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# Management Audit of the Natural Energy Laboratory of Hawai'i

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A Report to the  
Governor  
and the  
Legislature of  
the State of  
Hawai'i

Report No. 12-03  
May 2012



**THE AUDITOR**  
STATE OF HAWAII

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## Office of the Auditor

The missions of the Office of the Auditor are assigned by the Hawai'i State Constitution (Article VII, Section 10). The primary mission is to conduct post audits of the transactions, accounts, programs, and performance of public agencies. A supplemental mission is to conduct such other investigations and prepare such additional reports as may be directed by the Legislature.

Under its assigned missions, the office conducts the following types of examinations:

1. Financial audits attest to the fairness of the financial statements of agencies. They examine the adequacy of the financial records and accounting and internal controls, and they determine the legality and propriety of expenditures.
2. Management audits, which are also referred to as performance audits, examine the effectiveness of programs or the efficiency of agencies or both. These audits are also called program audits, when they focus on whether programs are attaining the objectives and results expected of them, and operations audits, when they examine how well agencies are organized and managed and how efficiently they acquire and utilize resources.
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8. Fiscal accountability reports analyze expenditures by the state Department of Education in various areas.
9. Special studies respond to requests from both houses of the Legislature. The studies usually address specific problems for which the Legislature is seeking solutions.

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**"It's a diamond in  
the rough."**

— State legislator's  
description of NELHA

Recommendations

Responses

Previous Audits

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# Management Audit of the Natural Energy Laboratory of Hawai'i Authority

Report No. 12-03, May 2012

*Achievement of NELHA's purpose is clouded by transparency and accountability issues*

## Ability to prove its worth undermined by transparency and accountability issues

After nearly 40 years, NELHA has yet to achieve its potential as an ocean-related research, education, and commercial center. In the absence of clearly reported progress and while continuing to struggle with the basics of open government, NELHA has had difficulty convincing legislators, taxpayers, and potential tenants of its worth and successes.

The authority has improved its transparency and accountability since new administration took over in June 2011, but there is still work to be done. The authority was sorely lacking in mission-critical plans and policies such as a master plan, financial plan, and administrative rules; and its policies and procedures manual is seriously out of date. The authority plans to address all of these areas. However, its board suffers from high turnover and a lack of training. Although there is a policy for a formal training program for new board members, none exists in practice. In addition, the Legislature may wish to reconsider the unusual structure of the board, which includes no public members but has six ex-officio members. Tenant representatives' voting on items related to rate setting is questionable and may violate both NELHA statute and the State Ethics Code.

The authority continues to struggle with Sunshine Law requirements. Timely access to minutes is not consistent, and there are problems with both the use and documentation of executive sessions. The statutorily required Research Advisory Committee is inappropriately operating as a "permitted interaction group" in violation of the Sunshine Law, and assignment of a staff member to a board task force was questionable.

Operational issues also exist. The authority's performance reporting is woefully inadequate; its website is outdated and incomplete; lease rent rates are not uniform; the transparency of seawater pumping rates has improved but controls on calculations are lacking; and fiscal information provided to the board is unreliable.

## Making progress under new management

Despite the many issues it faces, the authority is making progress under new management. Marketing, tenant relations, and alternative revenue streams are all being addressed. Self-sufficiency has been reached on an operating level, although the authority is still reliant on state funding for capital improvement projects and will be for the foreseeable future, deferrals in rent increases impact the authority's progress towards self-sufficiency, and critical issues such as a new frontage road and its freshwater allocation must be addressed in order for the authority to move forward.

## Agency response

The authority did not take issue with our findings. The board chair assured us there is a strong desire to implement our recommendations and that doing so will be made a top priority. The chair was pleased we acknowledged the authority's recent efforts and reported that the authority has already made progress in taking action on some of our recommendations, including a training session for board members on Sunshine laws, approving a new strategic plan, completing an economic impact analysis, updating the website, and reviewing the leasing policy. The authority also plans to adopt administrative rules.

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# Management Audit of the Natural Energy Laboratory of Hawai'i Authority

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A Report to the  
Governor  
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Hawai'i

Submitted by

**THE AUDITOR**  
STATE OF HAWAI'I

Report No. 12-03  
May 2012

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## Foreword

This is a report on our management audit of the Natural Energy Laboratory of Hawai'i Authority in response to Senate Concurrent Resolution No. 96, Senate Draft 1, of the 2008 Regular Session. We conducted the audit pursuant to Section 23-4, Hawai'i Revised Statutes, which requires the Auditor to conduct postaudits of the transactions, accounts, programs, and performance of all departments, offices, and agencies of the State and its political subdivisions.

We wish to express our appreciation for the cooperation and assistance extended to us by the board of directors, executive director, and staff of the Natural Energy Laboratory of Hawai'i Authority, and by others whom we contacted during the course of the audit.

Marion M. Higa  
State Auditor

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# Chapter 1

## Introduction

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This audit of the Natural Energy Laboratory of Hawai‘i Authority (NELHA) was requested by the Legislature through Senate Concurrent Resolution No. 96, Senate Draft 1, of the 2008 Regular Session. Prompted in large part by concerns about lack of accountability in setting seawater rates, the resolution asked the Auditor to conduct a program, performance, and financial audit of NELHA that included NELHA’s general operations, including its compliance with Chapter 92, Hawai‘i Revised Statutes (known as the “Sunshine Law”); the development and implementation of comprehensive plans to secure funding from both federal and private sources to sustain fiscal viability; and NELHA’s internal budgeting and fiscal controls to ensure effective and appropriate expenditures of both legislative appropriations and federal funds.

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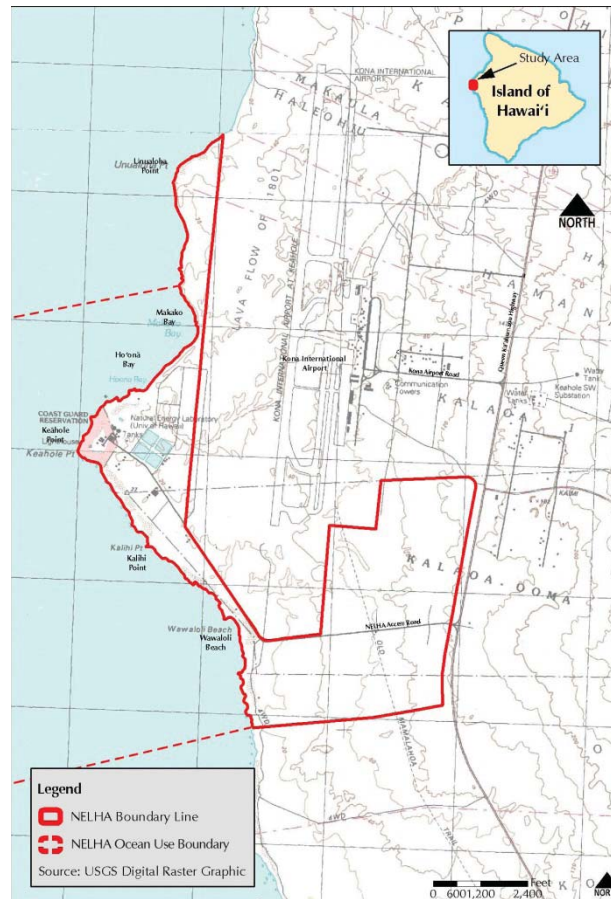
### **Background – What is NELHA?**

The Natural Energy Laboratory of Hawai‘i Authority manages an ocean science research and technology park on just over 870 acres of leased state land at Keahole Point in Kailua-Kona on the island of Hawai‘i. The authority also administers the National Defense Center of Excellence for Research in Ocean Sciences (CEROS), a program which is fully federally funded. Exhibit 1.1 shows the location of NELHA.

### ***History, mission, and funding of NELHA***

In response to the oil embargo of 1973-74 and the State’s concern about its near total dependence on fossil fuels, the 1974 Legislature established a Natural Energy Laboratory of Hawai‘i (NELH) on 322 acres of land at Keahole Point. The laboratory was created as a facility for research and development of alternative sources of renewable natural energy, in particular to provide a support facility for research on the ocean thermal energy conversion (OTEC) process of generating electricity using the temperature difference between deep and surface seawater and its related technologies. The laboratory was funded by public and private grants and had no commercial activities.

**Exhibit 1.1 Location of NELHA at Keahole Point**



Source: NELHA

By 1984 it became apparent that the seawater being pumped for OTEC research could also be used for other profitable uses, namely aquaculture and commercial purposes such as marine biotechnology, air conditioning, desalinated drinking water, chilled-soil agriculture, and alternative energy production using hydrogen, solar, oceanic, and other renewable energy resources. New legislation was passed allowing NELH to host commercial business ventures on its state property. In anticipation of growing business needs at NELH, the 1985 Legislature created the Hawai'i Ocean Science and Technology (HOST) Park on 548 acres adjacent to NELH. The park was developed by the High Technology Development Corporation (HTDC).

As the first commercial tenants began to reach profitability, NELH's revenue stream from land rents, seawater purchases, and support services



grew and fed its special fund, from which it could partially support its own operations.

In 1990 the Legislature merged the NELH and HOST Park to form the Natural Energy Laboratory of Hawai‘i Authority (NELHA) and attached it to the State’s Department of Business, Economic Development and Tourism (DBEDT) for administrative purposes. The Legislature further expanded NELHA’s role in 1993 to include economic development and in 1998 to allow other business activities that could enhance economic development and generate additional revenues to support the growing park. In 1995 NELHA’s responsibilities were again expanded when the CEROS program was transferred to it from HTDC.

By the end of the 1990s, NELHA began to benefit from its tenants’ commercial successes via percentage rents on startup businesses it had nurtured. In 2003 the first desalinated deep seawater bottling facility opened at NELHA, followed by five other water bottlers. In 2004 NELHA developed its *100% Hawai‘i Deep Seawater* logo as a trademark.

Today, NELHA provides land, infrastructure, facilities, natural resources, and services to commercial and non-commercial enterprises as part of the operation of its research and technology park.

### **Mission**

As stated in Section 227D-2, Hawai‘i Revised Statutes (HRS), the purpose of NELHA is to facilitate the research, development, and commercialization of natural energy resources and ocean-related research, technology, and industry in Hawai‘i and to engage in retail, commercial, or tourism activities that will financially support such research, development, and commercialization at a research and technology park in Hawai‘i. The authority’s duties include:

- Establishing, managing, and operating facilities that provide sites for research and development; commercial projects and businesses utilizing natural resources, such as ocean water or geothermal energy; compatible businesses engaged in scientific and technological investigations, or retail, commercial, and tourism activities; and businesses or educational facilities that support the primary projects and activities;
- Providing support, utilities, and other services to facility tenants and government agencies;

- Physically maintaining, promoting, and marketing the facilities;
- Promoting and marketing the reasonable utilization of available natural resources;
- Supporting ocean research and technology development projects that support national and state interests, use facilities and infrastructure in Hawai‘i, and foster potential commercial development; and
- Engaging in retail, commercial, and tourism activities that are not related to facilitating research, development, and commercialization of natural energy resources in Hawai‘i.

### Funding

The authority’s appropriations experienced a sharp increase between FY2008-09 and FY2009-10, largely due to a substantial increase in federal funding and therefore outside the scope of our audit. The authority’s general fund appropriations ceased in FY2009-10, and no future general funds are anticipated. Special fund appropriations have steadily increased, although these are appropriations only and do not reflect actual revenues and expenditures. Exhibit 1.2 shows NELHA’s appropriations for the period FY2008 through FY2012.

### Exhibit 1.2 NELHA Appropriations, FY2008–FY2012

|                               | <u>FY2008</u>        | <u>FY2009</u>        | <u>FY2010</u>        | <u>FY2011</u>        | <u>FY2012</u>        |
|-------------------------------|----------------------|----------------------|----------------------|----------------------|----------------------|
| <b>Operating</b>              |                      |                      |                      |                      |                      |
| General funds                 | \$ 365,000           | \$ 365,000           | \$ -                 | \$ -                 | \$ -                 |
| Special funds                 | \$ 5,387,491         | \$ 5,394,341         | \$ 6,413,710         | \$ 7,576,051         | \$ 7,672,917         |
| Other federal funds           | \$ 6,883,293         | \$ 6,883,294         | \$ 9,931,408         | \$ 9,874,464         | \$ 9,926,408         |
| <b>Subtotal</b>               | <b>\$ 12,635,784</b> | <b>\$ 12,642,635</b> | <b>\$ 16,345,118</b> | <b>\$ 17,450,515</b> | <b>\$ 17,599,325</b> |
| <b>Investment capital</b>     |                      |                      |                      |                      |                      |
| General obligation bond funds | \$ 5,250,000         | \$ 990,000           | \$ -                 | \$ -                 | \$ 3,500,000         |
| Other federal funds           | \$ -                 | \$ -                 | \$ -                 | \$ -                 | \$ -                 |
| <b>Subtotal</b>               | <b>\$ 5,250,000</b>  | <b>\$ 990,000</b>    | <b>\$ -</b>          | <b>\$ -</b>          | <b>\$ 3,500,000</b>  |
| <b>Total</b>                  | <b>\$ 17,885,784</b> | <b>\$ 13,632,635</b> | <b>\$ 16,345,118</b> | <b>\$ 17,450,515</b> | <b>\$ 20,099,325</b> |

Note: The \$3.5M CIP funding in FY2012 was for “Construction for mooring system of 40-inch seawater pipelines upgrade.”

Source: Office of the Auditor

## **What NELHA does and oversees**

In addition to the duties outlined above, NELHA has broad statutory powers to engage in more than 25 other activities.

### **Research incubator, economic development driver, and landlord**

Many of NELHA's powers relate to attracting and managing other revenue streams, acting as a research hub, promoting natural energy, and fostering economic development. Specific powers and duties include the ability to:

- Sell electricity generated by NELHA using renewable energy sources in facilities located at NELHA (known as *wheeling*, this is discussed in greater detail later in the report);
- Support ocean research and technology development projects that support national and state interests, use facilities and infrastructure in Hawai'i, and foster potential commercial development;
- Promote geothermal energy and natural resources sites;
- Impose and collect fees for use of the property and facilities and make contracts, including for concessions for cellular telephone relay towers;
- Create an environment that supports natural resource utilization and results in economic development, including supporting research projects and facilitating transition to pilot and then full commercial operation; develop educational and conservation programs; support commercialization of the natural resources at the research and technology park; identify issues and impediments to the development of natural resource utilization; and provide policy analysis and information important to development of natural resource utilization in Hawai'i; and
- Develop programs that support projects and companies at the research and technology park; and attract appropriate new uses of the natural resources, including retail, commercial, and tourism activities.

According to its 2011 budget testimony to the Legislature, NELHA's activities, in priority order, are to:

- Operate and maintain transmission and distribution systems for large volumes (approximately two tons per second) of deep and

surface seawater. Both warm (surface) and cold (deep) seawater are constantly pumped ashore for use in aquaculture, marine biotechnology, manufacturing of potable water (desalinated bottled water), and other technologies;

- Develop and lead the implementation of new alternative energy methods for the state's benefit;
- Identify, develop, and implement revenue enhancement opportunities that support NELHA's objectives and its efforts to maintain financial self-sufficiency and sustainability;
- Operate a water quality laboratory for an environmental monitoring program that samples groundwater, near shore water, and offshore water;
- Provide informational and educational material and lectures to school classes (K-12 and university level), professional associations, community groups, visitors, legislators, and the general public; and
- Coordinate administration and budgets with CEROS.

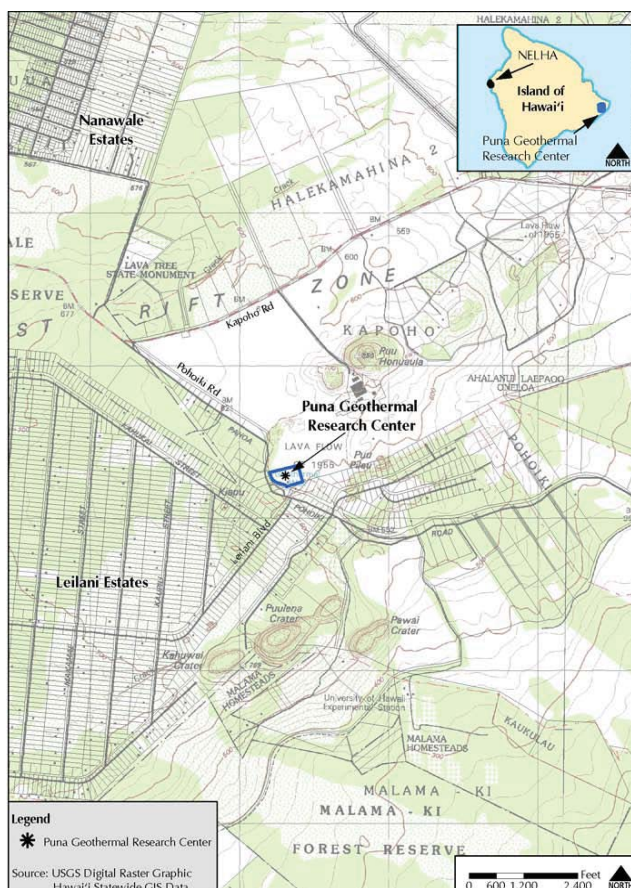
On an operational level, NELHA attracts tenants and promotes the facility; negotiates and manages land and facility leases; operates and maintains the warm and deep seawater distribution system; sets and collects charges for seawater pumping; and conducts environmental monitoring.

### **NELHA also oversees the Puna geothermal site**

In addition to approximately 870 acres at Keahole Point, NELHA also oversees four acres of a geothermal site at Puna, on the Hilo (east) side of

the island of Hawai‘i. The site is currently subleased to a company that generates electricity using underground heat from the site. Exhibit 1.3 shows the geothermal site at Puna.

### Exhibit 1.3 Puna Geothermal Site



Source: NELHA

### Ancillary responsibilities

Part of NELHA's lands are subject to the conditions of a Special Management Area (SMA) permit from the County of Hawai‘i. The permit requires that NELHA maintain access to facilities and parking for the Wawaloli Beach Park on its grounds. The beach park is popular with locals—a NELHA staff estimates that several hundred people visit the park daily each weekend—and includes restrooms and parking facilities. The beach park is mainly used for fishing, diving, and tide pool swimming. Camping is not permitted.

Historic sites are also present throughout NELHA's property. The authority's archaeological/historic preservation and interpretive management plan addresses the preservation and care of the Ho‘ona

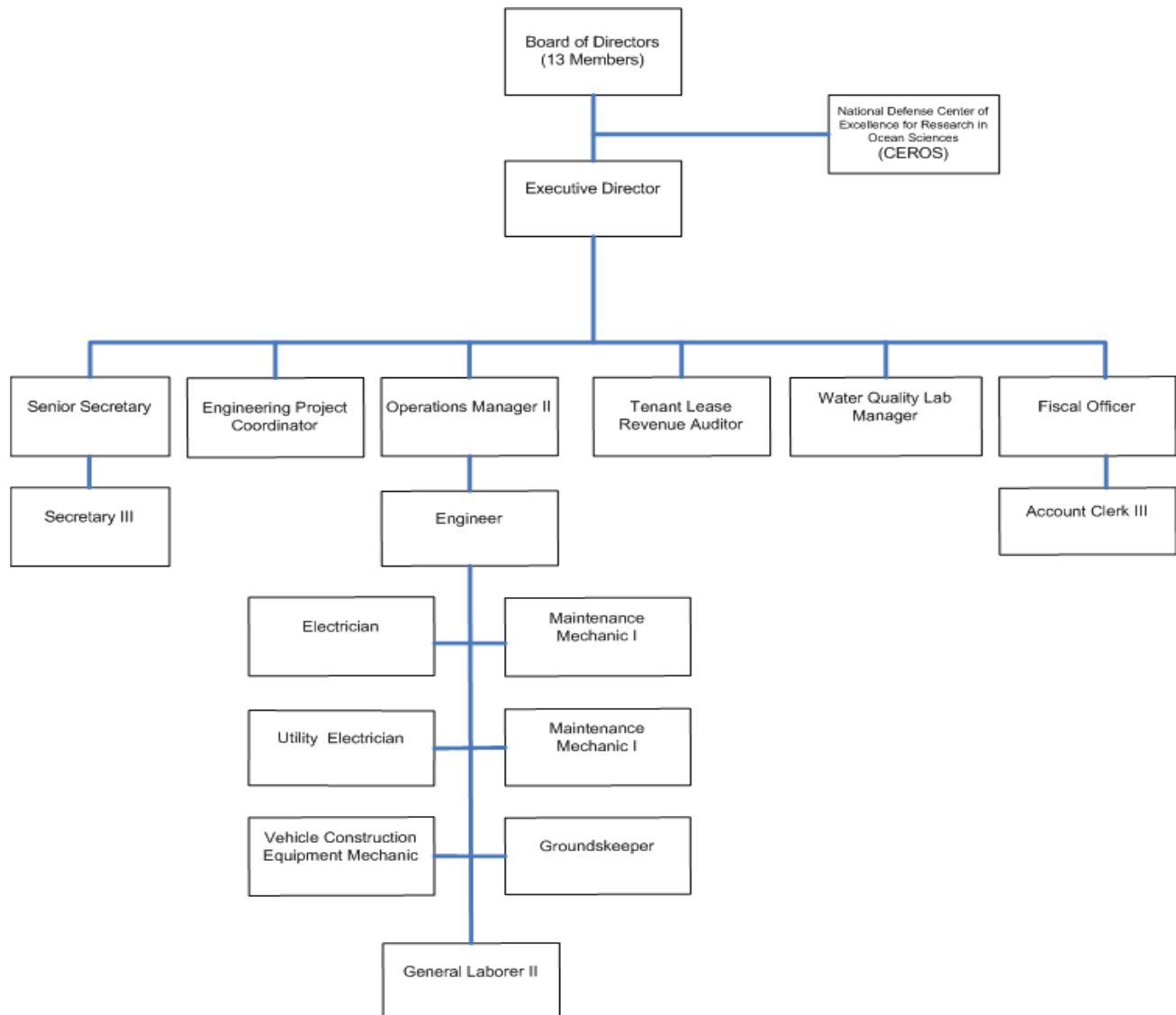
Archaeology Preserve area at the northern end of the property and another archaeology preserve at the ‘O‘oma (southern) end of the property.

The authority also issues up to eight permits per day for overnight fishing in a designated area of its beachfront. The permits are free and provided on a first-come, first-served basis from the NELHA administrative office.

## ***Organization***

The authority is administratively attached to the Department of Business, Economic Development and Tourism (DBEDT). It is comprised of a 13-member board of directors, an executive director with two support staff, an operations manager and eight staff, an engineering project coordinator, a tenant lease revenue auditor, a water quality lab manager, a fiscal officer, and an account clerk. As of November 2011 the authority had 17 employees, all of whom are exempt from civil service.

The National Defense Center of Excellence for Research in Ocean Sciences is in turn administratively attached to NELHA, as discussed below. Exhibit 1.4 shows the authority’s organizational structure.

**Exhibit 1.4 NELHA Organizational Chart**

Source: NELHA

The board is responsible for establishing policies pertaining to NELHA operations and growth, maintaining NELHA property and facilities, reviewing and approving proposals from prospective and existing tenants, and planning and coordinating the development of the NELHA site. The board also appoints the executive director.

The board has two standing committees: a Finance Committee, which has regularly scheduled meetings, and a statutorily required Research Advisory Committee (RAC), which conducts its business on an as-

needed basis. The latter provides expert and specialized counsel and advice on matters relating to scientific research. Two members of the RAC also serve as members of the full NELHA board.

## **CEROS**

The National Defense Center of Excellence for Research in Ocean Sciences is administratively attached to NELHA and is entirely federally funded. The program was created in 1993 to advance innovative concepts and new approaches to technology while leveraging existing facilities and infrastructure in Hawai'i and demonstrating beneficial commercial utility for the U.S. Department of Defense. Since its inception, CEROS has supported 238 projects through federal funding, based on annual competitive solicitations, worth over \$91.6 million. As CEROS does not receive any state funds, it was not included in this audit.

## **Prior audits**

This is the first audit of NELHA specifically. The authority's unaudited financials are included in DBEDT's annual financial statements. None of those statements for the period 2005 through 2009 (the latest available) note any internal control weaknesses related to NELHA.

In our 1992 *Review of Special and Revolving Funds of the Housing Finance and Development Corporation and the Department of Business, Economic Development and Tourism* (Report No. 92-3), we found that NELHA's special fund had not demonstrated a capacity to sustain itself. We recommended the fund be repealed and DBEDT budget NELHA's program expenses through the general fund. In response, the Legislature repealed NELHA's special fund through Act 180, Session Laws of Hawai'i (SLH) 1993. The authority fought the repeal by testifying that it needed its special fund, through which it intended to fully support itself in future. Self-sufficiency is an issue discussed later in this report. The Legislature reinstated NELHA's special fund through Act 179, SLH 1994.



## Objectives of the Audit

1. Assess how adequately NELHA has achieved its mission and objectives.
2. Assess whether NELHA is managed effectively and efficiently.
3. Make recommendations as appropriate.

## Scope and Methodology

Our audit focused on NELHA's management practices and controls as well as its compliance with state and federal laws, rules, and regulations. Our review covered the period since 1990—when NELH and the HOST Park were merged into NELHA—with an emphasis on recent operations and expenditures over the past five fiscal years. Audit work was performed from July 2008 to January 2009 and July 2011 to December 2011.

We interviewed board members, managers, and staff of NELHA. We examined applicable laws and statutes; strategic, master, and operating plans; policies and procedures; reports, studies, and contracts; board and committee meeting minutes; and other relevant documents and records. We interviewed relevant individuals and examined pertinent documents of other agencies and the private sector. We did not include the CEROS program in our audit because it is entirely federally funded. We did not perform a financial audit of NELHA as it is included in the annual financial statements of DBEDT.

We also examined the authority's 2003 agreement with the Hawaiian Electric Light Company (HELCO) regarding photovoltaic (PV) panels atop NELHA's Gateway Center, an issue which was referred to in the resolution requesting this audit. The agreement garnered much media attention because NELHA rented the center's roof space to HELCO—for 30 years, for free—and receives no compensating reduction in its electric bill in exchange. We interviewed NELHA's then-deputy attorney general, who told us his role in approving the contract as to form did not extend to advising NELHA on its business decision to enter into such a contract. We also found that, contrary to reports claiming the center's annual electricity costs were as much as \$31,000 per year, NELHA pays between \$8,500 and \$11,400 annually for the center's electricity, which represents 1 percent or less of NELHA's total annual electricity costs. The lease with HELCO expires on November 1, 2033, at which point NELHA is free to renegotiate a more advantageous agreement.

Our audit was conducted according to the Office of the Auditor's *Manual of Guides* and generally accepted government auditing standards (GAGAS). Those standards require that we plan and perform audits

to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence we obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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# Chapter 2

## Achievement of NELHA's Purpose Is Clouded by Transparency and Accountability Issues

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First conceived as an international institute dedicated to the study and development of natural energy, a natural energy laboratory of Hawai'i is a dream that dates back to 1974. By 1978, funds were released to provide for development of the site and facilities at Kona. The following year the Natural Energy Laboratory of Hawai'i (NELH) was established in statute and charged with managing and operating an outdoor research facility to provide for research, development, and demonstration of natural energy resources and other compatible scientific and technological investigations.

Eleven years later, in 1990, the Natural Energy Laboratory of Hawai'i Authority (NELHA) was formed, although its purpose—to facilitate research, development, and commercialization of natural energy resources in Hawai'i—was not legislated until three years later. In 1997 NELHA's purpose was amended to include engaging in ocean-related research, technology, and industry as well as one retail concession activity and one tour-related activity; two years later, it was again expanded to include retail, commercial, and tourism activities generally.

A push towards “greater self-reliance” came from Governor Benjamin Cayetano in 1995 and a mandate to become “self-sufficient” from Governor Linda Lingle in 2003. Since then additional legislative amendments have been made to give NELHA the tools it needs to achieve this purpose. In 2009 the authority was given the power to *wheel* electricity (discussed later in this report). In 2010 it was authorized to acquire, hold, and sell qualified securities subject to certain conditions; to accept donations of money, property, and services; and to enter into concessions for cellular telephone towers (also discussed later in this report).

As noted in its 2011 master plan, financial self-sufficiency is an extremely difficult goal for any research and development institution, and NELHA has struggled with it for many years. In the last two years, NELHA has approached an operational breakeven point using primarily only sales of ocean water and lease rents as revenue sources. The new master plan proposes additional programs, concepts, and potential revenue sources to make self-sufficiency a more routinely achieved goal. The plan also suggests options for future development and sources of revenue and encourages partnerships with other organizations to leverage

resources. Key ideas include roles as a master developer, expanded utility and institutional/anchor partners. Carbon trading, stewardship agreements, and Angels of Kona Venture Capital formation are also suggested.

Nearly four decades after its creation, the State's natural energy laboratory has yet to live up to its creators' vision. According to its website, NELHA's mission is to "develop and diversify the Hawai'i economy by providing resources and facilities for energy and ocean-related research, education, and commercial activities in an environmentally sound and culturally sensitive manner," and it defines itself as a "research support facility turned business incubator." With so many shifts in purpose and focus, the agency has struggled to clearly articulate its mission and objectives, let alone achieve them.

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## Summary of Findings

1. The Natural Energy Laboratory of Hawai'i Authority's ability to prove its worth is undermined by transparency and accountability issues.
2. The authority is making progress under new management.

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## NELHA's Ability To Prove Its Worth Is Undermined by Transparency and Accountability Issues

We found that the authority has improved its transparency and accountability lately, particularly since its new administration took over management in June 2011, but there is still work to be done. The authority was sorely lacking in mission-critical plans and policies such as a master plan, financial plan, and administrative rules; and its policies and procedures manual is seriously out of date. The authority plans to address all of these areas. We also found that the authority's board suffers from high turnover and a lack of training. Although there is a policy for a formal training program for new board members, none exists in practice. The Legislature may wish to reconsider the unusual structure of the board, which includes no public members but has six ex-officio members. Tenant representatives' voting on items related to rate setting is questionable and may violate both NELHA statute and the State Ethics Code.

The authority also continues to struggle with Sunshine Law requirements. Timely access to minutes is not consistent, and there are problems with both the use and documentation of executive sessions. The statutorily required Research Advisory Committee is inappropriately operating as a "permitted interaction group" in violation of the Sunshine Law, and assignment of a staff member to a board task force was questionable.

A number of operational issues also exist. The authority's performance reporting is woefully inadequate; its website is outdated and incomplete; lease rent rates are not uniform; the transparency of seawater pumping rates has improved, but controls on calculations are lacking; and internal fiscal controls are needed.

***Authority was sorely lacking in mission-critical plans and policies, but this is changing***

Plans support an institution's guiding principles as expressed in its mission, vision, and values. Plans also represent a snapshot at a point in time, as budgets, priorities, resources, and environments may change. To accommodate this, plans must change; the planning process should be repeated at least annually and adjustments made as needed. We found that the authority's plans and strategies have been seriously outdated, but it now intends to update most of these mission-critical plans and policies.

For example, NELH had a master plan from 1976, and the HOST Park had a master plan from 1989 (the two were merged into NELHA in 1990); a new master plan for NELHA was finally delivered in mid-2011. In addition, prior to June 2011 and the advent of a new executive director, the authority did not have a financial plan; as of November 2011 the authority was still working to complete its financial plan. We also found that administrative rules drafted in 1998 have never been completed; and its policies and procedures manual has not been updated since it was first published in 1995. The authority also plans to rectify these conditions.

Many of the authority's changes are recent and have occurred since June 2011, when a new executive director was hired. Prior to the new administration, the authority had at least 21 heads in 37 years, the longest serving of whom served from 2005–2011. Since taking up duties in mid-2011, the new executive director has made noticeable progress in a number of areas. The results of these efforts mostly remain to be seen, but the executive director's plans and intentions have been made public via informational reports to the board at its public meetings. We will hold the authority accountable for implementing these plans.

**Master plan was six years in the making but has finally been delivered**

The authority's general lease with the Department of Land and Natural Resources (DLNR) provides that it must have a master plan that is updated from time to time to remain current with future plans. The authority's previous master plan was from 1976 and its strategic plan is dated 1993. In 1999 a consultant recommended that the authority review its strategic plan and update its master plan. In 1999, 2000, and 2001 the authority held focus groups to review its strategic plan, but no updated document was produced as a result.

The authority's new master plan was six years in the making. The intention to hire a consultant, at an estimated cost of \$100,000, was first mentioned in February 2005 board minutes. The new master plan was finally delivered to the authority in August 2011 under a \$250,000 contract. According to the executive director, a request for proposals (RFP) for the contract was first issued sometime in 2005. A subsequent RFP was issued in April 2007, and work was begun in December 2007. Work was to be completed by December 2008, but with none of the deliverables met, the authority extended the contract to April 2009. At the contractor's request, the authority further revised the deadline to May 2009. Despite expiration of the contract, revisions to the 240-page document continued for more than two years. During that time—over 3.5 years—the contractor was paid only once, in July 2011.

In order to pay the contractor, the authority had to seek the State Procurement Office (SPO)'s approval for payment after the fact and was chastised by SPO for allowing work to continue after the contract had expired. The procurement office approved the waiver on the understanding that the authority will provide all staff participating in procurement activities a detailed plan of action to prevent recurrence of a similar situation. The procurement office reminded the authority that staff participating in procurement activities are required to have written delegated procurement authority and the appropriate mandatory procurement training.

Reasons for delay in the master plan are hazy. According to board members, the consultant did consult with the board and other stakeholders; however, according to at least one board member, the consultant was given conflicting directions from the board and the then-executive director, who ignored board input and gave contrary advice to the contractor as to how to proceed. The consultant finally presented the board with a full master plan in May 2009. Subsequently, NELHA staff refused to accept the final report until all numerical errors were corrected. According to both the consultant and current executive director, these errors were non-substantive; most were based on changes to the input numbers (due to rapid changes in economic forecasts at the time) and resulted in ripple effects throughout the 240-page plan, but the underlying assumptions in the plan did not change over this period. Delay in finalizing the master plan hampered the authority's ability to move forward with its plans, ultimately affecting fulfillment of its mission and the mandate to become self-sustaining.

### **Plans, rules, and policies and procedures do not exist or are outdated**

Written policies and procedures are a fundamental element of internal control since they define authority, responsibility, and procedures;

standardize and communicate approved practices; train new personnel and provide guidance; provide standards to evaluate performance; and increase the level of professionalism. Management is responsible for establishing and maintaining effective internal controls to ensure that financial information is reliable and properly reported and is accountable to the board of directors.

No reason was given by the agency for the lack of a financial plan and administrative rules, or for not updating the 1995 internal policies and procedures manual, although turnover in leadership may have been a contributing factor.

**Financial plan is incomplete.** As of November 2011 the authority did not yet have a complete financial plan. Without a financial plan, the authority is hampered in achieving its strategic direction as projections are not based on actual revenues and expenditures. However, as published in his informational reports to the board in July, September, and November 2011, the executive director intends to formulate a strategic business and financial plan based on concepts outlined in the master plan.

**The authority lacks administrative rules.** Draft administrative rules were created in 1998 but have never been finalized and require significant revision. We found that the authority uses its Project Initiation Packet (PIP) as quasi-administrative rules; however, the PIP did not go through the rulemaking process, is limited to setting out the steps involved in receiving and reviewing applications from prospective tenants, and was last updated in 2008. According to the executive director's report to the board, the PIP is currently being updated, and there are plans to draft administrative rules.

Lack of administrative rules means that the authority's law has not been properly implemented and nowhere is there a repository of publicly available information describing the authority's methods, practices, procedures, and policies—a fact which speaks to its transparency as an authority and the ultimate effect of loss of public and lawmakers' confidence. The purposes of administrative rulemaking are to implement legislation and to establish operating procedures for state agencies. Generally, statutes provide a skeleton or superstructure for a program. Agencies must then "fill in the details" to implement their programs on a day-to-day basis.

When a statute does not spell out requirements or conditions in great detail, agencies must make determinations in order to apply the statute to various members of the public. As a result, agencies are accorded a great deal of discretion in applying the law, particularly where a controlling



statute is couched in general terms (e.g., “misconduct”). Chapter 91, HRS, which controls administrative rulemaking, requires agencies to follow specified procedures before imposing requirements on the public which affect private rights. For a rule to be binding on the public, an agency must publish notice of a public hearing; hold a hearing in which all persons are allowed to submit data, views, or arguments orally or in writing; and have the rule approved by the governor and filed in the Office of the Lieutenant Governor on a permanent basis for public inspection. In this way, government remains transparent.

Section 227D-3, HRS, gives the authority broad powers under the auspices of “may” (not “shall”). Although statutory construction dictates that “may” is permissive (not mandatory, as is “shall”), the adoption of rules is necessary for the authority to effectively exercise and fulfill the intent of its statutory powers. As such, everything the authority does is arguably subject to challenge because it has no administrative rules to implement the law.

**Policies and procedures manual is outdated.** Similarly, the authority’s internal policies and procedures manual was created in 1995 and has never been updated. Although there are no current plans to revise this document, rule adoption will arguably necessitate its update as policies and procedures are needed to carry out administrative rules.

***Board suffers from high turnover and lack of training***

The authority’s board has had a high turnover in membership and therefore has experienced inconsistent attendance at board meetings. There have been at least 32 board members in the past five years (until 2009, total board size was 11; thereafter it has been 13). While the high turnover is largely due to the board’s composition—there are six ex-officio members, a fact which the Legislature may wish to reconsider—we also found that training on board responsibilities is lacking. Both affect the board’s ability to govern.

Among a board’s basic responsibilities are to create and review mission and purpose statements that articulate an organization’s goals, means, and primary constituents; and to provide financial oversight, approve an annual budget, and ensure proper financial controls are in place. Boards are also responsible for ensuring effective organizational planning by actively participating in an overall planning process and assisting in implementing and monitoring the plan’s goals. Boards must strengthen an agency’s programs and services by determining which programs are consistent with an agency’s mission and monitoring their effectiveness. High turnover affects institutional memory and continuity of a board, and can also affect, or be the effect of, board members’ commitment. With so many ex-officio members and their alternates, it can be very easy for members to avoid personal commitment and leave responsibility and decisionmaking to others.



As a side issue, we found that inconsistent terminology in the board minutes is confusing. It was difficult to identify which interests were present, as attendance shifted so frequently and the interests of those attending were inconsistently labeled. A similar issue exists with the appellation “absent” versus “excused”—it is unclear whether the board makes this distinction or it is simply sloppiness on the part of the note taker. This is relevant because three or more unexcused absences can be grounds for dismissal from any state board.

### **Board composition is unusual and may hamper decisionmaking**

In 1990 the Natural Energy Laboratory of Hawai‘i became the Natural Energy Laboratory of Hawai‘i Authority, and a board of nine was established to govern the authority. This included three gubernatorial appointees with specified expertise, one of whom must also be from the island of Hawai‘i, and four ex-officio members—from the departments of Business, Economic Development (DBED—now known as the Department of Business, Economic Development and Tourism, or DBEDT) and of Land and Natural Resources (DLNR); the University of Hawai‘i (UH); and the County of Hawai‘i. In 2000 the board was expanded to 11 members, including two additional ex-officio members—from the Hawai‘i Strategic Development Corporation and the High Technology Development Corporation, both of which are administratively attached to DBEDT. The authority’s board was again enlarged in 2009 to accommodate two tenant representatives; there are now 13 voting members on the board, six of whom are ex-officio and often represented by alternates. There are no *public members*—a term of art which is distinct from a *member of the public* and denotes a member who does not represent any of the special interests involved—on the board.

A board should be big enough to carry out its necessary responsibilities, but small enough to act as a deliberative body. In a very large board, the personal involvement of each member tends to decrease, and members fail to assume responsibilities that are properly theirs. However, Cyril O. Houle (*Governing Boards*, 1989) has also suggested that important elements in a board’s constituency—which in the case of a public agency means citizens of the unit of government concerned—should be represented on a board.

The authority’s relatively large board with its unusually high number of ex-officio members means that many board members are often, and sometimes exclusively, represented by alternates. In the 15 meetings between March 2009 and September 2011, five ex-officio members—the president of the University of Hawai‘i, the chair of the Board of Land and Natural Resources (BLNR), the mayor of the County of

Hawai'i, one board member from the Hawai'i Strategic Development Corporation (HSDC), and one board member from the High Technology Development Corporation (HTDC)—did not attend any of the authority's board meetings personally. The Hawai'i county mayor and the HSDC member were represented by two different alternates. One alternate appeared at various times for both the HSDC member and the DBEDT director. Furthermore, the DBEDT director attended one meeting himself and was represented by three different alternates at various times. While turnover in ex-officio board membership cannot be controlled, turnover and attendance arguably impact a board's corporate memory and very likely its ability to reach consensus since new or alternate members are constantly starting afresh. Only four of the current board members have been on the board for five years or more.

There was recently a bill in the Legislature to amend representation on the authority's board. House Bill 745 of the 2011 Regular Session proposed, among other things, to reduce the board to 11 members; eliminate the BLNR representation but add a member from the Office of Hawaiian Affairs (OHA); and replace the president of UH with the chancellor of UH-Hilo. The bill also proposed to restructure the Research Advisory Committee to specifically include members from the island of Hawai'i. We agree that a smaller board with more local representation may be appropriate. However, given that BLNR would be removed to eliminate any possible conflict of interest (since DLNR is the landlord for NELHA), we question the introduction of OHA as that arguably would raise a similar conflict of interest due to the authority's partial location on ceded lands.

### **Training for board members is lacking**

The authority's 1995 policies and procedures manual sets out a comprehensive standard orientation and briefing tour for new board members. This includes:

- a history of the authority;
- enabling legislation;
- staff organization;
- budget status;
- geographical overview of infrastructure;
- overview of tenants;

- lease rental structure;
- active capital improvement projects (CIP) and their status;
- economic development (marketing and public relations);
- significant projects ongoing by the authority's staff;
- a CEROS orientation brief; and
- a tour of the facility which includes the analytical laboratory, operations workshop and maintenance areas, administration office spaces, visitors center, tenants, and an archaeological site.

Despite this clearly stated and comprehensive policy, we found there is no formal training program for new board members in practice at the authority. We canvassed all current board members and their alternates regarding training; none indicated any formal program, uniform documents, or set orientation items regarding the board and its responsibilities. Introduction to the board appears to be ad hoc and may simply involve a welcome from the board chair and a tour of available tenants, which falls short of the comprehensive orientation laid out in the authority's policies and procedures manual.

Houle (*Governing Boards*, 1989) also suggests a number of ways in which to orient new board members. These include a welcome from the board chair, an initial and a subsequent orientation conference, assignment of a board sponsor, a thorough introduction to other board members, a tour of facilities, assignment of a small board-related task, and provision of literature describing the kind of agency that the board controls. Once board members have been oriented, they should not allow themselves to stagnate, nor be allowed to do so. The chairman of the board, in particular, cannot leave matters to chance. To achieve its full potential, a board must have a strong chair who creates and maintains a spirit of unity among board members and ensures the board works appropriately with agency staff in exercising power effectively and ethically.

### **Tenant representatives' voting is questionable and may violate both NELHA statute and the State Ethics Code**

The 2009 Legislature amended the authority's governing board to include 13 voting members, two of whom are tenant representatives. As

codified in Section 227D-2(b), HRS, tenant members must be recused from voting on setting lease rents, water rates, or utility rates but may participate in discussions. In the 12 board meetings since October 20, 2009, when tenant representatives first joined the board, we found seven instances in which tenant representatives voted on items that affected lease rents, water rates or utility rates, contrary to statute. Voting on items that affect lease rents, water rates, or utility rates is a violation of the authority's statute. We interviewed the tenant representatives to the board, the board chair, and the board's deputy attorney general regarding procedures and responsibility for recusing tenant members from voting on setting rates. None could confidently say how this was done and almost all expressed the opinion that no such instance had arisen since the tenant representatives had been on the board. We disagree.

There appears to be a lack of understanding as to what constitutes *setting* lease rents, water rates or utility rates. Of ten board meetings since October 20, 2009 for which agenda were available, we found 12 agenda items indicating decisionmaking on a lease rent rate would be taking place. The items were variously listed as "decision making on ... deferral of rental increase ...;" "decision making on lease re-opening terms;" "approval of [a tenant's] long-term lease;" "decision-making on... draft Facilities Rental Agreement;" "decision-making ... to modify rent structure on Sublease ...;" "possible action on ... request for relief of all deferred rent increases;" and "decision... for [tenant] lease... extension." A vote to extend a lease at its current rate or to defer a lease rent increase, is, in effect, a vote that sets a lease rent rate. Tenant representatives should be recused from such votes.

In addition to violating the authority's statute, voting on items that affect lease rents, water rates, or utility rates could also be construed as violating the State Ethics Code, an offense punishable by up to \$500 per violation. Section 84-14, HRS, of the State Ethics Code prohibits state employees—which includes all board members—from taking any official action directly affecting a business or undertaking in which they have a substantial financial interest. The State Ethics Commission has interpreted *official action* to include decisions, recommendations, approval or disapproval, or any other action that involves discretionary authority. It is clear that tenant representatives have significant financial interests in the businesses they represent, and therefore their official action in the form of voting on issues related to setting rates may constitute a violation of the State Ethics Code. Arguably, even voting on lease rents and rates that do not immediately affect a tenant board member's financial interests could set a precedent for future actions which do. We cannot know whether a tenant board member is casting a vote merely based on the merits of each case or with his or her own

business's future interests in mind. Because of this uncertainty, it would be prudent to remove such temptations and mitigate the risk of possible ethics violations by not voting on such matters.

In addition to a fine from the State Ethics Commission, improper voting also jeopardizes the validity of any decision made. A challenge to such a vote could result in a rescission of the decision, which wastes both time and money but ultimately also affects the public's confidence in the board's ability to conduct its business lawfully. Furthermore, according to the commission, the best practice for effectuating a recusal is to physically leave the room during such votes, so it is clear to the public in attendance and reflected in the minutes that the member in question was not involved in the vote.

In its request for this audit, the Legislature specifically noted that the authority has been criticized for failing to comply on numerous occasions with the Public Agency Meetings and Records Law ("Sunshine Law") codified in Chapter 92, HRS, and asked that we review the authority's compliance with it. We found that the authority continues to struggle with open meetings requirements, including access to minutes, use and documentation of executive sessions, amending agendas, and use of investigatory committees ("permitted interaction groups").

The authority's board of directors is one of nearly 160 boards and commissions in Hawai'i required to abide by the Sunshine Law. The law codifies the Legislature's intent that government processes are to be open to public scrutiny and participation:

In a democracy, the people are vested with the ultimate decision-making power. Governmental agencies exist to aid the people in the formation and conduct of public policy. Opening up the governmental processes to public scrutiny and participation is the only viable and reasonable method of protecting the public's interest. Therefore, the legislature declares that it is the policy of this State that the formation and conduct of public policy—the discussions, deliberations, decisions, and action of governmental agencies—shall be conducted as openly as possible.

***Compliance with  
Sunshine Law  
continues to elude  
the authority***

The law specifically states that it is the people's right to know about the formation and conduct of public policy—the discussion, deliberations, decisions, and action of governmental agencies—and that provisions requiring open meetings are to be liberally construed and exceptions are to be strictly construed against closed meetings.

Seven complaints, several with multiple Sunshine issues, have been brought against the authority's board since 2001. Of these, the board violated Sunshine in at least five instances. In 2001 a complaint was lodged that board members had discussed matters in executive session beyond the purpose on which members voted, and that an item of substantial public interest was added to the agenda during a board meeting. The Office of Information Practices (OIP), which administers the Sunshine Law and whose opinions are enforceable by the courts, substantiated the first allegation.

In 2005 the tenants' association claimed the board's Finance Investigative Task Force meetings did not qualify as permitted interactions of an investigative committee under Section 92.5, HRS, and that more than a quorum of the board attended these meetings. Although OIP did not specifically opine on the quorum issue, it did opine that the task force violated Sunshine Law, because after it reported back to the board on the matter it was originally authorized to investigate, the group ceased to be an investigative task force; it had become in essence a standing committee and its meetings were therefore required to be open to the public. Our current work found a similar situation is occurring with the Research Advisory Committee (discussed below). Also in 2005 a legislator questioned whether board minutes adequately stated reasons for going into executive session and if voting for seawater rate increases under the "committee reports" section of the agenda constituted violations of the Sunshine Law; both queries were substantiated by OIP as violations of Sunshine Law.

In 2006 a private organization contacted OIP regarding access to executive session minutes from three years prior. According to OIP, minutes of executive sessions can be withheld only so long as publication would defeat the lawful purpose of the executive session. The authority subsequently re-created the previously missing minutes and provided limited access to them. The organization also questioned whether current board members could approve minutes from three years prior and the board's use of boilerplate language regarding anticipated executive sessions. While OIP deemed the first was not a Sunshine Law issue as boards are not required to approve minutes, it reported that the second issue was being rectified by removing boilerplate language in one agenda and replacing boilerplate language with more specific language regarding an anticipated executive session in another agenda.

In 2007 the same private organization complained about not receiving notification of a board meeting despite being on the list of those to receive notice of meetings, as is required by law. The authority conceded this violation as well by voiding all action taken at the improperly noticed meeting and effectively re-doing all actions at a subsequent

board meeting. Also in 2007, the tenants' association complained that 1) rate increases were not on the agenda; 2) there was no public discussion of the increases; 3) there was no vote by the board for the increases; 4) NELHA staff were not providing supporting information to substantiate the increase; 5) the board chair had not responded to the association's request for intervention; 6) NELHA had deferred its next board meeting until after the rates became effective and bills were due; and 7) posted minutes for a previous board meeting conveyed no information. Based on information provided by NELHA that the board was not required to approve the yearly seawater rate, OIP deemed the first three issues were not Sunshine violations; that the fourth, fifth and sixth issues fell outside OIP jurisdiction; and that it was unable to determine the nature of the last complaint in relation to Sunshine Law. We note that although OIP found no violations of Sunshine Law, the issues complained of do pertain to the general transparency of the board and its activities.

No further Sunshine related complaints have been brought since 2007. We note that legal counsel has generally been present at board meetings since at least January 2008. Despite this, we found that the authority has yet to consistently comply with Sunshine Law requirements.

### **Access to board minutes within 30 days is not consistent**

Sunshine Law requires that board minutes be made available to the public within 30 days after the meeting. If board-approved minutes are not available within 30 days, then draft minutes must be made available upon request.

We have concerns that meeting minutes are not consistently available within 30 days. Minutes were not available upon request for either of two recent board meetings, even though our requests were made more than 30 days after each meeting in question. Furthermore, the authority's policies and procedures manual stipulates that final typewritten minutes are to be completed within 10 days of a board meeting. Therefore, minutes should have been immediately available to us upon request.

While there is no statutory requirement to publish minutes, according to the NELHA employee assigned to take minutes of board meetings, the authority generally posts draft meeting minutes on its website. We consider this a good practice but encourage the authority to continue doing so in a consistently timely manner. Easy access to board minutes will enhance the public's, tenants', and potential tenants' involvement with and knowledge of the authority; strongly contribute to the perception of transparency and accountability; and foster confidence in the authority and its activities.



### **Taking, keeping, and providing executive session minutes are problematic**

Written minutes must be kept of all meetings, including executive session meetings, which are by definition closed to the public. Minutes of executive sessions may be withheld from the public depending on their content, but can be withheld only so long as publication would defeat the lawful purpose of the executive session.

One of the complaints to the Office of Information Practices related to access to executive session minutes from three years prior. However, the complaint was not pursued to the point of having OIP review the appropriateness of the authority's withholding of the minutes in question. As part of our testing, we asked the authority to provide us with minutes for 17 executive sessions held between January 2008 and August 2011. Nearly two months after our initial request, the authority provided minutes recently approved by the board at its November 2011 meeting for seven of the requested executive sessions. The authority claimed attorney-client privilege over two. Almost half of the minutes we requested were reported as "not available," "available" but not provided to us, or not addressed at all. We note that there is no requirement that executive session minutes be either typewritten or approved. Furthermore, with the exception of privileged materials, state law authorizes disclosure of all government records to the Auditor. Despite their confidential nature, boards are required to take, keep, and provide executive session minutes under appropriate circumstances; the delay in responding to our request did not inspire our confidence that the minutes existed in conformance with Sunshine requirements.

### **Reasons for executive sessions are not always proper**

Sunshine Law allows for eight purposes for which an executive session can be convened, and the authority's statute allows for an additional purpose relating to confidential business trade secrets, proprietary commercial or financial information, or the competitive position of a prospective tenant. To convene an executive session, the board is subject to the procedural requirements of Section 92-4, HRS. The board must publicly announce the reason for the executive session and record in the minutes the vote of each member on the question of holding the executive session. Two-thirds of the board members present, provided they constitute a majority of the members to which a board is entitled, must vote in favor of the motion.

We found that the board has not been consistent in complying with these requirements. Of the 18 executive sessions the board entered into between January 2008 and September 2011, five were not convened in accordance with the Sunshine Law. In light of the State's policy and intent as stated in the Sunshine Law—namely, that opening governmental



processes to public scrutiny and participation is the only viable and reasonable method of protecting the public's interest, and that exceptions to open meetings requirements are to be strictly construed against closed meetings—the board needs to exercise more care when holding executive sessions.

To facilitate the board's compliance with the Sunshine Law, we encourage it to be more proactive in declaring the reason for executive sessions by citing the appropriate statutory provision both in its meetings and documenting the same in its minutes. We note that the board did this in only five of the 18 executive sessions we reviewed. Done consistently, this practice would ensure the board conducts its executive meetings in conformance with Sunshine Law as well as provide notice to stakeholders and the public.

### **Board attempted to amend agenda despite on-the-spot legal advice regarding Sunshine requirements**

Legal counsel is not required to be present at board meetings. However, the authority's deputy attorney general has attended most of its board meetings since 2008. Despite this, on an occasion when the usual deputy was not in attendance but another deputy happened to be present to provide a presentation on serial communications (another aspect of Sunshine Law), the board proceeded to take action against counsel's advice which, had it passed, would arguably have violated Sunshine Law.

Section 92-7, HRS, stipulates that once an agenda is filed with the Office of the Lieutenant Governor, it may not be changed at a meeting without a two-thirds vote of all members to which the board is entitled. Even with a two-thirds vote, a board may not add an item of major importance to an agenda during a meeting if the action taken will affect a significant number of people. During its October 2009 meeting, the former executive director informed the board of requests by tenants to add two new agenda items. A visiting deputy attorney general alerted the board that it was not allowed to amend the agenda if the items to be added were of "reasonably major importance and action on the item will affect a significant number of persons." Both proposed items had the potential to affect rates of other tenants and were therefore of reasonably major importance with the ability to affect a significant number of people.

Despite this on-the-spot legal advice regarding amending agendas, the board proceeded to vote on amending the agenda during the meeting. Although the motion to amend the agenda did not pass, the chair should have terminated discussion on amending the agenda, erring on the side of caution and postponing the items until they could be properly publicized on the next agenda.

### **Research Advisory Committee attempts to circumvent Sunshine Law by inappropriately behaving as a “permitted interaction group”**

The board's committees have a history of violating Sunshine requirements. As noted above, in 2005 the OIP found the board's Finance Investigative Task Force was not behaving as a proper investigative committee (also known as a “permitted interaction group”). The group subsequently became the standing Finance Committee, subject to Sunshine requirements. Similarly, our current work found that the Research Advisory Committee (RAC), which is statutorily required and therefore subject to Sunshine requirements, has been inappropriately circumventing Sunshine requirements by trying to behave as a permitted interaction group.

A permitted interaction group (known as a PIG) can be used for investigatory purposes and necessarily involves at least three board meetings and has a finite duration. Section 92-2.5(b), HRS, allows a board to designate two or more board members, but less than a quorum of the board, to investigate matters concerning board business. The scope of the investigation must be defined at a meeting of the board (first meeting). All resulting findings and recommendations must be presented to the board at a meeting of the board (second meeting); and deliberation and decisionmaking on the matter investigated may occur only at a subsequent, duly noticed (third) meeting of the board.

The RAC's chair informed us that due to the difficulty and expense of bringing RAC members together for regular face-to-face meetings, nearly all of the RAC's work is executed electronically. Proposals are circulated via email to RAC members by NELHA staff; members review each proposal and submit written comments, via email, to the RAC chair. The RAC chair compiles members' comments and summarizes them as necessary before providing the summary to the board chair for distribution at the board meeting where the proposal is discussed. The RAC chair or secretary orally summarizes the written comments at the board meeting and responds to questions. The RAC chair went on to inform us:

Because of “Sunshine Law” requirements, we are not able to formally recommend acceptance or rejection of an application to the Board. As a result, our function is to identify, for example, technical issues that may be identified in the proposed project, or possible financing challenges, or regulatory concerns. Alternatively, if a project is well conceived, adequately financed, and is unlikely to encounter significant regulatory issues, then our comments would reflect that. If concerns or weaknesses in the proposal can be addressed by placing conditions on the approval, then that option will be presented in the proposal review. The Board is completely free to proceed as

the consensus decides in terms of encouraging tenancy at NELHA or rejecting/modifying an applicant's request for tenancy; having the RAC Chair and Secretary on the Board does enable more detailed discussion of technical/financial/regulatory issues surrounding a proposal than can be included in the written summary.

This practice is of concern because the RAC chair appears to believe that the RAC is legitimately circumventing Sunshine requirements by behaving as a "permitted interaction group." However, there are several problems with this approach, and the Office of Information Practices concurs with our analysis:

1. The RAC may not simply choose to act as a PIG, which is subject to less stringent requirements than full Sunshine compliance. As a subgroup of the full NELHA board, the RAC is considered a *board* for purposes of the Sunshine Law and must therefore comply with the statute's requirements.
2. Even if the RAC could choose to adopt the lesser standards of a PIG, the RAC fails to qualify as a PIG because the RAC is an ongoing entity. Permitted interaction groups are statutorily limited in scope, which effectively means they are limited in time as well. This is the same issue that the board's Finance Investigative Task Force encountered in 2005 before it became the standing Finance Committee.
3. Even if the RAC were a PIG, it is not complying with PIG requirements because recommendations and decisionmaking occur at a single board meeting. Section 92-2.5(b), HRS, requires that a PIG's findings and recommendations be presented at one meeting but that deliberation and decisionmaking be postponed until a subsequent, and duly noticed, meeting.
4. The RAC may be violating the Sunshine Law prohibition on serial communications by compiling and summarizing comments before presenting them to the full board. Serial communications refers to the practice of having a one-on-one communication (whether in person, electronically, or through other means) with another board member about board business, and then discussing the same business with another board member. The OIP has opined that although two board members may discuss board business with each other outside an open meeting, this "permitted interaction" may not be used in a serial fashion to circumvent the spirit or requirements of Sunshine Law.

The plethora of issues raised by the RAC's scenario, combined with the apparent belief by its chair and the board that this behavior is legitimate, serve to highlight the board's lack of understanding about the scope of the Sunshine Law and the board's responsibilities under it. According to Houle (*Governing Boards*, 1989), although boards may be able to find a number of ways to escape the rigors of Sunshine Laws, any effort to evade the law is itself news and will cause the media to sniff out any presumed transgression and expose it. The best course of action is for boards to take extra precautions to be clear and candid about what they are doing.

### **Assigning staff member to a task force was questionable**

The board's interpretation of Section 92-2.5(b), HRS, was again questionable during its recent search for a new executive director. In early 2011 the board created the variously named "Investigative Committee," "Search Committee," "Executive Director Search Committee," and "Special Investigative Committee"—which is confusing to readers, and the authority should strive towards better uniformity in its nomenclature—to find and recommend a replacement executive director for the authority. This committee included a NELHA staff member.

As noted above, Section 92-2.5(b), HRS, allows a board to designate two or more board members, but less than a quorum of the board, to investigate matters concerning board business. Our discussion with the Office of Information Practices confirmed that the law neither authorizes nor prohibits staff members from being members of a permitted interaction group; however, in OIP's opinion, a better approach would have been to have only board members in the permitted interaction group, with a staff member assigned to support or consult. Given the board's other Sunshine-related issues, it would have been prudent to err on the side of caution by not assigning a staff member to the task force.

### **Mastery of Sunshine basics falls short**

Failure to understand basic Sunshine Law requirements hampers interested parties—such as tenants, private organizations (like Environment Hawai'i) and notably prospective tenants or other stakeholders—from discerning the board's activities and methods. Legislators and the public are apt to lose confidence in the authority's ability to competently pursue its business in an open and accountable manner; furthermore, lack of transparency ultimately affects the authority's reputation and, therefore, its ability to market itself and achieve its goals.

As part of our fieldwork, we canvassed board members regarding whether they had received any Sunshine Law training. The majority of board members said they received little to no training on the Sunshine Law upon their appointment or involvement with the board. Of 15 board members or alternates who answered our queries, ten received no training specific to Sunshine Law and five recalled receiving some training several years ago, though none could remember exactly when it occurred.

We found that, contrary to its policies and procedures manual—which describes orientation of new board members—the board has no formal training program. Furthermore, the orientation described in the policies and procedures manual does not include a review of Sunshine Law.

According to the Office of Information Practices, in years past, all new appointees to boards statewide were provided with an annual orientation session coordinated by the Office of the Governor; however, this practice ceased sometime during the previous (Lingle) administration. Between January 2008 and July 2011 the board had one formal training session, on serial communications under the Sunshine Law, presented by a deputy attorney general in October 2009. Only seven members of the current board were present at that meeting; the chair (who is still the chair) was absent.

More recently, and perhaps pursuant to our audit inquiries, at its meeting in November 2011, the board's deputy attorney general gave a short presentation (approximately 15 minutes) pursuant to the agenda item "Sunshine Law Summary overview and update by OIP or Deputy Attorney General." While we applaud this effort, we believe more comprehensive training is in order. Responsibility for ensuring board members are properly trained in Sunshine Law provisions rests with individual boards, and many boards contact the Office of Information Practices when they have new board members to request refresher training sessions. The OIP provides Sunshine Law training upon request; its shortest training is approximately 45 minutes long, and its normal training is about two hours long. In addition, OIP's website also contains a video, a comprehensive guide, and other information regarding Sunshine issues.

### ***Operational issues exist***

The authority needs to address several operational issues. At the time of our 2011 fieldwork, the authority's website was outdated and incomplete, its lease rent rates were not uniform despite its policy to the contrary, and the transparency of seawater pumping rates had improved, but controls were still lacking.

### **Performance reporting is woefully inadequate**

Performance reporting is vital to any organization, particularly one that receives state funding. To ensure accountability to lawmakers and taxpayers, agencies should identify measurable outcomes, current baselines, desired benchmarks, and objectively quantifiable measures. The comparison of baseline (prior activity) data to actual and desired data represents progress towards targets and quantifies an agency's performance.

We reviewed the authority's annual reports for FY2004 through FY2009; its Yearly Activity Plan (YAP) report to the Department of Business, Economic Development and Tourism; and relevant portions of budget reports to the Legislature. We found that the authority's performance reporting is seriously lacking. The budget reports, which are not widely known to the public, contain "measures of effectiveness," but these are somewhat redundant among them (for example, "Increase in NELHA revenues" versus "NELHA revenues"; and "Amount of NELHA tenant sales" versus "Total tenant revenue"). The measures are also inconsistently phrased (as a change from the previous reporting period in one report and as the current number itself in another).

In addition, what are reported as "outcomes" in the Yearly Activity Plan are largely activities, not outcomes. The activity plan does not provide any information on how tenants will benefit from the authority's planned work and does not identify specific changes that are to occur. For example, the FY2007–08 YAP listed "achieve total self-reliance for operating expenses through execution of higher yielding leases, continued ramping up of seawater delivery prices to reflect actual costs, and the development of independent revenue sources such as water laboratory services, and the delivery of energy services to others." Another stated outcome was to issue requests for proposals for various projects. The National State Auditors Association's *Best Practices in Performance Measurement* states that outcome measures should assess program impact and effectiveness.

There is not just a lack of meaningful metrics (also known as key performance indicators, or KPIs) generally: in fact, the authority does not consistently report *any* KPIs in its annual reports other than for CEROS, which is wholly federally funded and therefore not examined in this audit. Furthermore, the authority did not produce an annual report at all for FY2010.

We also found that the authority has been repeating the same economic impact numbers since its "CY2000 NELHA Private Tenant Impact"

report was published in 2002. However, we note the authority has budgeted \$30,000 for an updated economic impact study in 2012.

By not publishing meaningful performance indicators in a publicly accessible location, the authority is severely hampering its ability to prove its program effectiveness to legislators, taxpayers, tenants, and prospective tenants. As reported in a recent issue of *Government Technology*, although private companies may show their performance through stock value and quarterly revenues, “most public offices rely on performance metrics to determine how successfully they are delivering services to citizens and adhering to legislative regulations. By tracking everything from project deadlines to productivity levels [that is meaningful performance metrics], the public sector can better justify its [...] investments, communicate its overall value and garner support from citizens and state assemblies alike.”

### **Website outdated and incomplete**

An up-to-date and easily accessible website may go a long way in promoting NELHA and its mission to potential tenants and other ancillary revenue-generators. At the time of our fieldwork, however, NELHA's website was both outdated and incomplete. For example, the authority had posted its Project Initiation Package on its website for prospective tenants; but this stated that rates were effective as of September 1, 2008 and to check with the authority for current rates. The authority's seawater pumping rates methodology spreadsheet was also difficult to find on the website, outdated (rates were from 2007), and, as even a board member admitted, hard to take meaningful information from.

Not having such information easily accessible to potential tenants, legislators, taxpayers, and other stakeholders has clouded the authority's transparency and hampered its ability to justify itself to legislators and taxpayers. However, at the time of our fieldwork the authority had plans to update the website within the first half of 2012.

### **Lease rent rates are not uniform, despite policy to the contrary**

Nominally, the authority employs a tiered lease rent structure, but in practice almost all leases are different. Unlike the overall real estate market, which typically recognizes economies of scale, the authority assigns a rental rate based on use rather than size. Leases are individually negotiated based on each prospective tenant's type (research, educational, pre-commercial, or commercial), needs, and research or business proposal.



The authority's approximately 870 acres at Keahole Point include around 40 parcels of various shapes and sizes. Roughly 240 acres of land have been subleased, while another 170 acres are used for roadways or reserved for setbacks and preserves. The balance of approximately 460 acres of leasable land remains unimproved. As of July 2011, the authority had 41 tenants at Keahole Point consisting of 29 pre-commercial research and commercial tenants, four Gateway Center tenants, and eight research, educational and community service tenants. Tenants are further categorized as productive users—those who use seawater to grow or make something, extractive users—who take something out of the seawater, energy users—who research or generate power, and educational users.

According to NELHA staff, in 2006 the authority adopted a policy to set uniform standards for productive and extractive users' subleases. The policy acknowledges that the authority has been granting subleases on a case-by-case basis with varying terms, rents, performance requirements and provisions. The policy further notes that there has been no consistent basis on which the authority based its rental rates, which had been kept low due to the State's desire to incubate businesses and encourage development at NELHA. The end result of such inconsistency, as noted in the policy, was that "many parcels of land at NELHA are held at no or minimal cost and not available to new companies that would locate to the park ... the costs of maintaining NELHA are increasing dramatically with no corresponding offset from ... rents."

We reviewed 26 facilities rental agreements, facilities use agreements, memoranda of understanding, and sub-leases (collectively, "leases"), all of which were entered into between 2008 and 2011, and found considerable variation among them. The lease terms ranged from one month to 30 years. Six leases included a percentage fee of gross sales as part of their rent; fees for the research compound were applied uniformly, but those for the technical park and Gateway Center differed among them; seawater fees varied until mid-2009; three agreements were charged an overhead fee; and fees for electricity varied, with no clear trend in the base rate.

As a side issue, we also found that lease execution was sloppy. Of 26 lease-type agreements reviewed, less than one-third were properly executed. The deputy attorney general usually did not date his signature. In one case, the agreement date was so illegible that it was unclear whether it was January or June, and the signatures were at least



six months after the effective date and possibly 13 months after the agreement date. In another, the agreement date was blank and there were no dates on the signature page—the only date was the typed “effective” date on the first page. In two cases the signature page was completely undated. Although such breaches do not invalidate the contracts, they do raise concerns about the authority’s and its deputy attorney general’s diligence generally in executing tenant leases.

Variation in lease rates has caused problems among tenants, particularly upon renegotiation of existing leases. One notable example took over two years to settle following disagreement between the authority and the tenant over the appraised land value. That tenant’s base rate was finally agreed to at the September 2011 board meeting, and the authority now plans to use the arbitrated appraisal value as the basis for creating a Dilmore curve upon which future leases will be based. A Dilmore curve is used in real estate to assist in adjusting for disparities in size between a subject property and a comparable property. Creation of a Dilmore curve as a basis for future leases will lead to better transparency and, therefore, confidence in the authority.

### **Transparency of seawater pumping rates has improved, but controls are still lacking**

Seawater pumping rates were a highly contentious issue between the authority and its tenants for some time and appear to be one of the major impetuses behind the request for this audit. As stated in SCR No. 96, SD1 (2008), “the rates charged to tenants at the research and technology park for seawater pumping continue to be an issue of concern.”

Following the 2003 Governor Lingle directive that the authority’s goal was to become self-sustaining, the board decided to raise the price of seawater to tenants by 20 percent per year until the cost of delivering the seawater was actually met by its user tenants. The sudden hikes in rates caused tenants to question the authority’s costing methodology and raised concerns about transparency.

As a result of those concerns, transparency increased when the authority’s staff worked with a tenant representative to agree on the methodology behind the rates. The tenants association and a current board member who was instrumental in working on the methodology agree that tenants are now generally satisfied on most of the philosophical elements of the methodology. (According to that board member, there is still disagreement as to whether environmental monitoring charges should be part of the seawater pumping rate. At present only seawater-using tenants pay this charge even though

environmental monitoring is conducted on both seawater and seawater non-using tenants.)

Transparency is not complete, however. Although seawater pumping rates are published in the authority's Project Initiation Package, which is online, those rates are from 2008. At the time of our fieldwork, a convoluted spreadsheet showing the authority's methodology in calculating the rates was also available online, but it was hard to find, even more difficult to understand, and was from 2007 and thus did not reflect current rates.

The principle of open government espoused in Chapter 92F, HRS (the Uniform Information Practices Act), which declares it is the policy of this State to conduct its business as openly as possible, supports the view that the current numerical rates should be published, so that prospective tenants can accurately estimate what their costs are likely to be and base their business decisions on that. In the absence of a published rate, the authority is also free to charge tenants different rates, and this again hampers its transparency and ultimately affects the public's confidence in the authority.

In addition, according to at least one board member, there is still concern about the accuracy of the fees being charged. Monthly seawater pumping fees are calculated by one staff member using an enormous Lotus spreadsheet. Manual spreadsheets, especially large and complicated ones, are inherently prone to cut-and-paste errors; errors are more likely to be missed in the absence of a second reviewer. Further, a single staff member spends needless hours per month calculating tenants' invoices—time that would not be charged to the overhead rate if a more efficient database was used. However, lack of agreement over whether environmental monitoring charges should be included in the seawater pumping rate continues to stall the authority's ability to formalize and publish its methodology.

### **Fiscal information to board is unreliable**

The authority is required to keep its financial records and provide related reports in accordance with Generally Accepted Accounting Principles (GAAP), which are standards promulgated by the Financial Accounting Standards Board that must be followed in public accounting. These standards provide the framework for financial accounting and set the general methods used to process, prepare, and present financial transactions to ensure that financial information is consistent, relevant, reliable, and comparable.

Officials at NELHA are confused about GAAP. According to the authority's fiscal officer, the State does not use GAAP accounting.

The fiscal officer also told us NELHA uses QuickBooks for in-house reporting to the board and the State's Financial Accounting Management Information System (FAMIS) as its official accounting record, but these are not reconciled. Furthermore, according to the fiscal officer, financial statements provided to the board are not audited as they are not the official accounting system.

In the absence of reconciliation between QuickBooks and FAMIS, there is no way to ensure that the financial information in QuickBooks is correct, as the authority is free to manipulate the numbers. Ultimately, the board's reliance on unverified financial information may adversely affect its decisionmaking.

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## **NELHA Is Making Progress Under New Management**

The authority has had a high turnover in leadership but appears to be making progress under its new administration. There have been more than 20 heads of the authority or its predecessor agency, NELH, in almost four decades. The longest serving was a previous executive director—from 2005 to 2011—at just under six years. In 2010 an internal evaluation of the then-executive director found there were pre-existing staff morale problems and that the executive director's decisionmaking was decisive but abrupt and lacking explanation. Staff suggested a need for greater internal communications, weekly staff meetings, clearer goals for both the authority and the executive director, better marketing for new tenants, a succession plan, and more feedback from the executive director and the board. Many of the tenants were generally unhappy. One concern was that while past executive directors had brought in public funds, the then-executive director was more focused on receiving money from tenants. Tenants wanted an increase in the tenant base, and felt the executive director was disinterested or negative about marketing. Some felt legislative efforts were lacking, and that tenants were not involved. Of the staff and tenants interviewed, many were concerned about the executive director's communication style or tone, which was described as aggressive, dismissive, and angry. Respondents reported the executive director did not engage with tenants and preferred leaving it to the board. Some perceived the executive director to be unfair or partial.

At the time of our fieldwork in mid- to late-2011, we found that in the brief period since the previous executive director's departure from NELHA in February 2011, the authority has made significant progress in a number of areas. For example, marketing and promotion have resumed after years of inactivity; tenant relations are improving; and the authority is actively pursuing alternative revenue streams in accordance with its statutory powers. Several of these revenue streams have yet to

be realized, however. The wheeling law requires legislative clarification; additional cell phone tower concessions are on hold until a tower is built away from the authority's administration building; and the authority's ability to sell gravel offsite requires clarification.

We also found that self-sufficiency has been reached on an operating level, but the authority is still reliant on the State for capital improvement project (CIP) funding and will do so for the foreseeable future. Since land revenues make up close to 40 percent of the authority's operating revenues, deferrals in rent increases significantly impact the authority's ability to achieve its goal of self-sufficiency. Finally, several current issues are of critical importance and must be addressed for the authority to move forward. A potential stumbling block to future expansion of the NELHA property is the widening of the Queen Ka'ahumanu Highway, which necessitates the authority building a new frontage (access) road to the highway allowing left turns into and out of the property. The proposed road is featured in the authority's 2011 master plan and will cost approximately \$7 million; at the time of our fieldwork the authority intended to request this amount in CIP funds from the 2012 Legislature.

***Marketing, tenant relations, and alternative revenue streams are being addressed***

The authority's current administration is aware of the need to develop a strategy for identifying prospective projects and clients and to devise a marketing plan to target the demographic identified. The current administration is also pursuing revenue-diversification projects, including *wheeling* (the sale of electricity), cell phone tower concessions, and the sale of gravel.

**Marketing and promotion efforts have been renewed**

According to NELHA staff, in years past the authority engaged in limited marketing efforts, such as attending occasional trade shows, but these efforts ceased approximately ten years ago. Staff suspect that after state budgets started being cut in the late 1990s and the authority was first encouraged (in 1995) and then mandated (in 2003) to become self-sufficient, the authority discontinued a number of non-core activities.

The current executive director considers marketing essential to achieving both the authority's mission and its mandate to be self-sufficient and has budgeted \$50,000 for marketing activities in 2012. The executive director intends to develop a marketing plan to attract new businesses and to send staff to the National Renewable Energy Laboratory (NREL) to learn more about how to identify potential NELHA-appropriate projects, specific demographics of researchers, and how to effectively market to such groups. During our fieldwork in September 2011, the authority attended the Oceans '11 conference in Waikoloa, where it

rented a booth and distributed informational pamphlets about NELHA and the HOST Park. The 2011 master plan also recommends that the authority make a concerted effort to complement the marketing efforts of the Gateway Center and the Friends of NELHA with other facilities and outreach that encourage the local and visitor community to better understand the authority's research and development role, its achievements, and its relevance to the community and everyday life.

We agree with the new executive director's approach. The authority's ability to achieve its goal of self-sufficiency may be critically affected by how well it is able to promote itself to its target tenant population. Marketing the authority to appropriate target audiences will disseminate information about NELHA and encourage interest in and applications from prospective tenants, who will in turn help grow the site and facilitate the authority's achievement of its mission and goals.

### **Tenant relations are improving**

Tenants' relationship with the authority under the previous administration was adversarial and alienating. The tenants' association reported that tenant relations are now improving: the president expressed that the association is optimistic and positive about its relationship with the new executive director, especially regarding the transparency of seawater pumping rates. The association has faith that tenants' concerns will be given serious consideration, particularly regarding expanding the tenant base to share costs.

A positive relationship with its tenants is vital for the authority. Fostering such a relationship will likely cause tenants to perceive the authority as transparent and improve their confidence in the authority as a landlord and public agency. In turn this will facilitate the authority's reputation and help further its ability to achieve its mission and goals.

### **Alternative revenue streams are being pursued although most have yet to be realized**

In 1995 Governor Cayetano issued a memo encouraging the authority to become "more self-reliant." In 2003 Governor Lingle issued a directive that the authority's goal was to become "self-sufficient." To facilitate the authority's ability to achieve this goal, several sections of its statute have been amended to encompass language authorizing the authority to pursue alternative revenue streams. We found that several alternative revenue streams, including *wheeling*, cell phone tower concessions, and offsite gravel sales, are being pursued, but two of these have yet to be realized.

**The wheeling law is unclear.** Section 227D-1.5, HRS, codified a 2009 law allowing the authority to *wheel*. *Wheeling* refers to the sale of electricity. The authority may sell or provide electricity generated by the authority using renewable energy as its source in facilities located at NELHA, as long as all sales or provisions of electricity are made to users located adjacent to the authority on state lands leased by the user and as long as connection to the electrical grid is not needed in order to provide that electricity.

The authority is keen to pursue this revenue-generating option but believes the language in the wheeling law needs to be clarified. In July 2011 the authority asked the attorney general for an opinion regarding to whom it may sell electricity since as yet there is no administrative interpretation or practice in use regarding the issue. The attorney general responded in October 2011 saying it understood the question to be whether the authority would be considered a “public utility” under Chapter 269, HRS, if the authority constructed a renewable energy generation facility at Keahole Point and sold electricity to either its tenants or the adjacent Kona International Airport. The attorney general further understood the authority was considering leasing land to a third party, which would sell the electricity directly to the authority’s tenants or the airport without the authority’s involvement or use of the existing electrical grid. The attorney general advised that the authority could sell renewable energy to the airport and might be able to sell renewable energy to its tenants without being considered a public utility but that third parties would likely not be similarly exempt. The executive director reported to the board in November 2011 that he intends to approach the Legislature to “tweak” the wheeling law so that it is clear to whom the authority may sell electricity without being considered a public utility.

**Cell phone tower concessions have not been a priority.** Another amendment to the NELHA statute was made in 2010 via Act 61, SLH 2010, codified as Section 227D-3(6), HRS, which specifically allows the authority to sell concessions for cell towers. Concessions for cell towers refers to allowing cellular telephone providers to put relay stations on NELHA property for a rental fee. Keahole Point is a desirable location for cellular telephone providers to put relay stations, as it is the westernmost point on the island of Hawai‘i and therefore offers greater coverage than other areas.

The authority currently rents one cell tower, for approximately \$8,400 per year. The tower is located directly above the authority’s administration offices. The new master plan shows a small area of acreage away from the administration building where future towers will be located; because of the current tower’s proximity to staff offices and concerns about the effect microwaves may have on their health and



the relatively small revenue stream that such concessions produce, the executive director was not keen to pursue additional concessions until a new tower is erected further away. According to the executive director, the authority recently completed a bid process for \$1,500 per month (\$18,000 per year) and cell tower concessions have been made a priority even though it is not a key part of the authority's mission. Although such concessions are a relatively small revenue stream for the authority, any opportunity to generate revenue will contribute towards the authority's ability to achieve and sustain self-sufficiency.

**The authority's right to sell gravel offsite is mired in confusion.** The majority of NELHA's approximately 870 acres at Keahole Point is made up of pāhoehoe lava, with smaller areas of 'a'ā lava. There is very little soil at NELHA, which means that sites must be graded before tenants can occupy them. Grading produces gravel in the form of crushed lava.

The authority currently sells gravel between various locations on its property but has hesitated to sell gravel offsite and is unsure whether it has the right to do so. Under the terms of its lease with the Department of Land and Natural Resources, the department reserves the rights to keep all minerals on the property. The crux of the issue is dependent on whether lava is classified as a mineral and therefore must remain on the property.

In 2005 and 2008 private companies expressed interest in removing some of the authority's gravel offsite. In 2005 the former executive director advised the private company that gravel must stay on NELHA property. No reason was provided, but it appears the former executive director may have believed lava is classified as a mineral. In 2008 another private company also solicited the authority regarding a contract to grade 30 acres of NELHA property to produce gravel for the Queen Ka'ahumanu Highway widening project. According to authority staff, the former executive director stalled decisionmaking on the contract for so long that the company lost interest; however, staff was unaware of the reason for his hesitation.

In 2010 the authority pursued the gravel issue by requesting authority from DLNR to remove gravel from the NELHA property and invited comments from stakeholders. The Office of Hawaiian Affairs (OHA), which has a financial and cultural interest because it involves ceded lands, responded to the draft that it had no problems with the proposal, provided it was accorded its 20 percent on all revenues collected. Ultimately, the request for authority to remove gravel was not pursued and remains an open issue.

According to a NELHA staff, it is estimated that the 2008 contract, had it been pursued, would have resulted in revenues to the authority of approximately \$1.3 million. It is therefore worthwhile for the authority to clarify its authority to sell crushed lava offsite. Such sales would not only generate alternative revenues for the authority, but also serve mutually beneficial purposes. In the case of grading land in exchange for gravel, the authority would benefit by providing tenant-ready lots. In the case of selling gravel to the state Department of Transportation for use in its Queen Ka'ahumanu Highway widening project, both parties would benefit since they are both state entities.

***Self-sufficiency has been reached on an operating level, but NELHA is still reliant on CIP funding***

Pursuant to the 1995 Governor Cayetano memo encouraging NELHA to become “more self-reliant” and the 2003 Governor Lingle message mandating that NELHA become “self-sufficient,” the authority has not received any general funds since FY2009, but it is still reliant on the State to fund its capital improvement projects.

**NELHA will be relying on State CIP funding for the foreseeable future**

According to its executive director, the authority defines self-sufficiency as being able to meet its day-to-day operating expenditures; it does not consider the ability to meet its CIP needs as a prerequisite to claiming self-sufficiency. On this basis, the authority has achieved self-sufficiency from an operating standpoint and, according to the executive director, the authority hopes to be able to cover its own CIP costs within the next ten years. Exhibit 2.1 shows the authority's special fund balance over the last six years.

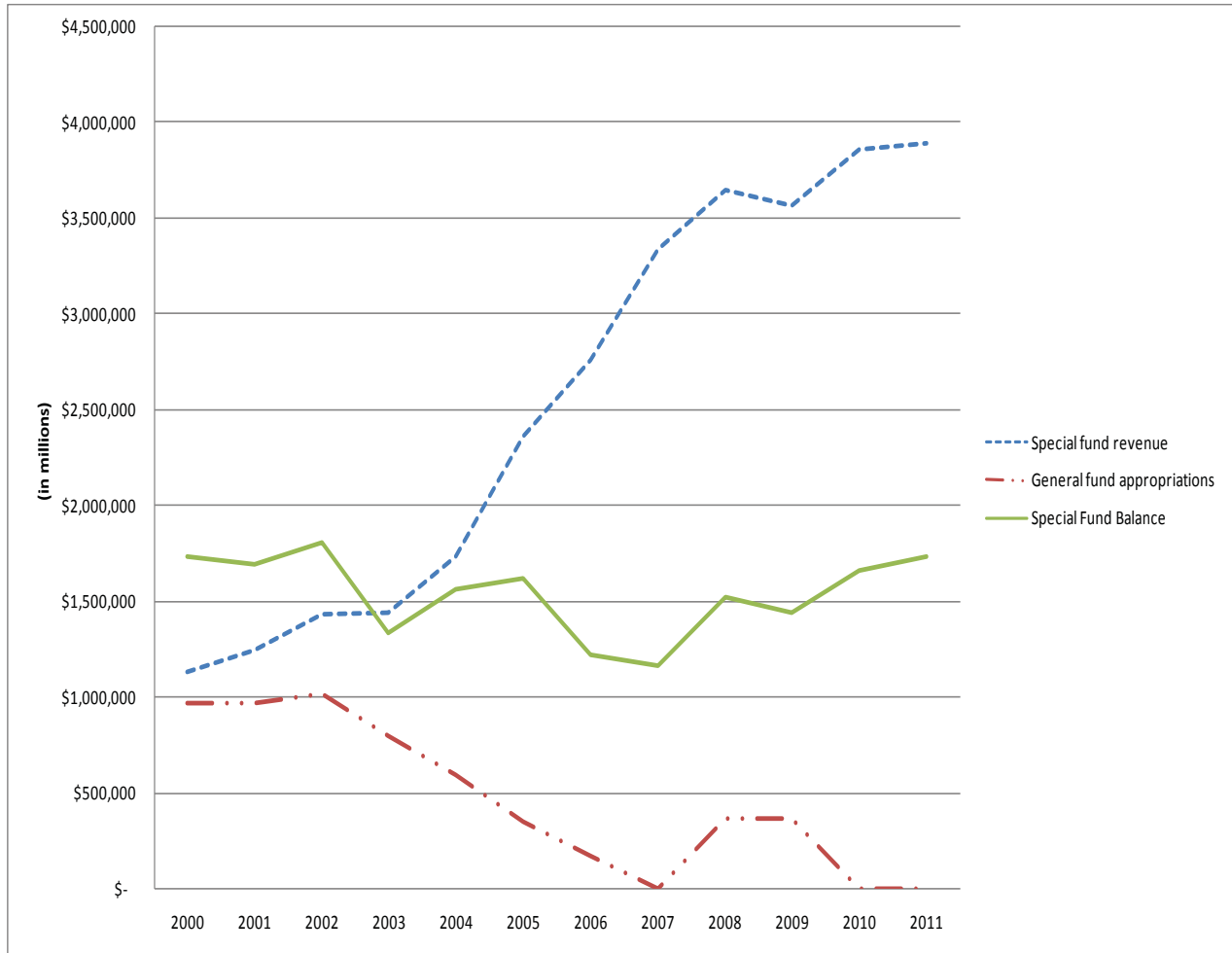
**Exhibit 2.1 Special Fund Revenues, Expenditures, and Balance, FY2006–FY2011**

|  | FY2006             | FY2007             | FY2008             | FY2009             | FY2010             | FY2011             |
|--|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|
| Special fund beginning balance   | \$1,619,797        | \$1,227,155        | \$1,159,737        | \$1,517,896        | \$1,441,587        | \$1,657,276        |
| General fund allotment   | \$ 713,893         | \$ -               | \$ 365,000         | \$ 365,000         | \$ -               | \$ -               |
| General fund expenditures  | \$ 15,425          | \$ -               | \$ 365,000         | \$ 357,669         | \$ -               | \$ -               |
| Special fund revenue   | \$2,767,000        | \$3,338,974        | \$3,648,608        | \$3,567,867        | \$3,863,612        | \$3,895,603        |
| Special fund transfer from prior year                                    |                    |                    |                    |                    |                    | (\$55,475)         |
| Special fund expenditures  | \$2,973,939        |                    | \$3,064,517        | \$3,351,622        | \$3,627,713        | \$4,142,735        |
| Special fund transfer to the state treasury                              |                    | \$3,172,756        | \$ -               |                    |                    |                    |
| Transfer to ceded lands  | \$ 191,183         | \$ 231,141         | \$ 220,960         | \$ 292,554         | \$ 320,210         |                    |
| Transfer to special fund from state civil defense for earthquake repairs |                    |                    |                    |                    | \$ 300,000         |                    |
| <b>Special fund balance</b>  | <b>\$1,221,675</b> | <b>\$1,162,232</b> | <b>\$1,522,868</b> | <b>\$1,441,587</b> | <b>\$1,657,276</b> | <b>\$1,354,668</b> |
| Source: NELHA  |                    |                    |                    |                    |                    |                    |



Exhibit 2.2 illustrates the authority's progress towards operational self-sufficiency over the last ten years.

**Exhibit 2.2 NELHA's Progress Towards Self-sufficiency, FY2001–FY2011**



Source: Office of the Auditor chart based on data by NELHA

Land use fees make up close to 40 percent of the authority's operating income, with another 36 percent provided by seawater pumping fees. Any reduction in these critical revenue areas would significantly impact the authority's ability to cover its costs. Until it is able to attract a substantial number of new tenants, the authority is unlikely to be able to pay for its own capital improvement projects such as its proposed new frontage road.

### **Rent deferrals hamper authority's progress towards self-sufficiency**

The authority is in a difficult position in regards to raising tenants' rents in order to meet its mandate of self-sufficiency. Low rents mean the authority cannot meet its mandate, while higher rents threaten to

put tenants out of business or otherwise cause them to leave the park. Uncollectible rents or loss of tenants both result in lower revenue to the authority. However, deferral of rent increases affects the authority's ability to be self-sufficient. Granting deferrals also sets a precedent for other tenants seeking relief.

In June 2010 an appraisal was conducted to provide an opinion of market rent for various land uses at NELHA. The appraiser found that:

- There were 25 tenants leasing acreage parcels at NELHA. Of these, 17 (68 percent) were productive users which utilize the land for commercial aquaculture. Their rents ranged from \$100 to \$1,000 per acre, per month;
- Extractive users (for example, water bottlers) made up approximately 20 percent of the authority's land sub-leases. These tenants leased their land for \$200 to \$2,000 per acre, per month. However, only one of the five extractive tenants was paying the top rate. The remaining tenants requested deferrals and were paying \$200 to \$486 per acre, per month;
- There were only two energy users leasing land at NELHA (8 percent of land sub-leases). These rental rates were \$1,200 and \$1,500 per acre, per month. However, the tenant leasing at \$1,200 had previously requested a rent deferral and was paying \$600 per acre, per month for a while but later paid \$1,385 per acre, per month to make up for the deferral; and
- The remaining 4 percent of land sub-leases (one lease) belongs to the West Hawai'i Explorations Academy Public Charter School, which uses the land for educational purposes.

Deferrals last from one to three years. At the end of the deferral period, tenants are responsible for paying all deferred rents, including interest. We found that although there were four requests for deferrals between March 2009 and September 2011, the authority's deferral policy—which applies specifically to rent increases—was not approved by the board until November 2010, the same day it approved two of the three rent increase deferral requests it had received up to that point. In addition, the policy is not maintained in a central location of board policies—according to the executive director, there is no such thing—which raises a transparency issue. This and other large, broad, or ongoing policies should be formalized as administrative rules, which are transparent by virtue of having been publicly vetted and approved and publicly available.

Despite there being a policy, deferrals are essentially determined on a case-by-case basis. In one instance, NELHA agreed to defer \$388,800 in rent plus \$81,083 in interest; in another instance it deferred an unspecified amount and later waived \$732,000 plus \$61,856 in interest. Made in this manner, deferrals are difficult to substantiate and even more difficult to defend, putting the authority's revenue stream and credibility at risk.

***Current issues must be addressed for authority to move forward***

The authority faces myriad issues that must be addressed in order to achieve its mission to facilitate the research, development, and commercialization of natural energy resources and ocean-related research, technology, and industry in Hawai'i. In his November 2011 presentation to the board, the executive director reported on 15 project areas, four of which (master plan, financial plan, marketing, and lease-related issues) are discussed earlier in this report. Several other issues, however, are of critical importance and must be addressed for the authority to move forward: the widening of the Queen Ka'ahumanu Highway, which requires that the authority construct a new connecting road to the highway; and the fact that the authority already exceeds its freshwater allocation. Both issues seriously impact the authority's ability to attract and retain tenants, which in turn affects its ability to achieve its mandate of self-sustainability and its overall mission.

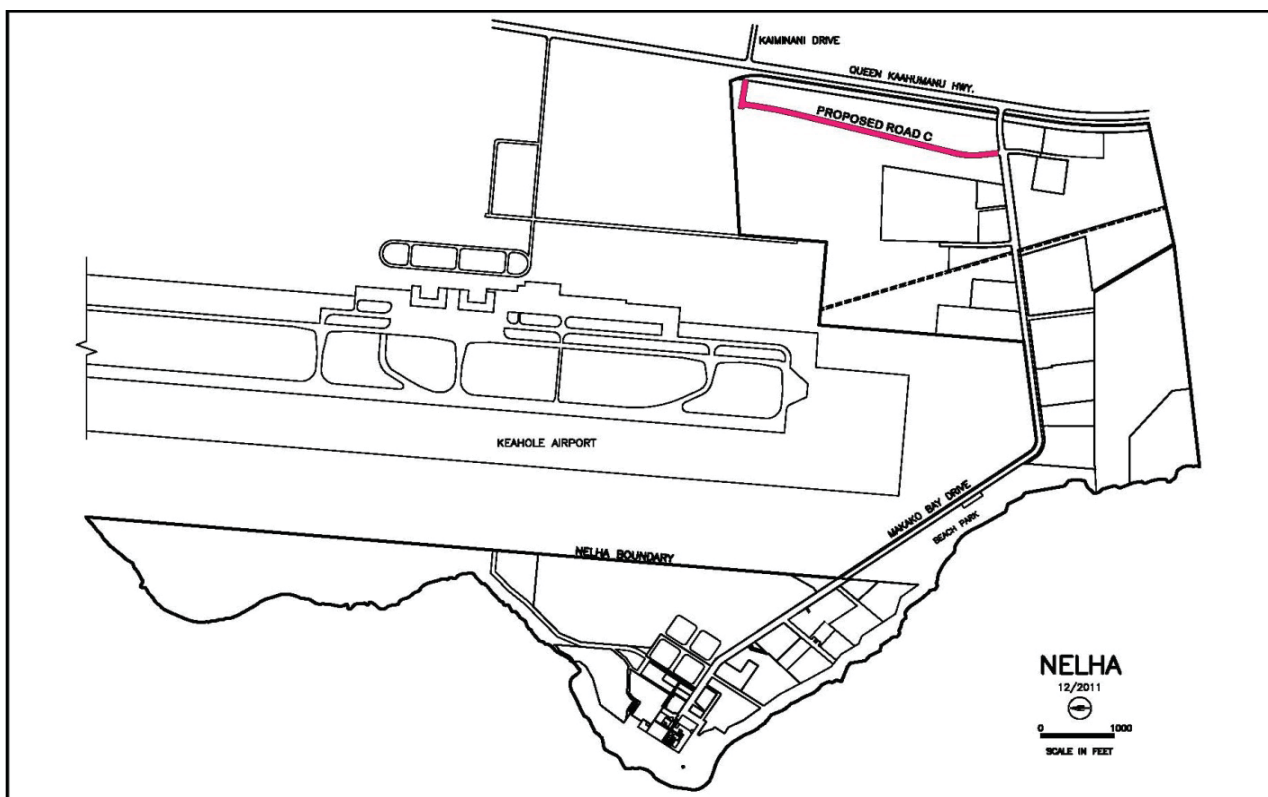
**Queen Ka'ahumanu Highway widening necessitates new frontage road**

The state Department of Transportation plans to widen the Queen Ka'ahumanu Highway from one lane in each direction to a two-lane, divided highway. The project, which fronts the NELHA complex at Keahole Point, is set to begin within the first half of 2012 and will limit vehicles' entrance into and exit from NELHA.

Right-in, right-out only access will eliminate vehicles' ability to make left turns into or out of NELHA. Drivers will have to travel up to several miles beyond NELHA and make a U-turn in order to change direction. This is particularly problematic and dangerous for the many large trucks, such as those used by the water bottlers that enter and leave the property daily and which must transport their products to market via Kona International Airport. Driving to the airport requires a left turn out of NELHA. In addition to hampering current tenants' activities, right-in, right-out only access will restrict the authority's ability to attract new tenants, whereas a new road will open up many potential lots for new tenants and allow for expansion of the research park as envisioned in the authority's new master plan.

In line with the master plan, the authority intends to address this issue by building a new “frontage road” that provides an alternate access road to NELHA. According to NELHA’s board chair, the transportation department has agreed to install a traffic light at Kaimanani Road, approximately one mile north of NELHA’s current entrance; the authority intends its new road to connect Makako Bay Drive (formerly known as Otec Road) to the Queen Ka’ahumanu Highway at Kaimanani Road. Exhibit 2.3 illustrates the location of the proposed new frontage road (“Proposed Road C,” in red).

**Exhibit 2.3 Proposed New Frontage Road**



Source: NELHA

As of November 2011 the authority estimated the new frontage road will cost \$7 million, and it intended to solicit capital improvement project funding from the Legislature for this purpose.

### **Fresh water allocation is already being exceeded**

Fresh water is critical to the authority’s operations. According to the executive director, in the 1970s the original NELH was given a freshwater allocation of 22,000 gallons per day. Later, an allocation of 400,000 gallons per day was provided to the developers of the HOST park. When NELH and the HOST park merged to become NELHA in

1990, the 400,000 gallons per day became the allotment for the entire property. However, today the park as a whole uses roughly 552,000 gallons per day. As a result, the authority exceeds its overall allocation. Although we observed that water is currently still flowing from its taps, without the ability to guarantee the provision of fresh water, the authority cannot in good faith continue to market its research park to potential tenants without disclosing that freshwater may not be available.

This issue has been ongoing since at least 2005, when it was discussed at a board meeting. It came to a head when the Hawai'i County Department of Water Supply advised the authority in August 2011 that it would not supply additional fresh water to one of NELHA's tenants—West Hawai'i Explorations Academy Public Charter School—when it relocates from its current location at NELHA to another lot also on NELHA grounds. The water department stated that it “can not [sic] provide any additional water at this time;” and that “extensive improvements and additions, which may include, but [are] not limited to source, storage, booster pumps, transmission, and distribution facilities, would be required. Currently, sufficient funding is not available ... for such improvements and no time schedule is set.”

As the executive director reported to the board in September 2011, the authority's freshwater system is the biggest constraint preventing the use of existing parcels and the subdivision of land to provide additional parcels for lease. The authority needs to work with the County of Hawai'i to increase the authority's fresh water allocation to allow for expansion. In response to this critical issue, the executive director reported that he met with the water department to discuss increasing the authority's allocation and has developed a strategy to obtain additional allocations in line with master plan projections.

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## Conclusion

The Natural Energy Laboratory of Hawai'i Authority has been described as a “diamond in the rough.” According to one legislator, “there are great things happening at NELHA” and “it should be a winner—why isn't it?” The legislator's concern is that the authority has “all the elements to bring about success, but it is not happening.” These comments underscore our overarching finding that the authority's ability to prove its worth has been undermined by its lack of transparency and accountability.

Our findings reflect an agency which, after nearly 40 years, has yet to achieve its potential as an ocean-related research, education, and commercial center. In the absence of clearly reported progress and while continuing to struggle with the basics of open government, it is no wonder the authority has had difficulty convincing legislators, taxpayers, and potential tenants of its worth and successes.

However, despite the myriad issues it faces, we found that the authority is making progress under new management. Marketing, tenant relations, and alternative revenue streams are all being addressed. Self-sufficiency has been reached on an operating level, but the authority is still reliant on state funding for capital improvement projects and will be for the foreseeable future. Deferrals in rent increases, however, impact the authority's progress towards self-sufficiency, and critical issues such as a new frontage road and its freshwater allocation must be addressed in order for the authority to move forward.

The authority has the power and tools to overcome these and other obstacles, and we look forward to learning that the many new plans it has sown of late have germinated to profitable and sustainable fruition in the next several years.

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## Recommendations

1. The chair of the Natural Energy Laboratory of Hawai'i Authority's board of directors should:
  - a. Ensure new board members are given orientation and training in relation to NELHA's statute; its roles, responsibilities and mission; and the board's roles and responsibilities as outlined in the authority's policies and procedures manual.
  - b. Ensure that all board members are trained in the requirements of Hawai'i's Sunshine Law, Chapter 92, HRS.
  - c. Ensure that tenant representatives are trained in when and how to recuse themselves from voting in relation to setting rates, as is required by Section 227D-2(b), HRS. The chair should take responsibility for ensuring that all board members are made aware of the interpretation and extent of restrictions on tenant representatives' voting rights, and how recusals are to be effectuated. This should be done through a training session and establishment of a policy and formalized as an administrative rule. The chair and note taker should also be aware of the implications that recusals have to quorum on individual votes.
  - d. Recognizing that the board continues to struggle with Sunshine requirements, request that the deputy attorney general assigned to the board provide stronger guidance on and control of board meetings in relation to Sunshine issues.

2. The board and executive director should:

- a. To facilitate transparency, create a compilation of all board-approved policies. Where they are ongoing or broad, these policies should be formalized as administrative rules.
- b. To facilitate transparency, establish a uniform land rent rate structure based on a Dilmore curve, and base future leases on this structure. This should be codified as a board policy and compiled appropriately.
- c. Seek needed legislative clarification regarding to whom the authority may *wheel* (sell electricity).
- d. As a matter of priority, follow through with plans to solicit capital improvement project funding from the Legislature for the purpose of constructing a new frontage road to the Queen Ka'ahumanu Highway.
- e. As a matter of priority, follow through with published plans to rectify the authority's fresh water allocation to ensure that current and future tenants can be assured of continued access to fresh water.

3. The executive director should:

- a. Ensure that pursuant to the State Procurement Office (SPO)'s advice, all staff participating in procurement activities are provided with a detailed plan of action to prevent recurrence of previous SPO violations. Individuals participating in procurement activities are required to be in compliance with Procurement Delegation No. 2010-01 and Amendment 1, and Procurement Circular No. 2010-05, *Statewide Procurement Training*, as appropriate.
- b. Follow through with published plans to create a strategic business and financial plan.
- c. Follow through with published plans to adopt administrative rules for the authority.
- d. Update the authority's 1995 policies and procedures manual to ensure it is current, complete, and ultimately aligned with administrative rules.



- e. Update the Project Initiation Packet (PIP) as appropriate to ensure that this information, which is available on the authority's website, remains current so as not to mislead potential tenants and other stakeholders.
- f. Ensure that staff responsible for taking minutes of board meetings are aware of the need for, and effectuate, a more consistent style of nomenclature in the minutes, particularly in regard to identifying which interests are represented by which attendees; whether members are merely *absent* or are, in fact, *excused*; and the appellation of investigatory or other transient committees or task forces.
- g. Ensure that staff responsible for taking minutes of board meetings are trained in, and effectuate, the requirements of Hawaii's Sunshine Law, Chapter 92, HRS, particularly in relation to:
  - i. Taking and storing minutes of both open board meetings and executive sessions;
  - ii. Recording votes of individual members where the vote is not unanimous;
  - iii. Ensuring minutes are publicly available within 30 days of a board meeting; and
  - iv. Documenting the reason and statutory reference for entering into any executive session. Minutes should be able to stand alone and not need to be read in conjunction with agendas to satisfy this requirement.
- h. Ensure the authority adopts and reports on meaningful key performance indicators in its annual report.
- i. Follow through with published plans to have the authority's 2001 economic impact analysis updated.
- j. Follow through with published plans to update the authority's website. The updated website should include up-to-date and complete information so that potential tenants and other stakeholders have easy access to the authority's mission, services, rates, and performance data.
- k. Follow through with plans to establish a Dilmore curve-based lease rent policy, and ensure the policy is available to relevant stakeholders.



- l. Establish and implement internal controls for the calculation of seawater rates. If the current Excel spreadsheet continues to be used, one or more staff members should be assigned to review monthly calculations for mathematical and cut-and-paste errors. Ideally, the current spreadsheet should be converted to a database to avoid errors inherent in manual calculations.
  - m. Ensure the authority makes its seawater pumping rates publicly available and that this information is kept up to date. There is no need to display the entire calculation of the rate; a narrative followed by the current numerical rate would suffice.
  - n. Reconcile the authority's financial information as reported in QuickBooks and FAMIS.
  - o. Continue implementing stated plans to market and promote NELHA to prospective tenants.
  - p. Pursue the recommendation in the master plan to locate future cellular telephone tower concessions on acreage away from the authority's administration building, and then enter into leases as appropriate to increase the authority's revenues.
  - q. Revisit the request to the Department of Land and Natural Resources for a license to remove gravel from NELHA property, and pursue the sale of such gravel to interested vendors.
4. The tenant representatives to the board should, if in doubt about whether a discussion item constitutes setting a rate, ensure they recuse themselves from a vote to avoid any perception of improper voting, which can jeopardize the validity of such a vote.
5. The Legislature may wish to consider amending the composition of the authority's board to reduce the unusually high number of ex-officio members and include public representation in the form of at least two public members.

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## Response of the Affected Agency

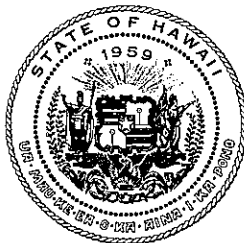
### Comments on Agency Response

We transmitted a draft of this report to the director of the Department of Business, Economic Development and Tourism, and to the board chair and the executive director of the Natural Energy Laboratory of Hawai'i Authority on May 8, 2012. A copy of the transmittal letter to the director is included as Attachment 1. The board's response, received on May 23, 2012, is included in its entirety as Attachment 2. The department did not provide a response.

The authority did not take issue with our findings. The board chair assured us there is a strong desire to implement our recommendations and that doing so will be made a top priority. The chair was pleased we acknowledged the authority's recent efforts and reported that the authority has already made progress in taking action on some of our recommendations, including a training session for board members on Sunshine laws, approving a new strategic plan, completing an economic impact analysis, updating the website, and reviewing the leasing policy. The authority also plans to adopt administrative rules.

We made a few technical corrections prior to publication.

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



MARION M. HIGA  
State Auditor

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

May 8, 2012

**COPY**

The Honorable Richard C. Lim  
Deputy Director  
Department of Business, Economic Development & Tourism  
250 South Hotel Street, 5<sup>th</sup> Floor  
Honolulu, Hawai'i 96813

Dear Mr. Lim:

Enclosed for your information are three copies, numbered 6 to 8, of our confidential draft report, *Management Audit of the Natural Energy Laboratory of Hawai'i Authority*. We ask that you telephone us by May 11, 2012, on whether or not you intend to comment on our recommendations. If you wish your comments to be included in the report, please submit them no later than May 21, 2012.

The Natural Energy Laboratory Authority of Hawai'i, Natural Energy Laboratory Authority of Hawai'i Board of Directors, Governor, and presiding officers of the two houses of the Legislature have also been provided copies of this confidential draft report.

Since this report is not in final form and changes may be made to it, access to the report should be restricted to those assisting you in preparing your response. Public release of the report will be made solely by our office and only after the report is published in its final form.

Sincerely,

Marion M. Higa  
State Auditor

Enclosures



# NATURAL ENERGY LABORATORY OF HAWAII AUTHORITY

*An Authority of the State of Hawaii attached to the Department of Business, Economic Development & Tourism*



May 21, 2012

Ms. Marion M. Higa  
State Auditor  
Office of the Auditor  
465 South King Street, Room 500  
Honolulu, Hawaii 96813-2917

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OFF. OF THE AUDITOR  
STATE OF HAWAII

Dear Ms. Higa:

Thank you for the opportunity to respond to the draft **Management Audit of the Natural Energy Laboratory of Hawaii Authority**. The NELHA Board of Directors met on May 15, 2012 to discuss the draft report and these comments are based upon our discussion.

We are very appreciative of the time that you and your agency took to review NELHA and complete a thorough and rigorous examination of our agency's management practices. In this regard, we believe that it is important that NELHA Board of Directors take your findings very seriously. I can assure you that there is a strong desire and willpower among the Board members and at the top of our agency to take corrective actions to implement your recommendations. We will also make it one of our top priorities.

We also take "great pride" in the progress you acknowledge and validate regarding the Authority's recent efforts to turn our agency around. We recognize that there were problems in the past and we still have much work to do to achieve our mission and objectives. Achieving operational self-sufficiency for a governmental agency is not an easy task, and the audit correctly points out that NELHA is fortunate to have been given the powers and tools by the Legislature to do so.

I can assure you that NELHA will increase its efforts to achieve our mission and objectives. We have already made much progress in taking action on some of the recommendations contained in your report. We have completed a training session for Board members regarding sunshine laws; approved a new Strategic Plan at our May Board meeting; completed an economic impact analysis of NELHA on the people of the State of Hawaii; began efforts to update our website; and, began reviewing the recently submitted new NELHA leasing policy.

With respect to NELHA's rules, we intend to adopt new administrative rules for NELHA relating to, for example, fishing permits, as well as other similar activities relating to the rights of the general public. The previously proposed rules may be outdated, and not useful in moving forward. We will also be discussing with our attorney whether rules are required for matters which are more internal to the management of NELHA, such as the manner in which NELHA reviews sublease proposals. To reiterate, however, we appreciate the fact that you raised this issue.

Finally, we would like to compliment the Auditor for what we view as a "fresh approach" with this report. Often, reports of this nature seem to stop short of providing detailed recommendations for making changes and improving an organizations effort to achieve its mission. We were pleasantly surprised with the level of detail and quality of the recommendations. We will be able to easily incorporate many of these into our operational level plans.

NELHA values the responsibility entrusted upon it to ensure proper planning and achievement of its mission and objectives. As indicated above and throughout the audit report, NELHA has and will continue to make great strides in fulfilling that trust.

Very truly yours,


John DeLong  
Chairman of the Board