

OFFICE OF THE CITY AUDITOR

City and County of Honolulu
State of Hawai'i

City and County of Honolulu Sewer Fund

**Financial Statements
June 30, 2015 and 2014**

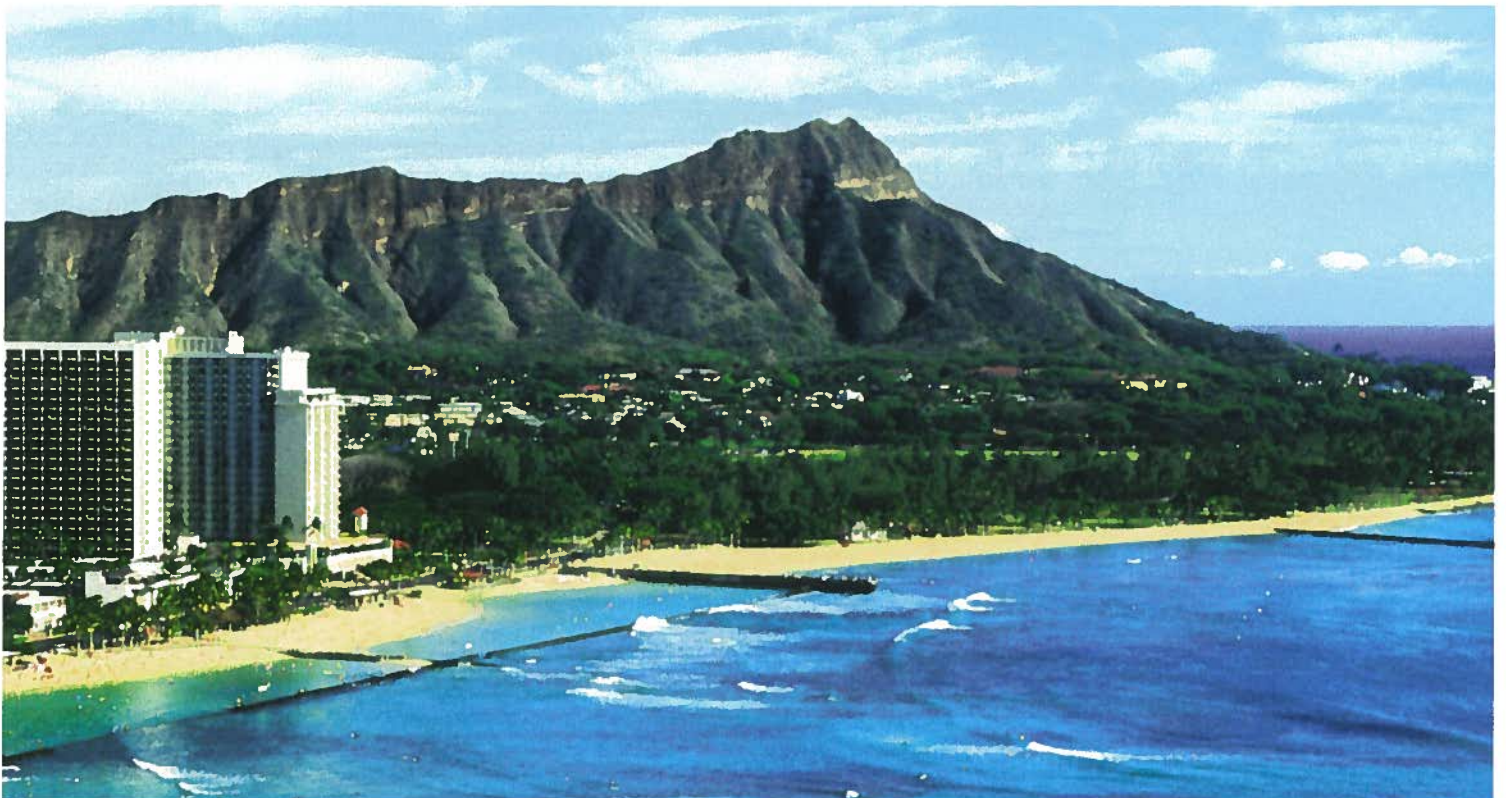


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A Hawaii Limited Liability Partnership

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, 2015 and 2014, 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, 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, 2015 and 2014, 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, 2015 and 2014, 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 2015 the Sewer Fund adopted Governmental Accounting Standards Board (GASB) Statements No. 68 (GASB 68), *Accounting and Reporting for Pensions (an amendment of GASB Statement No. 27)* and GASB Statement No. 71 (GASB 71), *Pension Transition for Contributions Made Subsequent to the Measurement Date, an Amendment of GASB Statement No. 68*. As a result of adopting these standards and management's determination that the restatement of the basic financial statements as of and for the year ended June 30, 2014 is not practical, the Sewer Fund has elected to restate beginning net position for fiscal year ended June 30, 2015. 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 County's proportionate share of the net pension liability, schedule of contributions and schedule of funding progress on pages 40, 41, and 42, respectively be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the GASB 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
February 17, 2016

City and County of Honolulu, Sewer Fund

Management's Discussion and Analysis
June 30, 2015 and 2014

The following summary discussion and analysis of the financial statements for the fiscal years ended June 30, 2015 and 2014 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

- 105.3 million gallons per day of wastewater were collected and treated in fiscal year 2015, an increase of 0.3% from fiscal year 2014. There were 105.0 million gallons per day of wastewater collected and treated in fiscal year 2014, 5.2% more than fiscal year 2013. As of June 30, 2015, the Wastewater Enterprise had approximately 145,700 customer accounts and served approximately 780,000 residents.
- Total assets and deferred outflows of resources were \$3,628.4 million and exceeded total liabilities and deferred inflows of resources by \$1,446.9 million as of June 30, 2015. As of June 30, 2014, total assets and deferred outflows of resources were \$3,512.2 million and exceeded total liabilities and deferred inflows of resources by \$1,401.6 million. As of June 30, 2015, net position (difference between assets, deferred inflows/outflows of resources, and liabilities) increased by \$45.3 million, or 3.2%, from June 30, 2014, while net position at June 30, 2014, increased by \$110.3 million, or 8.5%, from June 30, 2013. The increase in net position in 2015 was due to increased current and capital assets and the increase in net position in 2014 was due to increased capital assets.
- As of June 30, 2015, total assets increased by \$107.4 million to \$3,596.7 million, representing a 3.1% increase from the prior fiscal year, while total assets increased by \$86.7 million to \$3,489.3 million at June 30, 2014, representing a 2.5% increase from June 30, 2013. The increase in fiscal year 2015 and 2014 was due to additional capital assets.
- Total current and restricted assets decreased by 4.3% or \$43.3 million to \$952.5 million at June 30, 2015, while total current and restricted assets decreased by 1.2% or \$11.9 million to \$995.8 million at June 30, 2014. The decrease in 2015 and 2014 was primarily due to the expenditure of revenue bond proceeds.
- Total current liabilities increased by 13.2% or \$18.1 million to \$154.9 million primarily due to an increase in accounts payable. At June 30, 2015, total liabilities increased 2.7% or \$56.7 million to \$2,167.3 million due to an increase in accounts payable and inclusion of net pension liability. At June 30, 2014, total current liabilities decreased by 3.7% or \$5.2 million to \$136.8 million primarily due to a decrease in accounts payable. Total liabilities also decreased by 1.2% or \$25.1 million to \$2,110.6 million due to a decrease in accounts payable and bonds payable.

City and County of Honolulu, Sewer Fund

Management's Discussion and Analysis
June 30, 2015 and 2014

- Due to the implementation of Government Accounting Standards ("GASB") No. 68, *Accounting and Financial Reporting for Pensions*, during fiscal year 2015, the July 1, 2014 beginning net position has been restated in the amount of \$92.9 million. It was not practical to determine the amounts of all deferred inflows and outflows of resources for fiscal year 2014, therefore the 2014 financial statements have not been restated for the management's discussion and analysis.

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, 2015 and 2014

Financial Analysis

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

Statements of Net Position

	2015	2014	2013 (As Previously Restated)
Assets:			
Current assets	\$ 837,396	\$ 739,148	\$ 656,442
Restricted assets	115,089	256,627	351,253
Capital assets, net	2,642,920	2,492,101	2,393,340
Other noncurrent assets	1,314	1,462	1,622
Deferred Outflows of Resources	31,683	22,904	24,446
Total assets and deferred outflows	<u>\$ 3,628,402</u>	<u>\$ 3,512,242</u>	<u>\$ 3,427,103</u>
Liabilities:			
Current liabilities	\$ 154,915	\$ 136,849	\$ 142,039
Noncurrent liabilities	2,012,361	1,973,769	1,993,729
Deferred Inflows of Resources	14,224	-	-
Total liabilities and deferred inflows	<u>2,181,500</u>	<u>2,110,618</u>	<u>2,135,768</u>
Net investment in capital assets	713,781	659,812	638,760
Restricted for debt service	181,029	178,187	177,890
Unrestricted	552,092	563,625	474,685
Total net position	<u>1,446,902</u>	<u>1,401,624</u>	<u>1,291,335</u>
Total liabilities, deferred inflows, and net position	<u>\$ 3,628,402</u>	<u>\$ 3,512,242</u>	<u>\$ 3,427,103</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 \$1,446.9 million and \$1,401.6 million at the end of fiscal years 2015 and 2014, respectively. Additions of capital assets resulted in a 3.2% increase in net position from fiscal year 2014 to 2015. 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, 2015 and 2014

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

	2015	2014	2013 (As Previously Restated)
Operating revenues	\$ 397,389	\$ 390,351	\$ 372,394
Operating expenses	<u>(191,658)</u>	<u>(211,608)</u>	<u>(216,259)</u>
Operating income	205,731	178,743	156,135
Nonoperating revenues (expenses)			
Interest income	1,196	1,323	1,378
Interest expense	(60,541)	(65,162)	(59,844)
Other	<u>4,834</u>	<u>4,794</u>	<u>4,063</u>
Income before transfers and capital contributions	151,220	119,698	101,732
Transfers out	(13,805)	(9,915)	(12,885)
Capital contributions	<u>782</u>	<u>506</u>	<u>1,244</u>
Change in net position	138,197	110,289	90,091
Net position			
Beginning of year, as previously reported	1,401,624	1,291,335	1,201,244
Restatement due to change in accounting principle	<u>(92,919)</u>	<u>-</u>	<u>-</u>
Beginning of year, as restated	<u>1,308,705</u>	<u>1,291,335</u>	<u>1,201,244</u>
End of year	<u>\$ 1,446,902</u>	<u>\$ 1,401,624</u>	<u>\$ 1,291,335</u>

The changes in net position were primarily due to:

- Operating revenues, comprised mainly of sewer service charges, increased 1.8% to \$397.4 million for the fiscal year 2015 compared to the prior fiscal year and increased 4.8% to \$390.4 million for fiscal year 2014 compared to fiscal year 2013. Sewer service charge rates were raised 4 percent July 1, 2014. Full value of the rate increase was not reached due to continuing adjustments of base charges for non-residential customers initially implemented in January 2013.
- Operating expenses decreased \$19.9 million or 9.4% to \$191.7 million for fiscal year 2015 compared to the prior fiscal year and decreased \$4.7 million or 2.2% to \$211.6 million for fiscal year 2014 compared to fiscal year 2013. The primary decrease in 2015 was in administration and general, utilities, and contractual services. The primary decrease in 2014 was in administration and general, depreciation, and contractual services.

City and County of Honolulu, Sewer Fund

Management's Discussion and Analysis
June 30, 2015 and 2014

- Interest expense decreased by \$4.6 million or 7.1% to \$60.5 million for fiscal 2015 compared to the prior fiscal year and increased by \$5.3 million or 8.9% to \$65.2 million for fiscal 2014 compared to fiscal year 2013. The decrease in 2015 was due to a decrease in interest expense on wastewater revenue bonds and an increase in interest expense that was capitalized and the increase in 2014 was due to issuance of additional state revolving fund loans and a decrease in interest expense that was capitalized.
- Contributed capital increased to \$0.78 million in fiscal year 2015 up from \$0.51 million in fiscal year 2014 and \$1.24 million in fiscal year 2013. Contributed capital represents assets (primarily capital assets) transferred from other city governmental funds and other entities. Approximately \$13.8 million was transferred out during fiscal year 2015 for the Wastewater Enterprise's share of central administrative expenses incurred by the City and \$9.9 million was transferred out during fiscal year 2014 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 \$2.6 billion and \$2.5 billion, net of accumulated depreciation, as of June 30, 2015 and 2014, respectively, an increase of \$150.8 million or 6.1% in 2015 and \$98.8 million or 4.1% in 2014. Capital assets include land, buildings, infrastructure, land improvements, equipment and machinery for the 9 treatment plants, 68 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, 2015 and 2014 totaled \$1,665.7 million and \$1,718.0 million, respectively. The long term portion of state revolving fund notes payable outstanding at June 30, 2015 and 2014 totaled \$225.2 million and \$226.4 million, respectively.

Debt service coverage was 293% on Senior Revenue Bonds, 204% on all revenue bonds, and 178% on all debt at June 30, 2015, compared to 276% on Senior Revenue Bonds, 192% on all revenue bonds, and 165% on all debt at June 30, 2014. Debt service coverage exceeded the requirements of bond covenants and policies of the City Council in 2015 and 2014.

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, 2015 and 2014

Currently Known Facts, Decisions or Conditions

Sewer service charge rates were increased by 4% effective July 1, 2014. Rate structure changes were implemented July 1, 2012, for residential customers and January 23, 2013, for non-residential customers. Sewer service charges increased 5% on July 1, 2015. In support 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 2016.

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, 2015 and 2014
 (Amounts in thousands)

Assets and Deferred Outflows of Resources

	<u>2015</u>	<u>2014</u>
Current Assets:		
Cash and cash equivalents	\$ 243,703	\$ 446,343
Investments	522,685	222,289
Receivables:		
Accounts, net of allowance for uncollectible accounts of \$5,190 and \$4,397, respectively	51,752	52,690
Interest	174	191
Employee advances	951	1,012
Total receivables	<u>52,877</u>	<u>53,893</u>
Due from other City funds	321	337
Inventories of materials and supplies	15,251	13,848
Prepaid expenses	2,559	2,438
Total current assets	<u>837,396</u>	<u>739,148</u>
Restricted Assets – Investments	115,089	256,627
Capital Assets, Net	2,642,920	2,492,101
Other Assets	1,314	1,462
Total assets	<u>3,596,719</u>	<u>3,489,338</u>
Deferred Outflows of Resources:		
Deferred refunding costs, net	21,358	22,904
Deferred pension costs	10,325	-
Total deferred outflows of resources	<u>31,683</u>	<u>22,904</u>
Total assets and deferred outflows of resources	<u>\$ 3,628,402</u>	<u>\$ 3,512,242</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, 2015 and 2014
 (Amounts in thousands)

Liabilities, Deferred Inflows of Resources, and Net Position

	<u>2015</u>	<u>2014</u>
Current Liabilities:		
Accounts payable	\$ 56,568	\$ 38,298
Due to other City funds	4	6,024
Interest payable	30,524	31,140
Bonds payable	45,573	39,440
Notes payable	20,130	18,969
Accrued payroll	1,644	1,593
Other current liabilities	472	1,385
Total current liabilities	<u>154,915</u>	<u>136,849</u>
Revenue Bonds Payable, Net	1,665,702	1,717,990
Net Pension Liability	90,284	-
Notes Payable	225,157	226,376
General Obligation Bonds Payable, Net	853	874
Other Liabilities	30,365	28,529
Total liabilities	<u>2,167,276</u>	<u>2,110,618</u>
Deferred Inflows of Resources--		
Deferred Pension Costs	<u>14,224</u>	<u>-</u>
Net Position:		
Net investment in capital assets	713,781	659,812
Restricted for debt service	181,029	178,187
Unrestricted	552,092	563,625
Total net position	<u>1,446,902</u>	<u>1,401,624</u>
Total liabilities, deferred inflows of resources, and net position	<u>\$ 3,628,402</u>	<u>\$ 3,512,242</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, 2015 and 2014
 (Amounts in thousands)

	<u>2015</u>	<u>2014</u>
Operating Revenues:		
Sewer service charges	\$ 387,957	\$ 384,096
Other revenue	9,432	6,255
Total operating revenues	<u>397,389</u>	<u>390,351</u>
Operating Expenses:		
Administrative and general	55,308	68,387
Depreciation	58,111	55,991
Utilities	25,180	28,710
Fringe benefits	23,140	24,206
Contractual services	16,945	21,137
Materials and supplies	11,269	10,876
Fuel and lubricants	1,211	1,768
Maintenance	494	533
Total operating expenses	<u>191,658</u>	<u>211,608</u>
Income from operations	<u>205,731</u>	<u>178,743</u>
Nonoperating Revenues (Expenses):		
Interest income	1,196	1,323
Interest expense	(60,541)	(65,162)
Other	4,834	4,794
Total nonoperating expenses	<u>(54,511)</u>	<u>(59,045)</u>
Income before transfers and capital contributions	151,220	119,698
Transfers Out	(13,805)	(9,915)
Capital Contributions	782	506
Changes in net position	138,197	110,289
Net Position at Beginning of Year, as Previously Reported	1,401,624	1,291,335
Restatement Due to Change in Accounting Principle	(92,919)	-
Net Position at Beginning of Year, as Restated	<u>1,308,705</u>	<u>-</u>
Net Position, End of Year	<u>\$ 1,446,902</u>	<u>\$ 1,401,624</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, 2015 and 2014
 (Amounts in thousands)

	<u>2015</u>	<u>2014</u>
Cash Flows from Operating Activities:		
Cash received from customers	\$ 397,524	\$ 394,718
Cash payments to suppliers	(66,506)	(86,547)
Cash payments to employees	(61,466)	(59,427)
Net cash provided by operating activities	<u>269,552</u>	<u>248,744</u>
Cash Flows from Noncapital Financing Activities --		
Transfers Out	<u>(13,805)</u>	<u>(9,915)</u>
Cash Flows from Capital and Related Financing Activities:		
Acquisition and construction of capital assets	(180,649)	(158,894)
Proceeds from issuance of notes	20,000	44,445
Repayments on notes	(20,058)	(20,231)
Interest paid on notes	(2,372)	(2,446)
Proceeds from issuance of bonds, net of premium	2	-
Repayments on bonds	(41,984)	(33,663)
Interest paid on bonds	(80,759)	(80,627)
Interest subsidies for wastewater system revenue bonds	4,975	4,982
Non-operating revenue	106	-
Net cash used in capital and related financing activities	<u>(300,739)</u>	<u>(246,434)</u>
Cash Flows from Investing Activities:		
Purchase of investments	(1,412,096)	(1,271,180)
Proceeds from maturity of investments	1,253,235	1,284,764
Interest on investments	1,213	1,411
Net cash (used in) provided by investing activities	<u>(157,648)</u>	<u>14,995</u>
Net (decrease) increase in cash and cash equivalents	(202,640)	7,390
Cash and Cash Equivalents, Beginning of Year	<u>446,343</u>	<u>438,953</u>
Cash and Cash Equivalents, End of Year	<u>\$ 243,703</u>	<u>\$ 446,343</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, 2015 and 2014
 (Amounts in thousands)

	<u>2015</u>	<u>2014</u>
Reconciliation of Income from Operations to Net Cash		
Provided by Operating Activities:		
Income from operations	\$ 205,731	\$ 178,743
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation	58,111	55,991
Write-off of capital assets	6,144	6,581
Change in assets, liabilities and deferred inflows/outflows of resources:		
Accounts receivable	1,000	6,533
Due from other City funds	16	183
Inventories of materials and supplies	(1,403)	(967)
Deferred outflows of resources	119	-
Accounts payable	1,338	(2,106)
Other liabilities	974	2,723
Net pension liability	(13,079)	-
Due to other City funds	(3,623)	1,063
Deferred inflows of resources	14,224	-
Net cash provided by operating activities	<u>\$ 269,552</u>	<u>\$ 248,744</u>

Supplemental Disclosure of Noncash Capital and Related Financing Activities:

The Sewer Fund received \$0.8 million and \$0.5 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, 2015 and 2014, respectively.

Amortization of net bond premiums and discounts amounted to \$6.7 million in both fiscal years 2015 and 2014.

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

City and County of Honolulu, Sewer Fund

Notes to Financial Statements
June 30, 2015 and 2014

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.

New Accounting Standards Adopted

Effective July 1, 2014 the Sewer Fund implemented GASB Statement No. 68 (GASB 68), *Accounting and Reporting for Pensions (an amendment of GASB Statement No. 27)* and GASB Statement No. 71 (GASB 71), *Pension Transition for Contributions Made Subsequent to the Measurement Date, an Amendment of GASB Statement No. 68*. GASB 68 establishes standards of accounting and financial reporting for defined benefit pensions and defined contribution pensions provided to the employees of state and local government employers through pension plans that are administered through trusts or equivalent arrangements in which:

- Contributions from employers and nonemployer contributing entities to the pension plan and earnings on those contributions are irrevocable.

City and County of Honolulu, Sewer Fund

Notes to Financial Statements
June 30, 2015 and 2014

2. Summary of Significant Accounting Policies (continued)

b. Basis of Accounting (continued)

New Accounting Standards Adopted (continued)

- Pension plan assets are dedicated to providing pensions to plan members in accordance with the benefit terms.
- Pension plan assets are legally protected from the creditors of employer, nonemployee contributing entities, and the pension plan administrator. If the plan is a defined benefit pension plan, plan assets also are legally protected from creditors of the plan members.

GASB 68 replaces the requirements of GASB Statement No. 27 (GASB 27), *Accounting for Pensions by State and Local Governmental Employers*, as well as the requirements of GASB Statement No. 50 (GASB 50), *Pension Disclosures*, as they related to pensions that are provided through pension plans administered as trusts or equivalent arrangements that meet certain criteria. The requirements of GASB 27 and 50 remain applicable for pensions that are not covered by the scope of GASB 68.

GASB 71 is required to be implemented simultaneously with GASB 68 and amends the requirement related to certain pension contributions made to defined benefit pension plans prior to implementation of GASB 68 by employers and nonemployer contributing entities.

As permitted in GASB 68, since management has determined that the restatement of fiscal year 2014 is not practical, the cumulative effect of adopting GASB 68 related to prior fiscal years has been recorded as a prior period adjustment to beginning net position for the fiscal year ended June 30, 2015. The adoption of GASB 68 and 71 has resulted in the restatement of the Sewer Fund's fiscal year 2015 beginning net position by approximately \$(103,363,000) and \$10,444,000 related to changes in net pension liability and deferred outflows, respectively, from prior fiscal years. See Note 9 for further information.

City and County of Honolulu, Sewer Fund

Notes to Financial Statements
June 30, 2015 and 2014

2. Summary of Significant Accounting Policies (continued)

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.

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. government securities and are stated at cost, which approximates fair value.

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 \$23.9 million and \$24.9 million at June 30, 2015 and 2014, 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.

City and County of Honolulu, Sewer Fund

Notes to Financial Statements
June 30, 2015 and 2014

2. Summary of Significant Accounting Policies (continued)

h. Restricted Assets

Revenue bond indentures allow the City to invest in U.S. Government Securities. At June 30, 2015, restricted assets consist of unspent debt proceeds of \$6.9 million and revenue bond collateral reserves of approximately \$108.2 million. At June 30, 2014, restricted assets consist of unspent debt proceeds of \$148.4 million and revenue bond collateral reserves of approximately \$108.2 million.

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.

City and County of Honolulu, Sewer Fund

Notes to Financial Statements
June 30, 2015 and 2014

2. Summary of Significant Accounting Policies (continued)

k. 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 No. 68, 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 2014 fiscal year is 5.7661 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.

l. 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, 2015 and 2014

2. Summary of Significant Accounting Policies (continued)

m. 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.

n. 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.

o. 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.

p. 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, 2015 and 2014

2. Summary of Significant Accounting Policies (continued)

q. 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.

r. New Accounting Pronouncements

In February 2015, GASB issued Statement No. 72 (GASB 72), *Fair Value Measurement and Application*. GASB 72 establishes a hierarchy of inputs used to measure fair value consisting of three levels and requires the Sewer Fund to disclose the valuation inputs and valuation techniques that was used for fair value measurements. GASB 72 will be effective for the Sewer Funds's financial statements for the year ending June 30, 2016. Management is currently evaluating the impact of the adoption of GASB 72 will have on the Sewer Fund's financial statements.

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 will be effective for the Sewer Funds's financial statements for the year ending June 30, 2017. Management is currently evaluating the impact of the adoption of GASB 73 will have on the Sewer Fund's financial statements.

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 of the adoption of GASB 75 will have on the Sewer Fund's financial statements.

City and County of Honolulu, Sewer Fund

Notes to Financial Statements
June 30, 2015 and 2014

2. Summary of Significant Accounting Policies (continued)

r. New Accounting Pronouncements (continued)

In August 2015, GASB issued Statement No. 76 (GASB 76), *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. This statement supersedes Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. The objective of this Statement is to identify the hierarchy of generally accepted principles used to prepare financial statements of state and local governments. As a result, governments will apply financial reporting guidance with less variation, which will improve the usefulness of financial statements. The provisions of this Statement are effective for periods beginning after June 15, 2015. Management is currently assessing the impact of GASB 76 and has not yet determined the effect this Statement will have on its financial statements.

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, 2015 and 2014. The remaining balance at June 30, 2015 is invested in the City's pooled investment fund. Information pertaining to credit risk and interest rate risk 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.

City and County of Honolulu, Sewer Fund

Notes to Financial Statements
June 30, 2015 and 2014

4. Credit Risk (continued)

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, 2015, except as provided in the allowance for uncollectible accounts. The City manages its credit exposure through procedures designed to identify and monitor credit risk.

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 \$321,000 and \$337,000 at June 30, 2015 and 2014, 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, 2015 and 2014 were as follows (in thousands of dollars):

	Balance at July 1, 2014	Additions	Retirements/ Transfers	Balance at June 30, 2015
Depreciable assets				
Buildings and improvements	\$ 1,070,966	\$ 55,326	\$ -	\$ 1,126,292
Transmission and distribution system	1,528,690	36,029	(1,107)	1,563,612
Equipment and machinery	61,053	14,691	(1,121)	74,623
Land improvements	3,511	-	-	3,511
Total depreciable assets	2,664,220	106,046	(2,228)	2,768,038
Less: Accumulated depreciation				
Buildings and improvements	(216,272)	(23,960)	-	(240,232)
Transmission and distribution system	(312,584)	(29,514)	316	(341,782)
Equipment and machinery	(37,012)	(4,518)	808	(40,722)
Land improvements	(1,756)	(119)	-	(1,875)
Total accumulated depreciation	(567,624)	(58,111)	1,124	(624,611)
	2,096,596	47,935	(1,104)	2,143,427
Land	42,284	3,135	(9)	45,410
Construction in progress	353,221	197,410	(96,548)	454,083
	<u>\$ 2,492,101</u>	<u>\$ 248,480</u>	<u>\$ (97,661)</u>	<u>\$ 2,642,920</u>

City and County of Honolulu, Sewer Fund

Notes to Financial Statements
June 30, 2015 and 2014

6. Capital Assets (continued)

	Balance at June 30, 2013 (As Previously Restated)	Additions	Retirements/ Transfers	Balance at June 30, 2014
Depreciable assets				
Buildings and improvements	\$ 1,055,542	\$ 15,424	\$ -	\$ 1,070,966
Transmission and distribution system	1,494,068	34,752	(130)	1,528,690
Equipment and machinery	57,916	4,026	(889)	61,053
Land improvements	3,511	-	-	3,511
Total depreciable assets	<u>2,611,037</u>	<u>54,202</u>	<u>(1,019)</u>	<u>2,664,220</u>
Less: Accumulated depreciation				
Buildings and improvements	(193,350)	(22,922)	-	(216,272)
Transmission and distribution system	(283,812)	(28,844)	72	(312,584)
Equipment and machinery	(33,755)	(4,106)	849	(37,012)
Land improvements	(1,637)	(119)	-	(1,756)
Total accumulated depreciation	<u>(512,554)</u>	<u>(55,991)</u>	<u>921</u>	<u>(567,624)</u>
	2,098,483	(1,789)	(98)	2,096,596
Land	42,099	185	-	42,284
Construction in progress	252,758	145,646	(45,183)	353,221
	<u>\$ 2,393,340</u>	<u>\$ 144,042</u>	<u>\$ (45,281)</u>	<u>\$ 2,492,101</u>

Depreciation expense was approximately \$58.1 million and \$56.0 million for the years ended June 30, 2015 and 2014, 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 2015 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 0.7% to 5.0% at June 30, 2015. 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, 2015 and 2014

7. Long-Term Obligations (continued)

Wastewater system revenue bonds in the City's business-type activities were issued during fiscal years 1999 through 2013, in the original amount totaling \$2.2 billion, less discounts of \$36.1 million and adjusted for premiums of \$108.7 million, which are being amortized over the related term of the bonds. The bonds bear interest at 2.0% to 6.3% at June 30, 2015 and mature at various dates through fiscal year 2046. The wastewater system revenues collateralize the revenue bonds.

The notes payable to the State are for the construction of necessary treatment works. The notes amounted to \$245.3 million at June 30, 2015 and 2014, bearing interest ranging from 0.5% to 3.0%, and require annual principal and interest payments through fiscal year 2032.

Total interest costs incurred in 2015 and 2014 were approximately \$75.9 million and \$77.2 million, respectively, of which \$15.4 million and \$12.0 million was capitalized in 2015 and 2014, respectively.

Long-term obligations activity for the fiscal years ended June 30, 2015 and 2014 were as follows (in thousands of dollars):

	Balance at July 1, 2014 (Restated)	Additions	Reductions	Balance at June 30, 2015	Amount Due Within One Year
General obligation bonds	\$ 810	\$ 2	\$ (9)	\$ 803	\$ 9
Revenue bonds	1,691,650	-	(39,458)	1,652,192	45,564
Notes payable	245,345	20,000	(20,058)	245,287	20,130
	<u>1,937,805</u>	<u>20,002</u>	<u>(59,525)</u>	<u>1,898,282</u>	<u>65,703</u>
Add: Unamortized net premium (discount)	65,844	-	(6,711)	59,133	-
Total long-term debt	<u>2,003,649</u>	<u>20,002</u>	<u>(66,236)</u>	<u>1,957,415</u>	<u>65,703</u>
Net pension liability	103,363	-	(13,079)	90,284	-
Compensated absences	7,764	2,742	(2,947)	7,559	472
Other postretirement benefits	20,896	9,817	(7,435)	23,278	-
Arbitrage rebate	319	-	(319)	-	-
Total long-term obligations	<u>\$ 2,135,991</u>	<u>\$ 32,561</u>	<u>\$ (90,016)</u>	<u>\$ 2,078,536</u>	<u>\$ 66,175</u>

City and County of Honolulu, Sewer Fund

Notes to Financial Statements
June 30, 2015 and 2014

7. Long-Term Obligations (continued)

	Balance at July 1, 2013	Additions	Reductions	Balance at June 30, 2014	Amount Due Within One Year
General obligation bonds	\$ 821	\$ -	\$ (11)	\$ 810	\$ 8
Revenue bonds	1,727,586	-	(35,936)	1,691,650	39,432
Notes payable	221,131	44,445	(20,231)	245,345	18,969
	<u>1,949,538</u>	<u>44,445</u>	<u>(56,178)</u>	<u>1,937,805</u>	<u>58,409</u>
Add: Unamortized net premium (discount)	<u>72,569</u>	<u>-</u>	<u>(6,725)</u>	<u>65,844</u>	<u>-</u>
Total long-term debt	2,022,107	44,445	(62,903)	2,003,649	58,409
Compensated absences	7,778	2,731	(2,745)	7,764	450
Other postretirement benefits	18,908	9,931	(7,943)	20,896	-
Arbitrage rebate	311	8	-	319	-
Total long-term obligations	<u>\$ 2,049,104</u>	<u>\$ 57,115</u>	<u>\$ (73,591)</u>	<u>\$ 2,032,628</u>	<u>\$ 58,859</u>

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

Scheduled maturities of long-term debt at June 30, 2015 are as follows (in thousands of dollars):

Year ending June 30,	General Obligation Bonds	Revenue Bonds	Notes Payable	Total Principal	Total Interest
2016	\$ 9	\$ 45,564	\$ 20,130	\$ 65,703	\$ 79,317
2017	58	50,771	20,303	71,132	77,386
2018	60	55,588	20,143	75,791	75,294
2019	55	57,795	19,228	77,078	72,973
2020	58	60,082	17,782	77,922	70,543
2021–2025	327	343,806	85,259	429,392	307,269
2026–2030	236	406,114	51,146	457,496	214,924
2031–2035	-	336,460	11,296	347,756	120,908
2036–2040	-	235,779	-	235,779	43,574
2041–2045	-	60,117	-	60,117	3,538
2046	-	116	-	116	5,725
	<u>803</u>	<u>1,652,192</u>	<u>245,287</u>	<u>1,898,282</u>	<u>\$ 1,071,451</u>
Less: Current portion	<u>(9)</u>	<u>(45,564)</u>	<u>(20,130)</u>	<u>(65,703)</u>	
	<u>\$ 794</u>	<u>\$ 1,606,628</u>	<u>\$ 225,157</u>	<u>\$ 1,832,579</u>	

City and County of Honolulu, Sewer Fund

Notes to Financial Statements
June 30, 2015 and 2014

8. Net Position

At June 30, 2015 and 2014, net position consisted of the following (in thousands of dollars):

	<u>2015</u>	<u>2014</u>
Net investment in capital assets:		
Net property, plant and equipment	\$ 2,642,920	\$ 2,492,101
Deferred outflows of resources - deferred reunding costs, net	21,358	22,904
Less:		
Wastewater general obligation bonds payable, net of unamortized premiums and discounts	(862)	(874)
Wastewater system revenue bonds payable, net of unamortized premiums and discounts	(1,711,266)	(1,757,430)
Notes payable	(245,287)	(245,345)
Amount of debt related to unspent debt proceeds	<u>6,918</u>	<u>148,456</u>
	713,781	659,812
Restricted for debt service	181,029	178,187
Unrestricted	<u>552,092</u>	<u>563,625</u>
Total	<u>\$ 1,446,902</u>	<u>\$ 1,401,624</u>

At June 30, 2015 and 2014, restricted for debt service includes approximately \$108.2 million 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, 2015 and 2014

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, 2015 and 2014

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 requirement as of June 30, 2015, 2014, and 2013 were approximately \$7.6 million, \$7.1 million, and \$6.5 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. The rates for fiscal years 2015 and 2016 are as follows:

<u>Effective Starting</u>	<u>General Employees (%of total payroll)</u>
July 1, 2014	16.5%
July 1, 2015	17.0%

City and County of Honolulu, Sewer Fund

Notes to Financial Statements
June 30, 2015 and 2014

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, 2015 the Sewer Fund reported a liability of \$90.3 million for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2014, 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. There were no changes in other assumptions and inputs that affected the measurement of the total pension liability since the prior measurement date. There were no changes between the measurement date, June 30, 2014, and the reporting date, June 30, 2015, that are expected to have a significant effect on the proportionate share of the net pension liability. At June 30, 2014 the City's proportion was 16.31% which was a decrease of 0.45% from its proportion measured as of June 30, 2013. The Sewer Fund's proportionate share of the City's proportionate share is 6.91%.

City and County of Honolulu, Sewer Fund

Notes to Financial Statements
June 30, 2015 and 2014

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)

For the fiscal year ended June 30, 2015, the Sewer Fund recognized pension expense of \$10.2 million. At June 30, 2015, 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	\$ 528	\$ (1,385)
Net difference between projected and actual earnings on pension plan investments	-	(12,839)
Changes in proportion and differences between City contributions and proportionate share of contributions	813	-
City contributions subsequent to the measurement date	8,984	-
	<u>\$ 10,325</u>	<u>\$ (14,224)</u>

\$8.984 million reported as deferred outflows of resources related to pension 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, 2016. 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:	
2016	\$ (3,219)
2017	(3,219)
2018	(3,219)
2019	(3,219)
2020	(7)
	<u>\$ (12,883)</u>

City and County of Honolulu, Sewer Fund

Notes to Financial Statements
June 30, 2015 and 2014

9. Employee Benefit Plans (continued)

a. Defined Benefit Pension Plans (continued)

Actuarial Assumption

The total pension liability in the June 30, 2014 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.00 %
Payroll Growth Rate	3.50 %
Investment Rate of Return, Including Inflation	7.75 %

The same rates were applied to all periods. There were no changes to ad hoc postemployment benefits including COLA.

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.

The actuarial assumptions used in the June 30, 2014 valuation were based on the results of an actuarial experience study for the five year period ending June 30, 2010. The ERS updates their experience studies every five years.

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.

City and County of Honolulu, Sewer Fund

Notes to Financial Statements
June 30, 2015 and 2014

9. Employee Benefit Plans (continued)

a. Defined Benefit Pension Plans (continued)

Actuarial Assumption (continued)

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

Asset Class	Long-Term Target Allocation	Long-Term Expected Real Rate of Return
Domestic equity	30%	8.5%
International equity	26	9.0
Fixed income	20	3.1
Real estate	7*	8.5
Private equity	7*	11.8
Real return	5*	6.1
Covered calls	5	7.7
Total	100%	

*The real estate, private equity, and real return targets will be the percentage actually invested up to 7%, 7%, and 5%, respectively, of the total fund. Changes in the real estate, private equity, and real return targets will be offset by an equal percentage change in the large cap domestic equity target.

Discount Rate

The discount rate used to measure the total pension liability was 7.75%. 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. There has been no change in the discount rate since the prior measurement date.

City and County of Honolulu, Sewer Fund

Notes to Financial Statements
June 30, 2015 and 2014

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 7.75%, 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 (6.75%)	Current Discount Rate (7.75%)	1 percent Increase (8.75%)
Sewer Fund's proportionate share of the net pension liability	\$ 117,738	\$ 90,284	\$ 62,829

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, 2014 measurement date.

Payables to the Pension Plan

The Sewer Fund had no outstanding payable to the Pension Plan as of June 30, 2015.

City and County of Honolulu, Sewer Fund

Notes to Financial Statements
June 30, 2015 and 2014

9. Employee Benefit Plans (continued)

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

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 6.7% of the City’s ARC for the fiscal years ended June 30, 2015 and 2014, respectively. The following table shows the components of the annual OPEB cost for the fiscal years ended June 30, 2015 and 2014, the amount contributed to the plan, and changes in the Sewer Fund’s net OPEB obligation (in thousands of dollars):

	2015	2014
Annual required contribution	\$ 9,754	\$ 9,779
Interest on net OPEB obligation	1,632	1,472
Adjustment to annual required contribution	(1,569)	(1,320)
Annual OPEB cost	9,817	9,931
Contributions made	(7,435)	(7,943)
Increase in net OPEB obligation	2,382	1,988
Net OPEB obligation		
Beginning of year	20,896	18,908
End of year	\$ 23,278	\$ 20,896
Percentage of annual OPEB cost contributed	75.7%	80.0%

City and County of Honolulu, Sewer Fund

Notes to Financial Statements
June 30, 2015 and 2014

9. Employee Benefit Plans (continued)

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

Allocated OPEB Cost (continued)

Contributions made to the plan were \$7.4 million, \$7.9 million and \$7.7 million for the fiscal years ended June 30, 2015, 2014 and 2013, 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, 2013 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 8.25% for 2014, reduced in decrements to an ultimate rate of 5% after ten 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, 2015 and 2014

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 \$3.4 million and \$2.6 million for the years ended June 30, 2015 and 2014, respectively.

11. Commitments

a. Construction Contracts

The City has contractual commitments for the Sewer Fund of approximately \$412 million at June 30, 2015, 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, 2015 and 2014, accumulated sick leave, including vested and nonvested accumulated rights to receive sick leave benefits, amounted to approximately \$19.8 million and \$20.7 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, 2015 and 2014

11. Commitments (continued)

d. EPA Consent Decree

The City is complying with the terms of a consent decree entered on December 17, 2010 by the United States District Court 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 consent decree allows 10 years for completion of work on 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.

The City is expected to incur approximately \$3.5 billion in capital costs through fiscal year 2020, which coincides with the term of the collection system portion of the 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 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 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.

City and County of Honolulu, Sewer Fund

Notes to Financial Statements
June 30, 2015 and 2014

12. Subsequent Events

On August 12, 2015, the City issued wastewater system revenue bonds, Senior Series 2015A, 2015B and 2015C and Junior Series 2015A and 2015B in the aggregate amount of \$698.9 million. The bonds mature annually on July 1, 2016 through July 1, 2045 and bear interest rates of 0.6% to 5.0%. Except for taxable refunding Senior Series 2015C and Junior Series 2015B bonds, the bonds maturing on July 1, 2026 through July 1, 2045 are subject to redemption, at the option of the City on or after July 1, 2025, in whole or in part at any time with the exception of the following bond series and maturities, Senior Series 2015B July 1, 2028, 2033, and a portion of 2036 and Junior Series 2015A July 1, 2032 and a portion of 2027 maturities which do not have a call date. The proceeds from the bonds will be used to pay for the costs of certain additions and improvements to the wastewater system and to refund a portion of outstanding wastewater system revenue bonds and Series 2010 USDA Bond Resolution.

Required Supplementary Information

City and County of Honolulu, Sewer Fund

Schedule of County's Proportionate Share of the Net Pension Liability
 Fiscal Years 2013-2014
 (Amounts in Thousands)

Defined Benefit Plan

The following schedule presents the Schedule of County'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.

Fiscal Year Ended June 30,	Proportion of Net Pension Liability	Proportionate Share of Net Pension Liability	Covered Payroll	Proportionate Share of the Net Pension Liability as a Percentage of Covered Payroll	Plan Fiduciary Net Position as a Percentage of Total Pension Liability
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 2012-2015
 (Amounts in Thousands)

Defined Benefit Plan

The following schedule 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
2015	\$ 121,465	\$ 132,308	\$ 10,843	\$ 576,916	22.93%
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

Schedule of Funding Progress

June 30, 2015

(Amounts in Thousands)

Post-Employment Healthcare and Life Insurance Benefits

The following schedule 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, 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%
July 1, 2009	\$ 40,110	\$ 1,924,859	\$ 1,884,749	2.1%	\$ 556,742	338.5%

See Independent Auditor's Report.