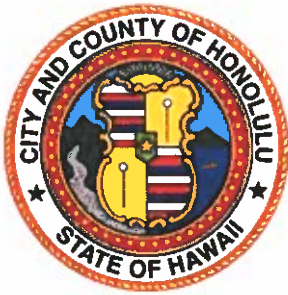




**Office of the City Auditor**



**City and County of  
Honolulu  
State of Hawai`i**

# **City and County of Honolulu Sewer Fund**

**Financial Statements and Supplemental Schedules  
June 30, 2017 and 2016**

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A Hawaii Limited Liability Partnership

## **Independent Auditor's Report**

To the Chair and Members of the City Council  
City and County of Honolulu

### **Report on the Financial Statements**

We have audited the accompanying financial statements of the City and County of Honolulu, Sewer Fund (Sewer Fund) which comprise the statements of net position as of June 30, 2017 and 2016, and the related statements of revenues, expenses, and changes in net position and cash flows for the years then ended and the related notes to the financial statements, which collectively comprise the Sewer Fund's basic financial statements as listed in the table of contents.

### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor's Responsibility**

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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Sewer Fund as of June 30, 2017 and 2016, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

### **Emphasis of Matter**

As discussed in Note 1, the financial statements referred to above include only the financial activities of the Sewer Fund, and are not intended to present fairly the financial position of the City and County of Honolulu as of June 30, 2017 and 2016, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

As discussed in Note 2, in 2017 the Sewer Fund adopted Governmental Accounting Standards Board (GASB) Statement No. 82 (GASB 82) *Pension Issues – An amendment of GASB Statements No. 67, No. 68, and No. 73*. As a result of adopting this standard, the Sewer Fund has restated the financial statements for the year ended June 30, 2016. Our opinion is not modified with respect to this matter.

### **Other Matter**

#### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 4 through 9 and the schedule of City's proportionate share of the net pension liability, schedule of contributions, notes to schedule of City's proportionate share of the net pension liability and schedule of funding progress on pages 42, 43, 44, and 45, respectively, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Government 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.

KMH LLP

KMH LLP

Honolulu, Hawaii  
December 13, 2017

# City and County of Honolulu, Sewer Fund

Management's Discussion and Analysis  
June 30, 2017 and 2016

The following summary discussion and analysis of the financial statements for the fiscal years ended June 30, 2017 and 2016 are provided by the City and County of Honolulu's wastewater enterprise (Wastewater Enterprise). The summary is designed to provide an introduction to the Sewer Fund financial statements and the financial condition of the Wastewater Enterprise. We encourage readers to also review the financial statements as a whole.

## Financial Highlights

- 116.9 million gallons per day of wastewater were collected and treated in fiscal year 2017, an increase of 3.5% from fiscal year 2016. There were 113.0 million gallons per day of wastewater collected and treated in fiscal year 2016, 7.3% more than fiscal year 2015. As of June 30, 2017, the Wastewater Enterprise had approximately 147,000 customer accounts and served approximately 780,000 residents.
- Total assets and deferred outflows of resources were \$4,449.2 million and exceeded total liabilities and deferred inflows of resources by \$1,827.9 million as of June 30, 2017. As of June 30, 2016, total assets and deferred outflows of resources were \$3,978.9 million and exceeded total liabilities and deferred inflows of resources by \$1,621.2 million. As of June 30, 2017, net position (difference between assets, deferred inflows/outflows of resources, and liabilities) increased by \$206.7 million, or 12.7%, from June 30, 2016, while net position at June 30, 2016, increased by \$174.3 million, or 12.0%, from June 30, 2015. The increase in net position in 2017 and 2016 was due to increased current and capital assets.
- As of June 30, 2017, total assets increased by \$418.3 million to \$4,347.5 million, representing a 10.7% increase from the prior fiscal year, while total assets increased by \$332.5 million to \$3,929.2 million at June 30, 2016, representing a 9.2% increase from June 30, 2015. The increase in fiscal year 2017 and 2016 was due to additional capital assets and current assets.
- Total current and restricted assets increased by 22.3% or \$249.5 million to \$1,368.9 million at June 30, 2017, while total current and restricted assets increased by 17.5% or \$166.9 million to \$1,119.4 million at June 30, 2016. The increase in 2017 and 2016 was primarily due to revenue bond proceeds and increased sewer service charge revenues.
- Total current liabilities increased by 16.5% or \$27.8 million to \$196.7 million primarily due to an increase in bonds and accounts payable. At June 30, 2017, total liabilities increased 11.3% or \$263.2 million to \$2,601.9 million due to an increase in net pension liability and bonds payable. At June 30, 2016, total current liabilities increased by 9.0% or \$13.9 million to \$168.8 million primarily due to an increase in interest and bonds payable. Total liabilities also increased by 7.9% or \$171.4 million to \$2,338.7 million due to an increase in bonds payable.

# City and County of Honolulu, Sewer Fund

Management's Discussion and Analysis  
June 30, 2017 and 2016

- Due to the implementation of Government Accounting Standards (GASB) No. 82, *Pension Issues – An Amendment of GASB Statements No. 67, No. 68, and No. 73*, during fiscal year 2017, the 2016 and 2015 financial statements have been restated retroactively for the management's discussion and analysis. Implementation of GASB No. 82 resulted in a prior year adjustment of \$3.1 million to the July 1, 2015 net position.

## Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Wastewater Enterprise's financial statements, which consist of the basic financial statements and notes to the financial statements.

**Basic financial statements.** The basic financial statements are designed to provide readers with a broad overview of the Wastewater Enterprise's finances, in a manner similar to a private-sector business.

The statements of net position presents information on the Wastewater Enterprise's assets, liabilities, and deferred inflows and outflows of resources with the difference reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the Wastewater Enterprise is improving or deteriorating. Net position increases when revenues and subsidies exceed expenses. Increases to assets without a corresponding increase to liabilities, result in increased net position, which indicates an improved financial position.

The statements of revenues, expenses, and changes in net position present information showing how the Wastewater Enterprise's net position changed during the past two fiscal years. All changes in net position are reported as soon as the underlying event occurs, regardless of timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods (e.g., earned but unused vacation leave).

The statements of cash flows present changes in cash and cash equivalents, resulting from operating, financing, and investing activities. This statement presents cash receipts and cash disbursements information, without consideration of the earnings event, when an obligation arises, or depreciation of capital assets.

**Notes to the financial statements.** The notes provide additional information that is essential to a full understanding of the data provided in the basic financial statements.

## City and County of Honolulu, Sewer Fund

Management's Discussion and Analysis  
June 30, 2017 and 2016

### Financial Analysis

The following are the highlights of the condensed statements of net position (in thousands of dollars) for the Wastewater Enterprise:

	<b>Statements of Net Position</b>		
	2017	2016 (As Restated)	2015
<b>Assets:</b>			
Current assets	\$ 1,121,172	\$ 963,355	\$ 837,396
Restricted assets	247,765	156,042	115,089
Capital assets, net	2,978,459	2,809,572	2,642,920
Other noncurrent assets	135	265	1,314
Deferred Outflows of Resources	101,631	49,694	31,683
Total assets and deferred outflows	<u>\$ 4,449,162</u>	<u>\$ 3,978,928</u>	<u>\$ 3,628,402</u>
<b>Liabilities:</b>			
Current liabilities	\$ 196,658	\$ 168,837	\$ 154,915
Noncurrent liabilities	2,405,223	2,169,880	2,012,361
Deferred Inflows of Resources	19,343	19,034	14,224
Total liabilities and deferred inflows	<u>2,621,224</u>	<u>2,357,751</u>	<u>2,181,500</u>
Net investment in capital assets	874,926	785,313	713,781
Restricted for debt service	165,226	174,514	181,029
Unrestricted	787,786	661,350	552,092
Total net position	<u>1,827,938</u>	<u>1,621,177</u>	<u>1,446,902</u>
Total liabilities, deferred inflows, and net position	<u>\$ 4,449,162</u>	<u>\$ 3,978,928</u>	<u>\$ 3,628,402</u>

### Net position

Net position (the difference between assets, liabilities, and deferred inflows/outflows of resources) may serve, over time, as a useful indicator of a government's financial position. In the case of the Wastewater Enterprise, assets and deferred outflows of resources exceeded liabilities by \$1,827.9 million and \$1,621.2 million at the end of fiscal years 2017 and 2016, respectively. Additions of capital assets resulted in a 12.8% increase in net position from fiscal year 2016 to 2017. The largest portion of the Wastewater Enterprise's net position represented its investment in capital assets (e.g., land, buildings, transmission and distribution system, etc.). The Wastewater Enterprise uses these capital assets to provide wastewater services on the Island of Oahu and consequently, capital assets are not available to liquidate liabilities or other spending.



## City and County of Honolulu, Sewer Fund

Management's Discussion and Analysis  
June 30, 2017 and 2016

The following are the highlights of the condensed statements of revenues, expenses and changes in net position (in thousands of dollars):

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

	2017	2016 (As Restated)	2015
Operating revenues	\$ 458,773	\$ 423,798	\$ 397,389
Operating expenses	(194,609)	(188,033)	(191,658)
Operating income	264,164	235,765	205,731
Nonoperating revenues (expenses)			
Interest income	7,718	3,432	1,196
Interest expense	(52,061)	(51,542)	(60,541)
Other	2,934	2,724	4,834
Income before transfers and capital contributions	222,755	190,379	151,220
Transfers out	(16,199)	(13,426)	(13,805)
Capital contributions	205	424	782
Change in net position	206,761	177,377	138,197
Net position			
Beginning of year, as previously reported	1,621,177	1,446,902	1,401,624
Restatement due to change in accounting principle	-	(3,102)	(92,919)
Beginning of year, as restated	1,621,177	1,443,800	1,308,705
End of year	<u>\$ 1,827,938</u>	<u>\$ 1,621,177</u>	<u>\$ 1,446,902</u>

The changes in net position were primarily due to:

- Operating revenues, comprised mainly of sewer service charges, increased 8.3% to \$458.8 million for the fiscal year 2017 compared to the prior fiscal year and increased 6.6% to \$423.8 million for fiscal year 2016 compared to fiscal year 2015. Sewer service charge rates were raised 8 percent July 1, 2016.
- Operating expenses increased \$6.6 million or 3.5% to \$194.6 million for fiscal year 2017 compared to the prior fiscal year and decreased \$3.6 million or 1.9% to \$188.0 million for fiscal year 2016 compared to fiscal year 2015. The primary increase in 2017 was in fringe benefits. The primary decrease in 2016 was in administration and general, utilities.

## City and County of Honolulu, Sewer Fund

Management's Discussion and Analysis  
June 30, 2017 and 2016

- Interest expense increased by \$0.6 million or 1.2% to \$52.1 million for fiscal 2017 compared to the prior fiscal year and decreased by \$9.0 million or 14.9% to \$51.5 million for fiscal 2016 compared to fiscal year 2015. The increase in 2017 was due to an increase in interest expense on wastewater revenue bonds and the decrease in 2016 was due to a decrease in interest expense on wastewater revenue bonds.
- Contributed capital decreased to \$0.21 million in fiscal year 2017 down from \$0.43 million in fiscal year 2016 and \$0.78 million in fiscal year 2015. Contributed capital represents assets (primarily capital assets) transferred from other city governmental funds and other entities. Approximately \$16.2 million was transferred out during fiscal year 2017 for the Wastewater Enterprise's share of central administrative expenses incurred by the City and \$13.4 million was transferred out during fiscal year 2016 for the Wastewater Enterprise's share of central administrative expenses incurred by the City.

### Capital Asset and Debt Administration

**Capital assets.** The Wastewater Enterprise's investment in capital assets amounted to \$3.0 billion and \$2.8 billion, net of accumulated depreciation, as of June 30, 2017 and 2016, respectively, an increase of \$168.9 million or 6.0% in 2017 and \$166.7 million or 6.3% in 2016. Capital assets include land, buildings, infrastructure, land improvements, equipment and machinery for the 9 treatment plants, 70 pumping stations, and over 2,100 miles of sewer line that makes up the Wastewater Enterprise. Capital assets are added, rehabilitated or replaced according to the infrastructure and facilities twenty-year capital plan.

**Long-term debt.** Wastewater revenue bonds and State revolving fund loans are the primary long-term financing instruments used to fund the acquisition of capital assets. The long term portion of revenue bonds outstanding as of June 30, 2017 and 2016 totaled \$2,012.4 million and \$1,817.0 million, respectively. The long term portion of state revolving fund notes payable outstanding at June 30, 2017 and 2016 totaled \$229.2 million and \$230.1 million, respectively.

Debt service coverage was 313% on Senior Revenue Bonds, 236% on all revenue bonds, and 206% on all debt at June 30, 2017, compared to 360% on Senior Revenue Bonds, 251% on all revenue bonds, and 216% on all debt at June 30, 2016. Debt service coverage exceeded the requirements of bond covenants and policies of the City Council in 2017 and 2016.

Additional information on the Wastewater Enterprise's capital assets and long-term debt can be found in the notes to the financial statements.

## **City and County of Honolulu, Sewer Fund**

Management's Discussion and Analysis  
June 30, 2017 and 2016

### **Currently Known Facts, Decisions or Conditions**

Sewer service charge rates were increased by 8% effective July 1, 2016. Rate structure changes were implemented July 1, 2012, for residential customers and January 23, 2013, for non-residential customers. In support of requirements in the 2010 Consent Decree (See Note 11 to the financial statement) and other system requirements, the City anticipates issuing additional wastewater system revenue bonds to pay for costs of certain additions and improvements to the wastewater system and to refund eligible previously issued bonds for economic savings during FY 2018.

### **Requests for Information**

Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the City and County of Honolulu, Department of Environmental Services, 1000 Uluohia Street, Suite 308, Kapolei, Hawaii 96707.

## City and County of Honolulu, Sewer Fund

Statements of Net Position  
 June 30, 2017 and 2016  
 (Amounts in thousands)

	<u>Assets and Deferred Outflows of Resources</u>	
	<u>2017</u>	<u>2016</u> <u>(As Restated)</u>
Current Assets:		
Cash and cash equivalents	\$ 123,233	\$ 127,856
Investments	919,358	759,729
Receivables:		
Accounts, net of allowance for uncollectible accounts of \$3,370 and \$4,057, respectively	60,887	55,381
Interest	1,860	1,124
Employee advances	802	894
Total receivables	63,549	57,399
Due from other City funds	-	325
Inventories of materials and supplies	15,032	15,406
Prepaid expenses	-	2,640
Total current assets	1,121,172	963,355
Restricted Assets – Investments	247,765	156,042
Capital Assets, Net	2,978,459	2,809,572
Other Assets	135	265
Total assets	<u>4,347,531</u>	<u>3,929,234</u>
Deferred Outflows of Resources:		
Deferred refunding costs, net	52,652	35,887
Deferred pension costs	48,979	13,807
Total deferred outflows of resources	<u>101,631</u>	<u>49,694</u>
Total assets and deferred outflows of resources	<u>\$ 4,449,162</u>	<u>\$ 3,978,928</u>

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

## City and County of Honolulu, Sewer Fund

Statements of Net Position (continued)  
 June 30, 2017 and 2016  
 (Amounts in thousands)

	<u>Liabilities, Deferred Inflows of Resources, and Net Position</u>	
	2017	2016 (As Restated)
Current Liabilities:		
Accounts payable	\$ 64,341	\$ 48,153
Due to other City funds	4	13
Interest payable	46,647	44,627
Bonds payable	59,875	51,813
Notes payable	23,587	22,066
Accrued payroll	1,715	1,666
Other current liabilities	489	499
Total current liabilities	<u>196,658</u>	<u>168,837</u>
Revenue Bonds Payable, Net	2,012,389	1,817,024
Net Pension Liability	127,677	88,686
Notes Payable	229,182	230,082
General Obligation Bonds Payable, Net	715	784
Other Liabilities	35,260	33,304
Total liabilities	<u>2,601,881</u>	<u>2,338,717</u>
Deferred Inflows of Resources--		
Deferred Pension Costs	<u>19,343</u>	<u>19,034</u>
Net Position:		
Net investment in capital assets	874,926	785,313
Restricted for debt service	165,226	174,514
Unrestricted	787,786	661,350
Total net position	<u>1,827,938</u>	<u>1,621,177</u>
Total liabilities, deferred inflows of resources, and net position	<u>\$ 4,449,162</u>	<u>\$ 3,978,928</u>

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

## City and County of Honolulu, Sewer Fund

Statements of Revenues, Expenses and Changes in Net Position  
 Years Ended June 30, 2017 and 2016  
 (Amounts in thousands)

	2017	2016 (As Restated)
Operating Revenues:		
Sewer service charges	\$ 447,457	\$ 411,996
Other revenue	11,316	11,802
Total operating revenues	<u>458,773</u>	<u>423,798</u>
Operating Expenses:		
Administrative and general	44,315	48,599
Depreciation	64,012	62,384
Utilities	21,768	20,779
Fringe benefits	27,284	20,176
Contractual services	21,743	20,881
Materials and supplies	14,325	13,803
Fuel and lubricants	752	902
Maintenance	410	509
Total operating expenses	<u>194,609</u>	<u>188,033</u>
Income from operations	<u>264,164</u>	<u>235,765</u>
Nonoperating Revenues (Expenses):		
Interest income	7,718	3,432
Interest expense	(52,061)	(51,542)
Unrealized (loss) on investments	(2,114)	-
Other	5,048	2,724
Total nonoperating expenses	<u>(41,409)</u>	<u>(45,386)</u>
Income before transfers and capital contributions	222,755	190,379
Transfers Out	(16,199)	(13,426)
Capital Contributions	205	424
Changes in net position	206,761	177,377
Net Position at Beginning of Year, as Previously Reported	1,621,177	1,446,902
Restatement Due to Change in Accounting Principle	-	(3,102)
Net Position at Beginning of Year, as Restated	<u>-</u>	<u>1,443,800</u>
Net Position, End of Year	<u>\$ 1,827,938</u>	<u>\$ 1,621,177</u>

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

## City and County of Honolulu, Sewer Fund

Statements of Cash Flows  
 Years Ended June 30, 2017 and 2016  
 (Amounts in thousands)

	<u>2017</u>	<u>2016</u> (As Restated)
Cash Flows from Operating Activities:		
Cash received from customers	\$ 454,070	\$ 421,362
Cash payments to suppliers	(61,534)	(62,800)
Cash payments to employees	(59,666)	(58,172)
Other receipts	1,900	-
Net cash provided by operating activities	<u>334,770</u>	<u>300,390</u>
Cash Flows from Noncapital Financing Activities --		
Transfers Out	<u>(16,199)</u>	<u>(13,426)</u>
Cash Flows from Capital and Related Financing Activities:		
Acquisition and construction of capital assets	(198,737)	(222,949)
Proceeds from issuance of notes	23,258	27,766
Repayments on notes	(22,638)	(20,905)
Interest paid on notes	(2,180)	(2,225)
Proceeds from issuance of bonds, net	510,000	770,847
Repayments on bonds	(310,161)	(620,887)
Interest paid on bonds	(81,241)	(63,940)
Interest subsidies for wastewater system revenue bonds	4,996	5,002
Net cash used in capital and related financing activities	<u>(76,703)</u>	<u>(127,291)</u>
Cash Flows from Investing Activities:		
Purchase of investments	(1,705,864)	(1,625,356)
Proceeds from maturity of investments	1,452,392	1,347,355
Interest on investments	6,981	2,481
Net cash used in investing activities	<u>(246,491)</u>	<u>(275,520)</u>
Net decrease in cash and cash equivalents	(4,623)	(115,847)
Cash and Cash Equivalents, Beginning of Year	<u>127,856</u>	<u>243,703</u>
Cash and Cash Equivalents, End of Year	<u>\$ 123,233</u>	<u>\$ 127,856</u>

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

## City and County of Honolulu, Sewer Fund

Statements of Cash Flows (continued)  
 Years Ended June 30, 2017 and 2016  
 (Amounts in thousands)

	<u>2017</u>	<u>2016</u> (As Restated)
Reconciliation of Income from Operations to Net Cash		
Provided by Operating Activities:		
Income from operations	\$ 264,164	\$ 235,765
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation	64,012	62,384
Write-off of capital assets	1,003	6,980
Other revenues	1,696	-
Change in assets, liabilities and deferred inflows/outflows of resources:		
Accounts receivable	(5,414)	(3,573)
Due from other City funds	325	(3)
Inventories of materials and supplies	375	(155)
Deferred outflows of resources	(35,172)	(6,584)
Accounts payable	2,495	(633)
Other liabilities	1,995	2,988
Net pension liability	38,991	(1,597)
Due to other City funds	(9)	9
Deferred inflows of resources	309	4,809
Net cash provided by operating activities	<u>\$ 334,770</u>	<u>\$ 300,390</u>

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

The Sewer Fund received \$0.2 million and \$0.4 million in contributions of capital assets from government agencies and developers, which are recorded as capital contributions at their cost or estimated cost at June 30, 2017 and 2016, respectively.

Amortization of net bond premiums/(discounts) amounted to \$16.1 million and \$11.6 million in fiscal years 2017 and 2016, respectively.

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



# City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2017 and 2016

## 1. Financial Reporting Entity

The City and County of Honolulu, Sewer Fund (Sewer Fund) was established as an enterprise fund effective July 1, 1999 in conjunction with the November 1998 City Resolution 98-193, CD1, authorizing the issuance of the Wastewater System Revenue Bonds for the City and County of Honolulu's (City) wastewater system. The fund accounts for the operations of the City's wastewater system.

## 2. Summary of Significant Accounting Policies

### a. Financial Statement Presentation

The Sewer Fund is one of the various enterprise funds of the City. The accompanying financial statements present only the activities of the Sewer Fund and do not include other organizations, activities and functions of the City. The City's Director of Budget and Fiscal Services maintains the central accounts for all City funds and publishes financial statements for the City annually, which includes the Sewer Fund's financial activities.

The accompanying financial statements of the Sewer Fund have been prepared in conformity with accounting principles generally accepted in the United States of America prescribed by the Governmental Accounting Standards Board (GASB).

### b. Basis of Accounting

The accompanying financial statements are presented using the economic resources measurement focus and the accrual basis of accounting, whereby revenues and expenses are recognized in the period earned or incurred.

### c. Use of Estimates

The preparation of financial statements in accordance 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. Significant items subject to such estimates and assumptions included revenue recognized related to unbilled accounts, allowance for uncollectible accounts, net pension liability and accrued liability for post-retirement health care benefits. Actual results could differ from those estimates.

# City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2017 and 2016

## 2. Summary of Significant Accounting Policies (continued)

### d. Cash and Cash Equivalents

Cash includes amounts in demand and time deposits primarily with various financial institutions in the State of Hawaii (State). Cash on deposit with financial institutions is collateralized in accordance with State statutes. Investments with original maturity of three months or less when purchased are considered cash equivalents.

### e. Investments

Investments consist of U.S. treasury and government securities and nonparticipating guaranteed investment contracts. All nonparticipating investment contracts are recorded at amortized cost. Participating investment contracts with maturities of one year or more are stated at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Participating investment contracts with maturities of less than one year are recorded at amortized cost.

### f. Inventories of Materials and Supplies

Inventories of materials and supplies are stated at weighted average cost. The costs of inventories are recorded as expenditures when consumed rather than when purchased.

### g. Receivables

Sewer service charge revenues are accrued by the City based on estimated billings for services provided through the end of the fiscal year. Receivables included estimated unbilled sewer charges amounting to approximately \$28.5 million and \$25.2 million at June 30, 2017 and 2016, respectively. The allowance for doubtful accounts is based on the aging of accounts receivable. Approximately 90% of balances over 120 days are regarded as uncollectible.

### h. Restricted Assets

Revenue bond indentures allow the City to invest in U.S. Government Securities. At June 30, 2017, restricted assets consist of unspent debt proceeds of \$169.6 million and revenue bond collateral reserves of approximately \$78.2 million. At June 30, 2016, restricted assets consist of unspent debt proceeds of \$61.6 million and revenue bond collateral reserves of approximately \$94.4 million.

# City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2017 and 2016

## 2. Summary of Significant Accounting Policies (continued)

### i. Capital Assets

Capital assets include property, plant and equipment, including infrastructure (sewer system, network of pipes and sewer mains). Assets with an initial individual cost of \$5,000 or more for equipment and \$100,000 for buildings, structures and infrastructure, and an estimated useful life of more than one year are capitalized. Such assets are recorded at cost or estimated cost. Interest cost is capitalized as part of the cost of acquiring certain assets.

Depreciation is calculated on a straight-line basis over the following estimated useful lives:

	<u>Years</u>
Buildings and land improvements	10 – 50
Transmission and distribution system	13 – 60
Equipment and machinery	5 – 20

Sales and retirements of depreciable property are recorded by removing the related cost and accumulated depreciation from the accounts. Gains or losses on sales and retirements of property are reflected in results of operations.

Normal maintenance and repairs that do not add to the value of the assets or materially extend asset lives are not capitalized. Betterments are capitalized and depreciated over the remaining useful lives of the related assets, as applicable.

### j. Original Issue Discounts or Premiums

Original issue discounts or premiums on bonds are amortized ratably over the terms of the respective issues and are offset against the bonds payable in the statements of net position.

### k. Accrued Vacation

Employees are credited with vacation at the rate of one and three-quarters working days per month. Accumulation of such vacation credits is limited to 90 days at calendar year-end and is convertible to pay upon termination of employment. Such accumulated vacation has been accrued and reflected in the statements of net position.

# City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2017 and 2016

## 2. Summary of Significant Accounting Policies (continued)

### l. Deferred Outflows and Inflows of Resources

Deferred outflows of resources represent consumptions of net position that apply to future periods and will not be recognized as an outflow of resources (expenditures) until then. The amount consists of:

- 1) Deferred charges on refunding bonds resulting from the difference between the carrying value of debt and its reacquisition price. This amount is deferred and amortized over the shorter of the life of the refunded or refunding debt on a basis that approximates the effective-interest method.
- 2) According to paragraph 33 of GASB Statement No. 68 (GASB 68), *Accounting and Reporting for Pensions (an amendment of GASB Statement No. 27)*, differences between expected and actual experience and changes in assumptions are recognized in pension expense using a systematic and rational method over a closed period equal to the average of the expected remaining service lives of all employees that are provided with pensions through the pension plan (active and inactive employees) determined as of the beginning of the measurement period. The average of expected remaining service lives for the purposes of recognizing the applicable deferred outflows and inflows of resources established in the 2016 fiscal year is 5.7626 years.

Additionally, differences between projected and actual earnings on pension plan investments are recognized in pension expense using a systematic and rational method over a closed five year period.

Contributions to the pension plan from the employer subsequent to the measurement date of the net pension liability and before the end of the reporting period are reported as a deferred outflows.

### m. Pension

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Employees' Retirement System of the State of Hawaii (ERS) and additions to/deductions from ERS's fiduciary net position have been determined on the same basis as they are reported by ERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

# City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2017 and 2016

## 2. Summary of Significant Accounting Policies (continued)

### n. Net Position

Net position is comprised of the accumulated income from operating and nonoperating revenues, expenses, transfers and capital contributions. Net position is classified in the following three components: net investment in capital assets; restricted for debt service; and unrestricted net position. Net investment in capital assets consists of capital assets, net of accumulated depreciation, and is 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 fiscal year-end are not included in the calculation of the amount of net investment in capital assets. Restricted for debt service consists of net position for which constraints are placed thereon by external parties, such as lenders, grantors, contributors, laws, regulations and enabling legislation, including self-imposed legal mandates. Unrestricted net position consists of all other net position not included in the above categories. When an expense is incurred for purposes for which both restricted and unrestricted net position is available, restricted resources are applied first, then unrestricted resources as they are needed.

### o. Operating Revenues and Expenses

The City distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services in connection with the Sewer Fund's principal wastewater operations. The principal operating revenues are from charges for wastewater system 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.

### p. Capital Contributions

Capital contributions represent assets transferred from or constructed utilizing contributions from governmental agencies and developers and recorded at cost on the date placed in service.

### q. Transfers

Transfers include authorized transfers of resources from the fund legally required to receive them to the fund through which such resources are to be expended. Transfers also include reimbursement of funds to the City's General Fund for expenditures paid by the General Fund on behalf of the Sewer Fund.

## City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2017 and 2016

### 2. Summary of Significant Accounting Policies (continued)

#### r. Risk Management

The City is exposed to various risks for losses related to torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and injuries to employees. A liability for a claim for a risk of loss is established if the information indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss is reasonably estimable.

#### s. New Accounting Pronouncements

In June 2015, GASB issued Statement No. 73 (GASB 73), *Accounting and Financial Reporting for Pensions and Related Assets that are not within the Scope of GASB Statement 68, and amendments to Certain Provisions of GASB Statements 67 and 68*. GASB 73 applies the accounting and financial reporting established in GASB 68 to all defined benefit and defined contribution pensions that are not within the scope of GASB 68. GASB 73 was effective for the Sewer Funds's financial statements for the year ending June 30, 2017. Management implemented the provisions of GASB 73 as of June 30, 2017. GASB 73 did not have a significant impact on the Sewer Fund's financial statements.

In March 2016, GASB issued Statement No. 82 (GASB 82), *Pension Issues – An Amendment of GASB Statements No. 67, No. 68, and No. 73*. GASB 82 addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information (2) the selection of assumptions and treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. GASB 82 was effective for the Sewer Fund's financial statements for the year ended June 30, 2017. The Sewer Fund implemented the provisions of GASB 82, which resulted in the restatement of the Sewer Fund's fiscal year 2016 financial statement as follows (in thousands of dollars):

	Net Position, Beginning of Year	Deferred Outflows	Operating Expenses	Net Position, End of Year
Balance, as previously reported	\$ 1,446,902	\$ 52,678	\$ (188,151)	\$ 1,624,161
Implementation of GASB 82	<u>(3,102)</u>	<u>(2,984)</u>	<u>118</u>	<u>(2,984)</u>
Balance, as restated	<u>\$ 1,443,800</u>	<u>\$ 49,694</u>	<u>\$ (188,033)</u>	<u>\$ 1,621,177</u>

## City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2017 and 2016

### 2. Summary of Significant Accounting Policies (continued)

#### s. New Accounting Pronouncements (continued)

In June 2015, GASB issued Statement No. 75 (GASB 75), *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. GASB 75 amends the accounting guidance related to employers' accounting for postemployment benefits other than pension (other postemployment benefits or OPEB) administered through trusts that meet specified criteria. GASB 75 establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expenditures related to OPEB. Note disclosures and required supplementary information are addressed by the statement. GASB 75 will be effective for the Sewer Fund's financial statements for the year ending June 30, 2018. Management is currently evaluating the impact the adoption of GASB 75 will have on the Sewer Fund's financial statements.

In March 2017, GASB issued Statement No. 85 (GASB 85), *Omnibus 2017*. GASB 85 addresses practice issues that have been identified during implementation and applications of certain GASB Statements. GASB 85 addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and applications, and postemployment benefits (pensions and other postemployment benefits). GASB 85 will be effective for the Sewer Fund's financial statement for the year ending June 30, 2018, with early adoption permitted. Management is currently evaluating the impact the adoption of GASB 85 will have on the Sewer Fund's financial statements.

In May 2017, GASB issued Statement No. 86 (GASB 86), *Certain Debt Extinguishments*. GASB 86 improves consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary asset acquired with only existing resources, resources other than the proceeds of refunding debt, are placed in an irremovable trust for the sole purpose of extinguishing debt. This statement also improves accounting and financial reporting for prepaid insurance on debt that is extinguished and notes to the financial statements for debt that is defeased in substance. GASB 86 will be effective for the Sewer Fund's financial statement for the year ended June 30, 2018, with early adoption permitted. Management is currently evaluating the impact the adoption of GASB 86 will have on the Sewer Fund's financial statements.

# City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2017 and 2016

## 2. Summary of Significant Accounting Policies (continued)

### t. Reclassifications

Certain reclassifications were made to the 2016 financial statements to conform to the 2017 presentation. Such reclassifications had no impact on the changes in net position as previously reported.

## 3. Cash and Cash Equivalents and Investments

The cash and cash equivalents and investment balances reported in the accompanying statements of net position are included in the City's cash and cash equivalents and investment pool that is substantially used by all of the City's funds. Investments include \$12.7 million with FSA Capital Management LLC at June 30, 2017 and 2016. The remaining balance at June 30, 2017 is invested in the City's pooled investment fund. Information pertaining to credit risk, interest rate risk and fair value measurements is available for only the total cash and cash equivalents and investment pool, which is disclosed in the City's Comprehensive Annual Financial Report (CAFR) available at City's website: <http://www.honolulu.gov/budget/budget-cafr.html>.

State statutes authorize the City to invest in obligations of the U.S. Treasury and U.S. Agencies, obligations of other states, cities and counties, mutual funds, and bank repurchase agreements. Investments in repurchase agreements are primarily U.S. government or federal agency securities. The City does not have a policy relative to interest rate risk.

## 4. Credit Risk

Financial instruments, which potentially expose the City to concentrations of credit risk, consist primarily of cash, investments in debt securities, and accounts receivable from customers. Cash and cash equivalents are maintained in various financial institutions in the State. Credit risk related to investments in debt securities has been mitigated by limiting such investments to debt obligations of the U.S. government.

The customer base is concentrated among commercial, industrial, residential and governmental customers located within Honolulu, Hawaii. Although the City is directly affected by Honolulu's economy, management does not believe significant credit risk exists at June 30, 2017, except as provided in the allowance for uncollectible accounts. The City manages its credit exposure through procedures designed to identify and monitor credit risk.



## City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2017 and 2016

### 5. Due From and Due To Other City Funds

Due from other City funds consists primarily of bond proceeds relating to bond issuances for the Sewer Fund held by the City's General Improvement Bond Fund of approximately nil and \$325,000 at June 30, 2017 and 2016, respectively. Due to other City funds consists primarily of bond principal and interest and pension expenses for the Sewer Fund temporarily advanced by the General Fund.

### 6. Capital Assets

The capital assets activity for the years ended June 30, 2017 and 2016 were as follows (in thousands of dollars):

	Balance at July 1, 2016	Additions	Retirements/ Transfers	Balance at June 30, 2017
Depreciable assets				
Buildings and improvements	\$ 1,137,389	\$ 3,121	\$ -	\$ 1,140,510
Transmission and distribution system	1,749,530	48,150	(25)	1,797,655
Equipment and machinery	77,104	7,648	(2,377)	82,375
Land improvements	3,841	3,667	-	7,508
Total depreciable assets	2,967,864	62,586	(2,402)	3,028,048
Less: Accumulated depreciation				
Buildings and improvements	(264,805)	(24,437)	-	(289,242)
Transmission and distribution system	(374,226)	(33,908)	11	(408,123)
Equipment and machinery	(44,228)	(5,470)	2,363	(47,335)
Land improvements	(1,996)	(197)	-	(2,193)
Total accumulated depreciation	(685,255)	(64,012)	2,374	(746,893)
	2,282,609	(1,426)	(28)	2,281,155
Land	45,839	186	-	46,025
Construction in progress	481,124	216,839	(46,684)	651,279
	<u>\$ 2,809,572</u>	<u>\$ 215,599</u>	<u>\$ (46,712)</u>	<u>\$ 2,978,459</u>

## City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2017 and 2016

### 6. Capital Assets (continued)

	Balance at July 1, 2015	Additions	Retirements/ Transfers	Balance at June 30, 2016
Depreciable assets				
Buildings and improvements	\$ 1,126,292	\$ 11,097	\$ -	\$ 1,137,389
Transmission and distribution system	1,563,612	186,384	(466)	1,749,530
Equipment and machinery	74,623	4,096	(1,615)	77,104
Land improvements	3,511	330	-	3,841
Total depreciable assets	2,768,038	201,907	(2,081)	2,967,864
Less: Accumulated depreciation				
Buildings and improvements	(240,232)	(24,573)	-	(264,805)
Transmission and distribution system	(341,782)	(32,581)	137	(374,226)
Equipment and machinery	(40,722)	(5,109)	1,603	(44,228)
Land improvements	(1,875)	(121)	-	(1,996)
Total accumulated depreciation	(624,611)	(62,384)	1,740	(685,255)
	2,143,427	139,523	(341)	2,282,609
Land	45,410	429	-	45,839
Construction in progress	454,083	211,288	(184,247)	481,124
	<u>\$ 2,642,920</u>	<u>\$ 351,240</u>	<u>\$ (184,588)</u>	<u>\$ 2,809,572</u>

Depreciation expense was approximately \$64.0 million and \$62.4 million for the years ended June 30, 2017 and 2016, respectively.

### 7. Long-Term Obligations

The City issues general obligation bonds for the construction of major capital facilities. The Sewer Fund's general obligation bonds are collateralized by or expected to be paid from sewer user charges. These instruments are a direct obligation of the City for which its full faith and credit is pledged. The general obligation bonds for the Sewer Fund were issued during fiscal years 1993 through 2013 in the original amount totaling \$181.7 million, and maturing serially through fiscal year 2028. The general obligation bonds bear interest at rates ranging from 1.3% to 5.0% at June 30, 2017. No new general obligation bonds have been issued to finance construction of sewer capital facilities since fiscal year 1998. Subsequently, sewer capital facilities were funded by wastewater system revenue bonds.

## City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2017 and 2016

### 7. Long-Term Obligations (continued)

At June 30, 2017, wastewater system revenue bonds outstanding in the City's business-type activities were issued during fiscal years 1999 through 2017, in the original amount totaling \$2.7 billion, less discounts of \$37.6 million and adjusted for premiums of \$220.4 million, which are being amortized over the related term of the bonds. The bonds bear interest at 0.6% to 6.3% at June 30, 2017 and mature at various dates through fiscal year 2047. The wastewater system revenues collateralize the revenue bonds.

On September 8, 2016, the City issued tax-exempt wastewater system revenue bonds of \$404.3 million and taxable wastewater system revenue bonds of \$43.9 million. The bonds were comprised of Senior series A, B, & C and Junior series A with total aggregate of \$448.2 million.

Senior series 2016A were issued for \$232.7 million. The proceeds of the bonds will be used to pay for certain additions and improvements to the wastewater system. The bonds mature annually on July 1, 2018 through July 1, 2046 and bear interest rates at 3.0% to 5.0%. For the bonds maturing on and after July 1, 2027 through July 1, 2036, the City may exercise its option of redemption on or after July 1, 2026 on or in part, at any time, in order of maturity selected by the City, and by lot within maturity, at the principal amount thereof, plus interest accrued to the date fixed for redemption thereof, without premium.

Senior series 2016B were issued for \$171.6 million. The proceeds of the bonds, along with release of \$9.4 million of common reserve funds, were used to refund a portion of revenue bond series 2006B, 2007A, 2009A, 2011A, and 2012A. The bonds mature annually on July 1, 2022 through July 1, 2037 and bear interest rates at 3.0% to 5.0%. For the bonds maturing on or after July 1, 2027 through July 1, 2037, the City may exercise its option of redemption on or after July 1, 2026 in whole or in part, at any time, in order of maturity selected by the City, and by lot within maturity, at the principal amount thereof, plus interest accrued to the date fixed for redemption thereof, without premium. The refunding was undertaken to reduce total debt service payments by \$41.2 million and resulted in an economic gain of approximately \$21.8 million.

Senior series 2016C were issued for \$14.3 million. The proceeds of the bonds, along with release of \$1.6 million of common reserve funds, were used to refund a portion of revenue bond series 2009A. The bonds mature annually on July 1, 2017 through July 1, 2027 and bear interest rates at 0.8% to 2.6%. The refunding was undertaken to reduce total debt service payments by \$3.2 million and resulted in an economic gain of approximately \$1.2 million.

## City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2017 and 2016

### 7. Long-Term Obligations (continued)

Junior series 2016A were issued for \$29.6 million. The proceeds of the bonds were used to refund a portion of revenue bond series 2009A. The bonds mature annually on July 1, 2017 through July 1, 2023 and bear interest rates at 0.9% to 2.2%. The refunding was undertaken to reduce total debt service payments by \$1.5 million and resulted in an economic gain of approximately \$1.4 million.

On August 12, 2015, the City issued tax-exempt wastewater system revenue bond of \$578.5 million and taxable wastewater system revenue bonds of \$120.4 million. The bonds were comprised of Senior series A, B & C and Junior series A & B with total aggregate of \$698.9 million.

Senior series 2015A were issued for \$185.0 million. The proceeds of the bonds will be used to pay for certain additions and improvements to the wastewater system. The bonds mature annually on July 1, 2017 through July 1, 2045 and bear interest rates at 2.0% to 5.0%. For the bonds maturing on and after July 1, 2026 through July 1, 2045, the City may exercise its option of redemption on or after July 1, 2025 in whole or in part, at any time, in any order of maturity selected by the City, and by lot within maturity, at the principal amount thereof, plus interest accrued to the date fixed for redemption thereof, without premium.

Senior series 2015B were issued for \$277.6 million. The proceeds of the bonds, along with the release of \$8.6 million of common reserve funds, were used to refund a portion of revenue bond series 2005A, 2006A, 2006B, 2006C, 2007A, 2009A. The bonds mature annually on July 1, 2016 through July 1, 2036 and bear interest rates at 3.0% to 5.0%. For the bonds maturing July 1, 2026 through July 1, 2036 except for the bonds with interest rate below 4.0% that will mature on July 1, 2028, 2033 and 2036, the City may exercise its option of redemption on or after July 1, 2025 in whole or in part, at any time, in any order of maturity selected by the City, and by lot within maturity, at the principal amount thereof, plus interest accrued to the date fixed for redemption thereof, without premium. The refunding was undertaken to reduce total debt service payments by \$58.7 million and resulted in an economic gain of approximately \$35.5 million.

Senior series 2015C were issued for \$98.1 million. The proceeds of the bonds, along with the release of \$1.7 million of common reserve funds, were used to refund a portion of revenue bond series 2006A, 2006B, 2006C, 2010 USDA. The bonds mature annually on July 1, 2016 through July 1, 2045 and bear interest rates at 0.6% to 4.6%. The refunding was undertaken to reduce total debt service payments by \$10.1 million and resulted in an economic gain of approximately \$5.9 million.

## City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2017 and 2016

### 7. Long-Term Obligations (continued)

Junior Series 2015A were issued for \$115.9 million. The proceeds of the bonds, along with the release of \$3.5 million of common reserve funds, were used to refund a portion of revenue bond series 2003A, 2003B, and 2008A. The bonds mature annually on July 1, 2017 through July 1, 2032 and bear interest rates at 3.0% to 5.0%. For the bonds maturing July 1, 2026 through July 1, 2031 except for the bonds with interest rate of 3.0% maturing on July 1, 2027, the City may exercise its option of redemption on or after July 1, 2025 in whole or in part, at any time, in any order of maturity selected by the City, and by lot within maturity, at the principal amount thereof, plus interest accrued to the date fixed for redemption thereof, without premium. The refunding was undertaken to reduce total debt service payments by \$17.3 million and resulted in an economic gain of approximately \$9.9 million.

Junior Series 2015B were issued for \$22.3 million. The proceeds of the bonds, along with the release of \$0.6 million of common reserve funds, were used to refund a portion of revenue bond series 2003A and B. The bonds mature annually on July 1, 2016 through July 1, 2032 and bear interest rates at 0.9% to 4.6%. The refunding was undertaken to reduce total debt service payments by \$2.2 million and resulted in an economic gain of approximately \$1.2 million.

The notes payable to the State are for the construction of necessary treatment works. During fiscal year 2017 and 2016, the City issued notes payable amounting to \$23.3 million and \$27.8 million, respectively. The notes amounted to \$252.8 million and \$252.1 million at June 30, 2017 and 2016, respectively, bearing interest ranging from 0.0% to 3.0%, and require annual principal and interest payments through fiscal year 2035.

Total interest costs incurred in 2017 and 2016 were approximately \$73.4 million and \$71.9 million, respectively, of which \$21.3 million and \$20.3 million was capitalized in 2017 and 2016, respectively.

## City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2017 and 2016

### 7. Long-Term Obligations (continued)

Long-term obligations activity for the fiscal years ended June 30, 2017 and 2016 were as follows (in thousands of dollars):

	Balance at July 1, 2016	Additions	Reductions	Balance at June 30, 2017	Amount Due Within One Year
General obligation bonds	\$ 794	\$ -	\$ (58)	\$ 736	\$ 60
Revenue bonds	1,763,170	448,155	(281,120)	1,930,205	59,815
Notes payable	252,148	23,258	(22,637)	252,769	23,587
	<u>2,016,112</u>	<u>471,413</u>	<u>(303,815)</u>	<u>2,183,710</u>	<u>83,462</u>
Add: Unamortized net premium	105,657	63,449	(27,068)	142,038	-
Total long-term debt	2,121,769	534,862	(330,883)	2,325,748	83,462
Net pension liability	88,686	38,991	-	127,677	-
Compensated absences	7,880	2,986	(3,053)	7,813	489
Other postretirement benefits	25,923	9,881	(7,868)	27,936	-
Total long-term obligations	<u>\$ 2,244,258</u>	<u>\$ 586,720</u>	<u>\$ (341,804)</u>	<u>\$ 2,489,174</u>	<u>\$ 83,951</u>
	Balance at July 1, 2015	Additions	Reductions	Balance at June 30, 2016	Amount Due Within One Year
General obligation bonds	\$ 803	\$ -	\$ (9)	\$ 794	\$ 58
Revenue bonds	1,652,192	698,930	(587,952)	1,763,170	51,755
Notes payable	245,287	27,766	(20,905)	252,148	22,066
	<u>1,898,282</u>	<u>726,696</u>	<u>(608,866)</u>	<u>2,016,112</u>	<u>73,879</u>
Add: Unamortized net premium	59,133	74,277	(27,753)	105,657	-
Total long-term debt	1,957,415	800,973	(636,619)	2,121,769	73,879
Net pension liability	90,284	-	(1,598)	88,686	-
Compensated absences	7,559	3,218	(2,897)	7,880	499
Other postretirement benefits	23,278	9,607	(6,962)	25,923	-
Total long-term obligations	<u>\$ 2,078,536</u>	<u>\$ 813,798</u>	<u>\$ (648,076)</u>	<u>\$ 2,244,258</u>	<u>\$ 74,378</u>

Compensated absences and other postretirement benefits are included on the accompanying statements of net position as other liabilities.

## City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2017 and 2016

### 7. Long-Term Obligations (continued)

Scheduled maturities of long-term debt at June 30, 2017 are as follows (in thousands of dollars):

Year ending June 30,	General Obligation Bonds	Revenue Bonds	Notes Payable	Total Principal	Total Interest
2018	\$ 60	\$ 59,815	\$ 23,587	\$ 83,462	\$ 89,409
2019	55	65,445	22,657	88,157	84,111
2020	58	67,720	21,196	88,974	81,496
2021	61	70,260	20,875	91,196	78,640
2022	62	73,565	20,770	94,397	75,450
2023–2027	357	416,495	98,547	515,399	325,952
2028–2032	83	438,580	43,176	481,839	224,155
2033–2037	-	366,020	1,961	367,981	129,961
2038–2042	-	258,415	-	258,415	51,472
2043–2047	-	113,890	-	113,890	9,442
	<u>736</u>	<u>1,930,205</u>	<u>252,769</u>	<u>2,183,710</u>	<u>\$ 1,150,088</u>
Less: Current portion	<u>(60)</u>	<u>(59,815)</u>	<u>(23,587)</u>	<u>(83,462)</u>	
	<u>\$ 676</u>	<u>\$ 1,870,390</u>	<u>\$ 229,182</u>	<u>\$ 2,100,248</u>	

## City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2017 and 2016

### 8. Net Position

At June 30, 2017 and 2016, net position consisted of the following (in thousands of dollars):

	2017	2016 (As Restated)
Net investment in capital assets:		
Net property, plant and equipment	\$ 2,978,459	\$ 2,809,572
Deferred outflows of resources - deferred refunding costs, net	52,652	35,887
Less:		
Wastewater general obligation bonds payable, net of unamortized premiums and discounts	(775)	(842)
Wastewater system revenue bonds payable, net of unamortized premiums and discounts	(2,072,204)	(1,868,779)
Notes payable	(252,769)	(252,148)
Amount of debt related to unspent debt proceeds	169,563	61,623
	874,926	785,313
Restricted for debt service	165,226	174,514
Unrestricted	787,786	661,350
Total	<u>\$ 1,827,938</u>	<u>\$ 1,621,177</u>

At June 30, 2017 and 2016, restricted for debt service includes approximately \$78.2 million and \$94.4 million, respectively, in collateral reserves related to its revenue bonds. The remaining amount relates to self-imposed restrictions for debt service.

### 9. Employee Benefit Plans

#### a. Defined Benefit Pension Plans

##### Plan Description

Substantially all eligible employees of the City are members of the ERS, a cost-sharing multiple-employer defined benefit pension 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 three classes, the contributory, the noncontributory and the hybrid retirement classes. Prior to July 1, 1984, the plan consisted of only a contributory class. In 1984, legislation was enacted to create a new noncontributory class for members of the ERS who are also covered under social security. Persons employed in positions not covered by social security were precluded from the noncontributory class. The noncontributory class provides for reduced benefits and covers most eligible employees hired starting July 1, 1984. Employees hired before that date were allowed to continue under the



## City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2017 and 2016

### 9. Employee Benefit Plans (continued)

#### a. Defined Benefit Pension Plans (continued)

##### Plan Description (continued)

contributory class or to elect the new noncontributory class and receive a refund of employee contributions. In 2004, legislation was enacted to create a hybrid retirement class, which took effect July 1, 2006. Employees in the contributory and noncontributory class were given the option to join the hybrid class or to remain in their existing class effective July 1, 2006. Starting July 1, 2006, all new employees covered by social security are required to join the hybrid class.

All benefits vest after five or ten years of credited service. Vesting is determined by the employee's class and date of hire. The monthly retirement allowance benefit formula is calculated based on the employee's age, years of credited service, average final compensation (AFC) and multiplier.

For employees who became members prior to January 1, 1971 the AFC is the average salary earned during the five highest paid years of service, including the vacation payment or the average salary earned during the three highest paid years of service excluding any lump sum vacation payment. For employees who became members on January 1, 1971 through June 30, 2012, the AFC is based on the three highest paid years of service excluding the vacation payment. For employees who became members after June 30, 2012, the AFC is the highest five years excluding any lump sum vacation payment.

The ERS issues a Comprehensive Annual Financial Report that may be obtained by writing to the Employees' Retirement System of the State of Hawaii, 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813 or found on the ERS website at <http://ers.hawaii.gov/resources/financials>.

## City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2017 and 2016

### 9. Employee Benefit Plans (continued)

#### a. Defined Benefit Pension Plans (continued)

##### Contributions

General employees covered under the contributory class and hired prior to July 1, 2012, are required to contribute 7.80% of their salary and will receive pensions based on a 2.00% multiplier. General employees hired after June 30, 2012, are required to contribute 9.80% of their salary with pensions based on a 1.75% multiplier. General employees covered under the hybrid class prior to July 1, 2012 are required to contribute 6.00% of their salary and will receive pensions based on a 2.00% multiplier. General employees hired after June 30, 2012, are required to contribute 8.00% of their salary with pensions based on a 1.75% multiplier. Employees covered under the noncontributory class will receive pensions based on a 1.25% multiplier.

Contributions are established by HRS Chapter 88 and may be amended through legislation. The employer rate is set by statute based on the recommendations of the ERS actuary resulting from an experience study conducted every five years. Since July 1, 2005, the employer contribution rate is a fixed percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liabilities. The Sewer Fund's contribution requirements as of June 30, 2017 and 2016 were approximately \$7.3 million and \$7.5 million, respectively.

The City is required to contribute the remaining amounts necessary to pay contributory class benefits and all amounts necessary to pay noncontributory class benefits. The funding method used to calculate the total employer contribution requirement is the Entry Age Normal Actuarial Cost Method.

Act 163/2011, which was effective July 1, 2012, established new employer contribution rates, which were effective through June 30, 2017. The rate for both fiscal years 2017 and 2016 is 17.0%.

On May 18, 2017, the Governor signed into law Act 17, SLH 2017, which increased future employer contributions are expected to increase pursuant to a phased-in contribution rate increase over four years beginning July 1, 2017. The rate for all employees increases to 18.00% on July 1, 2017; 19.00% on July 1, 2018; 22.00% on July 1, 2019; and 24.00% on July 1, 2020.

## City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2017 and 2016

### 9. Employee Benefit Plans (continued)

#### a. Defined Benefit Pension Plans (continued)

##### Pension Liabilities, Pension Expense, and Deferred Outflows and Deferred Inflows of Resources Related to Pensions

At June 30, 2017 and 2016, the Sewer Fund reported a liability of \$127.7 million and \$88.7 million, respectively, for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2016 and 2015, respectively, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Sewer Fund's proportion of the net pension liability was based on a projection of the Sewer Fund's long-term share of contributions to the pension plan relative to the projected contributions of all participating members of ERS, actuarially determined. At June 30, 2017, the City's proportion was 18.17%, which was an increase of 0.76% from its proportion measured as of June 30, 2015. At June 30, 2016, the City's proportion was 17.41%, which was an increase of 1.10% from its proportion measured as of June 30, 2014. The Sewer Fund's proportionate share of the City's proportionate share as of June 30, 2017 and 2016 was 5.26% and 5.83%, respectively.

For the fiscal year ended June 30, 2017 and 2016, the Sewer Fund recognized pension expense of \$11.9 million and \$7.5 million, respectively. At June 30, 2017, the Sewer Fund reported deferred outflows and inflows of resources related to pensions from the following sources (in thousands of dollars):

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Differences between expected and actual experience	\$ 4,754	\$ (1,393)
Net difference between projected and actual earnings on pension plan investments	8,620	-
Change of assumptions	26,096	-
Changes in proportion and differences between City contributions and proportionate share of contributions	2,202	(17,950)
City contributions subsequent to the measurement date	7,307	-
	<u>\$ 48,979</u>	<u>\$ (19,343)</u>

## City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2017 and 2016

### 9. Employee Benefit Plans (continued)

#### a. Defined Benefit Pension Plans (continued)

##### Pension Liabilities, Pension Expense, and Deferred Outflows and Deferred Inflows of Resources Related to Pensions (continued)

At June 30, 2016, as restated, the Sewer Fund reported deferred outflows and inflows of resources related to pensions from the following sources (in thousands of dollars):

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Differences between expected and actual experience	\$ 2,108	\$ (2,042)
Net difference between projected and actual earnings on pension plan investments	-	(3,520)
Change of assumptions	2,366	-
Changes in proportion and differences between City contributions and proportionate share of contributions	2,694	(13,472)
City contributions subsequent to the measurement date	<u>6,639</u>	<u>-</u>
	<u>\$ 13,807</u>	<u>\$ (19,034)</u>

\$7.3 million reported as deferred outflows of resources related to pension at June 30, 2016, resulting from Sewer Fund contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2017. Other amounts reported as deferred outflows and inflows of resources related to pension will be recognized in pension expense as follows (in thousands of dollars):

Year Ended June 30:	
2018	\$ (3,541)
2019	(3,541)
2020	(6,037)
2021	(5,918)
2022	<u>(3,292)</u>
	<u>\$ (22,329)</u>

# City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2017 and 2016

## 9. Employee Benefit Plans (continued)

### a. Defined Benefit Pension Plans (continued)

#### Actuarial Assumptions

The actuarial assumptions used in the June 30, 2015 valuation were based on the results of an actuarial experience study for the five year period ending June 30, 2010. There were significant changes in actuarial assumptions effective June 30, 2016 based on the Five-Year Experience Study report dated July 5, 2016 that resulted in a significant increase in the measurement of total pension liability. Primary drivers for the increase include a decrease in the investment return assumption and discount rate and decrease in mortality assumptions for longer life expectancy and an explicit assumption for continued future mortality improvement (generational approach). There were no other changes in assumptions between the measurement date, June 30, 2016, and the reporting date, June 30, 2017, that are expected to have a significant effect on the proportionate share of the net pension liability.

The total pension liability in the June 30, 2016 and 2015 actuarial valuation were determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	2.50% and 3.00%, respectively
Projected Salary Increases, Including Inflation	3.50% to 6.50% and 4.00% to 8.00%, respectively
Payroll Growth Rate	3.50%
Investment Rate of Return, Compounded Annually, Including Inflation	7.00% and 7.65%, respectively

There were no changes to ad hoc postemployment benefits including COLA.

For June 30, 2016, the post-retirement mortality rates are based on the 2016 Public Retirees of Hawaii mortality table with adjustments based on generational projections of the BB projection table for 2016 and full generational projection in future years. Pre-retirement mortality rates are based on multiples of RP-2014 mortality table based on the occupation of the member.

For June 30, 2015, the post-retirement mortality rates are based on client specific tables for general employees. Pre-retirement mortality rates are based on the RP-2000 combined mortality table.

# City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2017 and 2016

## 9. Employee Benefit Plans (continued)

### a. Defined Benefit Pension Plans (continued)

#### Actuarial Assumptions (continued)

The long-term expected rate of return on pension plan investments was determined using a “top down approach” of the Bespoke Client-Constrained Simulation-based Optimization Model (a statistical technique known as “re-sampling with replacement” that directly keys in on specific plan-level risk factors as stipulated by the ERS Board) in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.

The target allocation and best estimates of geometric real rates of return for each major asset class are summarized in the following table:

<u>Strategic Allocation (risk-based classes)</u>	<u>Target Allocation</u>	<u>Long-term Expected Geometric Rate of Return</u>
Broad growth	63.0%	8.35%
Principal protection	7.0%	2.20%
Real return	10.0%	6.15%
Crisis risk offset	<u>20.0%</u>	5.50%
	<u>100.0%</u>	

#### Discount Rate

The discount rate used to measure the total pension liability at June 30, 2016 and 2015 was 7.00% and 7.65%, respectively. The projection of cash flows used to determine the discount rate assumed that plan member contributions will be made at the current contribution rate and that employer contributions will be made at rates equal to the difference between actuarially determined contribution rates and the member rate. Based on these assumptions, the pension plan’s fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

## City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2017 and 2016

### 9. Employee Benefit Plans (continued)

#### a. Defined Benefit Pension Plans (continued)

##### Sensitivity of the Sewer Fund's proportionate share of the net pension liability to changes in the discount rate

The following presents the Sewer Fund's proportionate share of the net pension liability calculated using the single discount rate of 7.00%, as well as what the Sewer Fund's proportionate share of the net pension liability would be if it were calculated using a single discount rate that is 1-percentage point lower or 1-percentage-point higher than the current rates (in thousands of dollars):

	1 percent Decrease <u>(6.00%)</u>	Current Discount Rate (7.00%)	1 percent Increase <u>(8.00%)</u>
Sewer Fund's proportionate share of the net pension liability	\$ 165,127	\$ 127,677	\$ 96,689

##### Pension Plan fiduciary net position

The pension plan's fiduciary net position is determined on the same basis used by the pension plan. The ERS financial statements are prepared using the accrual basis of accounting under which expenses are recorded when the liability is incurred, and revenues are recorded in the accounting period in which they are earned and become measureable. Employer and member contributions are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan. Investment purchases and sales are recorded as of their trade date. Administrative expenses are financed exclusively with investment income. There were no significant changes after the June 30, 2016 measurement date.

##### Payables to the Pension Plan

The Sewer Fund had no outstanding payable to the Pension Plan as of June 30, 2017.

## City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2017 and 2016

### 9. Employee Benefit Plans (continued)

#### 10.

#### b. Post-Employment Healthcare and Life Insurance Benefits

The City contributes to the Hawaii Employer-Union Health Benefits Trust Fund (EUTF), an agent multiple-employer defined benefit plan. The EUTF was established to provide a single delivery system of health benefits for state and county workers, retirees, and their dependents. The eligibility requirements for retiree health benefits are based on date of hire. Act 88 established the EUTF during the State's 2001 legislative session and is codified in Chapter 87A, HRS.

#### City Policy

The actuarial valuation of the EUTF does not provide OPEB information by department or agency. Accordingly, the City's policy on the accounting and reporting for OPEB is to allocate a portion of the City's Annual Required Contribution (ARC), interest, and any adjustment to the ARC, to proprietary funds that are reported separately in stand-alone financial statements or in the City's CAFR. The basis for the allocation is the proportionate share of contributions made by each proprietary fund for retiree health benefits.

#### Allocated OPEB Cost

The Sewer Fund's OPEB expense is allocated by the City based on the Sewer Fund's proportionate share of contributions for retiree health benefits and was calculated at 6.2% and 6.3% of the City's ARC for the fiscal years ended June 30, 2017 and 2016, respectively. The following table shows the components of the annual OPEB cost for the fiscal years ended June 30, 2017 and 2016, the amount contributed to the plan, and changes in the Sewer Fund's net OPEB obligation (in thousands of dollars):

	<u>2017</u>	<u>2016</u>
Annual required contribution	\$ 9,971	\$ 9,664
Interest on net OPEB obligation	1,867	1,730
Adjustment to annual required contribution	<u>(1,957)</u>	<u>(1,787)</u>
Annual OPEB cost	9,881	9,607
Contributions made	<u>(7,868)</u>	<u>(6,962)</u>
Increase in net OPEB obligation	2,013	2,645
Net OPEB obligation:		
Beginning of year	<u>25,923</u>	<u>23,278</u>
End of year	<u>\$ 27,936</u>	<u>\$ 25,923</u>
Percentage of annual OPEB cost contributed	79.6%	72.5%



# City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2017 and 2016

## 9. Employee Benefit Plans (continued)

### b. Post-Employment Healthcare and Life Insurance Benefits (continued)

#### Allocated OPEB Cost (continued)

Contributions made to the plan were \$7.9 million, \$6.9 million and \$7.4 million for the fiscal years ended June 30, 2017, 2016 and 2015, respectively.

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 multi-year 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.

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, 2015 actuarial valuation, the entry age normal actuarial cost method was used. The actuarial assumptions included a discount rate of 7.0%, which was based on the City's anticipated funding level. Actuarial assumptions also included a blended annual health cost trend rate of 8.0% for 2016, reduced in decrements to an ultimate rate of 5.0% after eight years, and projected payroll increases of 3.5%. Actuarial assumptions also included an inflation rate of 3.0%, which was based on long-term expectations of inflation. The unfunded actuarial accrued liability is being amortized over a 30-year period as a level percentage of projected payroll on a closed basis.

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.

# City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2017 and 2016

## 10. Management Agreement

The Board of Water Supply (BWS) has an agreement with the City's Department of Environmental Services to provide certain services through June 30, 2017 for the billing and collection of sewer service charges. The revenue related to these fees is included in other operating revenues of BWS and the corresponding expense in the Sewer Fund. Service fees including credit card fees incurred amounted to \$3.1 million and \$3.9 million for the years ended June 30, 2017 and 2016, respectively, and is included on the statement of revenues, expenses and changes in net position as contractual services.

## 11. Commitments

### a. Construction Contracts

The City has contractual commitments for the Sewer Fund of approximately \$434.3 million at June 30, 2017, primarily for construction contracts.

### b. Accumulated Sick Leave Pay

Sick leave accumulates at the rate of one and three-quarters working days for each month, without limit. Sick leave is taken only in the event of illness and is not convertible to pay; accordingly, sick leave is not accrued. Employees who retire or leave government service in good standing with sixty or more unused sick leave days are entitled to an additional service credit in the retirement system. At June 30, 2017 and 2016, accumulated sick leave, including vested and nonvested accumulated rights to receive sick leave benefits, amounted to approximately \$20.6 million and \$20.9 million, respectively.

### c. Deferred Compensation Plan

All full-time employees of the Sewer Fund are eligible to participate in the City and County of Honolulu's Public Employees' Deferred Compensation Program (Plan) adopted pursuant to Internal Revenue Code Section 457. The Plan permits eligible employees to defer a portion of their salary until future years by contributing to a fund managed by a plan administrator. The deferred compensation amounts are not available to employees until termination, retirement, death or unforeseeable emergency.

A trust fund 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. Deferred compensation plan assets are not reported in the accompanying financial statements.

# City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2017 and 2016

## 11. Commitments (continued)

### d. EPA Consent Decree

The City is complying with the terms of a consent decree entered on December 17, 2010 (2010 Consent Decree), by the United States District Court for the District of Hawaii to resolve the claims of the United States Environmental Protection Agency (EPA), the State of Hawaii Department of Health (DOH), and various non-governmental entities related to the City's compliance with the federal Clean Water Act and State law. The 2010 Consent Decree allows 10 years for completion of work on improvement to the collection system, 14 years for the upgrade of the Honouliuli Wastewater Treatment Plant (WWTP) to secondary treatment, and up to 25 years, with the possibility of a three-year extension, for the upgrade of the Sand Island WWTP to secondary treatment.

Upon entering the 2010 Consent Decree, the City was expected to incur, in 2010 dollars, approximately \$3.5 billion in capital costs through fiscal year 2020, which coincides with the term of the collection system portion of the 2010 Consent Decree. This amount will largely be spent on the collection system, and much of it will go toward work that was already required or planned. This amount also includes a portion of the costs of treatment plant upgrades at Sand Island and Honouliuli. Costs for the treatment plant upgrades include, in 2010 dollars, approximately \$550 million to replace primary treatment facilities at both plants and \$1.15 billion to upgrade the plants to secondary treatment plants.

In March 2012, after providing an opportunity for public comment, the court approved an order at the request of all parties to modify the 2010 Consent Decree to substitute construction of a Kaneohe-Kailua gravity tunnel and an associated influent pump station for the construction of a new force main between the City's Kaneohe pump station and its Kailua treatment plant and to eliminate requirements to proceed with and maintain storage projects in Kaneohe and Kailua. The court order was the culmination of a year of negotiations among the parties after the EPA and DOH determined that the tunnel proposal offered potential environmental benefits. The Kaneohe-Kailua tunnel is presently under construction.

## **Required Supplementary Information**

## City and County of Honolulu, Sewer Fund

Schedule of City's Proportionate Share of the Net Pension Liability  
 Fiscal Years 2013-2016  
 (Amounts in Thousands)

### Defined Benefit Plan

The following presents the Schedule of City's Proportionate Share of the Net Pension Liability for the City as a whole, of which the Sewer Fund is one of its various enterprise funds.

<u>Fiscal Year Ended June 30,</u>	<u>Proportion of Net Pension Liability</u>	<u>Proportionate Share of Net Pension Liability</u>	<u>Covered Payroll</u>	<u>Proportionate Share of the Net Pension Liability as a Percentage of Covered Payroll</u>	<u>Plan Fiduciary Net Position as a Percentage of Total Pension Liability</u>
2016	18.17%	\$ 2,428,894	\$ 599,494	405.16%	51.28%
2015	17.41%	\$ 1,520,529	\$ 578,043	263.05%	62.42%
2014	16.31%	\$ 1,307,396	\$ 536,304	243.78%	63.92%
2013	16.76%	\$ 1,496,794	\$ 509,130	293.99%	57.96%

Prior Fiscal Years are not available. Table will be built prospectively.

See Independent Auditor's Report.

## City and County of Honolulu, Sewer Fund

Schedule of Contributions  
 Fiscal Years 2012-2017  
 (Amounts in Thousands)

### Defined Benefit Plan

The following presents the Schedule of Contributions for the City as a whole, of which the Sewer Fund is one of its various enterprise funds.

Fiscal Year Ended June 30,	Statutorily Required Contribution	Contributions in Relation to Statutorily Required Contribution	Contribution Excess (Deficiency)	Covered Payroll	Contribution as a Percentage of Covered Payroll
2017	\$ 140,342	\$ 139,569	\$ (773)	\$ 626,639	22.27%
2016	\$ 135,217	\$ 129,245	\$ (5,972)	\$ 599,494	21.56%
2015	\$ 121,465	\$ 132,308	\$ 10,843	\$ 578,043	22.89%
2014	\$ 102,885	\$ 87,979	\$ (14,906)	\$ 536,304	16.40%
2013	\$ 93,503	\$ 87,840	\$ (5,663)	\$ 509,130	17.25%
2012	\$ 89,275	\$ 81,690	\$ (7,585)	\$ 517,862	15.77%

Prior Fiscal Years are not available. Table will be built prospectively.

See Independent Auditor's Report.

## City and County of Honolulu, Sewer Fund

Notes to Schedule of City's Proportionate Share of the Net Pension Liability  
Fiscal Year Ended June 30, 2017

Amounts reported in the schedule of proportionate share of the net pension liability were significantly impacted by the following changes in assumptions for the measure period June 30, 2016:

- The discount rate decreased from 7.65% to 7.00%
- Mortality assumptions were modified to assume longer life expectancies, as well as continued mortality improvement.

Contribution rates are a percentage of pensionable payroll and are set by statute based on the recommendation of the ERS actuary. Act 256/2007 established contribution rates beginning July 1, 2008 through June 30, 2012. Act 163/2011 established contribution rates beginning July 1, 2012 through July 1, 2015. Act 17/2017 established new contribution rates beginning July 1, 2017 until statutory changes are implemented. Contribution rates by year are as follows:

<u>Effective Starting</u>	<u>Police and Fire</u>	<u>General Employees</u>
July 1, 2020	41.0%	24.0%
July 1, 2019	36.0%	22.0%
July 1, 2018	31.0%	19.0%
July 1, 2017	28.0%	18.0%
July 1, 2015	25.0%	17.0%
July 1, 2014	24.0%	16.5%
July 1, 2013	23.0%	16.0%
July 1, 2012	22.0%	15.5%
July 1, 2011	19.7%	15.0%

Act 152/2012 amended the definition of compensation for new employees hired after June 30, 2012 for the purpose of pension benefit calculations. Compensation is defined as normal periodic payments and does not include overtime, supplemental payments, bonuses, lump sum salary differentials and other types of differentials. For employees hired prior to July 1, 2012 compensation includes overtime, supplemental payments, bonuses and other types of differentials for the purpose of pension benefit calculations.

Act 153/2012 requires employers to pay additional contributions for those employees who retire on or after July 1, 2012 with significant "non-base pay" increases in the three or five years used to calculate their average final compensation and maximum retirement allowances. The amount is determined by comparing the maximum retirement allowance that would have been received without the significant non-base pay increase to the actual maximum allowance. These amounts are assessed, on a fiscal year basis, for all retirees meeting the criteria during the previous fiscal year.

See Independent Auditor's Report.

## City and County of Honolulu, Sewer Fund

Schedule of Funding Progress  
June 30, 2017  
(Amounts in Thousands)

### Post-Employment Healthcare and Life Insurance Benefits

The following presents the Schedule of Funding Progress for the City as a whole, of which the Sewer Fund is one of its various enterprise funds.

<u>Actuarial Valuation Date</u>	<u>Actuarial Value of Assets</u>	<u>Actuarial Accrued Liability (AAL)</u>	<u>Unfunded AAL (UAAL)</u>	<u>Funded Ratio</u>	<u>Covered Payroll</u>	<u>UAAL as a Percentage of Covered Payroll</u>
July 1, 2015	\$ 242,593	\$ 2,009,083	\$ 1,766,490	12.1%	\$ 613,054	288.1%
July 1, 2013	\$ 123,406	\$ 1,795,635	\$ 1,672,229	6.9%	\$ 551,642	303.1%
July 1, 2011	\$ 40,177	\$ 1,776,061	\$ 1,735,884	2.3%	\$ 548,355	316.6%

See Independent Auditor's Report.