

County of Hawai'i
Department of Water Supply
(A component unit of the County of Hawai'i, State of Hawai'i)
Financial Statements
June 30, 2011 and 2010



CERTIFIED PUBLIC ACCOUNTANTS

Report of Independent Auditors

The Water Board
County of Hawai'i

We have audited the accompanying balance sheets of the County of Hawai'i, Department of Water Supply (the "Department"), a component unit of the County of Hawai'i, State of Hawai'i (the "County"), as of June 30, 2011 and 2010, and the related statements of revenues, expenses and change in net assets and cash flows for the years then ended. These financial statements are the responsibility of the management of the Department. 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2, the financial statements of the Department are intended to present the financial position, and the changes in financial position and cash flows, of only that portion of the component unit information of the County that is attributable to the transactions of the Department. They do not purport to, and do not present fairly the financial position of the County as of June 30, 2011 and 2010, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the County of Hawai'i, Department of Water Supply, as of June 30, 2011 and 2010, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 28, 2011 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 the 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* and should be considered in assessing the results of our audit.

The accompanying management's discussion and analysis on pages 2 through 5 and schedule of funding progress on page 25 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Acuity LLP

Honolulu, Hawaii
October 28, 2011

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Management's Discussion and Analysis

County of Hawai'i
Department of Water Supply
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The Department of Water Supply, County of Hawai'i (the "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 balance sheets present information on all of the Department's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Department is improving or deteriorating. Net assets increase when revenues exceed expenses. Increases in assets, without a corresponding increase in liabilities, result in increased net assets, which indicate an improved financial position.

The statements of revenues, expenses, and change in net assets present information showing how an entity's net assets changed during the fiscal year. All components of the change in net assets 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 change in net assets. In the case of the Department, assets exceeded liabilities by \$225.5 million at the close of the most recent fiscal year. This represents an increase of \$0.5 million, or 0.2% above the previous year. At June 30, 2011, \$220.6 million of the Department's net assets were invested in capital assets (net of related debt), and \$4.9 million were unrestricted.

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Condensed Financial Information

The following are summaries from the Department's financial statements as of and for the years ended June 30, 2011, 2010 and 2009:

	2011	2010	2009
Assets			
Capital assets, net	\$ 268,020,831	\$ 248,757,319	\$ 226,898,463
Other assets	<u>45,836,159</u>	<u>43,670,866</u>	<u>66,934,940</u>
Total assets	<u>313,856,990</u>	<u>292,428,185</u>	<u>293,833,403</u>
Liabilities			
Long-term debt	63,378,412	43,714,532	42,109,178
Other liabilities	<u>25,023,665</u>	<u>23,713,483</u>	<u>22,577,110</u>
Total liabilities	<u>88,402,077</u>	<u>67,428,015</u>	<u>64,686,288</u>
Net assets			
Invested in capital assets, net of related debt	220,546,507	210,533,445	203,062,790
Unrestricted	<u>4,908,406</u>	<u>14,466,725</u>	<u>26,084,325</u>
Total net assets	<u>\$ 225,454,913</u>	<u>\$ 225,000,170</u>	<u>\$ 229,147,115</u>
Change in net assets			
Operating revenues – water sales	\$ 37,399,196	\$ 39,180,093	\$ 39,206,754
Total operating expenses	<u>(47,195,147)</u>	<u>(44,528,211)</u>	<u>(44,451,246)</u>
Operating loss	(9,795,951)	(5,348,118)	(5,244,492)
Total nonoperating revenues	12,582,125	3,628,591	12,821,135
Total nonoperating expenses	<u>(2,331,431)</u>	<u>(2,427,418)</u>	<u>(3,133,623)</u>
Change in net assets	454,743	(4,146,945)	4,443,020
Net assets			
Beginning of year	<u>225,000,170</u>	<u>229,147,115</u>	<u>224,704,095</u>
End of year	<u>\$ 225,454,913</u>	<u>\$ 225,000,170</u>	<u>\$ 229,147,115</u>

Financial Analysis

Capital assets, net increased by \$19.3 million, or 7.7%, in the fiscal year ended June 30, 2011 ("FY2011"), due primarily to an increase in utility plant in service of \$20.5 million. In the fiscal year ended June 30, 2010 ("FY2010"), capital assets, net increased by \$21.9 million, or 9.6%, due primarily to an increase in construction work in progress of \$24.1 million.

Other assets increased by \$2.2 million, or 5.0%, in FY2011, due primarily to increases of \$10.4 million in restricted investments and \$5.0 million in cash and cash equivalents, offset by a decrease in investments of \$11.2 million. In FY2010, other assets decreased by \$23.3 million, or 34.8%, due primarily to a net decrease of \$20.3 million in cash and cash equivalents and restricted cash, a result of the increase in construction work in progress.

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Long-term debt increased by \$19.7 million, or 45.0%, in FY2011, due to receipt of \$22.5 million in debt proceeds being offset by \$2.8 million in payments made on long-term obligations. In FY2010, long-term debt increased by \$1.6 million, or 3.8%, due to receipt of \$4.4 million in debt proceeds being offset by \$2.8 million in payments made on long-term debt obligations.

Net assets increased by \$0.5 million, or 0.2%, in FY2011, and decreased by \$4.1 million, or 1.8% in FY2010, primarily due to the results of the respective years' operations.

Operating revenues decreased by \$1.8 million or 4.6%, in FY2011, due primarily to a 698.5 million gallon or 7.3% decline in consumption. The decline in consumption was primarily due to a decrease in demand on the Kona coast from greater rainfall and the temporary closure of several hotels after the March 2011 tsunami.

Operating expenses increased by \$2.7 million or 6.0%, in FY2011, due primarily to increases in power and pumping of \$0.9 million, depreciation of \$0.8 million, and maintenance and repairs of \$0.8 million.

Nonoperating revenues increased by \$9.0 million, or 246.8%, in FY2011, due primarily to an increase of \$8.7 million in contributions in aid of construction. In FY2010, nonoperating revenues decreased by \$9.2 million, or 71.7%, due primarily to a decrease of \$8.3 million in contributions in aid of construction and a \$0.7 million decrease in interest income.

Capital Assets and Debt Administration

As of June 30, 2011 and 2010, the Department had \$268.0 million and \$248.8 million, respectively, invested in capital assets and \$63.4 million and \$43.7 million, respectively, of long-term debt outstanding.

During 2011, major capital asset additions included:

- \$4.2 million for the Palani Road transmission waterline.
- \$4.1 million for the Olaa production well and reservoir.
- \$3.4 million for the Queen Kaahumanu Highway widening project.
- \$2.1 million for Waikoloa reservoir repairs.
- \$1.3 million for the Ahualoa well.
- \$1.1 million for the islandwide spigot project.
- \$1.0 million for the Piihonua reservoir.

During 2010, major capital asset additions included:

- \$7.7 million for the Palani Road transmission waterline.
- \$6.0 million for Waikoloa reservoir repairs.
- \$3.6 million for the Piihonua reservoir.

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- \$3.1 million for the Ahualoa well.
- \$3.0 million for the Waiakea Office Plaza air conditioning system.
- \$2.3 million for the Waimea Treatment Plant sludge beds.
- \$2.0 million for the Pahala 0.5 million gallon reservoir.

More detailed information about the Department's capital assets is provided in Note 4 to the financial statements.

At June 30, 2011 and 2010, the Department had outstanding \$45.4 million and \$31.7 million, respectively, in County of Hawai'i general obligation bonds for public improvements and \$18.0 million and \$12.0 million, respectively, in State of Hawai'i revolving fund loans.

As of June 30, 2011, 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

Other statistics relating to the Department's operations are as follows:

	2011	2010	2009
Consumption (thousands of gallons)	8,806,677	9,505,218	9,171,424
Services (number of meters)	41,528	41,409	41,209

Currently Known Facts, Decisions, or Conditions

Effective July 1, 2011, water rates increased by approximately 6.8%.



Financial Statements

County of Hawai'i
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Balance Sheets
June 30, 2011 and 2010

	2011	2010
Assets		
Currents assets		
Cash and cash equivalents	\$ 18,804,723	\$ 13,801,181
Investments	-	11,245,453
Trade receivables, less allowance for doubtful accounts of \$1,378,000 and \$1,284,000 in 2011 and 2010, respectively	6,142,355	6,977,024
Interest receivable on investments	7,361	36,403
Inventories of materials and supplies	1,139,349	1,196,491
Prepaid expenses	152,498	401,424
Total current assets	<u>26,246,286</u>	<u>33,657,976</u>
Restricted investments	15,904,088	5,490,658
Capital assets		
Utility plant in services	366,730,898	346,223,076
Less: Accumulated depreciation	<u>(165,193,987)</u>	<u>(155,170,523)</u>
	201,536,911	191,052,553
Land and rights	1,783,726	1,714,727
Construction work in progress	64,700,194	55,990,039
Net capital assets	<u>268,020,831</u>	<u>248,757,319</u>
Deferred charges	<u>3,685,785</u>	<u>4,522,232</u>
Total assets	<u>\$ 313,856,990</u>	<u>\$ 292,428,185</u>

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

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Balance Sheets
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	2011	2010
Liabilities		
Current liabilities		
Accounts and construction contracts payable, including retainages	\$ 3,267,437	\$ 3,924,274
Long-term debt	7,105,000	4,488,000
Accrued compensation	1,088,803	1,120,241
Customers' deposits	607,615	600,167
Accrued vacation	392,948	461,200
Accrued interest payable	1,079,541	1,249,926
Accrued workers' compensation	54,135	62,412
Total current liabilities	<u>13,595,479</u>	<u>11,906,220</u>
Accrued workers' compensation, noncurrent	187,865	216,588
Accrued vacation, noncurrent	1,244,337	1,129,144
Deferred revenue, noncurrent	1,583,953	-
Customers' deposits, noncurrent	15,517,031	14,949,531
Long-term debt, noncurrent	<u>56,273,412</u>	<u>39,226,532</u>
Total liabilities	<u>88,402,077</u>	<u>67,428,015</u>
Commitments and contingencies		
Net Assets		
Invested in capital assets, net of related debt	220,546,507	210,533,445
Unrestricted	4,908,406	14,466,725
Total net assets	<u>225,454,913</u>	<u>225,000,170</u>
Total liabilities and net assets	<u>\$ 313,856,990</u>	<u>\$ 292,428,185</u>

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)
Statements of Revenues, Expenses and Change in Net Assets
Years Ended June 30, 2011 and 2010

	2011	2010
Operating revenues – water sales	\$ 37,399,196	\$ 39,180,093
Operating expenses		
Power and pumping	19,562,219	18,664,991
Depreciation	10,468,111	9,652,072
General and administrative	7,156,900	6,887,643
Transmission and distribution	4,965,271	4,496,616
Maintenance and repairs	2,258,298	1,410,565
Purification	1,532,052	1,992,253
Customers' accounting and collecting	1,252,296	1,424,071
Total operating expenses	<u>47,195,147</u>	<u>44,528,211</u>
Operating loss	<u>(9,795,951)</u>	<u>(5,348,118)</u>
Nonoperating revenues		
Contributions in aid of construction	11,582,090	2,911,333
Interest	188,026	205,012
Other	812,009	512,246
Total nonoperating revenues	<u>12,582,125</u>	<u>3,628,591</u>
Nonoperating expenses		
Interest on long-term debt	(1,947,494)	(1,560,410)
Loss on disposal of property	(205,215)	(682,219)
Other	(178,722)	(184,789)
Total nonoperating expenses	<u>(2,331,431)</u>	<u>(2,427,418)</u>
Change in net assets	454,743	(4,146,945)
Net assets		
Beginning of year	<u>225,000,170</u>	<u>229,147,115</u>
End of year	<u>\$ 225,454,913</u>	<u>\$ 225,000,170</u>

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

County of Hawai'i
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Statements of Cash Flows
Years Ended June 30, 2011 and 2010

	2011	2010
Cash flows from operating activities		
Cash received from customers	\$ 38,808,813	\$ 40,223,772
Cash payments to suppliers for goods and services	(29,021,407)	(24,081,304)
Cash payments to employees for services	<u>(8,077,895)</u>	<u>(9,422,161)</u>
Net cash provided by operating activities	<u>1,709,511</u>	<u>6,720,307</u>
Cash flows from capital and related financing activities		
Principal paid on long-term debt	(2,793,805)	(2,837,841)
Debt and bond proceeds	22,457,685	4,443,195
Interest paid on long-term debt	(2,117,879)	(1,579,060)
Acquisition and construction of capital assets	(18,801,711)	(29,344,250)
Contributions in aid of construction	<u>3,500,650</u>	<u>2,301,090</u>
Net cash provided by (used in) capital and related financing activities	<u>2,244,940</u>	<u>(27,016,866)</u>
Cash flows from investing activities		
Purchase of investments	(31,596,894)	(23,853,714)
Proceeds from sale and maturities of investments	32,428,917	23,613,179
Interest on investments	<u>217,068</u>	<u>194,751</u>
Net cash provided by (used in) investing activities	<u>1,049,091</u>	<u>(45,784)</u>
Net increase (decrease) in cash and cash equivalents	5,003,542	(20,342,343)
Cash and cash equivalents		
Beginning of year	<u>13,801,181</u>	<u>34,143,524</u>
End of year	<u>\$ 18,804,723</u>	<u>\$ 13,801,181</u>

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

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Statements of Cash Flows
Years Ended June 30, 2011 and 2010

	2011	2010
Reconciliation of operating loss to net cash provided by operating activities		
Operating loss	\$ (9,795,951)	\$ (5,348,118)
Depreciation	10,468,111	9,652,072
Changes in assets and liabilities		
Trade receivables, net	834,669	1,081,859
Loans receivable	-	256,006
Inventories of materials and supplies	57,142	129,570
Prepaid expenses	248,926	(206,105)
Accounts and construction contracts payable, including retainages	(656,837)	329,752
Customers' deposits	574,948	787,673
Other liabilities	(21,497)	37,598
Net cash provided by operating activities	<u>\$ 1,709,511</u>	<u>\$ 6,720,307</u>

Noncash capital activities

The Department received \$8,081,440 and \$610,243 of infrastructure as contributions in aid of construction in fiscal years 2011 and 2010, respectively.

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

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Notes to Financial Statements
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1. Administration

The Department of Water Supply, County of Hawai'i (the "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 (the "County") and are confirmed by the County Council, as required by the County Charter.

2. Summary of Significant Accounting Policies

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.

Measurement Focus and Basis of Accounting

The accounting policies of the Department conform to U.S. generally accepted accounting principles as applicable to enterprise activities of governmental units as promulgated by the Governmental Accounting Standards Board ("GASB"). The Department's operations are accounted for on the flow of economic resources management focus, and the accrual basis of accounting is utilized. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. Restricted assets are recorded at fair value.

The Department applies all applicable GASB pronouncements, as well as the following pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements, Financial Accounting Standards Board statements and interpretations, Accounting Principles Board opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures.

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 \$126,443 and \$258,892 at June 30, 2011 and 2010, respectively.

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

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

Distribution mains and accessories	40 years
Structures and improvements	40 – 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 – 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.

Cash and Cash Equivalents

For purposes of the statements 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. Cash equivalents amounted to \$2,787,000 and \$8,733,000 at June 30, 2011 and 2010, respectively.

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 collectibility. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote.

Investments

All of the Department's investments fall into categories that can be valued by cost-based measures. Investments are solely comprised of certificates of deposit. These investments are stated at cost which approximates fair value.

Inventories of Materials and Supplies

Materials and supplies are stated at cost on an average cost basis.

Restricted Assets

Unspent bond proceeds that are restricted for purchases of water system improvements are recorded as restricted assets.

Deferred Charges

Deferred charges consist of preliminary survey and investigation charges.

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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 accumulates without limit. 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, 2011 and 2010 amounted to \$5,531,000 and \$5,454,000, respectively.

Net Assets

Net assets comprise the accumulated net earnings (loss) from operating and nonoperating revenues, expenses, transfers and contributions. Net assets are classified in the following components: invested in capital assets and unrestricted net assets. Invested in capital assets consists of capital assets, net of accumulated depreciation less unspent bond proceeds. Unrestricted net assets consist of all other net assets 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.

Contributions in Aid of Construction

The Department recognized \$11,582,090 and \$2,911,333 of contributions in aid of construction as nonoperating revenues for the fiscal years ended June 30, 2011 and 2010, respectively.

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 residents 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.

Use of Estimates

The preparation of the financial statements in accordance with U.S. generally accepted accounting principles requires management to make a number of 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 the carrying amount of capital assets, valuation allowances for trade receivables, valuation of noncash contributions in aid of construction, accrued workers' compensation, and postretirement healthcare and life insurance benefits. Actual results could differ from those estimates.

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New Accounting Pronouncements

In December 2010, the GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The objective of this Statement is to enhance the usefulness of the Codification of Governmental Accounting and Financial Reporting Standards by incorporating guidance that previously could only be found in certain Financial Accounting Standards Board and American Institute of Certified Public Accountants pronouncements. The requirements of this Statement are effective for reporting periods beginning after December 15, 2011. Management does not expect that this Statement will have a material effect on the Department's financial statements.

Reclassifications

Certain balances in the 2010 financial statements have been reclassified to conform to the 2011 presentation. These reclassifications had no effect on the change in net assets as previously reported.

3. Deposits and Investments

Cash collected by the Department is deposited in separate accounts maintained with the County's Treasury. Complete information on a county-wide basis is contained in the County's Comprehensive Annual Financial Report. Hawai'i Revised Statutes ("HRS") authorize the County to invest, with certain restrictions, in obligations of the State of Hawai'i or the United States, federally insured savings accounts, and time certificates of deposits with federally insured banks and savings and loans associations authorized to do business in the State of Hawai'i, provided that all deposits are fully insured or collateralized.

At June 30, 2011 and 2010, deposits and investments, including restricted balances, consisted of the following:

	2011	2010
Cash and cash equivalents	\$ 18,804,723	\$ 13,801,181
Investments	<u>15,904,088</u>	<u>16,736,111</u>
	<u>\$ 34,708,811</u>	<u>\$ 30,537,292</u>

Custodial Credit Risk for Deposits and Investments

Custodial credit risk for deposits is the risk that 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 HRS does not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits, other than the provision that a financial institution must secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law. This risk is mitigated in that the Department's deposits are maintained at financial institutions that are fully insured or collateralized as required by state law.

At June 30, 2011 and 2010, the carrying amount of deposits (cash, time certificates of deposit, and money market funds) was \$34,708,811 and \$30,537,292, respectively, with bank balances of \$35,389,258 and \$32,597,948, respectively. These balances were fully insured or collateralized with securities held by the County's agent in the County's name.

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Investments

At June 30, 2011 and 2010, the Department's investment portfolio consists of certificates of deposit held by the County on behalf of the Department.

State law and regulations require that surplus moneys of the Department must be invested. The primary objective of the Department'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 general, the Department'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.

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. At June 30, 2011 and 2010, the investments weighted average maturity in years was 0.6 and 0.8, respectively.

Credit Risk

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization.

Concentration of Credit Risk

The Department's investment policy contains no limitations on the amount that can be invested in any one issuer beyond that stipulated by the HRS. As of June 30, 2011 and 2010, the Department's entire investment portfolio is invested in certificates of deposit which are not rated.

Custodial Credit Risk for Investments

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, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The HRS does not contain legal or policy requirements that would limit the exposure to custodial credit risk for investments. All securities owned by the Department are deposited in trust for safekeeping with a custodial bank and registered in the County's name. Securities are not held in broker-dealer accounts.

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4. Capital Assets

The following summarizes the Department's capital assets at June 30, 2011 and 2010:

	2011	2010
In service		
Distribution mains and accessories	\$ 129,461,421	\$ 123,385,632
Structures and improvements	111,441,210	105,317,532
Electric and hydraulic pumping equipment	39,710,395	35,202,023
Services	28,362,123	27,714,209
Transmission mains and accessories	21,803,243	21,413,870
Hydrants	8,381,705	7,930,620
Meters	10,342,608	8,365,344
Purification system	6,741,026	6,648,425
Transportation equipment	3,497,683	3,497,683
Communication equipment	2,578,871	2,420,680
Office equipment and furniture	1,997,599	1,921,795
Tools and work equipment	1,237,258	1,231,720
Other equipment	1,156,169	1,153,956
Other fire protection plant	19,587	19,587
Total in service	<u>366,730,898</u>	<u>346,223,076</u>
Less: Accumulated depreciation	<u>(165,193,987)</u>	<u>(155,170,523)</u>
	201,536,911	191,052,553
Land and rights	1,783,726	1,714,727
Construction work in progress	<u>64,700,194</u>	<u>55,990,039</u>
Net capital assets	<u>\$ 268,020,831</u>	<u>\$ 248,757,319</u>

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The following is a summary of changes in capital assets during the fiscal years ended June 30, 2011 and 2010:

	Balance July 1, 2010	Additions	Retirements/ Transfers	Balance June 30, 2011
Utility plant in services	\$ 346,223,076	\$ 21,157,684	\$ (649,862)	\$ 366,730,898
Less: Accumulated depreciation	(155,170,523)	(10,468,111)	444,647	(165,193,987)
	<u>191,052,553</u>	<u>10,689,573</u>	<u>(205,215)</u>	<u>201,536,911</u>
Land and rights	1,714,727	68,999	-	1,783,726
Construction work in progress	55,990,039	20,666,221	(11,956,066)	64,700,194
	<u>\$ 248,757,319</u>	<u>\$ 31,424,793</u>	<u>\$ (12,161,281)</u>	<u>\$ 268,020,831</u>

	Balance July 1, 2009	Additions	Retirements/ Transfers	Balance June 30, 2010
Utility plant in services	\$ 341,412,867	\$ 8,086,697	\$ (3,276,488)	\$ 346,223,076
Less: Accumulated depreciation	(148,112,720)	(9,652,072)	2,594,269	(155,170,523)
	<u>193,300,147</u>	<u>(1,565,375)</u>	<u>(682,219)</u>	<u>191,052,553</u>
Land and rights	1,714,727	-	-	1,714,727
Construction work in progress	31,883,589	29,852,643	(5,746,193)	55,990,039
	<u>\$ 226,898,463</u>	<u>\$ 28,287,268</u>	<u>\$ (6,428,412)</u>	<u>\$ 248,757,319</u>

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5. Long-Term Obligations

Long-Term Debt

At June 30, 2011 and 2010, long-term debt consisted of the following:

	2011	2010
Public Improvement bonds (\$8,000,000 issued) payable to the County, interest at 4% to 5.125%, due in annual installments through 2010	\$ -	\$ 375,652
Public Improvement bonds (\$10,000,000 issued) payable to the County, interest at 2.5% to 5.6%, due in annual installments through 2013	1,625,000	2,375,000
Public Improvement Refunding bonds (\$424,860 issued) payable to the County, interest at 2% to 5.25%, due in annual installments through 2015	185,076	227,756
Public Improvement Refunding bonds (\$5,752,612 issued) payable to the County, interest at 4% to 5%, due in annual installments beginning 2012 and through 2021	5,752,612	5,752,612
Public Improvement bonds (\$25,000,000 issued) payable to the County, interest at 4% to 5%, due in annual installments through 2026	21,725,000	22,607,500
Public Improvements bonds (\$9,585,706 issued) payable to the County, interest at 3.33% to 6.1%, due in semiannual installments through 2030	9,585,706	-
Public Improvements bonds (\$6,107,099 issued) payable to the County, interest at 3.33% to 6.1%, due in semiannual installments through 2030	6,107,099	-
Public Improvements bonds (\$259,200 issued) payable to the County, interest at 4.5%, due in semiannual installments through 2039	240,775	244,791
Public Improvements bonds (\$147,000 issued) payable to the County, interest at 4.125%, due in semiannual installments through 2043	144,830	147,000
State Revolving Fund loans (\$18,281,019 loaned) payable to the State of Hawaii, interest up to 1.37%, due in semiannual installments through 2030	14,064,339	10,278,382
American Recovery and Reinvestment Act State Revolving Fund loan from the State of Hawaii, non-interest bearing, with total principal forgiveness upon fulfillment of conditions	<u>3,947,975</u>	<u>1,705,839</u>
Total long-term debt	63,378,412	43,714,532
Less: Current portion	<u>(7,105,000)</u>	<u>(4,488,000)</u>
Long-term debt, noncurrent portion	<u>\$ 56,273,412</u>	<u>\$ 39,226,532</u>

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The public improvement bonds are County general obligation bonds issued for the purpose of improving the public water system.

The following is a summary of changes in long-term debt during the fiscal years ended June 30, 2011 and 2010:

	2011	2010
Beginning balance	\$ 43,714,532	\$ 42,109,178
Additions	22,457,685	4,443,195
Repayments	<u>(2,793,805)</u>	<u>(2,837,841)</u>
Ending balance	<u>\$ 63,378,412</u>	<u>\$ 43,714,532</u>

At June 30, 2011, future principal payments for long-term debt are scheduled as follows:

Year ending June 30,	
2012	\$ 7,105,000
2013	3,274,000
2014	2,515,000
2015	3,247,000
2016	3,307,000
2017 – 2021	18,265,000
2022 – 2026	16,647,000
2027 – 2031	8,832,000
2032 – 2036	83,000
2037 – 2041	87,000
Thereafter	<u>16,412</u>
Total	<u>\$ 63,378,412</u>

Other General Long-Term Obligations

The following is a summary of other general long-term obligations transactions for the fiscal years ended June 30, 2011 and 2010:

	Balance July 1, 2010	Additions	Deductions and Payments	Balance June 30, 2011	Due Within One Year
Accrued workers' compensation	\$ 279,000	\$ 138,003	\$ (175,003)	\$ 242,000	\$ 54,135
Accrued vacation	1,590,344	640,413	(593,472)	1,637,285	392,948
Customer deposits	<u>15,549,698</u>	<u>894,727</u>	<u>(319,779)</u>	<u>16,124,646</u>	<u>607,615</u>
Total	<u>\$ 17,419,042</u>	<u>\$ 1,673,143</u>	<u>\$ (1,088,254)</u>	<u>\$ 18,003,931</u>	<u>\$ 1,054,698</u>

	Balance July 1, 2009	Additions	Deductions and Payments	Balance June 30, 2010	Due Within One Year
Accrued workers' compensation	\$ 245,000	\$ 137,510	\$ (103,510)	\$ 279,000	\$ 62,412
Accrued vacation	1,671,374	675,470	(756,500)	1,590,344	461,200
Customer deposits	<u>14,762,025</u>	<u>1,013,526</u>	<u>(225,853)</u>	<u>15,549,698</u>	<u>600,167</u>
Total	<u>\$ 16,678,399</u>	<u>\$ 1,826,506</u>	<u>\$ (1,085,863)</u>	<u>\$ 17,419,042</u>	<u>\$ 1,123,779</u>

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6. Employee Benefits

Employees' Retirement System of the State of Hawai'i

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 (the "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 (1.25% or 2.00%) 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.

For postretirement increases, every retiree's original retirement allowance is increased by 2.5% on each July 1 following the calendar year of retirement. This cumulative benefit is not compounded and increases each year by 2.5% of the original retirement allowance without a ceiling (2.5% of the original retirement allowance the first year, 5.0% the second year, 7.5% the third year, etc.).

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

Contributory Plan

Employees in the contributory plan are required to contribute 7.8% of their salary and are fully vested for benefits upon receiving 5 years of credited service. The Department may also make contributions for these members. Under the contributory plan, 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.

Hybrid Plan

Employees in the hybrid plan are required to contribute 6.0% of their salary and are fully vested for benefits upon receiving 5 years of credited service. The Department may also make contributions for these members. 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%.

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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%.

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. 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. As of July 1, 2008, employers contribute 19.70% for police officers and firefighters and 15.00% for all other 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 years ended June 30, 2011, 2010, and 2009 were \$1,197,031, \$1,417,853, and \$1,383,338, respectively, which equal the required contributions for each year. Measurement of assets and actuarial valuations is made for the ERS as a whole and is not separately computed for individual participating employers such as the Department.

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

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.

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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 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; for those retiring with over 25 years of service, the Department pays the entire healthcare premium.

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 in accordance with the parameters of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. 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 current ARC rate is 24.6% of annual covered payroll. 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 obligation for fiscal years ended June 30, 2011 and 2010:

	2011	2010
Annual required contribution	\$ 2,319,000	\$ 1,607,000
Interest on net OPEB obligation	(18,000)	8,000
Adjustment to annual required contribution	14,000	99,000
Annual OPEB cost	<u>2,315,000</u>	<u>1,714,000</u>
Contributions made	<u>(2,069,000)</u>	<u>(1,964,000)</u>
Increase (decrease) in net OPEB obligation	246,000	(250,000)
Net OPEB asset at beginning of year	<u>(250,000)</u>	<u>-</u>
Net OPEB asset at end of year (reported as prepaid expenses in the accompanying balance sheets)	(4,000)	(250,000)
Less: Current portion	<u>4,000</u>	<u>250,000</u>
	<u>\$ -</u>	<u>\$ -</u>

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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, 2011, 2010 and 2009 were as follows:

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Asset
June 30, 2011	\$ 2,315,000	89.4%	\$ 4,000
June 30, 2010	1,714,000	114.6%	250,000
June 30, 2009	1,493,000	163.5%	-

The schedule of funding progress based on the actuarial valuation date of July 1, 2009 is as follows:

Actuarial accrued liability	\$ 27,937,000
Actuarial value of plan assets	<u>(1,863,000)</u>
Unfunded actuarial accrued liability ("UAAL")	<u>\$ 26,074,000</u>
Funded ratio	6.7%
Covered payroll (active plan members)	\$ 9,460,000
UAAL as a percentage of covered payroll	275.6%

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 (the plan understood by the employer and the plan members) 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.

In the July 1, 2009 actuarial valuation, the entry age normal cost method was used. The actuarial assumptions included a 7.0% discount rate, which is based on the Department's anticipated funding level, and an annual healthcare cost trend rate of 10.5% initially, reduced by decrements to an ultimate rate of 5.0% after nine years. The UAAL is being amortized as a level percentage of projected payroll on an open basis. The remaining amortization period at July 1, 2009 was 30 years.

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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

7. 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 \$21,758,000 and \$37,653,000, respectively, at June 30, 2011 and 2010.

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.



**Required
Supplementary Information**

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Schedule of Funding Progress
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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, 2009	\$ 1,863,000	\$ 27,937,000	\$ 26,074,000	6.7%	\$ 9,460,000	275.6%
July 1, 2007	\$ -	\$ 17,236,000	\$ 17,236,000	0.0%	\$ 8,689,000	198.4%