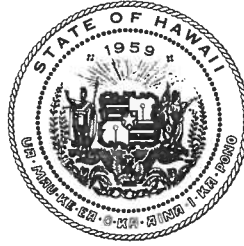


STATE OF HAWAII  
**OFFICE OF THE AUDITOR**  
465 S. King Street, Room 500  
Honolulu, Hawaii 96813-2917



**MARION M. HIGA**  
State Auditor

(808) 587-0800  
FAX: (808) 587-0830

January 5, 2010

The Honorable Colleen Hanabusa  
President of the Senate  
State Capitol, Room 409  
Honolulu, Hawaii 96813

Re: Senate Concurrent Resolution 84, 2009 Legislative Session

Dear Madam President:

This letter responds to Senate Concurrent Resolution 84 (SCR 84) of the 2009 Legislative Session, which requests the State Auditor to conduct an immediate financial statement audit of the Waters of Life Public Charter School for fiscal years 2006-07 and 2007-08.

### **Findings**

#### **The Waters of Life Public Charter School's Records Are Unauditable**

After completion of our preliminary research and discussion with the Charter School Administration Office (CSAO) and the contract auditor hired to conduct the school's FY2006 financial statement audit, James D. Jennings, CPA, Inc., we have determined that the financial statement audits requested in SCR 84 cannot be performed for the following reasons:

- James D. Jennings, CPA, Inc., issued a disclaimer of opinion for the FY2006 financial statements (which means that the firm was unable to render any opinion) and withdrew from the charter school's FY2007 and FY2008 engagements. The opinion states that the firm was not provided support and was unable to audit virtually every major account within the financial statements. Specific problems include no support for fixed assets, loans and mortgages, payroll, vacation, and other significant expenditures. A copy of the opinion is attached for reference as Attachment 1. The management letter that accompanies the disclaimer of opinion included six material weaknesses and two significant deficiencies highlighting the issues raised above. A copy of the management letter is attached for reference as Attachment 2.
- We spoke with Mr. James Jennings about the difficulties experienced when working with the Waters of Life Public Charter School and the deficiency of its records. Repeated

The Honorable Colleen Hanabusa  
January 5, 2010  
Page 2

requests by Mr. Jennings to the school principal for documents and records yielded none and email correspondence with the CSAO corroborated these difficulties. Ultimately, Mr. Jennings concluded that the school's records were unauditable.

Based on the contract auditor's conclusion that the Waters of Life Public Charter School's records are unauditable, we conclude there is little to be gained from procurement of another contractor to conduct financial statement audits of the school. Because the school's records are largely missing and cannot be recreated, any attempt to audit the school would be thwarted by a lack of information. Procurement of another auditor would not result in completed audits and would result in additional cost to the state.

### **The Need for the Audits Has Been Rendered Moot by Charter School Review Panel Action**

Further, it is our understanding that SCR 84 was supported by the Charter School Review Panel, the panel responsible by law (Section 302B-3, Hawai'i Revised Statutes) for issuing and revoking charters, approving Detailed Implementation Plan revisions, and conducting charter school evaluations. As stated in its testimony, the panel placed Waters of Life Public Charter School on probation for serious issues related to financial viability, organizational viability, and local school board governance. Independent audits were required by the terms of probation. Due to the disclaimed opinion and withdrawal of the contract auditor, the panel had been unsuccessful in finding another independent auditor willing to immediately undertake the fiscal years 2007 and 2008 audits. Hence, SCR 84 would have filled this void by requesting the State Auditor complete the financial statement audits. Even lacking these audits, however, the panel revoked the school's charter in June 2009 citing ongoing problems and deficiencies, a historical pattern of financial instability and poor fiscal management, and chronic issues with inadequate school facilities. We conclude that the panel's action rendered the audits moot.

### **The Third Circuit Court Enjoined the Charter School Review Panel From Revoking Charters Until the Board of Education Adopts Administrative Rules**

After the panel revoked the school's charter in June 2009, the school sought to enjoin the board and its panel from revocation of the school's charter. By Memorandum of Decision, Order, and Judgment filed July 31, 2009, in the Circuit Court of the Third Circuit, the court issued a permanent injunction preventing the Charter School Review Panel from revoking the school's charter absent the State of Hawai'i Board of Education's adoption of administrative rules governing revocation of the charter of a public charter school. With the court's ruling, no further action may be taken by the Charter School Review Panel to revoke the charter of a public charter school until the Board of Education adopts administrative rules. This ruling and its consequences further negate the need for the audits.

The Honorable Colleen Hanabusa  
January 5, 2010  
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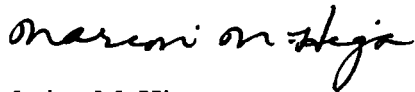
### **Conclusions and Recommendations**

Although we recognize the Legislature's concern regarding the lack of financial management of the State's funds by Waters of Life Public Charter School, we conclude that further attempts at financial statement audits of the school will not yield useful information. If anything, such attempts will spend scarce resources and may do nothing more than confirm that the school's records are unauditible.

Ultimately, the responsibility to issue and revoke charters rests with the Board of Education and its Charter School Review Panel. The Legislature should urge the board to hasten its efforts to adopt administrative rules to enable implementation of its charter school law. Thereafter, the board and its panel must hold the school accountable for the school's expenditure of state funds and the quality of the school's education.

Please do not hesitate to contact me should you have any questions.

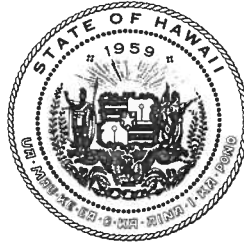
Sincerely,



Marion M. Higa  
State Auditor

c: Carol Taniguchi, Senate Clerk

STATE OF HAWAII  
**OFFICE OF THE AUDITOR**  
465 S. King Street, Room 500  
Honolulu, Hawaii 96813-2917



**MARION M. HIGA**  
State Auditor

(808) 587-0800  
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January 5, 2010

The Honorable Calvin K.Y. Say  
Speaker of the House of Representatives  
State Capitol, Room 431  
Honolulu, Hawaii 96813

Re: Senate Concurrent Resolution 84, 2009 Legislative Session

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The Honorable Calvin K.Y. Say  
January 5, 2010  
Page 2

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The Honorable Calvin K.Y. Say  
January 5, 2010  
Page 3

### **Conclusions and Recommendations**

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Please do not hesitate to contact me should you have any questions.

Sincerely,



Marion M. Higa  
State Auditor

c: Kevin Kuroda, House Sgt.-At-Arms  
Pat Mau-Shimizu, House Chief Clerk

**COPY**

**WATERS OF LIFE PUBLIC CHARTER SCHOOL**

**(A Public Charter School)**

**FINANCIAL STATEMENTS**

**For Year Ended June 30, 2006**

**And**

**INDEPENDENT AUDITOR'S REPORT**

**JAMES D. JENNINGS, CPA, INC.**  
*Certified Public Accountants*  
Honolulu, Hawaii



**WATERS OF LIFE PUBLIC CHARTER SCHOOL**  
**(A Public Charter School)**  
**(A Component Unit of the State of Hawaii)**  
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**WATERS OF LIFE PUBLIC CHARTER SCHOOL**  
(A Public Charter School)  
(A Component Unit of the State of Hawaii)

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

This section of the annual financial report of the Waters of Life Public Charter School ("Waters of Life") is designed to help the reader understand from an overview and analysis point of view of financial activities based on current known facts, decisions, and other conditions that have affected the Waters of Life during this reporting period. The report is designed to provide the reader with the understanding that it is a summary of the past years' activities and it should be reviewed together with the financial statements and accompanying notes to the financial statements.

**OVERVIEW OF THE FINANCIAL STATEMENTS**

The Fiscal Year 2006 Audit Report includes the Independent Auditor's Report, Management's Discussion and Analysis, Financial Statements with accompanying notes, Supplementary Information and Disclosures in Accordance with Government Auditing Standards.

The financial statements are prepared in accordance with the Governmental Accounting Standards Board Statements No. 34, *Basic Financial Statements - and Management Discussion and Analysis - for Public Colleges and Universities*, and No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*, and 38, *Certain Statement Note Disclosures*.

The financial statements of Waters of Life have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America, as prescribed by the Governmental accounting Standards Board (GASB). Under this basis of accounting, revenues are recognized in the period for which they are earned and expenses are recognized in the period in which they are incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenues as soon as all eligibility requirements have been met.

The Statement of Net Assets presents information on all of Waters of Life's assets and liabilities with the difference between the two reported as net assets. Assets and liabilities are reported at their book value, on the accrual basis.

All of the Fiscal Year 2006's revenues and expenses are reported. The Statement of Revenue Expenses and Change in Net Assets provides a measurement of Waters of Life's operations during 2005-2006 school year and can be used to determine whether Waters of Life has successfully recovered all its costs through fees and other charges and also to analyze sustainability and self supportiveness of its operations.

Information about Waters of Life's cash receipts and cash payments during 2005-06 period is reported. The Statement of Cash Flows reports cash receipts and cash payments resulting from operating, financing and investing activities. When read with other financial reports, related disclosures and information, the report should provide insight into (a) Waters of Life's ability to generate future net cash flows, (b) Waters of Life's ability to meet its obligations as they come due, (c) Waters of Life's needs for additional financing, (d) the reasons for differences between operating income and associated cash receipts and payments and (e) the effects on Waters of Life's financial position of both its cash and its non cash investing, capital and financing transactions during the period. The changes in cash balances are an important indicator of Waters of Life's liquidity and financial condition.

**WATERS OF LIFE PUBLIC CHARTER SCHOOL**

(A Public Charter School)

(A Component Unit of the State of Hawaii)

**MANAGEMENT'S DISCUSSION AND ANALYSIS – (Continued)**

The notes provide additional information that is essential to a full understanding of the data provided in the financial statements. This includes, but not limited to significant accounting policies, significant financial statement balances and activities, material risks, commitments and obligations and subsequent events, as applicable.

**REQUEST FOR INFORMATION**

All requests for additional information in regards to this report may be addressed to Waters of Life Public Charter School POB 1012, Kurtistown, HI 96778, 808-966-6175.



1600 Kapiolani Blvd., Suite 730  
Honolulu, Hawaii 96814  
Tel: 808-942-8813  
Fax: 808-943-0572  
Website: [www.jenningscpa.com](http://www.jenningscpa.com)

## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors  
Waters of Life Public Charter School

We were engaged to audit the accompanying statement of net assets of Waters of Life Public Charter School (a public charter school) as of June 30, 2006, and the related statements of revenue, expenses, and change in net assets and cash flows for the year then ended. These financial statements are the responsibility of the Organization's management.

A complete listing of all the Organization's fixed assets and equipment has not been maintain and the Organization has not recorded depreciation relating to these fixed assets since it was established in July 2000. Also, the Organization has not kept track on additions and disposals of fixed assets. Additionally, the Organization has not established the capitalization policy. Therefore, we were unable to satisfy ourselves about the amount at which the total fixed assets is recorded in the accompanying statement of net assets at June 30, 2006 (stated at \$532,906).

Certain supporting data and prior-year records were not available for our audit relating to accounts payable and notes payable. We were unable to satisfy ourselves about the amounts at which accounts payable and notes payable are recorded in the accompanying statement of net assets at June 30, 2006 (stated at \$111,491 and \$121,000 respectively).

The Organization was unable to provide certain supporting documents relating to payable and expenses. As such, we were unable to satisfy ourselves about the amount of credit card payable which is recorded in the accompanying statement of net assets at June 30, 2006 (stated at \$5,794) and the amounts of salaries and wages, repair and maintenance expenses, professional fees and operating supplies expenses for the year ended then (stated at \$816,337, \$28,925, \$44,098 and \$55,218 respectively).

The Organization did not record accrued payroll and accrued vacation as of June 30, 2006. We were not provided certain supporting documents, such as payroll register for employees that were being processed under the State of Hawaii, Department of Education. Additionally, the Organization was unable to provide the compensated absences policy. As such, we were unable to determine the accrued payroll and accrued vacation balances as of June 30, 2006.

The Organization did not accurately track and maintain records of financial activities on the mortgages payable relating to Ala Loop. The principal and interest payment schedule presented by the Organization showed different amounts and terms than those specified in the mortgage addendum and the promissory note. In addition, the Organization was unable to provide some cancelled checks which made us unable to confirm a payee. As such, we were unable to satisfy ourselves about the amount at which mortgages payable is recorded in the accompanying statement of net assets at June 30, 2006 (stated at \$255,000).

Because of the significance of the matters discussed in the preceding paragraphs, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements referred to in the first paragraph.

*James O Jennings CPA*

January 11, 2009

**WATERS OF LIFE PUBLIC CHARTER SCHOOL**  
**(A Public Charter School)**  
**(A Component Unit of the State of Hawaii)**  
**Statement of Net Assets**  
**June 30, 2006**

---

**ASSETS**

Current assets	
Cash and cash equivalents	\$ 68,953
Grant receivable	67,592
Accounts receivable	2,430
Deposits - Facilities	<u>4,335</u>
Total current assets	<u>143,310</u>
Noncurrent assets	
Capital assets, net (Note 3)	<u>532,906</u>
Total assets	<u>\$ 676,216</u>

**LIABILITIES AND NET ASSETS**

**LIABILITIES**

Current liabilities	
Accounts payable	\$ 117,285
Accrued payroll and payroll taxes	3,876
Mortgage payable - Ala Loop, current portion	50,000
Notes Payable - DOE Deficit, current portion	<u>40,000</u>
Total current liabilities	211,161
Noncurrent liabilities	
Notes Payable - DOE Deficit, net of current portion	81,000
Mortgages payable - Ala Loop, net of current portion	<u>205,000</u>
Total liabilities	<u>497,161</u>

---

**NET ASSETS**

Net assets	
Invested in Capital	532,906
Unrestricted	<u>(353,851)</u>
Total net assets	<u>179,055</u>
Total liabilities and net assets	<u>\$ 676,216</u>

See accompanying notes to financial statements

**WATERS OF LIFE PUBLIC CHARTER SCHOOL**  
**(A Public Charter School)**  
**(A Component Unit of the State of Hawaii)**  
**Statement of Revenue, Expenses, and Change in Net Assets**  
**Year Ended June 30, 2006**

**REVENUES**

State funding - General purpose	\$	996,274
State funding - Restricted		7,165
Federal funding - General purpose		57,832
Federal funding - Restricted		163,995
Local general purpose revenues		
Food service revenue	1,741	
Sales revenue	6,817	
Interest Income	1,299	
Total local general purpose revenues		9,857
Local restricted revenues		
Local grants	500	
School fees	655	
Donations	2,551	
Total local restricted revenues		3,706
Miscellaneous revenue		4,951
Total operating revenues		1,243,780

**EXPENSES**

Salaries and wages		816,337
Food service		92,855
General and administrative		66,391
Rent		57,839
Operating supplies		55,218
Employee benefits and payroll taxes		(2,461)
Utilities		31,583
Other operating expenses		33,041
Repairs and maintenance		28,925
Interest expense		17,965
Selling expenses		5,938
Taxes and permits		3,984
Total operating expenses		1,207,615
Change in net assets		36,165
Net assets, beginning of the year		142,890
Net assets, end of the year	\$	179,055

See notes to financial statements.

**WATERS OF LIFE PUBLIC CHARTER SCHOOL**  
**(A Public Charter School)**  
**(A Component Unit of the State of Hawaii)**  
**Statement of Cash Flows**  
**June 30, 2006**

Cash flows from operating activities:	
Federal grants	\$ 221,826
State grants	963,112
Private contributions	3,706
Other Income Collected	15,269
Payments to employees	(805,312)
Payments to suppliers	<u>(303,308)</u>
Net cash provided by operating activities	<u>95,293</u>
Cash flow used in capital and related financing activities:	
Acquisition of capital assets	(32,203)
Payment for Notes Payable	(40,000)
Payment for Mortgage Payable	<u>(50,000)</u>
Net cash used in capital and related financing activities:	<u>(122,203)</u>
Cash flows from investing activities	
Purchases of investment	-
Proceeds from sales of investments	<u>-</u>
Net cash provided by investing activities:	<u>-</u>
Net decrease in cash and cash equivalents	(26,910)
Cash and cash equivalents at beginning of year	<u>95,863</u>
Cash and cash equivalents at end of year	<u>\$ 68,953</u>
Reconciliation of operating gain to net cash used in operating activities:	
Operating income	\$ 36,165
Adjustments to reconcile change in operating income to net cash used for operating activities:	
Increase in depreciation expenses	-
Increase in Grant Receivable	(40,327)
Decrease in accounts receivable	461
Increase in deposits	(3,030)
Increase in accounts payable	93,461
Increase in accrued payroll and other employee benefits	<u>8,563</u>
Net cash provided by operating activities	<u>\$ 95,293</u>

See accompanying notes to financial statements

**WATERS OF LIFE PUBLIC CHARTER SCHOOL**  
**(A Public Charter School)**  
**(A Component Unit of the State of Hawaii)**  
**NOTES TO FINANCIAL STATEMENTS**  
**Year Ended June 30, 2006**

---

**1. Nature of Activities and Summary of Significant Accounting Policies**

**Nature of activities**

Waters of Life Public Charter School ("Waters of Life") is a public charter school which primary purpose is to provide regular and special education to children in kindergarten through grade 12 from the Puna and Hilo areas in the Big Island, Hawaii. Waters of Life was issued a charter by the Hawaii State Board of Education on July 20, 2000, and it has retained capable professionals who share the school's vision and have focused on process and results in teaching their students.

Waters of Life's vision is to lead and succeed as it cultivates global leaders and builds sustainable communities.

Waters of Life offers three standards and project based programs: Elementary School program, Secondary School program, as well as providing Special Education services to those students with special needs. Additionally, it has offered three special programs: Robotics and Underwater Remote Operated Vehicle (ROV) program, agriculture and ocean studies. In the ROV program, students work cooperatively with robotics systems to solve problems, build a robot to complete the task, then students would program their robots using Lego's iconic languages. Waters of Life students won several awards in 2006. In the agriculture program, Waters of Life students have the opportunity to work and learn on a 28 acre farm. Students learn the basics of agriculture from the ground up. During the ocean studies, students study the world of the ocean and the relationship of humans to it. Students learn about and visit salt and fresh water ecosystems and how human activities impact them.

**Summary of Significant Accounting Policies**

**Basis of accounting**

The financial statements of Waters of Life have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America, as prescribed by the Governmental Accounting Standards Board (GASB). Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenues as soon as all eligibility requirements have been met.

Waters of Life follows GASB Statement 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Government*, as their financial reporting module.

As a public charter school, Waters of Life is considered a special-purpose government under the provisions of GASB Statement 34. Waters of Life records revenue in part from program fees and other charges for services to external users and, accordingly, has chosen to present its financial statements using the reporting model for special-purpose governments engaged only in business-type activities. This model allows all financial information for Waters of Life to be reported in a single column in each of the financial statements using the accrual basis of accounting and economic resources measurement focus.



**WATERS OF LIFE PUBLIC CHARTER SCHOOL**  
**(A Public Charter School)**  
**(A Component Unit of the State of Hawaii)**  
**NOTES TO FINANCIAL STATEMENTS**  
**Year Ended June 30, 2006**

**1. Nature of Activities and Summary of Significant Accounting Policies – (Continued)**

**Classification of current and non-current assets and liabilities**

Waters of Life considers assets to be current that can reasonably be expected, as part of its normal business operations, to be converted to cash and be available for liquidation of current liabilities within 12 months of the statement of net assets date. Liabilities that reasonably can be expected, as part of normal business operations, to be liquidated within 12 months of the statement of net assets date as considered to be current. All other assets and liabilities are considered to be non-current.

**Capital assets**

Capital assets are stated at cost or estimated historical cost if purchased, or if donated, at estimated fair value at date of donation. There is no standard capitalization policy established. As such, items capitalized or expensed vary regardless of a value or a useful of assets. Capital assets are not depreciated since July 2000.

**Net assets**

Waters of Life's net assets are classified into the following net assets categories:

**Invested in capital assets:** Capital assets, net of accumulated depreciation (see note 3).

**Restricted – expendable:** Net assets subject to externally imposed conditions that can be fulfilled by the actions of Waters of Life.

**Unrestricted:** All other categories of net assets. In addition, unrestricted net assets may be designated for use by management of Waters of Life. These requirements limit the area of operations for which expenditures of net assets may be made and require that unrestricted net assets be designated to support future operations in these areas.

**Use of estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Classification of revenues and expenses**

Waters of Life considers operating revenues and expenses in the statement of revenues, expenses, and changes in net assets to be those revenues and expenses that result from exchange transactions or from other activities that are connected directly to Waters of Life's primary functions. Exchange transactions include charges for services rendered and the acquisition of goods and services.

**WATERS OF LIFE PUBLIC CHARTER SCHOOL**  
**(A Public Charter School)**  
**(A Component Unit of the State of Hawaii)**  
**NOTES TO FINANCIAL STATEMENTS**  
**Year Ended June 30, 2006**

**2. Cash and Cash Equivalents and Certificate of Deposit**

Waters of Life maintains its cash and cash equivalents in a financial institution in Hawaii. At June 30, 2006, Waters of Life has no deposits exceeded the Federal Deposit Insurance Corporation limit of \$100,000 per institution.

**3. Capital Assets**

Capital assets activity for the year ended June 30, 2006 is not available as no depreciation has been recorded since July 2000. Also, Waters of Life does not accurately track and maintain records relating to additions and disposals of capital assets.

**4. Long-term obligations**

Waters of Life accumulated a deficit that is due and owing to the Department of Education, State of Hawaii ("DOE"), of a sum of \$257,000 for the school years 2000-2001 and 2001-2002. No interest is imposed by the DOE. Waters of Life made repayment of \$96,000 in 2003, 2004 and 2005. Repayment must be completed by September 30, 2007 and obligation at June 30, 2006 is as follows:

<u>Balance</u> <u>6/30/05</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance</u> <u>6/30/06</u>	<u>Current</u> <u>Portion</u>
\$ 161,000	-	(40,000)	121,000	\$ 40,000
		<u>Payments on Notes</u>		
<u>Year</u>				
2007	\$ 40,000			
2008	81,000			
		<u>\$ 121,000</u>		

Waters of Life obtained a mortgage of Ala Loop in July 2003 which the principal loan amount of \$380,000 with the annual interest rate of 6%. Loan must be paid in full by November 1, 2008. Waters of Life is required to pay principal payment of \$25,000 plus interest on every November 1 and February 1 from 2003 to 2008. The loan obligation at June 30, 2006 is as follows:

<u>Balance</u> <u>6/30/05</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance</u> <u>6/30/06</u>	<u>Current</u> <u>Portion</u>
\$ 305,000	-	(50,000)	255,000	\$ 50,000

**WATERS OF LIFE PUBLIC CHARTER SCHOOL**  
**(A Public Charter School)**  
**(A Component Unit of the State of Hawaii)**  
**NOTES TO FINANCIAL STATEMENTS**  
**Year Ended June 30, 2006**

**4. Long-term obligations – (Continued)**

<u>Year</u>	<u>Mortgage Payment</u>
2007	\$ 50,000
2008	50,000
2009	155,000
	<u>\$ 255,000</u>

**5. Contingency**

Waters of Life is under the probation imposed by the Board of Education, State of Hawaii (“BOE”) due to the deficit owing to the DOE and is subject to certain contingency in the normal course of business. It would continue on the probation until the repayment is completed. In the event that Waters of Life fails to timely meet its obligations or incurs any further deficits, the BOE may deny the continuation of Waters of Life operations and revoke its charter.

**6. Subsequent Events**

Waters of Life completed repayment of the DOE deficits on August 6, 2007 in compliance with the settlement agreement with the BOE mentioned in note 4 and 5.

On June 12, 2008, Waters of Life was placed on probation for a term of one year, from June 16, 2008 to June 16, 2009 by the Charter School Review Panel (“Panel”). The Panel has the authority to close Waters of Life if full compliance with the items brought into question are not corrected and accounted for appropriate.

Waters of Life is in default of the mortgage payment, both principal and interest, from February 1, 2008. The principal due as of February 1, 2008 was \$180,000.



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January 11, 2009

To the Board of Directors  
Waters of Life Public Charter School  
P.O. Box 1012  
Kurtistown, HI 96760

In planning and performing our audit of the financial statement of Waters of Life Public Charter School ("the Organization") for the year ended June 30, 2006, in accordance with auditing standards generally accepted in United States of America, we considered the Organization's internal control in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies and other deficiencies that we consider to be material weaknesses.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the following deficiencies to be significant deficiencies in internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. We believe that the following deficiency constitute material weakness.

### **SIGNIFICANT DEFICIENCIES**

#### **06 - 1 Amount in the Organization Book and Invoice Do Not Match**

Observation:

During our audit, we noted that the Organization recorded repair and maintenance expense approximately \$2,200. Per review of the invoice, the amount was approximately \$1,600. Also, we requested some items relating to the beginning balance of accounts payable for 2006. We noted that the Organization recorded accounts payable approximately \$4,800 for one item as of June 30, 2005 which matched the invoice amount. Per review of cancelled check, the Organization paid \$2,000 in December 2003 which makes the account payable balance as of June 30, 2005 for this item \$2,800, not \$4,800. The Organization was unable to provide explanation and/or supporting documents if there is duplication.

**Recommendation:**

We recommend that the Organization to keep all business related documents in an organized way. Also, we recommend that the Organization to perform the monthly review for each financial line items and investigate if there is any irreconcilable transactions. The monthly financial review should be reviewed by either the Director or the Business Manager to verify accuracy.

**Management's Response:**

The Organization ("WOLPCS") has reviewed the deficiency and is receptive to implementing the recommendation to improve procedures in place (as of this writing). Our Local School Board Budget Committee, chaired by the treasurer, has begun the process of reviewing line items in a separate meeting and presenting proposals for adjustments to the greater board. The accountant and director review monthly financial reports and will incorporate the business manager into this practice.

**06 - 02 Check Number Off Do Not Match**

**Observation:**

During our audit, we noted that the Organization's book showed that check number 2955 was cut for a payment relating to operating supplies. Per review of copy of cancelled check, JJCPA noted that the actual check number was 2956. As such, one check number is off. This would be an irreconcilable item in cash accounts as there might be a cut off issue.

**Recommendation:**

We recommend that during the monthly bank reconciliation stated below, the Organization needs to review check numbers in the book and actual check numbers cut in a month match or not. Also, the Organization should verify all checks cut are in sequential and voided checks are properly reviewed and kept safe with other business related documents.

**Management's Response:**

WOLPCS has strengthened the monthly bank reconciliation process as of this writing. Both Director and accountant review the bank statements and numbers of cut checks. The storage of voided checks is managed by the business manager in a data bank. We can improve this practice by implementing the practice of having the Local School Board treasurer match the reconciliation statement against any voided checks.

**MATERIAL WEAKNESSES**

**06 - 03 Bank Reconciliations**

**Observation:**

During our audit, we noted that the beginning balance of June 2006 in the Organization's reconciliation details and First Hawaiian Bank checking account bank statement do not reconcile by \$2,000. Also, per review of the interbank transfers, JJCPA noted that \$90,000 was transferred from one bank account to another two bank accounts in July 2006. As such, this transfer should be recorded in the financial year

2007, but the Organization recorded as 2006 items. As a result, one bank account is understated by \$90,000 and another two bank accounts were overstated by \$30,000 and \$60,000 as of June 30, 2006. Per discussion with the Director, the Organization did not perform regular monthly bank reconciliations in financial years 2005 and 2006. As the bank accounts were not reconciled on a regular basis, there is a possible over or understatement in cash balances due to improper cut-off.

**Recommendation:**

We recommend that the Organization to perform bank reconciliations on the monthly basis and correct irreconcilable items on the timely basis. Also, we recommend the Director or the Business Manager to review an accountant's work and verify accuracy of monthly reconciliation.

**Management's Response:**

WOLPCS has strengthened the monthly bank reconciliation process as of this writing. Both Director and accountant review the bank statements and numbers of cut checks. The reconciliation process can be improved by having the Local School Board treasurer review the reconciliation statement after the director has reviewed and signed it.

**06 – 04 Transaction Unable to Verify**

**Observation:**

During our audit, we noted that the Organization debited Miscellaneous Expense and credited Cash by approximately \$11,000. The Organization was unable to provide supporting documents to confirm the existence and validity of this expense incurred in the financial year 2006. This would cause overstatement in expense and understatement in cash balances. Another way of this could have occurred is by not keeping up with bank reconciliations.

**Recommendation:**

We recommend that the Organization to set up the document retention policy and keep all business related documents in certain years. We also recommend the Organization to perform the monthly bank reconciliation.

**Management's Response:**

WOLPCS is receptive to the suggestion of developing a policy for retaining business documents for certain years. WOLPCS has a consistent practice of monthly bank reconciliation as of this writing.

**06 – 05 Fixed Assets**

**Observation:**

During our audit, we noted that the Organization has not kept a complete listing of all its fixed assets and equipments. A complete list of all the Organization's fixed assets would assure the safeguarding of the assets as part of the Organization's internal control.



Also, the Organization has not recorded depreciation expenses. As such, value of the fixed assets presented by the Organization are undeterminable as the Organization is unable to verify the cost of these fixed assets and equipment and no depreciation has been recorded since the Organization was established in July 2000.

In addition, the Organization has not kept track of additions and disposals of fixed assets. As the Organization receives significant grants from federal and state governments, internal control regarding assets used by the Organization becomes crucial as there is possibility that such grantors would inquire or inspect any purchases or disposals of assets acquired using the grants and/or contract monies.

Finally, JJCPA noted that the Organization has not established the capitalization policy. Because there is no threshold to distinguish items that should be capitalized or expensed, there are inconsistencies in the Organization's records. This would result in possible over and understatement in both the statement of net assets and statement of revenue, expenses and change in net assets.

**Recommendation:**

We recommend that the Organization assigns identifying labels and retain complete lists of all fixed assets, its physical location, and conduct & reconcile physical counts of all of its fixed assets and inventories regularly. Also, we recommend the Organization to determine the depreciation method and record depreciation expense and accumulated depreciation to reflect accurate fixed asset values. Additionally, we recommend that the Organization to create the capitalization policy and review its accounting records on the regular basis to ensure that the capitalization of the fixed assets are in agreement with its policy or modify their policy to better fit the needs of the Organization.

**Management's Response:**

WOLPCS is aware of this deficiency and has begun to store all assets in one physical location; these assets are to be re-inventoried, then determine a depreciation method to record depreciation expense and accumulated depreciation. The accountant and business manager have been tasked with creating a capitalization policy. WOLPCS will institute an ongoing fiscal record review to ensure capitalization of fixed assets comply with written policy.

**06 - 06 Mortgage Payable**

**Observation:**

During our audit, we noted that the Organization did not accurately track and maintain records of financial activities on the mortgage payable relating to Ala Loop. The principal and interest payment schedule presented by the Organization showed different amounts and terms than those specified in the mortgage addendum and the promissory note. In addition, the Organization was unable to provide cancelled checks which evidencing the total principal and interest payments in the financial year 2005 and 2006, amount of \$29,950 and \$67,925 respectively. As such, we could not confirm payees.

**Recommendation:**

We recommend that the Organization to recreate the payment schedule and track all financial activities made to reflect the accurate mortgage payable balance. Also, we recommend the Organization to set up the document retention policy and keep all business related documents in safe in certain years.

Management Response:

WOLPCS may request a statement of all payments by the school to the owners for the Ala Loop property to satisfy the objective of creating an accurate payment history.

**06 – 07 Unable to Provide Supporting Documents**

Observation:

During our audit, we noted that the Organization was unable to provide supporting documents for the following testings:

- Accounts Payable 2005 and 2006 – Approximately \$374,000 and \$360,000 not verified respectively
- Notes Payable 2005 and 2006 – Approximately \$30,000 and \$10,000 not verified respectively
- Credit Cards 2006 – Approximately \$2,600 not verified
- Repairs and Maintenance Expenses – Approximately \$8,600 not verified
- Professional Fees – Approximately \$31,400 not verified
- Operating Supplies Expenses – Approximately \$2,700 not verified

Note: JJCPA tested balances as of June 30, 2005 for the statement of net assets accounts as it was necessary to verify the beginning balance of the financial year 2006.

During the accounts payable testing, we noted that the Organization was unable to provide invoices and other supporting documents relating to both 2005 and 2006 accounts payable approximately \$374,000 and \$360,000 respectively. As such, JJCPA was unable to verify if the selected amounts were properly included or excluded as accounts payable as of June 30, 2006. For the notes payable testing, the Organization was unable to provide cancelled check so could not confirm payees. In addition, the Organization was unable to locate invoices and evidence of payments relating to various expense testings. As such, we could not confirm existence, accuracy and cut off.

Recommendation:

We recommended that the Organization to set up the document retention policy and keep all business related documents in vendor/customer files by fiscal year.

Management's Response:

WOLPCS is receptive to improving the document retention policy with the recommendation of safely storing vendor/customer files by fiscal year.

**06 – 08 Unable to Determine Accrued Payroll and Accrued Vacation Balances**

Observation:

During our audit, we noted that the Organization did not record accrued payroll and accrued vacation as of June 30, 2006. We did not receive adequate supporting documents, such as payroll register and documents processed by the Department of Education. Additionally, the Organization was unable to



Waters of Life Century Public Charter School

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provide us the compensated absences policy. As such, we were unable to determine the accrued payroll and accrued vacation balances as of June 30, 2006.

**Recommendation:**

We recommend the Organization to set up the standard compensated absences policy and review if the policy is followed on a regular basis. Also, we recommend the Organization to maintain payroll documents and the Director reviews accrued payroll and accrued vacation balances on a regular basis.

**Management's Response:**


WOLPCS began keeping leave documents in 7/2006. WOLPCS utilized the state payroll system during 2005-06 for a portion of the employees. Since that time payroll documents have been retained for employees paid through a private agency (this should be reflected in 2006-07 fiscal records).

\*\*\*\*\*

We have already discussed many of these comments and suggestions with various Organization personnel, and we will be pleased to discuss them with the Organization management in further detail, to perform any additional study of these matters, or to assist the management in implementing the recommendations.

The Organization's written response to the significant deficiencies and material weakness identified in our audit has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

We wish to thank the Director and staffs for their support and assistance during the audit. This communication is intended solely for the information and use of management, the Board of Directors, others within the Organization, and is not intended to be and should not be used by anyone other than these specified parties.



James D. Jennings, CPA, Inc