involvement in the Plan or perform the investment function for the Plan.

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

## **Notes to Financial Statements June 30, 2002 and 2001**

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### **9. 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, 2002, accumulated sick leave aggregated approximately \$20,600,000.

Other commitments, primarily for utility plant construction approximated \$123,164,000 at June 30, 2002.

### **10. Contingencies**

#### **Workers' Compensation Self-Insurance Liability**

The Board is self-insured for workers' compensation and disability claims below \$400,000 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. For the years ended June 30, 2002 and 2001, no provision was made for IBNR. Management believes all claims have been reported at year-end and 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, 2002 and 2001 for the Board's workers' compensation claims amounted to \$3,383,000 and \$2,849,000, respectively. Included in that amount is approximately \$1,670,000 and \$1,738,000 in permanent total disability (PTD) payments that have been discounted (at an annual rate of 5%) to a present value of approximately \$697,000 and \$702,000 for fiscal 2002 and 2001, respectively. Anticipated excess insurance (above the Board's \$400,000 self-retention) recoveries on one of the PTD claims reduces the case reserves by \$186,000 and \$178,250 for fiscal 2002 and 2001, respectively. Therefore, the total case reserves recorded by the Board were approximately \$2,223,000 at June 30, 2002 and approximately \$1,634,000 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 Environmental Protection Agency. Management believes 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.



# Board of Water Supply City and County of Honolulu

## Notes to Financial Statements June 30, 2002 and 2001

### 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 effect on the Board's financial position, results of operations, or liquidity.

### Credit Risk

Financial instruments, which potentially expose the Board to concentrations of credit risk, consist primarily of investments in debt securities and accounts receivable from retail customers. Credit risk related to investments in debt securities has been mitigated by limiting such investments to debt obligations of the U.S. government and agencies. 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, 2002, except as provided in the allowance for uncollectible accounts. The Board manages its credit exposure through procedures designed to identify and monitor credit risk.

### 11. Litigation Settlement

In fiscal 2002, the Board was a plaintiff in a lawsuit, which sought to recover the expenses associated with removing pesticides, which migrated into the groundwater under the pineapple fields in central Oahu. The Environmental Protection Agency has since restricted the use of some of the pesticides used, and treatment facilities were designed, constructed and maintained by the Board to filter the pesticides out of the ground water. The lawsuit was settled in January 2002 and the Board received proceeds of approximately \$14,145,000, net of \$5,805,000 in related expenses.

### 12. Prior Period Adjustment

During fiscal 2002, the Board had determined that the customer advance liability was overstated as the liability was not properly reduced and recognized as contributions in aid of construction revenue when the related water service was made available to the customer. Accordingly, proper adjustments were made to correct the customer advance liability and contributions in aid of construction revenue for fiscal 2001, resulting in a prior period adjustment of \$46,913,082 to the 2001 beginning net assets as follows:

	Contributions in Aid of Construction	Increase in Net Assets	Customer Advances	Net Assets, July 1, 2000
As previously reported	\$ 20,994,886	\$ 39,976,796	\$ 41,659,652	\$ 868,027,328
Adjustment	(7,283,708)	(7,283,708)	(39,629,374)	46,913,082
As restated	<u>\$ 13,711,178</u>	<u>\$ 32,693,088</u>	<u>\$ 2,030,278</u>	<u>\$ 914,940,410</u>

## **Supplemental Schedules**

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

**Supplemental Schedule of Property, Plant and Equipment  
For the Year Ended June 30, 2002  
(Excluding construction work in progress)**

<b>Assets</b>				
	<b>Balance July 1, 2001</b>	<b>Additions</b>	<b>Retirements</b>	<b>Balance June 30, 2002</b>
<b>Property, excluding land and land rights:</b>				
Source of supply	\$ 34,521,987	\$ 1,092,884	\$ 11,130	\$ 35,603,741
Pumping	134,271,782	5,473,634	538,034	139,207,382
Water treatment	30,909,093	51,830	18,063	30,942,860
Transmission and distribution	802,498,254	68,013,504	4,996,879	865,514,879
Water reclamation	48,100,000	26,614	1,492	48,125,122
General	57,353,499	12,120,169	1,326,430	68,147,238
	<u>1,107,654,615</u>	<u>86,778,635</u>	<u>6,892,028</u>	<u>1,187,541,222</u>
<b>Land and Land Rights:</b>				
Source of supply	19,649,062	-	-	19,649,062
Pumping	1,592,569	9,488	-	1,602,057
Water treatment	5,353	110,084	-	115,437
Transmission and distribution	482,445	379,738	-	862,183
General	7,832,773	-	-	7,832,773
	<u>29,562,202</u>	<u>499,310</u>	<u>-</u>	<u>30,061,512</u>
	<u>\$ 1,137,216,817</u>	<u>\$ 87,277,945</u>	<u>\$ 6,892,028</u>	<u>\$ 1,217,602,734</u>
<b>Obtained From:</b>				
Operating account		\$ 58,413,217		
Special expendable account		16,219,825		
Bond improvement account		5,001,245		
Contributions in aid:				
Government		2,086,109		
Other		5,557,549		
		<u>\$ 87,277,945</u>		

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

**Supplemental Schedule of Property, Plant and Equipment (continued)  
For the Year Ended June 30, 2002  
(Excluding construction work in progress)**

	<b>Accumulated Depreciation</b>			
	<b>Balance July 1, 2001</b>	<b>Additions</b>	<b>Retirements</b>	<b>Balance June 30, 2002</b>
<b>Property, excluding land and land rights:</b>				
Source of supply	\$ 17,627,834	\$ 1,068,619	\$ -	\$ 18,696,453
Pumping	61,942,018	5,118,463	354,730	66,705,751
Water treatment	8,975,433	1,477,121	-	10,452,554
Transmission and distribution	271,747,444	18,191,452	4,660,801	285,278,095
Water Reclamation	-	1,486,845	1,492	1,485,353
General	23,991,996	3,813,968	1,271,526	26,534,438
	<u>\$ 384,284,725</u>	<u>\$ 31,156,468</u>	<u>\$ 6,288,549</u>	<u>\$ 409,152,644</u>
Less amounts charged to jobbing contract work		<u>1,153,257</u>		
<b>Depreciation Expense</b>		<u><u>\$ 30,003,211</u></u>		

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

**Supplemental Schedule for Bonds Payable  
For the Year Ended June 30, 2002**

	<b>Last Installment</b>	<b>Interest Rate</b>	<b>Bond Dated</b>	<b>Maturing Serially From</b>	<b>Call Dates (1)</b>	<b>Outstanding June 30, 2002</b>
<b>Water System Revenue Bonds:</b>						
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
						<u>66,600,000</u>

- (1) Call dates indicated are optional.  
(2) Noncallable.

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

**Supplemental Schedule for Bonds Payable (continued)  
For the Year Ended June 30, 2002**

	<b>Last Installment</b>	<b>Interest Rate</b>	<b>Bond Dated</b>	<b>Maturing Serially From</b>	<b>Outstanding June 30, 2002</b>
<b>Water System Revenue Bonds:</b>					
Series 2002	2004	(1)	03-05-2002	07-01-2003	\$ 950,000
2002	2005	(1)	03-05-2002	07-01-2004	1,000,000
2002	2006	(1)	03-05-2002	07-01-2005	1,000,000
2002	2007	(1)	03-05-2002	07-01-2006	1,050,000
2002	2008	(1)	03-05-2002	07-01-2007	1,100,000
2002	2009	(1)	03-05-2002	07-01-2008	1,150,000
2002	2010	(1)	03-05-2002	07-01-2009	1,200,000
2002	2011	(1)	03-05-2002	07-01-2010	1,300,000
2002	2012	(1)	03-05-2002	07-01-2011	1,350,000
2002	2013	(1)	03-05-2002	07-01-2012	1,400,000
2002	2014	(1)	03-05-2002	07-01-2013	1,450,000
2002	2015	(1)	03-05-2002	07-01-2014	1,550,000
2002	2016	(1)	03-05-2002	07-01-2015	1,600,000
2002	2017	(1)	03-05-2002	07-01-2016	1,650,000
2002	2018	(1)	03-05-2002	07-01-2017	1,750,000
2002	2019	(1)	03-05-2002	07-01-2018	1,850,000
2002	2020	(1)	03-05-2002	07-01-2019	1,900,000
2002	2021	(1)	03-05-2002	07-01-2020	2,000,000
2002	2022	(1)	03-05-2002	07-01-2021	2,100,000
2002	2023	(1)	03-05-2002	07-01-2022	2,200,000
2002	2024	(1)	03-05-2002	07-01-2023	2,300,000
2002	2025	(1)	03-05-2002	07-01-2024	2,400,000
2002	2026	(1)	03-05-2002	07-01-2025	2,500,000
2002	2027	(1)	03-05-2002	07-01-2026	2,600,000
2002	2028	(1)	03-05-2002	07-01-2027	2,750,000
2002	2029	(1)	03-05-2002	07-01-2028	2,850,000
2002	2030	(1)	03-05-2002	07-01-2029	3,000,000
2002	2031	(1)	03-05-2002	07-01-2030	3,150,000
2002	2032	(1)	03-05-2002	07-01-2031	3,300,000
					<u>54,400,000</u>
<b>Total Bonds Payable</b>					<u><u>\$121,000,000</u></u>

(1) Interest rates are at the auctioned rate.

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

**Supplemental Schedule of Net Revenue Requirement  
For the Year Ended June 30, 2002**

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**Revenues:**

Water sales	\$ 100,695,638
Other, principally litigation settlement (net of expenses of approximately \$5,805,000)	16,478,113
Interest	<u>5,554,251</u>
Total revenues	<u>122,728,002</u>

**Deductions:**

Operating expenses	103,702,304
Less depreciation expense	<u>(30,003,211)</u>
Total deductions	<u>73,699,093</u>
Net revenues	<u><u>\$ 49,028,909</u></u>

**Net Revenue Requirement**

Greater of –

1) Aggregate debt service for 2002	\$ 4,608,074
Required deposits:	
Reimbursable obligation fund	<u>-</u>
	<u>4,608,074</u>
2) Aggregate debt service for 2002	4,608,074
	x 1.20
	<u>5,529,689</u>
Net revenue requirement	<u><u>\$ 5,529,689</u></u>