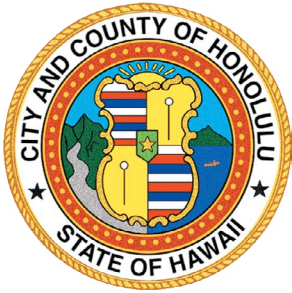




Office of the City Auditor



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

**City and County of Honolulu
Sewer Fund**

**Financial Statements
June 30, 2020 and 2019**

**City and County of Honolulu
Sewer Fund
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Report of Independent Auditors

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 June 30, 2020 and 2019, and the related notes to the financial statements, as listed in the index.

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.

Auditors' 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 auditors' 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 auditors consider 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, 2020 and 2019, and the changes in financial position and its cash flows thereof 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 present only the Sewer Fund and do not purport to, and do not present fairly the financial position of the City and County of Honolulu ("City") as of June 30, 2020 and 2019, 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.

Other Matters***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 7 and the schedule of the City's proportionate share of the net pension liability, schedule of pension contributions, schedule of changes in net other postemployment benefits ("OPEB") liability and related ratios, and schedule of OPEB contributions on pages 37 through 42 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.

Accuity LLP

Honolulu, Hawaii
December 9, 2020

City and County of Honolulu

Sewer Fund

Management's Discussion and Analysis

June 30, 2020 and 2019

The following summary discussion and analysis of the financial statements for the fiscal years ended June 30, 2020 and 2019 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

- 107.0 million gallons per day of wastewater were collected and treated in fiscal year 2020, a decrease of 3.3% from fiscal year 2019. There were 110.7 million gallons per day of wastewater collected and treated in fiscal year 2019, 2.9% less than fiscal year 2018. As of June 30, 2020, the Wastewater Enterprise had approximately 148,000 customer accounts and served approximately 780,000 residents.
- Total assets and deferred outflows of resources were \$5.4 billion and exceeded total liabilities by \$2.3 billion as of June 30, 2020. As of June 30, 2019, total assets and deferred outflows of resources were \$5.0 billion and exceeded total liabilities by \$2.1 billion. As of June 30, 2020, net position (difference between assets, deferred inflows/outflows of resources, and liabilities) increased by \$171.3 million, or 8.2%, from June 30, 2019, while net position at June 30, 2019, increased by \$181.6 million, or 9.5%, from June 30, 2018. The increase in net position in fiscal years 2020 and 2019 was due to increased capital assets.
- As of June 30, 2020, total assets increased by \$368.6 million to \$5.2 billion, representing a 7.6% increase from the prior fiscal year, while total assets increased by \$91.2 million to \$4.9 billion, at June 30, 2019, representing a 1.9% increase from June 30, 2018. The increase in fiscal year 2020 was due to increased capital and current assets and in fiscal year 2019 was due to increased capital assets.
- Total current and restricted assets increased by 8.5% or \$138.0 million to \$1.8 billion at June 30, 2020, while total current and restricted assets decreased by 2.9% or \$49.0 million to \$1.6 billion at June 30, 2019. The increase in fiscal year 2020 was primarily due to revenue bond proceeds and the decrease in fiscal year 2019 was primarily due to expenditure of revenue bonds proceeds.
- Total current liabilities increased by 10.7% or \$22.4 million to \$231.7 million at June 30, 2020, primarily due to an increase in accounts payable. At June 30, 2020, total liabilities increased 7.5% or \$213.2 million to \$3.1 billion due to an increase in notes and bonds payable. At June 30, 2019, total current liabilities increased by 6.4% or \$12.5 million to \$209.3 million due to an increase in accounts payable. Total liabilities also decreased by 3.0% or \$88.8 million to \$2.9 billion due to decreases in notes and bonds payable.

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.

City and County of Honolulu
Sewer Fund
Management's Discussion and Analysis
June 30, 2020 and 2019

The *statements of net position* present information of the Wastewater Enterprise's assets and liabilities, 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 results in increased net position, which indicate an improved financial position.

The *statements of revenues, expenses, and change 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.

Financial Analysis

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

Statements of Net Position

	2020	2019	2018
Assets			
Current assets	\$ 1,449,774	\$ 1,357,126	\$ 1,225,345
Restricted assets, noncurrent	302,773	257,443	438,207
Capital assets, net	3,483,986	3,253,365	3,113,168
Deferred outflows of resources	116,198	103,352	104,893
Total assets and deferred outflows	<u>\$ 5,352,731</u>	<u>\$ 4,971,286</u>	<u>\$ 4,881,613</u>
Liabilities			
Current liabilities	\$ 231,657	\$ 209,301	\$ 196,760
Noncurrent liabilities	2,836,636	2,645,839	2,747,184
Deferred inflows of resources	12,834	15,801	18,970
Total liabilities and deferred inflows	<u>3,081,127</u>	<u>2,870,941</u>	<u>2,962,914</u>
Net investment in capital assets	1,159,974	954,970	852,641
Restricted for debt service	181,860	259,977	260,091
Unrestricted	929,770	885,398	805,967
Total net position	<u>2,271,604</u>	<u>2,100,345</u>	<u>1,918,699</u>
Total liabilities, deferred inflows, and net position	<u>\$ 5,352,731</u>	<u>\$ 4,971,286</u>	<u>\$ 4,881,613</u>

City and County of Honolulu
Sewer Fund
Management's Discussion and Analysis
June 30, 2020 and 2019

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 \$2.3 billion and \$2.1 billion at the end of fiscal years 2020 and 2019, respectively. Additions of capital assets resulted in an 8.2% increase in net position from fiscal year 2019 to fiscal year 2020. 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.

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

	2020	2019	2018
Operating revenues	\$ 454,901	\$ 461,011	\$ 455,438
Operating expenses	<u>(219,132)</u>	<u>(221,263)</u>	<u>(206,419)</u>
Operating income	235,769	239,748	249,019
Nonoperating revenues (expenses)			
Interest income	23,781	33,992	14,436
Interest expense	(71,451)	(82,025)	(74,614)
Other	<u>1,463</u>	<u>8,018</u>	<u>3,578</u>
Income before transfers and capital contributions	189,562	199,733	192,419
Transfers out	(19,093)	(20,404)	(18,170)
Capital contributions	<u>790</u>	<u>2,317</u>	<u>8</u>
Change in net position	171,259	181,646	174,257
Net position			
Beginning of year	<u>2,100,345</u>	<u>1,918,699</u>	<u>1,744,442</u>
End of year	<u>\$ 2,271,604</u>	<u>\$ 2,100,345</u>	<u>\$ 1,918,699</u>

The changes in net position were primarily due to:

- Operating revenues, comprised mainly of sewer service charges, decreased 1.3% to \$454.9 million for the fiscal year 2019 compared to the prior fiscal year, and increased 1.2% to \$461.0 million for the fiscal year 2019 compared to fiscal year 2018. Sewer service charge rates remained the same in fiscal year 2020.
- Operating expenses decreased \$2.1 million or 1.0% to \$219.1 million for fiscal year 2020 compared to the prior fiscal year and increased \$14.8 million or 7.2% to \$221.2 million for fiscal year 2019, compared to fiscal year 2018. The primary decrease in fiscal year 2020 was due to decreased administrative and general expenses, partially offset by increased fringe benefits and contractual services expenses. The primary increase in fiscal year 2019 was due to increased administrative and general, depreciation and utilities expenses.

City and County of Honolulu

Sewer Fund

Management's Discussion and Analysis

June 30, 2020 and 2019

- Interest expense decreased by \$10.6 million or 12.9% to \$71.5 million for fiscal year 2020 compared to the prior fiscal year, and increased by \$7.4 million or 9.9% to \$82.0 million for fiscal year 2019 compared to fiscal year 2018. The decrease in fiscal year 2020 was due to a decrease in interest expense on wastewater revenue bonds. The increase in fiscal year 2019 was due to an increase in interest expense on wastewater revenue bonds.
- Contributed capital decreased to \$790,000 in fiscal year 2020, down from \$2.3 million in fiscal year 2019 and up from \$8,000 in fiscal year 2018. Contributed capital represents assets (primarily capital assets) transferred from other City governmental funds and other entities. Approximately \$19.1 million was transferred out during fiscal year 2020 for the Wastewater Enterprise's share of central administrative expenses incurred by the City and \$20.4 million was transferred out during fiscal year 2019 for the Wastewater Enterprise's share of central administrative expenses incurred by the City.

Capital Assets and Debt Administration

Capital Assets

The Wastewater Enterprise's investment in capital assets amounted to \$3.5 billion and \$3.3 billion, net of accumulated depreciation, as of June 30, 2020 and 2019, respectively, an increase of \$230.6 million or 7.1% in fiscal year 2020 and \$140.2 million or 4.5% in fiscal year 2019. Capital assets include land, buildings, infrastructure, land improvements, equipment and machinery for the nine treatment plants, 71 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. Revenue bonds outstanding as of June 30, 2020 and 2019 totaled \$2.4 billion and \$2.3 billion, respectively. State revolving fund notes payable outstanding at June 30, 2020 and 2019 totaled \$295.9 million and \$210.3 million, respectively.

Debt service coverage was 271% on Senior Revenue Bonds, 215% on all revenue bonds, and 178% on all debt at June 30, 2020, compared to 288% on Senior Revenue Bonds, 226% on all revenue bonds, and 179% on all debt at June 30, 2019. Debt service coverage exceeded the requirements of bond covenants and policies of the City Council in 2020 and 2019.

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

Currently Known Facts, Decisions or Conditions

The Department of Environmental Services (the "Department") is monitoring the Coronavirus Disease 2019 ("COVID-19") pandemic, and to date the Wastewater System has not experienced any material adverse impact on its operations or finances from COVID-19. The Department does not expect significant decreases in Wastewater System service charge revenues as a result of the COVID-19 outbreak, as approximately 67% of the total revenue from sewer service charges comes from residential accounts and the Department's rates and charges include fixed monthly charges. The Department is allowing payment deferrals and payment plans but is not waiving fees.

**City and County of Honolulu
Sewer Fund
Management's Discussion and Analysis
June 30, 2020 and 2019**

Although the Department believes COVID-19 will not materially adversely impact the operations or revenues of the Wastewater System, the ultimate impact of COVID-19 on the operations and finances of the City and County of Honolulu and the Wastewater System is unknown at this time. Additionally, the Department cannot predict to what extent the City and County of Honolulu may desire or need to provide customer assistance measures or deferrals, forbearances, adjustments or other changes to customers and the effect of any such measures on the operations or revenues of the Wastewater System. The Department's fiscal year 2022 budget will include consideration of the effects of the COVID-19 outbreak.

In support of requirements in the 2010 Consent Decree (see Note 11 to the financial statements) and other system requirements, the City plans to issue during December 2020 additional wastewater system revenue bonds to refund eligible previously issued bonds for economic savings.

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, 2020 and 2019
(Amounts in thousands)

	2020	2019
Assets and Deferred Outflows of Resources		
Current assets		
Cash and cash equivalents	\$ 278,021	\$ 383,202
Investments	1,023,426	835,690
Receivables		
Accounts, net of allowance for uncollectible accounts of \$4,870 and \$4,679 in 2020 and 2019, respectively	66,193	73,487
Interest	6,682	11,510
Employee advances	620	671
Inventories of materials and supplies	10,677	11,516
Restricted assets		
Cash and cash equivalents	<u>64,155</u>	<u>41,050</u>
Total current assets	1,449,774	1,357,126
Restricted assets – investments	302,773	257,443
Capital assets, net	<u>3,483,986</u>	<u>3,253,365</u>
Total assets	<u>5,236,533</u>	<u>4,867,934</u>
Deferred outflows of resources		
Deferred refunding costs, net	67,466	53,069
Deferred pension costs	27,310	29,808
Deferred other postemployment benefit costs	16,491	15,195
Deferred asset retirement obligations costs	<u>4,931</u>	<u>5,280</u>
Total deferred outflows of resources	<u>116,198</u>	<u>103,352</u>
Total assets and deferred outflows of resources	<u>\$ 5,352,731</u>	<u>\$ 4,971,286</u>

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

City and County of Honolulu
Sewer Fund
Statements of Net Position
June 30, 2020 and 2019
(Amounts in thousands)

	2020	2019
Liabilities, Deferred Inflows of Resources, and Net Position		
Current liabilities		
Accounts payable	\$ 82,679	\$ 66,444
Due to other City funds	355	8
Interest payable	47,449	46,501
Bonds payable	74,881	72,518
Notes payable	23,991	21,483
Accrued payroll	1,775	1,856
Compensated absences	527	491
Total current liabilities	<u>231,657</u>	<u>209,301</u>
Notes payable	271,922	188,807
General obligation bonds payable, net	525	586
Asset retirement obligations	12,168	12,012
Revenue bonds payable, net	2,299,959	2,198,904
Net pension liability	129,465	122,953
Net other postemployment benefit liability	115,290	115,348
Compensated absences	7,307	7,229
Total liabilities	<u>3,068,293</u>	<u>2,855,140</u>
Deferred inflows of resources		
Deferred pension costs	10,906	13,528
Deferred other postemployment benefit costs	1,928	2,273
Total deferred inflows of resources	<u>12,834</u>	<u>15,801</u>
Net position		
Net investment in capital assets	1,159,974	954,970
Restricted for debt service	181,860	259,977
Unrestricted	929,770	885,398
Total net position	<u>2,271,604</u>	<u>2,100,345</u>
Total liabilities, deferred inflows of resources, and net position	<u>\$ 5,352,731</u>	<u>\$ 4,971,286</u>

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

City and County of Honolulu
Sewer Fund
Statements of Revenues, Expenses, and Changes in Net Position
Years Ended June 30, 2020 and 2019
(Amounts in thousands)

	2020	2019
Operating revenues		
Sewer service charges	\$ 444,292	\$ 458,218
Other revenue	10,609	2,793
Total operating revenues	<u>454,901</u>	<u>461,011</u>
Operating expenses		
Depreciation	79,989	77,184
Administrative and general	42,213	53,532
Fringe benefits	34,516	27,021
Contractual services	23,940	20,918
Utilities	23,896	25,200
Materials and supplies	12,480	15,484
Maintenance	1,215	898
Fuel and lubricants	883	1,026
Total operating expenses	<u>219,132</u>	<u>221,263</u>
Operating income	<u>235,769</u>	<u>239,748</u>
Nonoperating revenues (expenses)		
Interest income	23,781	33,992
Interest expense	(71,451)	(82,025)
Net increase in fair value of investments	897	2,964
Other	566	5,054
Total nonoperating expenses	<u>(46,207)</u>	<u>(40,015)</u>
Income before transfers and capital contributions	189,562	199,733
Transfers out	(19,093)	(20,404)
Capital contributions	790	2,317
Change in net position	171,259	181,646
Net position		
Beginning of year	<u>2,100,345</u>	<u>1,918,699</u>
End of year	<u>\$ 2,271,604</u>	<u>\$ 2,100,345</u>

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

City and County of Honolulu
Sewer Fund
Statements of Cash Flows
Years Ended June 30, 2020 and 2019
(Amounts in thousands)

	2020	2019
Cash flows from operating activities		
Cash received from customers	\$ 460,969	\$ 451,686
Cash payments to suppliers	(63,105)	(64,825)
Cash payments to employees	(67,607)	(68,879)
Other receipts	1,064	558
Net cash provided by operating activities	<u>331,321</u>	<u>318,540</u>
Cash flows from noncapital financing activities		
Transfers out	<u>(19,093)</u>	<u>(20,404)</u>
Net cash used in noncapital financing activities	<u>(19,093)</u>	<u>(20,404)</u>
Cash flows from capital and related financing activities		
Acquisition and construction of capital assets	(295,364)	(209,998)
Proceeds from issuance of notes	107,827	3,900
Repayments on notes	(22,204)	(22,670)
Interest paid on notes	(1,996)	(1,781)
Proceeds from issuance of bonds, net	568,810	-
Repayments on bonds	(426,017)	(70,545)
Interest paid on bonds	(80,811)	(89,622)
Interest subsidies for wastewater system revenue bonds	2,287	5,035
Net cash used in capital and related financing activities	<u>(147,468)</u>	<u>(385,681)</u>
Cash flows from investing activities		
Purchase of investments	(2,248,808)	(1,640,689)
Proceeds from maturity of investments	1,975,197	1,970,678
Interest on investments	26,775	24,627
Net cash provided by (used in) investing activities	<u>(246,836)</u>	<u>354,616</u>
Net increase (decrease) in cash and cash equivalents	(82,076)	267,071
Cash and cash equivalents		
Beginning of year	<u>424,252</u>	<u>157,181</u>
End of year (including \$64,155 and \$41,050 in restricted cash and cash equivalents at June 30, 2020 and 2019, respectively)	<u>\$ 342,176</u>	<u>\$ 424,252</u>

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

City and County of Honolulu
Sewer Fund
Statements of Cash Flows
Years Ended June 30, 2020 and 2019
(Amounts in thousands)

	2020	2019
Reconciliation of operating income to net cash provided by operating activities		
Operating income	\$ 235,769	\$ 239,748
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	79,989	77,184
Write-off of capital assets	837	7,411
Other expense	(26)	(20)
Change in		
Accounts receivable	7,345	(7,006)
Inventories of materials and supplies	839	2,341
Deferred outflows from pension	2,498	3,457
Deferred outflows from other postemployment benefits	(1,296)	(6,416)
Deferred outflows from asset retirement obligations	349	244
Accounts payable	994	(397)
Other liabilities	33	208
Net pension liability	6,512	5,233
Asset retirement obligations	156	247
Net other postemployment benefits liability	(58)	(177)
Due to other City funds	347	(348)
Deferred inflows from pension	(2,622)	(5,010)
Deferred inflows from other postemployment benefits	(345)	1,841
Net cash provided by operating activities	<u>\$ 331,321</u>	<u>\$ 318,540</u>

Supplemental disclosure of noncash capital and related financing activities

The Sewer Fund received \$790,000 and \$2.3 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, 2020 and 2019, respectively.

Amortization of net bond premiums, (discounts), and (deferred loss on refunding) amounted to \$19.1 million, (\$121,000), and (\$5.0) million in fiscal 2020 and \$16.8 million, (\$471,000), and (\$4.3) million in fiscal 2019.

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

City and County of Honolulu

Sewer Fund

Notes to Financial Statements

June 30, 2020 and 2019

1. Financial Reporting Entity

The 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.

The Sewer Fund is one of the various enterprise funds of the City. The Sewer Fund's financial statements reflect only its portion of the proprietary fund type. 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.

2. Summary of Significant Accounting Policies

Financial Statement Presentation

The Sewer Fund is included in the City's Enterprise Funds. The Sewer Fund's financial statements are intended to present the financial position, change in financial position, and cash flows of only that portion of the funds of the City's Enterprise Funds that is attributable to the transactions of the Sewer Fund.

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").

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.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant items subject to such estimates and assumptions included revenue recognized related to unbilled accounts, allowance for uncollectible accounts, net pension liability, net other postemployment benefits ("OPEB"), and asset retirement obligations ("ARO"). Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash includes amounts in demand and time deposits primarily with various financial institutions in the State of Hawaii. 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.

City and County of Honolulu
Sewer Fund
Notes to Financial Statements
June 30, 2020 and 2019

Investments

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

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.

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 \$31.9 million and \$37.8 million at June 30, 2020 and 2019, 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.

Restricted Assets

Revenue bond indentures allow the City to invest in U.S. government securities. At June 30, 2020, restricted assets consisted of unspent debt proceeds of \$279.8 million, revenue bond collateral reserves of approximately \$23.0 million, and cash and cash equivalents held in escrow accounts for crossover refunding bonds of \$64.2 million, totaling \$367.0 million. As June 30, 2019, restricted assets consisted of unspent debt proceeds of \$130.8 million, revenue bond collateral reserves of approximately \$62.4 million, and cash and cash equivalents and investments held in escrow accounts for crossover refunding bonds of \$41.1 million and \$64.2 million, respectively, totaling \$298.5 million.

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.

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

	Years
Buildings and land improvements	10 – 50
Transmission and distribution system	13 – 100
Equipment and machinery	5 – 25

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.

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Asset Retirement Obligations

AROs represent the liabilities where both an external obligating event and internal obligating event have occurred, and the liability is reasonably estimable and recorded based on the City's best estimates of the current value of outlays expected to be incurred. The AROs are reevaluated annually for the effects of general inflation or deflation and any events that would cause a significant change in the estimated outlays. Refer to Note 7 for more information.

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.

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.

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 balances consist 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 GASB Statement No. 68, *Accounting and Reporting for Pensions (an amendment of GASB Statement No. 27)*, and GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pension*, differences between projected and actual experience and changes in assumptions are recognized in pension/OPEB 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/OPEB through the pension/OPEB plans (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 fiscal year 2019 for pension and OPEB are 5.3135 years and 5.8431 years, respectively.
- 3) According to GASB Statement No. 83, *Certain Asset Retirement Obligations*, when an ARO is recognized, a corresponding deferred outflow of resources equal to the ARO is also recognized. The deferred outflow of resources is amortized over the remaining useful life of the related capital assets.

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

Contributions to the pension/OPEB plans from the employer subsequent to the measurement date of the net pension/OPEB liability and before the end of the reporting period are reported as deferred outflows of resources.

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Pension

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

Other Postemployment Benefits

For purposes of measuring the net OPEB liability, deferred outflows of resources and deferred inflows of resources related to OPEB and OPEB expense, information about the fiduciary net position of the Hawaii Employer-Union Health Benefits Trust Fund ("EUTF"), and additions to/deductions from the EUTF's fiduciary net position have been determined on the same basis as they are reported by the EUTF. For this purpose, benefit payments are recognized when due and payable in accordance with benefits terms. Investments are reported at their fair value.

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.

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.

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.

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.

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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.

Coronavirus Disease 2019 (“COVID-19”)

The Department of Environmental Services (the “Department”) is monitoring the COVID-19 pandemic, and to date the wastewater system has not experienced any material adverse impact on its operations or finances from COVID-19. The Department does not expect significant decreases in wastewater system service charge revenues as a result of the COVID-19 outbreak, as approximately 67% of the total revenue from sewer service charges comes from residential accounts and the Department’s rates and charges include fixed monthly charges. The Department is allowing payment deferrals and payment plans but is not waiving fees.

Although the Department believes COVID-19 will not materially adversely impact the operations or revenues of the wastewater system, the ultimate impact of COVID-19 on the operations and finances of the City and the wastewater system is unknown at this time. Additionally, the Department cannot predict to what extent the City may desire or need to provide customer assistance measures or deferrals, forbearances, adjustments or other changes to customers and the effect of any such measures on the operations or revenues of the wastewater system. The Department’s fiscal year 2022 budget will include consideration of the effects of the COVID-19 outbreak.

New Accounting Pronouncements

GASB Statement No. 87

In June 2017, GASB issued Statement No. 87 (“GASB 87”), *Leases*. This Statement increases the usefulness of governments’ financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. Upon the issuance of GASB Statement No. 95, *Postponement of the Effective Dates of Certain Authoritative Guidance*, the provisions of GASB 87 were deferred to periods beginning after June 15, 2021. Management has not yet determined the effect this Statement will have on its financial statements.

GASB Statement No. 96

In May 2020, GASB issued Statement No. 96, *Subscription-Based Information Technology Arrangements*. This Statement provides guidance on the accounting and financial reporting for subscription-based information technology arrangements for government end users. This Statement is effective for periods beginning after June 15, 2022. Management has not yet determined the effect this Statement will have on its financial statements.

3. Cash and Investments

The cash and investment balances reported in the accompanying statements of net position are included in the City’s 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, 2020 and 2019. The remaining balance at June 30, 2020 and 2019 was invested in the City’s pooled investment fund. Information pertaining to credit risk, interest rate risk, and fair value measurements is

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available for only the 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.

Investments

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. Section 46-50, Hawaii Revised Statutes, the City's investment policy, and resolution 18-115, CD1 govern acceptable types of investments. The City's resolution 07-51, CD1 govern the deposit and short-term investment of general excise and use tax revenues.

Interest Rate Risk

The City structures the investment portfolio so that securities mature to meet cash requirements for ongoing operations, avoiding the need to sell securities on the open market prior to maturity. This practice decreases the City's exposure to risk caused by the fluctuation in interest rates. The City may invest operating funds primarily in shorter-term securities, money market mutual funds, or similar investment pools. As of June 30, 2020, the City had no investments in money market mutual funds or external investment pools.

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.

Investments include \$12.7 million with FSA Capital Management LLC at June 30, 2020 and 2019. The remaining balance at June 30, 2020 and 2019 was invested in the City's pooled investment fund.

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, 2020, 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 To Other City Funds

Due to other City funds consists primarily of payroll-related expenses for the Sewer Fund temporarily advanced by the General Fund.

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6. Capital Assets

The capital assets activity for the years ended June 30, 2020 and 2019 were as follows (in thousands of dollars):

	Balance at July 1, 2019	Additions	Retirements/ Transfers	Balance at June 30, 2020
Depreciable assets				
Buildings and improvements	\$ 1,377,855	\$ 17,429	\$ -	\$ 1,395,284
Transmission and distribution system	2,163,335	165,878	(6)	2,329,207
Equipment and machinery	123,231	29,394	(811)	151,814
Land improvements	7,944	55	-	7,999
Total depreciable assets	<u>3,672,365</u>	<u>212,756</u>	<u>(817)</u>	<u>3,884,304</u>
Less: Accumulated depreciation				
Buildings and improvements	(342,651)	(29,141)	-	(371,792)
Transmission and distribution system	(485,162)	(41,775)	5	(526,932)
Equipment and machinery	(61,438)	(8,846)	803	(69,481)
Land improvements	(2,622)	(227)	-	(2,849)
Total accumulated depreciation	<u>(891,873)</u>	<u>(79,989)</u>	<u>808</u>	<u>(971,054)</u>
	2,780,492	132,767	(9)	2,913,250
Land	47,526	516	(2)	48,040
Construction in progress	<u>425,347</u>	<u>302,822</u>	<u>(205,473)</u>	<u>522,696</u>
Total capital assets, net	<u>\$ 3,253,365</u>	<u>\$ 436,105</u>	<u>\$ (205,484)</u>	<u>\$ 3,483,986</u>
	Balance at July 1, 2018	Additions	Retirements/ Transfers	Balance at June 30, 2019
Depreciable assets				
Buildings and improvements	\$ 1,357,132	\$ 32,746	\$ (12,023)	\$ 1,377,855
Transmission and distribution system	2,100,265	63,271	(201)	2,163,335
Equipment and machinery	119,345	4,295	(409)	123,231
Land improvements	7,598	346	-	7,944
Total depreciable assets	<u>3,584,340</u>	<u>100,658</u>	<u>(12,633)</u>	<u>3,672,365</u>
Less: Accumulated depreciation				
Buildings and improvements	(313,731)	(28,920)	-	(342,651)
Transmission and distribution system	(444,828)	(40,335)	1	(485,162)
Equipment and machinery	(54,126)	(7,712)	400	(61,438)
Land improvements	(2,405)	(217)	-	(2,622)
Total accumulated depreciation	<u>(815,090)</u>	<u>(77,184)</u>	<u>401</u>	<u>(891,873)</u>
	2,769,250	23,474	(12,232)	2,780,492
Land	46,033	1,496	(3)	47,526
Construction in progress	<u>297,885</u>	<u>204,827</u>	<u>(77,365)</u>	<u>425,347</u>
Total capital assets, net	<u>\$ 3,113,168</u>	<u>\$ 229,797</u>	<u>\$ (89,600)</u>	<u>\$ 3,253,365</u>

Depreciation expense was \$80.0 million and \$77.2 million for the years ended June 30, 2020 and 2019, respectively.

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7. Long-Term Liabilities

General Obligation Bonds

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 2010 through 2020 in the original amount totaling approximately \$1,250,000 and mature serially through fiscal year 2028. The general obligation bonds bear interest at rates ranging from 1.26% to 5.00% at June 30, 2020. No new general obligation bonds have been issued to finance construction of Sewer Fund capital facilities since fiscal year 1998. Subsequently, Sewer Fund capital facilities were funded by wastewater system revenue bonds.

Wastewater System Revenue Bonds

Wastewater system revenue bonds in the City's business-type activities were issued during fiscal years 1999 through 2020, in the original amount totaling \$3.5 billion, less discounts of \$3.0 million and adjusted for premiums of \$237.3 million, which are being amortized over the related term of the bonds. The bonds bear interest at 0.60% to 6.34% at June 30, 2020 and mature at various dates through fiscal year 2050. The wastewater system revenues collateralize the revenue bonds.

The wastewater system revenue bonds issued are limited special obligations of the City. The net revenues and all funds and accounts established other than the rebate account, the subordinate obligation account, and the reimbursable obligation account, and, in certain instances, the common reserve account or separate series reserve accounts have been pledged as security for the payment of debt service on the bonds. In an event of default, the bonds contain a provision that the holders of not less than 25% in principal amount of the bonds then outstanding may declare that all the principal and accrued interest is due and payable immediately. An event of default includes but is not limited to the following situations: failure to pay principal, redemption price, and interest due; failure to punctually perform or observe any of the covenants, agreements or conditions; and filing a petition in bankruptcy. The City has covenanted and agreed to maintain the wastewater system in good repair, to fix rates and charges sufficient to meet the net revenue requirement, to not dispose of the properties comprising the wastewater system, to maintain and keep proper books, and other actions consistent with conducting the business of the wastewater system in an efficient and economical manner.

On November 6, 2019, the City issued tax-exempt wastewater system revenue bonds of \$414.1 million and taxable wastewater system revenue bonds of \$82.8 million. The bonds were comprised of Senior Series A, B & C and Junior Series A & B totaling \$496.9 million.

Senior Series 2019A was issued for \$216.6 million. The proceeds of the bonds will be used to fund the cost of certain additions and improvements to the wastewater system. The bonds mature annually from July 1, 2020 through July 1, 2049 and bear interest ranging from 4.00% to 5.00%.

Senior Series 2019B was issued for \$174.7 million. The proceeds of the bonds, along with the release of \$7.7 million in common reserve funds, were used to refund a portion of revenue bond Series 2009A, 2009C, 2010B and 2015C. The bonds mature annually from July 1, 2020 through July 1, 2040 and bear interest ranging from 4.00% to 5.00%. The refunding was undertaken to reduce total debt service payments by \$36.3 million and resulted in an economic gain of approximately \$19.9 million.

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Senior Series 2019C was issued for \$20.8 million. The proceeds of the bonds, along with release of \$2.3 million in common reserve funds, were used to refund a portion of revenue bond Series 2012B. The bonds mature annually from July 1, 2025 through July 1, 2030 and bear interest ranging from 2.22% to 2.65%. The refunding was undertaken to reduce total debt service payments by \$3.7 million and resulted in an economic gain of approximately \$1.0 million.

Junior Series 2019A was issued for \$22.8 million. The proceeds of the bonds, along with release of \$3.2 million in common reserve funds, were used to refund a portion of revenue bond Series 2009A and 2015B. The bonds mature annually from July 1, 2020 through July 1, 2032 and bear interest ranging from 3.00% to 5.00%. The refunding was undertaken to reduce total debt service payments by \$4.2 million and resulted in an economic gain of approximately \$0.9 million.

Junior Series 2019B was issued for \$62.0 million. The proceeds of the bonds, along with release of \$21.5 million in common reserve funds, were used to refund a portion of revenue bond Series 2010A. The bonds mature annually from July 1, 2024 through July 1, 2028 and bear interest ranging from 2.23% to 2.59%. The refunding was undertaken to reduce total debt service payments by \$33.1 million and resulted in an economic gain of approximately \$8.1 million.

Defeased Bonds

The Sewer Fund defeased certain general obligation and revenue bonds by placing the proceeds of new bonds in irrevocable trusts to provide for all future debt service payments on the old bonds. Accordingly, the assets of the irrevocable trusts and the liability for the defeased bonds are not included in the Sewer Fund's financial statements. At June 30, 2020, approximately \$646.2 million of the Sewer Fund's bonds outstanding were considered defeased.

Notes Payable

The notes payable to the State are for the construction of necessary treatment works and for other projects intended for wastewater reclamation or waste management. During fiscal year 2020, the City issued notes payable amounting to \$107.8 million. The notes amounted to \$295.9 million and \$210.3 million at June 30, 2020 and 2019, respectively, bearing interest ranging from 0.00% to 2.34%, and require annual principal and interest payments through fiscal year 2042.

The notes payable are collateralized by the City's wastewater net revenue. The outstanding loans contain a provision that, in the event of default, the Director of the State of Hawaii Department of Health ("DOH") shall be entitled to collect a rate of 12% simple interest per year commencing on the repayment due date and ending on the date of the check or warrant issued by the City. A default is deemed to exist if repayment of loan fees or current loans are not paid when due, if the City fails to fulfill its obligation, or if the City becomes financially insolvent. The City covenanted that it shall exercise its revenue bonds, revenue, assessment, and other authority as needed to the extent allowed by law to pay the semiannual repayments and loan fees.

Total interest costs incurred in 2020 and 2019 were \$71.5 million and \$82.0 million, respectively.

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

Year ending June 30,	General Obligation Bonds	Revenue Bonds – Direct Placements	Revenue Bonds	Notes Payable – Direct Borrowings	Total Principal	Total Interest
2021	\$ 61	\$ 6,605	\$ 68,215	\$ 23,991	\$ 98,872	\$ 92,368
2022	67	7,120	74,780	24,326	106,293	88,395
2023	73	13,445	79,945	25,452	118,915	84,744
2024	74	14,015	82,465	25,579	122,133	80,808
2025	75	14,095	83,670	25,708	123,548	76,818
2026-2030	236	89,680	439,550	93,526	622,992	319,018
2031-2035	-	96,560	361,530	47,274	505,364	211,876
2036-2040	-	-	374,660	26,448	401,108	120,897
2041-2045	-	-	261,355	3,609	264,964	52,942
2046-2050	-	-	132,315	-	132,315	10,389
	586	241,520	1,958,485	295,913	2,496,504	\$ 1,138,255
Less: Current portion	(61)	(6,605)	(68,215)	(23,991)	(98,872)	
	\$ 525	\$ 234,915	\$ 1,890,270	\$ 271,922	\$ 2,397,632	

Asset Retirement Obligations

The Sewer Fund accounts for certain costs associated with the future dismantling and removal of underground storage tanks in accordance with GASB Statement No. 83, *Certain Asset Retirement Obligations*. Under Statement No. 83, the act of placing the tanks into operation requires the Sewer Fund to recognize a liability and corresponding deferred outflow of resources equal to the estimated current cost of activities that state law requires the City to perform upon retirement of the tanks in the future. The tanks currently have estimated lives ranging from 10–24 years.

The amounts reported as a liability and deferred outflow of resources at June 30, 2020 and 2019 were determined based on probability-weighted engineering estimates of what it would cost to perform all dismantling and removal tasks. Actual costs may be higher due to inflation, changes in technology, or changes in regulations.

Changes in Long-Term Liabilities

Activity for long-term liabilities, other than net pension and OPEB, for the fiscal years ended June 30, 2020 and 2019 were as follows (in thousands of dollars):

	Balance at July 1, 2019	Additions	Reductions	Balance at June 30, 2020	Amount Due Within One Year
General obligation bonds	\$ 621	\$ 473	\$ (508)	\$ 586	\$ 61
Revenue bonds – direct placements	246,995	-	(5,475)	241,520	6,605
Revenue bonds	1,901,570	496,910	(439,995)	1,958,485	68,215
Notes payable – direct borrowings	210,290	107,827	(22,204)	295,913	23,991
	2,359,476	605,210	(468,182)	2,496,504	98,872
Add: Unamortized net premium	122,822	73,175	(21,223)	174,774	-
Total long-term debt	2,482,298	678,385	(489,405)	2,671,278	98,872
Compensated absences	7,720	2,870	(2,756)	7,834	527
Asset retirement obligations	12,012	156	-	12,168	-
Total long-term liabilities	\$ 2,502,030	\$ 681,411	\$ (492,161)	\$ 2,691,280	\$ 99,399

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	Balance at July 1, 2018	Additions	Reductions	Balance at June 30, 2019	Amount Due Within One Year
General obligation bonds	\$ 676	\$ -	\$ (55)	\$ 621	\$ 58
Revenue bonds – direct placements	252,520	-	(5,525)	246,995	5,475
Revenue bonds	1,966,535	-	(64,965)	1,901,570	66,985
Notes payable – direct borrowings	229,398	3,562	(22,670)	210,290	21,483
	<u>2,449,129</u>	<u>3,562</u>	<u>(93,215)</u>	<u>2,359,476</u>	<u>94,001</u>
Add: Unamortized net premium	139,132	-	(16,310)	122,822	-
Total long-term debt	2,588,261	3,562	(109,525)	2,482,298	94,001
Compensated absences	7,630	3,125	(3,035)	7,720	491
Asset retirement obligations	11,765	247	-	12,012	-
Total long-term liabilities	<u>\$ 2,607,656</u>	<u>\$ 6,934</u>	<u>\$ (112,560)</u>	<u>\$ 2,502,030</u>	<u>\$ 94,492</u>

8. Net Position

At June 30, 2020 and 2019, net position consisted of the following (in thousands of dollars):

	2020	2019
Net investment in capital assets		
Net property, plant and equipment	\$ 3,483,986	\$ 3,253,365
Deferred outflows of resources – deferred refunding costs, net	67,466	53,069
Less:		
Wastewater general obligation bonds payable, net of unamortized premiums and discounts	(586)	(644)
Wastewater system revenue bonds payable, net of unamortized premium, discount, and issue cost	(2,374,779)	(2,271,364)
Notes payable	(295,913)	(210,290)
Amount of debt related to unspent debt proceeds	<u>279,800</u>	<u>130,834</u>
	1,159,974	954,970
Restricted for debt service	181,860	259,977
Unrestricted	<u>929,770</u>	<u>885,398</u>
	<u>\$ 2,271,604</u>	<u>\$ 2,100,345</u>

9. Employee Benefit Plans

Defined Benefit Pension Plan

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

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reduced benefits and covers most eligible employees hired starting July 1, 1984. Employees hired before that date were allowed to continue under the 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>.

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% 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% of their salary with pensions based on a 1.75% multiplier. Employees covered under the noncontributory class will receive pensions based on a 1.25% multiplier.

Contributions are established by HRS Chapter 88 and may be amended through legislation. The employer rate is set by statute based on the recommendations of the ERS actuary resulting from an experience study conducted every five years. Since July 1, 2005, the employer contribution rate is a fixed percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liabilities. The Sewer Fund's contribution requirements as of June 30, 2020 and 2019 were approximately \$9.0 million and \$8.3 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.

On May 18, 2017, the Governor signed into law Act 17 (Session Laws of Hawaii ("SLH") 2017), which increased future employer contributions to a phased-in contribution rate increase over four years beginning July 1, 2017. The rate for all employees, other than police and firefighters, increased to 19.00% on July 1, 2018; 22.00% on July 1, 2019; and 24.00% on July 1, 2020.

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

At June 30, 2020 and 2019, the Sewer Fund reported a liability of \$129.5 million and \$123.0 million, respectively, for its proportionate share of the net pension liability. The net pension liability at June 30, 2020 was measured as of June 30, 2019, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Sewer Fund's proportion of the net pension liability was based on a projection of the Sewer Fund's long-term share of contributions to the pension plan relative to the projected contributions of all participating members of ERS, actuarially determined. At June 30, 2019 and 2018, the City's proportion was 18.81% and 18.20%, respectively. The Sewer Fund's proportionate share of the City's proportionate share as of June 30, 2019 and 2018 was 4.86% and 5.07%, respectively.

For the fiscal years ended June 30, 2020 and 2019, the Sewer Fund recognized pension expense of \$20.2 million and \$13.1 million, respectively. At June 30, 2020 and 2019, the Sewer Fund reported deferred outflows and inflows of resources related to pensions from the following sources (in thousands of dollars):

	Deferred Outflows of Resources	Deferred Inflows of Resources
2020		
Difference between actual and expected experience	\$ 6,398	\$ (105)
Net difference between projected and actual earnings on pension plan investments	-	(340)
Changes of assumptions	8,926	(102)
Changes in proportion and differences between employer contributions and proportionate share of contributions	2,998	(10,359)
Sewer Fund contributions subsequent to the measurement date	8,988	-
	<u>\$ 27,310</u>	<u>\$ (10,906)</u>
2019		
Difference between actual and expected experience	\$ 4,508	\$ (487)
Net difference between projected and actual earnings on pension plan investments	-	(741)
Changes of assumptions	14,294	-
Changes in proportion and differences between employer contributions and proportionate share of contributions	2,665	(12,300)
Sewer Fund contributions subsequent to the measurement date	8,341	-
	<u>\$ 29,808</u>	<u>\$ (13,528)</u>

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The \$9.0 million reported as deferred outflows of resources related to pension at June 30, 2020, resulting from Sewer Fund contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ending June 30, 2021. 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):

Years ending June 30,	
2021	\$ 4,008
2022	1,668
2023	668
2024	966
2025	106
	<u>\$ 7,416</u>

Actuarial Assumptions

The total pension liability in the June 30, 2019 and 2018 actuarial valuations were determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	2.50 %
Projected salary increases, including inflation	3.50 % – 6.50 %
Investment rate of return, including inflation	7.00 %

There were no changes to ad hoc postemployment benefits including cost-of-living adjustments.

There were no other changes in assumptions between the measurement date, June 30, 2019, and the reporting date, June 30, 2020, that are expected to have a significant effect on the proportionate share of the net pension liability.

The post-retirement mortality rates are based on the 2019 Public Retirees of Hawaii mortality table with adjustments based on generational projections of the BB projection table for 2019 and full generational projection in future years. Pre-retirement mortality rates are based on multiples of the RP-2014 mortality table based on the occupation of the member.

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.

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

	Long-Term Target Allocation	Long-Term Expected Geometric Rate of Return
Strategic Allocation		
Broad growth	63.0 %	7.65 %
Principal protection	7.0 %	3.00 %
Real return	10.0 %	4.55 %
Crisis risk offset	20.0 %	5.15 %
	100.0 %	

Discount Rate

The discount rate used to measure the total pension liability was 7%. 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.

Sensitivity of the Sewer Fund's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate

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

	1% Decrease (6.00%)	Current Discount Rate (7.00%)	1% Increase (8.00%)
Sewer Fund's proportionate share of the net pension liability	\$ 170,338	\$ 129,465	\$ 100,037

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 measurable. 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, 2019 measurement date.

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Payables to the Pension Plan

As of June 30, 2020, the Sewer Fund had a payable of approximately \$715,000 to ERS. As of June 30, 2019, the Sewer Fund had no payable to ERS.

Postemployment Healthcare and Life Insurance Benefits

Plan Description

Pursuant to Act 88 (SLH 2001), the employers provide certain health care (medical, prescription, vision and dental) and life insurance benefits to all qualified employees. The EUTF, established on July 1, 2003, is an agent, multiple-employer defined benefit plan.

The EUTF issues a stand-alone financial report that is publicly available at <https://eutf.hawaii.gov>. Questions concerning any of the information contained therein or requests for any additional financial information related to that report should be addressed to EUTF, P.O. Box 2121, Honolulu, Hawaii 96805-2121.

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 net OPEB liability, deferred inflows and outflows, and OPEB expense 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.

Benefits Provided

For employees hired before July 1, 1996, the employers pay 100% of the base monthly contribution for employees retiring with ten or more years of credited service, and 50% of the base monthly contribution for employees retiring with fewer than ten years of credited service. The employers' contributions are based on the plan (single, two-party or family) selected by the retiree.

For employees hired after June 30, 1996 and retiring with 25 years or more of service, the employers pay the entire base monthly contribution. For employees retiring with at least 15 years but fewer than 25 years of service, the employers pay 75% of the base monthly contribution. For those retiring with at least ten years but fewer than 15 years of service, the employers pay 50% of the base monthly contribution. For those retiring with fewer than ten years of service, the employers make no contributions. If the retiree was hired before July 1, 2001, the employers' contributions are based on the plan (single, two-party or family) selected by the retiree. If the retiree was hired on or after July 1, 2001, the employers are responsible for the single plan base monthly contribution while the retiree must pay the difference if family coverage is elected.

Employees Covered by Benefit Terms

At July 1, 2019 and 2018, the State had the following number of plan members covered:

	2019	2018
Inactive plan members or beneficiaries currently receiving benefits	7,484	7,370
Inactive plan members entitled to but not yet receiving benefits	904	911
Active plan members	<u>8,585</u>	<u>8,576</u>
Total plan members	<u>16,973</u>	<u>16,857</u>

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Contributions

Act 268 (SLH 2013) required EUTF to establish and administer separate trust accounts for each public employer for the purpose of receiving irrevocable employer contributions to prefund OPEB for retirees and their beneficiaries. It established the Hawaii EUTF Trust Fund Task Force to examine further steps to address the unfunded liability and requires all public employers to make their annual required contributions (now known as actuarially determined contributions) effective with fiscal year 2014.

The employers' OPEB contributions (comprised of pay-as-you-go retiree costs and prefunding amounts paid to EUTF) are established by Hawaii State statutes. The retiree is responsible to pay the difference if the single plan base monthly contribution is less than the cost of the monthly premium for those employees hired on or after July 1, 2001. For fiscal years 2019 through 2021, the employers' prefunding contribution shall be equal to 100% of the valuation amount determined by an actuary retained by the EUTF board. Commencing with fiscal year 2019, the annual contribution shall be equal to the actuarially determined amount. In any fiscal year, should an employer's contribution be less than the actuarially determined amount, the difference shall be transferred to the OPEB trust account from the employer's portion of the transient accommodations tax revenues and all other of its revenues held by the State.

The Fourteenth Supplementary Proclamation, issued on October 13, 2020, suspended specific provisions of law. Included were Sections 87A-42(b) – (f), HRS, other postemployment benefits trust, 87A-43, HRS, payment of public employer contributions to the other postemployment benefits trust, and 237-31(3), HRS, remittances, related to the requirement for public employers to pay the annual required contribution to the EUTF in fiscal year 2021.

OPEB contributions for the fiscal years ended June 30, 2020 and 2019 amounted to approximately \$14.0 million and \$13.6 million, respectively. The employer is required to make all contributions for members.

OPEB Liability, OPEB Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to OPEB

At June 30, 2020 and 2019, the Sewer Fund reported a liability of \$115.3 million for its proportionate share of net OPEB liability. The net OPEB liability was measured as of July 1, 2019 and 2018, respectively, and the total OPEB liability used to calculate the net OPEB liability was determined by an actuarial valuation as of that date. The City's proportion of the net OPEB liability was based on a projection of the City's long-term share of contributions to the EUTF relative to projected contributions of all participants, actuarially determined. The City's proportion of the net OPEB liability was based on an allocation of the City's net OPEB liability based on the proportionate share of qualified payroll. At June 30, 2019 and 2018, the Sewer Fund's share of the City's net OPEB liability was 6.16% and 6.10%, respectively.

The demographic assumptions were updated to reflect the 2019 ERS Actuarial Experience Study. In addition, the dependent coverage assumptions were updated to reflect anticipated experience. There were no changes in assumptions between the measurement date, July 1, 2019, and the reporting date, June 30, 2020, that are expected to have a significant effect on the proportionate share of the net OPEB liability.

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For the years ended June 30, 2020 and 2019, the Sewer Fund recognized OPEB expense of approximately \$8.5 million and \$11.6 million, respectively. At June 30, 2020, the Sewer Fund reported deferred outflows of resources and deferred inflows of resources related to OPEB from the following sources (in thousands of dollars):

	Deferred Outflows of Resources	Deferred Inflows of Resources
2020		
Differences between expected and actual experience	\$ -	\$ (1,928)
Changes of assumptions	2,120	-
Net difference between projected and actual earnings on OPEB plan investments	350	-
Sewer Fund contributions subsequent to the measurement date	14,021	-
	<u>\$ 16,491</u>	<u>\$ (1,928)</u>
2019		
Differences between expected and actual experience	\$ -	\$ (1,829)
Changes of assumptions	1,609	-
Net difference between projected and actual earnings on OPEB plan investments	-	(444)
Sewer Fund contributions subsequent to the measurement date	13,586	-
	<u>\$ 15,195</u>	<u>\$ (2,273)</u>

The \$14.0 million reported as deferred outflows of resources related to OPEB at June 30, 2020 resulting from Sewer Fund's contribution subsequent to measurement date will be recognized as a reduction of the net OPEB liability in the fiscal year ending June 30, 2021. Other amounts reported as deferred inflows of resources related to OPEB will be recognized in OPEB expense as follows:

Years ending June 30,	
2021	\$ 57
2022	57
2023	164
2024	201
2025	63
	<u>\$ 542</u>

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Actuarial Assumptions

The total OPEB liability reflected in the actuarial valuation report as of July 1, 2019 was determined using the following actuarial assumptions and methods, applied to all periods including in the measurement, unless otherwise specified:

Valuation date	July 1, 2019
Actuarial cost method	Entry age normal
Discount rate	7.00%
Inflation	2.50%
Salary increases	3.50% to 7.00% including inflation
Demographic assumptions	Based on the experience study covering the five-year period ended June 30, 2018 as conducted for the ERS
Mortality	System-specific mortality tables utilizing scale BB to project generational mortality improvement
Participation rates	98% healthcare participation assumption for retirees that receive 100% of the Base Monthly Contribution ("BMC"). Healthcare participation rates of 25%, 65% and 90% for retirees that receive 0%, 50% or 75% of the BMC, respectively. 100% for life insurance and 98% for Medicare Part B
Healthcare cost trend rates	
PPO*	Initial rate of 8.00% declining to a rate of 4.86% after 12 years
HMO*	Initial rate of 8.00% declining to a rate of 4.86% after 12 years
Part B & Base Monthly Contribution ("BMC")	Initial rates of 5.00% declining to a rate of 4.70% after 11 years
Dental	Initial rate of 5.00% for first two years, followed by 4.00%
Vision	Initial rate of 0.00% for first two years, followed by 2.50%
Life insurance	0.00%

* Blended rates for medical and prescription drugs.

The demographic assumptions were updated to reflect the 2019 ERS Actuarial Experience Study. In addition, the dependent coverage assumptions were updated to reflect anticipated experience.

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The long-term expected rate of return on EUTF's investments was determined using a building-block method in which best-estimate ranges of expected future real rate of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of 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
Private equity	10.0 %	8.80 %
U.S. microcap	7.0 %	7.30 %
U.S. equity	15.0 %	5.35 %
Non-U.S. equity	17.0 %	6.90 %
Global options	7.0 %	4.75 %
Core real estate	10.0 %	3.90 %
Private credit	6.0 %	5.60 %
Core bonds	3.0 %	1.50 %
TIPS	5.0 %	1.20 %
Long treasuries	6.0 %	2.00 %
Alternative risk premia	5.0 %	2.75 %
Trend following	9.0 %	3.25 %
	<u>100.0 %</u>	

Single Discount Rate

The discount rate used to measure the net OPEB liability was 7.00%, based on the expected rate of return on OPEB plan investments of 7.00% and the municipal bond rate of 3.13% (based on the daily rate closest to but not later than the measurement date of the Fidelity "20-year Municipal GO AA index"). Beginning with the fiscal year 2019 contribution, the Sewer Fund's funding policy is to pay the recommended actuarially determined contribution, which is based on layered, closed amortization periods. Based on those assumptions, the OPEB plan's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive plan members. Therefore, the long-term expected rate of return on OPEB plan investments was applied to all periods of projected benefit payments to determine the total OPEB liability.

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Changes in Net OPEB Liability

The following table represents a schedule of changes in the net OPEB liability. The ending balances are as of the measurement date, July 1, 2019.

	Total OPEB Liability	Plan Fiduciary Net Position	Net OPEB Liability
Balance at July 1, 2018	\$ 138,556	\$ 23,031	\$ 115,525
Service cost	2,726	-	2,726
Interest on the total OPEB liability	9,497	-	9,497
Difference between expected and actual experience	(2,204)	-	(2,204)
Changes of assumptions	1,938	-	1,938
Employer contributions	-	8,779	(8,779)
Net investment income	-	1,882	(1,882)
Benefit payments	(4,914)	(4,914)	-
Administrative expense	-	(6)	6
Other	(1,792)	(313)	(1,479)
Net changes	<u>5,251</u>	<u>5,428</u>	<u>(177)</u>
Balance at June 30, 2019	<u>143,807</u>	<u>28,459</u>	<u>115,348</u>
Service cost	2,828	-	2,828
Interest on the total OPEB liability	10,085	-	10,085
Difference between expected and actual experience	(554)	-	(554)
Changes of assumptions	1,000	-	1,000
Employer contributions	-	13,586	(13,586)
Net investment income	-	1,390	(1,390)
Benefit payments	(5,117)	(5,117)	-
Administrative expense	-	(10)	10
Other	1,414	(135)	1,549
Net changes	<u>9,656</u>	<u>9,714</u>	<u>(58)</u>
Balance at June 30, 2020	<u>\$ 153,463</u>	<u>\$ 38,173</u>	<u>\$ 115,290</u>

***Sensitivity of the Net OPEB Liability to Changes in the Discount Rate
and Healthcare Cost Trend Rates***

The following table presents the Sewer Fund's net OPEB liability calculated using the discount rate of 7.00%, as well as what the Sewer Fund's net OPEB liability would be if it were calculated using a discount rate that is one percentage point lower (6.00%) or one percentage point higher (8.00%) than the current discount rate (amounts in thousands):

	1% Decrease (6.00%)	Current Discount Rate (7.00%)	1% Increase (8.00%)
Sewer Fund's proportionate share of the net OPEB liability	<u>\$ 139,441</u>	<u>\$ 115,290</u>	<u>\$ 96,296</u>

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The following table presents the Sewer Fund's net OPEB liability calculated using the assumed healthcare cost trend rate, as well as what the Sewer Fund's net OPEB liability would be if it were calculated using the trend rate that is one percentage point lower or one percentage point higher than the current healthcare cost trend rate:

	1% Decrease	Healthcare Cost Trend	1% Increase
Sewer Fund's proportionate share of the net OPEB liability	<u>\$ 95,657</u>	<u>\$ 115,290</u>	<u>\$ 140,586</u>

Payables to the OPEB Plan

At June 30, 2020 and 2019, the Sewer Fund had no payables to EUTF.

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. BWS and City agreed to a month-to-month extension of the agreement until a new agreement is made. The revenue related to these fees is included in other operating revenues of BWS and contractual services in the Sewer Fund. Service fees, in addition to credit card fees incurred, amounted to \$3.3 million and \$2.6 million for the years ended June 30, 2020 and 2019, respectively. A new agreement between BWS and City was executed on July 28, 2020 to extend the billing and collection services to June 30, 2024.

11. Commitments

Construction Contracts

The City has contractual commitments for the Sewer Fund of approximately \$776.9 million at June 30, 2020, primarily for construction contracts.

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, 2020 and 2019, accumulated sick leave, including vested and nonvested accumulated rights to receive sick leave benefits, amounted to approximately \$18.4 million and \$19.8 million, respectively.

Deferred Compensation Plan

All full-time employees of the Sewer Fund are eligible to participate in the City'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.

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Environmental Protection Agency Consent Decree

The Wastewater Treatment Plants (“WWTP”) and other facilities operated by the Department are governed either by National Pollutant Discharge Elimination System (“NPDES”) permits or by the State’s Department of Health (“DOH”) Underground Injection Control or Wastewater Management Permits or Clean Air Branch Covered Source and Non-Covered Source Permits.

The City is contesting certain conditions for the Waianae WWTP NPDES permit. The matter is currently pending before the Intermediate Court of Appeals on a procedural issue.

In addition, during the course of operating the wastewater system, occasional events of non-compliance with other permits, laws and regulations occur, including:

- Wastewater spills, which are subject to reporting pursuant to the NPDES permits, the 2010 Consent Decree described below, and DOH regulations.
- Exceedance of interim effluent limits set forth in the 2010 Consent Decree for the Sand Island and Honouliuli WWTPs, which are reported monthly with the discharge monitoring reports for the plants.
- Exceedance of effluent limits set forth in the NPDES permits for the WWTPs, which are reported monthly with the discharge monitoring reports for the plants.
- On November 26, 2014, DOH issued a Notice of Apparent Violation regarding the City’s pretreatment program. The City responded on March 6, 2015.
- On August 11, 2020, DOH issued a Notice of Apparent Violation and Request for Information regarding the City’s Honouliuli WWTP. The City responded on September 10, 2020.
- No other incident of noncompliance is subject to existing or threatened enforcement.

The City is complying with the terms of a consent decree (the “2010 Consent Decree”) entered by the United States District Court in Hawaii to settle certain previous environmental lawsuits relating to the Wastewater System. The Court retains continuing jurisdiction to enforce the 2010 Consent Decree. The following is a brief discussion of the 2010 Consent Decree and the City’s obligations thereunder.

The 2010 Consent Decree, approved by the Environmental Protection Agency (“EPA”), DOH, the Sierra Club, Hawaii Chapter, Our Children’s Earth Foundation, and Hawaii’s Thousand Friends, was entered by the United States District Court in Hawaii. Three previous environmental lawsuits were dismissed. The City’s appeal of the EPA’s January 2009 final decisions denying the City’s applications to renew its permit variances from secondary treatment for the Honouliuli and Sand Island WWTP was dismissed on February 2, 2011. The 2010 Consent Decree allows 10 years for completion of work on the collection system, 14 years for the upgrade of the Honouliuli 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 \$3.2 billion in 2010 dollars 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

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the plants to secondary treatment plants. As part of the settlement, the City paid a civil penalty in the amount of \$800,000 to the United States, and \$800,000 to the State. In addition, the City paid \$800,000 to the Sierra Club, Hawaii Chapter, Our Children's Earth Foundation, and Hawaii's Thousand Friends, to fund four supplemental environmental projects. The Honouliuli WWTP and Sand Island WWTP upgrades are expected to be completed by 2024 and 2035, respectively.

The 2010 Consent Decree became effective upon its entry by the Court on December 17, 2010. The City also settled the nonprofit organizations' claim for their attorneys' fees and costs for an additional payment of \$1.1 million.

The 2010 Consent Decree was amended on March 27, 2012. This amendment modified the 2010 Consent Decree to substitute construction of a Kaneohe-Kailua gravity tunnel and an associated influent pump station for the construction of a new force main between the City's Kaneohe pump station and its Kailua treatment plant and to eliminate requirements to proceed with and maintain storage projects in Kaneohe and Kailua. This amendment also allowed for non-material time extensions and modifications on projects under the 2010 Consent Decree by written agreement with the U.S. Department of Justice, the State, and the City. On July 15, 2020, the U.S. Department of Justice, the State, and the City entered into an agreement to extend the completion of the single remaining collection system project, SI-CS-10, to August 31, 2021. The City is on track to meet this deadline.

On March 13, 2017, the City and DOH voluntarily entered into an Administrative Order on Consent ("2017 Administrative Order on Consent") to resolve all liability of the City for certain 2015 wastewater spills. The City made no admissions as to fact, violation, fault or liability in entering the 2017 Administrative Order on Consent. On August 6, 2020, DOH issued a letter confirming that the City has complied with all requirements of the 2017 Administrative Order on Consent, and accordingly closed that administrative action.

Pending Wastewater System Litigation

The City and the Department generally are self-insured with respect to general liability claims. In fiscal years ended June 30, 2018, June 30, 2019, and June 30, 2020, the Department reached settlements of lawsuits and claims related to the Wastewater System and paid with Judgment, Settlements and Losses general funds approximating \$7,000, \$14,000, and \$15,000, respectively.

The City's Corporation Counsel is of the opinion that the expected liability arising out of any pending litigation would not constitute a material impairment of the Department's financial position.

Required Supplementary Information

City and County of Honolulu
Sewer Fund
Schedule of the City's Proportionate Share of the Net Pension Liability
Fiscal Years 2013–2019
(Amounts in thousands)

Defined Benefit Plan

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

Year ending June 30,	Proportion of Net Pension Liability	Proportionate Share of Net Pension Liability	Covered Payroll	Proportionate Share of Net Pension Liability as a Percentage of Covered Payroll	Plan Fiduciary Net Position as a Percentage of Total Pension Liability
2019	18.81 %	\$ 2,665,560	\$ 666,311	400.05 %	54.87 %
2018	18.20 %	\$ 2,424,496	\$ 640,203	378.71 %	55.48 %
2017	17.82 %	\$ 2,307,225	\$ 626,639	368.19 %	54.80 %
2016	18.17 %	\$ 2,428,894	\$ 599,494	405.16 %	51.28 %
2015	17.41 %	\$ 1,520,529	\$ 578,043	263.05 %	62.42 %
2014	16.31 %	\$ 1,307,396	\$ 536,304	243.78 %	63.92 %
2013	16.76 %	\$ 1,496,794	\$ 509,130	293.99 %	57.96 %

Prior fiscal years are not available. Table will be built prospectively.

See accompanying independent auditors' report.

City and County of Honolulu
Sewer Fund
Notes to Schedule of the City's Proportionate Share of the Net Pension Liability
Fiscal Years 2013–2020
(Amounts in thousands)

There were no changes in assumptions for the measurement period June 30, 2019.

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

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

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

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

See accompanying independent auditors' report.

**City and County of Honolulu
Sewer Fund
Schedule of Pension Contributions
Fiscal Years 2012–2020
(Amounts in thousands)**

Defined Benefit Plan

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

Year ending June 30,	Statutorily Required Contributions	Contributions in Relation to Statutorily Required Contributions	Contribution Excess (Deficiency)	Covered Payroll	Contributions as a Percentage of Covered Payroll
2020	\$ 212,405	\$ 212,694	\$ 289	\$ 689,084	30.87 %
2019	176,114	176,416	302	666,311	26.48 %
2018	152,657	157,686	5,029	640,203	24.63 %
2017	140,342	139,569	(773)	626,639	22.27 %
2016	135,217	129,245	(5,972)	599,494	21.56 %
2015	121,465	132,308	10,843	578,043	22.89 %
2014	102,885	87,979	(14,906)	536,304	16.40 %
2013	93,503	87,840	(5,663)	509,130	17.25 %
2012	89,275	81,690	(7,585)	517,862	15.77 %

Prior fiscal years are not available. Table will be built prospectively.

See accompanying independent auditors' report.

City and County of Honolulu
Sewer Fund
Schedule of Changes in Net OPEB Liability and Related Ratios
Fiscal Years 2017–2019
(Amounts in thousands)

Postemployment Healthcare and Life Insurance Benefits

The following presents the Schedule of Changes in Net OPEB Liability and Related Ratios, for the City as a whole, of which the Sewer Fund is one of its various enterprise funds.

	2019	2018	2017
Total other postemployment benefits (“OPEB”) liability			
Service cost	\$ 45,917	\$ 44,698	\$ 43,835
Interest on the total OPEB liability	163,723	155,684	147,732
Difference between expected and actual experience in the measurement of total OPEB liability	(9,002)	(36,127)	-
Changes of assumptions	16,227	31,781	-
Benefit payments	<u>(83,074)</u>	<u>(80,555)</u>	<u>(76,220)</u>
Net change in total OPEB liability	133,791	115,481	115,347
Total OPEB liability – beginning	<u>2,357,481</u>	<u>2,242,000</u>	<u>2,126,653</u>
Total OPEB liability – ending	<u>\$ 2,491,272</u>	<u>\$ 2,357,481</u>	<u>\$ 2,242,000</u>
Plan fiduciary net position			
Employer contributions	\$ 177,331	\$ 143,665	\$ 125,017
Net investment income	22,566	30,844	30,907
Benefit payments	(83,074)	(80,555)	(76,220)
OPEB plan administrative expense	(169)	(95)	(72)
Other	<u>36,505</u>	<u>-</u>	<u>1,147</u>
Net change in plan fiduciary net position	153,159	93,859	80,779
Plan fiduciary net position – beginning	<u>466,530</u>	<u>372,671</u>	<u>291,892</u>
Plan fiduciary net position – ending	<u>619,689</u>	<u>466,530</u>	<u>372,671</u>
Net OPEB liability – ending	<u>\$ 1,871,583</u>	<u>\$ 1,890,951</u>	<u>\$ 1,869,329</u>
Plan fiduciary net position as a percentage of total OPEB liability	24.87 %	19.79 %	16.62 %
Covered-employee payroll	\$ 667,656	\$ 648,001	\$ 626,639
Net OPEB liability as a percentage of covered-employee payroll	280.32 %	291.81 %	298.31 %

Data for prior fiscal years is not available. Table will be built prospectively.

Notes to Schedule of Changes in Net OPEB Liability and Related Ratios: None

2019: The demographic assumptions were updated to reflect the 2019 ERS Actuarial Experience Study. Additionally, the participation assumptions were updated to better reflect the plan's anticipated experience.

2018: The short-term healthcare trend assumptions were updated.

See accompanying independent auditors' report.

**City and County of Honolulu
Sewer Fund
Schedule of OPEB Contributions
Fiscal Years 2018-2020
(Amounts in thousands)**

Postemployment Healthcare and Life Insurance Benefits

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

	2020	2019	2018
Actuarially determined contribution	\$ 183,677	\$ 177,331	\$ 166,876
Actual contribution	<u>183,677</u>	<u>177,331</u>	<u>143,665</u>
Contributions excess (deficiency)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (23,211)</u>
Covered-employee payroll	\$ 689,084	\$ 667,656	\$ 648,001 *
Contributions as a percentage of covered-employee payroll	26.66 %	26.56 %	22.17 %

Information prior to the fiscal year ended June 30, 2018 is not available. As information becomes available in future years, up to ten years will be displayed prospectively.

* Revised from previous CAFR.

See accompanying independent auditors' report.

City and County of Honolulu
Sewer Fund
Notes to Schedule of OPEB Contributions
Year Ended June 30, 2020

Valuation date	The actuarially determined contribution for fiscal year ended June 30, 2020 was developed in the July 1, 2018 valuation
Actuarial cost method	Entry age normal
Discount rate	7.00%
Inflation	2.50%
Amortization method*	Level percent, closed
Equivalent single amortization period	19.10% as of fiscal year ended June 30, 2020
Payroll growth	3.50%
Asset method	Smoothed
Salary increases	3.50% to 7.00%; including inflation
Demographic assumptions	Based on the experience study covering the five-year period ended June 30, 2015 as conducted for the ERS
Mortality	System-specific mortality tables utilizing scale BB to project generational mortality improvement
Participation rates	98.00% healthcare participation assumptions for retirees that receive 100% of the Base Monthly Contribution ("BMC"). Healthcare participation rates of 25%, 65% and 90% for retirees that receive 0%, 50% or 75% of the BMC, respectively. 100% for life insurance and 98% for Medicare Part B
Healthcare cost trend rates	
PPO**	Initial rate of 10.00% declining to a rate of 4.86% after 13 years
HMO**	Initial rate of 10.00% declining to a rate of 4.86% after 13 years
Part B & Base Monthly Contribution ("BMC")	Initial rates of 4.00% and 5.00% declining to a rate of 4.70% after 12 years
Dental	5.00% for the first three years, then 4.00% for all future years
Vision	0.00% for the first three years, then 2.50% for all future years
Life insurance	0.00%

* Closed bases are established at each valuation for new unfunded liabilities.

** Blended rates for medical and prescription drugs.

See accompanying independent auditors' report.