

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

**FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION  
WITH INDEPENDENT AUDITORS' REPORT**

**Fiscal Year Ended June 30, 2006**

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

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**Board of Water Supply  
City and County of Honolulu  
INTRODUCTION  
Fiscal Year Ended June 30, 2006**

The Board of Water Supply, City and County of Honolulu (Board) is pleased to present its Annual Financial Report for the fiscal year 2006. 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 accounting principles generally accepted in the United States of America, accompanied by the independent auditors' report, follow the management's discussion and analysis.

### **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 municipal water systems of the City, together with all materials, supplies, and equipment, and all real and personal property used or useful in connection with such water systems. The Board was established in 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 13 operating units - Chief of Staff, Capital Projects, Communications, Customer Care, Finance, Human Resources, Information Technology, Legal Counsel, Field Operations, Water System Operations, Land, Security and Strategic Development. 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 by the Board of Directors. Such rates are not subject to regulation by any governmental body or authority, however public hearings are held to provide an open forum for public discussion.

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 163,988 accounts and a residential population of 902,704. The service area covers the island of Oahu and is 596.7 square miles. The customer base includes the residential population, businesses and industries, and agriculture. Of the total accounts, 152,100 are residential (92.8%), representing 59.7% of the total amount received from water sales in fiscal year 2006. 11,046 are commercial and industrial (6.7%), representing 39.3% of the total amount received from water sales in fiscal year 2006, and 842 are agricultural (0.5%), representing .9% of the total amount received from water sales in fiscal year 2006.

**Board of Water Supply  
City and County of Honolulu  
INTRODUCTION (Continued)  
Fiscal Year Ended June 30, 2006**

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 148.5 millions gallons per day (mgd), the Board delivers approximately 8.3 mgd of recycled water to various golf courses, as well as Ewa and Campbell industrial park users in West Oahu.

### **Mission**

The mission of the Board is to improve the quality of life in the community by providing world - class water services. The Board's mission statement, "Water for Life - Ka Wai Ola," addresses the need to ensure customers continued access to safe and dependable water supplies now and into the future.

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

- **Resource sustainability** ensures the protection of natural groundwater supplies and its efficient management.
- **Economic sustainability** calls for a diversity of financial resources to be employed to support system operating and capital needs, while keeping water rates affordable.
- **Organizational sustainability** calls for a sound, well structured, efficient organization with the tools and skills necessary to provide exceptional value to the Board customers, the community, and the watersheds.

### **Looking Ahead**

Board of Water Supply employees continued to concentrate their efforts and attention in support of the Board's mission, "Water for Life - Ka Wai Ola," with a focus on the following strategic objectives:

- **Resource sustainability**, which ensures that natural groundwater supplies are protected and managed efficiently, guided the following programs that were undertaken in fiscal year 2006 and which will continue for years to come:
  - The Board's aggressive and proactive water main replacement program and successful leak detection program have contributed to a decrease in the number of main breaks during the past year. There were 357 broken water mains repaired this year, 30 less than last year and 43 less than two years ago. Reducing the number of main breaks is an important measure to help reduce the amount of water lost within the Board's system.

**Board of Water Supply  
City and County of Honolulu  
INTRODUCTION (Continued)  
Fiscal Year Ended June 30, 2006**

The Board's Capital Program is budgeted at \$50 million for the upcoming fiscal year, with approximately 66% of the budget to cover the repair and replacement of pipelines to ensure reliability of service and the adequacy of water supply for future generations, and the remaining 34% of the budget to cover storage, pumping, water treatment, source projects and other facilities related projects.

- Another program that aims to control preventable water loss, including from leaks and main breaks, gained momentum this year. Known as **QUINCI (Quality Infrastructure Conservation Initiative)**, a team comprised of multi-divisional employees examines and analyzes evidence to pinpoint the causes of pipeline failure. Team members develop solutions to remedy potential problems in the design, installation, and/or maintenance of the waterline, and share their expertise and knowledge in a unified effort to reduce water loss and increase the longevity of the Board's water system.
- The Board continues to look at diversification of water sources to more efficiently address water needs of the community. The Honouliuli Water Recycling Facility connected the Ewa Beach Golf Course and the Navy's Barbers Point Golf Course to the recycled water system, and the Board continues to negotiate with community water users to provide recycled rather than potable water for irrigation purposes. Also, the Board is still pursuing the use of cold seawater for building cooling as a water and energy conservation effort.
- The second strategic objective, **economic sustainability**, calls for diversity in the financial resources used to support the Board's operating and capital needs, while keeping water rates affordable. In support of this objective, the Board continues to pursue opportunities to expand its core business and to generate revenue through new initiatives:
  - It has always been the cornerstone of the Board to provide the highest quality water at the lowest possible cost to island water users. Although uncontrollable operating expenses have risen steadily for the past 11 years, the Board has consistently deferred raising water rates. In order to meet those higher operational costs and to sustain existing levels of service, it became evident that the Board must carefully examine the need for a water rate adjustment.

During this fiscal year, the first phase of a comprehensive cost of service study was completed that included an assessment of the Board system conditions and needs, operating costs, and financial performance. The conclusion was that the Board must raise rates to continue providing customers with high quality services and reinvesting in an aging infrastructure.

**Board of Water Supply  
City and County of Honolulu  
INTRODUCTION (Continued)  
Fiscal Year Ended June 30, 2006**

- A new Computerized Maintenance Management System (CMMS) was implemented in June 2006. The Board's Information Technology (IT) personnel spearheaded the design and development of the CMMS, which will replace the labor-intensive work order system and allow greater efficiency by tracking work and cost data electronically. Field Operations Division crews at Manana Corporation Yard have started to use this system.
- The Board's third objective, **organizational sustainability**, calls for a sound, well-structured, efficient organization with the tools and skills necessary to provide exceptional value to customers, the community, and watersheds. These programs and events characterize ongoing efforts during this fiscal year:
  - Career pathing is the process that identifies specific career goals within the Board, and the sequential steps in education and skills-and-experience-building that are needed to attain those goals. Human Resources personnel researched and developed a Career Pathways pilot program to help employees achieve their career goals, and to develop their leadership skills, reaffirming the Board's principle that "people are the Department's greatest asset." Groundskeepers from the Field Operations Division were the first to participate in the program this year.
  - IT personnel began moving the existing Customer Accounting System (CAS) software to a modern platform and environment, which will allow the Board to realize greater efficiency and effectiveness in its business and core operations.



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## INDEPENDENT AUDITORS' REPORT

To 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 (the Board), a component unit of the City and County of Honolulu, as of June 30, 2006, and the related statements of revenues, expenses, and changes in net assets and cash flows for the fiscal 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, 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, 2006, and the results of its operations and its cash flows for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 11, 2006, 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 grant agreements and other matters. The purpose of that report is to

describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis information on pages 9 - 15 are not a required part of the basic financial statements but are 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 as of and for the fiscal year ended June 30, 2006, 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 basic financial statements and, in our opinion, are fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

*Nishihama & Kishida, CPAs, Inc.*

Honolulu, Hawaii  
October 11, 2006



**Board of Water Supply  
City and County of Honolulu  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
Fiscal Year Ended June 30, 2006**

This section presents management's discussion and analysis of the Board's financial condition and activities for the fiscal year ended June 30, 2006. This information should be read in conjunction with the financial statements.

**Financial Highlights**

After 11 years of deferring water rate increases, the Board determined that rate increases were needed to meet rising costs of delivering water to customers and to continue its proactive infrastructure repair and replacement programs. Despite a concerted effort to keep operational costs down, uncontrollable costs to run the Board continues to escalate - in 2006, the Board spent \$3.5 million for emergency road repaving (more than eleven times the repaving dollars expended in 1995); electricity rose by 34 percent from 1995 to 2005; and between 1996 and 2005, fuel costs for the Board's vehicles escalated by 94 percent. Water rates will increase by 13 percent, approximately \$3 more on the monthly water bill for an average single-family residential customer, effective October 1, 2006.

In addition to rising operating costs, construction costs to improve our aging infrastructure also continued to escalate. The cost of ductile iron pipe increased by 18 percent and polyvinyl chloride (PVC) pipe increased by 29 percent between April 2005 and April 2006. The shortage and rising price of asphalt on Oahu had an immediate impact on the Board's construction project schedule and costs. Several water main projects near completion in the community, including Haleiwa and Kalihi, were delayed because contractors had to wait for availability of asphalt materials. This problem will likely continue to impact the Board well into the next fiscal year.

Despite these pressures, the Board still maintains a relatively strong financial performance with a manageable capital program. However, Management continues to carefully evaluate the Board's finances to ensure optimum performance. Outstanding debt continues to be reasonably low, cash reserves are healthy, and all debt covenants were exceeded. Key financial highlights are listed below:

- The financial statements reflect a prior period adjustment described in Note O to the financial statements. In addition, in 2006, the Board implemented GASB Statement No. 46, *Net Assets Restricted By Legislation* an amendment of GASB Statement No. 34, which establishes and modifies requirements related to restrictions of net assets resulting from enabling legislation. As a result of this pronouncement, certain prior year balances have been reclassified to conform to the 2006 presentation. Ensuing comments and comparisons in this discussion and analysis are based on restated and reclassified balances as of and for the fiscal year ended June 30, 2005.
- Total cash and investments are \$108.5 million at June 30, 2006. This represents a decrease of \$38.4 million from June 30, 2005. This decrease was primarily attributed to a spend down of bond proceeds for its water system infrastructure.
- Total assets at fiscal year-end are \$1.24 billion and exceed liabilities by \$975 million.

**Board of Water Supply  
City and County of Honolulu  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2006**

- The Board's unrestricted current assets at June 30, 2006 are 3.1 times its related current liabilities compared to 4.4 at June 30, 2005.
- The Board's debt to equity ratio is 22.7% at June 30, 2006, indicating additional capacity to issue debt. This ratio will increase as the Board has issued additional bonded debt of \$214 million on July 7, 2006, of which \$104 million will refund existing debt.
- Operating revenues for fiscal year 2006 are \$103.0 million, a minimal increase over the \$101.0 million reported for the fiscal year 2005.
- Net assets decreased \$16.1 million in fiscal year 2006, from \$991.4 million at the end of fiscal year 2005 to \$975.3 million at the end of fiscal year 2006. This was primarily due to a minimal increase to revenues, while operating expenses increased by \$7.7 million and interest expense increased \$1.5 million from the previous fiscal year.

As the second phase of the comprehensive cost of service study, Management is currently analyzing its water systems facilities charges (WSFC). These fees are levied against all new developments and residential properties requiring water from the Board's systems. The Board is carefully evaluating the possibility of moderate increases to the WSFC for the first time in more than a decade.

### **Overview of Financial Report**

The Board is a semi-autonomous 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 data, key financial and operational indicators used in the Board's annual report, budget, 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, 2006. The statement of revenues, expenses and changes in net assets presents the results of operations for the fiscal year then ended, and the resultant ending net asset 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, capital and related financing activities, and non-capital financing activities.

**Board of Water Supply  
City and County of Honolulu  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2006**

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

**Financial Analysis**

***Results of Operations***

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

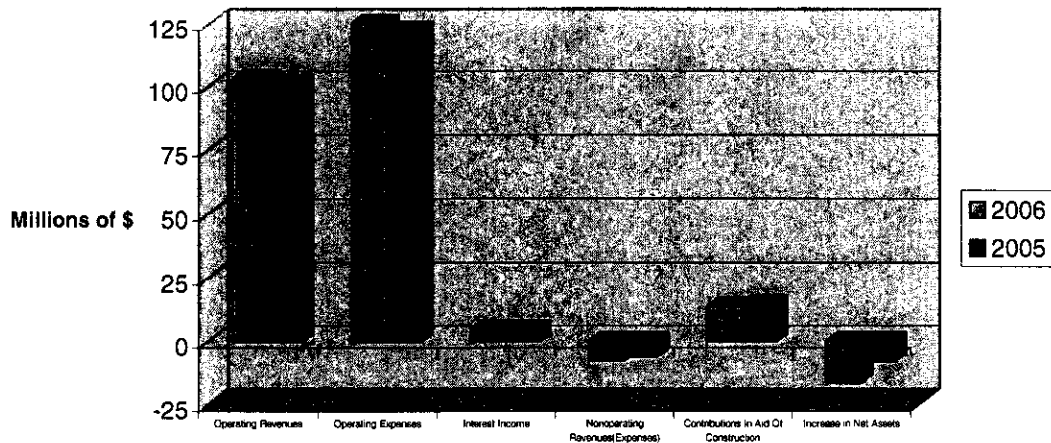
	<u>June 30,</u> <u>2006</u>	<u>2005</u> <u>Restated</u> <u>(in thousands)</u>	<u>%</u> <u>Variance</u>
Operating revenues	\$ <u>103,009</u>	\$ <u>101,000</u>	2.0%
Operating expenses			
Depreciation	37,745	34,208	10.3%
Administrative and general	31,245	33,179	-5.8%
Water reclamation	3,309	4,354	-24.0%
Other operating expenses	<u>57,461</u>	<u>50,270</u>	14.3%
Total operating expenses	<u>129,760</u>	<u>122,011</u>	6.4%
Operating loss	<u>(26,751)</u>	<u>(21,011)</u>	27.3%
Nonoperating revenues(expenses)			
Interest income	4,519	4,418	2.3%
Others	<u>(7,456)</u>	<u>(5,689)</u>	31.1%
Total nonoperating revenues (expenses)	<u>(2,937)</u>	<u>(1,271)</u>	131.1%
Contributions in aid of construction	<u>13,554</u>	<u>14,655</u>	-7.5%
Increase (decrease) in net assets	<u>\$ (16,134)</u>	<u>\$ (7,627)</u>	111.5%

Note : June 30, 2005 balances restated to reflect prior period adjustment described in Note O to the financial statements.

The decrease in net assets for the fiscal year ended June 30, 2006 was \$16.1 million, which is \$8.5 million greater than last year's decrease of \$7.6 million. The changes in revenues and expenses are explained below.

**Board of Water Supply  
City and County of Honolulu  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2006**

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



Operating revenues for fiscal year 2006 were \$103.0 million, a minimal increase from fiscal year 2005 revenues of \$101.0 million. For the eleventh year in a row, water rates and charges remained unchanged. As indicated in the Financial Highlights, the Board approved a 13% increase to the water rates effective October 1, 2006.

Total operating expenses increased to \$129.8 million in fiscal year 2006, an increase of \$7.7 million from fiscal year 2005. Factors contributing to this increase are explained below.

Depreciation expense increased by \$3.5 million from fiscal year 2005. This is attributable to \$119 million in property, plant and equipment being added to capital assets over the last two fiscal years.

In the Other Operating Expense category, electricity costs increased \$3.4 million, road repaving increased \$2.2 million, maintenance and repair of infrastructure increased \$1 million and labor costs increased by \$1 million.

Other non-operating revenues decreased by \$1.8 million due to higher bond interest expense, greater loss from disposal of assets and a reduction in federal operating grants received.

**Board of Water Supply  
City and County of Honolulu  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2006**

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 sources, transmission, and daily storage facilities. In addition, contributions of capital assets from governmental agencies, developers, and customers are recorded as contributions in aid of construction at their cost. The Board realized contributions in aid of construction of \$13.6 million in fiscal year 2006 compared to \$14.7 million in fiscal year 2005.

***Financial Condition***

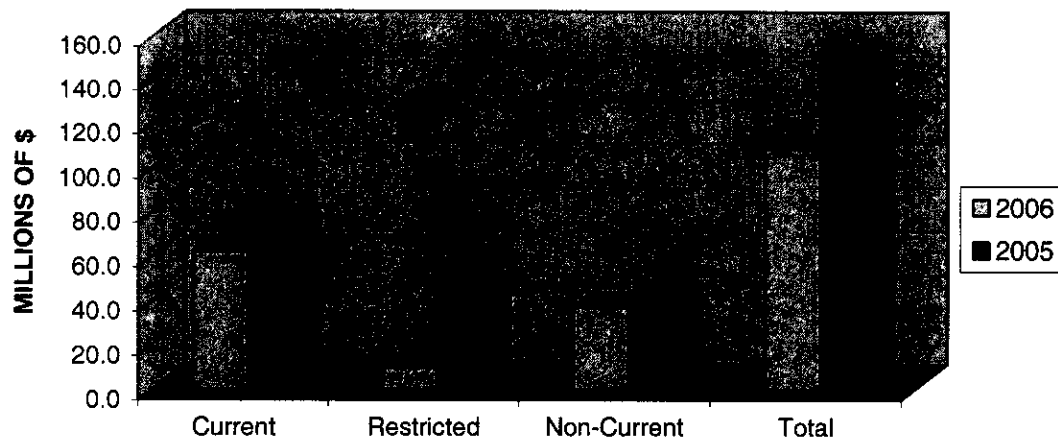
**CONDENSED STATEMENTS OF NET ASSETS**

	June 30,		%
	2006	2005	Variance
	Restated		
	(in thousands)		
Current Assets			
Cash and equivalents	\$ 10,147	\$ 11,443	-11.3%
Investments	51,663	56,976	-9.3%
Other current assets	24,884	22,223	12.0%
Restricted Assets			
Cash and equivalents	7,516	11,440	-34.3%
Investments	2,047	24,410	-91.6%
Investments	37,167	42,667	-12.9%
Other assets	2,398	2,491	-3.7%
Property, plant and equipment-net of accumulated depreciation	<u>1,109,371</u>	<u>1,076,840</u>	<u>3.0%</u>
Total assets	<u>\$ 1,245,193</u>	<u>\$ 1,248,490</u>	<u>-0.3%</u>
Current liabilities	\$ 27,827	\$ 20,458	36.0%
Other liabilities	30,492	20,837	46.3%
Bonds payable, noncurrent	<u>211,577</u>	<u>215,764</u>	<u>-1.9%</u>
Total liabilities	<u>269,896</u>	<u>257,059</u>	<u>5.0%</u>
Net Assets			
Invested in capital assets, net of related debt	890,159	883,484	0.8%
Restricted for capital activity and debt service	4,885	27,200	-82.0%
Unrestricted	<u>80,253</u>	<u>80,747</u>	<u>-0.6%</u>
Total net assets	<u>975,297</u>	<u>991,431</u>	<u>-1.6%</u>
Total liabilities and net assets	<u>\$ 1,245,193</u>	<u>\$ 1,248,490</u>	<u>-0.3%</u>

Note : June 30, 2005 balances restated to reflect prior period adjustment described in Note O to financial statements and reclassification of assets and liabilities due to GASB Statement No. 46.

**Board of Water Supply  
City and County of Honolulu  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2006**

**Cash and Investments**



The Board's total cash and investments decreased by \$38.3 million in 2006 from \$146.9 million in 2005 to \$108.6 million in 2006. This resulted from spending down the Series 2004 bond proceeds for water system infrastructure.

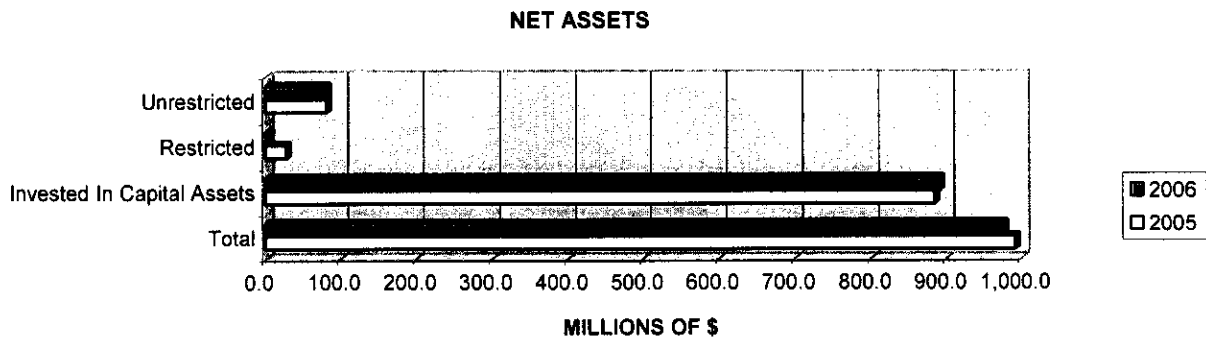
Subsequent events to June 30, 2006 will improve the Board's cash position. On July 7, 2006, the Board issued \$214 million in additional revenue bonds of which \$105 million will be used for the water system infrastructure. \$104 million of the bond proceeds will be used to refund existing bonds at a lower interest rate. Effective October 1, 2006, the Board increased its water rates by 13% with subsequent scheduled annual increases totaling 35% through June 30, 2011.

The Board's current ratio (current assets divided by current liabilities) was 2.7 and 4.5 at June 30, 2006 and 2005, respectively. The Board's unrestricted current assets at June 30, 2006 are 3.1 times its related current liabilities compared to 4.4 times at June 30, 2005. These decreases in the ratios are attributable to greater current liabilities for construction and the central administrative services fee at June 30, 2006.

The Board issues long term bonds to finance part of its capital improvement program. The Board's debt to equity ratio is 22.7% at June 30, 2006 and 22.1% at June 30, 2005. As indicated above, the Board issued additional revenue bonds on July 7, 2006. This issue along with future anticipated financing were considered in a completed cost of service study which has resulted in the Board's amended schedule of rates and charges.

Net assets decreased by \$16.1 million or 1.6% from \$991.4 in fiscal year 2005 to \$975.3 million at the end of fiscal year 2006. This reflects the rising costs of operating and maintaining the water system coupled with relatively flat revenues. As stated above, the Board has approved scheduled water rate increases.

**Board of Water Supply  
City and County of Honolulu  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2006**



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

During the fiscal year, the Board capitalized \$87.6 million to its utility plant in service. Major assets added were the John A. Burns School of Medicine ocean cooling wells, pumping equipment, mains, \$13.1 million; Farrington Highway transmission and distribution mains, \$11.6 million; Nimitz Highway transmission and distribution mains, \$8.9 million, Hoaeae Wells granular activated carbon equipment and structure, \$6.5 million, various other transmission and distribution mains, \$32.9 million; and various distribution systems, \$5.9 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 Board's revenue bond debt service coverage for the fiscal year ended June 30, 2006 is 1.27. The bond covenant for debt service coverage is 1.20.

***Request for Information***

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

**Board of Water Supply  
City and County of Honolulu  
STATEMENT OF NET ASSETS  
June 30, 2006**

**ASSETS**

**CURRENT ASSETS**

Cash and cash equivalents	\$ 10,147,357
Investments	51,662,547
Interest receivable	759,943
Customer receivables	
Billed, less allowances for uncollectible accounts of \$1,327,100	6,628,523
Unbilled	7,109,725
Other receivables, less allowances for uncollectible accounts of \$510,868	5,564,480
Materials and supplies	4,708,631
Prepaid expenses	<u>112,496</u>
 Total current assets	 <u>86,693,702</u>

**RESTRICTED ASSETS**

Cash and cash equivalents	7,515,952
Investments	<u>2,047,525</u>
 Total restricted assets	 <u>9,563,477</u>

**INVESTMENTS**

37,166,857

**BOND ISSUE COSTS**

Net of accumulated amortization of \$337,721	<u>2,398,363</u>
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**CAPITAL ASSETS**

Land	32,373,064
Infrastructure	1,112,105,648
Building and improvements	125,640,996
Equipment and machinery	189,705,707
Construction work in progress	<u>183,540,855</u>
	1,643,366,270
 Accumulated depreciation	 <u>(533,995,113)</u>
 Capital assets - net	 <u>1,109,371,157</u>

**TOTAL**

\$ 1,245,193,556



**Board of Water Supply  
City and County of Honolulu  
STATEMENT OF NET ASSETS (Continued)  
June 30, 2006**

**LIABILITIES AND NET ASSETS**

**CURRENT LIABILITIES**

Payable from current assets	
Accounts payable	\$ 15,316,435
Contracts payable, including retainages	10,680,002
Accrued vacation, current portion	1,830,771
	<u>27,827,208</u>

Payable from restricted assets	
Contracts payable, including retainages	94,546
Accrued interest payable	3,995,889
Bonds payable, current portion	3,170,000
Notes payable, current portion	278,000
Other	587,947
	<u>8,126,382</u>

Total current liabilities	<u>35,953,590</u>
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**OTHER LIABILITIES**

Customer advances	7,636,443
Accrued vacation, noncurrent portion	4,779,448
Accrued workers' compensation	2,230,713
Notes payable, noncurrent portion	6,793,039
Other	926,025
	<u>22,365,668</u>

Total other liabilities	<u>22,365,668</u>
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<b>BONDS PAYABLE - NONCURRENT</b>	<u>211,577,375</u>
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Total liabilities	<u>269,896,633</u>
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**NET ASSETS**

Invested in capital assets - net of related debt	890,158,936
Restricted for capital activity and debt service	4,885,095
Unrestricted	80,252,892
	<u>975,296,923</u>

Total net assets	<u>975,296,923</u>
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<b>TOTAL</b>	<u>\$ 1,245,193,556</u>
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See accompanying notes to financial statements.

**Board of Water Supply  
City and County of Honolulu  
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS  
Fiscal Year Ended June 30, 2006**

**OPERATING REVENUES**

Water sales	\$ 100,876,964
Other, principally contract and service fees	<u>2,131,629</u>
Total operating revenues	<u>103,008,593</u>

**OPERATING EXPENSES**

Depreciation	37,744,551
Administrative and general	31,244,916
Power and pumping	22,648,427
Maintenance	14,568,900
Transmission and distribution	13,438,010
Water reclamation	3,309,121
Customers' accounting and collection	3,340,041
Central administrative services expense fees	3,300,000
Water treatment	107,756
Source of supply	<u>58,176</u>
Total operating expenses	<u>129,759,898</u>

**LOSS FROM OPERATIONS**

(26,751,305)

**NONOPERATING REVENUES (EXPENSES)**

Interest income	4,519,164
Interest expense, net of interest capitalized of \$ 4,930,671	(4,554,168)
Realized and unrealized loss on investments	(794,283)
Loss from disposal of capital assets	(2,505,891)
Other	<u>397,951</u>
Total nonoperating expenses	<u>(2,937,227)</u>

**CONTRIBUTIONS IN AID OF CONSTRUCTION**

13,554,001

**DECREASE IN NET ASSETS**

(16,134,531)

**NET ASSETS AT BEGINNING OF FISCAL YEAR**

As previously reported	993,556,663
Prior period adjustment	<u>(2,125,209)</u>
As restated	<u>991,431,454</u>

**NET ASSETS AT END OF FISCAL YEAR**

\$ 975,296,923

See accompanying notes to financial statements.

**Board of Water Supply  
City and County of Honolulu  
STATEMENT OF CASH FLOWS  
Fiscal Year Ended June 30, 2006**

**CASH FLOWS FROM OPERATING ACTIVITIES**

Cash received from customers	\$ 103,668,173
Payments to suppliers for goods and services	(55,869,382)
Payments to employees for services	(31,077,035)
Other revenues - net	<u>397,951</u>
Net cash provided by operating activities	<u>17,119,707</u>

**CASH FLOWS FROM INVESTING ACTIVITIES**

Purchase of investments	(123,933,770)
Proceeds from maturity of investments	156,315,151
Interest on investments	<u>4,660,828</u>
Net cash provided by investing activities	<u>37,042,209</u>

**CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES**

Acquisition and construction of capital assets - net of contributions in aid of construction of \$5,418,075	(51,280,776)
Proceeds from sale of capital assets	174,954
Customer advances for capital projects	2,924,170
Interest paid on bonds	(9,195,460)
Interest paid on notes payable	(93,286)
Principal paid on bonds	(4,120,000)
Proceeds from notes payable	2,283,516
Principal paid on notes payable	<u>(74,124)</u>
Net cash used in capital and related financing activities	<u>(59,381,006)</u>

**NET DECREASE IN CASH AND CASH EQUIVALENTS** (5,219,090)

**CASH AND CASH EQUIVALENTS AT BEGINNING OF FISCAL YEAR** 22,882,399

**CASH AND CASH EQUIVALENTS AT END OF FISCAL YEAR**  
(including \$7,515,952 in restricted accounts) \$ 17,663,309

**Board of Water Supply  
City and County of Honolulu  
STATEMENT OF CASH FLOWS (Continued)  
Fiscal Year Ended June 30, 2006**

**PROVIDED BY OPERATING ACTIVITIES**

Loss from operations	\$ (26,751,305)
Adjustments to reconcile loss from operations to net cash provided by operating activities	
Depreciation	38,827,552
Provision for doubtful accounts	91,522
Provision for workers' compensation	(473,867)
Other revenues	397,951
Change in operating assets and liabilities	
Customer receivables	660,894
Materials and supplies	(551,689)
Other receivables	(92,836)
Prepaid expenses and other	68,701
Accounts and contracts payable	5,023,850
Accrued vacation	66,300
Other liabilities	<u>(147,366)</u>
Net cash provided by operating activities	\$ <u>17,119,707</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	\$ 5,418,075
Capital assets included in accounts and contracts payable	\$ 10,057,692
Interest capitalized in capital assets	\$ 4,930,671
Capital assets financed by the seller	\$ 2,350,000
Amortization of bond issue costs	\$ 92,497
Amortization of bond premium/discount	\$ (221,640)
Amortization of deferred loss on refunding	\$ 255,089

See accompanying notes to financial statements.

**Board of Water Supply  
City and County of Honolulu  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2006**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

- (1) **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.

- (2) **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.

- (3) **Basis of Accounting** - The accompanying financial statements are presented using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

The 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.

- (4) **Use of Estimates** - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

- (5) **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.

- (6) **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.

**Board of Water Supply  
City and County of Honolulu  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2006**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

- (7) **Investments** - Investments are stated at fair value. Fair value has been determined based on quoted market prices. The cost of securities sold is generally determined by the weighted average method.
- (8) **Materials and Supplies** - Materials and supplies are stated at the lower of weighted average cost (which approximates the first-in, first-out method) or market. The costs of materials and supplies are recorded as expenses when consumed rather than when purchased.
- (9) **Restricted Assets** - Restricted assets are comprised of cash and cash equivalents and investments maintained in accordance with bond resolutions and other agreements for the purpose of funding certain debt service payments, construction, improvements, and renewal and replacements of the water system. Restricted assets comprise the following:
- The debt service account accumulates transfers from the operating account throughout the fiscal year to make principal and interest payments on the outstanding water revenue bonds and other loans payable.
  - The renewal and replacement account provides funding for improvements, reconstruction, emergency or extraordinary repairs, and renewals or replacements of the water system.
  - The improvement account holds the proceeds of the series bond issuance pursuant to the series resolution or series certificates. These proceeds are only applied to costs specified in the applicable series resolution or series certificate.
- (10) **Capital Assets** - Capital assets include those assets in excess of \$5,000 for buildings, structures, infrastructure, and equipment and machinery with a useful life of more than one year. Capital assets are stated at cost and include contributions by governmental agencies, private subdividers, and customers at their cost or estimated cost of new construction.

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.

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

**Board of Water Supply  
City and County of Honolulu  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2006**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

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	5 to 50 years

- (11) ***Bond Issue Costs, Original Issue Discount or Premium and Deferred Loss on Refundings*** - Bond issue costs are deferred and are amortized over the life of the respective issue on a straight-line basis. Original issue discount or premium and deferred loss on refundings are amortized using the effective interest method over the terms of the respective issues and are added to or offset against the bonds payable in the statement of net assets.

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

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

- (13) ***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 designated for the construction of water facilities.

- (14) ***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. Unrestricted consists of all other net assets not included in the above categories.

**Board of Water Supply  
City and County of Honolulu  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2006**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

- (15) **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 and related receivables reflected in the accompanying financial statements is based on estimated usage from the latest meter reading date to the end of the fiscal period.
- (16) **Pension Expense** - The Board's contributions to the Employees' Retirement System of the State of Hawaii are based upon actuarial computations and include current service costs and amortization of prior service costs. The Board's policy is to fund pension costs accrued.
- (17) **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.
- (18) **Recent Accounting Pronouncements** - In November 2003, the GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This Statement establishes accounting and financial reporting standards for impairment of capital assets and also clarifies and establishes accounting requirements for insurance recoveries. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2004. The provisions of this Statement have been implemented for the fiscal year ended June 30, 2006.

In 2006, the Board implemented GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation* an amendment of GASB Statement No. 34, which establishes and modifies requirements related to restrictions of net assets resulting from enabling legislation.

**NOTE B - CASH AND INVESTMENTS**

Cash deposited with the City is maintained in separate accounts by the Department of Budget and Fiscal Services of the City. The Hawaii Revised Statutes (HRS) provide for the City's Director of Finance to deposit the cash with any national or state bank or federally insured financial institution authorized to do business in the State of Hawaii, provided that all deposits are fully insured or collateralized.

The 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.



**Board of Water Supply  
City and County of Honolulu  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2006**

**NOTE B - CASH AND INVESTMENTS (Continued)**

The Board's portfolio is managed by various investment managers. These investments consist mainly of U.S. government securities, which are recorded at fair value based on quoted market prices.

At June 30, 2006, investments consisted of the following:

	<u>Cost</u>	<u>Fair Value</u>
U.S. government treasury obligations - short-term	\$ 29,360,117	\$ 29,233,274
U.S. government agencies short-term	24,689,792	24,476,798
U.S. government treasury obligations	20,403,435	20,049,558
U.S. government agencies	<u>17,324,218</u>	<u>17,117,299</u>
	\$ <u>91,777,562</u>	\$ <u>90,876,929</u>

At June 30, 2006, the maturities of the investments were as follows:

	<u>Investment Maturities (In Years)</u>				
	<u>Fair Value</u>	<u>Less Than 1</u>	<u>1 - 5</u>	<u>6 - 10</u>	<u>More Than 10</u>
U.S. government treasury obligations - short-term	\$ 29,233,274	\$ 29,233,274	\$ --	\$ --	\$ --
U.S. government agencies short-term	24,476,798	24,476,798	--	--	--
U.S. government treasury obligations	20,049,558	--	20,049,558	--	--
U.S. government agencies	<u>17,117,299</u>	--	<u>17,117,299</u>	--	--
	\$ <u>90,876,929</u>	\$ <u>53,710,072</u>	\$ <u>37,166,857</u>	\$ --	\$ --

**Interest Rate Risk** - As a means of limiting its exposure to fair value losses arising from rising interest rates, the Board's investment policy includes:

- Structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities on the open market prior to maturity.
- Investing operating funds primarily in shorter-term securities, money market mutual funds, or similar investment pools.

**Credit Rate Risk and Foreign Currency Risk** - Because the Board invests in obligations of the U.S. government, it is not exposed to any credit rate risk or foreign currency risk.

**Board of Water Supply  
City and County of Honolulu  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2006**

**NOTE B - CASH AND INVESTMENTS (Continued)**

The investments are reflected in the statement of net assets as follows:

	<u>Amount</u>
Investments:	
Unrestricted - current	\$ 51,662,547
Unrestricted - noncurrent	37,166,857
Restricted	<u>2,047,525</u>
	<u>\$ 90,876,929</u>

**NOTE C - RESTRICTED ASSETS**

At June 30, 2006, restricted assets were held for the following purposes:

	<u>Amount</u>
Construction, renewals and replacements	\$ 2,205,285
Debt service	<u>7,358,192</u>
	<u>\$ 9,563,477</u>

**NOTE D - CAPITAL ASSETS**

Capital assets activity during 2006, was as follows:

	Balance July 1, 2005 (Restated)	Additions	Transfers	Retirements	Balance June 30, 2006
Depreciable assets					
Infrastructure	\$ 1,045,626,963	\$ 5,068,794	\$ 64,705,366	\$ (3,295,475)	\$ 1,112,105,648
Buildings and improvements	121,950,772	359,632	3,330,592	--	125,640,996
Equipment and machinery	<u>179,957,606</u>	<u>2,887,461</u>	<u>11,223,670</u>	<u>(4,363,030)</u>	<u>189,705,707</u>
Total depreciable assets	1,347,535,341	8,315,887	79,259,628	(7,658,505)	1,427,452,351
Less accumulated depreciation	<u>(500,145,221)</u>	<u>(38,827,552)</u>	<u>--</u>	<u>4,977,660</u>	<u>(533,995,113)</u>
Total depreciable assets - net	847,390,120	(30,511,665)	79,259,628	(2,680,845)	893,457,238
Land	32,300,079	--	72,985	--	32,373,064
Construction work in progress	<u>197,150,304</u>	<u>72,117,622</u>	<u>(85,727,071)</u>	<u>--</u>	<u>183,540,855</u>
Capital assets - net	<u>\$ 1,076,840,503</u>	<u>\$ 41,605,957</u>	<u>\$ (6,394,458)</u>	<u>\$ (2,680,845)</u>	<u>\$ 1,109,371,157</u>

**Board of Water Supply  
City and County of Honolulu  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2006**

**NOTE D - CAPITAL ASSETS (Continued)**

Depreciation of \$1,083,001 was allocated to various functions and not to depreciation expense in fiscal year 2006.

The Board received \$174,954 in proceeds from the sale of capital assets in fiscal year 2006.

**NOTE E - ACCRUED VACATION**

At June 30, 2006, accrued vacation consisted of the following:

	<u>Beginning of Year</u>	<u>Additions</u>	<u>Reductions</u>	<u>End of Year</u>	<u>Current Portion</u>	<u>Noncurrent Portion</u>
Accrued vacation	\$ <u>6,543,919</u>	\$ <u>1,897,071</u>	\$ <u>(1,830,771)</u>	\$ <u>6,610,219</u>	\$ <u>1,830,771</u>	\$ <u>4,779,448</u>

**NOTE F - BONDS PAYABLE**

At June 30, 2006, bonds payable consisted of the following:

	<u>Amount</u>
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%.	\$ 62,415,000
Water System Revenue Bonds, Series 2002, annual principal due commencing July 1, 2003, ranging from \$1,000,000 to \$3,300,000 through July 1, 2031, with interest at the monthly auction rates (3.40% to 3.65% per annum at June 30, 2006).	50,400,000
Water System Revenue Bonds, Series 2004, annual principal due commencing July 1, 2005, ranging from \$1,890,000 to \$6,245,000 through June 30, 2034, with interest ranging from 2% to 5%.	<u>98,110,000</u> 210,925,000
Add unamortized premium	4,340,252
Less unamortized discount	(517,877)
Less current portion	<u>(3,170,000)</u>
Noncurrent portion	\$ <u>211,577,375</u>

**Board of Water Supply  
City and County of Honolulu  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2006**

**NOTE F - BONDS PAYABLE (Continued)**

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 2006, was as follows:

	Balance July 1, 2005	Additions	Reductions	Balance June 30, 2006	Current Portion
Water System Revenue Bonds:					
Series 2001	\$ 63,595,000	\$ --	\$ (1,180,000)	\$ 62,415,000	\$ 1,240,000
Series 2002	51,450,000	--	(1,050,000)	50,400,000	--
Series 2004	100,000,000	--	(1,890,000)	98,110,000	1,930,000
	<u>\$ 215,045,000</u>	<u>\$ --</u>	<u>\$ (4,120,000)</u>	<u>\$ 210,925,000</u>	<u>\$ 3,170,000</u>

Future bond principal and interest payments are as follows:

<u>Fiscal Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$ 3,170,000	\$ 9,462,000	\$ 12,632,000
2008	4,350,000	9,336,000	13,686,000
2009	4,505,000	9,189,000	13,694,000
2010	4,685,000	9,020,000	13,705,000
2011	4,910,000	8,848,000	13,758,000
2012 - 2016	27,695,000	41,180,000	68,875,000
2017 - 2021	34,930,000	34,264,000	69,194,000
2022 - 2026	44,505,000	25,169,000	69,674,000
2027 - 2031	56,830,000	13,360,000	70,190,000
2032 - 2033	<u>25,345,000</u>	<u>1,595,000</u>	<u>26,940,000</u>
Total	<u>\$210,925,000</u>	<u>\$161,423,000</u>	<u>\$372,348,000</u>

In February 2001, the Board created an irrevocable trust with an escrow agent to retire \$32,460,000 of the Board's outstanding 1992 general obligation water bonds. The escrow agent will pay all future debt service payments on the 1992 Series bonds out of the irrevocable trust. Consequently, the 1992 Series bonds were considered to be defeased and the liability for the bonds was removed from the Board's financial statements in 2001. At June 30, 2006, the outstanding 1992 Series defeased bonds amounted to \$24,485,000.

**Board of Water Supply  
City and County of Honolulu  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2006**

**NOTE F - BONDS PAYABLE (Continued)**

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 liability for those bonds was removed from the Board's financial statements in 2001. At June 30, 2006, the outstanding 1996 Series defeased bonds amounted to \$13,950,000.

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 January 2004, the Board issued \$100,000,000 in water system revenue bonds. Proceeds of the issuance were used to fund capital improvement projects.

**NOTE G - NOTES PAYABLE**

The Board's notes payable as of June 30, 2006, are summarized as follows:

	<u>Amount</u>
Notes payable to Department of Health	
Note payable in semi-annual installments of \$28,608, including interest at .10%, secured by net revenues of the Board, due June 1, 2025.	\$ 1,076,438
Note payable in semi-annual installments of \$24,333, including interest at .31%, secured by net revenues of the Board, due November 28, 2025.	919,539
Note payable in semi-annual installments of \$10,230, including interest at .10%, secured by net revenues of the Board, due November 15, 2025.	<u>395,054</u>
Balance forward	\$ <u>2,391,031</u>

**Board of Water Supply  
City and County of Honolulu  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2006**

**NOTE G - NOTES PAYABLE (Continued)**

	<u>Amount</u>
Balance carried forward	\$ 2,391,031
Note payable in semi-annual installments of \$39,276, including interest at .10%, secured by net revenues of the Board, due February 27, 2026.	1,516,057
Non-interest bearing payable in semi-annual installments of \$22,313, secured by net revenues of the Board, due September 6, 2025.	870,215
Notes payable to other lenders	
Note payable in annual installments of \$188,570, including interest at 5%, due on September 16, 2025. Each annual installment is divided into 12 monthly payments of principal and interest of \$15,715.	2,293,736
	<u>7,071,039</u>
Less current maturities	<u>278,000</u>
	\$ <u><u>6,793,039</u></u>

The aggregate future maturities of notes payable and interest payments are as follows:

<u>Fiscal Year Ending June 30.</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$ 278,000	\$ 120,800	\$ 398,800
2008	321,600	116,500	438,100
2009	325,800	112,300	438,100
2010	330,100	108,000	438,100
2011	334,700	103,400	438,100
2012 - 2016	1,750,100	440,400	2,190,500
2017 - 2021	1,901,500	288,900	2,190,400
2022 - 2026	<u>1,829,239</u>	<u>97,692</u>	<u>1,926,931</u>
	\$ <u><u>7,071,039</u></u>	\$ <u><u>1,387,992</u></u>	\$ <u><u>8,459,031</u></u>

**Board of Water Supply  
City and County of Honolulu  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2006**

**NOTE H - NET ASSETS**

At June 30, 2006, net assets consisted of the following:

	<u>Amount</u>
Invested in capital assets - net of related debt	
Capital assets - net	\$ 1,109,371,157
Less water system revenue bonds payable	(214,747,375)
Less other loans payable	(4,559,392)
Add unspent debt proceeds	<u>94,546</u>
	<u>890,158,936</u>
Restricted for capital activity and debt service	
Restricted cash and cash equivalents	7,515,952
Restricted investments	2,047,525
Less	
Contracts payable, including retainages	(94,546)
Accrued interest payable	(3,995,889)
Other payable from restricted assets	<u>(587,947)</u>
	<u>4,885,095</u>
Unrestricted	<u>80,252,892</u>
	<u>\$ 975,296,923</u>

**NOTE I - LEASES**

The Board leases certain properties to other users, primarily utility and telecommunications companies, under multi-year license agreements. The terms of these agreements range from 5 to 30 years. The agreements are generally based on fixed annual amounts, with provisions for increases. Information regarding the cost and related accumulated depreciation of these facilities, which is required to be disclosed by Statement of Financial Accounting Standards No. 13, *Accounting for Leases*, is not provided because the accumulation of such data was not considered practical and because the information, when compared to the future minimum rentals to be received, would not be an accurate indication of the productivity of the property on lease or held for lease, due to the methods by which and the long period of time over which the properties were acquired.

The Board also leases space for its deep seawater cooling project on Oahu under a noncancelable operating lease that extends through September 2025.

**Board of Water Supply  
City and County of Honolulu  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2006**

**NOTE I - LEASES (Continued)**

The future minimum rental payments and sublease income from these operating leases at June 30, 2006, approximated the following:

<u>Fiscal Year Ending June 30,</u>	<u>Minimum Future Rental Payments</u>	<u>Less Sublease Income</u>	<u>Net Minimum Future Rentals (Income) Expense</u>
2007	\$ 158,600	\$ 156,300	\$ 2,300
2008	158,600	117,300	41,300
2009	158,600	115,800	42,800
2010	158,600	116,200	42,400
2011	158,600	116,700	41,900
2012 - 2016	793,000	517,200	275,800
2017 - 2021	793,000	500,000	293,000
2022 - 2026	666,596	500,000	166,596
2027 - 2031	<u>--</u>	<u>450,094</u>	<u>(450,094)</u>
	\$ <u>3,045,596</u>	\$ <u>2,589,594</u>	\$ <u>456,002</u>

**NOTE J - 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, 2006, 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 year 2006. The revenues related to these fees are included in other operating revenues in the accompanying statement 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 the payment of accrued CASE fees from prior fiscal years are currently being negotiated between the Board and the City, the Board has accrued its best estimate of approximately \$3,300,000 for the fiscal year ended June 30, 2006.

***Amount Due to/from the City*** - Amounts due from the City approximated \$923,600 as of June 30, 2006, and is included in other receivables. Amounts due to the City approximated \$9,926,000 as of June 30, 2006, and is included in accounts payable.



**Board of Water Supply  
City and County of Honolulu  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2006**

**NOTE K - 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 under 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 fiscal year ended June 30, 2006, was approximately \$29,671,000. The Board's total payroll was approximately \$30,682,000. The contribution requirement for the fiscal years ended June 30, 2006, 2005, and 2004, was approximately \$4,080,000, \$3,380,000, and \$2,595,000, respectively, which represented approximately 13.8%, 11.8%, and 9.8% of the Board's covered payroll for fiscal years 2006, 2005, and 2004, respectively. The Board's contribution requirement represented approximately 1.0%, 1.0%, and 1.1%, respectively, of the total contribution requirement for all employees for fiscal years 2006, 2005, and 2004.

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 1400, Honolulu, Hawaii 96813.

**Board of Water Supply  
City and County of Honolulu  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2006**

**NOTE K - EMPLOYEE BENEFIT PLANS (Continued)**

**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 ERS by extending the payment schedule for the actuarial present value cost of the early retirement incentive bonus from 5 to 19 years beginning with ERS payments for the fiscal year ended June 30, 2001. The retirement contribution liability related to this program was approximately \$506,200 as of June 30, 2006.

**Post-Retirement Health Care and Life Insurance Benefits**

In addition to providing pension benefits, the State of Hawaii Employer-Union Health Benefits Trust 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, 533 Board retirees and surviving dependents are eligible to receive health care benefits and 424 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 fiscal year ended June 30, 2006, aggregated approximately \$3,600,000, and is 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, 2006**

**NOTE L - COMMITMENTS**

At June 30, 2006, accumulated sick leave aggregated approximately \$20,612,000. Sick leave accumulates at the rate of one and three-quarters working days for each month of service without limit, but can be taken only in the event of illness and is not convertible to pay upon termination of employment. However, an employee who retires or leaves government service in good standing with 60 or more unused sick days is entitled to additional service credit in the ERS.

Other commitments, primarily for utility plant construction, approximated \$204,853,000 at June 30, 2006. Such amounts are to be funded by operating revenues, contributed capital, and cash investments on hand.

**NOTE M - CONTINGENCIES**

**Workers' Compensation Self-Insurance Liability**

The Board is self-insured for workers' compensation and disability claims below \$500,000 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 was approximately \$2,230,000 as of June 30, 2006.

**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.

**Board of Water Supply  
City and County of Honolulu  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2006**

**NOTE M - CONTINGENCIES (Continued)**

**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 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, 2006, except as provided in the allowance for uncollectible accounts. The Board manages its credit exposure through procedures designed to identify and monitor credit risk.

**NOTE N - SUBSEQUENT EVENT**

In July 2006, the Board issued \$213,805,000 in water system revenue bonds, which consisted of \$165,195,000 of Series 2006A and \$48,610,000 of Series 2006B bonds. The proceeds of the issuance were primarily used to refund, on a current basis, all of the Board's outstanding Series 2002A and Series 2002B bonds, to advance refund a portion of the outstanding Series 2001 and Series 2004 bonds, and to pay the costs of various capital improvements to the water system.

**NOTE O - PRIOR PERIOD ADJUSTMENT**

During the fiscal year ended June 30, 2006, the Board determined that certain costs included in construction work in progress in prior fiscal years should have been expensed in the fiscal years in which the costs were incurred. In addition, estimated service fee adjustments related to the operation and maintenance of its water reclamation facility was not accrued during the periods in which services were received by the Board. As a result, at July 1, 2005, construction work in progress was overstated by \$1,596,707 and contracts payable was understated by \$528,502. Accordingly, adjustments were made to these accounts with a corresponding entry to reduce net assets as of July 1, 2005, by \$2,125,209.

## **SUPPLEMENTARY SCHEDULES**

**Board of Water Supply**  
**City and County of Honolulu**  
**SUPPLEMENTARY SCHEDULE FOR BONDS PAYABLE**  
**June 30, 2006**

	<u>Interest Rate</u>	<u>Bond Dated</u>	<u>Maturing Serially From</u>	<u>Call Dates (1)</u>	<u>Outstanding June 30, 2006</u>
Water System Revenue Bonds Series 2001	3.875%	5/15/2001	7/1/2006	(2)	\$ 1,240,000
	4.000%	5/15/2001	7/1/2007	(2)	1,285,000
	5.000%	5/15/2001	7/1/2008	(2)	1,165,000
	4.125%	5/15/2001	7/1/2008	(2)	175,000
	5.000%	5/15/2001	7/1/2009	(2)	1,105,000
	4.250%	5/15/2001	7/1/2009	(2)	300,000
	5.000%	5/15/2001	7/1/2010	(2)	250,000
	4.375%	5/15/2001	7/1/2010	(2)	1,220,000
	5.000%	5/15/2001	7/1/2011	(2)	200,000
	4.500%	5/15/2001	7/1/2011	(2)	1,335,000
	5.375%	5/15/2001	7/1/2012	7/1/2011	535,000
	4.600%	5/15/2001	7/1/2012	7/1/2011	1,075,000
	4.700%	5/15/2001	7/1/2013	7/1/2011	1,685,000
	5.500%	5/15/2001	7/1/2014	7/1/2011	1,765,000
	5.500%	5/15/2001	7/1/2015	7/1/2011	1,860,000
	5.500%	5/15/2001	7/1/2016	7/1/2011	1,735,000
	5.000%	5/15/2001	7/1/2016	7/1/2011	230,000
	5.000%	5/15/2001	7/1/2017	7/1/2011	2,070,000
	5.125%	5/15/2001	7/1/2018	7/1/2011	2,175,000
	5.125%	5/15/2001	7/1/2019	7/1/2011	2,285,000
	5.125%	5/15/2001	7/1/2020	7/1/2011	2,405,000
	5.125%	5/15/2001	7/1/2021	7/1/2011	2,525,000
	5.250%	5/15/2001	7/1/2022	7/1/2011	2,655,000
	5.250%	5/15/2001	7/1/2023	7/1/2011	2,795,000
	5.250%	5/15/2001	7/1/2024	7/1/2011	2,940,000
	5.250%	5/15/2001	7/1/2025	7/1/2011	3,095,000
	5.250%	5/15/2001	7/1/2026	7/1/2011	3,260,000
	5.250%	5/15/2001	7/1/2027	7/1/2011	3,430,000
	5.250%	5/15/2001	7/1/2028	7/1/2011	3,610,000
	5.250%	5/15/2001	7/1/2029	7/1/2011	3,800,000
	5.250%	5/15/2001	7/1/2030	7/1/2011	4,000,000
	5.250%	5/15/2001	7/1/2031	7/1/2011	4,210,000
					<u>\$ 62,415,000</u>

(1) Call dates indicated are optional.

(2) Noncallable.

**Board of Water Supply  
City and County of Honolulu  
SUPPLEMENTARY SCHEDULE FOR BONDS PAYABLE (Continued)  
June 30, 2006**

	<u>Interest Rate</u>	<u>Bond Dated</u>	<u>Maturing Serially From</u>	<u>Outstanding June 30, 2006</u>
Water System Revenue Bonds				
Series 2002	(1)	3/5/2002	7/1/2007	\$ 1,100,000
	(1)	3/5/2002	7/1/2008	1,150,000
	(1)	3/5/2002	7/1/2009	1,200,000
	(1)	3/5/2002	7/1/2010	1,300,000
	(1)	3/5/2002	7/1/2011	1,350,000
	(1)	3/5/2002	7/1/2012	1,400,000
	(1)	3/5/2002	7/1/2013	1,450,000
	(1)	3/5/2002	7/1/2014	1,550,000
	(1)	3/5/2002	7/1/2015	1,600,000
	(1)	3/5/2002	7/1/2016	1,650,000
	(1)	3/5/2002	7/1/2017	1,750,000
	(1)	3/5/2002	7/1/2018	1,850,000
	(1)	3/5/2002	7/1/2019	1,900,000
	(1)	3/5/2002	7/1/2020	2,000,000
	(1)	3/5/2002	7/1/2021	2,100,000
	(1)	3/5/2002	7/1/2022	2,200,000
	(1)	3/5/2002	7/1/2023	2,300,000
	(1)	3/5/2002	7/1/2024	2,400,000
	(1)	3/5/2002	7/1/2025	2,500,000
	(1)	3/5/2002	7/1/2026	2,600,000
	(1)	3/5/2002	7/1/2027	2,750,000
	(1)	3/5/2002	7/1/2028	2,850,000
	(1)	3/5/2002	7/1/2029	3,000,000
	(1)	3/5/2002	7/1/2030	3,150,000
	(1)	3/5/2002	7/1/2031	<u>3,300,000</u>
				<u>\$ 50,400,000</u>

(1) Interest rates are at the auctioned rate.

**Board of Water Supply  
City and County of Honolulu  
SUPPLEMENTARY SCHEDULE FOR BONDS PAYABLE (Continued)  
June 30, 2006**

	<u>Interest Rate</u>	<u>Bond Dated</u>	<u>Maturing Serially From</u>	<u>Call Dates (1)</u>	<u>Outstanding June 30, 2006</u>
Water System Revenue Bonds					
Series 2004					
Uninsured Serial Bonds	2.000%	1/28/2004	7/1/2006	(2)	\$ 1,930,000
	2.000%	1/28/2004	7/1/2007	(2)	1,965,000
	3.000%	1/28/2004	7/1/2008	(2)	2,015,000
Insured Serial Bonds:	3.000%	1/28/2004	7/1/2009	(2)	2,080,000
	3.000%	1/28/2004	7/1/2010	(2)	2,140,000
	3.000%	1/28/2004	7/1/2011	(2)	2,205,000
	3.500%	1/28/2004	7/1/2012	(2)	2,280,000
	4.000%	1/28/2004	7/1/2013	(2)	2,365,000
	4.000%	1/28/2004	7/1/2014	(2)	2,465,000
	4.750%	1/28/2004	7/1/2015	7/1/2014	2,575,000
	4.750%	1/28/2004	7/1/2016	7/1/2014	2,700,000
	4.750%	1/28/2004	7/1/2017	7/1/2014	2,830,000
	4.750%	1/28/2004	7/1/2018	7/1/2014	2,970,000
	4.750%	1/28/2004	7/1/2019	7/1/2014	3,115,000
	4.750%	1/28/2004	7/1/2020	7/1/2014	3,265,000
	5.000%	1/28/2004	7/1/2021	7/1/2014	3,430,000
	5.000%	1/28/2004	7/1/2022	7/1/2014	3,605,000
	5.000%	1/28/2004	7/1/2023	7/1/2014	3,790,000
	5.000%	1/28/2004	7/1/2024	7/1/2014	3,985,000
	5.000%	1/28/2004	7/1/2025	7/1/2014	4,185,000
Insured Term Bonds	5.000%	1/28/2004	7/1/2033	7/1/2014	<u>42,215,000</u>
					<u>98,110,000</u>
					<u>\$ 210,925,000</u>

(1) Call dates indicated are optional.

(2) Noncallable.



**Board of Water Supply  
City and County of Honolulu  
SUPPLEMENTAL SCHEDULE OF NET REVENUE REQUIREMENT  
Fiscal Year Ended June 30, 2006**

	<u>Amount</u>
<b>REVENUES</b>	
Water sales	\$ 100,876,964
Interest	4,519,164
Other	<u>2,529,580</u>
Total revenues	<u>107,925,708</u>
<b>Deductions</b>	
Operating expenses	129,759,898
Less depreciation expense	<u>(38,827,552)</u>
Total deductions	<u>90,932,346</u>
Net revenues	\$ <u>16,993,362</u>
<b>NET REVENUE REQUIREMENT</b>	
Greater of:	
1) Aggregate debt service	\$ 13,372,881
Required deposits - subordinate obligation fund	<u>206,000</u>
	\$ <u>13,578,881</u>
2) Aggregate debt service	\$ 13,372,881
	x <u>1.20</u>
	\$ <u>16,047,457</u>
Net revenue requirement	\$ <u>16,047,457</u>