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 Years Ended June 30, 2019 and 2018

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, as of and for the fiscal years ended June 30, 2019 and 2018, and the related notes to the financial statements, which collectively comprise the Department's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Department as of June 30, 2019 and 2018, and the changes in its financial position and its cash flows for the fiscal years then ended in accordance with accounting principles generally accepted in the United States of America.

Prior Period Adjustment

As discussed in Note J to the financial statements, amounts related to customer deposits and related capital assessment fees were not properly recorded during the fiscal year ended June 30, 2018. Accordingly, an adjustment has been made to the 2018 financial statements to correct this error. 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 7 through 11 and the schedules of the Department's proportionate share of the net pension liability, employer pension contributions, changes in the net OPEB liability and related ratios, and contributions (OPEB) on pages 48 through 52 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 20, 2019 on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely 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 the effectiveness of the Department's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Department's internal control over financial reporting and compliance.

N&K CPAs, Inc.

Honolulu, Hawaii
December 20, 2019

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 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 $223.9 million, at the close of the most recent fiscal year. This represents a decrease of $5.5 million, or 2.40% less than the previous year. At June 30, 2019, $226.8 million of the Department’s net position was invested in capital assets (net of related debt), and ($2.8) million was unrestricted.

The statements of revenues, expenses and changes in net position present information showing how the Department’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 the statements for some items that will result in cash flows in future fiscal periods.

Notes to Financial Statements

The notes to the 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 following are summaries from the Department’s financial statements as of and for the fiscal years ended June 30, 2019 and 2018.

STATEMENTS OF NET POSITION

	2019	2018 (as restated)
Assets		
Capital assets, net	$ 296,556,069	$ 303,062,991
Other assets	63,430,514	63,769,326
Total assets	359,986,583	366,832,317
Deferred outflows of resources		
Deferred outflows of resources	12,278,889	10,143,200
Total deferred outflows of resources	12,278,889	10,143,200
Total assets and deferred outflows of resources	$ 372,265,472	$ 376,975,517
Liabilities		
Long-term debt	$ 70,622,680	$ 74,523,523
Other liabilities	75,197,730	70,857,883
Total liabilities	145,820,410	145,381,406
Deferred inflows of resources		
Deferred inflows of resources	2,515,745	2,161,311
Total deferred inflows of resources	2,515,745	2,161,311
Net position		
Net investment in capital assets	226,821,614	229,427,693
Unrestricted	(2,892,297)	5,107
Total net position	223,929,317	229,432,800
Total liabilities, deferred inflows of resources and net position	$ 372,265,472	$ 376,975,517

Condensed Financial Information (Continued)

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION

	2019	2018 (as restated)
Changes in net position		
Operating revenues - water sales	$ 49,218,324	$ 45,016,591
Operating expenses	58,985,608	56,198,520
Operating loss	(9,767,284)	(11,181,929)
Nonoperating revenues	1,478,183	1,300,484
Nonoperating expenses	(2,246,105)	(3,645,490)
Loss before contributions	(10,535,206)	(13,526,935)
Contributions in aid of construction	5,031,723	8,122,713
Change in net position	(5,503,483)	(5,404,222)
Net position at beginning of fiscal year	229,432,800	234,837,022
Net position end of fiscal year	$ 223,929,317	$ 229,432,800

Financial Analysis

Capital assets, net decreased by $6.5 million, or 2.15%, during the fiscal years ended June 30, 2019 (FY2019), due primarily to an increase in accumulated depreciation of $13.3 million, offset by increases in utility plant of $3.0 million, and CIP of $3.4 million. During the fiscal year ended June 30, 2018 (FY2018), capital assets, net increased by $2.2 million, or 0.72%, due primarily to increases in utility plant of $6.7 million, construction work in progress of $5.9 million, and preliminary survey and investigations of $0.5 million, offset by an increase in accumulated depreciation of $11.2 million.

Other assets decreased by $0.3 million, or 0.53%, in FY2019, due primarily to a decrease in cash and investments of $3.2 million, offset by increases in trade receivables of $0.6 million, intergovernmental receivables of $1.9 million, and interest receivable of $0.4 million. In FY2018, other assets increased by $3.7 million, or 6.12%, due primarily to an increase in cash and cash equivalents of $3.8 million.

Deferred outflows of resources increased by $2.1 million or 21.06% in FY2019, due primarily to increases in deferred outflows of resources for pensions of $1.7 million and deferred outflows of resources for OPEB of $0.4 million. During FY2018, deferred outflows of resources decreased by $1.7 million, or 14.44%, due primarily to adoption of GASB 75 and the recording of deferred outflows of resources related to OPEB of $1.9 million, offset by a decrease in deferred outflows of resources related to pensions of $3.6 million.

Financial Analysis (Continued)

Long-term debt decreased by $3.9 million or 5.23% in FY2019, due primarily to bond and loan repayments of $5.5 million and loan forgiveness of $0.6 million, offset by loan proceeds of $2.5 million. During FY2018, long-term debt increased by $9.0 million, of 13.69%, due primarily to receipt of loan proceeds of $15.6 million, offset by bond and loan repayments of $5.1 million and bond refunding of $1.1 million.

Other liabilities increased by $4.3 million or 6.12% in FY2019, due primarily to an increase in net pension liability of $5.1 million, offset by a decrease of net OPEB liability of $0.8 million. In FY2018, other liabilities increased by $16.6 million, or 29.78%, due primarily to adoption of GASB 75 and the recording of a net OPEB liability of $17.3 million, offset by a decrease in net pension liability of $0.9 million.

Deferred inflows of resources increased by $0.4 million or 16.40% in FY2019, due primarily to a decrease in deferred inflows of resources for pensions of $0.5 million, offset by increase in deferred inflows of resources for OPEB of $0.9 million. In FY2018, deferred inflows of resources decreased by $0.4 million of 67.89%, due primarily to decrease in deferred inflows of resources related to pensions of $0.6 million offset with an increase in deferred inflows of resources related to OPEB of $0.2 million.

Total net investment in capital assets decreased by $2.6 million or 1.14% in FY2019, due primarily to a reduction net capital assets of $6.5 million, offset by a reduction in long term debt of $3.9 million.

Total net position decreased by $5.5 million, or 2.40% in FY2019, due primarily to the results of operations of ($5.5 million). In FY2018, net position decreased by $21.1 million, or 8.48%, due primarily to the results of operations of $5.4 million and a restatement for the adoption of GASB 75 of $15.7 million.

Operating revenues increased $4.2 million or 9.33% in FY2019, due primarily to a 5% rate increase and a 3.63% increase in consumption. In FY2018, operating revenues decreased by $1.5 million, or 3.17%, due primarily to a 7.89% reduction in consumption equating to $1.3 million.

Operating expenses increased by $2.8 million or 4.96% in FY2019, due primarily to an increase in purchased power of $1.6 million. In FY2018, operating expenses increased by $2.6 million, or 4.93%, due primarily to a $0.8 million power system study and $0.4 million for water hauling.

Non-operating revenues increased $0.2 million or 13.66%, in FY2019, due primarily to an increase in interest revenue of $0.2 million. In FY2018, nonoperating revenues increased by $0.2 million or 19.63%, due primarily to increased interest earned on certificates of deposit of $0.2 million.

Non-operating expenses decreased by $1.4 million or 38.39% in FY2019, due primarily to the Kapoho lava flow infrastructure losses incurred in the prior year of $1.5 million. In FY2018, non-operating expenses increased by $1.4 million, or 62.08%, due primarily by infrastructure losses incurred by lava flow destruction of $1.5 million.

Financial Analysis (Continued)

Contributions in aid of construction decreased by $3.1 million or 38.05% in FY2019, due primarily to generators valued at $0.5 million and State of Hawaii construction funding of $0.6 million received in the prior year but not in FY 2019. The variance was also attributed to a $2.5 million decrease in water system dedications. In FY2018, contributions in aid of construction decreased by $1.2 million, or 12.75%, due primarily to a $1.6 million decrease in loan forgiveness.

Capital Assets and Debt Administration

As of June 30, 2019 and 2018, the Department had $296.6 million and $303.1 million, respectively, invested in capital assets, and $70.6 million and $74.5 million, respectively, of long-term debt outstanding.

During 2019, major capital asset additions included:

- $0.4 million for the Paukaa waterline.
- $0.4 million for the HOVE well repairs.
- $0.2 million for Kahaluu booster repairs.
- $0.2 million for Kaieie Mauka well repairs.
- $0.2 million for Olaa #6 well repairs.
- $0.2 million for Hawi #2 well repairs.
- $0.2 million for Kaloko Mauka #3 booster repairs.

During 2018, major capital asset additions included:

- $3.8 million for the Laupahoehoe reservoir.
- $3.5 million for the Makalei Estates well.

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

At June 30, 2019 and 2018, the Department had outstanding $24.8 million and $27.4 million, respectively, in County of Hawai‘i general obligation bonds for public improvements and $44.3 million and $45.4 million, respectively, in State of Hawai‘i revolving fund loans.

As of June 30, 2019, 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.

Currently Known Facts, Decisions, or Conditions

Effective July 1, 2019, water rates increased by approximately 5.0%.

County of Hawai‘i
Department of Water Supply
(A component unit of the County of Hawai‘i, State of Hawai‘i)
STATEMENTS OF NET POSITION
June 30, 2019 and 2018

	2019	2018 (as restated)
ASSETS		
Current assets		
Cash and cash equivalents	$ 20,115,848	$ 28,285,759
Investments	13,000,000	5,000,000
Interest receivable	791,922	434,009
Trade receivables, less allowance for doubtful accounts $1,293,000 in 2019 and $1,304,000 in 2018	7,299,899	6,694,241
Intergovernmental receivables	2,480,348	611,460
Other receivables	266,823	278,599
Inventories of materials and supplies	1,531,481	1,498,341
Prepaid expenses and other	55,968	78,692
Total current assets	45,542,289	42,881,101
Restricted cash	888,225	888,225
Investments	17,000,000	20,000,000
Capital assets		
Utility plant in service	508,026,103	504,994,061
Less accumulated depreciation	(262,121,118)	(248,865,070)
	245,904,985	256,128,991
Land and rights	5,204,598	5,194,398
Preliminary survey and investigation charges	6,140,398	5,840,355
Construction work in progress	39,306,088	35,899,247
Net capital assets	296,556,069	303,062,991
Total assets	359,986,583	366,832,317
DEFERRED OUTFLOWS OF RESOURCES		
Deferred outflows of resources related to pensions	9,921,877	8,206,652
Deferred outflows of resources related to OPEB	2,357,012	1,936,548
Total deferred outflows of resources	12,278,889	10,143,200
Total assets and deferred outflows of resources	$ 372,265,472	$ 376,975,517

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 NET POSITION (Continued)
June 30, 2019 and 2018

	2019	2018 (as restated)
LIABILITIES		
Current liabilities		
Accounts and construction contracts payable, including retainages	$ 3,099,214	$ 3,224,460
Long-term debt, current portion	5,613,168	5,140,705
Accrued compensation	1,582,476	1,458,734
Accrued interest payable	605,077	652,468
Accrued workers' compensation	174,262	153,011
Accrued vacation, current portion	563,533	557,915
Customers' deposits, current portion	200,460	185,800
Total current liabilities	11,838,190	11,373,093
Accrued workers' compensation, noncurrent	604,738	530,989
Accrued vacation, noncurrent	1,144,142	1,132,737
Unearned revenue	1,583,953	1,583,953
Customers' deposits, noncurrent	15,686,076	15,746,635
Net pension liability	33,522,053	28,365,453
Net OPEB liability	16,431,746	17,265,728
Long-term debt, noncurrent	65,009,512	69,382,818
Total liabilities	145,820,410	145,381,406
DEFERRED INFLOWS OF RESOURCES		
Deferred inflows of resources related to pensions	1,251,594	1,831,581
Deferred inflows of resources related to OPEB	1,194,508	238,862
Unamortized gain on advanced refunding	69,643	90,868
Total deferred inflows of resources	2,515,745	2,161,311
NET POSITION		
Net investment in capital assets	226,821,614	229,427,693
Unrestricted	(2,892,297)	5,107
Total net position	223,929,317	229,432,800
Total liabilities, deferred inflows of resources and net position	$ 372,265,472	$ 376,975,517

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 CHANGES IN NET POSITION
Fiscal Years ended June 30, 2019 and 2018

	2019	2018 (as restated)
OPERATING REVENUES		
Water sales	$ 49,218,324	$ 45,016,591
OPERATING EXPENSES		
Power and pumping	20,642,928	19,067,863
Depreciation	15,274,501	15,342,548
General and administrative	11,469,496	10,120,707
Transmission and distribution	6,755,397	7,030,844
Purification	1,850,821	1,662,445
Maintenance and repairs	1,727,475	1,678,946
Customers' accounting and collecting	1,264,990	1,295,167
Total operating expenses	58,985,608	56,198,520
Operating loss	(9,767,284)	(11,181,929)
NONOPERATING REVENUES		
Interest income	824,715	611,109
Other	653,468	689,375
Total nonoperating revenues	1,478,183	1,300,484
NONOPERATING EXPENSES		
Interest expense on long-term debt	(1,714,080)	(1,758,442)
Loss on disposal of capital assets	(326,031)	(1,675,992)
Other	(205,994)	(211,056)
Total nonoperating expenses	(2,246,105)	(3,645,490)
Loss before contributions	(10,535,206)	(13,526,935)
CONTRIBUTIONS IN AID OF CONSTRUCTION	5,031,723	8,122,713
Change in net position	(5,503,483)	(5,404,222)
NET POSITION		
Beginning of year, as previously reported	--	233,195,485
Restatement adjustment	--	1,641,537
Beginning of year 2019 and as restated at beginning of year 2018	229,432,800	234,837,022
End of year	$ 223,929,317	$ 229,432,800

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 CASH FLOWS
Fiscal Years ended June 30, 2019 and 2018

	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from customers	$ 46,709,655	$ 45,498,828
Cash payments to suppliers for goods and services	(25,331,995)	(24,316,721)
Cash payments to employees for services	(15,716,422)	(14,545,170)
Net cash provided by operating activities	5,661,238	6,636,937
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Principal paid on long-term debt	(5,530,182)	(5,140,533)
Debt proceeds	2,478,870	14,455,137
Interest paid on long-term debt	(1,984,026)	(2,027,053)
Acquisition and construction of capital assets	(5,679,219)	(12,912,114)
Proceeds on sale of capital assets	13,333	--
Contributions in aid of construction	1,403,273	2,375,109
Net cash used in capital and related financing activities	(9,297,951)	(3,249,454)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investments	(10,000,000)	(5,000,000)
Proceeds from sale and maturities of investments	5,000,000	5,000,000
Interest received	466,802	375,660
Net cash provided by (used in) investing activities	(4,533,198)	375,660
Net increase (decrease) in cash and cash equivalents	(8,169,911)	3,763,143
CASH AND CASH EQUIVALENTS - BEGINNING OF FISCAL YEAR	29,173,984	25,410,841
CASH AND CASH EQUIVALENTS - END OF FISCAL YEAR	$ 21,004,073	$ 29,173,984
RECONCILIATION OF CASH AND CASH EQUIVALENTS TO THE STATEMENTS OF NET POSITION		
Unrestricted	$ 20,115,848	$ 28,285,759
Restricted	888,225	888,225
	$ 21,004,073	$ 29,173,984

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 CASH FLOWS (Continued)
Fiscal Years ended June 30, 2019 and 2018

	2019	2018
RECONCILIATION OF OPERATING LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating loss	$ (9,767,284)	$ (11,181,929)
Depreciation	15,274,501	15,342,548
Provision for doubtful accounts	172,014	275,892
Change in assets, deferred outflows of resources, liabilities and deferred inflows of resources		
Trade and other receivables	(2,634,784)	(280,988)
Inventories of materials and supplies	(33,140)	42,443
Prepaid expenses and other	22,724	128,119
Deferred outflows of resources related to pensions	(1,715,225)	3,648,695
Deferred outflows of resources related to OPEB	(420,464)	(68,760)
Accounts and construction contracts payable, including retainages	(125,246)	(414,102)
Customers' deposits	(45,899)	487,333
Other accrued liabilities	235,765	216,028
Net pension liability	5,156,600	(882,154)
Net OPEB liability	(833,982)	(304,418)
Deferred inflows of resources related to pensions	(579,988)	(610,632)
Deferred inflows of resources related to OPEB	955,646	238,862
Net cash provided by operating activities	$ 5,661,238	$ 6,636,937
SUPPLEMENTAL DISCLOSURE OF NONCASH CAPITAL AND RELATED FINANCING ACTIVITIES		
Contributions of capital assets that are recorded as contributions in aid of construction	$ 2,980,250	$ 5,646,462
Amortization of unamortized gain on advanced refunding	$ 21,224	$ 21,224
Amortization of bond premium	$ 201,331	$ 201,331
Principal forgiveness of long-term debt	$ 648,200	$ 101,142

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 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.

(4) ***Investments*** - Investments in time certificates of deposits are carried at cost, which approximates fair value.

(5) ***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.

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

(7) ***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)

(8) ***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.

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.

(9) ***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.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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, 2019 and 2018 amounted to $6,533,000 and $6,273,000, respectively.

(10) ***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/deductions from the ERS's fiduciary net position have been determined on the same basis as they are reported by the ERS. For this purpose, employer and member contributions are recognized in the period in which the contributions are legally due and benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with benefit terms. Investments are reported at fair value.

(11) ***Postemployment Benefits Other Than Pensions ("OPEB")*** - For the purposes of measuring the net OPEB liability, deferred outflows of resources and deferred inflows of resources related to OPEB, and OPEB expense, information about the fiduciary net position of the Hawaii Employer-Union Health Benefits Trust Fund ("EUTF") and additions to/deductions from EUTF's fiduciary net position have been determined on the same basis as they are reported by EUTF. For this purpose, EUTF recognizes benefit payments when due and payable in accordance with the benefit terms. Investments are reported at fair value, except for investments in commingled and money market funds, which are reported at net asset value (NAV). The NAV is based on the fair value of the underlying assets held by the respective fund less its liabilities.

(12) ***Net Position*** - Net position represents the difference between assets and deferred outflows of resources less liabilities and deferred inflows of resources. Net position is classified in the following components: net investment in capital assets and unrestricted net position. Net investment 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 net investment 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.

(13) ***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)

(14) ***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. It also includes the forgiveness of principal due on state revolving fund loans that were used to finance the costs of infrastructure needed to maintain the water system. Contributions in aid of construction are recognized when they are accepted by the Water Board and when all applicable eligibility requirements have been met.

(15) ***Deferred Amounts on Advanced Refundings*** **-** For advanced refunding resulting in defeasance of debt, the difference between the reacquisition price and the carrying amount of the old debt is deferred. This amount is amortized as a component of interest expense using the bonds outstanding method over the remaining life of the old debt or the life of the new, whichever is shorter. The amount deferred is reported as a deferred inflow or outflow of resources.

(16) ***Deferred Outflows of Resources and Deferred Inflows of Resources*** **-** Deferred outflows of resources represent a consumption of net position that applies to a future period and will not be recognized as an outflow of resources (expense) until that time. Deferred inflows of resources represent an acquisition of net position that applies to a future period and will not be recognized as an inflow of resources (revenue) until that time.

(17) ***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.

(18) ***New Accounting Pronouncements*** **-** The Government Accounting Standards Board (the "GASB") issued Statement No. 83, *Certain Asset Retirement Obligations*. This Statement addresses accounting and financial reporting for certain asset retirement obligations ("AROs"). An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. A government that has legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability based on the guidance in this Statement. The requirements of this Statement are effective for reporting periods beginning after June 15, 2018. Management has determined that this Statement does not have a material impact on the Department's financial statements.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The GASB issued Statement No. 84, *Fiduciary Activities*. This Statement establishes specific criteria for identifying activities that should be reported as fiduciary activities and clarifies whether and how business-type activities should report their fiduciary activities. The requirements of this Statement are effective for reporting periods beginning after December 15, 2018. Management has not yet determined the effect this Statement will have on the Department’s financial statements.

The GASB issued Statement No. 87, *Leases.* This Statement requires the recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources. The requirements of this Statement are effective for reporting periods beginning after December 15, 2019. Management has not yet determined the effect this Statement will have on the Department’s financial statements.

The GASB issued Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*. This Statement defines debt for purposes of disclosure in notes to financial statements and establishes additional financial statement note disclosure requirements related to debt obligations of governments, including direct borrowings (for example, a government entering into a loan agreement with a lender) and direct placements (for example, a government issuing a debt security directly to an investor). Direct borrowings and direct placements have terms negotiated directly with the investor or lender and are not offered for public sale. The requirements of this Statement are effective for reporting periods beginning after June 15, 2018. Management has adopted the applicable requirements of this new standard as presented in the Department’s financial statements.

The GASB issued Statement No. 90, *Majority Equity Interests an amendment of GASB Statements No. 14 and No. 61*. The primary objectives of this Statement are to improve the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and to improve the relevance of financial statement information for certain component units. It defines a majority equity interest and specifies that a majority equity interest in a legally separate organization should be reported as an investment if a government's holding of the equity interest meets the definition of an investment. The requirements of this Statement are effective for reporting periods beginning after December 15, 2018. Management has not yet determined the effect this Statement will have on the Department’s financial statements.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The GASB issued Statement No. 91, *Conduit Debt Obligations*. The primary objectives of this Statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in practice associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. For accounting and financial reporting purposes, a conduit debt obligation is a debt instrument issued in the name of a state or local government (the issuer) that is for the benefit of a third party primarily liable for the repayment of the debt instrument (the third-party obligor). The requirements of this Statement are effective for reporting periods beginning after December 15, 2020. 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, 2019 and 2018, the carrying amount of deposits (cash, time certificates of deposit, and money market funds) were $51,004,073 and $54,173,984, respectively, with corresponding bank balances of $52,005,269 and $55,178,034, respectively. These amounts were fully insured or collateralized with securities held by the County’s agent in the County’s name.

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. Investments in time certificates of deposits totaled $30,000,000 and $25,000,000 at June 30, 2019 and 2018, respectively.

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.

NOTE C - DEPOSITS AND INVESTMENTS (Continued)

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-term 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, 2019 and 2018:

	2019	2018
Utility plant in service		
Distribution mains and accessories	$ 143,922,145	$ 141,524,493
Structures and improvements	188,900,281	188,900,281
Electric and hydraulic pumping equipment	64,429,458	63,527,045
Services	32,012,173	31,717,257
Transmission mains and accessories	36,229,522	36,229,522
Hydrants	9,466,414	9,370,492
Meters	11,100,028	10,942,699
Purification system	9,128,460	9,128,460
Transportation equipment	3,797,998	4,839,250
Communication equipment	3,178,729	3,178,729
Office equipment and furniture	2,655,687	2,502,785
Tools and work equipment	1,594,288	1,579,546
Other equipment	1,591,333	1,533,915
Other fire protection plant	19,587	19,587
Total utility plant in service	508,026,103	504,994,061
Less accumulated depreciation	(262,121,118)	(248,865,070)
	245,904,985	256,128,991
Land and rights	5,204,598	5,194,398
Preliminary survey and investigation charges	6,140,398	5,840,355
Construction work in progress	39,306,088	35,899,247
Net capital assets	$ 296,556,069	$ 303,062,991

NOTE D - CAPITAL ASSETS (Continued)

The following is a summary of changes in capital assets during the fiscal years ended June 30, 2019 and 2018:

	Balance July 1, 2018	Additions	Retirements/ Transfers	Balance June 30, 2019
Utility plant in service	$ 504,994,061	$ 5,379,172	$ (2,347,130)	$ 508,026,103
Less accumulated depreciation	(248,865,070)	(15,274,501)	2,018,453	(262,121,118)
	256,128,991	(9,895,329)	(328,677)	245,904,985
Land and rights	5,194,398	10,200	--	5,204,598
Preliminary survey and investigation charges	5,840,355	367,426	(67,383)	6,140,398
Construction work in progress	35,899,247	6,571,496	(3,164,655)	39,306,088
	$ 303,062,991	$ (2,946,207)	$ (3,560,715)	$ 296,556,069

	Balance July 1, 2017	Additions	Retirements/ Transfers	Balance June 30, 2018
Utility plant in service	$ 498,316,252	$ 12,464,085	$ (5,786,276)	$ 504,994,061
Less: Accumulated depreciation	(237,640,279)	(15,342,548)	4,117,757	(248,865,070)
	260,675,973	(2,878,463)	(1,668,519)	256,128,991
Land and rights	4,898,583	309,165	(13,350)	5,194,398
Preliminary survey and investigation charges	5,337,002	779,072	(275,719)	5,840,355
Construction work in progress	29,979,075	12,622,172	(6,702,000)	35,899,247
	$ 300,890,633	$ 10,831,946	$ (8,659,588)	$ 303,062,991

NOTE E - LONG-TERM OBLIGATIONS

At June 30, 2019 and 2018, long-term debt consisted of the following:

	2019	2018
Public improvement refunding bonds ($13,497,500 issued), 2016 Series B, payable to the County, interest at 3% to 5%, due in semiannual installments through 2026	$ 11,257,500	$ 12,397,500
Public improvement refunding bonds ($6,353,750 issued), 2016 Series E, payable to the County, interest at 2% to 5%, due in semiannual installments through 2029	6,353,750	6,353,750
Public improvement bonds ($6,107,099 issued), 2010 Series B, payable to the County, interest at 3.33% to 6.1%, due in semiannual installments through 2030	4,730,000	5,041,250
Public improvement refunding bonds ($5,752,612 issued), 2007 Series C, payable to the County, interest at 4% to 5%, due in semiannual installments through 2021	1,250,341	1,250,341
Public improvement refunding bonds ($1,111,221 issued), 2017 Series C, payable to the County, interest at 4% to 5%, due in semiannual installments through 2019	568,653	1,111,221
Public improvement bonds ($9,585,706 issued), 2010 Series A, payable to the County, interest at 4% to 5%, due in semiannual installments through 2020	485,000	947,500
Public improvement bonds ($147,000 issued), 2008 Series A, payable to the County, interest at 4.125%, due in semiannual installments through 2043	123,915	126,914
Public improvement bonds ($259,200 issued), 2004 Series, payable to the County, interest at 4.5%, paid off in 2019	--	207,117
Total public improvement bonds	24,769,159	27,435,593
State Revolving Fund loans ($72,510,539 loaned) payable to the State of Hawaii, interest up to 1.37%, due in semiannual installments through 2038	44,326,655	45,359,733
Total long-term debt	69,095,814	72,795,326
Add: Unamortized premium	1,526,866	1,728,197
	70,622,680	74,523,523
Less: Current portion	(5,613,168)	(5,140,705)
Noncurrent portion	$ 65,009,512	$ 69,382,818

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 County's general obligation bonds are an absolute and unconditional general obligation of the County for which its full faith and credit are pledged. The principal and interest payments on the bonds are a first charge on the general fund of the County.

The Department's State Revolving Fund Loans are direct borrowings of the Department for which its full faith and credit are pledged. The State Revolving Fund Loans are secured by the gross revenues of the Department.

The following is a summary of changes in long-term debt during the fiscal years ended June 30, 2019 and 2018:

	Balance July 1, 2018	Additions	Decreases	Balance June 30, 2019	Due Within One Year
State Revolving Fund Loans	$ 45,359,733	$ 2,478,870	$ (3,511,948)	$ 44,326,655	$ 3,042,642
Public improvement refunding bonds	27,435,593	--	(2,666,434)	24,769,159	2,570,526
Total	$ 72,795,326	$ 2,478,870	$ (6,178,382)	$ 69,095,814	$ 5,613,168

	Balance July 1, 2017	Additions	Decreases	Balance June 30, 2018	Due Within One Year
State Revolving Fund loans	$ 33,756,825	$ 14,455,137	$ (2,852,229)	$ 45,359,733	$ 2,675,676
Public improvement refunding bonds	29,861,558	--	(2,425,965)	27,435,593	2,465,029
Total	$ 63,618,383	$ 14,455,137	$ (5,278,194)	$ 72,795,326	$ 5,140,705

At June 30, 2019, future principal and interest payments for long-term debt are scheduled as follows:

Year Ending June 30,	State Revolving Fund Loans Principal	State Revolving Fund Loans Interest	Public Improvement Refunding Bonds Principal	Public Improvement Refunding Bonds Interest	Total Principal	Total Interest
2020	$ 3,042,642	$ 724,168	$ 2,570,526	$ 1,095,355	$ 5,613,168	$ 1,819,523
2021	3,034,013	655,489	2,709,890	963,039	5,743,903	1,618,528
2022	3,017,700	587,030	2,848,337	824,355	5,866,037	1,411,385
2023	2,527,759	526,310	2,323,525	694,487	4,851,284	1,220,797
2024	2,555,595	481,290	2,443,671	574,107	4,999,266	1,055,397
2025 - 2029	12,742,527	1,728,632	10,488,252	1,262,923	23,230,779	2,991,555
2030 - 2034	11,383,961	768,215	1,324,151	59,224	12,708,112	827,439
2035 - 2039	6,022,458	146,246	31,090	10,080	6,053,548	156,326
2040 - 2044	--	--	29,717	3,121	29,717	3,121
	$ 44,326,655	$ 5,617,380	$ 24,769,159	$ 5,486,691	$ 69,095,814	$ 11,104,071

NOTE E - LONG-TERM OBLIGATIONS (Continued)

In July 2017, the County issued $139,895,000 in general obligation bonds which included $3,195,000 of 2017 Series C refunding general obligation bonds. The proceeds of the 2017 Series C issuance were placed in an escrow fund used to defease and advance refund the County’s 2007 Series C bonds. The Department has a 34.78% proportionate share of the 2007 Series C general obligation bond. As a result of the refunding, total debt service payments were reduced by approximately $46,200 and resulted in an economic gain of approximately $48,200. At June 30, 2019 and 2018, defeased bonds totaled $584,304 and $1,147, 740, respectively. Accordingly, the assets of the irrevocable trust and the liability of the defeased bonds are not included on the Department’s financial statements.

In prior years, the County issued the 2016 Series B and Series E refunding general obligation bonds, in which proceeds were placed in an escrow fund, to repay future debt service payments on the 2006 Series A and 2010 Series A general obligation bonds. The Department has a 50% and 25% proportionate share of the 2006 Series A and 2010 Series A general obligation bonds, respectively. As of June 30, 2019 and 2018, the Department’s proportionate share of the outstanding balance of the unpaid defeased bonds amounted to $19,110,000 and $20,407,500, respectively. Accordingly, the assets of the irrevocable trust and the liability of the defeased bonds are not included on the Department’s financial statements.

NOTE F - OTHER LONG-TERM OBLIGATIONS

The following is a summary of other long-term obligations transactions for the fiscal years ended June 30, 2019 and 2018:

	Balance July 1, 2018	Additions	Deductions and Payments	Balance June 30, 2019	Due Within One Year
Accrued workers’ compensation	$ 684,000	$ 313,516	$ (218,516)	$ 779,000	$ 174,262
Accrued vacation	1,690,652	813,635	(796,612)	1,707,675	563,533
Customers’ deposits	17,573,972	730,635	(2,418,071)	15,886,536	200,460
Total	$ 19,948,624	$ 1,857,786	$ (3,433,199)	$ 18,373,211	$ 938,255

	Balance July 1, 2017	Additions	Deductions and Payments	Balance June 30, 2018	Due Within One Year
Accrued workers' compensation	$ 583,000	$ 221,661	$ (120,661)	$ 684,000	$ 153,011
Accrued vacation	1,681,982	770,120	(761,450)	1,690,652	557,915
Customer deposits	17,086,639	861,338	(374,005)	17,573,972	185,800
Total	$ 19,351,621	$ 1,853,119	$ (1,256,116)	$ 19,948,624	$ 896,726

NOTE G - EMPLOYEE BENEFITS

Pension Plan

Plan Description - Generally, all full-time employees of the State and counties are required to be members of the ERS, a cost-sharing multiple-employer defined benefit pension plan that administers the State's pension benefits program. Benefits, eligibility, and contribution requirements are governed by HRS Chapter 88 and can be amended through legislation. The ERS issues publicly available annual financial reports that can be obtained at ERS' website: http://ers.ehawaii.gov/.

Benefits Provided - The ERS Pension Trust is comprised of three pension classes for membership purposes and considered to be a single plan for accounting purposes since all assets of the ERS may legally be used to pay the benefits of any of the ERS members or beneficiaries. The ERS provides retirement, disability and death benefits with three membership classes known as the noncontributory, contributory, and hybrid retirement classes. The three classes provide a monthly retirement allowance equal to the benefit multiplier (generally 1.25% or 2%) multiplied by the average final compensation multiplied by years of credited service. Average final compensation for members hired prior to July 1, 2012 is an average of the highest salaries during any three years of credited service, excluding any salary paid in lieu of vacation for members hired January 1, 1971 or later and the average of the highest salaries during any five years of credited service including any salary paid in lieu of vacation for members hired prior to January 1, 1971. For members hired after June 30, 2012, average final compensation is an average of the highest salaries during any five years of credited service excluding any salary paid in lieu of vacation.

Each retiree's original retirement allowance is increased on each July 1 beginning the calendar year after retirement. Retirees first hired as members prior to July 1, 2012, receive a 2.5% increase each year of their original retirement allowance without a ceiling. Retirees first hired as members after June 30, 2012, receive a 1.5% increase each year of their original retirement allowance without a ceiling. The annual increase is not compounded.

The following summarizes the provisions relevant to the largest employee groups of the respective membership class. Retirement benefits for certain groups, such as police officers, firefighters, some investigators, sewer workers, judges, and elected officials, vary from general employees.

<u>Noncontributory Class</u>

Retirement Benefits - General employees' retirement benefits are determined as 1.25% of average final compensation multiplied by the years of credited service. Employees with ten years of credited service are eligible to retire at age 62. Employees with 30 years of credited service are eligible to retire at age 55.

NOTE G - EMPLOYEE BENEFITS (Continued)

Disability Benefits - Members are eligible for service-related disability benefits regardless of length of service and receive a lifetime pension of 35% of their average final compensation. Ten years of credited service is required for ordinary disability. Ordinary disability benefits are determined in the same manner as retirement benefits but are payable immediately, without an actuarial reduction, and at a minimum of 12.5% of average final compensation.

Death Benefits - For service-connected deaths, the surviving spouse/reciprocal beneficiary receives a monthly benefit of 30% of the average final compensation until remarriage or re-entry into a new reciprocal beneficiary relationship. Additional benefits are payable to surviving dependent children up to age 18. If there is no spouse/reciprocal beneficiary or dependent children, no benefit is payable.

Ordinary death benefits are available to employees who were active at time of death with at least ten years of credited service. The surviving spouse/reciprocal beneficiary (until remarriage/re-entry into a new reciprocal beneficiary relationship) and dependent children (up to age 18) receive a benefit equal to a percentage of the member’s accrued maximum allowance unreduced for age or, if the member was eligible for retirement at the time of death, the surviving spouse/reciprocal beneficiary receives 100% Joint and Survivor lifetime pension and the dependent children receive a percentage of the member’s accrued maximum allowance unreduced for age.

Contributory Class for Members Hired prior to July 1, 2012

Retirement Benefits - General employees’ retirement benefits are determined as 2% of average final compensation multiplied by the years of credited service. General employees with five years of credited service are eligible to retire at age 55.

Police officers and firefighters’ retirement benefits are determined using the benefit multiplier of 2.5% for qualified service, up to a maximum of 80% of average final compensation. Police officers and firefighters with five years of credited service are eligible to retire at age 55. Police officers and firefighters with 25 years of credited service are eligible to retire at any age, provided the last five years is service credited in these occupations.

Disability Benefits - Members are eligible for service-related disability benefits regardless of length of service and receive a one-time payment of the member’s contributions and accrued interest plus a lifetime pension of 50% of their average final compensation. Ten years of credited service is required for ordinary disability. Ordinary disability benefits are determined as 1.75% of average final compensation multiplied by the years of credited service but are payable immediately, without an actuarial reduction, and at a minimum of 30% of average final compensation.

NOTE G - EMPLOYEE BENEFITS (Continued)

Death Benefits - For service-connected deaths, the surviving spouse/reciprocal beneficiary receives a lump-sum payment of the member's contributions and accrued interest plus a monthly benefit of 50% of the average final compensation until remarriage or re-entry into a new reciprocal beneficiary relationship. If there is no surviving spouse/reciprocal beneficiary, surviving children (up to age 18) or dependent parents are eligible for the monthly benefit. If there is no spouse/reciprocal beneficiary or dependent children/parents, the ordinary death benefit is payable to the designated beneficiary.

Ordinary death benefits are available to employees who were active at time of death with at least one year of service. Ordinary death benefits consist of a lump-sum payment of the member's contributions and accrued interest plus a percentage of the salary earned in the 12 months preceding death, or 50% Joint and Survivor lifetime pension if the member was not eligible for retirement at the time of death but was credited with at least ten years of service and designated one beneficiary, or 100% Joint and Survivor lifetime pension if the member was eligible for retirement at the time of death and designated one beneficiary.

Contributory Class for Members Hired After June 30, 2012

Retirement Benefits - General employees' retirement benefits are determined as 1.75% of average final compensation multiplied by the years of credited service. General employees with ten years of credited service are eligible to retire at age 60. Judges and elected officers' retirement benefits are determined as 3.0% of average final compensation multiplied by the years of credited service up to a maximum of 75%. Judges and elected officers with ten years of credited service are eligible to retire at age 60.

Police officers and firefighters' retirement benefits are determined using the benefit multiplier of 2.25% for qualified service, up to a maximum of 80% of average final compensation. Police officers and firefighters with ten years of credited service are eligible to retire at age 60. Police officers and firefighters with 25 years of credited service are eligible to retire at age 55, provided the last five years is service credited in these occupations.

Disability and Death Benefits - Members are eligible for service-related disability benefits regardless of length of service and receive a lifetime pension of 50% of their average final compensation plus refund of contributions and accrued interest. Ten years of credited service is required for ordinary disability. Ordinary disability benefits are 3% of average final compensation for each year of service for judges and elected officers and 1.75% of average final compensation for each year of service for police officers and firefighters and are payable immediately, without an actuarial reduction, at a minimum of 30% of average final compensation.

Death benefits for contributory members hired after June 30, 2012 are generally the same as those for contributory members hired June 30, 2012 and prior.

NOTE G - EMPLOYEE BENEFITS (Continued)

Hybrid Class for Members Hired Prior to July 1, 2012

Retirement Benefits - General employees' retirement benefits are determined as 2% of average final compensation multiplied by the years of credited service. General employees with five years of credited service are eligible to retire at age 62. General employees with 30 years of credited service are eligible to retire at age 55.

Disability Benefits - Members are eligible for service-related disability benefits regardless of length of service and receive a lifetime pension of 35% of their average final compensation plus refund of their contributions and accrued interest. Ten years of credited service is required for ordinary disability. Ordinary disability benefits are determined in the same manner as retirement benefits but are payable immediately, without an actuarial reduction, and at a minimum of 25% of average final compensation.

Death Benefits - For service-connected deaths, the designated surviving spouse/reciprocal beneficiary receives a lump-sum payment of the member's contributions and accrued interest plus a monthly benefit of 50% of the average final compensation until remarriage or re-entry into a new reciprocal beneficiary relationship. If there is no surviving spouse/reciprocal beneficiary, surviving dependent children (up to age 18) or dependent parents are eligible for the monthly benefit. If there is no spouse/reciprocal beneficiary or dependent children/parents, the ordinary death benefit is payable to the designated beneficiary.

Ordinary death benefits are available to employees who were active at time of death with at least five years of service. Ordinary death benefits consist of a lump-sum payment of the member's contributions and accrued interest plus a percentage multiplied by 150%, or 50% Joint and Survivor lifetime pension if the member was not eligible for retirement at the time of death but was credited with at least ten years of service and designated one beneficiary, or 100% Joint and Survivor lifetime pension if the member was eligible for retirement at the time of death and designated one beneficiary.

Hybrid Class for Members Hired After June 30, 2012

Retirement Benefits - General employees' retirement benefits are determined as 1.75% of average final compensation multiplied by the years of credited service. General employees with ten years of credited service are eligible to retire at age 65. Employees with 30 years of credited service are eligible to retire at age 60. Sewer workers, water safety officers, and emergency medical technicians may retire with 25 years of credited service at age 55.

NOTE G - EMPLOYEE BENEFITS (Continued)

Disability and Death Benefits - Provisions for disability and death benefits generally remain the same except for ordinary death benefits. Ordinary death benefits are available to employees who were active at time of death with at least ten years of service. Ordinary death benefits consist of a lump-sum payment of the member’s contributions and accrued interest, or 50% Joint and Survivor lifetime pension if the member was not eligible for retirement at the time of death but was credited with at least ten years of service and designated one beneficiary, or 100% Joint and Survivor lifetime pension if the member was eligible for retirement at the time of death and designated one beneficiary.

Contributions - Contributions are governed by HRS Chapter 88 and may be amended through legislation. The employer rate is set by statute based on the recommendations of the ERS actuary resulting from an experience study conducted every five years. Since July 1, 2005, the employer contribution rate is a fixed percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liabilities. The contribution rates for fiscal years 2019 and 2018 were 31.00% and 28.00%, respectively, for police officers and firefighters, and 19.00% and 18.00%, respectively. for all other employees. Contributions to the pension plan from the Department were $1,950,328 and $1,757,461 for the fiscal years ended June 30, 2019 and 2018, respectively.

On May 18, 2017, the Governor signed into law Act 17 SLH 2017. Per Act 17, future employer contributions from the State and counties are expected to increase pursuant to a phased-in contribution rate increase over four years beginning July 1, 2017. The rate for police officers and firefighters increases to 31.00% on July 1, 2018; 36.00% on July 1, 2019; and 41.00% on July 1, 2020 and the rate for all other employees’ increases to 19.00% on July 1, 2018; 22.00% on July 1, 2019; and 24.00% on July 1, 2020.

The employer is required to make all contributions for noncontributory members. Contributory members hired prior to July 1, 2012 are required to contribute 7.8% of their salary, except for police officers and firefighters who are required to contribute 12.2% of their salary. Contributory members hired after June 30, 2012 are required to contribute 9.8% of their salary, except for police officers and firefighters who are required to contribute 14.2% of their salary. Hybrid members hired prior to July 1, 2012 are required to contribute 6.0% of their salary. Hybrid members hired after June 30, 2012 are required to contribute 8.0% of their salary.

Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions - At June 30, 2019 and 2018, the Department reported a liability of $33,522,053 and $28,365,453, respectively, for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2018 and 2017, 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 a projection of the Department’s long-term share of contributions to the pension plan relative to projected contributions of all participants, actuarially determined. At June 30, 2018, the Department’s proportion was 0.25%, an increase of 0.03% from its proportion measured as of June 30, 2017. At June 30, 2017, the Department’s proportion was 0.22%, which remained unchanged from its proportion measured as of June 30, 2016.

NOTE G - EMPLOYEE BENEFITS (Continued)

For the fiscal years ended June 30, 2019 and 2018, the Department recognized pension expense of $5,162,420 and $4,033,140, respectively. At June 30, 2019 and 2018, the Department reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	June 30, 2019	
	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	$ 604,656	$ 210,052
Changes in assumptions	3,614,219	--
Net difference between projected and actual earnings on pension plan investments	--	173,185
Changes in proportion and differences between Department contributions and proportionate share of contributions	3,752,674	868,357
Department contributions subsequent to the measurement date	1,950,328	--
Total	$ 9,921,877	$ 1,251,594

	June 30, 2018	
	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	$ 454,580	$ 303,978
Changes in assumptions	4,331,298	--
Net difference between projected and actual earnings on pension plan investments	--	83,986
Changes in proportion and differences between Department contributions and proportionate share of contributions	1,663,313	1,443,617
Department contributions subsequent to the measurement date	1,757,461	--
Total	$ 8,206,652	$ 1,831,581

NOTE G - EMPLOYEE BENEFITS (Continued)

At June 30, 2019, the Department reported $1,950,328 of deferred outflows of resources related to pensions resulting from the Department's contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the fiscal year ended June 30, 2020. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions at June 30, 2019 will be recognized in pension expense as follows:

Fiscal Year Ending June 30,	Net Deferred Outflows (Inflows)
2020	$ 2,516,812
2021	1,959,638
2022	1,299,979
2023	664,488
2024	279,038
	$ 6,719,955

Actuarial Assumptions - The total pension liability in the June 30, 2018 and 2017 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

	2018	2017
Inflation	2.50%	2.50%
Investment rate of return, including inflation	7.00%	7.00%
Salary increases, including inflation		
Police and fire employees	5.00% to 7.00%	5.00% to 7.00%
General employees	3.50% to 6.50%	3.50% to 6.50%
Teachers	3.75% to 5.75%	3.75% to 5.75%

Mortality rates used in the actuarial valuation as of June 30, 2018 and 2017 were based on the following:

Active members - Multiples of the RP 2014 mortality table for active employees based on the occupation of the member.

Healthy retirees - The 2016 Public Retirees of Hawaii mortality table, generational projecting using the BB projection table from the year 2016 and with multipliers based on plan and group experience.

Disabled retirees - Base table for healthy retirees' occupation, set forward five years, generational projection using the BB projection table from the year 2016. Minimum mortality rate of 3.50% for males and 2.50% for females.

The actuarial assumptions used in the actuarial valuation as of June 30, 2018 and 2017 were based on the results of an actuarial experience study for the five-year period ended June 30, 2015.

NOTE G - EMPLOYEE BENEFITS (Continued)

The long-term expected rate of return on pension plan investments, based on ERS' investment consultant, 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 geometric real rates of return for each major asset class as of June 30, 2018 and 2017 are summarized in the following tables:

	June 30, 2018		
Strategic Allocation (Risk-Based Classes)	Target Allocation	Long-Term Expected Rate of Return	Long-Term Expected Real Rate of Return*
Broad growth	63.00%	7.10%	4.85%
Crisis risk offset	20.00%	4.60%	2.35%
Real return	10.00%	4.10%	1.85%
Principal protection	7.00%	2.50%	0.25%
	100.00%		

*Uses an expected inflation of 2.25%

	June 30, 2017		
Strategic Allocation (Risk-Based Classes)	Target Allocation	Long-Term Expected Rate of Return	Long-Term Expected Real Rate of Return*
Broad growth	63.00%	8.05%	5.80%
Crisis risk offset	20.00%	5.35%	3.10%
Real return	10.00%	5.80%	3.55%
Principal protection	7.00%	2.45%	0.20%
	100.00%		

*Uses an expected inflation of 2.25%

Discount Rate - The discount rate used to measure the net pension liability at June 30, 2019 and 2018 was 7.00%. 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 Department 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.

NOTE G - EMPLOYEE BENEFITS (Continued)

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 at June 30, 2019 and 2018 calculated using the discount rate of 7.00%, 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 one percentage point lower (6.00%) or one percentage point higher (8.00%) than the current rate:

	June 30, 2019		
	1% Decrease (6.00%)	Discount Rate (7.00%)	1% Increase (8.00%)
Department's proportionate share of the net pension liability	$ 43,590,009	$ 33,522,053	$ 25,222,572

	June 30, 2018		
	1% Decrease (6.00%)	Discount Rate (7.00%)	1% Increase (8.00%)
Department's proportionate share of the net pension liability	$ 36,758,783	$ 28,365,453	$ 21,444,724

Pension Plan Fiduciary Net Position - Detailed information about the pension plan's fiduciary net position is available in the separately issued ERS financial report. ERS' complete financial statements are available at: http://www.ers.ehawaii.gov.

Payables to the Pension Plan - At June 30, 2019 and 2018, the amount payable to the ERS were $106,258 and $146,403, respectively, which consists of statutorily required employer contributions for the month of June and an accrual for excess pension costs attributed to the fiscal year, as required by the HRS.

Postemployment Benefits Other Than Pensions (OPEB)

General Information about the OPEB Plan

Plan description. Chapter 87A of the Hawaii Revised Statutes ("HRS") established the EUTF, an agent multiple-employer defined benefit plan, which provides a single delivery system of health and other benefits for state and county workers, retirees and their eligible dependents. The EUTF issues a stand-alone financial report that is available to the public on its website at https://eutf.hawaii.gov.

Benefits provided. Chapter 87A of the HRS grants the authority to establish and amend the benefit terms to the board of trustees of the EUTF. The EUTF currently provides medical, prescription drug, dental, vision, chiropractic, supplemental medical and prescription drug, and group life insurance benefits for retirees and their dependents. The following table provides a summary of the number of employees covered by the benefits terms as of July 1, 2018 and 2017**:**

NOTE G - EMPLOYEE BENEFITS (Continued)

	2019	2018
Inactive employees or beneficiaries currently receiving benefits	98	93
Inactive employees entitle but not yet receiving benefit payments	11	10
Active employees	157	158
	266	261

Contributions. The Department's contribution levels are established by Chapter 87A of the HRS. For the fiscal years ended June 30, 2019 and 2018, the Department was required to contribute 100% and 80%, respectively, of the annual required contribution ("ARC"), as determined by an actuary retained by the board of trustees of the EUTF. The ARC represents a level of funding that is sufficient to cover, 1) the normal cost, which is the cost of the other postemployment benefits attributable to the current year of service; and 2) an amortization payment, which is a catch-up payment for past service costs to fund the unfunded actuarial accrued liability over the next thirty years. For the fiscal years ended June 30, 2019 and 2018, contributions to the OPEB Plan from the Department totaled $1,990,000 and $1,936,548, respectively, which resulted in an average contribution rate of approximately 18.38% and 18.96%, respectively, of covered-employee payroll.

For employees hired before July 1, 1996, the Department pays the entire base monthly contribution for employees retiring with 10 or more years of credited service, and 50% of the base monthly contribution for employees retiring with fewer than 10 years of credited service. A retiree can elect a family plan to cover dependents. The Department's contribution is based on the plan selected by the retiree (single, two-party, or family plans).

For employees hired after June 30, 1996, but before July 1, 2001, and who retire with fewer than 10 years of service, the Department makes no contributions. For those retiring with at least 10 years of service but fewer than 15 years of service, the Department pays 50% of the base monthly contribution. For employees retiring with at least 15 years of service but fewer than 25 years of service, the Department pays 75% of the base monthly contribution. For employees retiring with at least 25 years of service, the Department pays 100% of the base monthly contribution. The Department's contribution is based on the plan selected by the retiree (single, two-party, or family plans).

For employees hired on or after July 1, 2001, and who retire with less 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 base monthly contribution. For those retiring with at least 15 years but fewer than 25 years of service, the Department pays 75% of the base monthly contribution. For those employees retiring with at least 25 years of

NOTE G - EMPLOYEE BENEFITS (Continued)

service, the Department pays 100% of the base monthly contribution. Only single plan coverage is provided for retirees in this category. The Department's contribution is based on the single plan base monthly contribution. Retirees can elect family coverage but must pay the difference.

Net OPEB Liability

The Department's net OPEB liability as of June 30, 2019 and 2018 was measured as of July 1, 2018 and 2017, respectively, and the total OPEB liability used to calculate the net OPEB liability was determined by an actuarial valuation as of those dates.

Actuarial assumptions. The total OPEB liability in the July 1, 2018 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement, unless otherwise specified:

Inflation	2.50%
Salary increases	3.50% to 7.00% including inflation
Investment rate of return	7.00%
Healthcare cost trend rates	
PPO	Initial rates of 10.00%; declining to a rate of 4.86% after 13 years
HMO	Initial rate of 10.00%%; declining to a rate of 4.86% after 13 years
Part B & base monthly contribution	Initial rates of 4.00% and 5.00%, declining to a rate of 4.70% after 12 years
Dental	Initial rates of 5.00% for first three years; followed by 4.00%
Vision	Initial rates of 0.00% for first 3 years, followed by 2.50%
Life insurance	0.00%

NOTE G - EMPLOYEE BENEFITS (Continued)

The total OPEB liability in the July 1, 2017 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement, unless otherwise specified:

Inflation	2.50%
Salary increases	3.50% to 7.00%, including inflation
Investment rate of return	7.00%
Healthcare cost trend rates	
PPO	Initial rates of 6.60%, 6.60% and 9.00%; declining to a rate of 4.86% after 14 years
HMO	Initial rate of 9.00%; declining to a rate of 4.86% after 14 years
Part B & base monthly contribution	Initial rates of 2.00% and 5.00%, declining to a rate of 4.70% after 14 years
Dental	3.50%
Vision	2.50%
Life insurance	0.00%

Mortality rates used in the actuarial valuation as of July 1, 2018 and 2017 were based on the following:

Active members - Multiples of the RP 2014 mortality table for employees with generational projection using the BB projection table from the year 2014 based on the occupation of the member.

Healthy retirees - The 2016 Public Retirees of Hawaii mortality table, generational projection using the BB projection table from the year 2016 and with multipliers based on plan and group experience.

Disabled retirees - Base table for healthy retirees' occupation, set forward five years, generational projection using the BB projection table from the year 2016. Minimum mortality rate of 3.50% for males and 2.50% for females.

The actuarial assumptions used in the actuarial valuation as of July 1, 2018 and 2017, were based on the results of an actuarial experience study for the five-year period ended June 30, 2015 as conducted for the ERS.

NOTE G - EMPLOYEE BENEFITS (Continued)

The long-term expected rate of return on OPEB 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 OPEB 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 as of July 1, 2018 and 2017 are summarized in the following table:

	2019		2018	
Asset Class	Target Allocation	Long-Term Expected Real Rate of Return	Target Allocation	Long-Term Expected Real Rate of Return
International equity	17.00%	6.50%	19.00%	7.00%
U.S. equity	15.00%	5.05%	19.00%	5.50%
Private equity	10.00%	8.65%	10.00%	9.25%
Core real estate	10.00%	4.10%	10.00%	3.80%
Trend following	9.00%	3.00%	7.00%	1.75%
U.S. microcap	7.00%	7.00%	7.00%	7.00%
Global options	7.00%	4.50%	7.00%	5.50%
Private credit	6.00%	5.25%	0.00%	0.00%
Long treasuries	6.00%	1.90%	7.00%	1.90%
Alternative risk premium	5.00%	2.45%	0.00%	0.00%
TIPS	5.00%	0.75%	5.00%	0.50%
Core bonds	3.00%	1.30%	3.00%	0.55%
REITS	0.00%	0.00%	6.00%	5.85%
	100.00%		100.00%	

Discount rate. The discount rate used to measure the total OPEB liability at June 30, 2019 and 2018 was 7.00%. The projection of cash flows used to determine the discount rate assumed that Department contributions will be made at rates equal to the actuarially determined contribution rates. Based on those assumptions, the OPEB plan’s fiduciary net position was projected to be available to make all projected future benefit payments for current active and inactive employees. Therefore, the long-term expected rate of return on OPEB plan investments was applied to all periods of projected benefit payments to determine the total OPEB liability.

NOTE G - EMPLOYEE BENEFITS (Continued)

Changes in the Net OPEB Liability

The following schedules presents the changes in the net OPEB liability for the fiscal years ending June 30, 2019 and 2018:

	Increase (Decrease)		
	Total OPEB Liability (a)	Plan Fiduciary Net Position (b)	Net OPEB Liability (a) - (b)
Balance at June 30, 2018	$ 32,509,555	$ 15,243,827	$ 17,265,728
Changes for the fiscal year:			
Service cost	698,126	--	698,126
Interest on the total OPEB liability	2,264,524	--	2,264,524
Difference between expected and actual experience	(1,184,347)	--	(1,184,347)
Change of assumptions	432,233	--	432,233
Contributions - employer	--	1,936,548	(1,936,548)
Net investment income	--	1,111,306	(1,111,306)
Benefit payments	(1,016,548)	(1,016,548)	--
Administrative expense	--	(3,336)	3,336
Net changes	1,193,988	2,027,970	(833,982)
Balance at June 30, 2019	$ 33,703,543	$ 17,271,797	$ 16,431,746

	Increase (Decrease)		
	Total OPEB Liability (a)	Plan Fiduciary Net Position (b)	Net OPEB Liability (a) - (b)
Balance at June 30, 2017	$ 30,639,939	$ 13,069,793	$ 17,570,146
Changes for the fiscal year:			
Serivce cost	687,414	--	687,414
Interest on the total OPEB liability	2,135,490	--	2,135,490
Contributions - employer	--	1,867,788	(1,867,788)
Net investment income	--	1,245,946	(1,245,946)
Benefits payments	(953,288)	(953,288)	--
Administrative expense	--	(2,782)	2,782
Other	--	16,370	(16,370)
Net changes	1,869,616	2,174,034	(304,418)
Balance at June 30, 2018	$ 32,509,555	$ 15,243,827	$ 17,265,728

NOTE G - EMPLOYEE BENEFITS (Continued)

Sensitivity of the net OPEB Liability to changes in the discount rate. The following presents the net OPEB liability of the Department, as well as what the Department’s net OPEB liability would be if it were calculated using a discount rate that is 1-percentage point lower or 1-percentage point higher than the current discount rate:

	June 30, 2019		
	1% Decrease (6.00%)	Discount Rate (7.00%)	1% Increase (8.00%)
Net OPEB Liability	$ 21,771,815	$ 16,431,746	$ 12,191,806

	June 30, 2018		
	1% Decrease (6.00%)	Discount Rate (7.00%)	1% Increase (8.00%)
Net OPEB Liability	$ 22,400,212	$ 17,265,728	$ 13,078,475

Sensitivity of the net OPEB Liability to changes in the healthcare cost trend rates. The following presents the net OPEB liability of the Department, as well as what the Department’s net OPEB liability would be if it were calculated using healthcare cost trend rates that are 1-percentage point lower or 1-percentage point higher than the current healthcare cost trend rates:

	June 30, 2019		
	1% Decrease	Current Healthcare Cost Trend Rates	1% Increase
Net OPEB Liability	$ 11,914,743	$ 16,431,746	$ 22,247,534

	June 30, 2018		
	1% Decrease	Current Healthcare Cost Trend Rates	1% Increase
Net OPEB Liability	$ 12,783,340	$ 17,265,728	$ 22,896,636

NOTE G - EMPLOYEE BENEFITS (Continued)

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

For the fiscal years ended June 30, 2019 and 2018, the Department recognized OPEB expense of $1,691,200 and $1,802,232. At June 30, 2019 and 2018, the Department reported deferred outflows of resources and deferred inflows of resources related to OPEB from the following sources:

	June 30, 2019	
	Deferred Outflows of Resources	Deferred Inflows of Resources
Net difference between expected and actual experience	$ --	$ 1,005,637
Changes of assumptions	367,012	--
Net difference between projected and actual earnings on OBEB plan investments	--	188,871
Employer contributions subsequent to the measurement date	1,990,000	--
	$ 2,357,012	$ 1,194,508

	June 30, 2018	
	Deferred Outflows of Resources	Deferred Inflows of Resources
Net difference between projected and actual earnings on OBEB plan investments	$ --	$ 238,862
Employer contributions subsequent to the measurement date	1,936,548	--
	$ 1,936,548	$ 238,862

NOTE G - EMPLOYEE BENEFITS (Continued)

At June 30, 2019, the Department reported $1,990,000 as deferred outflows of resources related to OPEB resulting from Department contributions subsequent to the measurement date, which will be recognized as a reduction of the net OPEB liability in the fiscal year ended June 30, 2020. Other amounts reported as deferred outflows of resources and deferred inflows of resources at June 30, 2019 will be recognized in OPEB expense as follows:

Fiscal Year Ended June 30:	Net Deferred Outflows (Inflows)
2020	$ (175,635)
2021	(175,635)
2022	(175,637)
2023	(115,920)
2024	(113,489)
Thereafter	(71,180)
	$ (827,496)

Deferred Compensation Plan

The Department participates in a deferred compensation plan established by the State of Hawai‘i in accordance with Internal Revenue Code Section 457. The plan is available to all the Department employees, and permits employees to defer a portion of their salary until future years. The deferred compensation is 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 Department 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.

NOTE H - 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. Claim liabilities 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.

NOTE H - COMMITMENTS AND CONTINGENT LIABILITIES (Continued)

Construction Contracts - The Department is obligated under construction contracts for the utility plant and other projects. Such commitments totaled $43,754,063 and $14,525,161 at June 30, 2019 and 2018, respectively.

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 I - 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 $24,769,159 and $27,435,593 at June 30, 2019 and 2018, respectively. Accrued interest payable to the County totaled $460,092 and $502,685 at June 30, 2019 and 2018, respectively.

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 totaled approximately $236,000 during the fiscal years ended June 30, 2019 and 2018.

As of June 30, 2019, future minimum lease rental income was as follows:

Fiscal Year Ending June 30,	Amount
2020	$ 236,000
2021	236,000
2022	236,000
2023	236,000
2024	59,000
	$ 1,003,000

NOTE I - RELATED PARTY TRANSACTIONS (Continued)

Other - Amounts due to the County totaled approximately $198,000 and $191,000 as of June 30, 2019 and 2018, respectively, and is included in accounts payable.

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 J - PRIOR PERIOD ADJUSTMENT

The financial statements for the fiscal year ended June 30, 2018 contained an error related to capital assessment fees, which were recorded incorrectly as a liability. These balances should have been treated as an exchange-type transaction where revenues are recorded when measurable and probable of collection.

An adjustment was made to reduce non-current customer deposits and increase unrestricted net position by $1,641,537 as of June 30, 2018. Beginning net position as of July 1, 2017 was also increased by $1,641,537.

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 THE DEPARTMENT'S PROPORTIONATE SHARE OF THE NET PENSION LIABILITY
Last Ten Fiscal Years*

Measurement Period Ended	Department's Proportionate 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, 2018	0.25%	$ 33,522,053	$ 9,742,400	344.1%	55.48%
June 30, 2017	0.22%	$ 28,365,453	$ 9,358,187	303.1%	54.80%
June 30, 2016	0.22%	$ 29,247,607	$ 9,046,930	323.3%	51.28%
June 30, 2015	0.22%	$ 18,940,065	$ 9,012,196	210.2%	62.42%
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.

See accompanying notes to required supplementary information.

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, 2019	$ 1,950,328	$ 1,950,328	$ --	$ 10,318,136	18.90%
June 30, 2018	$ 1,757,461	$ 1,757,461	$ --	$ 9,742,400	18.04%
June 30, 2017	$ 1,603,278	$ 1,603,278	$ --	$ 9,358,187	17.13%
June 30, 2016	$ 1,553,128	$ 1,553,128	$ --	$ 9,046,930	17.17%
June 30, 2015	$ 1,520,994	$ 1,520,994	$ --	$ 9,012,196	16.88%
June 30, 2014	$ 1,664,580	$ 1,664,580	$ --	$ 8,272,307	20.12%
June 30, 2013	$ 1,214,933	$ 1,214,933	$ --	$ 7,640,477	15.90%
June 30, 2012	$ 1,210,106	$ 1,210,106	$ --	$ 7,849,473	15.42%
June 30, 2011	$ 1,197,031	$ 1,197,031	$ --	$ 7,726,278	15.49%
June 30, 2010	$ 1,417,853	$ 1,417,853	$ --	$ 9,076,143	15.62%

See accompanying notes to required supplementary information.

NOTE A - CHANGES OF ASSUMPTIONS

There were no changes of assumptions or other inputs that significantly affected the measurement of the total pension liability since the measurement period ended June 30, 2016.

Amounts reported in the schedule of the proportionate share of the net pension liability as of the measurement period ended June 30, 2016 (fiscal year ended June 30, 2017) were significantly impacted by the following changes of actuarial assumptions:

- The investment return assumption decreased from 7.65% to 7.00%
- Mortality assumptions were modified to assume longer life expectancies as well as to reflect continuous mortality improvement

Prior to the measurement period ended June 30, 2016 (fiscal year ended June 30, 2017), there were no other factors, including the use of different assumptions that significantly affect trends reported in these schedules.

County of Hawai‘i
Department of Water Supply
(A component unit of the County of Hawai‘i, State of Hawai‘i)
SCHEDULE OF CHANGES IN THE NET OPEB LIABILITY AND RELATED RATIOS
Last Ten Fiscal Years *

	2019	2018
Total OPEB liability		
Service cost	$ 698,126	$ 687,414
Interest on the total OPEB liability	2,264,524	2,135,490
Difference between expected and actual experience of the total OPEB liability	(1,184,347)	--
Changes of assumptions	432,233	--
Benefit payments	(1,016,548)	(953,288)
Net change in total OPEB liability	1,193,988	1,869,616
Total OPEB liability - Beginning	32,509,555	30,639,939
Total OPEB liability - Ending	$ 33,703,543	$ 32,509,555
Plan fiduciary net position		
Contributions - employer	$ 1,936,548	$ 1,867,788
Net investment income	1,111,306	1,245,946
Benefit payments	(1,016,548)	(953,288)
Administrative expense	(3,336)	(2,782)
Other	--	16,370
Net change in plan fiduciary net position	2,027,970	2,174,034
Plan fiduciary net position - Beginning	15,243,827	13,069,793
Plan fiduciary net position - Ending	$ 17,271,797	$ 15,243,827
Net OPEB liability	$ 16,431,746	$ 17,265,728
Plan fiducairy net position as a percentage of the total OPEB liability	51.25%	46.89%
Covered-employee payroll	$ 10,212,595	$ 9,791,132
Net OPEB Liability as a Percentage of Covered-employee Payroll	160.90%	176.34%

*This schedule is intended to present information for ten years for each respective fiscal year. Additional years will be built prospectively as information becomes available.

See accompanying notes to required supplementary information.

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

Fiscal Year Ended	Actuarially Determined Contribution	Contributions in Relation to the Actuarially Determined Contribution	Contribution Deficiency (Excess)	Covered-Employee Payroll	Contributions as a %age of Covered-Employee Payroll
June 30, 2019	$ 1,990,000	$ 1,990,000	$ --	$ 10,829,700	18.38%
June 30, 2018	$ 1,933,000	$ 1,936,548	$ (3,548)	$ 10,212,595	18.96%
June 30, 2017	$ 1,867,000	$ 1,867,788	$ (788)	$ 9,791,132	19.08%
June 30, 2016	$ 1,914,000	$ 1,913,204	$ 796	$ 9,464,649	20.21%
June 30, 2015	$ 1,850,000	$ 1,848,389	$ 1,611	$ 9,426,509	19.61%
June 30, 2014	$ 1,899,000	$ 1,900,758	$ (1,758)	$ 8,635,402	22.01%
June 30, 2013	$ 1,834,000	$ 1,833,733	$ 267	$ 7,966,529	23.02%
June 30, 2012	$ 2,400,000	$ 2,401,487	$ (1,487)	$ 8,182,968	29.35%
June 30, 2011	$ 2,319,000	$ 2,067,678	$ 251,322	$ 8,056,398	25.67%
June 30, 2010	$ 1,607,000	$ 1,963,719	$ (356,719)	$ 9,459,759	20.76%

See accompanying notes to required supplementary information.

NOTE A - SIGNIFICANT METHODS AND ASSUMPTIONS

The actuarially determined annual required contributions ("ARC") for the fiscal year ending June 30, 2019 was developed in the July 1, 2017 valuation. The following summarizes the significant methods and assumptions used to determine the actuarially determined contribution for the fiscal year ended June 30, 2019:

Actuarial valuation date	July 1, 2017
Actuarial cost method	Entry Age Normal
Amortization method	Level percent, closed
Equivalent single amortization period	18.9 as of June 30, 2019
Asset valuation method	Market
Inflation rate	2.50%
Investment rate of return	7.00%
Payroll growth	3.50%
Salary increases	3.50% to 7.00% including inflation
Demographic assumptions	Based on the experience study covering the five year period ending June 30, 2015 as conducted for the Hawaii Employees' Retirement System (ERS)
Mortality	System-specific mortality tables utilizing scale BB to project generational mortality improvement
Participation rates	98% healthcare participation assumption for retirees that receive 100% of the Base Monthly Contribution. Healthcare participation rates of 25%, 65%, and 90% for retirees that receive 0%, 50%, or 75% of the base monthly contribution, respectively. 100% for life insurance and 98% for Medicare Part B
Healthcare cost trend rates	
PPO	Initial rate of 6.6%, 6.6%, and 9.0%, declining to a rate of 4.86% after 14 years
HMO	Initial rate of 9.0%, declining to a rate of 4.86% after 14 years
Part B	Initial rate of 2.0% and 5%; declining to a rate of 4.7% after 14 years
Dental	3.50%
Vision	2.50%
Life Insurance	0.00%

NOTE A - SIGNIFICANT METHODS AND ASSUMPTIONS (Continued)

The following summarizes the significant methods and assumptions used to determine the actuarially determined contribution for the fiscal year ended June 30, 2018:

Actuarial valuation date	July 1, 2015
Actuarial cost method	Entry Age Normal
Amortization method	Level percent, closed
Equivalent single amortization period	19.9 as of June 30, 2018
Asset valuation method	Market
Inflation rate	3.00%
Investment rate of return	7.00%
Payroll growth	3.50%
Salary increases	4.00% to 19.00% including inflation
Demographic assumptions	Based on the experience study covering the five year period ending June 30, 2010 as conducted for the Hawaii Employees' Retirement System
Mortality	System-specific mortality tables
Participation rates	98% healthcare participation assumption for retirees that receive 100% of the Base Monthly Contribution. Healthcare participation rates of 25%, 65%, and 90% for retirees that receive 0%, 50%, or 75% of the base monthly contribution, respectively. 100% for life insurance and 98% for Medicare Part B
Healthcare cost trend rates	
PPO	Initial rate of 9%, declining to a rate of 5% after 8 8 years
HMO	Initial rate of 7%, declining to a rate of 5% after 8 years
Part B	Initial rate of 3% for the first two years, 5% thereafter
Dental	4.00%
Vision	3.00%
Life Insurance	0.00%

The actuarial valuation as of July 1, 2009, which was used to develop the ARC for fiscal year 2011 and 2012, included a reduction to the discount rate used from the prior valuation. The discount rate changed from a blended discount rate of 7% - 8% to 7%. This resulted in an overall increase to the actuarially determined OPEB liability and the ARC.

There were no other factors that significantly affected trends in the amounts reported in the schedule of changes in the net OPEB liability and related ratios or the schedule of contributions (OPEB).

N&K CPAs, Inc.
ACCOUNTANTS | CONSULTANTS

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HONOLULU, HAWAII 96813-3696
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INDEPENDENT AUDITOR'S 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*

To the Water Board
County of Hawaiʻi, Department of Water Supply

We have audited, 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, the financial statements of the County of Hawaiʻi, Department of Water Supply (Department), a component unit of the County of Hawaiʻi, State of Hawaiʻi, as of and for the fiscal year ended June 30, 2019, and the related notes to the financial statements, and have issued our report thereon dated December 20, 2019.

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 have not been 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 and responses as item 2019-001 that we consider to be a material weakness.

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 Findings

The Department's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. 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 20, 2019

2019-001 Properly Account for Capital Assessment Fees

Criteria:

Capital assessment fees were imposed to specific customers to enable additional funding for water source development in the Kona area. The capital assessment fees meet the criteria of an imposed nonexchange transaction in accordance with GASB Statement 33.

Governmental accounting standards state that entities should recognize assets from imposed nonexchange revenue transactions in the period when an enforceable legal claim to the assets arises or when the resources are received, whichever occurs first. Imposed nonexchange revenues should be recognized in the same period that assets are recognized unless the enabling legislation includes time requirements.

Condition:

Capital assessment fees collected in prior fiscal years were recorded as a liability by the Department.

During the course of our audit, we determined that in accordance with governmental accounting standards, capital assessment fees should have been recognized as revenue in prior fiscal years.

Cause:

Capital assessment fees were not accounted for in accordance with governmental accounting standards.

Effect:

An adjustment was necessary to reduce the customer’s deposits liability balance and increase unrestricted net position by $1,641,537 as of July 1, 2017.

Recommendation:

The various fees and deposits collected by the Department may carry unique restrictions which could result in differences in accounting. Management should account for capital assessment fees in accordance with governmental accounting standards.

Views of Responsible Officials and Planned Corrective Action:

The Department agrees with the finding and recommendation. See Corrective Action Plan.

CORRECTIVE ACTION PLAN

DEPARTMENT OF WATER SUPPLY • COUNTY OF HAWAI'I
345 KEKŪANAŌ'A STREET, SUITE 20 • HILO, HAWAI'I 96720
TELEPHONE (808) 961-8050 • FAX (808) 961-8657

December 20, 2019

Mr. Chad K. Funasaki, CPA, CGMA
N&K CPAs, Inc.
American Savings Bank Tower
1001 Bishop Street, Suite 1700
Honolulu, HI 96813

Dear Mr. Funasaki:

Subject: **N&K CPAs Independent Auditor's Report, Schedule of Findings and Responses, Fiscal Year Ended June 30, 2019**

N&K CPAs' Independent Auditor's Report of the Department of Water Supply (DWS) has been reviewed. The finding included in the report will be addressed in accordance with your recommendation as follows:

2019-001 Properly Account for Capital Assessment Fees

Management's Response:
The Department intends to implement the auditor's recommendation. Management will evaluate fees and deposits, including capital assessment fees, to ensure accounting is in accordance with governmental accounting standards.

We appreciate your recommendations and look forward to working with you again in the next fiscal year.

Sincerely yours,

Keith K. Okamoto, P.E.
Manager-Chief Engineer

CG:dmj

... *Water, Our Most Precious Resource . . . Ka Wai A Kāne . . .*

The Department of Water Supply is an Equal Opportunity provider and employer.

County of Hawai'i
Department of Water Supply
(A component unit of the County of Hawai'i, State of Hawai'i)
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS - STATUS REPORT
Fiscal Year Ended June 30, 2019

This section contains the current status of the prior audit recommendations. The recommendations are referenced to the pages of the previous audit report for the fiscal year ended June 30, 2018, dated December 19, 2018.

Reference Number	Recommendation	Current Status
2018-001	**Strengthen Controls Over Logical Access in the Financial Accounting Software** (pages 51 - 52)	
	Management, with oversight from the board of directors, should reevaluate the permissions granted to all employees who have access to the Department's financial accounting software to ensure that incompatible duties are appropriately segregated and that employees are only provided with access to functions that are necessary to perform their normal, assigned duties. If it is not practical to limit the access provided to certain users, management should design and implement compensating controls that have the requisite level of precision needed to mitigate the risks related to the potential lack of segregation of duties.	Accomplished.