

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

***Financial Statements for the Year Ended June 30, 2003,  
Supplemental Information for the Year Ended June 30,  
2003 and Independent Auditors' Report***

# **BOARD OF WATER SUPPLY CITY AND COUNTY OF HONOLULU**

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# **BOARD OF WATER SUPPLY CITY AND COUNTY OF HONOLULU**

## **INTRODUCTION JUNE 30, 2003**

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The Board of Water Supply, City and County of Honolulu ("Board") is pleased to present its Annual Financial Report. This introduction provides an overview of the mission, organization, and operations of the Board. The following management's discussion and analysis is intended to provide the reader with an easily understandable analysis of the Board's financial performance and to enable the reader to assess all aspects of its financial position. Financial statements presenting the financial position and results of operations of the Board in conformity with generally accepted accounting principles, accompanied by the independent auditors' report, follow the management's discussion and analysis.

### **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:

1. Provide world-class customer service
2. Establish a performance culture at all levels
3. Develop our staff and renew the Board's ohana
4. Expand water resources and assure long-term viability
5. Improve infrastructure reliability
6. 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 of Directors.

The Board consists of six operating units – Business Development, Business Services, Customer Care, Maintenance, Operations, and Water Resources. All are 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 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 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 160,170 accounts and a residential population of 896,019. 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, 148,524 are residential (92.7%), representing 60.9% of the total amount received from water sales in fiscal year 2003; 10,827 are commercial and industrial (6.8%), representing 38.1% of the total amount received from water sales in fiscal year 2003; and 819 are agricultural (0.5%), representing 1.0% of the total amount received from water sales in fiscal year 2003.

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 9 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 five-year reengineering program to transform itself into a highly competitive 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 fiscal year 2003, there were 544 positions, a decrease of 17% with no layoffs. Even with the decrease in staffing, the Board has been able to support the water system's growth, as well as take on significant projects to modernize its business systems and change its work practices.

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.

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. In 2003, the Board implemented a new automated financial accounting system and, as a result, the finance area was reorganized to optimize new work functions, and work processes throughout the Board were reengineered. In fiscal years 2004 and 2005, the Board will be engaged in the implementation of two major computerized information systems – 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 fiscal year 2004 that 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 has conducted a water system assessment and provided emergency water testing services to Pohnpei Utilities in the Federated States of Micronesia, and has entered into an alliance agreement to provide technical assistance to the Local Water Utilities Administration in the Philippines. Projects such as these help to promote the Board's presence and to build relationships in the Asia Pacific region. These initiatives are expected to bring in new revenues and provide opportunities to 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 \$398 million over the next five years. The Board's primary 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 \$229 million, or 57% of the Board's total RFIP and CIP, is budgeted for the repair and replacement of pipelines. Of the remaining amount, 17% is budgeted for source projects, 18% for facilities projects, and 8% for research and development, storage, pumping, and water treatment projects.

The Board is well positioned financially to support ongoing and future reengineering efforts and execution of its capital program and strategic plan. Its annual revenues, at an average of \$101.8 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 seventh year in a row, the Board has not found it necessary to raise its water rates due to prudent financial management.

# **BOARD OF WATER SUPPLY CITY AND COUNTY OF HONOLULU**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS YEAR ENDED JUNE 30, 2003**

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This section presents management's discussion and analysis of the Board's financial condition and activities for the year ended June 30, 2003. 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 seventh year in a row, the Board maintains a strong financial performance and a manageable capital improvements program. Outstanding debt is relatively low, cash reserves are high, and all debt covenants were exceeded. Key financial highlights follow:

- Total cash and investments are \$142.8 million at June 30, 2003.
- Total assets at year-end are \$1,146.5 million and exceed liabilities by \$991.7 million.
- The Board's unrestricted current assets at June 30, 2003 are 2.2 times its related current liabilities.
- The Board's debt to equity ratio is 12.0% at June 30, 2003, indicating a large capacity to issue additional bonds.
- Operating revenues for fiscal year 2003 are \$105.6 million, up \$4.4 million from revenues of \$101.2 million in fiscal year 2002, reflecting a recovery from the effects of September 11 on consumption for hotels and commercial customers and a continued growth in residential water sales.
- Net assets increased \$16.1 million in fiscal year 2003.

### **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 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, 2003. The statement of revenues, expenses and changes in net assets presents the results of operations for the year then ended, 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 financial 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 capital assets, outstanding bonds, and net revenue requirements are also included.

## Financial Analysis

### Results of Operations

#### CONDENSED STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

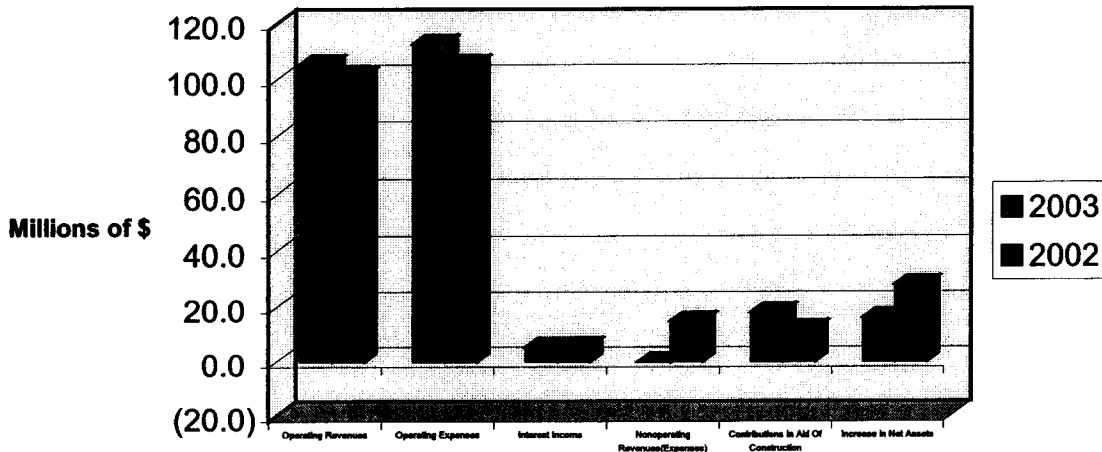
	June 30,		%
	2003	2002 (as restated)(a)	Variance
	(in thousands)		
Operating revenues	\$ 105,647	\$ 101,235	4.4 %
Operating expenses:			
Depreciation	33,837	30,003	12.8 %
Administrative and general	29,891	27,027	10.6 %
Water reclamation	4,128	3,679	12.2 %
Other operating expenses	44,988	44,850	0.3 %
Total operating expenses	112,844	105,559	6.9 %
Operating loss	(7,197)	(4,324)	66.4 %
Nonoperating revenues (expenses):			
Interest income	5,367	5,554	(3.4)%
Litigation settlement - net		14,145	N/C
Others	(234)	726	(132.2)%
Nonoperating revenues - net	5,133	20,425	(74.9)%
Contributions in aid of construction	18,124	11,857	52.9 %
Increase in net assets	\$ 16,060	\$ 27,958	(42.6)%

(a) Restated to reflect a prior period adjustment as described in Note 12 to the financial statements.

N/C = Not calculated.

The increase in net assets for the fiscal year ending June 30, 2003 amounted to \$16.1 million, which is \$11.9 million lower than last year's increase. This is primarily due to a litigation settlement in 2002 that resulted in a one-time increase in net assets in 2002. Other changes in revenues and expenses as presented above are further described below.

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



Operating revenues for fiscal year 2003 were \$105.6 million, 4.4% higher than fiscal year 2002 revenues of \$101.2 million. Water revenues in fiscal year 2002 were negatively affected by a decrease in water consumption by hotel and commercial water customers brought on by the events of September 11, 2001. The combined water consumption of these customers decreased by 4.7% in 2002. In fiscal year 2003, commercial consumption stabilized, while residential revenues continued to increase (\$2.1 million) and industrial consumption, including recycled water, increased by 25.9%. For the seventh year in a row, water rates and charges remained unchanged.

Total operating expenses increased to \$112.8 million in fiscal year 2003 from \$105.6 million in fiscal year 2002, an increase of \$7.3 million or 6.9%. Factors contributing to this increase are explained below.

Depreciation expense increased by \$3.8 million from fiscal year 2002. This was attributable to \$87.3 million in property, plant and equipment being added to capital assets in fiscal year 2002.

Administrative and general expenses increased \$2.9 million due primarily to costs of the Board's reengineering program and other services of approximately \$2.4 million. The Board is undergoing a significant reengineering effort to transform the organization into a highly competitive, world-class organization. This program, referred to as QUEST (Quality Utility Employees Succeeding Together), seeks to improve customer service and achieve greater operational efficiencies and effectiveness. The goals of QUEST are to provide world-class customer service, establish a performance culture at all levels, develop staff, expand water resources and assure long-term viability, improve infrastructure reliability, and identify growth opportunities. Specialized services were retained to help the Board in this effort. Major accomplishments include implementing an automated financial accounting system, reorganizing the Business Services unit and re-engineering related operating and finance work processes throughout the Board, designing and implementing a geographic information system, and creating a website linking asset and customer information that is available to the Board's clients. Other accomplishments include implementing an automated time and attendance system replacing manual timesheets, converting approximately 150,000 residential water meters for electronic reading, performing water system vulnerability assessments, implementing electronic document scanning, and designing a multi-skilled worker pilot program for field



workers. In addition, an increase in contributions of \$800,000 was required from the State's Employees Retirement System. Partially offsetting these increases was a decrease of \$500,000 in security service expenses as the initial impact of September 11 was partially moderated in 2003.

Water reclamation expenses include expenses of operating the Honouliuli Recycled Water Facility, which is in its third year of operation. In 2003, increases in water sales, which are included in operating revenues, offset increases in water reclamation expenses, which are included in operating expenses. Other water reclamation expenses include soil aquifer treatment studies, which are expenses of the Board's overall water reclamation program.

The Board's interest income decreased slightly as a result of decreased balances of cash and investments as the Board uses its cash reserves to fund operations and capital projects as planned. While interest rates remain low, the Board has realized favorable returns on its investments through the use of money managers to invest its funds, which has partially offset the impact of the decrease in investment balances in 2003.

In fiscal year 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 was a one-time increase to the net assets in that year.

Other nonoperating revenues decreased in 2003 mainly due to a decrease in gains from changes in fair value of investments.

Contributions in aid of construction result from water system facilities charges that are levied against all new developments and residential properties requiring water from the Board's systems, except those developments that have paid for and installed a complete water system, including source, transmission and daily storage facilities. In addition, contributions of capital assets from governmental agencies, developers and customers are recorded as contributions in aid of construction at their cost. In 2003, as a result of increased development, contributions in aid of construction increased by \$6.3 million or 52.9% over 2002.

# **Financial Condition**

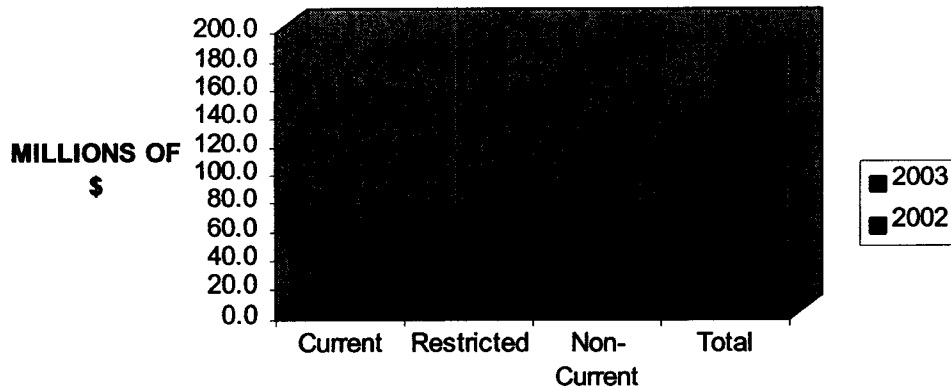
## **CONDENSED STATEMENTS OF NET ASSETS**

	<b>June 30,</b>		<b>%</b>
	<b>2003</b>	<b>2002</b>	<b>Variance</b>
	<b>(in thousands)</b>	<b>(as restated)(a)</b>	
<b>Current assets:</b>			
Cash and investments	\$ 21,024	\$ 47,689	(55.9)%
Other current assets	20,369	19,452	4.7 %
<b>Restricted assets:</b>			
Cash and investments	58,223	80,071	(27.3)%
Other restricted assets	843	848	(0.6)%
Investments	63,546	52,981	19.9 %
Other assets	2,732	3,028	(9.8)%
Property, plant and equipment - net of accumulated depreciation	979,759	933,460	5.0 %
<b>Total assets</b>	<b>\$ 1,146,496</b>	<b>\$ 1,137,529</b>	<b>0.8 %</b>
<b>Current liabilities</b>	<b>\$ 25,194</b>	<b>\$ 29,936</b>	<b>(15.8)%</b>
Other liabilities	11,470	11,781	(2.6)%
Bonds payable, noncurrent	118,180	120,220	(1.7)%
<b>Total liabilities</b>	<b>154,844</b>	<b>161,937</b>	<b>(4.4)%</b>
<b>Net assets:</b>			
Invested in capital assets - net of related debt	863,803	836,511	3.3 %
Restricted for capital activity and debt service	46,228	43,487	6.3 %
Unrestricted	81,621	95,594	(14.6)%
<b>Total net assets</b>	<b>991,652</b>	<b>975,592</b>	<b>1.6 %</b>
<b>Total liabilities and net assets</b>	<b>\$ 1,146,496</b>	<b>\$ 1,137,529</b>	<b>0.8 %</b>

(a) Restated to reflect a prior period adjustment as described in Note 12 to the financial statements.

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

## CASH AND INVESTMENTS



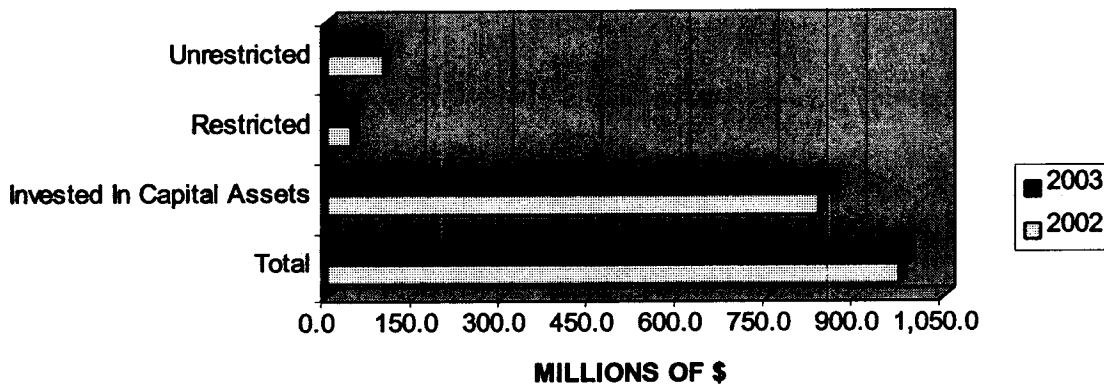
The Board's total cash and investments decreased by \$37.9 million in 2003 from \$180.7 million in 2002. This was the result of a planned reduction to fund operations and capital projects. At June 30, 2003, the Board's cash and investments balance of \$142.8 million exceeds the total annual operating budget of the Board for fiscal year 2004 of \$139.6 million, which includes \$46.0 million of capital projects anticipated to be funded from the operating budget. This is before taking into account operating fund revenues for fiscal year 2004, which are projected at \$110.6 million. The unrestricted portion of cash and investments at June 30, 2003 of \$84.6 million represents 107.0% of the Board's total operating expenses for fiscal year 2003 excluding depreciation.

The Board's liquidity ratio (current assets divided by current liabilities) is 1.6 and 2.2 for June 30, 2003 and 2002, respectively. The Board's unrestricted current assets at June 30, 2003 are 2.2 times its related current liabilities.

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 12.0% and 12.4% for June 30, 2003 and 2002, respectively.

Net assets increased 1.6% from \$975.6 million in fiscal year 2002 to \$991.7 million in fiscal year 2003. Due to a prior period adjustment identified in 2003 relating to construction work in progress at June 30, 2002, the 2002 increase in net assets decreased by \$1.9 million from amounts previously reported.

## NET ASSETS



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

During the year, the Board capitalized \$83.6 million to its utility plant in service. Major assets added were Fort Weaver Road non-potable transmission main, \$11.2 million; Dillingham Boulevard transmission main, \$7.1 million; Kamehameha Highway transmission mains (Windward and Waialua), \$8.5 million; financial accounting system upgrade, \$2.5 million; automatic meter reading components, \$1.6 million; and various transmission and distribution mains, primarily in the Suburban District, \$41.4 million.

All 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 (the Board has none). The Board's net revenue for 2003 for purposes of this requirement is 5.7 times the requirement. The Board's revenue bond debt service coverage for the fiscal year ending June 30, 2003 is 6.8.

### **Request 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.



## INDEPENDENT AUDITORS' REPORT

The Board of Directors  
Board of Water Supply  
City and County of Honolulu:

We have audited the statement of net assets of the Board of Water Supply, City and County of Honolulu (the "Board"), as of June 30, 2003, and the related statements of revenues, expenses, and changes in net assets and of cash flows for the year then ended. 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 in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Board at June 30, 2003, 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.

The management's discussion and analysis information on pages 4 to 10 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standard Board. This information is the responsibility of the management of the 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 financial statements taken as a whole. The supplemental schedules as of and for the year ended June 30, 2003 are presented for the purpose of additional analysis and are not a required part of the basic financial statements. Such supplemental schedules have been subjected to the auditing procedures applied in our audit of the financial statements and, in our opinion, are fairly stated in all material respects when considered in relation to the financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 17, 2003 on our consideration of the Board's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

*Deloitte & Touche LLP*

October 17, 2003

# BOARD OF WATER SUPPLY CITY AND COUNTY OF HONOLULU

## STATEMENT OF NET ASSETS JUNE 30, 2003

### ASSETS

#### CURRENT ASSETS:

Cash and cash equivalents	\$ 7,924,488
Investments	13,099,945
Interest receivable	689,833
Customer receivables:	
Billed, less allowances of \$1,741,000 for uncollectible accounts	7,767,433
Unbilled	7,062,000
Other receivables	879,133
Materials and supplies	3,849,918
Prepaid expenses	120,749

Total current assets 41,393,499

#### RESTRICTED ASSETS:

Cash and cash equivalents	6,073,944
Investments	52,148,859
Other receivables, less allowances of \$2,564,230 for uncollectible accounts	540,557
Interest receivable	302,795

Total restricted assets 59,066,155

INVESTMENTS 63,545,946

OTHER ASSETS 2,732,110

#### CAPITAL ASSETS:

Land	30,090,079
Infrastructure	979,913,704
Buildings and improvements	117,750,636
Equipment and machinery	169,197,374
Construction work in progress	121,578,439

Accumulated depreciation 1,418,530,232  
(438,771,701)

Capital assets - net 979,758,531

TOTAL \$1,146,496,241

# BOARD OF WATER SUPPLY CITY AND COUNTY OF HONOLULU

## STATEMENT OF NET ASSETS (Continued) JUNE 30, 2003

### LIABILITIES AND NET ASSETS

#### CURRENT LIABILITIES:

##### Payable from current assets:

Contracts payable, including retainages	\$ 4,919,368
Accounts payable	9,693,219
Accrued vacation, current portion	2,496,348
Accrued interest payable	1,689,067
	<u>18,798,002</u>

##### Payable from restricted assets:

Contracts payable, including retainages	5,299,916
Bonds payable, current portion	1,090,000
Other	6,032
	<u>6,395,948</u>

Total current liabilities 25,193,950

#### OTHER LIABILITIES:

Customer advances	4,218,313
Accrued vacation - noncurrent portion	4,039,463
Accrued workers' compensation	2,270,835
Other	941,731
	<u>11,470,342</u>

Total other liabilities 11,470,342

BONDS PAYABLE - Less current portion 118,180,000

Total liabilities 154,844,292

#### COMMITMENTS AND CONTINGENCIES

#### NET ASSETS:

Invested in capital assets - net of related debt	863,802,757
Restricted for capital activity and debt service	46,227,668
Unrestricted	81,621,524
	<u>991,651,949</u>

Total net assets 991,651,949

TOTAL \$1,146,496,241

See notes to financial statements.



# BOARD OF WATER SUPPLY CITY AND COUNTY OF HONOLULU

## STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS YEAR ENDED JUNE 30, 2003

### OPERATING REVENUES:

Water sales	\$ 103,817,187
Other, principally contract and service fees	1,830,239

Total operating revenues	105,647,426
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### OPERATING EXPENSES:

Depreciation	33,837,030
Administrative and general	29,890,579
Maintenance	15,396,722
Power and pumping	13,687,398
Transmission and distribution	7,715,513
Customers' accounting and collection	4,433,507
Water reclamation	4,128,213
Central administrative services expense fees	3,400,960
Water treatment	233,082
Source of supply	120,934

Total operating expenses	112,843,938
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LOSS FROM OPERATIONS	(7,196,512)
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### NONOPERATING REVENUES (EXPENSES):

Interest income	5,367,233
Interest expense - net of interest capitalized of \$2,966,000	(1,403,012)
Other	1,169,055

Nonoperating revenues - net	5,133,276
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CONTRIBUTIONS IN AID OF CONSTRUCTION	18,123,874
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INCREASE IN NET ASSETS	16,060,638
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### NET ASSETS, BEGINNING OF YEAR:

As previously reported	977,540,809
Prior period adjustment	(1,949,498)

As restated	975,591,311
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NET ASSETS, END OF YEAR	\$991,651,949
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See notes to financial statements.

# **BOARD OF WATER SUPPLY CITY AND COUNTY OF HONOLULU**

## **STATEMENT OF CASH FLOWS YEAR ENDED JUNE 30, 2003**

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### **OPERATING ACTIVITIES:**

Cash received from customers	\$ 105,090,934
Payments to suppliers for goods and services	(66,275,812)
Payments to employees for services	(26,052,047)
Other revenues	464,031

Net cash provided by operating activities	13,227,106
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### **INVESTING ACTIVITIES:**

Proceeds from maturity of investments	185,854,375
Purchase of investments	(158,546,996)
Interest on investments	4,755,420

Net cash provided by investing activities	32,062,799
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### **CAPITAL AND RELATED FINANCING ACTIVITIES:**

Acquisition and construction of capital assets - net of contributions in aid of construction	(60,938,107)
Customer advances for capital projects	10,098,210
Repayments on bonds	(1,730,000)
Interest paid on bonds	(4,113,664)

Net cash used in capital and related financing activities	(56,683,561)
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NET DECREASE IN CASH AND CASH EQUIVALENTS	(11,393,656)
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CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	25,392,088
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CASH AND CASH EQUIVALENTS, END OF YEAR (Including \$6,073,944 in restricted accounts)	\$ 13,998,432
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# **BOARD OF WATER SUPPLY CITY AND COUNTY OF HONOLULU**

## **STATEMENT OF CASH FLOWS (Continued) YEAR ENDED JUNE 30, 2003**

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### **RECONCILIATION OF LOSS FROM OPERATIONS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:**

Loss from operations	\$ (7,196,512)
Adjustments to reconcile loss from operations to net cash provided by operating activities:	
Depreciation	33,837,030
Central administrative services expense fees	3,400,960
Other revenues	464,031
Change in operating assets and liabilities:	
Customer receivables	(572,640)
Materials and supplies	295,365
Other receivables	(19,554)
Prepaid expenses and other	(3,779)
Accounts payable	(16,941,012)
Accrued vacation	(95,835)
Accrued workers' compensation	47,521
Other liabilities	11,531
	<hr/>
Net cash provided by operating activities	<u>\$ 13,227,106</u>

### **SUPPLEMENTAL DISCLOSURE OF NONCASH CAPITAL AND RELATED FINANCING ACTIVITIES:**

• Contributions of capital assets from government agencies, developers and customers that are recorded as contributions in aid of construction at their cost or estimated cost	\$ 10,219,000
• Capital assets included in accounts payable	6,061,000

See notes to financial statements.

# BOARD OF WATER SUPPLY CITY AND COUNTY OF HONOLULU

## NOTES TO FINANCIAL STATEMENTS YEAR ENDED JUNE 30, 2003

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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 ("Board") as a semi-autonomous body of the City and County of Honolulu government ("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 Standard 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 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.

**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 ("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.

**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.

**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.

**Capital Assets** - Capital assets are stated at cost and include contributions by governmental agencies, private subdividers, and customers at their cost or estimated cost of new construction.

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 capital assets 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

**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.

***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.

***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 is not included in the calculation of invested in capital assets, net of related debt. Restricted for capital activity and debt service consists of net 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.

***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.

***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.

***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 judgments as discussed in Note 11.

***New Accounting Pronouncements*** - In May 2002, the GASB issued Statement No. 39, *Determining Whether Certain Organizations Are Component Units - an amendment of GASB Statement No. 14*. This Statement provides additional guidance to determine whether certain organizations for which the primary government is not financially accountable should be reported as component units based on the nature and significance of their relationship with the primary government. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2003. Management does not expect the adoption of this Statement to have a significant impact on the financial statements.

In March 2003, the GASB issued Statement No. 40, *Deposit and Investment Risk Disclosures - an amendment of GASB Statement No. 3*. This Statement requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. Deposit and investment policies related to the risks identified in this Statement are also to be disclosed. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2004. Management is uncertain as to the additional disclosures that may be required, once the provisions of this Statement are implemented.

## 2. INVESTMENTS

In fiscal year 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. The Board's portfolio is 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.

At June 30, 2003, investments consisted of the following:

	<b>Cost</b>	<b>Fair Value</b>
Mutual funds	\$ 23,844,050	\$ 23,895,976
U.S. government treasury obligations	57,306,604	57,406,014
U.S. government agencies	35,283,681	36,017,238
Treasury bills - short-term	11,476,029	11,475,522
	<hr/>	<hr/>
Total	\$ 127,910,364	\$ 128,794,750

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, 2003, restricted assets were held for the following purposes:

Construction	\$ 54,238,620
Renewals and replacements	2,030,166
Bond interest and redemption	2,797,369
	<hr/>
Total	\$ 59,066,155

#### 4. CAPITAL ASSETS

Capital assets activity during 2003 was as follows:

	Balance, July 1, 2002	Additions	Transfers	Retirements	Balance, June 30, 2003
Depreciable assets:					
Infrastructure	\$ 909,331,196	\$ 1,711,272	\$ 71,247,283	\$ (2,376,047)	\$ 979,913,704
Buildings and improvements	117,554,004	208,234	(11,602)		117,750,636
Equipment and machinery	160,656,021	256,255	10,175,921	(1,890,823)	169,197,374
Total depreciable assets	1,187,541,221	2,175,761	81,411,602	(4,266,870)	1,266,861,714
Less accumulated depreciation	(409,152,644)	(33,885,927)		4,266,870	(438,771,701)
Total depreciable assets - net	778,388,577	(31,710,166)	81,411,602		828,090,013
Land	30,061,512	28,567			30,090,079
Construction work in progress	125,009,500	77,980,541	(81,411,602)		121,578,439
Capital assets - net	<u>\$ 933,459,589</u>	<u>\$ 46,298,942</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 979,758,531</u>

#### 5. ACCRUED VACATION

At June 30, 2003, accrued vacation consisted of the following:

	Beginning of Year	Additions	Reductions	End of Year	Current Portion	Noncurrent Portion
Accrued vacation	\$ 6,631,646	\$ 2,400,513	\$ (2,496,348)	\$ 6,535,811	\$ 2,496,348	\$ 4,039,463

#### 6. BONDS PAYABLE

At June 30, 2003, bonds payable consisted of the following:

Water System Revenue Bonds, Series 2001, annual principal due ranging from \$1,090,000 to \$4,210,000 through July 1, 2032, with interest ranging from 3.5% to 5.5% (4.0% at June 30, 2003)	\$ 65,820,000
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 (1.1% to 1.2% at June 30, 2003)	53,450,000
Total	119,270,000
Less current portion	(1,090,000)
Noncurrent portion	<u>\$118,180,000</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 100 percent of the principal amount plus accrued interest without premium.



Bonds payable activity during 2003 was as follows:

	Balance, July 1, 2002	Additions	Reductions	Balance, June 30, 2003	Current Portion
Water System Revenue Bonds:					
2001 Series	\$ 66,600,000		\$ (780,000)	\$ 65,820,000	\$ 1,090,000
2002 Series	54,400,000		(950,000)	53,450,000	
Total	<u>\$ 121,000,000</u>	<u>\$ -</u>	<u>\$(1,730,000)</u>	<u>\$ 119,270,000</u>	<u>\$ 1,090,000</u>

Future bond principal and interest payments are as follows:

	Principal	Interest	Total
Year ending June 30,			
2004	\$ 1,090,000	\$ 3,945,000	\$ 5,035,000
2005	2,135,000	3,890,000	6,025,000
2006	2,180,000	3,826,000	6,006,000
2007	2,290,000	3,762,000	6,052,000
2008	2,385,000	3,700,000	6,085,000
2009-2013	13,760,000	17,325,000	31,085,000
2014-2018	17,345,000	14,859,000	32,204,000
2019-2023	22,095,000	11,587,000	33,682,000
2024-2028	28,070,000	7,379,000	35,449,000
2025-2032	27,920,000	2,056,000	29,976,000
Total	<u>\$119,270,000</u>	<u>\$72,329,000</u>	<u>\$191,599,000</u>

In February 2001, the Board created an irrevocable trust with an escrow agent to retire \$1,560,000 and \$32,460,000 of the Board's outstanding 1978 and 1992 general obligation water bonds, respectively. The escrow agent will pay all future debt service payments on the 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, 2003, the outstanding defeased bonds amounted to \$30,605,000 for the 1992 Series bonds. As of June 30, 2003, the 1978 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, 2003, the outstanding 1996 Series defeased bonds amounted to \$15,936,000.

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.

In July 2003, the Board was authorized to issue a maximum of \$150,000,000 in water system revenue bonds and interest rate swap agreements to be used for the improvement of capital assets.

## 7. NET ASSETS

At June 30, 2003, net assets consisted of the following:

Invested in Capital Assets - net of related debt:	
Property, plant and equipment - net	\$ 979,758,531
Less water system revenue bonds payable	(119,270,000)
Add unspent debt proceeds	3,314,226
	<hr/>
	863,802,757
Restricted for Capital Activity and Debt Service:	
Restricted cash and cash equivalents	6,073,944
Restricted investments	52,148,859
Restricted interest receivable	302,795
Restricted other receivables	540,557
Less:	
Unspent debt proceeds	(3,314,226)
Contracts payable, including retainages	(5,299,916)
Customer advances	(4,218,313)
Other payable from restricted assets	(6,032)
	<hr/>
	46,227,668
Unrestricted	<hr/>
	81,621,524
Total net assets	<hr/>
	\$ 991,651,949

## 8. 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 net assets.

**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. 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 its best estimate of approximately \$3,401,000 for the year ended June 30, 2003.

**Ewa Villages Water System Facilities Charge** - Based upon negotiations with the City, the Board 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's estimation of 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, 2003, the Board has recorded a receivable and related allowance for uncollectible accounts of approximately \$1.9 million 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 ("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 was paid as of June 30, 2003 as the facility met certain performance standards specified in the Sale Agreement.

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.

***Amounts Due to/from the City*** - Amount due from the City approximated \$950,000 as of June 30, 2003 and is included in accounts receivable. Amount due to the City is approximately \$7,353,000 as of June 30, 2003 and is included in accounts payable.

## **9. 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 year ended June 30, 2003 was approximately \$26,043,000; the Board's total payroll was approximately \$26,226,000. The contribution requirement for the year ended June 30, 2003 was approximately \$2,394,000, which represented approximately 9.2% of the Board's covered payroll for the fiscal year. The Board's contribution requirement for fiscal year 2003 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.

### **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, 2003 was approximately \$633,000.

### **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, 538 Board retirees and surviving dependents are eligible to receive health care benefits and 416 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 the year ended June 30, 2003 aggregated approximately \$2,500,000 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.

## **10. 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, 2003, accumulated sick leave aggregated approximately \$20,063,000.

Other commitments, primarily for utility plant construction, approximated \$167,525,000 at June 30, 2003.

## **11. 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 judgment 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. The total reserves recorded by the Board were approximately \$2,271,000 at June 30, 2003.

### **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.

### **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, 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, 2003, except as provided in the allowance for uncollectible accounts. The Board manages its credit exposure through procedures designed to identify and monitor credit risk.

## **12. PRIOR PERIOD ADJUSTMENT**

During fiscal year 2003, the Board determined that certain amounts included in construction work in progress at June 30, 2002 and charged to expenses in fiscal year 2003 should have been charged to expenses in fiscal year 2002. Accordingly, adjustments of \$1,949,498 were made to restate the net assets as of July 1, 2002.

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# BOARD OF WATER SUPPLY CITY AND COUNTY OF HONOLULU

## SUPPLEMENTAL SCHEDULE OF CAPITAL ASSETS (EXCLUDING CONSTRUCTION WORK IN PROGRESS) YEAR ENDED JUNE 30, 2003

	Balance, July 1, 2002	Additions	Retire- ments	Balance, June 30, 2003
<b>ASSETS</b>				
Property, excluding land and land rights:				
Source of supply	\$ 35,603,741	\$ 158,118		\$ 35,761,859
Pumping	139,207,382	1,562,284	\$(1,607,707)	139,161,959
Water treatment	30,942,860	1,388,442		32,331,302
Transmission and distribution	865,514,879	61,612,082	(2,376,047)	924,750,914
Water reclamation	48,125,122	11,214,837		59,339,959
General	68,147,237	7,651,600	(283,116)	75,515,721
	<u>1,187,541,221</u>	<u>83,587,363</u>	<u>(4,266,870)</u>	<u>1,266,861,714</u>
Land and land rights:				
Source of supply	19,649,062			19,649,062
Pumping	1,602,057			1,602,057
Water treatment	115,437			115,437
Transmission and distribution	862,183	28,567		890,750
General	7,832,773			7,832,773
	<u>30,061,512</u>	<u>28,567</u>		<u>30,090,079</u>
	<u>\$ 1,217,602,733</u>	<u>\$ 83,615,930</u>	<u>\$(4,266,870)</u>	<u>\$ 1,296,951,793</u>
Obtained from:				
Operating account		\$ 31,146,023		
Special expendable account		16,377,627		
Bond improvement account		25,872,794		
Contributions in aid:				
Government		317,894		
Other		9,901,592		
		<u>\$ 83,615,930</u>		
<b>ACCUMULATED DEPRECIATION</b>				
Property, excluding land and land rights:				
Source of supply	\$ 18,696,453	\$ 1,104,642		\$ 19,801,095
Pumping	66,705,751	5,292,567	\$(1,607,707)	70,390,611
Water treatment	10,452,554	1,478,452		11,931,006
Transmission and distribution	285,278,095	19,650,717	(2,376,047)	302,552,765
Water reclamation	1,485,353	1,487,347		2,972,700
General	26,534,438	4,872,202	(283,116)	31,123,524
	<u>\$ 409,152,644</u>	<u>33,885,927</u>	<u>\$(4,266,870)</u>	<u>\$ 438,771,701</u>
Less amounts charged to jobbing contract work		<u>(48,897)</u>		
DEPRECIATION EXPENSE		<u>\$ 33,837,030</u>		

# BOARD OF WATER SUPPLY CITY AND COUNTY OF HONOLULU

## SUPPLEMENTAL SCHEDULE FOR BONDS PAYABLE YEAR ENDED JUNE 30, 2003

	Last Installment	Interest Rate	Bond Dated	Maturing Serially From	Call Dates (1)	Outstanding June 30, 2003
Water System Revenue Bonds:						
Series 2001:	2004	4.000	5/15/2001	7/1/2003	(2)	\$ 1,090,000
	2005	4.000	5/15/2001	7/1/2004	(2)	1,035,000
	2005	3.500	5/15/2001	7/1/2004	(2)	100,000
	2006	5.000	5/15/2001	7/1/2005	(2)	1,130,000
	2006	3.700	5/15/2001	7/1/2005	(2)	50,000
	2007	3.875	5/15/2001	7/1/2006	(2)	1,240,000
	2008	4.000	5/15/2001	7/1/2007	(2)	1,285,000
	2009	5.000	5/15/2001	7/1/2008	(2)	1,165,000
	2009	4.125	5/15/2001	7/1/2008	(2)	175,000
	2010	5.000	5/15/2001	7/1/2009	(2)	1,105,000
	2010	4.250	5/15/2001	7/1/2009	(2)	300,000
	2011	5.000	5/15/2001	7/1/2010	(2)	250,000
	2011	4.375	5/15/2001	7/1/2010	(2)	1,220,000
	2012	5.000	5/15/2001	7/1/2011	(2)	200,000
	2012	4.500	5/15/2001	7/1/2011	(2)	1,335,000
	2013	5.375	5/15/2001	7/1/2012	7/1/2011	535,000
	2013	4.600	5/15/2001	7/1/2012	7/1/2011	1,075,000
	2014	4.700	5/15/2001	7/1/2013	7/1/2011	1,685,000
	2015	5.500	5/15/2001	7/1/2014	7/1/2011	1,765,000
	2016	5.500	5/15/2001	7/1/2015	7/1/2011	1,860,000
	2017	5.500	5/15/2001	7/1/2016	7/1/2011	1,735,000
	2017	5.000	5/15/2001	7/1/2016	7/1/2011	230,000
	2018	5.000	5/15/2001	7/1/2017	7/1/2011	2,070,000
	2019	5.125	5/15/2001	7/1/2018	7/1/2011	2,175,000
	2020	5.125	5/15/2001	7/1/2019	7/1/2011	2,285,000
	2021	5.125	5/15/2001	7/1/2020	7/1/2011	2,405,000
	2022	5.125	5/15/2001	7/1/2021	7/1/2011	2,525,000
	2023	5.250	5/15/2001	7/1/2022	7/1/2011	2,655,000
	2024	5.250	5/15/2001	7/1/2023	7/1/2011	2,795,000
	2025	5.250	5/15/2001	7/1/2024	7/1/2011	2,940,000
	2026	5.250	5/15/2001	7/1/2025	7/1/2011	3,095,000
	2027	5.250	5/15/2001	7/1/2026	7/1/2011	3,260,000
	2028	5.250	5/15/2001	7/1/2027	7/1/2011	3,430,000
	2029	5.250	5/15/2001	7/1/2028	7/1/2011	3,610,000
	2030	5.250	5/15/2001	7/1/2029	7/1/2011	3,800,000
	2031	5.250	5/15/2001	7/1/2030	7/1/2011	4,000,000
	2032	5.250	5/15/2001	7/1/2031	7/1/2011	4,210,000
						<u>65,820,000</u>

(1) Call dates indicated are optional.

(2) Noncallable.



# BOARD OF WATER SUPPLY CITY AND COUNTY OF HONOLULU

## SUPPLEMENTAL SCHEDULE FOR BONDS PAYABLE (Continued) YEAR ENDED JUNE 30, 2003

	Last Installment	Interest Rate	Bond Dated	Maturing Serially From	Outstanding June 30, 2003
Water System Revenue Bonds:					
Series 2002:	2005	(1)	3/5/2002	7/1/2004	\$ 1,000,000
	2006	(1)	3/5/2002	7/1/2005	1,000,000
	2007	(1)	3/5/2002	7/1/2006	1,050,000
	2008	(1)	3/5/2002	7/1/2007	1,100,000
	2009	(1)	3/5/2002	7/1/2008	1,150,000
	2010	(1)	3/5/2002	7/1/2009	1,200,000
	2011	(1)	3/5/2002	7/1/2010	1,300,000
	2012	(1)	3/5/2002	7/1/2011	1,350,000
	2013	(1)	3/5/2002	7/1/2012	1,400,000
	2014	(1)	3/5/2002	7/1/2013	1,450,000
	2015	(1)	3/5/2002	7/1/2014	1,550,000
	2016	(1)	3/5/2002	7/1/2015	1,600,000
	2017	(1)	3/5/2002	7/1/2016	1,650,000
	2018	(1)	3/5/2002	7/1/2017	1,750,000
	2019	(1)	3/5/2002	7/1/2018	1,850,000
	2020	(1)	3/5/2002	7/1/2019	1,900,000
	2021	(1)	3/5/2002	7/1/2020	2,000,000
	2022	(1)	3/5/2002	7/1/2021	2,100,000
	2023	(1)	3/5/2002	7/1/2022	2,200,000
	2024	(1)	3/5/2002	7/1/2023	2,300,000
	2025	(1)	3/5/2002	7/1/2024	2,400,000
	2026	(1)	3/5/2002	7/1/2025	2,500,000
	2027	(1)	3/5/2002	7/1/2026	2,600,000
	2028	(1)	3/5/2002	7/1/2027	2,750,000
	2029	(1)	3/5/2002	7/1/2028	2,850,000
	2030	(1)	3/5/2002	7/1/2029	3,000,000
	2031	(1)	3/5/2002	7/1/2030	3,150,000
	2032	(1)	3/5/2002	7/1/2031	3,300,000
					<u>53,450,000</u>
					<u>\$ 119,270,000</u>

(1) Interest rates are at the auctioned rate.

# **BOARD OF WATER SUPPLY CITY AND COUNTY OF HONOLULU**

## **SUPPLEMENTAL SCHEDULE OF NET REVENUE REQUIREMENT YEAR ENDED JUNE 30, 2003**

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### **REVENUES:**

Water sales	\$ 103,817,187
Interest	5,367,233
Other	<u>2,999,294</u>

Total revenues 112,183,714

### **DEDUCTIONS:**

Operating expenses	112,843,938
Less depreciation expense	<u>(33,837,030)</u>

Total deductions 79,006,908

Net revenues \$ 33,176,806

### **NET REVENUE REQUIREMENT:**

Greater of:

1) Aggregate debt service for 2003	\$ 4,893,310
Required deposits - Reimbursable obligation fund	<u>-</u>

4,893,310

2) Aggregate debt service for 2003	4,893,310
	<u>1.20</u>

x

5,871,972

Net revenue requirement \$ 5,871,972



**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL CONTROL  
OVER FINANCIAL REPORTING BASED UPON THE AUDIT PERFORMED IN  
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

The Board of Directors  
Board of Water Supply  
City and County of Honolulu:

We have audited the financial statements of the Board of Water Supply, City and County of Honolulu (the "Board") as of and for the year ended June 30, 2003, and have issued our report thereon dated October 17, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Compliance**

As part of obtaining reasonable assurance about whether the Board's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the Board's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Board of Directors, management, and the City and County of Honolulu and is not intended to be and should not be used by anyone other than these specified parties.

*Deloitte & Touche LLP*

October 17, 2003