

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

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

Fiscal Years Ended June 30, 2012 and 2011



N&K CPAs, Inc.

ACCOUNTANTS|CONSULTANTS

**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, 2012**

The Board of Water Supply of the City and County of Honolulu (the BWS) is pleased to present its Annual Financial Report for the fiscal year 2012. This introduction provides an overview of the mission, organization, and operations of the BWS. The following management's discussion and analysis is intended to provide the reader with an easily understandable analysis of the BWS's financial performance and all aspects of its financial position. Financial statements presenting the financial position and results of operations of the BWS is in conformity with accounting principles generally accepted in the United States of America, accompanied by the independent auditors' report, follows the management's discussion and analysis.

Organization and Business

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

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

The BWS consists of 14 Divisions and Support Offices - Business Development, Capital Projects, Communications, Customer Care, Finance, Human Resources, Information Technology, Legal, Field Operations, Water System Operations, Water Resources, Land, Security and the Office of the Manager and Chief Engineer. All are under the direction of the Manager and Chief Engineer (Manager), who is appointed by the Board of Directors, and the Deputy Manager.

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 a public hearing to receive public testimony regarding any proposed rate increase, and final approval by the Board of Directors.

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

The BWS services 167,334 accounts and a residential population of 963,607. 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, 155,228 are residential (92.8%), representing 58.4% of the total amount received from water sales in fiscal year 2012; 11,205 are commercial and industrial (6.7%), representing 40.5% of the total amount received from water sales in fiscal year 2012; and 901 are agricultural (0.5%), representing 1.1% of the total amount received from water sales in fiscal year 2012.

**Board of Water Supply
City and County of Honolulu
INTRODUCTION (Continued)
Fiscal Year Ended June 30, 2012**

The BWS provides potable quality water at reasonable rates, while managing the long-term viability of Oahu's water resources and protecting the environment. In addition to providing potable water of 139 million gallons per day (mgd), the BWS is capable of delivering approximately 10 mgd of recycled water for irrigation of various golf courses, landscaped areas in Ewa, and for industrial processing in Campbell Industrial Park.

Mission

The mission of the BWS is to provide a safe and dependable water supply 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 by 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 BWS's customers, the community, and watersheds.

Looking Ahead

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

1. Resource Sustainability

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

- The BWS continues its successful leak detection and repair program, proactively identifying and repairing leaks before they become an emergency main break. The BWS Leak Detection Team surveys approximately 50 miles of pipelines per month to find leaks in the distribution system and have resulted in an estimated savings of approximately 1.4 million gallons of water per day (mgd) or about 506 million gallons per year. Water loss in the distribution system is currently 12.5 percent of the total water production. The BWS's goal is to reduce water loss to 10 percent.

**Board of Water Supply
City and County of Honolulu
INTRODUCTION (Continued)
Fiscal Year Ended June 30, 2012**

- Recycled water is an important component of a host of conservation and drought mitigation strategies to reduce potable water consumption. The BWS continues to support the use of recycled water in the Ewa area as an appropriate and more efficient source of water for irrigation and industrial purposes. Recycled water use from the Honouliuli Water Recycling Facility continues to provide alternative water supply in Ewa for irrigation and industrial purposes. Recycled water production averaged 8.6 million gallons per day (mgd) in fiscal year 2012, which was on average 1.0 mgd more than the previous fiscal year due to the difference in average rainfall.
- The Koolau-poko Watershed Management Plans (WMP) is expected to be adopted in August 2012, and the North Shore and Ewa WMPs have been initiated. The Central Oahu WMP was initiated in FY 2012. The Waianae and Koolauloa WMP's were adopted in 2011. These plans are the regional component of long-range strategic water plans for the City that is concurrent with the City's development and sustainable communities plan for Oahu. WMPs provide the strategic planning framework for watershed protection projects and water use and development for the BWS's long-range capital program, ensuring that adequate water supplies and water system infrastructure will meet Oahu's future water demands.
- The BWS implemented and expanded upon a wide array of public information and education programs that support and reinforce efforts to educate customers about the importance of conserving water throughout the year and about other BWS programs.
- The BWS continues to ensure that the community's potable water supply complies with all Federal and State safe drinking water regulations by monitoring changes in safe drinking water regulations and installing new and replacement water treatment facilities as necessary.

2. Economic Sustainability

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

- The BWS Board of Directors approved a revised rate schedule to fund the operation, maintenance, and replacement of Oahu's aging water infrastructure. The water rate increase will be spread over a five-year schedule, at 9.65 percent each year to minimize impact to customers. The first year of the revised rate schedule took effect on January 1, 2012 with the following four increases to take effect on July 1st, for the next four fiscal years.

**Board of Water Supply
City and County of Honolulu
INTRODUCTION (Continued)
Fiscal Year Ended June 30, 2012**

- The BWS completed an \$85.2 million bond issue on its Water Revenue Refunding Bonds, which will result in an expected net savings of approximately \$7.15 million over the life of the bonds. By taking advantage of low interest rates and the BWS's high credit ratings, this bond refinance is a financial move that will yield a cost savings of approximately \$430,000 a year. The bond refinancing was part of the BWS's ongoing efforts to minimize costs and ensure fiscal stability to Oahu water ratepayers.
- Moody's Investors Service and Fitch Ratings, which establish bond ratings used when municipalities borrow money, affirmed the BWS's bond rating at Aa2 and AA+, respectively, maintaining a "stable outlook" in both cases. The bond ratings from Moody's and Fitch should be seen as an affirmation of the BWS's creditworthiness, and will thus ensure low borrowing costs for the BWS in the bond market.
- A total of \$24.5 million in capital program contracts, of which more than \$3.0 million are professional services contracts, were awarded as of June 30, 2012. The repair, replacement and improvement projects proactively address the needs of our aging infrastructure to ensure continuity of core services. In addition, \$5.5 million of operating budget contracts were awarded that provide the necessary waterworks materials, services and supplies, automotive and construction equipment and information technology systems to support our core operations.
- According to the American Water Works Association, water utilities nationwide should strive for roughly 25-30 breaks per 100 miles of pipeline. The BWS ratio was better than the national experience. In fiscal year 2012, the BWS employees responded to a total of 305 main breaks or about 15 breaks per 100 miles of pipeline.
- The BWS is completing the replacement of its 14-year-old customer information and billing system with a state-of-the-art Customer Information System (CIS). Online capabilities for customer requests to initiate and terminate service have already been implemented and online account history and payment will soon be available.
- The BWS's nationally recognized Geographic Information System (GIS) database and applications continues to be upgraded for best in class industry functionality and performance. This system gives department users access to GIS layers and updated imagery, and integrates map service sharing with other City departments. Concurrent with this, the Global Positioning System Asset Collection and Verification project, which began last year, was completed and resulted in the mapping of 248,756 locations (e.g. hydrants, meters, and valves).
- The BWS is currently piloting a Project Information Management System which is designed to track the entire life cycle of BWS capital projects, as well as private projects. This system should improve internal controls over project management and provide broad access to a meaningful set of project status measures and supporting data.

**Board of Water Supply
City and County of Honolulu
INTRODUCTION (Continued)
Fiscal Year Ended June 30, 2012**

- The BWS initiated an IT equipment refresh program in the last quarter of FY 2012; replacing old and technologically obsolete laptops and desktops with the latest hardware platforms running current applications. This program, in conjunction with the selective utilization of "thin-client" systems, assures an efficient and cost effective end-user systems platform, and will be completed by the second quarter of FY 2013.
- The BWS continues to upgrade facility video surveillance capabilities by deploying state-of-the-art digital video systems in conjunction with sensor based triggering systems and fencing. These upgrades have already resulted in the prevention and/or reduction of criminal activities, and the apprehension of perpetrators. Additional cameras and sensors are planned for deployment in parallel with the progress of the BWS Wireless Network Project (WNP).
- The BWS WNP continued with the addition of high speed backbone links to the Kalihi Corporation Yard and several Windward backbone sites, as well as the installation of additional wireless links to pump stations and reservoirs in Leeward Oahu. Video surveillance was also installed at each site. Plans for FY 2013 call for extending the wireless network backbone to Windward Oahu and the installation of links to pump stations and reservoirs from Diamond Head to Hawaii Kai and part of Windward Oahu.

3. Organizational Sustainability

The BWS's third objective calls for a sound, well structured, efficient organization with the tools and skills necessary to provide exceptional value to customers, the community and watersheds.

- The BWS successfully processed more than 13,000 customer calls and inquiries regarding bill payments and delinquent bills during the fiscal year. The BWS also implemented online forms in April 2012, to give customers another way to contact the BWS and processed more than 2,500 forms in the three month period.
- In October 2011, the BWS began its Call Center for customers. Prior to this, two separate groups of Customer Service Representative (CSR) responded to inquiries – one for credit and collection questions and another for billing and service inquiries. With the Call Center, there is one central CSR group and they assist customers with all billing, payment and service inquiries.
- The BWS continually works with the City and County of Honolulu Department of Emergency Management (DEM) and the Hawaii State Civil Defense to insure it has the plans and procedures in place to respond effectively to emergency situations such as a tropical cyclone, an island wide power outage, pandemic flu, tsunami, or other major events.

**Board of Water Supply
City and County of Honolulu
INTRODUCTION (Continued)
Fiscal Year Ended June 30, 2012**

- In November 2011, the BWS worked with law enforcement and emergency response agencies to prepare plans to support the 2011 Asia Pacific Economic Cooperation (APEC) Conference held in Honolulu. Working with the United States Secret Service, United States Department of State, the Honolulu Police and Fire Departments, DEM and other agencies, the BWS prepared the Department's APEC Operations Plan outlining the procedures and practices BWS would use to monitor, report, and respond to any water system incidences that could have impacted the conference.
- Employee development continues to be a top priority for the BWS. Opportunities for employees to learn more about their field and to enhance their leadership and team building skills are readily available.
- To ensure a continuing pool of qualified employees for specialized jobs, BWS is establishing a Trades Apprenticeship Program for Plant Electrical/Electronic Equipment Repairer positions in our Water System Operations Division. These positions install, repair, and maintain the water pumping and related equipment that distributes water throughout the BWS system. Trades apprentices learn the needed skills through on-the-job training and evening classes at Honolulu Community College. Currently, the successful Pipefitter Trades Apprenticeship program graduates sufficient journey worker pipefitters to maintain needed staffing levels.
- Open communication with public employee union shop stewards of the Hawaii Government Employees Association (HGEA) and United Public Workers (UPW) continues to foster improved labor-management relationships. The meetings are a forum where stewards are able to obtain clarification and guidance on personnel-related questions and concerns. These sessions also encourage open dialogue to clarify issues before they become problematic.
- Employee recognition programs are a key element to foster employee morale and encourage continuing excellence. These programs continue to be an important priority for BWS management.

INDEPENDENT AUDITORS' REPORT

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

We have audited the statements of net assets of the Board of Water Supply (the BWS), a component unit of the City and County of Honolulu, as of June 30, 2012 and 2011, and the related statements of revenues, expenses, and changes in net assets and cash flows for the fiscal years then ended. These financial statements are the responsibility of the BWS's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 audits provide 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 BWS as of June 30, 2012 and 2011, and the results of its operations and its cash flows for the fiscal years 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 23, 2012, on our consideration of the BWS's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis information on pages 11 through 16 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The introductory section and supplementary information are presented for the purpose of additional analysis and are not a required part of the financial statements. The supplementary information is the responsibility of management and was derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The supplementary information have been subjected to the auditing procedures applied in our audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated in all material respects in relation to the financial statements as a whole. The introductory section has not been subjected to the auditing procedures applied in the audits of the basic financial statements, and, accordingly, we do not express an opinion or provide any assurance on them.

N&K CPAs, Inc.

Honolulu, Hawaii
October 23, 2012

**Board of Water Supply
City and County of Honolulu
MANAGEMENT'S DISCUSSION AND ANALYSIS
Fiscal Year Ended June 30, 2012**

This section presents the management's discussion and analysis of the BWS's financial condition and activities for the fiscal year ended June 30, 2012. This information should be read in conjunction with the financial statements.

Financial Highlights

The BWS implemented the first of five (5) scheduled rate increases in January 2012 to meet the rising costs of delivering water to customers and to continue its infrastructure repair and replacement programs. Water rates increased by 9.65 percent, more than \$4 on monthly water charges for an average single-family residential customer effective January 1, 2012.

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

- Net assets increased \$19.4 million in fiscal year 2012 compared to \$12.4 million in fiscal year 2011.
- Total assets at year-end were \$1.4 billion, which exceeded liabilities by \$1.0 billion.
- The BWS's unrestricted current assets at June 30, 2012 were 7.5 times its related current liabilities compared to 5.1 times at June 30, 2011.
- The BWS's debt to equity ratio was 30.5% at June 30, 2012, indicating the continuance of capacity to issue additional debt.

Overview of Financial Report

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

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

The basic financial statements include 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 BWS at June 30, 2012. 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.

**Board of Water Supply
City and County of Honolulu
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Fiscal Year Ended June 30, 2012**

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.

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

Financial Analysis

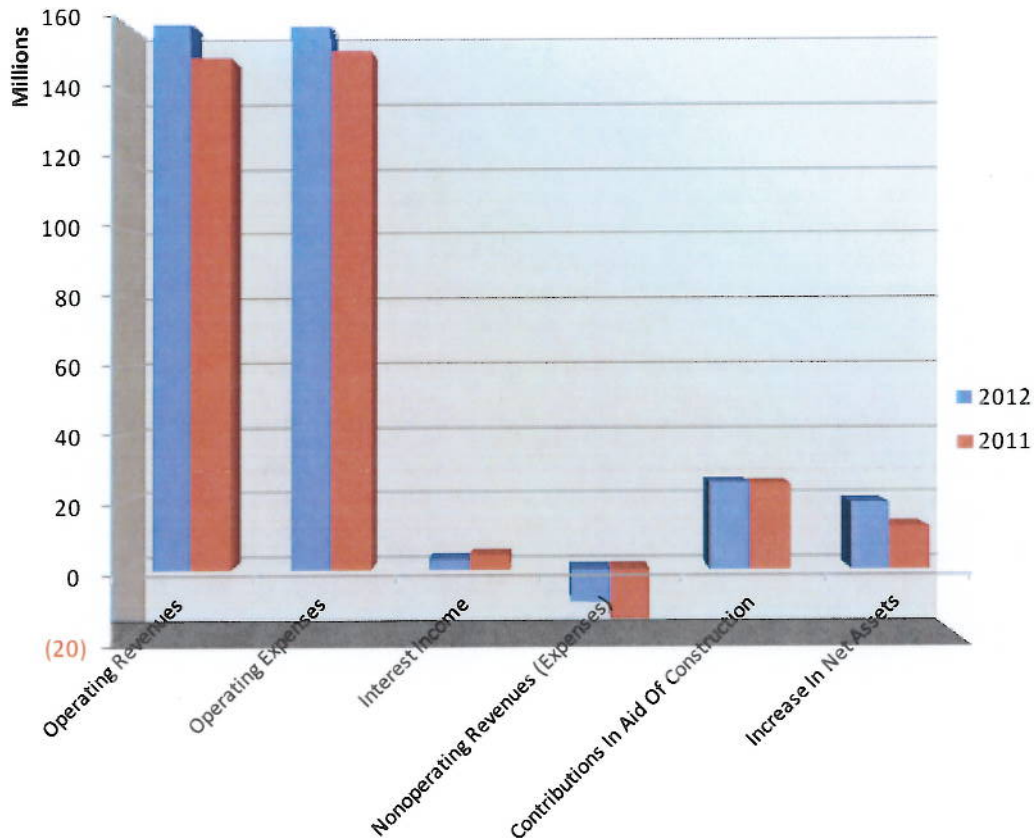
Results of Operations

CONDENSED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

| | June 30, | | % |
|--|----------------|------------|--------|
| | 2012 | 2011 | Change |
| | (in thousands) | | |
| Operating revenues | \$ 159,508 | \$ 149,894 | 6.4% |
| Operating expenses: | | | |
| Depreciation | 43,376 | 41,247 | 5.2% |
| Administrative and general | 39,392 | 42,137 | -6.5% |
| Power and pumping | 33,202 | 28,631 | 16.0% |
| Other operating expenses | 42,754 | 39,818 | 7.4% |
| Total operating expenses | 158,724 | 151,833 | 4.5% |
| Earnings (loss) from operations | 784 | (1,939) | |
| Nonoperating revenues (expenses): | | | |
| Interest income | 2,903 | 3,929 | -26.1% |
| Others | (9,499) | (14,434) | -34.2% |
| Total nonoperating revenues (expenses) | (6,596) | (10,505) | -37.2% |
| Contributions in aid of construction | 25,198 | 24,838 | 1.4% |
| Increase in net assets | \$ 19,386 | \$ 12,394 | |

**Board of Water Supply
City and County of Honolulu
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Fiscal Year Ended June 30, 2012**

Statement of Revenues, Expenses and Changes in Net Assets



The increase in net assets for the fiscal year ended June 30, 2012 was \$19.4 million, compared to an increase of \$12.4 million for fiscal year ended June 30, 2011.

Operating revenues for fiscal year 2012 were \$159.5 million, an increase of \$9.6 million from fiscal year 2011 revenues of \$ 149.9 million.

Total operating expenses increased to \$158.7 million in fiscal year 2012, an increase of \$6.9 million from fiscal year 2011. Factors contributing to this change are explained below.

Administrative and general expenses decreased \$2.7 million mainly due to a decrease in professional services, gasoline, motor vehicle parts and accessories and other contractual services.

Power and pumping expenses increased \$4.6 million from fiscal year 2011. This was primarily due to an increase in electricity costs of \$4.6 million offset by a decrease in various items including other materials and supplies and the repair and maintenance of equipment.

Other operating expenses increased \$2.9 million due to an increase in non-potable water treatment. This increase was due to a change in CPI and current electrical rates. Maintenance expenses increased mainly due to an increase in transmission maintenance expenditures.

**Board of Water Supply
City and County of Honolulu
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Fiscal Year Ended June 30, 2012**

Non-operating expenses decreased by \$3.9 million due primarily to a decrease in interest expenses of \$1.5 million and a decrease in the loss from disposition of property.

Contributions in aid of construction result from water system facilities charges that are levied against all new developments and residential properties requiring water from the BWS's systems, except those developments that have paid for and installed a complete water system, including sources, transmission, and daily storage facilities. In addition, contributions of capital assets from governmental agencies, developers, and customers are recorded as contributions in aid of construction at their cost. The BWS realized contributions in aid of construction of \$25.2 million in fiscal year 2012 compared to \$24.8 million in fiscal year 2011. The increase in contributions in aid of \$.4 million was due to an increase in projects completed by governmental funds of \$.5 million, an increase in the Water Service Facilities Charge (WSFC) of \$.8 million offset by a decrease in private development contributions of \$.9 million. In fiscal year 2012, the major developments completed were Ocean Point Development, Mehana at Kapolei, Phase 1 and Kapolei City Urban Core 4.

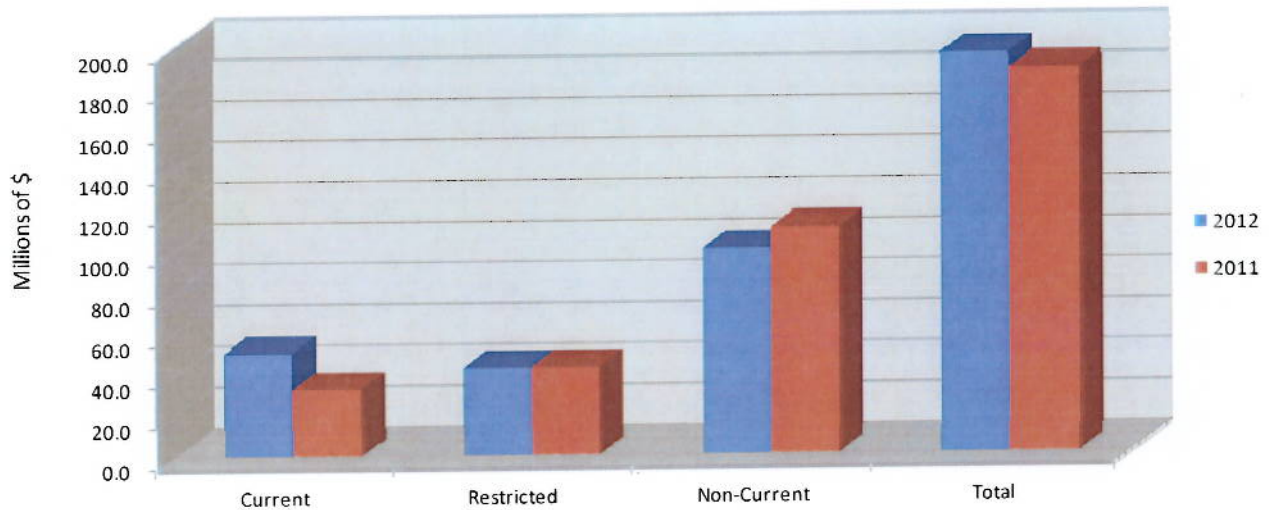
Financial Condition

CONDENSED STATEMENTS OF NET ASSETS

| | June 30, | | % |
|--|---------------------|---------------------|--------|
| | 2012 | 2011 | Change |
| | (in thousands) | | |
| Current Assets | | | |
| Cash and cash equivalents | \$ 14,354 | \$ 7,159 | 100.5% |
| Investments | 36,653 | 26,034 | 40.8% |
| Other current assets | 26,869 | 26,658 | 0.8% |
| Restricted Assets | | | |
| Cash and equivalents | 15,682 | 14,975 | 4.7% |
| Investments | 27,681 | 28,532 | -3.0% |
| Investments | 100,659 | 110,862 | -9.2% |
| Other Assets | 2,294 | 2,805 | -18.2% |
| Property, plant and equipment, net of accumulated depreciation | <u>1,146,784</u> | <u>1,157,677</u> | -0.9% |
| Total assets | \$ <u>1,370,976</u> | \$ <u>1,374,702</u> | -0.3% |
| Current liabilities | \$ 10,326 | \$ 11,750 | -12.1% |
| Other liabilities | 48,860 | 61,786 | -20.9% |
| Bonds payable, noncurrent | <u>282,870</u> | <u>291,632</u> | -3.0% |
| Total liabilities | <u>342,056</u> | <u>365,168</u> | -6.3% |
| Net Assets: | | | |
| Invested in capital assets, net of related debt | 842,391 | 834,243 | 1.0% |
| Restricted for capital activity and debt service | 26,410 | 25,609 | 3.1% |
| Unrestricted | <u>160,119</u> | <u>149,682</u> | 7.0% |
| Total net assets | <u>1,028,920</u> | <u>1,009,534</u> | 1.9% |
| Total liabilities and net assets | \$ <u>1,370,976</u> | \$ <u>1,374,702</u> | -0.3% |

**Board of Water Supply
City and County of Honolulu
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Fiscal Year Ended June 30, 2012**

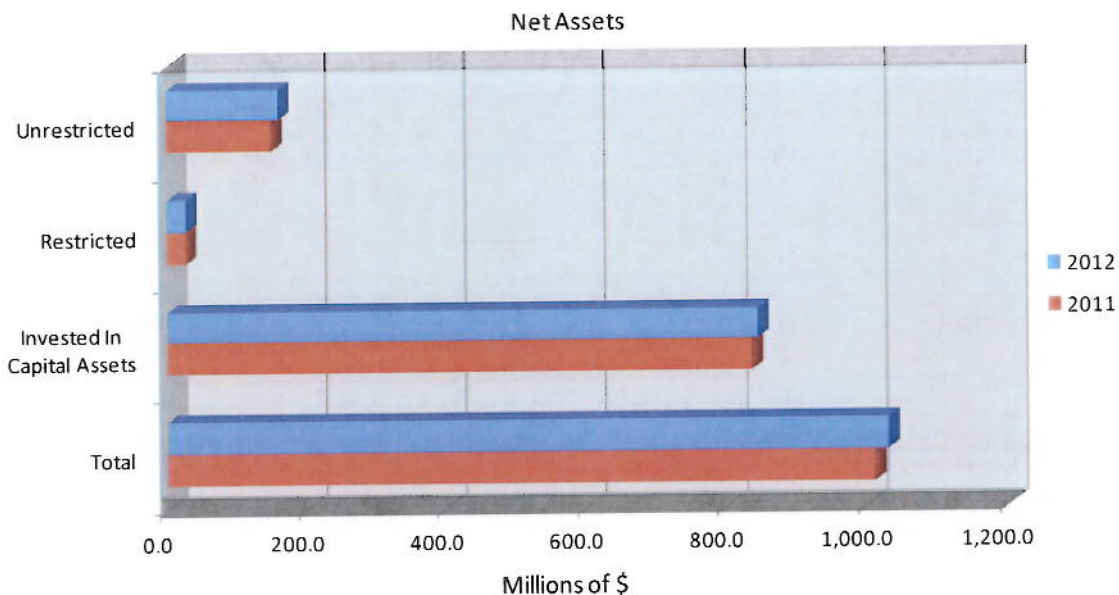
Cash and Investments



Effective January 1, 2012, the BWS increased its water rates by approximately 9.65 percent. Four (4) more annual water rate increases have been approved.

The BWS's unrestricted current assets at June 30, 2012 were 7.5 times its related current liabilities compared to 5.1 times at June 30, 2011. The ratio increase was due to an increase in cash and investments.

Net assets increased by \$19.4 million or 1.9%; from \$1.01 billion in fiscal year 2011 to \$1.03 billion at the end of fiscal year 2012. This reflects consistent operating revenue, an increase in contributions in aid of construction and a decrease in other non-operating expenses.



**Board of Water Supply
City and County of Honolulu
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Fiscal Year Ended June 30, 2012**

Capital Assets and Long-Term Debt

During the fiscal year, the BWS capitalized \$31.0 million to its utility plant in service. Major assets added were Waipahu Wells III, \$6.2 million; East Kapolei Transmission Main, \$4.2 million; Kamehameha Highway Sunset Beach water system improvements, \$3.6 million; and Kamehameha Highway 8 inch Main (Kaneohe), \$2.5 million.

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

The BWS issued \$85,195,000 principal amount of Board of Water Supply Water System Revenue Bonds, Series 2012A bonds on March 14, 2012. Net present value savings of \$7,152,408 will be realized with the refunding.

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

Rate Covenant

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

Request for Information

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

**Board of Water Supply
City and County of Honolulu
STATEMENTS OF NET ASSETS
June 30, 2012 and 2011**

| | <u>2012</u> | <u>2011</u> |
|--|-------------------------|-------------------------|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | \$ 14,354,299 | \$ 7,159,813 |
| Investments | 36,652,935 | 26,034,201 |
| Interest receivable | 868,151 | 894,933 |
| Customer receivables | | |
| Billed, less allowances for uncollectible accounts of | | |
| \$1,522,304 in 2012 and \$1,232,871 in 2011 | 7,640,511 | 8,653,986 |
| Unbilled | 11,776,533 | 8,486,868 |
| Other receivables, less allowances for uncollectible | | |
| accounts of \$510,868 in 2012 and 2011 | 1,788,407 | 3,694,772 |
| Materials and supplies | 4,942,267 | 4,508,600 |
| Prepaid expenses | <u>252,738</u> | <u>417,974</u> |
| Total current assets | <u>78,275,841</u> | <u>59,851,147</u> |
| RESTRICTED ASSETS | | |
| Cash and cash equivalents | 15,682,582 | 14,974,855 |
| Investments | <u>27,680,574</u> | <u>28,532,116</u> |
| Total restricted assets | <u>43,363,156</u> | <u>43,506,971</u> |
| INVESTMENTS | <u>100,659,263</u> | <u>110,862,238</u> |
| BOND ISSUE COSTS | | |
| Net of accumulated amortization of \$1,448,697 in 2012 | | |
| and \$1,023,727 in 2011 | <u>2,293,819</u> | <u>2,804,798</u> |
| CAPITAL ASSETS | | |
| Infrastructure | 1,323,318,170 | 1,303,009,505 |
| Building and improvements | 149,119,056 | 148,085,176 |
| Equipment and machinery | <u>243,497,917</u> | <u>237,113,104</u> |
| | 1,715,935,143 | 1,688,207,785 |
| Less accumulated depreciation | <u>766,708,010</u> | <u>725,640,773</u> |
| | 949,227,133 | 962,567,012 |
| Land | 32,373,064 | 32,373,064 |
| Construction work in progress | <u>164,784,029</u> | <u>162,737,147</u> |
| Capital assets - net | <u>1,146,384,226</u> | <u>1,157,677,223</u> |
| TOTAL | <u>\$ 1,370,976,305</u> | <u>\$ 1,374,702,377</u> |

See accompanying notes to financial statements.

**Board of Water Supply
City and County of Honolulu
STATEMENTS OF NET ASSETS (Continued)
June 30, 2012 and 2011**

| | <u>2012</u> | <u>2011</u> |
|--|-------------------------|-------------------------|
| LIABILITIES AND NET ASSETS | | |
| CURRENT LIABILITIES | | |
| Payable from current assets | | |
| Accounts payable | \$ 4,962,834 | \$ 5,436,825 |
| Contracts payable, including retainages | 3,737,463 | 3,550,195 |
| Accrued vacation, current portion | 1,611,211 | 1,875,947 |
| Other | 14,948 | 886,797 |
| | <u>10,326,456</u> | <u>11,749,764</u> |
| Payable from restricted assets | | |
| Contracts payable, including retainages | 1,172,195 | 2,057,177 |
| Accrued interest payable | 5,955,485 | 7,297,300 |
| Bonds payable, current portion | 7,985,000 | 6,710,000 |
| Notes payable, current portion | 1,540,637 | 1,533,389 |
| Other | 300,160 | 300,160 |
| | <u>16,953,477</u> | <u>17,898,026</u> |
| Total current liabilities | <u>27,279,933</u> | <u>29,647,790</u> |
| OTHER LIABILITIES | | |
| Customer advances | 1,387,908 | 2,210,966 |
| Accrued vacation, noncurrent portion | 4,610,403 | 3,973,247 |
| Accrued workers' compensation | 2,393,549 | 2,235,157 |
| Other postemployment benefits | 12,000 | 1,008,000 |
| Notes payable, noncurrent portion | 21,123,227 | 31,802,717 |
| Accrued arbitrage rebate and yield restriction | 48,873 | 954,413 |
| Other | 2,330,845 | 1,704,062 |
| Total other liabilities | <u>31,906,805</u> | <u>43,888,562</u> |
| BONDS PAYABLE - NONCURRENT | <u>282,869,112</u> | <u>291,631,677</u> |
| Total liabilities | <u>342,055,850</u> | <u>365,168,029</u> |
| NET ASSETS | | |
| Invested in capital assets - net of related debt | 842,391,887 | 834,242,829 |
| Restricted for capital activity and debt service | 26,409,679 | 25,608,944 |
| Unrestricted | 160,118,889 | 149,682,575 |
| Total net assets | <u>1,028,920,455</u> | <u>1,009,534,348</u> |
| TOTAL | <u>\$ 1,370,976,305</u> | <u>\$ 1,374,702,377</u> |

See accompanying notes to financial statements.

**Board of Water Supply
City and County of Honolulu
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
Fiscal Years Ended June 30, 2012 and 2011**

| | <u>2012</u> | <u>2011</u> |
|---|-------------------------|-------------------------|
| OPERATING REVENUES | | |
| Water sales | \$ 155,819,396 | \$ 146,287,716 |
| Other, principally contract and service fees | <u>3,688,333</u> | <u>3,606,760</u> |
| Total operating revenues | <u>159,507,729</u> | <u>149,894,476</u> |
| OPERATING EXPENSES | | |
| Depreciation | 42,376,263 | 41,246,765 |
| Administrative and general | 39,392,068 | 42,137,019 |
| Power and pumping | 33,202,387 | 28,631,436 |
| Transmission and distribution | 13,741,862 | 14,977,311 |
| Maintenance | 17,286,240 | 13,832,056 |
| Water reclamation | 6,318,530 | 4,794,146 |
| Customers' accounting and collection | 2,838,379 | 2,877,189 |
| Central administrative services expense fees | 3,300,000 | 3,300,000 |
| Source of supply | <u>267,921</u> | <u>37,368</u> |
| Total operating expenses | <u>158,723,650</u> | <u>151,833,290</u> |
| EARNINGS (LOSS) FROM OPERATIONS | <u>784,079</u> | <u>(1,938,814)</u> |
| NONOPERATING REVENUES (EXPENSES) | | |
| Interest income | 2,902,587 | 3,929,911 |
| Interest expense, net of interest capitalized of \$3,921,239 in 2012 and \$2,112,248 in 2011 | (8,671,709) | (12,045,462) |
| Loss from disposal of capital assets | (359,250) | (1,483,091) |
| Realized and unrealized loss on investments | (916,009) | (1,608,476) |
| Other | <u>448,169</u> | <u>702,150</u> |
| Total nonoperating expenses | <u>(6,596,212)</u> | <u>(10,504,968)</u> |
| CONTRIBUTIONS IN AID OF CONSTRUCTION | <u>25,198,240</u> | <u>24,837,778</u> |
| INCREASE IN NET ASSETS | 19,386,107 | 12,393,996 |
| NET ASSETS AT BEGINNING OF FISCAL YEAR | <u>1,009,534,348</u> | <u>997,140,352</u> |
| NET ASSETS AT END OF FISCAL YEAR | \$ <u>1,028,920,455</u> | \$ <u>1,009,534,348</u> |

See accompanying notes to financial statements.

**Board of Water Supply
City and County of Honolulu
STATEMENTS OF CASH FLOWS
Fiscal Years Ended June 30, 2012 and 2011**

| | <u>2012</u> | <u>2011</u> |
|---|----------------------|----------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Cash received from customers | \$ 159,137,904 | \$ 150,883,891 |
| Payments to suppliers for goods and services | (68,910,138) | (64,274,574) |
| Payments to employees for services | (46,520,944) | (48,147,484) |
| Other operating expenses - net | <u>(423,681)</u> | <u>1,157,502</u> |
| Net cash provided by operating activities | <u>43,283,141</u> | <u>39,619,335</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Purchase of investments | (139,097,887) | (329,999,834) |
| Proceeds from maturity of investments | 138,617,661 | 325,800,008 |
| Interest on investments | <u>2,929,369</u> | <u>3,604,789</u> |
| Net cash provided by (used in) investing activities | <u>2,449,143</u> | <u>(595,037)</u> |
| CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES | | |
| Acquisition and construction of capital assets - net of contributions in aid of construction of \$10,002,536 in 2012 and \$19,603,732 in 2011 | (20,436,212) | (22,226,745) |
| Proceeds from sale of capital assets | 53,643 | 324,172 |
| Customer payments for capital projects | 5,901,365 | 5,666,024 |
| Principal paid on bonds | (6,710,000) | (6,435,000) |
| Interest paid on bonds | (14,070,711) | (14,348,737) |
| Payments on arbitrage liability | (905,540) | -- |
| Proceeds from notes payable | 11,492 | 3,931,784 |
| Interest paid on notes payable | (130,639) | (135,796) |
| Principal paid on notes payable | <u>(1,543,469)</u> | <u>(1,527,988)</u> |
| Net cash used in capital and related financing activities | <u>(37,830,071)</u> | <u>(34,752,286)</u> |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 7,902,213 | 4,272,012 |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF FISCAL YEAR | <u>22,134,668</u> | <u>17,862,656</u> |
| CASH AND CASH EQUIVALENTS AT END OF FISCAL YEAR (including \$15,682,582 in 2012 and \$14,974,855 in 2011 in restricted accounts) | \$ <u>30,036,881</u> | \$ <u>22,134,668</u> |

**Board of Water Supply
City and County of Honolulu
STATEMENTS OF CASH FLOWS (Continued)
Fiscal Years Ended June 30, 2012 and 2011**

| | <u>2012</u> | <u>2011</u> |
|--|----------------------|----------------------|
| RECONCILIATION OF EARNINGS (LOSS) FROM OPERATIONS TO NET CASH PROVIDED BY OPERATING ACTIVITIES | | |
| Earnings (loss) from operations | \$ 784,079 | \$ (1,938,814) |
| Adjustments to reconcile earnings (loss) from operations to net cash provided by operating activities: | | |
| Depreciation | 43,966,589 | 42,532,578 |
| Provision for doubtful accounts | (538,635) | (1,265,347) |
| Provision for workers' compensation | 158,392 | 325,026 |
| Other revenues | 448,169 | 702,150 |
| Change in operating assets and liabilities: | | |
| Customer receivables | (1,737,555) | 3,120,698 |
| Materials and supplies | (433,667) | (533,019) |
| Other receivables | 1,906,365 | (865,937) |
| Prepaid expenses and other | 165,236 | (108,239) |
| Accounts and contracts payable | 101,798 | 14,630 |
| Accrued vacation | 372,420 | (864,166) |
| Other postemployment benefits | (996,000) | (1,913,377) |
| Other liabilities | <u>(914,050)</u> | <u>413,152</u> |
| Net cash provided by operating activities | \$ <u>43,283,141</u> | \$ <u>39,619,335</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 | \$ 10,002,536 | \$ 19,603,732 |
| Amortization of bond issue costs | \$ 134,603 | \$ 139,139 |
| Amortization of bond premium/discount | \$ (621,684) | \$ (483,195) |
| Amortization of deferred loss on refunding | \$ 220,494 | \$ 164,267 |
| Bond proceeds deposited directly with escrow agent for refunding of previously issued debt | \$ 97,821,826 | \$ -- |
| Bond proceeds used for bond issuance costs | \$ 687,342 | \$ -- |
| Forgiveness of principal due on notes payable | \$ 9,140,265 | \$ -- |

See accompanying notes to financial statements.

**Board of Water Supply
City and County of Honolulu
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011**

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

- (1) **Operations** - The Revised Charter of the City and County of Honolulu provides for the operation of the Board of Water Supply (the BWS) as a semi-autonomous body of the City and County of Honolulu government (City). The BWS has full and complete authority to manage, control and operate the City's water system and related properties.
- (2) **Financial Statement Presentation** - The BWS is a component unit of the City (the primary government).

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

- (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 BWS's seven-member board of directors has the authority to establish and adjust water rates and charges so that the revenues derived shall be sufficient to make the BWS self-supporting. The BWS 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 BWS considers all cash on hand, demand deposits, and short-term investments (including restricted assets) with original maturities of three months or less from the date of acquisition to be cash and cash equivalents.

**Board of Water Supply
City and County of Honolulu
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011**

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 cost 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. When both restricted and unrestricted assets are available for use, it is the BWS's policy to use restricted assets first, then unrestricted assets as they are needed. Restricted assets comprise the following:
- The debt service account accumulates transfers from the operating account throughout the fiscal year to make principal and interest payments on the outstanding water revenue bonds and other notes payable.
 - The renewal and replacement account provides funding for improvements, reconstruction, emergency or extraordinary repairs, and renewals or replacements of the water system.
 - The improvement account holds the proceeds of the series bond issuance pursuant to the series resolution or series certificates. These proceeds are only applied to costs specified in the applicable series resolution or series certificates.
 - The extramural account holds reimbursements received from any governmental agency or private entity, pursuant to negotiated agreements, contracts and/or grants.
- (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 BWS also capitalizes certain indirect costs to construction work based upon actual construction direct labor. Maintenance, repairs, and replacements that do not improve or extend the lives of the assets are charged to expense.

Assets are depreciated over the individual asset's estimated useful life 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, 2012 and 2011**

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 also amortized using the straight-line method over the terms of the respective issues and are added to or offset against the bonds payable in the statements of net 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 BWS 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 BWS's systems, except those developments that have paid for and installed a complete water system, including source, transmission, and daily storage facilities. The amounts collected are initially recorded as customer advances and are recognized as contributions in aid of construction when water service is made available to the customer. The use of these funds is designated for the construction of water facilities.

- (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, 2012 and 2011**

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

- (15) **Revenue Recognition** - The BWS'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 BWS's contributions to the Employees' Retirement System of the State of Hawaii are based upon actuarial computations and include current service costs and amortization of prior service costs. The BWS's policy is to fund pension costs accrued.
- (17) **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 BWS has excluded the Plan's assets and liabilities from the financial statements because the BWS and the City do not have significant administrative involvement in the Plan or perform the investment function for the Plan.

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

The ranges of insurance limits and deductibles are as follows:

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

There have been no significant reductions in insurance coverage's from the prior fiscal year.

- (19) **Reclassification** - Certain amounts in the prior year financial statements have been reclassified for comparative purposes to conform with the presentation in the current year financial statements.

**Board of Water Supply
City and County of Honolulu
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011**

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 City's demand deposits are fully insured or collateralized with securities held by the City or its agents in the City's name.

The HRS authorizes the BWS to invest, with certain restrictions, in obligations of the State of Hawaii or the United States, in federally insured savings accounts, time certificates of deposit, and bank repurchase agreements with federally insured financial institutions authorized to do business in the State of Hawaii.

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

Interest Rate Risk - As a means of limiting its exposure to fair value losses arising from rising interest rates, the BWS invests operating funds primarily in shorter-term securities, money market mutual funds, or similar investment pools.

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

Custodial Credit Risk - Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty to a transaction, the BWS will not be able to recover the value of investments or collateral securities that are in the possession of an outside party. All investments are registered in the name of the BWS and are held in the possession of a broker/dealer firm. At June 30, 2012, approximately \$12,154,200 in cash and cash equivalents and all investments were held by a broker/dealer firm. Cash, cash equivalents and investments held by the broker/dealer firm are insured up to \$500,000, of which up to \$250,000 may be uninvested cash, by the Securities Investor Protection Corporation (SIPC). Excess coverage purchased from a private insurer by the broker/dealer firm is designed to provide additional protection up to the full net equity value of each account.

Concentration of Credit Risk - Concentration of credit risk is the risk of a loss attributed to the magnitude of a government's investment in a single issuer. Financial instruments, which potentially expose the BWS to concentrations of credit risk, consist primarily of investments in debt securities. Concentration of credit risk related to investments in debt securities has been mitigated by limiting such investments to primarily debt obligations of the U.S. government and U.S. government-sponsored enterprises.

**Board of Water Supply
City and County of Honolulu
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011**

NOTE B - CASH AND INVESTMENTS (Continued)

At June 30, 2012 and 2011, investments consisted of the following:

| | 2012 | | 2011 | |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
| | Cost | Fair Value | Cost | Fair Value |
| U. S. government treasury obligations - short-term | \$ 10,308,006 | \$ 10,078,605 | \$ 20,792,968 | \$ 20,624,509 |
| U.S. government agencies short-term | 34,500,544 | 34,391,581 | 19,026,959 | 18,575,920 |
| U. S. government treasury obligations | 57,688,407 | 57,839,792 | 41,515,477 | 41,659,732 |
| U.S. government agencies | 63,502,574 | 62,682,794 | 84,097,035 | 83,472,081 |
| Corporate bonds | -- | -- | 1,095,610 | 1,096,313 |
| | <u>\$ 165,999,531</u> | <u>\$ 164,992,772</u> | <u>\$ 166,528,049</u> | <u>\$ 165,428,555</u> |

At June 30, 2012, credit quality distribution for investments, with credit exposure as a percentage of total investments were as follows:

| | Percent of Total | Fair Value | Credit Quality Rating as of June 30, 2012 | | | |
|--|------------------|-----------------------|---|-------------------|--------------|--------------|
| | | | Aaa | Aa | A | Not Rated |
| U. S. government treasury obligations | 41 % | \$ 67,918,396 | \$ 67,918,396 | \$ -- | \$ -- | \$ -- |
| U.S. government agencies | | | | | | |
| Federal National Mortgage Association | 31 % | 51,163,803 | 50,561,397 | 602,406 | -- | -- |
| Federal Home Loan Mortgage Corporation | 20 % | 33,418,763 | 33,418,763 | -- | -- | -- |
| Federal Home Loan Bank | 7 % | 11,943,745 | 11,943,745 | -- | -- | -- |
| Federal Farm Credit Bank | 1 % | 548,065 | 548,065 | -- | -- | -- |
| | <u>100 %</u> | <u>\$ 164,992,772</u> | <u>\$ 164,390,366</u> | <u>\$ 602,406</u> | <u>\$ --</u> | <u>\$ --</u> |

**Board of Water Supply
City and County of Honolulu
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011**

NOTE B - CASH AND INVESTMENTS (Continued)

At June 30, 2012, the maturities of the investments were as follows:

| | Fair Value | Investment Maturities (In Years) | | | |
|--|-----------------------|----------------------------------|-----------------------|--------------|--------------|
| | | Less Than 1 | 1 - 5 | 6 - 10 | More Than 10 |
| U. S. government treasury obligations - short-term | \$ 10,078,605 | \$ 10,078,605 | \$ -- | \$ -- | \$ -- |
| U.S. government agencies short-term | 34,391,581 | 34,391,581 | -- | -- | -- |
| U. S. government treasury obligations | 57,839,792 | -- | 57,839,792 | -- | -- |
| U.S. government agencies | <u>62,682,794</u> | <u>--</u> | <u>62,682,794</u> | <u>--</u> | <u>--</u> |
| | <u>\$ 164,992,772</u> | <u>\$ 44,470,186</u> | <u>\$ 120,522,586</u> | <u>\$ --</u> | <u>\$ --</u> |

The investments are reflected in the statements of net assets as of June 30, 2012 and 2011 are as follows:

| | 2012 | 2011 |
|---------------------------|-----------------------|-----------------------|
| Investments | | |
| Unrestricted - current | \$ 36,652,935 | \$ 26,034,201 |
| Unrestricted - noncurrent | 100,659,263 | 110,862,238 |
| Restricted | <u>27,680,574</u> | <u>28,532,116</u> |
| Total | <u>\$ 164,992,772</u> | <u>\$ 165,428,555</u> |

NOTE C - RESTRICTED ASSETS

At June 30, 2012 and 2011, restricted assets were held for the following purposes:

| | 2012 | 2011 |
|--|----------------------|----------------------|
| Construction, renewals, and replacements | \$ 2,895,470 | \$ 2,922,776 |
| Debt service | <u>40,467,686</u> | <u>40,584,195</u> |
| | <u>\$ 43,363,156</u> | <u>\$ 43,506,971</u> |

**Board of Water Supply
City and County of Honolulu
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011**

NOTE D - CAPITAL ASSETS

Capital assets activity during 2012 and 2011, were as follows:

| | Balance July 1, 2011 | Additions | Transfers | Retirements | Balance June 30, 2012 |
|--------------------------------|-------------------------|---------------------|------------------------|---------------------|--------------------------|
| Depreciable assets | | | | | |
| Infrastructure | \$ 1,303,009,505 | \$ 10,096,793 | \$ 11,010,691 | \$ (798,819) | \$ 1,323,318,170 |
| Buildings and improvements | 148,085,176 | -- | 1,142,608 | (108,728) | 149,119,056 |
| Equipment and machinery | <u>237,113,104</u> | <u>2,405,327</u> | <u>6,384,183</u> | <u>(2,404,697)</u> | <u>243,497,917</u> |
| Total depreciable assets | 1,688,207,785 | 12,502,120 | 18,537,482 | (3,312,244) | 1,715,935,143 |
| Less accumulated depreciation | <u>(725,640,773)</u> | <u>(43,966,589)</u> | <u>--</u> | <u>2,899,352</u> | <u>(766,708,010)</u> |
| Total depreciable assets - net | 962,567,012 | (31,464,469) | 18,537,482 | (412,892) | 949,227,133 |
| Land | 32,373,064 | -- | -- | -- | 32,373,064 |
| Construction work in progress | <u>162,737,147</u> | <u>30,778,855</u> | <u>(28,731,973)</u> | <u>--</u> | <u>164,784,029</u> |
| Capital assets - net | \$ <u>1,157,677,223</u> | \$ <u>(685,614)</u> | \$ <u>(10,194,491)</u> | \$ <u>(412,892)</u> | \$ <u>1,146,384,226</u> |

| | Balance July 1, 2010 | Additions | Transfers | Retirements | Balance June 30, 2011 |
|--------------------------------|-------------------------|----------------------|------------------------|-----------------------|--------------------------|
| Depreciable assets | | | | | |
| Infrastructure | \$ 1,244,973,961 | \$ 18,917,108 | \$ 42,334,951 | \$ (3,216,515) | \$ 1,303,009,505 |
| Buildings and improvements | 147,577,951 | 452,800 | 78,668 | (24,243) | 148,085,176 |
| Equipment and machinery | <u>231,508,650</u> | <u>4,345,826</u> | <u>2,875,541</u> | <u>(1,616,913)</u> | <u>237,113,104</u> |
| Total depreciable assets | 1,624,060,562 | 23,715,734 | 45,289,160 | (4,857,671) | 1,688,207,785 |
| Less accumulated depreciation | <u>(686,158,609)</u> | <u>(42,532,578)</u> | <u>--</u> | <u>3,050,414</u> | <u>(725,640,773)</u> |
| Total depreciable assets - net | 937,901,953 | (18,816,844) | 45,289,160 | (1,807,257) | 962,567,012 |
| Land | 32,373,064 | -- | -- | -- | 32,373,064 |
| Construction work in progress | <u>187,997,848</u> | <u>32,210,834</u> | <u>(57,471,535)</u> | <u>--</u> | <u>162,737,147</u> |
| Capital assets - net | \$ <u>1,158,272,865</u> | \$ <u>13,393,990</u> | \$ <u>(12,182,375)</u> | \$ <u>(1,807,257)</u> | \$ <u>1,157,677,223</u> |

**Board of Water Supply
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NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011**

NOTE D - CAPITAL ASSETS (Continued)

Depreciation of \$1,590,326 and \$1,285,813 was allocated to various functions and not to depreciation expense in fiscal year 2012 and 2011, respectively.

The BWS received \$51,612 and \$63,890 in proceeds from the sale of capital assets in fiscal year 2012 and 2011, respectively.

NOTE E - BONDS PAYABLE

At June 30, 2012 and 2011, bonds payable consisted of the following:

| | <u>2012</u> | <u>2011</u> |
|---|----------------------------------|--------------------------|
| Water System Revenue Bonds, Series 2001, annual principal due ranging from \$810,000 to \$1,535,000 through July 1, 2021, with interest ranging from 4.5% to 5.5%. These bonds were fully refunded by 2012A series bonds. | \$ -- | \$ 11,780,000 |
| Water System Revenue Bonds, Series 2004, annual principal due ranging from \$2,280,000 to \$2,465,000 through July 1, 2014, with interest ranging from 3.5% to 4%. | 7,110,000 | 79,875,000 |
| Water System Revenue Bonds, Series 2006A, annual principal due commencing July 1, 2012, ranging from \$975,000 to \$11,965,000 through July 1, 2036, with interest ranging from 4% to 5%. | 157,720,000 | 165,195,000 |
| Water System Revenue Bonds, Series 2006B, annual principal due ranging from \$2,335,000 to \$4,455,000 through July 1, 2021, with interest ranging from 5% to 5.25%. | 35,140,000 | 38,110,000 |
| Water System Revenue Bonds, Series 2012A, annual principal due ranging from \$860,000 to \$8,535,000 through July 1, 2033, with interest ranging from 2% to 5%. | <u>85,195,000</u> 285,165,000 | <u>--</u> 294,960,000 |
| Add unamortized premium | 15,526,367 | 5,390,505 |
| Less unamortized discount | -- | (117,027) |
| Less deferred loss on refunding | (9,837,255) | (1,891,801) |
| Less current portion | <u>(7,985,000)</u> | <u>(6,710,000)</u> |
| Noncurrent portion | \$ <u>282,869,112</u> | \$ <u>291,631,677</u> |

**Board of Water Supply
City and County of Honolulu
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011**

NOTE E - BONDS PAYABLE (Continued)

Principal and interest payments on water system revenue bonds are to be paid from the BWS's revenue. Water system revenue bonds are subject to redemption on and after specific dates prior to maturity at the option of the BWS at 100 percent of the principal amount plus accrued interest without premium.

Bonds payable activity during 2012 and 2011, were as follows:

| | Balance July 1, 2011 | Additions | Reductions | Balance June 30, 2012 | Current Portion |
|-----------------------------|-------------------------|----------------------|------------------------|--------------------------|---------------------|
| Water System Revenue Bonds: | | | | | |
| Series 2001 | \$ 11,780,000 | \$ -- | \$ (11,780,000) | \$ -- | \$ -- |
| Series 2004 | 79,875,000 | -- | (72,765,000) | 7,110,000 | 2,280,000 |
| Series 2006A | 165,195,000 | -- | (7,475,000) | 157,720,000 | 975,000 |
| Series 2006B | 38,110,000 | -- | (2,970,000) | 35,140,000 | 2,940,000 |
| Series 2012A | -- | 85,195,000 | -- | 85,195,000 | 1,790,000 |
| | <u>\$ 294,960,000</u> | <u>\$ 85,195,000</u> | <u>\$ (94,990,000)</u> | <u>\$ 285,165,000</u> | <u>\$ 7,985,000</u> |

| | Balance July 1, 2010 | Additions | Reductions | Balance June 30, 2011 | Current Portion |
|-----------------------------|-------------------------|--------------|-----------------------|--------------------------|---------------------|
| Water System Revenue Bonds: | | | | | |
| Series 2001 | \$ 13,250,000 | \$ -- | \$ (1,470,000) | \$ 11,780,000 | \$ 1,535,000 |
| Series 2004 | 82,015,000 | -- | (2,140,000) | 79,875,000 | 2,205,000 |
| Series 2006A | 165,195,000 | -- | -- | 165,195,000 | -- |
| Series 2006B | 40,935,000 | -- | (2,825,000) | 38,110,000 | 2,970,000 |
| | <u>\$ 301,395,000</u> | <u>\$ --</u> | <u>\$ (6,435,000)</u> | <u>\$ 294,960,000</u> | <u>\$ 6,710,000</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> |
|------------------------------------|-----------------------|-----------------------|-----------------------|
| 2013 | \$ 7,985,000 | \$ 12,361,000 | \$ 20,346,000 |
| 2014 | 7,335,000 | 13,011,000 | 20,346,000 |
| 2015 | 7,660,000 | 12,688,000 | 20,348,000 |
| 2016 | 8,005,000 | 12,346,000 | 20,351,000 |
| 2017 | 8,365,000 | 11,984,000 | 20,349,000 |
| 2018 - 2022 | 48,110,000 | 53,634,000 | 101,744,000 |
| 2023 - 2027 | 62,135,000 | 40,503,000 | 102,638,000 |
| 2028 - 2032 | 78,675,000 | 23,863,000 | 102,538,000 |
| 2033 - 2037 | <u>56,895,000</u> | <u>6,494,000</u> | <u>63,389,000</u> |
| Total | <u>\$ 285,165,000</u> | <u>\$ 186,884,000</u> | <u>\$ 472,049,000</u> |

**Board of Water Supply
City and County of Honolulu
NOTES TO FINANCIAL STATEMENTS
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NOTE E - BONDS PAYABLE (Continued)

In February 2001, the BWS created an irrevocable trust with an escrow agent to retire \$32,460,000 of the BWS's outstanding 1992 general obligation water bonds. The escrow agent will pay all future debt service payments on the 1992 Series bonds out of the irrevocable trust. Consequently, the 1992 Series bonds were considered to be defeased and the liability for the bonds was removed from the BWS's financial statements in 2001. At June 30, 2012 and 2011, the outstanding 1992 Series defeased bonds amounted to \$11,520,000 and \$14,005,000, respectively.

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

In March 2012, the BWS issued \$85,195,000 in Series 2012A water system revenue bonds. The proceeds of the issuance were used to refund, on a current basis, all of the BWS's outstanding Series 2001 bonds and to advance refund a portion of the outstanding 2004 Series and 2006A Series bonds. Consequently, a portion of the 2004 Series and 2006A Series bonds were considered defeased and were removed from the BWS's financial statements in 2012. This refunding was undertaken to reduce total debt service payments by \$9,512,024 and resulted in an economic gain of approximately \$7,152,000. At June 30, 2012 and 2011, the outstanding 2004 Series defeased bonds amounted to \$78,665,000 and \$8,105,000 and the outstanding 2006A Series defeased bonds amounted to \$7,475,000 and \$-0-, respectively.

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

NOTE F - NOTES PAYABLE

At June 30, 2012 and 2011, notes payable consisted of the following:

| | <u>2012</u> | <u>2011</u> |
|--|---------------------|---------------------|
| Notes payable to Department of Health | | |
| Note payable in semi-annual installments of approximately \$56,100, including interest at .10%, secured by net revenues of the BWS, due June 2025. | \$ <u>1,460,973</u> | \$ <u>1,560,194</u> |
| Balance forward | \$ <u>1,460,973</u> | \$ <u>1,560,194</u> |

**Board of Water Supply
City and County of Honolulu
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011**

NOTE F - NOTES PAYABLE (Continued)

| | <u>2012</u> | <u>2011</u> |
|---|----------------------|----------------------|
| Balance carried forward | \$ 1,460,973 | \$ 1,560,194 |
| Notes payable to Department of Health (Continued) | | |
| Note payable in semi-annual installments of approximately \$104,400, including interest at .31%, secured by net revenues of the BWS, due November 2025. | 2,759,596 | 2,959,439 |
| Note payable in semi-annual installments of approximately \$10,200, including interest at .10%, secured by net revenues of the BWS, due January 2027. | 294,411 | 314,564 |
| Note payable in semi-annual installments of approximately \$302,500 including interest at .10%, secured by net revenues of the BWS, due February 2026. | 8,409,892 | 9,006,109 |
| Non-interest bearing payable in semi-annual installments of approximately \$74,900, secured by net revenues of the BWS, due September 2025. | 2,023,734 | 2,173,640 |
| Note payable in semi-annual installments of approximately \$32,500 including interest at .01%, secured by net revenues of the BWS, due March 2028. | 1,039,390 | 1,104,297 |
| Note payable in semi-annual installments of approximately \$70,200 including interest at .01%, secured by net revenues of the BWS, due August 2027. | 2,175,245 | 2,315,472 |
| Note payable in semi-annual installments of approximately \$49,700 including interest at .01%, secured by net revenues of the BWS, due March 2028. | <u>1,589,316</u> | <u>1,688,563</u> |
| Balance forward | \$ <u>19,752,557</u> | \$ <u>21,122,278</u> |

**Board of Water Supply
City and County of Honolulu
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011**

NOTE F - NOTES PAYABLE (Continued)

| | <u>2012</u> | <u>2011</u> |
|--|--------------------------------|--------------------------------|
| Balance carried forward | \$ 19,752,557 | \$ 21,122,278 |
| Notes payable to Department of Health (Continued) | | |
| Note payable in semi-annual installments of approximately \$36,100 including interest at .36%, secured by net revenues of the BWS, due June 2028. | 1,120,118 | 1,188,078 |
| Non-interest bearing principal forgiveness notes secured by net revenues of the BWS. | -- | 9,140,265 |
| Notes payable to other lenders | | |
| Note payable in annual installments of \$188,570, including interest at 5%, due September 2025. Each annual installment is divided into 12 monthly payments of principal and interest of \$15,715. | <u>1,791,189</u> 22,663,864 | <u>1,885,485</u> 33,336,106 |
| Less current maturities | <u>1,540,637</u> | <u>1,533,389</u> |
| | \$ <u>21,123,227</u> | \$ <u>31,802,717</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> |
|------------------------------------|----------------------|-------------------|----------------------|
| 2013 | \$ 1,540,637 | \$ 112,400 | \$ 1,653,037 |
| 2014 | 1,557,300 | 105,800 | 1,663,100 |
| 2015 | 1,564,100 | 99,000 | 1,663,100 |
| 2016 | 1,571,200 | 91,900 | 1,663,100 |
| 2017 | 1,578,600 | 84,500 | 1,663,100 |
| 2018-2022 | 8,014,100 | 301,400 | 8,315,500 |
| 2023-2027 | 6,532,700 | 75,300 | 6,608,000 |
| 2028 | <u>305,227</u> | <u>200</u> | <u>305,427</u> |
| | \$ <u>22,663,864</u> | \$ <u>870,500</u> | \$ <u>23,534,364</u> |

**Board of Water Supply
City and County of Honolulu
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011**

NOTE G - OTHER LONG-TERM LIABILITIES

The following is a summary of changes in other long-term liabilities during the fiscal years ended June 30, 2012 and 2011:

| | Balance July 1, 2011 | Additions | Reductions | Balance June 30, 2012 | Current Portion |
|------------------------------------|-------------------------|----------------------|------------------------|--------------------------|---------------------|
| Customer advances | \$ 2,210,966 | \$ 6,055,440 | \$ (6,878,498) | \$ 1,387,908 | \$ -- |
| Accrued vacation | 5,849,194 | 1,983,631 | (1,611,211) | 6,221,614 | 1,611,211 |
| Accrued workers' compensation | 2,235,157 | 1,140,112 | (981,720) | 2,393,549 | -- |
| Other postemployment benefits | 1,008,000 | 10,759,000 | (11,755,000) | 12,000 | -- |
| Accrued arbitrage rebate liability | 954,413 | -- | (905,540) | 48,873 | -- |
| Other | 1,704,062 | 1,216,123 | (589,340) | 2,330,845 | -- |
| | <u>\$ 13,961,792</u> | <u>\$ 21,154,306</u> | <u>\$ (22,721,309)</u> | <u>\$ 12,394,789</u> | <u>\$ 1,611,211</u> |

| | Balance July 1, 2010 | Additions | Retirements | Balance June 30, 2011 | Current Portion |
|------------------------------------|-------------------------|----------------------|------------------------|--------------------------|---------------------|
| Customer advances | \$ 1,872,552 | \$ 5,234,046 | \$ (4,895,632) | \$ 2,210,966 | \$ -- |
| Accrued vacation | 6,713,360 | 1,011,781 | (1,875,947) | 5,849,194 | 1,875,947 |
| Accrued workers' compensation | 1,910,131 | 1,285,551 | (960,525) | 2,235,157 | -- |
| Other postemployment benefits | 2,921,377 | 10,426,000 | (12,339,377) | 1,008,000 | -- |
| Accrued arbitrage rebate liability | 1,137,568 | -- | (183,155) | 954,413 | -- |
| Other | 1,652,698 | 540,465 | (489,101) | 1,704,062 | -- |
| | <u>\$ 16,207,686</u> | <u>\$ 18,497,843</u> | <u>\$ (20,743,737)</u> | <u>\$ 13,961,792</u> | <u>\$ 1,875,947</u> |

NOTE H - NET ASSETS

At June 30, 2012 and 2011, net assets consisted of the following:

| | 2012 | 2011 |
|--|-----------------------|-----------------------|
| Invested in capital assets - net of related debt | | |
| Capital assets - net | \$ 1,146,384,226 | \$ 1,157,677,223 |
| Less water system revenue bonds payable, noncurrent portion | (282,869,112) | (291,631,677) |
| Less other loans payable | <u>(21,123,227)</u> | <u>(31,802,717)</u> |
| | <u>\$ 842,391,887</u> | <u>\$ 834,242,829</u> |

**Board of Water Supply
City and County of Honolulu
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011**

NOTE H - NET ASSETS (Continued)

| | <u>2012</u> | <u>2011</u> |
|--|-------------------------|-------------------------|
| Restricted for capital activity and debt service | | |
| Restricted cash and cash equivalents | \$ 15,682,582 | \$ 14,974,855 |
| Restricted investments | 27,680,574 | 28,532,116 |
| Less | | |
| Contracts payable, including retainages | (1,172,195) | (2,057,177) |
| Accrued interest payable | (5,955,485) | (7,297,300) |
| Bonds payable, current portion | (7,985,000) | (6,710,000) |
| Notes payable, current portion | (1,540,637) | (1,533,389) |
| Other payable from restricted assets | (300,160) | (300,160) |
| | <u>26,409,679</u> | <u>25,608,945</u> |
| Unrestricted | <u>160,118,889</u> | <u>149,682,574</u> |
| | <u>\$ 1,028,920,455</u> | <u>\$ 1,009,534,348</u> |

NOTE I - LEASES

The BWS leases certain properties to other users, primarily utility and telecommunications companies, under multi-year license agreements. The terms of these agreements range from 5 to 30 years. The agreements are generally based on fixed annual amounts, with provisions for increases. Information regarding the cost and related accumulated depreciation of these facilities, which is required to be disclosed by professional standards, 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 and the long period of time over which the properties were acquired.

The BWS 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, 2012 and 2011**

NOTE I - LEASES (Continued)

The future minimum rental payments and sublease income from these operating leases at June 30, 2012, 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 Rental (Income) Expense</u> |
|------------------------------------|---|-------------------------------------|---|
| 2013 | \$ 170,100 | \$ 158,600 | \$ 11,500 |
| 2014 | 148,300 | 158,600 | (10,300) |
| 2015 | 146,500 | 158,600 | (12,100) |
| 2016 | 137,300 | 158,600 | (21,300) |
| 2017 | 116,600 | 158,600 | (42,000) |
| 2018-2022 | 500,000 | 792,800 | (292,800) |
| 2023-2027 | 500,000 | 508,700 | (8,700) |
| 2028-2032 | 450,000 | -- | 450,000 |
| | <u>\$ 2,168,800</u> | <u>\$ 2,094,500</u> | <u>\$ 74,300</u> |

NOTE J - RELATED PARTY TRANSACTIONS

Billing and Collection Services - The BWS has an agreement with the Department of Environmental Services, City and County of Honolulu to provide certain services relating to the billing and collection of sewer service charges. Fees related to these services were negotiated at approximately \$1,422,300 and \$1,421,400 for the fiscal years ended June 30, 2012 and 2011, respectively. 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 - The BWS has an agreement with the City to pay a Central Administrative Services Expense (CASE) fee for treasury, personnel, purchasing, and other services that the City provides to the BWS on an on-going basis. The BWS's Charter allows for a CASE fee to the extent that it represents a reasonable charge for services necessary for the BWS to perform its duties. As of June 30, 2012 and 2011, CASE fees totaled \$3,300,000.

Amount from the City - Amounts due from the City approximated \$423,860 and \$2,115,798 as of June 30, 2012 and 2011, respectively, and is included in other receivables.

Joint Construction Projects - The BWS has entered into agreements on projects for which the City has advanced amounts. During the fiscal years ended June 30, 2012 and 2011, the City advanced approximately \$928,325 and \$186,579 respectively, to the BWS for the City's share of total project expenses. At June 30, 2012 and 2011, approximately \$1,161,883 and \$1,355,136, respectively, of these funds have not been expended. Accordingly, the balances are included in other liabilities in the accompanying statements of net assets.

**Board of Water Supply
City and County of Honolulu
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011**

NOTE K - EMPLOYEE BENEFIT PLANS

Defined Benefit Pension Plan

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

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

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

Most covered employees under the contributory plan are required to contribute 7.8% of their salary. Prior to July 1, 2005, the funding method used to calculate the total employer contribution requirement was the Entry Age Normal Actuarial Cost Method. Under this method, employer contributions to the ERS were comprised of normal cost plus level annual payments required to liquidate the unfunded actuarial liability over the remaining period of 29 years from July 1, 2000. Effective July 1, 2008, employer contribution rates are a fixed percentage of compensation, generally 15.0% for most covered employees. The BWS's contributions to the ERS as of June 30, 2012, 2011, and 2010, were approximately \$4,405,000, \$4,540,000, and \$4,866,000, respectively, which represented approximately 15% of the BWS's covered payroll for the fiscal years ended June 30, 2012, 2011, and 2010, respectively.

The 2004 State of Hawaii legislative sessions approved a hybrid retirement plan, which took effect on July 1, 2006. Employees who chose to be under this plan are required to contribute 6.0% of their salary and will receive pensions based on a 2.0% benefit formula instead of a 1.25% benefit formula under the current noncontributory plan. The hybrid plan does not affect the BWS's contributions to the ERS.

**Board of Water Supply
City and County of Honolulu
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011**

NOTE K - EMPLOYEE BENEFIT PLANS (Continued)

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

Post-Retirement Health Care and Life Insurance Benefits

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

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

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

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

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

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

**Board of Water Supply
City and County of Honolulu
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011**

NOTE K - EMPLOYEE BENEFIT PLANS (Continued)

For the fiscal years ended June 30, 2012, 2011 and 2010, the components of the BWS's annual OPEB costs, the amounts contributed to the plan and the changes to the BWS's net OPEB obligation are summarized as follows:

| | 2012 | 2011 | 2010 | 2009 |
|---|---------------------|---------------------|---------------------|---------------------|
| Annual required contribution | \$ 10,750,000 | \$ 10,387,000 | \$ 7,837,000 | \$ 7,577,000 |
| Interest on net OPEB obligation | 53,000 | 191,000 | 131,000 | 101,000 |
| Adjustment to annual required contribution | <u>(44,000)</u> | <u>(152,000)</u> | <u>(106,000)</u> | <u>(78,000)</u> |
| Annual OPEB cost | 10,759,000 | 10,426,000 | 7,862,000 | 7,600,000 |
| Contributions made | <u>(11,755,000)</u> | <u>(12,339,000)</u> | <u>(8,773,000)</u> | <u>(5,206,000)</u> |
| Increase (decrease) in net OPEB obligation | (996,000) | (1,913,000) | (911,000) | 2,394,000 |
| Net OPEB obligation at beginning of fiscal year | <u>1,008,000</u> | <u>2,921,000</u> | <u>3,832,000</u> | <u>1,438,000</u> |
| Net OPEB obligation at end of fiscal year | \$ <u>12,000</u> | \$ <u>1,008,000</u> | \$ <u>2,921,000</u> | \$ <u>3,832,000</u> |
| Percentage of annual OPEB cost contributed | 109% | 118% | 112% | 69% |

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

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

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

**Board of Water Supply
City and County of Honolulu
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011**

NOTE K - EMPLOYEE BENEFIT PLANS (Continued)

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

In the July 1, 2011, actuarial valuation, the entry age normal actuarial cost method was used. The actuarial assumptions included a discount rate of 7%, projected salary increases of 3.5%, and an annual health cost trend rate of 8%, reduced by decrements to an ultimate rate of 6% after 8 years. The unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll amounts over a thirty-year closed period ending June 30, 2037.

The EUTF issues a stand-alone financial report that includes financial statements and required supplementary information, which may be obtained at the following address: State of Hawaii Employer-Union Health Benefits Trust Fund, 201 Merchant Street, Suite 1520, Honolulu, Hawaii 96813.

NOTE L - COMMITMENTS

At June 30, 2012 and 2011, accumulated sick leave aggregated approximately \$17,840,000 and \$17,730,000, respectively. Sick leave accumulates at the rate of one and three-quarters working days for each month of service without limit, but can be taken only in the event of illness and is not convertible to pay upon termination of employment. However, an employee who retires or leaves government service in good standing with 60 or more unused sick days is entitled to additional service credit in the ERS.

Other commitments, primarily for utility plant construction, approximated \$89,590,000 and \$66,430,000 at June 30, 2012 and 2011, respectively. Such amounts are to be funded by operating revenues, contributed capital, cash and investments on hand.

NOTE M - CONTINGENCIES

Workers' Compensation Self-Insurance Liability

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

**Board of Water Supply
City and County of Honolulu
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011**

NOTE M - CONTINGENCIES (Continued)

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. The estimated liability is presented at its net present value using a discount rate of 3%.

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

Arbitrage

The BWS is required to annually calculate rebates to the U.S. Treasury on revenue bond issues. In accordance with the requirements of Section 148 of the Internal Revenue Code of 1986, as amended, rebates are calculated by bond series based on the amounts by which the cumulative amount of investment income exceeds the amount that would have been earned had funds been invested at the bond yield. At June 30, 2012 and 2011, the arbitrage rebate and yield restriction liability totaled \$48,873 and \$954,413, respectively.

Determination of the arbitrage liability is a significant estimate. It is reasonably possible that one or more future events could result in a material change in the liability in the near term.

Safe Drinking Water

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

Other Legal Matters

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

SUPPLEMENTARY INFORMATION

**Board of Water Supply
City and County of Honolulu
Required Supplementary Information
SCHEDULE OF FUNDING PROGRESS
June 30, 2012**

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

**Board of Water Supply
City and County of Honolulu
SCHEDULE OF BONDS PAYABLE
June 30, 2012**

| | <u>Interest Rate</u> | <u>Bond Dated</u> | <u>Maturing Serially From</u> | <u>Call Dates (1)</u> | <u>Outstanding June 30, 2012</u> |
|----------------------------|----------------------|-------------------|-----------------------------------|-----------------------|--------------------------------------|
| Water System Revenue Bonds | | | | | |
| Series 2004 | | | | | |
| Insured Serial Bonds: | | | | | |
| | 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) | <u>2,465,000</u> |
| | | | | | <u>\$ 7,110,000</u> |

(1) Call dates indicated are optional.

(2) Noncallable.

**Board of Water Supply
City and County of Honolulu
SCHEDULE OF BONDS PAYABLE (Continued)
June 30, 2012**

| | <u>Interest Rate</u> | <u>Bond Dated</u> | <u>Maturing Serially From</u> | <u>Call Dates (1)</u> | <u>Outstanding June 30, 2012</u> |
|----------------------------|----------------------|-------------------|-----------------------------------|-----------------------|--------------------------------------|
| Water System Revenue Bonds | | | | | |
| Series 2006A (Non-AMT) | | | | | |
| Insured Serial Bonds: | | | | | |
| | 4.000% | 7/7/2006 | 7/1/2012 | (2) | \$ 975,000 |
| | 4.000% | 7/7/2006 | 7/1/2013 | (2) | 1,015,000 |
| | 4.000% | 7/7/2006 | 7/1/2014 | (2) | 1,050,000 |
| | 4.250% | 7/7/2006 | 7/1/2015 | (2) | 3,660,000 |
| | 4.250% | 7/7/2006 | 7/1/2016 | (2) | 3,820,000 |
| | 4.000% | 7/7/2006 | 7/1/2017 | (2) | 3,000,000 |
| | 4.125% | 7/7/2006 | 7/1/2017 | (2) | 975,000 |
| | 4.200% | 7/7/2006 | 7/1/2018 | (2) | 1,185,000 |
| | 5.000% | 7/7/2006 | 7/1/2019 | 7/1/2016 | 595,000 |
| | 4.125% | 7/7/2006 | 7/1/2019 | (2) | 645,000 |
| | 4.125% | 7/7/2006 | 7/1/2020 | (2) | 1,290,000 |
| | 5.000% | 7/7/2006 | 7/1/2021 | 7/1/2016 | 960,000 |
| | 4.300% | 7/7/2006 | 7/1/2021 | (2) | 390,000 |
| | 4.500% | 7/7/2006 | 7/1/2022 | (2) | 2,740,000 |
| | 4.500% | 7/7/2006 | 7/1/2023 | (2) | 8,225,000 |
| | 4.500% | 7/7/2006 | 7/1/2024 | (2) | 8,595,000 |
| | 5.000% | 7/7/2006 | 7/1/2025 | 7/1/2016 | 9,010,000 |
| | 5.000% | 7/7/2006 | 7/1/2026 | 7/1/2016 | 9,470,000 |
| | 4.500% | 7/7/2006 | 7/1/2027 | (2) | 9,925,000 |
| Insured Term Bonds: | 4.750% | 7/7/2006 | 7/1/2028 | 7/1/2016 | 10,390,000 |
| | 4.750% | 7/7/2006 | 7/1/2029 | 7/1/2016 | 10,890,000 |
| | 4.750% | 7/7/2006 | 7/1/2030 | 7/1/2016 | 11,420,000 |
| | 4.750% | 7/7/2006 | 7/1/2031 | 7/1/2016 | 11,965,000 |
| | 5.000% | 7/7/2006 | 7/1/2032 | 7/1/2016 | 8,220,000 |
| | 5.000% | 7/7/2006 | 7/1/2033 | 7/1/2016 | 8,640,000 |
| | 5.000% | 7/7/2006 | 7/1/2034 | 7/1/2016 | 9,080,000 |
| | 5.000% | 7/7/2006 | 7/1/2035 | 7/1/2016 | 9,550,000 |
| | 5.000% | 7/7/2006 | 7/1/2036 | 7/1/2016 | 10,040,000 |
| | | | | | <u>\$ 157,720,000</u> |

(1) Call dates indicated are optional.

(2) Noncallable.

**Board of Water Supply
City and County of Honolulu
SCHEDULE OF BONDS PAYABLE (Continued)
June 30, 2012**

| | <u>Interest Rate</u> | <u>Bond Dated</u> | <u>Maturing Serially From</u> | <u>Call Dates (1)</u> | <u>Outstanding June 30, 2012</u> |
|----------------------------|----------------------|-------------------|-----------------------------------|-----------------------|--------------------------------------|
| Water System Revenue Bonds | | | | | |
| Series 2006B (AMT) | | | | | |
| Insured Serial Bonds: | | | | | |
| | 5.000% | 7/7/2006 | 7/1/2012 | (2) | \$ 2,940,000 |
| | 5.000% | 7/7/2006 | 7/1/2013 | (2) | 3,095,000 |
| | 5.000% | 7/7/2006 | 7/1/2014 | (2) | 3,255,000 |
| | 5.000% | 7/7/2006 | 7/1/2015 | (2) | 3,430,000 |
| | 5.000% | 7/7/2006 | 7/1/2016 | (2) | 3,605,000 |
| | 5.250% | 7/7/2006 | 7/1/2017 | 7/1/2016 | 3,800,000 |
| | 5.250% | 7/7/2006 | 7/1/2018 | 7/1/2016 | 4,005,000 |
| | 5.250% | 7/7/2006 | 7/1/2019 | 7/1/2016 | 4,220,000 |
| | 5.250% | 7/7/2006 | 7/1/2020 | 7/1/2016 | 4,455,000 |
| | 5.250% | 7/7/2006 | 7/1/2021 | 7/1/2016 | <u>2,335,000</u> |
| | | | | | \$ <u>35,140,000</u> |

(1) Call dates indicated are optional.

(2) Noncallable.

**Board of Water Supply
City and County of Honolulu
SCHEDULE OF BONDS PAYABLE (Continued)
June 30, 2012**

| | <u>Interest Rate</u> | <u>Bond Dated</u> | <u>Maturing Serially From</u> | <u>Call Dates (1)</u> | <u>Outstanding June 30, 2012</u> |
|--|----------------------|-------------------|-----------------------------------|-----------------------|--------------------------------------|
| Water System Revenue Bonds: | | | | | |
| Series 2012A | | | | | |
| Serial Bonds: | | | | | |
| | 2.00% | 3/29/2012 | 7/1/2012 | (2) | \$ 1,790,000 |
| | 3.00% | 3/29/2012 | 7/1/2013 | (2) | 860,000 |
| | 3.00% | 3/29/2012 | 7/1/2014 | (2) | 890,000 |
| | 3.00% | 3/29/2012 | 7/1/2015 | (2) | 915,000 |
| | 3.00% | 3/29/2012 | 7/1/2016 | (2) | 940,000 |
| | 3.00% | 3/29/2012 | 7/1/2017 | (2) | 970,000 |
| | 4.00% | 3/29/2012 | 7/1/2018 | (2) | 3,960,000 |
| | 5.00% | 3/29/2012 | 7/1/2019 | (2) | 4,140,000 |
| | 5.00% | 3/29/2012 | 7/1/2020 | (2) | 2,320,000 |
| | 5.00% | 3/29/2012 | 7/1/2021 | (2) | 6,865,000 |
| | 5.00% | 3/29/2012 | 7/1/2022 | (2) | 8,535,000 |
| | 5.00% | 3/29/2012 | 7/1/2023 | 7/1/2022 | 3,605,000 |
| | 5.00% | 3/29/2012 | 7/1/2024 | 7/1/2022 | 3,790,000 |
| | 5.00% | 3/29/2012 | 7/1/2025 | 7/1/2022 | 3,980,000 |
| | 5.00% | 3/29/2012 | 7/1/2026 | 7/1/2022 | 4,185,000 |
| | 4.50% | 3/29/2012 | 7/1/2027 | 7/1/2022 | 4,390,000 |
| | 4.50% | 3/29/2012 | 7/1/2028 | 7/1/2022 | 4,595,000 |
| | 4.50% | 3/29/2012 | 7/1/2029 | 7/1/2022 | 4,805,000 |
| | 4.50% | 3/29/2012 | 7/1/2030 | 7/1/2022 | 5,025,000 |
| | 5.00% | 3/29/2012 | 7/1/2031 | 7/1/2022 | 5,270,000 |
| | 5.00% | 3/29/2012 | 7/1/2032 | 7/1/2022 | 5,540,000 |
| | 5.00% | 3/29/2012 | 7/1/2033 | 7/1/2022 | 5,825,000 |
| Bifurcated Serial Bonds: | 2.00% | 3/29/2012 | 7/1/2020 | (2) | <u>2,000,000</u> |
| | | | | | <u>85,195,000</u> |
| (1) Call dates indicated are optional. | | | | | \$ <u>285,165,000</u> |
| (2) Noncallable. | | | | | |

**Board of Water Supply
City and County of Honolulu
SCHEDULE OF NET REVENUE REQUIREMENT
Fiscal Years Ended June 30, 2012 and 2011**

| | <u>2012</u> | <u>2011</u> |
|---|----------------------|----------------------|
| REVENUES | | |
| Water sales | \$ 155,819,396 | \$ 146,287,716 |
| Interest | 2,902,587 | 3,929,911 |
| Other | <u>4,136,502</u> | <u>4,308,910</u> |
| Total revenues | <u>162,858,485</u> | <u>154,526,537</u> |
| DEDUCTIONS | | |
| Operating expenses | 158,723,650 | 151,833,290 |
| Less depreciation expense | <u>(43,966,589)</u> | <u>(42,532,578)</u> |
| Total deductions | <u>114,757,061</u> | <u>109,300,712</u> |
| Net revenues | \$ <u>48,101,424</u> | \$ <u>45,225,825</u> |
| NET REVENUE REQUIREMENT | | |
| Greater of: | | |
| 1) Aggregate debt service | \$ 20,726,065 | \$ 20,923,074 |
| Required deposits | <u>--</u> | <u>--</u> |
| | \$ <u>20,726,065</u> | \$ <u>20,923,074</u> |
| 2) Aggregate debt service | \$ 20,726,065 | \$ 20,923,074 |
| | x <u>1.20</u> | x <u>1.20</u> |
| | \$ <u>24,871,278</u> | \$ <u>25,107,689</u> |
| Net revenue requirement | \$ <u>24,871,278</u> | \$ <u>25,107,689</u> |
| Net revenue to aggregate debt service ratio | <u>2.32</u> | <u>2.16</u> |

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

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

We have audited the financial statements of the Board of Water Supply, City and County of Honolulu, (the BWS), as of and for the fiscal year ended June 30, 2012, and have issued our report thereon dated October 23, 2012. 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.

Internal Control Over Financial Reporting

Management of the BWS is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the BWS's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the BWS's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the BWS's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the BWS's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the BWS's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 or other matters that are required to be reported under *Government Auditing Standards*.

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.

N&K CPAs, Inc.

Honolulu, Hawaii
October 23, 2012