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CABLE DIVISION
COMMERCE AND CONSUMER AFFAIRS
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July 26, 2005

Mr. Glen Chock
CATV Project Specialist
Cable Television Division
Dept. of Commerce & Consumer Affairs
P O Box 541
Honolulu, HI 96809

RE: Independent Third Party Review of the PEGS

Dear Mr. Chock:

This letter provides Na Leo's comments to the Merina Report, as requested in your letter of June 15, 2005. Na Leo is mindful of the fact that each PEG has unique requirements appropriate to its community and that the "one size fits all" approach advocated by Merina may not be the optimum way; what may be appropriate for Oahu probably is not appropriate for the neighbor islands. Recommendations with regard to the variety of plans espoused by Merina, such as needs assessments, may be appropriate for a large organization like 'Olelo, but would tie the neighbor island PEGs in knots both financially and in personnel. Keeping further in mind that "DCCA has stated they have no wish to run the PEGs, but simply ensure PEG compliance with their agreements ..", Na Leo has consulted with its Auditor in reviewing the Report and has come to the following conclusions:

Financial Reporting

Na Leo is of the opinion that a standardized Chart of Accounts, a standardized Revenue recognition and Financial Reporting System could be useful, but that the mandatory imposition by the State could be construed as an unusual degree of intrusion into the affairs of a private business. A better way might be for the PEGs to work together to develop a shared and consistent policy.

1. Na Leo 's Auditor also expressed his opinion that he considers Capital Funds and unspent Capital Funds to be Deferred Revenue rather than be labeled Permanently Restricted. He has also expressed his disagreement with Merina's assertion that Capital Funds revert back to the State if the contract is terminated.

2. As DCCA is aware, the lateness of the Audits for the period 2001-2003 were occasioned by the different accounting interpretations between Na Leo's understanding of the funds used for building the current Hilo facility and the Auditor from the Dolan & Associates firm's understanding of the use of funds. Applying their understanding of FASB, Dolan regarded funds received pursuant to franchise fee payments as a donation from the State. Under that interpretation, operational funds spent for capital assets might be considered to be improperly spent. However, recent Federal and State court cases have clarified the relationship between the PEGs and the State. Monies received by the PEGs are in payment for services rendered as per any other commercial contract rather than a donation. Therefore, Na Leo's original treatment of funds is validated as correct.

IRS forms 990 will be amended with appropriate audit adjustments. An adjusting entry will also be made on the 2004 Audit for prior year entries for the land and building purchased by Na Leo. Provision is has been made and will continue to be made for the allocation of funds among the P, E and G sectors on Form 990, although that is not being done on the monthly Financial Statements as Merina recommends. A copy of Merina's Report and their criticism of late monthly Statements has been forwarded to Na Leo's bookkeeping firm. As a result, submission of monthly Financial Statements is current.

3. Na Leo supports the recommended revenue recognition schema.

4. Na Leo's auditor is opposed to sharing management letters with the State. He considers Management letters to be private, confidential documents for company use rather than for public consumption. If DCCA intends to periodically have the PEGs independently audited, it would be appropriate to make the documents, if any, available to the Auditor at that time.

5. Na Leo and its Auditor disagree with the recommendation of requiring the PEGs to identify the source of funds used for equipment purchases. Currently, Na Leo equipment is purchased exclusively with PEG capital funds. If, in the future, PEGs were to develop non-PEG sources of funding, it would be prudent for the PEGs to internally identify equipment purchased with those funds, but non-PEG funded equipment purchases should be of no consequence to DCCA.

6. Na Leo's funds are currently spread among four different Hawaii banking institutions. It would be helpful if PEGs were allowed to diversify their funds among mainland institutions as well as Hawaii based institutions. However, Na Leo will investigate in investing in Treasury paper as opposed to Certificates of Deposit.

7. Na Leo's Auditor does not agree with the recommendation of verifying to DCCA that all audit adjustments have been made to bookkeeping records. As detailed in # 2 above, the discrepancies were occasioned by different interpretations of FASB and appropriate adjustments will be made by filing amended 990's and making entries in the bookkeeping records.

Equipment Inventory

Although Na Leo recently purchased new computers able to use the Facil database system, an inventory database of items purchased since July 1994 exists. Merina only asked for inventory from 2000 – 2003, which was provided, including all the suggested information with the exception of Asset Tag number, funding source and insurance status. The funding source for all equipment purchases has been the capital funding received from the cable operator pursuant to the franchise agreement and a Legislative grant of a few years ago to purchase some additional VCRs.

Na Leo agrees with the recommendation of affixing an asset tag number to inventory items and will implement equipment tagging with all due speed. Although insurance coverage is reviewed annually, and takes into account new and obsolete items as well as depreciation valuations, Na Leo agrees with the goal of the obsolete equipment recommendation.

Operations

Na Leo believes that it is in compliance with the requirements if HRS 414D-301. Appropriate Board actions and activities are routinely taken and are reflected in the Minutes. Na Leo further believes that it is the responsibility of the Board to assure compliance with the requirements.

Na Leo makes provision for non-discrimination and ADA compliance in its Employee Handbook and on its Employment Application forms and, as stated in the Merina report, Na Leo's facilities are in compliance with ADA requirements. As such, Na Leo is in compliance with federal and state laws.

Na Leo would like clarification on the different manuals mentioned by Merina, particularly the Accounting Manual, inasmuch as Na Leo does not do the accounting but utilizes an outside accounting firm. Na Leo does have both an Employee Manual and Policies and Procedures Manual. The Cash Disbursement Policy was revisited by the Board recently, is reflected in the Minutes, and is simple: Any expenditure over $250.00 requires two signatures. Likewise, the Reimbursement Policy is simple: no receipt, no reimbursement. Na Leo's investment policy is dictated by DCCA's contract provisions and Na Leo does not have a company credit card.

It is Na Leo's opinion that DCCA has a legitimate interest in how Na Leo's Operating Policies affect the public. It is also Na Leo's opinion that, although some of the Merina recommendations are helpful and well intentioned, that internal corporate documents, human relations issues, etc. are the responsibility of Na Leo rather than the State.

Self Sufficiency & Diversification

Na Leo's Board discussed self sufficiency, the provision of additional services and alternate/additional income streams extensively in 1999 in adopting Na Leo's self sufficiency plan. Inasmuch as it appeared that Na Leo could not generate enough revenue to pay electricity, telephone service, etc., much less pay any personnel, and would be a skeleton of its former self, Na Leo's plan consisted of the winding down of operations in 6 months time should franchise fees be eliminated or drastically reduced. That Plan has not changed.

Na Leo agrees that it may be time to again address the issue during the development of a new five year plan. Na Leo believes that in depth discussions should be initiated along with the other PEGs and DCCA about the possibilities/probabilities of diversifying PEG services and generating alternative revenues while developing into the Media Services model envisioned by Merina. At that time, it would be appropriate to set up an accounting system/account numbers to track income and expenses attributable to the diversified media revenue and expense stream.

Operational Reporting

Na Leo agrees with the recommendations regarding streamlined reporting and standardized definitions. Now that all Hawaii PEGs use the Facil program, it should be possible to develop reporting requirements that the program is capable of supplying. Na Leo suggests that DCCA and the PEGs work together to develop these standardized reports, definitions and timetables.

Na Leo does not agree with Merina's recommendation re: needs assessment. Needs assessments are prohibitively expensive for the neighbor island PEGs. The last time the neighbor islands conducted a needs assessment, DCCA provided a grant and the neighbor islands collectively decided on the firm, split the grant and decided on the parameters of the assessment. Na Leo also believes that community needs do not change as rapidly as implied by Merina and would suggest a new study be conducted on a more realistic timetable, say every five or ten years.

Complaint Reporting

Na Leo tracks complaints and their resolution, although not the time to resolve the complaint. Na Leo strives to resolve the complaint as expeditiously as possible if it is within Na Leo's power to do so. However, a few complaints are beyond Na Leo's power to resolve expeditiously. For example, Na Leo uses the I-Net to send programming to and from Hilo; frequently, the I-NET develops problems that need to be resolved by State personnel, who may not be available for some time. Obviously, any complaints regarding program availability during that time cannot be resolved until the I-NET is up and running again.

Equipment Reporting

Na Leo agrees with the recommendation to adjust the reporting date to coincide with the Annual Report.

Should you require further comments or explanations, please let me know.

Very truly yours,

Juergen Denecke
General Manager

cc: Board