COUNTY OF HAWAIʻI
DEPARTMENT OF WATER SUPPLY
(A component unit of the County of Hawaiʻi, State of Hawaiʻi)

FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION
WITH INDEPENDENT AUDITOR'S REPORT

Fiscal Year Ended June 30, 2015

N&K CPAs, Inc.
ACCOUNTANTS|CONSULTANTS

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INDEPENDENT AUDITOR'S REPORT

To the Water Board
County of Hawai‘i, Department of Water Supply

Report on the Financial Statements

We have audited the accompanying financial statements of the County of Hawai‘i, Department of Water Supply (Department), a component unit of the County of Hawai‘i, State of Hawai‘i (County), as of and for the fiscal year ended June 30, 2015, 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 audit. We conducted our audit 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 audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the net position of the Department as of June 30, 2015, and the changes in its net position and its cash flows for the fiscal year then ended in accordance with accounting principles generally accepted in the United States of America.

Change in Accounting Principle

As discussed in Note I to the basic financial statements, the Department adopted new accounting guidance that establishes standards for accounting and financial reporting for pensions that are provided to the employees of state and local governmental employers. 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 6 through 9, schedule of funding progress - EUTF on page 38, schedule of the Department's proportionate share of the net pension liability on page 39, and the schedule of employer pension contributions on page 40 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 Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated December 21, 2015 on our consideration of the County of Hawai‘i, Department of Water Supply'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 County of Hawai‘i, Department of Water Supply's internal control over financial reporting and compliance.

N&K CPAs, Inc.

Honolulu, Hawaii
December 21, 2015

County of Hawai‘i
Department of Water Supply
(A component unit of the County of Hawai‘i, State of Hawai‘i)
MANAGEMENT’S DISCUSSION AND ANALYSIS
June 30, 2015

The Department of Water Supply, County of Hawai‘i (Department) operates as a semiautonomous agency charged with the responsibility of operating and maintaining the County of Hawai‘i’s public water systems. The Department is a utility enterprise and presents its financial statements using the economic resources measurement focus and the full accrual basis of accounting. 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. Readers are encouraged to consider the information presented here in conjunction with the financial statements taken as a whole.

Financial Statements

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 statements of net position present information on all of the Department’s assets, deferred outflows of resources, liabilities, and deferred inflows of resources, with the residual amount 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 Department is improving or deteriorating. Net position increases when revenues exceed expenses. Increases in assets and deferred outflows of resources, without a corresponding increase in liabilities and deferred inflows of resources, result in increased net position, which indicate an improved financial position. In the case of the Department, assets plus deferred outflows of resources exceeded liabilities plus deferred inflows of resources by $233.8 million at the close of the most recent fiscal year. This represents a decrease of $7.3 million, or 3.01% less than the previous year. At June 30, 2015, $231.2 million of the Department’s net position was invested in capital assets (net of related debt), and $2.6 million was unrestricted.

The statements of revenues, expenses and changes in net position present information showing how an entity’s net position changed during the fiscal year. All components of the changes in net position are reported as soon as the underlying event occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in these statements for some items that will result in cash flows in future fiscal periods.

Notes to Financial Statements

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

Other Information

In addition to the financial statements and accompanying notes, this report also presents certain required supplementary information concerning the Department’s participation in the Employees’ Retirement System of the State of Hawai‘i (ERS) and the Employer-Union Health Benefits Trust Fund of the State of Hawai‘i (EUTF).

Condensed Financial Information

The Department adopted the provisions of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions - an amendment of GASB Statement No. 27* (GASB 68), effective for the fiscal year ended June 30, 2015. The following condensed financial information for the fiscal year ended June 30, 2014 has not been restated to reflect the changes necessary to comply with GASB 68. More detailed information about the impact of this change in accounting principle is provided in Note I to the financial statements. The following are summaries from the Department's financial statements as of and for the fiscal years ended June 30, 2015 and 2014 (as previously reported):

	2015	2014 As previously reported
Assets		
Capital assets, net	$ 279,148,879	$ 267,240,531
Other assets	46,545,565	51,218,763
Total assets	325,694,444	318,459,294
Deferred outflows of resources		
Deferred outflows of resources	5,579,208	--
Total deferred outflows of resources	5,579,208	--
Liabilities		
Long-term debt	49,494,566	52,857,218
Other liabilities	45,599,359	24,529,081
Total liabilities	95,093,925	77,386,299
Deferred inflows of resources		
Deferred inflows of resources	2,382,270	--
Total deferred inflows of resources	2,382,270	--
Net position		
Net investment in capital assets	231,198,521	216,468,447
Unrestricted	2,598,936	24,604,548
Total net position	$ 233,797,457	$ 241,072,995

Condensed Financial Information (Continued)

	2015	2014 As previously reported
Changes in net position		
Operating revenues - water sales	$ 48,457,620	$ 47,590,318
Operating expenses	(51,901,771)	(51,834,738)
Operating loss	(3,444,151)	(4,244,420)
Nonoperating revenues	1,068,078	947,001
Nonoperating expenses	(2,422,380)	(2,471,452)
Loss before contributions	(4,798,453)	(5,768,871)
Contributions in aid of construction	13,964,639	10,299,452
Change in net position	9,166,186	4,530,581
Net position beginning of year	224,631,271	236,542,414
Net position end of year	$ 233,797,457	$ 241,072,995

Financial Analysis

Capital assets, net increased by $11.9 million, or 4.46%, in the fiscal year ended June 30, 2015 (FY2015), due primarily to increases in distribution reservoirs of $6.3 million, transmission mains of $5.1 million, distribution mains of $2.0 million, and construction work in progress of $4.8 million, offset by depreciation of $12.3 million.

Long-term debt decreased by $3.4 million, or 6.36%, in FY2015, due primarily to repayment of $3.4 million in long-term debt obligations.

Net position decreased by $7.3 million, or 3.01%, in FY2015, due primarily to the implementation of the provisions of GASB 68 which resulted in a restatement of net position at July 1, 2014 of $16.4 million, offset by the results of operations in FY2015.

Operating revenues increased by $0.9 million, or 1.82%, in FY2015, due primarily to a 1.27% increase in consumption and a 2.7% increase in standby rates.

Operating expenses increased by $0.07 million, or 0.13%, in FY2015, due primarily to a $1.5 million decrease in power and pumping expenses, offset by an increase in general and administrative expenses of $1.6 million, including an increase in pension expense of $0.8 million which was the result of the implementation of GASB 68 in FY2015.

Contributions in aid of construction increased $3.7 million, or 35.59%, in FY2015, due primarily to the timing of dedicated projects accepted and placed into service.

Capital Assets and Debt Administration

As of June 30, 2015 and 2014, the Department had $279.1 million and $267.2 million, respectively, invested in capital assets and $49.5 million and $52.9 million, respectively, of long-term debt outstanding.

During 2015, major capital asset additions included:

- $10.0 million for the Waiaha water system.
- $1.0 million for Kona Oceanview improvements.

During 2014, major capital asset additions included:

- $2.4 million for the Kawailani Tank.
- $2.2 million for the Kynnersley reservoir.
- $1.7 million for the Kulaimano well.

More detailed information about the Department’s capital assets is provided in Note D to the financial statements.

At June 30, 2015 and 2014, the Department had outstanding $36.4 million and $38.6 million, respectively, in County of Hawai‘i general obligation bonds for public improvements and $12.6 million and $13.7 million, respectively, in State of Hawai‘i revolving fund loans.

As of June 30, 2015, the Department, through the County of Hawai‘i, maintained an “AA-” rating from Standard & Poor’s, an “Aa2” rating from Moody’s and an “AA-” rating from Fitch for general obligation debt.

Other Data

	2015	2014
Consumption (thousands of gallons)	9,195,926	9,080,401
Services (number of meters)	42,759	42,378

Currently Known Facts, Decisions, or Conditions

Effective July 1, 2015, water rates increased by approximately 3.0%.

County of Hawai‘i
Department of Water Supply
(A component unit of the County of Hawai‘i, State of Hawai‘i)
STATEMENT OF NET POSITION
June 30, 2015

ASSETS		
Current assets		
Cash and cash equivalents	$	34,752,680
Trade receivables, less allowance for doubtful accounts of $1,201,000		7,484,292
Other receivables		1,254,756
Inventories of materials and supplies		1,343,868
Prepaid expenses and other		165,761
Total current assets		45,001,357
Restricted cash		1,544,208
Capital assets		
Utility plant in services		469,346,953
Less: Accumulated depreciation		(211,518,942)
		257,828,011
Land and rights		4,706,302
Preliminary survey and investigation charges		4,428,754
Construction work in progress		12,185,812
Net capital assets		279,148,879
Total assets		325,694,444
DEFERRED OUTFLOWS OF RESOURCES		
Deferred outflows of resources related to pensions		5,579,208
Total deferred outflows of resources	$	5,579,208

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

County of Hawai‘i
Department of Water Supply
(A component unit of the County of Hawai‘i, State of Hawai‘i)
STATEMENT OF NET POSITION (Continued)
June 30, 2015

LIABILITIES		
Current liabilities		
Accounts and construction contracts payable, including retainages	$	2,716,085
Long-term debt		3,438,282
Accrued compensation		1,174,172
Customers' deposits		607,136
Accrued vacation		507,958
Accrued interest payable		922,633
Accrued workers' compensation		62,636
Total current liabilities		9,428,902
Accrued workers' compensation, noncurrent		217,364
Accrued vacation, noncurrent		1,079,412
Unearned revenue, noncurrent		1,583,953
Customers' deposits, noncurrent		16,201,017
Net pension liability, noncurrent		20,526,993
Long-term debt, noncurrent		46,056,284
Total liabilities		95,093,925
DEFERRED INFLOWS OF RESOURCES		
Deferred inflows of resources related to pensions		2,382,270
Total deferred inflows of resources		2,382,270
NET POSITION		
Net investment in capital assets		231,198,521
Unrestricted		2,598,936
Total net position	$	233,797,457

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

County of Hawai‘i
Department of Water Supply
(A component unit of the County of Hawai‘i, State of Hawai‘i)
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
Fiscal Year Ended June 30, 2015

OPERATING REVENUES		
Water sales	$	48,457,620
OPERATING EXPENSES		
Power and pumping		21,394,853
Depreciation		12,319,532
General and administrative		8,553,315
Transmission and distribution		5,150,863
Purification		1,622,005
Maintenance and repairs		1,578,327
Customers' accounting and collecting		1,282,876
Total operating expenses		51,901,771
Operating loss		(3,444,151)
NONOPERATING REVENUES		
Interest		223,681
Other		844,397
Total nonoperating revenues		1,068,078
NONOPERATING EXPENSES		
Interest on long-term debt		(2,107,539)
Loss on disposal of property		(60,899)
Other		(253,942)
Total nonoperating expenses		(2,422,380)
Loss before contributions		(4,798,453)
CONTRIBUTIONS IN AID OF CONSTRUCTION		13,964,639
Change in net position		9,166,186
Net position - beginning of year, as restated		224,631,271
Net position - end of year	$	233,797,457

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

County of Hawaiʻi
Department of Water Supply
(A component unit of the County of Hawaiʻi, State of Hawaiʻi)
STATEMENT OF CASH FLOWS
Fiscal Year Ended June 30, 2015

CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from customers	$	48,152,672
Cash payments to suppliers for goods and services		(24,271,979)
Cash payments to employees for services		(14,605,877)
Net cash provided by operating activities		9,274,816
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Principal paid on long-term debt		(3,376,104)
Debt proceeds		48,092
Interest paid on long-term debt		(2,204,228)
Acquisition and construction of capital assets		(8,473,499)
Contributions in aid of construction		2,472,557
Net cash used in capital and related financing activities		(11,533,182)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest income		223,681
Net cash provided by investing activities		223,681
Net decrease in cash and cash equivalents		(2,034,685)
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR		38,331,573
CASH AND CASH EQUIVALENTS - END OF YEAR		36,296,888
Restricted - end of year		1,544,208
Unrestricted - end of year	$	34,752,680

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

County of Hawaiʻi
Department of Water Supply
(A component unit of the County of Hawaiʻi, State of Hawaiʻi)
STATEMENT OF CASH FLOWS (Continued)
Fiscal Year Ended June 30, 2015

RECONCILIATION OF OPERATING LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating loss	$	(3,444,151)
Depreciation		12,319,532
Pension expense		2,823,637
Provision for doubtful accounts		110,450
Change in assets, deferred outlfows of resources, liabilities and deferred inflows of resources		
Trade and other receivables		(1,009,980)
Inventories of materials and supplies		(200,794)
Prepaid expenses and other		6,094
Deferred outflows of resources related to pensions		(1,935,306)
Accounts and construction contracts payable, including retainages		229,696
Customers' deposits		594,582
Other accrued liabilities		(218,944)
Net cash provided by operating activities	$	9,274,816
NONCASH CAPITAL AND FINANCING ACTIVITIES		
Contributions of capital assets that are recorded as contributions in aid of construction	$	11,492,082

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

NOTE A - NATURE OF ACTIVITIES

The Department of Water Supply, County of Hawai‘i (Department) is administered by the Water Board, which consists of nine members who serve staggered terms of five years in length. Board members are appointed by the Mayor of the County of Hawai‘i, State of Hawai‘i (County) and are confirmed by the County Council, as required by the County Charter.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(1) ***Financial Statement Presentation*** - The Department is a component unit of the County (primary government). The accompanying financial statements present only the financial position and activities of the Department and do not purport to, and do not present the financial position of the County, the changes in its financial position, or, where applicable, its cash flows.

(2) ***Measurement Focus and Basis of Accounting*** - The Department’s financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

(3) ***Cash and Cash Equivalents*** - For purposes of the statement of cash flows, the Department considers all highly liquid investments with a maturity of three months or less or money market funds with a weighted average maturity of three months or less when purchased to be cash equivalents.

(4) ***Trade Receivables*** - Trade receivables are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is the Department’s best estimate of the amount of probable credit losses in the Department’s existing trade receivables. The Department determines the allowance based on historical write-off experience. The Department reviews its allowance for doubtful accounts monthly. Past-due balances over 90 days and over a specified amount are reviewed individually for collectability. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote.

(5) ***Inventories of Materials and Supplies*** - Materials and supplies are stated at cost on an average cost basis.

(6) ***Restricted Assets*** - Unspent bond proceeds that are restricted for purchases of water system improvements are recorded as restricted assets.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(7) ***Capital Assets*** - Capital assets in service as of January 1, 1950, date of inception of the Department, were recorded at the cost of the assets acquired by the County for its water system from January 1, 1924 to December 31, 1949, less accumulated depreciation to December 31, 1949 as determined by the Department. Assets purchased prior to 1924 and property acquired by gift or grant prior to 1950 are not included in capital assets. Additions to capital assets since January 1, 1950 are stated at cost and include contributions by governmental agencies, private subdividers, and customers at their cost or estimated cost. The capitalization threshold of assets is $400 with estimated useful lives greater than one year. Construction costs include amounts for contract work, engineering supervision, and other direct costs and overhead costs. Construction period interest is capitalized on capital assets constructed with tax-exempt debt and amounted to $8,425 for the fiscal year ended June 30, 2015.

Preliminary survey and investigation charges represent expenditures incurred to determine the feasibility of potential water system sites for future development.

Maintenance and repairs and minor replacements are charged to operations. Major replacements, renewals, and betterments are capitalized to capital asset accounts.

Depreciation is computed using the straight-line method over the following estimated useful lives:

Distribution mains and accessories	40 years
Structures and improvements	40 to 50 years
Electric and hydraulic pumping equipment	10 years
Services	25 years
Transmission mains and accessories, hydrants and purification system	40 years
Meters	10 years
Transportation, communication, tools and office equipment and furniture	5 years
Other equipment	5 to 10 years
Other fire protection plant	25 years

Annual depreciation rates are applied to costs of the various classes of depreciable assets on the group basis or, as to transportation equipment, to the cost of individual units of property.

Gains or losses resulting from the sale, retirement, or disposal of capital assets in service are charged or credited to operations in the year realized.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(8) ***Compensated Absences*** - Employees earn vacation credits at the rate of one and three-quarter working days for each month of service. Up to 90 days of vacation leave credits can be accumulated per employee. In addition, employees who work overtime can elect to take compensatory time off instead of overtime pay. The time off is earned at the rate of one and a half hours for each hour of overtime worked. Both compensatory time off and vacation credits are converted to pay upon termination of employment.

Sick leave can be taken only in the event of illness and is not convertible to pay upon termination of employment. Accumulated sick leave at June 30, 2015 amounted to $5,684,415.

(9) ***Pensions*** - 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 Hawai'i (ERS) and additions to and 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.

(10) ***Net Position*** - Net position comprises the accumulated net earnings from operating and nonoperating revenues, expenses, transfers and contributions. Net position is classified in the following components: invested in capital assets and unrestricted net position. Invested in capital assets consists of capital assets, net of accumulated depreciation, reduced by outstanding debt related to the acquisition or construction of those assets, less unspent bond proceeds. Unrestricted net position consists of all other net position not categorized as invested in capital assets.

When both restricted and unrestricted resources are available for use, generally, it is management's policy to use restricted resources first, then unrestricted resources as they are needed.

(11) ***Operating Revenues and Expenses*** - Revenues and expenses are distinguished between operating and nonoperating items. Operating revenues generally result from providing services in connection with the Department's principal ongoing operations. The principal operating revenues of the Department are fees charged to customers for providing water services. Operating expenses include the costs associated with providing water services, administrative expenses and depreciation on capital assets. All revenues and expenses not meeting these definitions are reported as nonoperating revenues and expenses.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(12) ***Contributions in Aid of Construction*** - Contributions in aid of construction represent cash or capital assets received by the Department to aid in the construction of infrastructure assets. Contributions in aid of construction are recognized when they are accepted by the Water Board and when all applicable eligibility requirements have been met.

(13) ***Use of Estimates*** - The preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make a number of estimates and assumptions that affect the reported amounts of assets, deferred outflows of resources, liabilities, deferred inflows of resources 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 the carrying amount of capital assets, valuation allowances for trade receivables, valuation of noncash contributions in aid of construction, accrued workers' compensation, pensions and postretirement healthcare and life insurance benefits. Actual results could differ from those estimates.

(14) ***New Accounting Pronouncements*** - GASB Statement No. 68, *Accounting and Financial Reporting for Pensions - an amendment of GASB Statement No. 27*: This Statement establishes standards of accounting and financial reporting for pensions that are provided to the employees of state and local governmental employers through pension plans that are administered through trusts or equivalent arrangements. The requirements of this Statement are effective for reporting periods beginning after June 15, 2014. Management adopted the provisions of this Statement as of and for the fiscal year ended June 30, 2015. Refer to Note I.

GASB Statement No. 69, *Government Combinations and Disposals of Government Operations*: This statement establishes accounting and financial reporting standards related to government combinations and disposals of government operations. The requirements of this Statement are effective for reporting periods beginning after December 15, 2013. This Statement did not have a material impact on the Department's financial statements.

GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*: This statement establishes accounting and financial reporting standards for financial guarantees that are nonexchange transactions. The requirements of this Statement are effective for reporting periods beginning after June 15, 2013. This Statement did not have a material impact on the Department's financial statements.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date - an amendment of GASB Statement No. 68*: This Statement amends the transition provisions of GASB Statement No. 68 related to contributions made by a state or local government employer to a defined benefit pension after the measurement date of the government’s beginning pension liability. The requirements of this Statement are effective for reporting periods beginning after June 15, 2014. Management adopted the provisions of this statement as of and for the fiscal year ended June 30, 2015. Refer to Note I.

GASB Statement No. 72, *Fair Value Measurements and Application*: This Statement will require measurement of certain assets and liabilities at fair value using a consistent and more detailed definition of fair value and accepted valuation techniques. This Statement also will enhance fair value application guidance and related disclosures in order to provide information to financial statement users about the impact of fair value measurements on a government’s financial position. The requirements of this Statement are effective for reporting periods beginning after June 15, 2015. Management has not yet determined the effect this Statement will have on the Department’s financial statements.

GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*: This Statement addresses accounting and financial reporting for postemployment benefits other than pensions that is provided to the employees of state and local governmental employers. The requirements of this Statement are effective for reporting periods beginning after June 15, 2017. Management has not yet determined the effect this Statement will have on the Department’s financial statements.

GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*: This Statement establishes the order of priority of pronouncements and other sources of accounting and financial reporting guidance that a governmental entity should apply. The requirements of this Statement are effective for reporting periods beginning after June 15, 2015. Management has not yet determined the effect this Statement will have on the Department’s financial statements.

NOTE C - DEPOSITS AND INVESTMENTS

At June 30, 2015 the carrying amount of deposits (cash, time certificates of deposit, and money market funds) was $36,296,888, with corresponding bank balances of $37,414,497. These amounts were fully insured or collateralized with securities held by the County’s agent in the County’s name.

NOTE C - DEPOSITS AND INVESTMENTS (Continued)

The Hawai‘i Revised Statutes (HRS) authorizes the County Director of Finance to invest Department moneys that are in excess of the amounts necessary for meeting immediate requirements. The primary objective of the County’s investment policy is to safeguard the principal. The secondary objective is to meet the liquidity needs of the Department. The third objective is to return an acceptable yield. In accordance with the HRS, the County’s investment policy permits investments in obligations of or guaranteed by the U.S. government, obligations of the State of Hawai‘i, federally insured savings and checking accounts, time certificates of deposit, and repurchase agreements with federally insured financial institutions. There were no investments at June 30, 2015.

Custodial Credit Risk - Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the Department will not be able to recover deposits or will not be able to recover collateral securities that are in possession of an outside party. The Department’s policy requires deposits to be maintained at financial institutions that are members of the Federal Deposit Insurance Corporation and for deposits in excess of insured amounts to be collateralized with securities in accordance with the HRS.

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, the Department will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The Department’s policy provides a list of authorized counterparties as well as minimum requirements that counterparties must demonstrate in order to be utilized by the Department.

Interest Rate Risk - Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the Department manages its exposure to interest rate risk is by purchasing a combination of short- and mid-term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or nearing maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations. The Department monitors the interest rate risk inherent in its portfolio by measuring the weighted average maturity of its portfolio.

Credit Risk and Concentration of Credit Risk - Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. Concentration of credit risk is the risk of loss attributed to the magnitude of a government’s investment in a single issuer. The Department’s policy limits investment options to those authorized in the HRS and requires the diversification of assets as to issuer.

NOTE D - CAPITAL ASSETS

The following summarizes the Department’s capital assets at June 30, 2015:

		Amount
Utility plant in service		
Distribution mains and accessories	$	138,320,719
Structures and improvements		175,706,400
Electric and hydraulic pumping equipment		50,014,160
Services		30,687,750
Transmission mains and accessories		36,446,082
Hydrants		9,013,223
Meters		10,745,363
Purification system		6,833,797
Transportation equipment		3,979,291
Communication equipment		2,690,675
Office equipment and furniture		2,232,260
Tools and work equipment		1,430,258
Other equipment		1,227,388
Other fire protection plant		19,587
Total utility plant in service		469,346,953
Less: Accumulated depreciation		(211,518,942)
		257,828,011
Land and rights		4,706,302
Preliminary survey and investigation charges		4,428,754
Construction work in progress		12,185,812
Net capital assets	$	279,148,879

NOTE D - CAPITAL ASSETS (Continued)

The following is a summary of changes in capital assets during the fiscal year ended June 30, 2015:

	Balance July 1, 2014	Additions	Retirements/ Transfers	Balance June 30, 2015
Utility plant in service	$ 454,575,245	$ 14,890,765	$ (119,057)	$ 469,346,953
Less: Accumulated depreciation	(199,257,568)	(12,319,532)	58,158	(211,518,942)
	255,317,677	2,571,233	(60,899)	257,828,011
Land and rights	4,564,602	141,700	--	4,706,302
Preliminary survey and investigation charges	3,732,743	702,067	(6,056)	4,428,754
Construction work in progress	7,358,252	6,925,516	(2,097,956)	12,185,812
	$ 270,973,274	$ 10,340,516	$ (2,164,911)	$ 279,148,879

NOTE E - LONG-TERM OBLIGATIONS

At June 30, 2015, long-term debt consisted of the following:

		Amount
Public Improvement Refunding bonds ($5,752,612 issued) payable to the County, interest at 4% to 5%, due in annual installments through 2021	$	3,949,269
Public Improvement bonds ($25,000,000 issued) payable to the County, interest at 4% to 5%, due in annual installments through 2026		17,730,000
Public Improvement bonds ($8,831,250 issued) payable to the County, interest at 3.33% to 6.1%, due in semiannual installments and through 2030		8,443,750
Public Improvement bonds ($6,168,750 issued) payable to the County, interest at 3.33% to 6.1%, due in semiannual installments through 2030		5,902,500
Public Improvement bonds ($259,200 issued) payable to the County, interest at 4.5%, due in semiannual installments through 2039		222,818
Public Improvement bonds ($147,000 issued) payable to the County, interest at 4.125%, due in semiannual installments through 2043		135,216
State Revolving Fund loans ($21,216,049 loaned) payable to the State of Hawaii, interest up to 1.37%, due in semiannual installments through 2032		12,591,409
Total long-term debt		48,974,962
Add: Unamortized premium		519,604
		49,494,566
Less: Current portion		(3,438,282)
Long-term debt, noncurrent portion	$	46,056,284

NOTE E - LONG-TERM OBLIGATIONS (Continued)

The public improvement bonds consist of long-term obligations to the County that reflect the Department’s proportionate share of general obligation bonds that were issued by the County, in part, for the purpose of improving the public water system.

The following is a summary of changes in long-term debt during the fiscal year ended June 30, 2015:

	Amount
Beginning balance	$ 52,302,974
Additions	48,092
Retirements	(3,376,104)
Ending balance	$ 48,974,962

At June 30, 2015, future principal payments for long-term debt are scheduled as follows:

Year ending June 30,	Principal	Interest	Total
2016	$ 3,438,382	$ 1,715,588	$ 5,153,970
2017	3,547,543	1,602,091	5,149,634
2018	3,668,323	1,483,352	5,151,675
2019	3,793,239	1,368,874	5,162,113
2020	3,916,380	1,238,621	5,155,001
2021 - 2025	17,852,089	4,170,117	22,022,206
2026 - 2030	12,108,751	1,223,046	13,331,797
2031 - 2035	529,375	40,777	570,152
2036 - 2040	98,172	16,440	114,612
2041 - 2045	22,708	1,895	24,603
	$ 48,974,962	$ 12,860,801	$ 61,835,763

NOTE E - LONG-TERM OBLIGATIONS (Continued)

Other Long-term Obligations - The following is a summary of other long-term obligations transactions for the fiscal year ended June 30, 2015:

	Balance July 1, 2014	Additions	Deductions and Payments	Balance June 30, 2015	Due Within One Year
Accrued workers' compensation	$ 307,000	$ 113,049	$ (140,049)	$ 280,000	$ 62,636
Accrued vacation	1,577,380	708,094	(698,104)	1,587,370	507,958
Customer deposits	16,213,571	858,366	(263,784)	16,808,153	607,136
Total	$ 18,097,951	$ 1,679,509	$ (1,101,937)	$ 18,675,523	$ 1,177,730

NOTE F - EMPLOYEE BENEFITS

Pension Plan

Plan Description - All eligible employees of the Department are required by Chapter 88, HRS, to become members of the Employees’ Retirement System of the State of Hawai‘i (ERS), a cost-sharing, multiple-employer public employee retirement plan. The ERS provides retirement, survivor and disability benefits with multiple benefit structures known as the contributory, hybrid and noncontributory plans. All contributions, benefits and eligibility requirements are established by Chapter 88, HRS, and can be amended by legislative action.

Employees covered by Social Security in June 30, 1984 were given the option of joining the noncontributory plan or remaining in the contributory plan. All new employees hired after June 30, 1984 and before July 1, 2006, who are covered by Social Security, were generally required to join the noncontributory plan. Qualified employees in the contributory and noncontributory plans were given the option of joining the hybrid plan effective July 1, 2006, or remaining in their existing plan. Starting July 1, 2006, all new employees covered by Social Security are required to join the hybrid plan.

The three plans provide a monthly retirement allowance equal to the benefit multiplier percentage multiplied by the average final compensation (AFC) multiplied by the years of credited service. The AFC is the average salary earned during the five highest paid years of service, including the payment of salary in lieu of vacation, or three highest paid years of service, excluding the payment of salary in lieu of vacation, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after this date is based on the three highest paid years of service, excluding the payment of salary in lieu of vacation.

NOTE F - EMPLOYEE BENEFITS (Continued)

A post retirement allowance, which is an automatic annual increase of 1.5% (if the employee became a member after June 30, 2012) or 2.5% (if the employee became a member before July 1, 2012), is provided to all retirees beginning July 1 of the calendar year following retirement and on each July 1 thereafter.

The following summarizes the three plan provisions relevant to the general employees of the respective plan:

Contributory Plan - Membership date prior to July 1, 2012: Employees are generally required to contribute 7.8% of their salary and are fully vested for benefits upon receiving 5 years of credited service. Employees may retire with full benefits at age 55 and 5 years of credited service, or may retire early at any age with at least 25 years of credited service and reduced benefits. The benefit multiplier is 2.0% for employees covered by Social Security.

Membership date after June 30, 2012: Employees are generally required to contribute 9.8% of their salary and are fully vested for benefits upon receiving 10 years of credited service. Employees may retire with full benefits at age 60 and 10 years of credited service, or may retire early at age 55 and 25 years of credited service with reduced benefits. The benefit multiplier is 1.75% for employees covered by Social Security.

Hybrid Plan - Membership date prior to July 1, 2012: Employees are generally required to contribute 6.0% of their salary and are fully vested for benefits upon receiving 5 years of credited service. Employees may retire with full benefits at age 62 and 5 years of credited service or at age 55 and 30 years of credited service, or may retire at age 55 and 20 years of credited service with reduced benefits. The benefit multiplier used to calculate retirement benefits is 2.0%.

Membership date after June 30, 2012: Employees are generally required to contribute 8.0% of their salary and are fully vested for benefits upon receiving 10 years of credited service. Employees may retire with full benefits at age 65 and 10 years of credited service or at age 60 and 30 years of credited service, or may retire at age 55 and 20 years of credited service with reduced benefits. The benefit multiplier used to calculate retirement benefits is 1.75%.

Noncontributory Plan - Employees in the noncontributory plan are fully vested upon receiving 10 years of credited service. The Department is required to make all contributions for these members. Employees may retire with full benefits at age 62 years and 10 years of credited service or age 55 and 30 years of credited services or age 55 years and 20 years of credited service with reduced benefits. The benefit multiplier used to calculate retirement benefits is 1.25%.

NOTE F - EMPLOYEE BENEFITS (Continued)

The ERS funding policy provides for periodic employer contributions at actuarially determined rates, expressed as a percentage of annual covered payroll, such that the employer contributions, along with employee contributions and an actuarially determined rate of investment return, are adequate to accumulate sufficient assets to pay benefits when due. The funding method used to calculate the total employer contribution required is the entry age normal actuarial cost method. Employer contribution rates are a fixed percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liability. As of June 30, 2015 employers contribute 16.50% for all general employees. Employer rates are set by statute based on the recommendation of the ERS actuary resulting from an experience study conducted every five years.

The pension contributions by the Department for the fiscal year ended June 30, 2015 was $1,935,306, which equal the required contributions for the year plus Department-paid employee contributions that are also classified as employer contributions pursuant to IRC section 414(h)(2).

The ERS issues a Comprehensive Annual Financial Report that includes financial statements and required supplementary information, which may be obtained from the following address:

Employees' Retirement System of the State of Hawai'i
201 Merchant Street, Suite 1400
Honolulu, Hawai'i 96813

Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions - At June 30, 2015, the Department reported a liability of $20,526,993 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2014, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Department's proportion of the net pension liability was based on the actual employer contributions to the pension plan relative to the contributions of all participating employers. At June 30, 2014, the Department's proportion was 0.26%, which was an increase of 0.05% from its proportion measured as of June 30, 2013.

NOTE F - EMPLOYEE BENEFITS (Continued)

For the year ended June 30, 2015, the Department recognized pension expense of $2,823,637. At June 30, 2015, the Department reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	$ 261,030	$ --
Net difference between projected and actual investment earnings on pension plan investments	--	(2,382,270)
Changes in proportion and differences between employer contributions and proportionate share of contributions	3,382,872	--
Department contributions subsequent to the measurement date	1,935,306	--
Total	$ 5,579,208	$ (2,382,270)

The $1,935,306 reported as deferred outflows of resources related to the Department's contributions to the pension plan subsequent to the measurement date will be recognized as a reduction of the net pension liability in the fiscal year ended June 30, 2016. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Fiscal Year Ended June 30,	Amount
2016	$ 168,978
2017	168,978
2018	168,978
2019	168,978
2020	585,720
Thereafter	--
	$ 1,261,632

NOTE F - EMPLOYEE BENEFITS (Continued)

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

Inflation	3.00%
Payroll growth rate	3.50% per annum
Salary increases	4.00% - 19.00%, including inflation
Investment rate of return	7.75% per annum, including inflation
Cost of living adjustments	2.50%/1.50%

Post-retirement mortality rates were based on either the Client Specific Tables, for general employees, or the 1994 US Group Annuity Mortality Static Table, for police and firefighters. Pre-retirement mortality rates were based on the RP-2000 Mortality Tables.

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

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

NOTE F - EMPLOYEE BENEFITS (Continued)

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
Domestic equity	30.00%	8.50%
International equity	26.00%	9.00%
Fixed income	20.00%	3.10%
Real estate	7.00% *	8.46%
Private equity	7.00% *	11.75%
Real return	5.00% *	6.10%
Covered calls	5.00%	7.65%
	100.00%	

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

Discount rate – The discount rate used to measure the net pension liability was 7.75%. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current contribution rate and that contributions from the County will be made at statutorily required rates, actuarially determined. Based on those assumptions, the pension plan’s fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all period of projected benefit payments to determine the total pension liability. There has been no change in the discount rate since the prior measurement date.

Sensitivity of the Department’s proportionate share of the net pension liability to changes in the discount rate - The following presents the Department’s proportionate share of the net pension liability calculated using the discount rate of 7.75%, as well as what the Department’s proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (6.75%) or 1-percentage-point higher (8.75%) than the current rate:

	1% Decrease (6.75%)	Current Discount Rate (7.75%)	1% Increase (8.75%)
Department's proportionate share of the net pension liability	$ 26,017,563	$ 20,526,993	$ 15,036,423

NOTE F - EMPLOYEE BENEFITS (Continued)

Pension plan fiduciary net position – Detailed information about the pension plan’s fiduciary net position is available in the separately issued ERS Comprehensive Annual Financial Report that includes financial statements and required supplementary information.

Payables to the pension plan – At June 30, 2015, the amount payable to the ERS totaled $125,036, which represents the employer contribution for the month of June 2015, as required by the HRS.

Deferred Compensation Plan

All full-time employees are eligible to participate in the County’s Public Employees’ Deferred Compensation 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.

All plan assets are held in a trust fund to protect them from claims of general creditors and from diversion to any uses other than paying benefits to participants and beneficiaries. The County has no responsibility for loss due to the investment or failure of investment of funds and assets in the plans, but does have the duty of due care that would be required of an ordinary prudent investor.

Postretirement Healthcare and Life Insurance Benefits

In addition to providing pension benefits, the Department, pursuant to HRS Chapter 87A, is a participating employer in an agent, multiple-employer defined benefit plan providing certain healthcare and life insurance benefits to all qualified employees and retirees. The Employer-Union Health Benefits Trust Fund (EUTF) was established on July 1, 2003 to design, provide and administer medical, prescription, drug, dental, vision, chiropractic, dual-coverage medical and prescription, and group life benefits.

For employees hired before July 1, 1996, the Department pays the entire monthly healthcare premium for employees retiring with 10 or more years of credited service, and 50% of the monthly premium for employees retiring with fewer than 10 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

NOTE F - EMPLOYEE BENEFITS (Continued)

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 healthcare premium.

For employees hired after June 30, 2001, 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 based on the self plan. For employees hired after June 30, 2001, 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 based on the self plan; for those retiring with over 25 years of service, the Department pays the entire healthcare premium based on the self plan.

For active employees, the employee'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's annual other postemployment benefit (OPEB) cost is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined. 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 (or funding excess) over a period not to exceed 30 years. The following table presents the components of the Department's annual OPEB cost, the amount actually contributed to the plan, and changes in the net OPEB asset for fiscal year ended June 30, 2015:

		Amount
Annual required contribution/annual OPEB cost	$	1,850,000
Contributions made		(1,846,343)
Decrease in net OPEB asset		(3,657)
Net OPEB asset at beginning of year		4,758
Net OPEB asset at end of year (reported as prepaid expenses in the statement of net position)	$	1,101

NOTE F - EMPLOYEE BENEFITS (Continued)

The annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB asset for the fiscal years ended June 30, 2015, 2014 and 2013 were as follows:

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Asset
June 30, 2015	$ 1,850,000	99.8%	$ 1,101
June 30, 2014	$ 1,899,000	100.0%	$ 4,758
June 30, 2013	$ 1,834,000	100.0%	$ 3,000

The schedule of funding progress based on the actuarial valuation date of July 1, 2013 is as follows:

Actuarial accrued liability	$ 25,166,000
Actuarial value of plan assets	(7,471,000)
Unfunded actuarial accrued liability (UAAL)	$ 17,695,000
Funded ratio	29.7%
Covered payroll (active plan members)	8,310,000
UAAL as a percentage of covered payroll	212.9%

The schedule of funding progress presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

Projections of benefits for financial reporting purposes are based on the substantive plan and include the types of benefits provided at the time of each valuation and the historical pattern of sharing 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.

NOTE F - EMPLOYEE BENEFITS (Continued)

In the July 1, 2013 actuarial valuation, the entry age normal cost method was used. The actuarial assumptions included a 7.0% discount rate, which is based on the assumption that employers pre-fund contributions, an assumed inflation rate of 3.0%, and an annual healthcare cost trend rate of approximately 8.5% initially, reduced by decrements to an ultimate rate of 5.0% after ten years. The UAAL is being amortized as a level percentage of projected payroll on a closed basis. The remaining amortization period at July 1, 2013 was 22.8 years.

The EUTF issues a financial report that includes financial statements and required supplementary information, which may be obtained from the following address:

Hawai‘i Employer-Union Health Benefits Trust Fund
P.O. Box 2121
Honolulu, Hawai‘i 96805-2121

NOTE G - COMMITMENTS AND CONTINGENT LIABILITIES

Risk Management - The Department is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; employee injuries and illnesses; and natural disasters. The Department maintains property, auto liability, and general liability insurance policies. The Department remains self-insured for workers’ compensation liability.

Liabilities are recorded when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. These losses 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, and include incremental costs for the hiring of special counsel and expert witnesses. Claims liabilities are estimated by a case-by-case review of all claims and the application of historical experience to outstanding claims. Estimates of IBNR are based on historical experience.

Construction Contracts - The Department is obligated under construction contracts for the utility plant and other projects. Such commitments approximated $23,995,000 at June 30, 2015.

Litigation - The Department is involved in various legal proceedings arising in the ordinary course of business. The Department provides for losses that, in the opinion of management, are both probable of being incurred and that can be reasonably estimated. In management’s opinion, losses, if any, would not materially affect the Department’s financial position or results of operations.

NOTE H - RELATED PARTY TRANSACTIONS

Long-term debt - As discussed in Note E, the County has issued general obligation bonds on the Department's behalf for improvements to the water system. The Department is liable to the County for its proportionate share of the debt service requirements. In connection with these general obligation bond issues, long-term debt payable to the County totaled $36,383,553 at June 30, 2015. Accrued interest payable to the County totaled $811,000 at June 30, 2015.

Operating lease - The Department leases office space in its Hilo office to the County. The term of the lease is for ten years, starting on October 1, 2013, with an option to extend for an additional ten years. The County is also obligated to pay for common area maintenance expense. Thereafter and for the duration of the lease term, annual lease rent from the County, including common area maintenance will be approximately $236,000, subject to annual adjustments to the monthly common area maintenance charge. Payments received from the County in connection with this lease approximated $236,000 during the fiscal year ended June 30, 2015.

Other - The County provides the Department with various administrative services including treasury, legal, audit, and workers' compensation administration. The cost for these services are generally invoiced and reimbursed on an annual basis.

NOTE I – CHANGE IN ACCOUNTING PRINCIPLE

Effective for the fiscal year ending June 30, 2015, the Department has adopted the requirements of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27* (GASB 68), as amended by GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date – an amendment of GASB Statement No. 68.* GASB 68, as amended, establishes standards for accounting and financial reporting for pensions that are provided to the employees of state and local governmental employers through pension plans that are administered through trusts or equivalent arrangements.

NOTE I – CHANGE IN ACCOUNTING PRINCIPLE (Continued)

The effect of adopting the provisions of GASB 68, as amended, resulted in a decrease in beginning net position of $16,441,724 at July 1, 2014 and a decrease to the change in net position of $888,331 for the fiscal year ended June 30, 2015. The impact on beginning net position is summarized as follows:

	Amount
Net position at June 30, 2014, as previously stated	$ 241,072,995
Cumulative effect of applying GASB 68, as amended:	
Net pension liability at June 30, 2014	(18,469,400)
Deferred outflows of resources – employer contributions made subsequent to the measurement date of the beginning net pension liability but prior to June 30, 2014	2,027,676
Net position at June 30, 2014, as restated	$ 224,631,271

Management of the Department concluded that it was not practical to determine the amounts of all pension-related deferred inflows of resources and deferred outflows of resources at July 1, 2014. Accordingly, as permitted under the provisions of GASB 68, as amended, the Department has only reported the beginning deferred outflow of resources resulting from employer pension contributions made subsequent to the measurement date of the beginning net pension liability (June 30, 2013) but prior to June 30, 2014.

REQUIRED SUPPLEMENTARY INFORMATION OTHER THAN MANAGEMENT'S DISCUSSION AND ANALYSIS

County of Hawai‘i
Department of Water Supply
(A component unit of the County of Hawai‘i, State of Hawai‘i)
SCHEDULE OF FUNDING PROGRESS - EUTF
June 30, 2015

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded Actuarial Accrued Liability (UAAL) (b-a)	Funded Ratio (a/b)	Annual Covered Payroll (c)	UAAL as a Percentage of Annual Covered Payroll ((b-a)/c)
July 1, 2013	$ 7,471,000	$ 25,166,000	$ 17,695,000	29.7%	$ 8,310,000	212.9%
July 1, 2011	$ 4,479,000	$ 24,492,000	$ 20,013,000	18.3%	$ 7,995,000	250.3%
July 1, 2009	$ 1,863,000	$ 27,937,000	$ 26,074,000	6.7%	$ 9,460,000	275.6%

County of Hawai‘i
Department of Water Supply
(A component unit of the County of Hawai‘i, State of Hawai‘i)
SCHEDULE OF THE DEPARTMENT’S PROPORTIONATE
SHARE OF THE NET PENSION LIABILITY
Last 10 Fiscal Years*

Measurement Period Ended	Department's Proportion of the Net Pension Liability (%)	Department's Proportionate Share of the Net Pension Liability ($)	Department's Covered Payroll	Proportionate Share of the Net Pension Liability as a %age of Covered Payroll	Plan Fiduciary Net Position as a %age of the Total Pension Liability
June 30, 2014	0.26%	$ 20,526,993	$ 8,272,307	248.1%	63.92%
June 30, 2013	0.21%	$ 18,469,400	$ 7,640,477	241.7%	57.96%

* This schedule is intended to present information for 10 years, as of the measurement date of the collective net pension liability for each respective fiscal year. Additional years will be built prospectively as information becomes available.

County of Hawai‘i
Department of Water Supply
(A component unit of the County of Hawai‘i, State of Hawai‘i)
SCHEDULE OF EMPLOYER PENSION CONTRIBUTIONS
Last Ten Fiscal Years

Fiscal Year Ended	Statutorily Required Contribution	Actual Department Contributions Recognized by the Plan	Contribution Deficiency (Excess)	Department's Covered Payroll	Contributions as a %age of Covered Payroll
June 30, 2015	$ 1,935,306	$ 1,935,306	$ --	$ 9,012,196	21.47%
June 30, 2014	$ 2,027,676	$ 2,027,676	$ --	$ 8,272,307	24.51%
June 30, 2013	$ 1,540,984	$ 1,540,984	$ --	$ 7,640,477	20.17%
June 30, 2012	$ 1,543,601	$ 1,543,601	$ --	$ 7,849,473	19.67%
June 30, 2011	$ 1,527,151	$ 1,527,151	$ --	$ 7,726,278	19.77%
June 30, 2010	$ 1,801,469	$ 1,801,469	$ --	$ 9,076,143	19.85%
June 30, 2009	$ 1,760,955	$ 1,760,955	$ --	$ 8,878,193	19.83%
June 30, 2008	$ 1,532,117	$ 1,532,117	$ --	$ 8,339,974	18.37%
June 30, 2007	$ 1,353,209	$ 1,353,209	$ --	$ 7,381,457	18.33%
June 30, 2006	$ 1,068,295	$ 1,068,295	$ --	$ 7,171,081	14.90%

NOTE: Employer contributions include Department-paid employee contributions that are classified as employer contributions pursuant to IRC section 414(h)(2).

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REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

INDEPENDENT AUDITOR'S REPORT

To the Water Board
County of Hawai‘i, Department of Water Supply

We have audited, in accordance with the 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, the financial statements of the County of Hawai‘i, Department of Water Supply (Department), a component unit of the County of Hawai‘i, State of Hawai‘i (County), which comprise the statement of net position as of June 30, 2015, and the related statements of revenues, expenses and changes in net position and cash flows for the fiscal year then ended, and the related notes to the financial statements and have issued our report thereon dated December 21, 2015.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Department's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify a deficiency in internal control, described in the accompanying schedule of findings as item 2015-001, that we consider to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Department's Response to Finding

The Department's response to the finding identified in our audit is described in the schedule of findings. The Department's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

N&K CPAs, Inc.

Honolulu, Hawaii
December 21, 2015

County of Hawai‘i
Department of Water Supply
(A component unit of the County of Hawai‘i, State of Hawai‘i)
SCHEDULE OF FINDINGS
Fiscal Year Ended June 30, 2015

Ref. No.	Description

2015-001 Improve Internal Controls Over Cash Collections

Criteria: The responsibility for authorizing transactions, recording transactions, performing bank account reconciliations and having access to cash should be segregated and assigned to different people to minimize the risk of misstatements, whether due to fraud or errors.

Condition: During our audit of the Department for the fiscal year ended June 30, 2015, we selected a sample of 25 business days to test certain internal control procedures over the daily cash collections process. No irregularities or significant errors were noted during our testing of the sample. However, in gaining an understanding of the cash collections process, we identified the following deficiency in the design of internal controls:

The Waterworks Controller is responsible for performing the final review of the reconciliation of daily cash collections and for making the nightly deposit to the bank. The Waterworks Controller also has full access in the Department’s accounting system and is able to record transactions and performs the monthly bank account reconciliation. Therefore, the duties assigned to the Waterworks Controller do not appear to be adequately segregated.

Cause: The design of internal controls over the daily cash collections does not adequately segregate certain critical internal control duties.

Effect: Insufficient segregation of duties related to cash collections could provide an opportunity for a single person to both perpetrate and conceal the misappropriation of cash.

Recommendation

Management should reevaluate the design of internal controls over cash collections.

Management’s Response

This finding was not based on an error or problem that was found in the Department's records, nor does it take into account other controls the Department has in place to safeguard receipts. Specifically, the Department has another accountant responsible for reconciling deposits with transactions recorded by the bank on a daily basis. This reconciliation would identify deposits that are not made, or that are changed from their original amount, in a timely manner. Management feels this finding is adequately addressed.