



# **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, 2014 and 2013**



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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") as of and for the year ended June 30, 2014, 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 audit. We conducted our audit 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, 2014, and the changes in its financial position and its cash flows for the year 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, 2014, and the changes in its financial position and its cash flows for the year 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 12 to the financial statements, the 2013 financial statements have been restated to correct misstatements. We also audited the adjustments described in Note 12 that were applied to restate the 2013 financial statements. In our opinion, such adjustments are appropriate and have been properly applied. Our opinion is not modified with respect to this matter.

## **Other Matters**

### *2013 Financial Statements*

The financial statements of the Sewer Fund, as of and for the year ended June 30, 2013, before they were restated for the matters discussed in Note 12 to the financial statements, were audited by other auditors whose report dated November 22, 2013 expressed an unmodified opinion on those statements.

### *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 10 and the schedule of funding progress on page 31 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic

financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*KMH LLP*

KMH LLP

Honolulu, Hawaii  
December 18, 2014

## City and County of Honolulu, Sewer Fund

Management's Discussion and Analysis  
June 30, 2014 and 2013

The following summary discussion and analysis of the financial statements for the fiscal years ended June 30, 2014 and 2013 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 million gallons per day of wastewater were collected and treated in fiscal year 2014, an increase of 5.2% from fiscal year 2013. There were 99.5 million gallons per day of wastewater collected and treated in fiscal year 2013, 0.5% less than fiscal year 2012. As of June 30, 2014, the Wastewater Enterprise had approximately 145,700 customer accounts and served approximately 780,000 residents.
- Total assets and deferred outflows of resources were \$3,512.2 million and exceeded total liabilities by \$1,401.6 million as of June 30, 2014. As of June 30, 2013, total assets and deferred outflows of resources were \$3,427.1 million and exceeded total liabilities by \$1,291.3 million. As of June 30, 2014, net position (difference between assets, deferred inflows/outflows of resources, and liabilities) increased by \$110.3 million, or 8.5%, from June 30, 2013, while net position at June 30, 2013, increased by \$90.1 million, or 7.5%, from June 30, 2012. The increases in net position in 2014 and 2013 are due to increased capital assets.
- As of June 30, 2014, total assets increased by \$86.7 million to \$3,489.3 million, representing a 2.5% increase from the prior fiscal year, while total assets increased by \$220.1 million to \$3,402.7 million at June 30, 2013, representing a 6.9% increase from June 30, 2012. The increase in fiscal year 2014 was due to additional capital assets and 2013 was due to additional capital assets and increased investments.
- Total current and restricted assets decreased by 1.2% or \$11.9 million to \$995.8 million at June 30, 2014, while total current and restricted assets increased by 16.1% or \$139.9 million to \$1,007.7 million at June 30, 2013. The decrease in 2014 was primarily due to the expenditure of revenue bond proceeds and the increase in 2013 was primarily due to the addition of revenue bond proceeds and increased sewer service charge revenues.
- Total current liabilities decreased by 3.7% or \$5.2 million to \$136.8 million primarily due to a decrease in accounts payable. At June 30, 2014, total liabilities decreased 1.2% or \$25.1 million to \$2,110.6 million due to a decrease in accounts payable and bonds payable. At June 30, 2013, total current liabilities increased by 11.5% or \$14.7 million to \$142.0 million primarily due to an increase in accounts payable. Total liabilities also increased by 7.5% or \$149.6 million to \$2,135.8 million due to an increase in accounts payable and bonds payable.

## City and County of Honolulu, Sewer Fund

Management's Discussion and Analysis  
June 30, 2014 and 2013

- Due to the implementation of Government Accounting Standards (“GASB”) No. 65, *Items Previously Reported as Assets and Liabilities*, during fiscal year 2014, the 2013 and 2012 financial statements have been restated retroactively for the management’s discussion and analysis. Implementation of GASB No. 65 resulted in a prior year adjustment of \$9.0 million to the July 1, 2013 net position.
- The City determined that the inventories of material and supplies and related expense were overstated at June 30, 2013. As a result the materials and supplies expense and the year end inventory balances were restated resulting in an adjustment of approximately \$6.1 million to the July 1, 2013 net position.
- The City determined that prepaid expenses were overstated at June 30, 2013. As a result the bond interest expense and the prepaid expenses were restated resulting in an adjustment of approximately \$9.4 million to the July 1, 2013 net position.
- The City determined that construction in progress was overstated at June 30, 2013. As a result the construction in progress balance was restated resulting in an adjustment of approximately \$3.7 million to the July 1, 2013 net position.
- The City reclassified approximately \$351.3 million of current assets at June 30, 2013 to restricted assets for capital outlays and debt service. There was no impact to net position at July 1, 2013 for the reclassification.
- The City determined that the pension expense was understated for the year ended June 30, 2013. As a result, fringe benefits and due to other funds were restated resulting in an adjustment of \$1.1 million to the July 1, 2013 net position.

# City and County of Honolulu, Sewer Fund

Management's Discussion and Analysis  
June 30, 2014 and 2013

## Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to 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, 2014 and 2013

### 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

	2014	2013 (As Restated)	2012 (As Restated)
Assets:			
Current assets	\$ 739,148	\$ 656,442	\$ 551,502
Restricted assets	256,627	351,253	316,334
Capital assets, net	2,492,101	2,393,340	2,312,954
Other noncurrent assets	1,462	1,622	1,794
Deferred Outflows of Resources	22,904	24,446	4,835
Total assets and deferred outflows	<u>\$ 3,512,242</u>	<u>\$ 3,427,103</u>	<u>\$ 3,187,419</u>
Current liabilities	\$ 136,849	\$ 142,039	\$ 127,338
Noncurrent liabilities	1,973,769	1,993,729	1,858,837
Total liabilities	<u>2,110,618</u>	<u>2,135,768</u>	<u>1,986,175</u>
Net investment in capital assets	659,812	638,760	642,216
Restricted for debt service	178,187	177,890	171,010
Unrestricted	563,625	474,685	388,018
Total net position	<u>1,401,624</u>	<u>1,291,335</u>	<u>1,201,244</u>
Total liabilities and net position	<u>\$ 3,512,242</u>	<u>\$ 3,427,103</u>	<u>\$ 3,187,419</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 \$1,401.6 million and \$1,291.3 million at the end of fiscal years 2014 and 2013, respectively. Additions of capital assets resulted in an 8.5% increase in net position from fiscal year 2013 to 2014. 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, 2014 and 2013

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

	2014	2013 (As Restated)	2012 (As Restated)
Operating revenues	\$ 390,351	\$ 372,394	\$ 362,585
Operating expenses	<u>(211,608)</u>	<u>(216,259)</u>	<u>(180,470)</u>
Operating income	178,743	156,135	182,115
Nonoperating revenues (expenses)			
Interest income	1,323	1,378	1,041
Interest expense	(65,162)	(59,844)	(57,010)
Other	<u>4,794</u>	<u>4,063</u>	<u>14,375</u>
Income before transfers and capital contributions	119,698	101,732	140,521
Transfers out	(9,915)	(12,885)	(9,184)
Capital contributions	<u>506</u>	<u>1,244</u>	<u>42,867</u>
Change in net position	110,289	90,091	174,204
Net position			
Beginning of year, as restated	<u>1,291,335</u>	<u>1,201,244</u>	<u>1,027,040</u>
End of year	<u><u>\$ 1,401,624</u></u>	<u><u>\$ 1,291,335</u></u>	<u><u>\$ 1,201,244</u></u>

The changes in net position were primarily due to:

- Operating revenues, comprised mainly of sewer service charges, increased 4.8% to \$390.4 million for the fiscal year 2014 compared to the prior fiscal year and increased 2.7% to \$372.4 million for fiscal year 2013 compared to fiscal year 2012. Sewer service charge rates were raised 4 percent July 1, 2013.
- Operating expenses decreased \$4.7 million or 2.2% to \$211.6 million for fiscal year 2014 compared to the prior fiscal year and increased \$35.8 million or 19.8% to \$216.3 million for fiscal year 2013 compared to fiscal year 2012. The primary decrease in 2014 was in administration and general, depreciation, and contractual services. The primary increase in 2013 was in administration and general, depreciation, and contractual services.

## City and County of Honolulu, Sewer Fund

Management's Discussion and Analysis  
June 30, 2014 and 2013

- Interest expense increased by \$5.3 million or 8.9% to \$65.1 million for fiscal 2014 compared to the prior fiscal year and increased by \$2.8 million or 5.0% to \$59.8 million for fiscal 2013 compared to fiscal year 2012. The increase in 2014 was due to issuance of additional state revolving fund loans and a decrease in interest expense that was capitalized and the increase in 2013 was due to the issuance of additional revenue bonds.
- Contributed capital decreased to \$0.51 million in fiscal year 2014 down from \$1.24 million in fiscal year 2013 and \$42.87 million in fiscal year 2012. Contributed capital represents assets (primarily capital assets) transferred from other city governmental funds and other entities. Approximately \$9.92 million was transferred out during fiscal year 2014 for the Wastewater Enterprise's share of central administrative expenses incurred by the City and \$12.89 million was transferred out during fiscal year 2013 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 \$2.5 billion and \$2.4 billion, net of accumulated depreciation, as of June 30, 2014 and 2013, respectively, an increase of \$98.8 million or 4.1 % in 2014 and \$80.4 million or 3.5 % in 2013. 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, 2014 and 2013 totaled \$1,718.0 million and \$1,764.2 million, respectively. The long term portion of state revolving fund notes payable outstanding at June 30, 2014 and 2013 totaled \$226.4 million and \$202.1 million, respectively.

Debt service coverage was 276% on Senior Revenue Bonds, 192% on all revenue bonds, and 165% on all debt at June 30, 2014, compared to 268% on Senior Revenue Bonds, 182% on all revenue bonds, and 155% on all debt at June 30, 2013. Debt service coverage exceeded the requirements of bond covenants and policies of the City Council in 2014 and 2013.

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, 2014 and 2013

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

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

### **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, 2014 and 2013  
 (Amounts in thousands)

	<u>Assets and Deferred Outflows</u>	
	2014	2013 (As Restated)
Current Assets:		
Cash and cash equivalents	\$ 446,343	\$ 438,953
Investments	222,289	141,247
Receivables:		
Accounts, net of allowance for uncollectible accounts of \$4,397 and \$2,300, respectively	52,690	59,170
Interest	191	279
Employee advances	1,012	1,066
Total receivables	53,893	60,515
Due from other City funds	337	521
Inventories of materials and supplies	13,848	12,880
Prepaid expenses	2,438	2,326
Total current assets	739,148	656,442
Restricted Assets – Investments	256,627	351,253
Capital Assets, Net	2,492,101	2,393,340
Other Assets	1,462	1,622
Total assets	<u>3,489,338</u>	<u>3,402,657</u>
Deferred Outflows of Resources –		
Deferred Refunding Costs, net	22,904	24,446
Total assets and deferred outflows	<u>\$ 3,512,242</u>	<u>\$ 3,427,103</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, 2014 and 2013  
 (Amounts in thousands)

	<u>Liabilities and Net Position</u>	
	2014	2013 (As Restated)
Current Liabilities:		
Accounts payable	\$ 38,298	\$ 50,483
Due to other City funds	6,024	1,123
Interest payable	31,140	33,271
Bonds payable	39,440	35,947
Notes payable	18,969	19,044
Accrued payroll	1,593	1,483
Other current liabilities	1,385	688
Total current liabilities	136,849	142,039
Notes Payable	226,376	202,087
General Obligation Bonds Payable, Net	874	893
Revenue Bonds Payable, Net	1,717,990	1,764,136
Other Liabilities	28,529	26,613
Total liabilities	2,110,618	2,135,768
Net Position:		
Net investment in capital assets	659,812	638,760
Restricted for debt service	178,187	177,890
Unrestricted	563,625	474,685
Total net position	1,401,624	1,291,335
Total liabilities and net position	\$ 3,512,242	\$ 3,427,103

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, 2014 and 2013  
 (Amounts in thousands)

	2014	2013 (As Restated)
Operating Revenues:		
Sewer service charges	\$ 384,096	\$ 368,125
Other revenue	6,255	4,269
Total operating revenues	<u>390,351</u>	<u>372,394</u>
Operating Expenses:		
Administrative and general	68,387	75,622
Depreciation	55,991	58,262
Utilities	28,710	27,436
Fringe benefits	24,206	20,845
Contractual services	21,137	21,398
Materials and supplies	10,876	10,927
Fuel and lubricants	1,768	1,331
Maintenance	533	438
Total operating expenses	<u>211,608</u>	<u>216,259</u>
Income from operations	<u>178,743</u>	<u>156,135</u>
Nonoperating Revenues (Expenses):		
Interest income	1,323	1,378
Interest expense	(65,162)	(59,844)
Other	4,794	4,063
Total nonoperating expenses	<u>(59,045)</u>	<u>(54,403)</u>
Income before transfers and capital contributions	119,698	101,732
Transfers Out	(9,915)	(12,885)
Capital Contributions	506	1,244
Changes in net position	110,289	90,091
Net Position, Beginning of Year, as Restated	<u>1,291,335</u>	<u>1,201,244</u>
Net Position, End of Year	<u>\$ 1,401,624</u>	<u>\$ 1,291,335</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, 2014 and 2013  
 (Amounts in thousands)

	2014	2013 (As Restated)
Cash Flows from Operating Activities:		
Cash received from customers	\$ 394,718	\$ 360,148
Cash payments to suppliers	(86,547)	(81,295)
Cash payments to employees	(59,427)	(55,114)
Net cash provided by operating activities	<u>248,744</u>	<u>223,739</u>
Cash Flows from Noncapital Financing Activities --		
Transfers Out	<u>(9,915)</u>	<u>(12,885)</u>
Cash Flows from Capital and Related Financing Activities:		
Acquisition and construction of capital assets	(158,894)	(124,509)
Proceeds from issuance of notes	44,445	18,267
Repayments on notes	(20,231)	(19,645)
Interest paid on notes	(2,446)	(2,729)
Proceeds from issuance of bonds, net of premium	-	284,685
Repayments on bonds	(33,663)	(164,611)
Interest paid on bonds	(80,627)	(83,273)
Interest subsidies for wastewater system revenue bonds	4,982	5,566
Net cash used in capital and related financing activities	<u>(246,434)</u>	<u>(86,249)</u>
Cash Flows from Investing Activities:		
Purchase of investments	(1,271,180)	(1,312,048)
Proceeds from maturity of investments	1,284,764	909,723
Interest on investments	1,411	1,200
Net cash provided by (used in) investing activities	<u>14,995</u>	<u>(401,125)</u>
Net increase (decrease) in cash and cash equivalents	7,390	(276,520)
Cash and Cash Equivalents, Beginning of Year	<u>438,953</u>	<u>715,473</u>
Cash and Cash Equivalents, End of Year	<u>\$ 446,343</u>	<u>\$ 438,953</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, 2014 and 2013  
 (Amounts in thousands)

	2014	2013 (As Restated)
Reconciliation of Income from Operations to Net Cash		
Provided by Operating Activities:		
Income from operations	\$ 178,743	\$ 156,135
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation	55,991	58,262
Writeoff of capital assets	6,581	19,318
Change in assets and liabilities:		
Accounts receivable	6,533	(12,209)
Due from other City funds	183	489
Inventories of materials and supplies	(967)	(2,051)
Accounts payable	(2,106)	845
Other liabilities	2,723	2,658
Due to other City funds	1,063	292
Net cash provided by operating activities	<u>\$ 248,744</u>	<u>\$ 223,739</u>

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

The Sewer Fund received \$0.5 million and \$1.2 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, 2014 and 2013, respectively.

Amortization of net bond premiums and discounts amounted to \$6.7 million and \$5.8 million in fiscal year 2014 and 2013, 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, 2014 and 2013

## 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. Actual results could differ from those estimates.

# City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2014 and 2013

## 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. 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 \$24.9 million and \$22.2 million at June 30, 2014 and 2013, 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, 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.

# City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2014 and 2013

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

### i. Capital Assets (continued)

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. Deferred Outflows 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 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.

### 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, 2014 and 2013

## 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, 2014 and 2013

### 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

Effective July 1, 2013, the Sewer Fund implemented Government Accounting Standards Board Statement No. 65 ("GASB 65"), *Items Previously Reported as Assets and Liabilities*. GASB 65 reclassifies, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as revenues and expenses, certain items that were previously reported as assets and liabilities. GASB 65 requires debt issuance costs to be recognized as an expense in the period incurred. Previously, these costs were amortized over the life of the related debt issuance. The adoption of this statement was applied retroactively by restating financial statements for all periods presented. The effect on net position due to the implementation of GASB 65 is presented at Note 12.

In March 2012, the GASB issued Statement No. 66 ("GASB 66"), *Technical Corrections – 2012*. The objective of GASB 66 is to enhance usefulness of financial reports by resolving conflicting accounting and financial reporting guidance that could diminish the consistency of financial reporting. The adoption of GASB 66 for the year ended June 30, 2014 did not result in a significant impact to the Sewer Fund's financial statements.

In June 2012, the GASB issued Statement No. 68 ("GASB 68"), *Accounting and Reporting for Pensions* (an amendment of GASB Statement No. 27). GASB 68 amends the accounting guidance related to employers' accounting for pension plans administered through trusts or similar arrangements and requires the recognition of a liability for the employers' accumulated obligation for pension benefits. GASB 68 also provides additional guidance regarding the recognition of annual costs of pension benefits and revises the disclosure requirements for the notes to the financial statements and required supplementary information. GASB 68 will be effective for the Sewer Fund's financial statements for the year ending June 30, 2015. Management is currently evaluating the impact the adoption of GASB 68 will have on the Sewer Fund's financial statements.

# City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2014 and 2013

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

### r. New Accounting Pronouncements (continued)

In May 2014, the GASB approved an exposure draft for issuance which will significantly revise the existing GASB standards contained in GASB Statement No. 45 (“GASB 45”), *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. If adopted as exposed, the revised accounting for other postemployment benefits (OPEB) will mirror the accounting and reporting framework used in GASB 68 described above. The exposure draft as issued will be effective for the Sewer Fund’s financial statements for the year ending June 30, 2018.

## 3. Cash and Investments

The cash and investment balances reported in the accompanying statements of net position are included in the City’s cash 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, 2014 and 2013. The remaining balance at June 30, 2014 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 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, 2014 and 2013

### 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, 2014, 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 \$337,000 and \$521,000 at June 30, 2014 and 2013, 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, 2014 and 2013 were as follows (in thousands of dollars):

	Balance at July 1, 2013 (As 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	2,611,037	54,202	(1,019)	2,664,220
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	(512,554)	(55,991)	921	(567,624)
	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>



## City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2014 and 2013

### 6. Capital Assets (continued)

	Balance at July 1, 2012 (As Restated)	Additions	Retirements/ Transfers	Balance at June 30, 2013 (As Restated)
Depreciable assets				
Buildings and improvements	\$ 913,115	\$ 142,427	\$ -	\$ 1,055,542
Transmission and distribution system	1,490,293	117,808	(114,033)	1,494,068
Equipment and machinery	44,354	14,626	(1,064)	57,916
Land improvements	3,511	-	-	3,511
Total depreciable assets	<u>2,451,273</u>	<u>274,861</u>	<u>(115,097)</u>	<u>2,611,037</u>
Less: Accumulated depreciation				
Buildings and improvements	(170,373)	(22,977)	-	(193,350)
Transmission and distribution system	(256,136)	(27,921)	245	(283,812)
Equipment and machinery	(27,479)	(7,245)	969	(33,755)
Land improvements	(1,518)	(119)	-	(1,637)
Total accumulated depreciation	<u>(455,506)</u>	<u>(58,262)</u>	<u>1,214</u>	<u>(512,554)</u>
	1,995,767	216,599	(113,883)	2,098,483
Land	41,214	903	(18)	42,099
Construction in progress	275,973	117,470	(140,685)	252,758
	<u>\$ 2,312,954</u>	<u>\$ 334,972</u>	<u>\$ (254,586)</u>	<u>\$ 2,393,340</u>

Depreciation expense was approximately \$56.0 million and \$58.3 million for the years ended June 30, 2014 and 2013, 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 1.1% to 5.6% at June 30, 2014. 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.

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

## City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2014 and 2013

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

term of the bonds. The bonds bear interest at 2.0% to 6.3% at June 30, 2014 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 and \$221.1 million at June 30, 2014 and 2013, respectively, 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 2014 and 2013 were approximately \$77.2 million and \$75.6 million, respectively, of which \$12.0 million and \$15.8 million was capitalized in 2014 and 2013, respectively.

Long-term obligations activity for the fiscal years ended June 30, 2014 and 2013 were as follows (in thousands of dollars):

	Balance at July 1, 2013 (As Restated)	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)	72,569	-	(6,725)	65,844	-
Total long-term debt	<u>2,022,107</u>	<u>44,445</u>	<u>(62,903)</u>	<u>2,003,649</u>	<u>58,409</u>
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>

# City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2014 and 2013

## 7. Long-Term Obligations (continued)

	Balance at July 1, 2012 (As Restated)	Additions	Reductions	Balance at June 30, 2013 (As Restated)	Amount Due Within One Year
General obligation bonds	\$ 831	\$ 28	\$ (38)	\$ 821	\$ 11
Revenue bonds	1,625,196	265,610	(163,220)	1,727,586	35,936
Notes payable	222,509	18,267	(19,645)	221,131	19,044
	<u>1,848,536</u>	<u>283,905</u>	<u>(182,903)</u>	<u>1,949,538</u>	<u>54,991</u>
Add: Unamortized net premium (discount)	<u>39,134</u>	<u>39,224</u>	<u>(5,789)</u>	<u>72,569</u>	<u>-</u>
Total long-term debt	1,887,670	323,129	(188,692)	2,022,107	54,991
Compensated absences	7,375	2,399	(1,996)	7,778	384
Other postretirement benefits	16,961	9,600	(7,653)	18,908	-
Arbitrage rebate	217	94	-	311	-
Total long-term obligations	<u>\$ 1,912,223</u>	<u>\$ 335,222</u>	<u>\$ (198,341)</u>	<u>\$ 2,049,104</u>	<u>\$ 55,375</u>

Scheduled maturities of long-term debt are as follows (in thousands of dollars):

Year ending June 30,	General Obligation Bonds	Revenue Bonds	Notes Payable	Total Principal	Total Interest
2015	\$ 8	\$ 39,432	\$ 18,969	\$ 58,409	\$ 80,896
2016	9	45,564	19,063	64,636	79,223
2017	58	50,771	19,229	70,058	77,299
2018	60	55,588	19,065	74,713	75,211
2019	55	57,795	18,144	75,994	72,895
2020-2024	313	328,479	80,658	409,450	322,760
2025-2029	307	413,475	56,387	470,169	234,592
2030-2034	-	342,974	13,830	356,804	138,382
2035-2039	-	261,358	-	261,358	56,834
2040-2044	-	95,933	-	95,933	7,677
2045-2046	-	281	-	281	17
	<u>810</u>	<u>1,691,650</u>	<u>245,345</u>	<u>1,937,805</u>	<u>\$ 1,145,786</u>
Less: Current portion	<u>(8)</u>	<u>(39,432)</u>	<u>(18,969)</u>	<u>(58,409)</u>	
	<u>\$ 802</u>	<u>\$ 1,652,218</u>	<u>\$ 226,376</u>	<u>\$ 1,879,396</u>	

## City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2014 and 2013

### 8. Net Position

At June 30, 2014 and 2013, net position consisted of the following (in thousands of dollars):

	2014	2013 (Restated)
Net investment in capital assets:		
Net property, plant and equipment	\$ 2,492,101	\$ 2,393,340
Deferred outflows of resources	22,904	24,446
Less:		
Wastewater general obligation bonds payable	(874)	(821)
Wastewater system revenue bonds payable, net of unamortized premiums and discounts	(1,757,430)	(1,800,155)
Notes payable	(245,345)	(221,131)
Amount of debt related to unspent debt proceeds	148,456	243,081
	659,812	638,760
Restricted for debt service	178,187	177,890
Unrestricted	563,625	474,685
Total	<u>\$ 1,401,624</u>	<u>\$ 1,291,335</u>

At June 30, 2014 and 2013, 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

Substantially all employees of the Sewer Fund participate in the City's various employee benefit plans, including the State's Employees Retirement System ("ERS"), post-employment healthcare and life insurance plan, and a deferred compensation plan. For more information on the State's benefit plans in which the City's employees participate, refer to the City and ERS CAFR. The ERS CAFR can be found at the ERS website: <http://ers.ehawaii.gov/resources/financials>.

#### a. Employees' Retirement System

The ERS is a cost-sharing, multiple-employer public employee defined benefit pension plan. The ERS provides retirement benefits as well as death and disability benefits. All contributions, benefits and eligibility requirements are established by Chapter 88, Hawaii Revised Statutes ("HRS"), and can be amended by legislative action. Contributions made to the plan were \$6.1 million, \$5.7 million and \$5.6 million for the fiscal years ended June 30, 2014, 2013 and 2012, respectively. As of June 30, 2014 and 2013, the Sewer Fund had an accrued pension payable of approximately \$2.1 million and \$1.1 million, respectively, which is included in due to other City funds in the accompanying statements of net position.

## City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2014 and 2013

### 10. Employee Benefit Plans (continued)

#### 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.

#### c. 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.

#### d. 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, 2014 and 2013, respectively. The following table shows the components of the annual OPEB cost for the fiscal years ended June 30, 2014 and 2013, the amount contributed to the plan, and changes in the Sewer Fund’s net OPEB obligation (in thousands of dollars):

	2014	2013
Annual required contribution	\$ 9,779	\$ 9,426
Interest on net OPEB obligation	1,472	1,294
Adjustment to annual required contribution	(1,320)	(1,120)
Annual OPEB cost	9,931	9,600
Contributions made	(7,943)	(7,653)
Increase in net OPEB obligation	1,988	1,947
Net OPEB obligation		
Beginning of year	18,908	16,961
End of year	\$ 20,896	\$ 18,908
Percentage of annual OPEB cost contributed	80.0%	79.7%

## City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2014 and 2013

### 9. Employee Benefit Plans (continued)

#### d. Allocated OPEB Cost (continued)

Contributions made to the plan were \$7.9 million, \$7.7 million and \$6.9 million for the fiscal years ended June 30, 2014, 2013 and 2012, 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, 2014 and 2013

### 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 \$2.6 million and \$1.5 million for the years ended June 30, 2014 and 2013, respectively.

### 11. Commitments

#### a. Construction Contracts

The City has contractual commitments for the Sewer Fund of approximately \$515 million at June 30, 2014, 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, 2014 and 2013, accumulated sick leave, including vested and nonvested accumulated rights to receive sick leave benefits, amounted to approximately \$20.7 million and \$21.9 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 financial statements.

## City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2014 and 2013

### 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. In March 2012, the consent decree was modified to allow substitution of the Kaneohe-Kailua gravity tunnel and associated pump station in place of a required force main replacement. 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.

### 12. Restatements

During the current year, the following restatement adjustments to the Sewer Fund were identified:

- The City determined that prepaid expenses were overstated at June 30, 2013. As a result, bond interest expense and prepaid expenses were restated resulting in an adjustment of approximately \$9.4 million to the July 1, 2013 net position.
- The City determined that inventories of material and supplies and related expense were overstated at June 30, 2013. As a result, the materials and supplies expense and the inventory balance were restated resulting in an adjustment of approximately \$6.1 million to the July 1, 2013 net position.
- Certain construction in progress capital assets were identified that should have been written off in prior years. For the year ended June 30, 2013, \$0.5 million was expensed and the remaining \$3.2 million was an adjustment to the beginning net position as of June 30, 2012.



## City and County of Honolulu, Sewer Fund

Notes to Financial Statements  
June 30, 2014 and 2013

### 12. Restatements (continued)

- The City determined that the pension expense was understated for the year ended June 30, 2013. As a result, fringe benefits and due to other City funds were restated resulting in an adjustment of \$1.1 million to the July 1, 2013 net position.
- Implementation of GASB 65 resulted in an adjustment of approximately \$9.0 million to the July 1, 2013 net position. The restatement was a result of the write off of debt issuance costs that were previously capitalized and amortized over the life of the bond.

The results of these adjustments have the following impact on the June 30, 2013 financial statements (amounts in thousands):

	Net Position, Beginning of Year	Operating Expenses	Nonoperating Expenses	Net Position, End of Year
Balance, as previously reported	\$ 1,213,788	\$ (209,246)	\$ (44,606)	\$ 1,320,689
Inventory overstatement adjustment	-	(6,148)	-	(6,148)
Understated interest expense adjustment	-	-	(9,355)	(9,355)
Implementation of GASB 65	(8,602)	-	(442)	(9,044)
Construction in progress adjustment	(3,214)	(477)	-	(3,691)
Pension accrual adjustment	(728)	(388)	-	(1,116)
Balance, as restated	<u>\$ 1,201,244</u>	<u>\$ (216,259)</u>	<u>\$ (54,403)</u>	<u>\$ 1,291,335</u>

Certain reclassifications have been made to prior year amounts to conform to current year classifications. The Sewer Fund has reclassified investments related to unspent bond proceeds restricted for capital outlays and collateral reserves required by the revenue bonds to restricted assets. This change in presentation resulted in a decrease in current assets of approximately \$351.3 million at June 30, 2013. This reclassification adjustment had no impact to previously reported net position.

## **Required Supplementary Information**

## City and County of Honolulu, Sewer Fund

Schedule of Funding Progress

June 30, 2014

(Amounts in thousands)

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

The following schedule presents the actuarially-determined funding progress for the post-retirement health care and life insurance benefits for the City as a whole, of which the Sewer Fund is one of its various enterprise funds.

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability ("AAL")	Unfunded AAL ("UAAL")	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
July 1, 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%