

BOARD OF WATER SUPPLY of the COUNTY OF KAUA'I

SPECIAL BOARD MEETING

Second Floor, Microbiology Lab Bldg
Kaua'i County Department of Water
4398 Pua Loke Street, Lihu'e, Kaua'i, Hawai'i 96766

THURSDAY, NOVEMBER 14, 2013

3:00 p.m.

Or soon thereafter

A. CALL TO ORDER

B. ROLL CALL

C. ACCEPTANCE OF AGENDA

D. NEW BUSINESS

1. Draft Annual Audit for FY 2012-2013

E. EXECUTIVE SESSION

Pursuant to H.R.S. §92-7(a), the Board may, when deemed necessary, hold an executive session on any agenda item without written public notice if the executive session was not anticipated in advance. Any such executive session shall be held pursuant to H.R.S. §92-4 and shall be limited to those items described in H.R.S. §92-5(a).

F. ADJOURNMENT

**Department of Water
County of Kauai**

Financial Statements
As of June 30, 2013 and 2012
Together with Independent Auditor's Report

DRAFT

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Independent Auditor's Report

To the Board of Water Supply
Department of Water, County of Kauai:

Report on the Financial Statements

We have audited the accompanying financial statements of the Department of Water (the Department), a component unit of the County of Kauai, Hawaii, as of and for the year ended June 30, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the Department's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Department of Water, County of Kauai, as of June 30, 2013 and 2012, 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.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and the schedule of funding progress for the Hawaii Employer-Union Health Benefits Trust Fund on pages 4 through 8 and page 40, respectively, 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.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Department's basic financial statements. The accompanying Schedules I and II are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The accompanying Schedules I and II are the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial

statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the accompanying supplemental information in Schedules I and II is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated [DATE] on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Department's internal control over financial reporting and compliance.

KMH LLP

Honolulu, Hawaii

[DATE]

Department of Water, County of Kauai

Management's Discussion and Analysis
June 30, 2013

The Department of Water of the County of Kauai is a semi-autonomous agency consisting of a Board of Water Supply, Manager and Chief Engineer, and support staff. The Board of Water Supply is responsible for the management, control, and operation of the County of Kauai's water system. This discussion and analysis is designed to assist the reader in focusing on the significant financial issues and activities and to identify any significant changes in financial position. We encourage readers to consider the information presented here in conjunction with the financial statements.

Financial Highlights

- Total assets at fiscal year-end were \$283.1 million and exceeded liabilities by \$177.4 million.
- Total net position increased by \$7 million or 4% and is basically the result of the current year's operations and capital contributions.
- Total cash and investments at June 30, 2013 were \$56.5 million, a decrease of \$3.4 million from the prior year.
- The Department's liquidity ratio is 2.4 for FY 2013 and 2.2 for FY 2012.
- The debt to equity ratio, including capital leases, is 55% for FY 2013 and 59% for FY 2012.
- Operating revenues for FY 2013 were \$28 million, an increase of \$5.4 million or 24% higher from FY 2012. The increases are attributable to a 10% increase in billed consumption or 420M gallons of water usage higher than FY 2012 and the implementation of the 2nd year water rate increase as approved in the 2011 Water Rate Study.
- Operating expenses for the current year totaled \$20.9 million, a decrease of approximately half a million (\$.55M) as compared to the prior year. Administrative Expenses, Power & Pumping costs were the components of these decreases in operating expenditures.
- Long-term debt decreased by \$4.1 million, or 4%. The Department's annual debt service requirements include principal, interest and loan fee charges. For FY 2014, \$4M in total principal payments is due and payable for the State Revolving Fund (SRF) loans and Bonds payment amortization. In addition, the issuance of the 2012A Series Refunding Bond by the Department through the County of Kauai resulted in a net savings or decreased bond principal payments.

Department of Water, County of Kauai

Management's Discussion and Analysis
June 30, 2013

Overview of the Financial Statements

The financial statements are presented using the economic resources measurement focus and accrual basis of accounting, whereby revenues and expenses are recognized in the period earned or incurred. The financial statements are designed to provide readers with a broad overview of the Department's finances in a manner similar to a private-sector business.

The basic financial statements include a statement of net assets, a statement of revenues, expenses and changes in net assets, a statement of cash flows, and notes to basic financial statements. The statement of net assets presents all of the Department's assets and liabilities and provides information on the nature of its resources and obligations. The statement of revenues, expenses and changes in net assets presents the results of operations and the resulting change in net assets for the year. The statement of cash flows presents changes in cash resulting from operating activities, capital and related financing activities, and investing activities.

The notes to the basic financial statements provide required disclosures and additional information that is essential to a full understanding of the data provided in the basic financial statements. In addition to the basic financial statements and accompanying notes, this report also presents certain supplementary information on utility plant in service and selective account classifications.

Department of Water, County of Kauai

Management's Discussion and Analysis
June 30, 2013

Financial Analysis

Statements of Net Position - Condensed
June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>	<u>% Change</u>
Assets:			
Current and Other Assets	\$ 37,587,371	\$ 31,284,920	20%
Capital Assets, net	217,854,455	211,436,207	3%
Other Non-current Assets	<u>27,699,541</u>	<u>37,002,927</u>	(25%)
Total assets	<u>\$ 283,141,367</u>	<u>\$ 279,724,054</u>	1%
Liabilities:			
Current Liabilities	\$ 11,684,377	\$ 10,696,213	9%
Long-term Debt, net	90,390,810	94,520,882	(4%)
Other Long-term Liabilities	<u>3,698,944</u>	<u>4,160,402</u>	(11%)
Total liabilities	<u>\$ 105,774,131</u>	<u>\$ 109,377,497</u>	(3%)
Net Position:			
Invested in Capital Assets, net of related debt	\$ 144,652,168	\$ 142,687,999	1%
Restricted	969,667	3,197,055	(70%)
Unrestricted	<u>31,745,401</u>	<u>24,461,503</u>	30%
Total net position	<u>\$ 177,367,236</u>	<u>\$ 170,346,557</u>	4%

Statements of Revenues, Expenses and Change in Net Position - Condensed
June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>	<u>% Change</u>
Operating Revenues	\$ 27,964,725	\$ 22,521,775	24%
Operating Expenses	<u>20,904,079</u>	<u>20,363,077</u>	3%
Income from operations	<u>7,060,646</u>	<u>2,158,698</u>	227%
Non Operating Expenses	(3,523,050)	(2,991,510)	17%
Capital Contributions	<u>3,483,083</u>	<u>22,063,405</u>	(84%)
Change in net position	<u>\$ 7,020,679</u>	<u>\$ 21,230,593</u>	(67%)

Department of Water, County of Kauai

Management's Discussion and Analysis
June 30, 2013

The Department's financial condition remains positive at the year-end. As described earlier, net position is the reported difference between assets and liabilities and which over time, may serve as a useful indicator of the Department's overall financial position. The total assets at year-end for the Department was \$283.1 million and exceeded liabilities by \$177.3 million (net position). Total net position increased by \$7 million, or 4%, in FY 2013.

Total cash and investments (including restricted funds) decreased by \$3.47 million from \$59.8 million in FY 2012 to \$56.5 million in FY 2013. While the department's unrestricted cash and investments increased by \$4M, the restricted cash and other pooled investments decreased by \$7.4M. The decrease is primarily related to capital expenditures in FY 2013.

The Department's liquidity ratio is (current assets divided by current liabilities) 2.4 for FY 2013 and 2.2 for FY 2012.

The Department finances part of its capital improvement and rehabilitation program through long-term bond issues and State Revolving Fund loans. The debt to equity ratio, including capital leases, for FY 2013 and FY 2012 was 55% and 59%, respectively. The debt service coverage, including capital leases, for FY 2013 is 2.9 which is above the Department's debt service coverage target of 1.5.

The increase in net position for FY 2013 amounted to \$7 million and is basically a result of the current year's operations and capital contributions. Key elements of this increase are as follows:

Operating revenues for FY 2013 amounted to \$28 million. This was \$5.4 million or 24% higher than FY 2012. The increases in operating revenues are attributable to the increase in billed consumption by 420M gallons or 10% higher from last year and increased revenue receipts due to the implementation of the 2nd year water rate increase.

Total operating expenses increased from \$20.4 million in FY 2012 to \$20.9 million in FY 2013, a slight increase of \$.5 million or 3%. The major components of the operating expenditures are as follows:

Depreciation expense increased by \$780 thousand (780K) and is attributable to capitalized assets added to property, plant and equipment last year.

Power and pumping expense decreased by \$420K or 10% lower. The decrease is due to the elimination of SCADA maintenance contract and decreased labor and materials.

Transmission and distribution expense increased by \$124K. The slight increase is due to labor and materials. No new major expenditure incurred.

Department of Water, County of Kauai

Management's Discussion and Analysis
June 30, 2013

Administrative and general expense decreased by \$151K. County Contra Account expenditure was higher by 360K but it was offset with a decreased Employee Health and OPEB costs as compared to the prior year.

Capital contributions, which are included as non-operating income amounted to \$3.5 million for FY 2013, \$18.6M decrease or 84% as compared from last year's \$22 million in capital contributions.

Capital Assets and Debt Administration

Capital assets are made up of property, plant and equipment. As of June 30, 2013, the Department had net capital assets of \$217.9 million. Utility plant additions completed in FY 2013 amounted to \$11.1 million. Major capital asset additions included:

Kekaha Well B Renovation	\$1.0 million
Waimea Well A Renovation	\$1.0 million
Wailua – Pipeline Replacement along Wailua, Ohana, Anolani & Kuamoo Roads and Lehia Lane	\$1.6 million
Wailua – Waipouli Main Replacement	\$2.5 million
Lihue – Main Replacement Phase I, Nawiliwili, Niumalu & Kupolo 6", 8" & 12"	\$3.7 million

Long-term debt obligations outstanding as of June 30, 2013 amounted to \$93.8 million which consisted of \$70 million in public improvement bonds and \$23.8 million in State Revolving Fund (SRF) loans. As noted earlier, long-term debt decreased by \$4.1million, or 4%. This decrease is a result of principal payments made during the year with just minimal additional borrowing through State Revolving Fund loan agreements with the State of Hawaii Department of Health. The Department issued through the County of Kauai \$3.1 million in general obligation bonds for the purpose of partially refunding the 2005A Series bonds. More detailed information about the Department's long-term debt is provided in Note 6 of the notes to the basic financial statements.

Department of Water, County of Kauai

Statements of Net Position

June 30, 2013 and 2012

	<u>Assets</u>	
	<u>2013</u>	<u>2012</u>
Current Assets:		
Cash	\$ 17,105,705	\$ 13,105,838
Equity interest in pooled investments	4,519,250	4,518,770
Receivables:		
Accounts, net of allowance for doubtful accounts of approximately \$412,000 and \$303,000, respectively	2,557,178	2,713,770
Unbilled accounts	1,102,851	1,522,451
Receivable from primary government	-	9,226
Grants and subsidies	1,278,068	425,161
Accrued interest	16,267	7,653
Total receivables	<u>4,954,364</u>	<u>4,678,261</u>
Materials and supplies	794,114	848,159
Prepaid expenses	101,967	260,511
Total current assets	<u>27,475,400</u>	<u>23,411,539</u>
Restricted Assets:		
Facility reserve charge funds:		
Cash	739,693	2,483,487
Equity interest in pooled investments	1,924,000	2,451,703
Accrued interest receivable	5,606	6,389
Total facility reserve charge funds	<u>2,669,299</u>	<u>4,941,579</u>
Bond funds:		
Cash	380,692	1,037,406
Equity interest in pooled investments	24,649,550	31,023,942
Total bond funds	<u>25,030,242</u>	<u>32,061,348</u>
Total restricted assets	<u>27,699,541</u>	<u>37,002,927</u>
Equity Interest in Pooled Investments - Noncurrent	7,159,806	5,209,187
Accrued Interest - Noncurrent	2,381,374	2,084,422
Other Assets	570,791	579,772
Utility Plant:		
In service	293,790,071	282,650,130
Accumulated depreciation	(93,031,575)	(87,055,306)
Total utility plant	<u>200,758,496</u>	<u>195,594,824</u>
Construction work in progress	17,095,959	15,841,383
Total property, plant and equipment	<u>217,854,455</u>	<u>211,436,207</u>
Total assets	<u>\$283,141,367</u>	<u>\$279,724,054</u>

See accompanying notes to basic financial statements.

Department of Water, County of Kauai

Statements of Net Position (continued)

June 30, 2013 and 2012

	<u>Liabilities and Net Position</u>	
	<u>2013</u>	<u>2012</u>
Current Liabilities:		
Current portion of long-term debt	\$ 4,034,944	\$ 1,951,000
Current portion of capital lease obligation	592,000	545,000
Accounts payable and accrued liabilities	4,159,999	4,118,047
Contracts payable, including retainages	1,819,379	1,847,491
Customer advances for construction	100,319	657,195
Accrued vacation and compensatory pay	479,000	487,000
Customer deposits	494,631	242,429
Due to primary government	3,939	-
Post-retirement health care benefits payable	-	848,051
Total current liabilities	<u>11,684,211</u>	<u>10,696,213</u>
Long-Term Debt, Net of Current Portion, Unamortized		
Premiums and Deferred Refunding Costs	90,390,810	94,520,882
Capital Lease Obligation, Net of Current Portion	3,214,775	3,792,674
Accrued Vacation and Compensatory Pay, Net of Current Portion	<u>484,335</u>	<u>367,728</u>
Total liabilities	<u>105,774,131</u>	<u>109,377,497</u>
Commitments and Contingencies		
Net Position:		
Invested in capital assets, net of related debt	144,652,168	142,687,999
Restricted for capital activity and debt service	969,667	3,197,055
Unrestricted	<u>31,745,401</u>	<u>24,461,503</u>
Total net position	<u>\$ 177,367,236</u>	<u>\$ 170,346,557</u>

See accompanying notes to basic financial statements.

Department of Water, County of Kauai

Statements of Revenues, Expenses and Changes in Net Position
For the Years Ended June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Operating Revenues:		
Water sales	\$ 25,837,871	\$ 21,283,377
Other water revenue:		
Public fire protection service	1,511,190	1,147,741
Other	<u>615,664</u>	<u>90,657</u>
Total operating revenues	<u>27,964,725</u>	<u>22,521,775</u>
Operating Expenses:		
Depreciation and amortization	6,936,653	6,163,290
Administrative and general	4,964,047	5,115,101
Power and pumping	3,595,798	4,015,455
Transmission and distribution	3,626,316	3,501,544
Source of supply	875,722	787,402
Customer accounting and collection	688,517	605,480
Purification	<u>217,026</u>	<u>174,805</u>
Total operating expenses	<u>20,904,079</u>	<u>20,363,077</u>
Income from operations	<u>7,060,646</u>	<u>2,158,698</u>
Non-Operating Income (expense):		
Investment income	392,418	1,878,897
Interest expense, net of amounts capitalized	(3,915,468)	(4,083,069)
Loss on disposal of assets	<u>-</u>	<u>(787,338)</u>
Total non-operating expenses	<u>(3,523,050)</u>	<u>(2,991,510)</u>
Income (loss) before contributions	3,537,596	(832,812)
Capital contributions	<u>3,483,083</u>	<u>22,063,405</u>
Change in net position	7,020,679	21,230,593
Net Position at Beginning of Year	<u>170,346,557</u>	<u>149,115,964</u>
Net Position at End of Year	<u><u>\$ 177,367,236</u></u>	<u><u>\$ 170,346,557</u></u>

See accompanying notes to basic financial statements.

Department of Water, County of Kauai

Statements of Cash Flows

For the Years Ended June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Cash Flows from Operating Activities:		
Cash received from customers	\$ 26,423,289	\$ 20,295,341
Cash payments to suppliers for goods and services	(9,638,047)	(9,583,011)
Cash payments to employees for services	(4,472,533)	(4,367,959)
Other cash receipts	<u>2,126,854</u>	<u>1,238,398</u>
Net cash provided by operating activities	<u>14,439,563</u>	<u>7,582,769</u>
Cash Flows from Capital and Related Financing Activities:		
Proceeds from issuance of public improvement bonds	3,100,706	5,440,298
Acquisition and construction of capital assets	(11,970,589)	(18,615,589)
Proceeds from revolving fund loan	400,548	204,867
Principal paid on revolving fund loan	(1,598,095)	(1,586,203)
Payments for bond issuance costs	(31,010)	(59,345)
Principal paid on public improvement bond maturities	(531,000)	(425,500)
Principal paid on capital lease obligation	(544,978)	(513,331)
Cash paid for defeasance of public improvement bond	(3,069,696)	(5,240,000)
Interest paid on long-term debt	(5,416,409)	(5,711,673)
Proceeds from state government capital grants	4,080	1,427,482
Proceeds from BAB Subsidy	1,016,308	1,022,308
Net proceeds from FRC Program	<u>761,300</u>	<u>584,000</u>
Net cash used in capital and related financing activities	<u>(17,878,835)</u>	<u>(23,472,686)</u>
Cash Flows from Investing Activities:		
Purchases of investments	(11,856,347)	(422,694,579)
Sales and maturities of investments	16,805,467	440,800,200
Interest on investments	<u>89,511</u>	<u>90,124</u>
Net cash provided by investing activities	<u>5,038,631</u>	<u>18,195,745</u>
Net increase in cash (including restricted cash)	1,599,359	2,305,828
Cash (including restricted cash),		
Beginning of Year	<u>16,626,731</u>	<u>14,320,903</u>
Cash (including \$1,120,385 and \$3,520,893 in restricted cash, respectively), End of Year	<u><u>\$ 18,226,090</u></u>	<u><u>\$ 16,626,731</u></u>

See accompanying notes to basic financial statements.

Department of Water, County of Kauai

Statements of Cash Flows (continued)
For the Years Ended June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Reconciliation of Cash Flows from Operating Activities:		
Income from operations	\$ 7,060,646	\$ 2,158,698
Depreciation expense	6,936,653	6,163,290
Bad debt expense	108,517	24,561
(Increase) decrease in assets:		
Accounts receivable, net	48,075	(562,830)
Unbilled accounts and other receivables	428,826	(449,767)
Materials and supplies	54,045	24,829
Prepaid expenses and other assets	198,535	(39,237)
Increase (decrease) in liabilities:		
Accounts payable and accrued liabilities	87,569	310,584
Accrued vacation and compensatory pay	108,607	(18,271)
Post-retirement healthcare benefits payable	(848,051)	2,092
Due to primary government	3,939	(4,317)
Customer deposits	252,202	(26,863)
Net cash provided by operating activities	<u>\$ 14,439,563</u>	<u>\$ 7,582,769</u>

Supplemental Disclosure of Non-cash Capital and Related Financing Activities:

The Department received approximately \$514,000 and \$20,453,000 for the years ended June 30, 2013 and 2012, respectively, in contributions of property, plant and equipment from governmental agencies, developers and customers which are recorded as contributions at estimated fair value at the date of donation.

See accompanying notes to basic financial statements.

Department of Water, County of Kauai

Notes to Basic Financial Statements
June 30, 2013 and 2012

1. Background

On May 10, 1960, by authority of Act 20, Session Laws of Hawaii 1960, the Board of Water Supply (the Board) of the County of Kauai, Hawaii (the County) was created. The County transferred to the Board the operation and management of the water transmission and distribution systems. Under Act 20, the Board has the power to make and alter rules and regulations relating to the management, control, operation, preservation and protection of the waterworks. The rules and regulations adopted by the Board have the force and effect of law.

As of January 2, 1969, under a new charter for the County, the policy-making responsibility for the water system was retained by the Board. The Board, however, is specifically stated to be an executive department of the County government. To the extent that they were not in conflict with the provisions of the charter, laws governing the County water supply which were in existence at the time of the enactment of the charter continued in effect. The water system is now being operated as the Department of Water, County of Kauai (the Department), a self-supporting component unit (enterprise fund) of the County which renders water services throughout the island.

The Department is responsible for establishing rates for services based upon current operating costs and expected future capital and operating revenue requirements. The rates determined by the Department are subject to approval by the Board. Effective July 1, 2012, the Board raised rates an average 9 percent and raised the service charge rate an average of 12 percent. Effective January 1, 2012, the Board raised rates an average 26 percent and decreased the service charge rate an average of 49 percent.

2. Summary of Significant Accounting Policies

a. Financial Statement Presentation

The Department is a component unit of the County (the primary government). The accompanying financial statements present only the activities of the Department and do not include other organizations, activities and functions of the County.

b. Basis of Accounting

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

Department of Water, County of Kauai

Notes to Basic Financial Statements
June 30, 2013 and 2012

2. Summary of Significant Accounting Policies (continued)

b. Basis of Accounting (continued)

The Department has implemented GASB Statement No. 62, "Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements"(GASB No. 62), which supercedes GASB Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting." GASB No. 62 incorporates Financial Accounting Standards Board pronouncements, not conflicting with GASB pronouncements, and issued on or before November 30, 1989, into the GASB authoritative literature. The implementation of this Statement had no impact on the Department's statements for the year ended June 30, 2013.

The Department has also implemented GASB Statement No. 63, "Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position"(GASB 63). GASB 63 provides guidance for reporting deferred outflows of resources, deferred inflows of resources, and identifies net position as the residual of all other elements presented in a statement of financial position. The Department's statements of net position as of June 30, 2013 and 2012 have been presented in accordance with the guidance provided in this Statement.

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

c. Cash

The Department's cash include cash on hand, demand deposits and short-term investments with original maturities of three months or less from the date of acquisition.

d. Investments

The Department has stated its investments at fair value. Changes in the fair value of investments are recognized in the statements of revenues, expenses and changes in net position.

Department of Water, County of Kauai

Notes to Basic Financial Statements
June 30, 2013 and 2012

2. Summary of Significant Accounting Policies (continued)

e. Management 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 include revenue recognized related to unbilled accounts, accrued liability for workers' compensation claims and judgments and accrued liability for post-retirement health care benefits. Actual results could differ from those estimates.

f. Utility Plant in Service (UPIS) and Depreciation

In July 1966, a detailed report on the inventory and valuation of water utility properties of the Board was submitted by R. W. Beck and Associates, Analytical and Consulting Engineers, of Seattle, Washington. The estimated original cost of \$5.8 million and the reserve for depreciation of \$1.4 million were recorded in the accounts. Additions to the utility plant since the date of the valuation are stated at cost and include contributions by government agencies, private developers and customers at their fair value at the date of contribution.

Depreciation on the utility plant is computed over the estimated useful lives of the various individual and group assets using the straight-line method. Depreciation expense for the year is calculated using plant balances, including contributions in aid of construction, at the beginning of the year.

The estimated useful lives of the various individual and group assets are as follows:

Motor vehicles	7 to 10 years
Equipment and machinery	5 to 20 years
Buildings and improvements	40 to 50 years
Transmission and distribution equipment	18 to 63 years

Normal maintenance and repairs are charged to operations as incurred. All expenditures for major additions, betterments and replacements for the utility plant are capitalized, and expenditures for the general plant greater than \$5,000 are capitalized. The Department capitalizes certain indirect costs to construction work orders based upon actual construction direct labor hours.

Department of Water, County of Kauai

Notes to Basic Financial Statements
June 30, 2013 and 2012

2. Summary of Significant Accounting Policies (continued)

g. Capitalization of Interest

Interest costs have been capitalized, in accordance with accounting principles generally accepted in the United States of America, based on an average of expended costs through the end of the year. Capitalized interest in 2013 and 2012 was approximately \$434,000 and \$533,000, respectively.

h. Material and Supplies

Materials and supplies are stated at lower of average cost (which approximates the first-in, first-out method) or market.

i. Revenue Recognition

The Department recognizes revenue on the accrual method of accounting as services are rendered. Revenue recognized for services rendered but not billed is reflected as unbilled accounts in the accompanying statements of net assets.

j. Risk Management

The Department is exposed to various risks of loss from: (1) torts, (2) theft of, damage to and destruction of assets, (3) employee injuries and illnesses, (4) natural disasters, (5) employee health, dental and accident benefits, and (6) miscellaneous others. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims in excess of this commercial coverage was not significant in any of the three preceding years. The Department is self-insured for workers' compensation claims and judgments.

k. Capital Contributions

The following transactions represent voluntary non-exchange transactions and are recorded at fair value and are included as non-operating income in the statements of revenues, expenses and changes in net position:

- Receipts from federal and state financial assistance restricted to the acquisition of fixed assets
- Contributed utility plant in service
- Receipts of facility reserve charges
- Interest subsidies related to certain bonds (see Note 6)
- Loan forgiveness related to certain loans (see Note 6)

Department of Water, County of Kauai

Notes to Basic Financial Statements
June 30, 2013 and 2012

2. Summary of Significant Accounting Policies (continued)

k. Capital Contribution (continued)

For the years ended June 30, 2013 and 2012, the Department recorded approximately \$988,000 and \$1,023,000, respectively, of interest subsidies related to Build America Bonds as contributions in the accompanying statement of revenues, expenses and changes in net position. At June 30, 2013 and 2012, the Department recorded approximately \$387,000 and \$421,000, respectively, of accrued interest subsidies in grants and subsidies receivable in the accompanying statements of net position.

l. Facilities Reserve Charge (FRC)

Under the authority provided to the Board mentioned in Note 1, the Department assesses a fee to commercial and residential developers based upon the number and size of water meters installed at respective projects. These fees are restricted to fund the capital improvements of the water supply system and recorded as contributions in the statements of revenues, expenses and changes in net position.

m. Net Position

Net position comprise the various net earnings from operating and non-operating revenues, expenses and contributions in aid of construction. Net position are classified in the following three components: invested in capital assets, net of related debt; restricted for capital activity and debt service; and unrestricted net assets. Invested in capital assets, net of related debt, consist of capital assets, net of accumulated depreciation and reduced by outstanding debt that is attributable to the acquisition, construction or improvement of those assets. Debt related to unspent proceeds or other restricted cash and investments at year-end are not included in the calculation of invested in capital assets, net of related debt. Restricted for capital activity and debt service consists of net assets for which constraints are placed thereon by external parties, such as lenders, grantors, contributors, laws, regulations and enabling legislation, including self-imposed legal mandates. Unrestricted consists of all other net position not included in the above categories.

n. Reclassifications

Certain 2012 balances have been reclassified to be consistent with the current year presentation. Such reclassifications had no effect on the previously reported results of operations.

Department of Water, County of Kauai

Notes to Basic Financial Statements
June 30, 2013 and 2012

3. Deposits

The Department's deposits consist of cash, money market accounts and non-negotiable certificates of deposits. The Department's deposits are controlled by the Director of Finance of the County of Kauai.

At June 30, 2013 and 2012, the carrying value of the Department's cash deposits amount to approximately \$18,226,000 and \$16,627,000, respectively, of which approximately \$1,116,000 and \$5,665,000, respectively, were held by the County in the County's name. The bank balances at June 30, 2013 and 2012 amounted to approximately \$19,052,000 and \$16,458,000, respectively. The Director of Finance has arranged for all of the Department's deposits at June 30, 2013 and 2012 to be collateralized with securities held by the pledging financial institution in the County's name.

4. Investments

The Department's investments are controlled by the Director of Finance of the County of Kauai and are generally invested in certificates of deposit, repurchase agreements, government sponsored entity securities (i.e., Federal Home Loan Bank notes and bonds, Federal Home Loan Mortgage Corporation bonds, and Federal National Mortgage Association notes and bonds) with federally insured financial institutions and mutual funds. The Department's investment vehicles are consistent with the investment guidelines contained in the Hawaii Revised Statutes (HRS).

The Department participates in an investment pool with the County. The Department's portion of this pool is displayed on the statements of net assets as equity interest in pooled investments. The following is the composition of the Department's portion of these investments as of June 30, 2013 and 2012:

2013:	Fair Value (approximate)	Maturity (in years)	
		0-1	1-5
Government sponsored entities and other agencies	\$ 29,219,000	\$ 12,755,000	\$ 16,464,000
Money market funds	3,332,000	3,332,000	-
Other fixed income	2,020,000	2,020,000	-
US governments	2,009,000	2,009,000	-
US corporates	97,000	97,000	-
Total	<u>\$ 36,677,000</u>	<u>\$ 20,213,000</u>	<u>\$ 16,464,000</u>

Department of Water, County of Kauai

Notes to Basic Financial Statements
June 30, 2013 and 2012

4. Investments (continued)

2012:	Fair Value (approximate)	Maturity (in years)	
		0-1	1-5
Government sponsored entities and other agencies	\$ 34,237,000	\$ 29,227,000	\$ 5,010,000
US governments	3,314,000	2,281,000	1,033,000
Other fixed income	2,020,000	2,020,000	-
Money market funds	1,982,000	1,982,000	-
US corporates	102,000	-	102,000
Total	<u>\$ 41,655,000</u>	<u>\$ 35,510,000</u>	<u>\$ 6,145,000</u>

As of June 30, 2013 and 2012, excluded from the above disclosures is approximately \$1,576,000 and \$1,549,000, respectively, of non-negotiable certificates of deposit which are classified as equity interest in pooled investments in the statements of net position, but are considered deposits for the purposes of this disclosure.

Interest Rate Risk – State law limits the Department’s investment portfolio to maturities of less than five years. The Department does not have a formal investment policy that further limits investment maturities.

Credit Risk – State law limits investments to the top rating issued by nationally recognized statistical rating organizations (NRSROs). The Department has no investment policy that would further limit its investment choices. As of June 30, 2013, with the exception of the Department’s investment in certain fixed income and mutual funds which was not rated, all of the Department’s investments were rated Baa-AA.

Custodial Credit Risk – For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Department will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party.

Concentration of Credit Risk – The Department places no limit on the amount which may be invested in any one issuer. As of June 30, 2013, more than 5 percent of the Department’s investments are held in the following: Fannie Mae (30%), Federal Home Loan Bank (22%), Freddie Mac (14%), Blackrock Liquidity Funds (9%) and Federal Farm Credit Bank (6%).

Department of Water, County of Kauai

Notes to Basic Financial Statements
June 30, 2013 and 2012

5. Property, Plant and Equipment

Property, plant and equipment activity during 2013 and 2012 was as follows:

	Balance June 30, 2012	Additions	Reductions/ Transfers	Balance June 30, 2013
Utility Plant in Service	\$ 282,650,130	\$ 12,169,317	\$ (1,029,376)	\$ 293,790,071
Accumulated Depreciation	(87,055,306)	(6,936,653)	960,384	(93,031,575)
	<u>195,594,824</u>	<u>5,232,664</u>	<u>(68,992)</u>	<u>200,758,496</u>
Construction in Progress	15,841,383	11,274,954	(10,020,378)	17,095,959
Total	<u>\$ 211,436,207</u>	<u>\$ 16,507,618</u>	<u>\$(10,089,370)</u>	<u>\$ 217,854,455</u>
	Balance June 30, 2011	Additions	Reductions/ Transfers	Balance June 30, 2012
Utility Plant in Service	\$ 244,193,482	\$ 40,119,263	\$ (1,662,615)	\$ 282,650,130
Accumulated Depreciation	(81,767,293)	(6,950,628)	1,662,615	(87,055,306)
	<u>162,426,189</u>	<u>33,168,635</u>	<u>-</u>	<u>195,594,824</u>
Construction in Progress	22,536,793	14,723,038	(21,418,448)	15,841,383
Total	<u>\$ 184,962,982</u>	<u>\$ 47,891,673</u>	<u>\$(21,418,448)</u>	<u>\$ 211,436,207</u>

In 2013 and 2012, no impairment losses were identified by the Department.

Department of Water, County of Kauai

Notes to Basic Financial Statements
June 30, 2013 and 2012

6. Long-Term Liabilities

Bonds Payable

The full faith and credit of the County is pledged for the payment of the Department's obligations. The County has the power and is obligated to levy ad valorem taxes, without limitation as to rate or amount, on all real property subject to taxation by the County.

Unamortized bond issuance cost was approximately \$571,000 and \$572,000 at June 30, 2013 and 2012, respectively. This cost is amortized over the term of the respective bond and is included as other assets in the accompanying statements of net position.

On July 10, 2012, the Department issued through the County \$2,745,000 in general obligation bonds, with a premium of approximately \$356,000 and an average interest rate of 4.00 percent, for the purpose of refunding \$3,245,000 of outstanding 2005A Serial bonds, with an average rate of 4.13 percent. The net proceeds of the issuance was \$3,069,696 after payment of \$31,010 in underwriting fees and other issuance costs. The net proceeds were transferred to an escrow deposit account to redeem the outstanding 2005A Series bonds.

The advance refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of approximately \$175,000. The amount is being netted against the new debt and amortized over the new debt's life. The Department completed the current refunding to reduce its total debt service payments over the next 16 years by approximately \$225,000 and to obtain an economic gain (difference between the present values of the old and new debt service payments) of approximately \$158,000.

Department of Water, County of Kauai

Notes to Basic Financial Statements
June 30, 2013 and 2012

6. Long-Term Liabilities (continued)

As of June 30, 2013 and 2012, bonds payable consisted of the following:

	<u>2013</u>	<u>2012</u>
Public Improvement Bonds--County Series 2012A, last installment 2029. Maturing serially from August 1, 2016. Interest rate – 3.00 to 5.00 percent. Date issued – July 10, 2012. Original amount - \$2,745,000.	\$ 2,745,000	\$ -
Public Improvement Bonds--County Series 2011A, last installment 2025. Maturing serially from August 1, 2012. Interest rate – 2.00 to 5.00 percent. Date issued – July 7, 2011. Original amount - \$5,125,000.	4,505,000	4,780,000
Build America Bonds--County Series 2010A, last installment 2033. Maturing serially from August 1, 2013. Interest rate – 1.96 to 5.76 percent. Date issued – March 24, 2010. Original amount - \$60,000,000.	60,000,000	60,000,000
Public Improvement Bonds--County Series 2005A, last installment 2021. Maturing serially from August 1, 2008. Interest rate - 3.25 to 5.00 percent. Date issued - November 10, 2005. Original amount - \$6,485,000.	2,755,000	6,240,000
Public Improvement Bonds--County Series 1980, last installment 2015. Maturing serially from March 1, 1983. Interest rate - 5 percent. Date issued - April 7, 1980. Original amount - \$300,000.	35,000	51,000
Total bonds payable	<u>70,040,000</u>	<u>71,071,000</u>
Premium on bond issuance and deferred refunding costs	<u>632,253</u>	<u>140,584</u>
Total bonds payable, net	<u><u>\$ 70,672,253</u></u>	<u><u>\$ 71,211,584</u></u>

Department of Water, County of Kauai

Notes to Basic Financial Statements
June 30, 2013 and 2012

6. Long-Term Liabilities (continued)

Bonds Payable (continued)

The approximate annual debt service requirements through 2018 and in five-year increments thereafter to maturity as of June 30, 2013 are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Years ending June 30:			
2014	\$ 2,422,000	\$ 3,300,000	\$ 5,722,000
2015	2,593,000	3,233,000	5,826,000
2016	2,655,000	3,155,000	5,810,000
2017	2,800,000	3,064,000	5,864,000
2018	2,910,000	2,959,000	5,869,000
2019-2023	15,670,000	12,876,000	28,546,000
2024-2028	17,500,000	8,960,000	26,460,000
2029-2033	20,500,000	3,874,000	24,374,000
2034	2,990,000	86,000	3,076,000
	<u>\$ 70,040,000</u>	<u>\$ 41,507,000</u>	<u>\$ 111,547,000</u>

Department of Water, County of Kauai

Notes to Basic Financial Statements
June 30, 2013 and 2012

6. Long-Term Liabilities (continued)

Loans Payable

As of June 30, 2013 and 2012, the loans payable consisted of the following:

	2013	2012
State Revolving Fund (SRF) Loan – Stable 1.0 MG Tank, last installment 2029. Interest rate – .260 percent. Semi-annual loan fee rate – 1.625 percent. Date issued – March 15, 2009. Original amount \$7,274,996.	\$ 6,123,590	\$ 6,498,004
SRF Loan – Poipu Road 16 Inch Main Replacement, last installment 2027. Interest rate – .160 percent. Semi-annual loan fee rate – 1.625 percent. Date issued – January 15, 2007. Original amount - \$5,595,979.	3,726,747	3,989,775
SRF Loan – Kaunualii Highway 12 Inch Main Replacement, last installment 2029. Interest rate – .320 percent. Semi-annual loan fee rate – 1.625 percent. Date issued – August 15, 2009. Original amount - \$3,989,537.	3,401,725	3,602,184
SRF Loan – Kapilimao 0.5 MG Tank, last installment 2030. Interest rate – .420 percent. Semi-annual loan fee rate – 1.625 percent. Date issued – January 15, 2010. Original amount - \$3,793,779.	3,384,582	3,570,629
SRF Loan – 16 Inch Waterline Replacement along Kuhio Highway, Leho Drive to North Papaloa Road, last installment 2026. Interest rate – .160 percent. Semi-annual loan fee rate – 1.625 percent. Date issued – August 15, 2005. Original amount - \$2,481,289.	1,585,469	1,706,073
SRF Loan – Waha, Wawae & Niho Roads Main Replacement, last installment 2029. Interest rate – .320 percent. Semi-annual loan fee rate – 1.625 percent. Date issued – August 15, 2009. Original amount - \$1,844,718.	1,657,160	1,660,876
SRF Loan – Rehabilitate Lihue Steel Tanks 1 & 2, last installment 2024. Interest rate – .46 percent. Semi-annual loan fee rate – 1.625 percent. Date issued – January 15, 2004. Original amount - \$1,243,017.	803,676	868,641
SRF Loan – Damage Repairs to Kokolau Tunnel, last installment 2021. Interest rate – 1.37 percent. Semi-annual loan fee rate – 1.625 percent. Date issued – July 15, 2001. Original amount - \$1,755,329.	782,698	868,942

Department of Water, County of Kauai

Notes to Basic Financial Statements
June 30, 2013 and 2012

6. Long-Term Liabilities (continued)

Loans Payable (continued)

	<u>2013</u>	<u>2012</u>
SRF Loan – Replace Pipeline at Hanapepe River Crossing and Control of Slope; Failure at Hanapepe Well No. 3, last installment 2023. Interest rate – .99 percent. Semi-annual loan fee rate – 1.625 percent. Date issued – July 15, 2003. Original amount - \$1,345,040.	\$ 699,144	\$ 762,027
SRF Loan – Ornellas 0.2 MG Tank, last installment 2025. Interest rate – .58 percent. Semi-annual loan fee rate – 1.625 percent. Date issued – January 15, 2005. Original amount - \$809,398.	516,803	558,285
SRF Loan – Kekaha Well, last installment 2022. Interest rate – 1.01 percent. Semi-annual loan fee rate – 1.625 percent. Date issued – April 15, 2002. Original amount - \$1,097,536.	446,050	493,169
SRF Loan – Rehabilitation of 27 Inch Steel Pipeline – Hanapepe - Eleele Water System, last installment 2023. Interest rate – .99 percent. Semi-annual loan fee rate – 1.625 percent. Date issued – July 15, 2003. Original amount - \$691,134.	389,661	424,704
SRF Loan – Wailua Homesteads Well No. 3, last installment 2024. Interest rate – .54 percent. Semi-annual loan fee rate – 1.625 percent. Date issued – March 15, 2004. Original amount - \$418,967.	236,196	256,989
	<u>\$ 23,753,501</u>	<u>\$ 25,260,298</u>

In February 2012, the Department entered into a \$4.6 million SRF Loan agreement for the *Phase I Wailua Houselots Main Replacement* project. The agreement provided for a loan forgiveness of \$750,000, which shall be disbursed in its entirety before the interest accruing portion of the loan. For the year ended June 30, 2013, the Department's qualified reimbursable costs, as defined, recorded as a forgiveness of debt was approximately \$750,000 and included in contributions in the accompanying financial statements. As of June 30, 2013, the Department recorded a related grant receivable of \$750,000 in the accompanying statements of net position.

Department of Water, County of Kauai

Notes to Basic Financial Statements
June 30, 2013 and 2012

6. Long-Term Liabilities (continued)

In August 2012, the Department entered into a \$2.0 million SRF Loan agreement for the *Kahili Horizontal Directional Drilled Well* project. The agreement provided for a loan forgiveness of \$1,000,000, which shall be disbursed in its entirety before the interest accruing portion of the loan. For the year ended June 30, 2013, the Department's qualified reimbursable costs, as defined, recorded as a forgiveness of debt was approximately \$451,000 and included in contributions in the accompanying financial statements. As of June 30, 2013, the Department recorded a related grant receivable of \$141,314 in the accompanying statements of net position.

The approximate annual debt service requirements through 2018 and in five-year increments thereafter to maturity as of June 30, 2013 are as follows:

Years ending June 30:	Principal	Interest	Total
2014	\$ 1,613,000	\$ 846,000	\$ 2,459,000
2015	1,620,000	787,000	2,407,000
2016	1,626,000	727,000	2,353,000
2017	1,633,000	668,000	2,301,000
2018	1,640,000	608,000	2,248,000
2019-2023	8,104,000	2,134,000	10,238,000
2024-2028	6,246,000	787,000	7,033,000
2029-2030	1,271,000	46,000	1,317,000
	<u>\$ 23,753,000</u>	<u>\$ 6,603,000</u>	<u>\$ 30,356,000</u>

Department of Water, County of Kauai

Notes to Basic Financial Statements
June 30, 2013 and 2012

6. Long-Term Liabilities (continued)

Capital Lease Obligation

On February 19, 2004, the Department entered into a Water Treatment and Delivery Agreement (Agreement) with an unrelated third party developer. The Agreement requires the developer to build, operate and maintain a surface water treatment plant (SWTP) with a capacity of 3.0 million gallons per day (MGD). The Department is required to purchase, at a minimum, 2.0 MGD and also to provide the developer a credit towards its facility reserve charge. The term of the Agreement is 15 years and the Agreement also provides the Department with the option of accepting the dedication of the SWTP at no cost after the reimbursement date, as defined. The Department commenced water purchases on January 1, 2006. This arrangement has been recorded as a capital lease in the accompanying basic financial statements.

The capital lease obligation is amortized at an implicit rate of approximately 6.0 percent. The utility plant related to the SWTP facility approximated \$7,181,000 as of June 30, 2013 and 2012. The accumulated provision for depreciation related to the SWTP facility approximated \$4,006,000 and \$3,475,000 as of June 30, 2013 and 2012, respectively.

The annual requirements to amortize all capital lease obligations as of June 30, 2013 are approximately as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Years ending June 30:			
2014	\$ 592,000	\$ 213,000	\$ 805,000
2015	616,000	177,000	793,000
2016	653,000	139,000	792,000
2017	693,000	99,000	792,000
2018	737,000	55,000	792,000
thereafter	516,000	12,000	528,000
	<u>\$ 3,807,000</u>	<u>\$ 695,000</u>	<u>\$ 4,502,000</u>

Department of Water, County of Kauai

Notes to Basic Financial Statements
June 30, 2013 and 2012

6. Long-Term Liabilities (continued)

Changes in long-term liabilities

Long-term liability activity for the years ended June 30, 2013 and 2012 was as follows:

	Balance June 30, 2012	Additions	Reductions	Balance June 30, 2013	Approximate amounts due within one year
Bonds payable:					
General obligation bonds	\$ 71,071,000	\$ 2,745,000	\$ 3,776,000	\$ 70,040,000	\$ 2,422,000
Deferred costs:					
For premiums on bond issuance	431,782	355,706	56,478	731,010	-
On refunding	(291,198)	175,304	(17,137)	(98,757)	-
	<u>140,584</u>	<u>531,010</u>	<u>39,341</u>	<u>632,253</u>	<u>-</u>
Total bonds payable	71,211,584	3,276,010	3,815,341	70,672,253	2,422,000
Loans payable	25,260,298	91,298	1,598,095	23,753,501	1,613,000
Total long term debt	96,471,882	3,367,308	5,413,436	94,425,754	4,035,000
Compensated absences	854,728	511,990	403,383	963,335	479,000
Capital lease obligation	4,337,674	14,079	544,978	3,806,775	592,000
Total	<u>\$101,664,284</u>	<u>\$ 3,893,377</u>	<u>\$ 6,361,797</u>	<u>\$ 99,195,864</u>	<u>\$ 5,106,000</u>
	Balance			Balance	Approximate
	June 30, 2011	Additions	Reductions	June 30, 2012	amounts due within one year
Bonds payable:					
General obligation bonds	\$ 71,611,500	\$ 5,125,000	\$ 5,665,500	\$ 71,071,000	\$ 356,000
Deferred costs:					
For premiums on bond issuance	221,622	315,298	105,138	431,782	-
On refunding	(384,366)	(168,655)	(261,823)	(291,198)	-
	<u>(162,744)</u>	<u>146,643</u>	<u>(156,685)</u>	<u>140,584</u>	<u>-</u>
Total bonds payable	71,448,756	5,425,726	5,662,898	71,211,584	356,000
Loans payable	26,641,634	204,867	1,586,203	25,260,298	1,595,000
Total long term debt	98,090,390	5,630,593	7,249,101	96,471,882	1,951,000
Compensated absences	872,999	513,389	531,660	854,728	487,000
Capital lease obligation	4,851,000	-	513,326	4,337,674	545,000
Total	<u>\$103,814,389</u>	<u>\$ 6,143,982</u>	<u>\$ 8,294,087</u>	<u>\$ 101,664,284</u>	<u>\$ 2,983,000</u>

Department of Water, County of Kauai

Notes to Basic Financial Statements
June 30, 2013 and 2012

7. Net Position

At June 30, 2013 and 2012, net position consisted of the following:

	2013	2012
Invested in Capital Assets, Net of Related Debt:		
Net property, plant and equipment	\$ 217,854,455	\$ 211,436,207
Less: Long term debt, net	(94,425,754)	(96,471,882)
Less: Capital lease obligation	(3,806,775)	(4,337,674)
Add: Unspent debt proceeds	25,030,242	32,061,348
	<u>144,652,168</u>	<u>142,687,999</u>
Restricted for Capital Activity and Debt Service:		
FRC net position	2,669,299	4,941,579
Restricted cash – Bond funds	380,692	1,037,406
Restricted investments – Bond funds	24,649,550	31,023,942
Less:		
Accrued interest payable	(1,699,632)	(1,744,524)
Unspent debt proceeds	(25,030,242)	(32,061,348)
	<u>969,667</u>	<u>3,197,055</u>
Unrestricted	<u>31,745,401</u>	<u>24,461,503</u>
Total net position	<u>\$ 177,367,236</u>	<u>\$ 170,346,557</u>

As of June 30, 2013 and 2012, FRC net position consisted of the following:

	2013	2012
FRC assets restricted for utility plant construction:		
Cash	\$ 739,693	\$ 2,483,487
Equity interest in pooled investments	1,924,000	2,451,703
Accrued interest receivable	5,606	6,389
	<u>2,669,299</u>	<u>4,941,579</u>
FRC liabilities	<u>-</u>	<u>-</u>
FRC net position	<u>\$ 2,669,299</u>	<u>\$ 4,941,579</u>

Department of Water, County of Kauai

Notes to Basic Financial Statements
June 30, 2013 and 2012

7. Net Position (continued)

For the years ended June 30, 2013 and 2012, FRC change in net position consisted of the following:

	2013	2012
Contributions	\$ 761,300	\$ 551,700
Capital expenditures	54,434	(76,501)
Interest income	31,757	34,457
Transfers out	(2,982,399)	-
Other expenditures	(28,604)	(9,305)
Change in net position	(2,272,380)	653,353
FRC net position at beginning of year	4,941,579	4,288,226
FRC net position at end of year	\$ 2,669,199	\$ 4,941,579

8. Employees' Retirement System

a. Description of Plan

All eligible employees of the State and counties are required by Hawaii Revised Statutes (HRS) Chapter 88, to become members of the Employees' Retirement System of the State of Hawaii (ERS), a cost-sharing multiple-employer public employee retirement plan. The ERS 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 issues a comprehensive annual financial report that is available to the public. That report may be obtained by writing to the ERS at 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813.

Prior to June 30, 1984, the plan consisted of only a contributory plan. In 1984, legislation was enacted to add a new noncontributory plan for members of the ERS who are also covered under Social Security. Policy officers, firefighters, judges, elected officials, and person employed in positions not covered by Social Security are precluded from the noncontributory plan. The noncontributory plan provides for reduced benefits and covers most eligible employees hired after June 30, 1984. Employees hired before that date were allowed to continue under the contributory plan or to elect the new noncontributory plan and receive a refund of employee contributions. All benefits vest after five and ten year credited service under the contributory and noncontributory plans, respectively.

Department of Water, County of Kauai

Notes to Basic Financial Statements
June 30, 2013 and 2012

8. Employees' Retirement System (continued)

a. Description of Plan (continued)

Both plan options provide a monthly retirement allowance based on the employee's age, years of credited service, and average final compensation (AFC). The AFC is the average salary earned during the five highest paid years of service, including the vacation payment, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after that date is based on the three highest paid years of service, excluding the vacation payment.

On July 1, 2006, a new hybrid contributory plan became effective pursuant to Act 179, SLH of 2004. Members in the hybrid plan are eligible for retirement at age 62 with 5 years of credited services or age 55 and 30 years of credit service. Members will receive a benefit multiplier of 2 percent for each year of credited service in the hybrid plan. The benefit payment options are similar to the current contributory plan. Almost 58,000 current members, all members of the noncontributory plan and certain members of the contributory plan are eligible to join the new hybrid plan. Most of the new employees hired from July 1, 2006 are required to join the new hybrid plan.

b. Funding Policy

Most covered employees of the contributory option are required to contribute 7.8 percent of their salary. Police officers, firefighters, investigators of the department of the County Prosecuting Attorney and the Attorney General, narcotics enforcement investigators, and public safety investigators are required to contribute 12.2 percent of their salary. The funding method used to calculate the total employer contribution requirement is the Entry Age Normal Actuarial Cost Method. Effective July 1, 2005, employer contribution rates are a fixed percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liability.

The ERS provides basic pension benefits to individuals receiving pensions. Employer contributions to the ERS are comprised of normal cost plus level annual payments required to liquidate the unfunded accrued liability of the ERS. The ERS uses the entry age normal cost funding method to calculate the unfunded accrued liability. In 2002, the Legislature of the State of Hawaii approved Act 147 that extends the amortization period to liquidate the unfunded liability from 15 years to 29 years.

Department of Water, County of Kauai

Notes to Basic Financial Statements
June 30, 2013 and 2012

8. Employees' Retirement System (continued)

b. Funding Policy (continued)

The Department's payroll for employees covered by the plan was approximately \$4,385,000, \$4,285,000, and \$4,014,000 for 2013, 2012, and 2011, respectively. The payroll for all of the Department's employees was approximately \$4,473,000, \$4,368,000, and \$4,190,000 for 2013, 2012, and 2011, respectively. The Department is required to contribute an actuarially determined amount to the ERS. The Department's contributions requirements as of June 30, 2013, 2012, and 2011 were approximately \$679,000, \$642,000, and \$601,000, respectively. The contribution rate was 15.50 percent for the year ended June 30, 2013, and 15.00 percent for the years ended June 30, 2012 and 2011.

9. Post-Retirement Health Care and Life Insurance Benefits

a. Plan Description

The Department provides certain other postemployment benefits (OPEB) other than pensions to all qualified employees. Pursuant to Chapter 87A of the Hawaii Revised Statutes (HRS), the Department contributes to the Hawaii Employer-Union Health Benefits Trust Fund (EUTF). The EUTF was established to provide a single delivery system of health benefits for state and county workers, retirees and their dependents. The EUTF currently provides medical, dental, vision, and life insurance benefits. The EUTF issues an annual financial report that is available to the public. That report may be obtained by writing to the EUTF at 201 Merchant Street, Suite 1520, Honolulu, Hawaii 96813.

The eligibility requirements for retiree health benefits are as follows:

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

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

Department of Water, County of Kauai

Notes to Basic Financial Statements
June 30, 2013 and 2012

9. Post-Retirement Healthcare and Life Insurance Benefits (continued)

b. Funding Policy

For active employees, the employer's contributions are based upon negotiated collective bargaining agreements. Employer contributions for employees not covered by collective bargaining agreements and for retirees are prescribed by the HRS.

The Department is required to contribute the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost each year and amortize any unfunded actuarial liabilities over 30 years. The current ARC rate for the Department is approximately 25% of annual covered payroll.

c. Annual OPEB Cost

The following table shows the components of the Department's annual OPEB cost for 2013 and 2012, the amount actually contributed to the plan, and changes in the Department's net OPEB asset to EUTF:

	2013	2012
Annual required contribution (ARC)	\$ 850,000	\$ 1,110,000
Interest on net OPEB obligation (asset)	-	(4,000)
Adjustment to the ARC	-	3,000
Annual OPEB Cost	850,000	1,109,000
Contributions made	(870,000)	(1,089,000)
(Increase) decrease in net OPEB asset	(20,000)	20,000
Net OPEB asset – beginning of year	(30,000)	(50,000)
Net OPEB asset – end of year	<u>\$ (50,000)</u>	<u>\$ (30,000)</u>

Department of Water, County of Kauai

Notes to Basic Financial Statements
June 30, 2013 and 2012

9. Post-Retirement Healthcare and Life Insurance Benefits (continued)

c. Annual OPEB Cost (continued)

The Department's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan and the net OPEB obligation for 2013, 2012 and 2011 were approximately as follows:

Fiscal Year Ended June 30,	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation (Asset)
2011	\$ 1,072,000	104.7%	\$ (50,000)
2012	1,109,000	98.2%	(30,000)
2013	850,000	102.37%	(50,000)

At June 30, 2013 and 2012, the Department's post-retirement healthcare payable of nil and \$848,051, respectively, is considered a short-term difference and has been included in the respective annual OPEB contributions in accordance with GASB Statement No. 45.

d. Funded Status and Funding Progress

The funded status of the plan as of July 1, 2011, the effective date of the most recent biennial actuarial valuation, was as follows:

Actuarial accrued liability (AAL)	\$ 11,586,000
Assets	<u>2,281,000</u>
Unfunded AAL (UAAL)	<u><u>\$ 9,305,000</u></u>
Covered payroll	\$ 4,368,000
UAAL as a percentage of covered payroll	213%

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

Department of Water, County of Kauai

Notes to Basic Financial Statements
June 30, 2013 and 2012

9. Post-Retirement Healthcare and Life Insurance Benefits (continued)

e. Actuarial Methods and Assumptions

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

Valuation date	July 1, 2011
Actuarial cost method	Entry age normal
Amortization method	Level percentage of pay, closed
Remaining amortization period	30 years
Actuarial assumptions:	
Investment rate of return	7%
Healthcare cost trend rate:	
Medical and prescription drug	8.5% initial; 5% ultimate
Dental	4% initial; 4% ultimate
Vision	3% initial; 3% ultimate
Medicare Part B	13.43 initial; 5% ultimate
Projected salary increases	3.5%

The number of participants as of July 1, 2011, the effective date of the most recent biennial OPEB valuation, follows. There have been no significant changes in the number of covered or the type of coverage since that date.

Active employees	76
Retired employees	36
Deferred vested employees	<u>4</u>
Total	<u><u>116</u></u>

Department of Water, County of Kauai

Notes to Basic Financial Statements
June 30, 2013 and 2012

10. Deferred Compensation Plan

The Department offers its employees, through the County, a deferred compensation plan established in accordance with Internal Revenue Code Section 457. The plan, available to all full-time Department employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death or an unforeseeable emergency. The plan's assets have been placed in trust accounts with the plan administrators for exclusive benefit of participants and their beneficiaries and are not considered assets of the County or the Department.

In accordance with GASB Statement 32, *Accounting and Financial Reporting Code Section 457 – Deferred Compensation Plans*, the Department has excluded the plan assets from the financial statements. All such amounts are not subject to the claims of the Department or the County's general creditors.

11. Commitments and Contingencies

a. Sick Leave

Accumulated sick leave as of June 30, 2013 and 2012 was approximately \$1,719,000 and \$1,785,000, respectively. Sick leave accumulates at the rate of 14 hours for each month of service, as defined, without limit. Sick pay can be taken only in the event of illness and is not convertible to pay upon termination of employment. As a result, no liability for sick pay is recorded in the accompanying financial statements. However, a public employee who retires or leaves government service in good standing with sixty days or more of unused sick leave is entitled to additional service credit in the ERS.

b. Insurance

The Department is fully self-insured for workers' compensation claims. Such claims are reported to and managed by the County. The Department provides reserves for claims not covered by insurance that in the opinion of counsel will result in probable judgment against the Department. These reserves include an estimate of claims that have been incurred but not reported (IBNR). Claim liabilities, including IBNR, are based on the estimated ultimate cost of settling the claims. Claims liabilities are estimated by a case-by-case review of all claims and the application of historical experience to outstanding claims. As of June 30, 2013 and 2012, the workers' compensation liability amounted to approximately \$118,000 and \$114,000, respectively, and is recorded in accounts payable and accrued liabilities on the accompanying statements of net position.

Department of Water, County of Kauai

Notes to Basic Financial Statements
June 30, 2013 and 2012

11. Commitments and Contingencies (continued)

c. Safe Drinking Water Act

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

d. Other Legal Matters

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

e. Other

Other commitments, primarily for utility plant construction, approximated \$15,262,000 and \$22,580,000 at June 30, 2013 and 2012, respectively.

12. Related Party Transactions

The Department charges the County for fire protection services (hydrant use) at agreed-to rates that approximate the cost for such services. The County provides certain services to the Department and charges the Department for these services at an amount equal to the charge for fire protection services. The amounts charged approximated \$1,511,000 and \$1,148,000 in 2013 and 2012, respectively.

Department of Water, County of Kauai

Notes to Basic Financial Statements
June 30, 2013 and 2012

13. New Pronouncements for Financial Reporting

In March 2012, the GASB issued GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities* (GASB 65). This Statement reclassifies, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as revenues and expenses, certain items that were previously reported as assets and liabilities. The provisions of GASB 65 are effective for periods beginning after December 15, 2012. Management is currently assessing the impact of this Statement on its financial position and results of operations and has not determined if the adoption will have a material effect on its financial statements.

In June 2012, GASB issued Statement No. 68 (GASB 68), *Accounting and Reporting for Pensions (an amendment of GASB Statement No. 27)*. GASB 68 amends the accounting guidance related to employers' accounting for pension plans administered through trusts or similar arrangements and requires the recognition of a liability for the employers' accumulated obligation for pension benefits. GASB 68 also provides additional guidance regarding the recognition of annual costs of pension benefits and revises the disclosure requirements for the notes to the financial statements and required supplementary information. GASB 68 will be effective for the Department's financial statements for the year ending June 30, 2015. Management is currently assessing the impact of GASB 68 on its financial position and results of operations and has not determined if the adoption will have a material effect on its financial statements.

Department of Water, County of Kauai

Schedule of Funding Progress for the
Hawaii Employer-Union Health Benefits Trust Fund

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Unfunded AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
7/1/2007	\$ -	\$8,465,000	\$8,465,000	0%	\$ 4,585,000	185%
7/1/2009	930,000	13,531,000	12,601,000	7%	4,424,000	285%
7/1/2011	2,281,000	11,586,000	9,305,000	20%	4,368,000	213%

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See accompanying independent auditor's report.

Department of Water, County of Kauai

Schedule I

Supplemental Schedule of Utility Plant in Service
For the Year Ended June 30, 2013

	June 30, 2012				June 30, 2013	
	Balance	Adjustments	Additions	Retirements	Balance	
Cost Basis:						
Water Utility Plant:						
Source	\$ 9,298,876	\$ -	\$ -	\$ -	\$ 9,298,876	
Pumping	41,333,100	-	2,324,237	(82,047)	43,575,290	
Water Treatment	9,404,549	-	34,881	(31,555)	9,407,875	
Transmission & Distribution	210,765,358	(10)	9,296,957	(410,334)	219,651,971	
General	10,505,111	(596,127)	513,245	(513,556)	9,908,673	
	<u>281,306,994</u>	<u>(596,137)</u>	<u>12,169,320</u>	<u>(1,037,492)</u>	<u>291,842,685</u>	
Land and Land Rights:						
Source	843,346	(5,467)	-	-	837,879	
Pumping	381	(225)	-	-	156	
Water Treatment	150	-	-	-	150	
Transmission & Distribution	499,259	(30,022)	-	-	469,237	
	<u>1,343,136</u>	<u>(35,714)</u>	<u>-</u>	<u>-</u>	<u>1,307,422</u>	
Intangible Assets:						
Easements	-	35,722	-	-	35,722	
Software	-	604,242	-	-	604,242	
	<u>-</u>	<u>639,964</u>	<u>-</u>	<u>-</u>	<u>639,964</u>	
Total	<u>\$ 282,650,130</u>	<u>\$ 8,113</u>	<u>\$ 12,169,320</u>	<u>\$ (1,037,492)</u>	<u>\$ 293,790,071</u>	
Accumulated Depreciation						
Water Utility Plant:						
Source	\$ 4,340,731	\$ -	\$ 202,158	\$ -	\$ 4,542,889	
Pumping	18,102,756	30,964	1,532,995	(82,047)	19,584,668	
Water Treatment	5,132,541	7,280	710,978	(31,555)	5,819,244	
Transmission & Distribution	53,784,159	258,245	3,699,457	(410,334)	57,331,527	
General	5,695,119	(479,870)	478,267	(513,556)	5,179,960	
Intangible Assets - Software	-	556,981	16,306	-	573,287	
Total	<u>\$ 87,055,306</u>	<u>\$ 373,600</u>	<u>\$ 6,640,161</u>	<u>\$ (1,037,492)</u>	<u>\$ 93,031,575</u>	

See accompanying independent auditor's report.

Department of Water, County of Kauai

Schedule II

Supplemental Schedule of Selective Account Classifications (in 000's)
For the Five Years Ended June 30, 2013

	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
<u>Balance Sheet:</u>					
Utility plant in service	\$ 293,790	\$ 282,650	\$ 244,193	\$ 223,914	\$ 204,355
Net Assets:					
Invested in capital assets, net	\$ 144,652	\$ 142,688	\$ 132,139	\$ 124,943	\$ 121,962
Restricted for capital activity and debt service	970	3,197	2,483	3,977	5,561
Unrestricted	31,745	24,462	14,494	16,533	9,965
Total	<u>\$ 177,367</u>	<u>\$ 170,347</u>	<u>\$ 149,116</u>	<u>\$ 145,453</u>	<u>\$ 137,488</u>
<u>Income Statement:</u>					
Resources:					
Water sales	\$ 25,838	\$ 21,283	\$ 19,829	\$ 18,772	\$ 17,533
Other	2,127	1,239	970	1,014	842
Total	<u>27,965</u>	<u>22,522</u>	<u>20,799</u>	<u>19,786</u>	<u>18,375</u>
Operating Expenses:					
Depreciation	6,937	6,163	5,743	5,898	5,182
Administrative and general	4,964	5,115	4,165	4,299	4,192
Power and pumping	3,596	4,015	3,323	3,178	3,139
Transmission and distribution	3,626	3,502	3,017	3,441	3,221
Accounting and collection	688	606	591	584	576
All other	1,093	962	824	1,054	1,134
Total	20,904	20,363	17,663	18,454	17,444
Non-Operating (Expense) Income	(3,523)	(2,991)	(3,552)	(1,031)	(330)
Contributions	3,483	22,063	4,079	7,664	6,013
Increase in net assets	<u>\$ 7,021</u>	<u>\$ 21,231</u>	<u>\$ 3,663</u>	<u>\$ 7,965</u>	<u>\$ 6,614</u>

See accompanying independent auditor's report.