

**MERINA  
& COMPANY, LLP**

Certified Public Accountants and Consultants

**CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS**

CABLE DIVISION  
COMMERCIAL  
PARTNERS

JOHN W. MERINA, CPA \* KAMALA K. AUSTIN, CPA

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FILE.....

December 19, 2003

Mr. Mark E. Recktenwald  
Director  
Department of Commerce and Consumer Affairs  
State of Hawaii  
335 Merchant Street  
Honolulu, Hawaii 96809

Dear Mr. Recktenwald:


Enclosed please find the following letters and reports:

- Report to DCCA
- Procedures Performed By Merina & Company, LLP
- Independent Accountants' Report of Revenue Statements
- Independent Accountants' Report on Carry-forward Analysis

These reports have also been transmitted to Mr. Clyde Sonobe in PDF format for posting to your web site.

If you have any further questions, please feel free to call our office.

Sincerely,



John Merina, CPA  
Managing Partner  
Merina & Co., LLP  
Certified Public Accountants and Consultants

DIRECTOR'S OFFICE  
COMMERCE AND  
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**December 19, 2003**

**Mr. Mark E. Recktenwald  
Director  
Department of Commerce and Consumer Affairs  
State of Hawaii  
335 Merchant Street  
Honolulu, Hawaii 96809**

**Dear Mr. Recktenwald:**

The Department of Commerce and Consumer Affairs (DCCA) requested that Public Knowledge, Inc. and Merina & Company, LLP perform a verification of a "Carry-Forward Analysis" submitted to DCCA by Time Warner Entertainment Company, L.P. (TWE), doing business as Oceanic Cablevision (Oceanic) on the Island of Oahu. The Oceanic analysis covers the period January 1, 1995 through December 31, 2002. The purpose of the analysis was to derive certain financial balances relevant to DCCA's regulation of Oceanic:

- The cumulative carry-forward balance of the over- (or under-) collection of franchise fees. This balance expresses the difference between the amount of franchise fees collected from Oceanic subscribers on Oahu (inflows to Oceanic), and the fees Oceanic paid to certain entities designated to receive franchise fee payments (outflows from Oceanic).
- Over- (or under-) payments by Oceanic of franchise fees due to the entities designated to receive payments.

This letter and the attachments report on our verification of the Oceanic analysis, organized as follows:

- Background
- Overview of procedures
- Overview of the "Carry Forward Analysis"
- Conclusions and recommendation

## Background

DCCA's applicable decisions and orders and rules specify three elements of the franchise fees relating to the Oahu cable operation:

- Three percent of gross revenue for an "Access Operating Fee" is to be paid to the DCCA Director or the Director's designee (currently 'Olelo)
- One percent of gross revenue is to be paid to the Hawaii Public Broadcasting Authority (HPBA Fee)
- One percent of a portion of income received from subscribers is to be paid to DCCA (Administrative Fee).

"Gross revenue" is defined differently for the Access Operating Fee and the HPBA Fee than it is for the Administrative Fee, and the definition applicable to the Access Operating Fee and the HPBA Fee changed during the period under analysis.

- DCCA Decision and Order No. 154 (January 27, 1993) defined "gross revenues" for the purpose of the Access Operating Fee and the HPBA Fee as:

"... all cash, credits, property of any kind or nature or other consideration derived directly or indirectly by Oceanic, its affiliates, subsidiaries, parents, and any other person or entity in which Oceanic has a financial interest or which has a financial interest in Oceanic, arising from or attributable to operation of the Hawaii Cable System, including but not limited to:

- (a) revenue from all charges for entertainment and nonentertainment services provided to Subscribers
- (b) revenue from all charges for the insertion of commercial advertisements upon the Cable System
- (c) revenue from all charges for the leased use of studios or Channels
- (d) revenue from all charges for installation, connection and reinstatement of equipment necessary for the utilization of the Cable System and the provision of Subscriber and other service; and
- (e) revenue from the sale, exchange or use or cablecast of any programming developed for community use or institutional users."

- DCCA Decision and Order No. 261 (August 11, 2000) changed the definition of gross revenue applicable to the Access Operating Fee and HPBA Fee. The new definition, applicable beginning January 1, 2001, specifies that "gross revenue" includes:

"... charges billed for and collected from Subscribers. Such charges shall include customer billings and collections for entertainment and nonentertainment services, installation, collection, reconnection and reinstatement of equipment necessary for the utilization of the Cable System. 'Gross Revenue' shall exclude revenues from charges and collections for nonsubscription or nonsubscriber related sources such as advertising sales, home shopping commissions, franchise fees passed through to Subscribers, and uncollected debt except that once such debt is actually collected it shall be included as part of Gross Revenue."

- Hawaii Administrative Rules, Title 16, Chapter 132 defines "income received from subscribers" for the purpose of the Administrative Fee as:

"... revenues derived from the supplying of regular subscriber service and includes installation fees, disconnect and reconnect fees and fees for regular cable benefits. It does not include per-program channel charges, leased channel revenues, advertising revenues and other income derived from the system."

The prescribed timing of the franchise fee payments differs among three fee elements:

- Decision and Order No. 154 specifies that the HPBA Fee be paid by January 31 each year based on the revenue reported for the previous calendar year (retroactive calculation).
- Decision and Order No. 154 specified that the Access Operating Fee be paid on the first day of the year based on an estimate for the year, and then reconciled the following year (prospective payment). However, Decision and Order No. 261 changed the payment schedule for the Access Operating Fee, making it retroactively based, effective with the January 2002 payment.
- Administrative Rule ¶ 16-132 set up a schedule for the Administrative Fee requiring two payments each year, in by the first day of June and by the first day of December.

## Overview of procedures

We divided our assessment of the Oceanic "Carry-Forward Analysis" into three periods, in order to avoid duplication of work performed previously for DCCA by the public accounting firm of PricewaterhouseCoopers, LLP.

- For calendar years 1995 through 1997 the public accounting firm of Merina & Company, LLP tested the reasonableness of the stated beginning balances, checked the mathematical accuracy of the calculations, and checked to assure that certain figures in the analysis agreed to supporting documentation.
- PricewaterhouseCoopers, LLP had performed a related agreed-upon-procedures engagement previously for DCCA, covering calendar years 1998 through 2000. Merina & Company, LLP determined that the procedures performed by PricewaterhouseCoopers LLP were sufficient to determine the compliance of franchise fee payments made by Oceanic during that period. Merina & Company, LLP checked the mathematical accuracy of Oceanic's "Carry-Forward Analysis" calculations and checked to assure that certain figures in the analysis agreed to supporting documentation for this period.
- For calendar years 2001 and 2002 Merina & Company, LLP performed a more extensive assessment, including:
  - Reviewed DCCA's applicable franchise fee requirements
  - Documented Oceanic's policies and procedures for preparing annual "Revenue Statements" that Oceanic submits to DCCA for franchise fee purposes
  - Traced amounts used in the franchise fee computations to Oceanic's books of account
  - Checked the mathematical accuracy of Oceanic's "Carry-Forward Analysis" calculations
  - Checked to assure that certain figures in the analysis agreed to supporting documentation for this period.

A more detailed description of the procedures is attached to this letter, along with Merina & Company, LLP's opinion letters.

## Overview of the "Carry-Forward Analysis"

Several key points will aid an understanding of the "Carry-Forward Analysis":

- Oceanic itemizes franchise fees on subscriber bills. Over time the amount Oceanic had collected in itemized franchise fees differed from the amount remitted to the entities that receive franchise fee payments. This difference was attributable to timing matters and to the subscriber bill itemization methodology. Nothing came to our attention that would suggest Oceanic deviated from the billing and remittance methodology permitted by DCCA at that time.

- The original prospective basis for the Access Operating Fee and the delayed payment schedule of the Administrative Fee meant that the payments that Oceanic made to the fee recipients in any given calendar year would, in all likelihood, not match to the fees collected from subscribers for the preceding year.
- For much of the period under review the franchise fee itemization on subscriber bills was a selected flat amount for each subscriber, not directly tied to the amounts for cable services on each individual subscriber's bill. This practice meant that the amount itemized as the franchise fee would not necessarily conform precisely to the controlling "percentage of gross revenue" definitions cited above. Oceanic has since changed this practice: now the itemized amount on each subscriber's bill relates to the amounts for cable services shown on the bill.
- Oceanic prepared the "Carry-Forward Analysis" to identify the cumulative amounts of the over (or under) collections of franchise fees from subscribers, compared to the amounts remitted to the entities receiving franchise fee payments. The basic outline of the "Carry-Forward Analysis" is as follows:
  - The analysis includes separate computations for the Access Operating Fee, the HPBA Fee, and the Administrative Fee.
  - For each fee, the analysis begins with the balance of the difference between the collection of itemized franchise fees and the payments to recipient entities as of January 1, 1995.
    - Theoretically, the analysis could have extended retroactively to the point that Oceanic began to itemize franchise fees on subscriber bills.
    - As a practical matter it was helpful to select a beginning point within a period for which relevant records were accessible.
    - DCCA stipulated January 1, 1995 as the beginning date for the analysis.
  - For each calendar year between January 1, 1995 and December 31, 2002, the analysis adjusts the cumulative balances to reflect both subscriber billings of the itemized franchise fee (inflows to Oceanic) and payments to the entities receiving the franchise fee payments (outflows from Oceanic).
  - The analysis culminates in cumulative balances of over- (or under-) collections as of December 31, 2002 (adjusted for certain accruals).
- One key issue subsumed in the analysis is whether Oceanic's franchise fee payments were compliant with DCCA requirements. The basic question is whether the amount of revenue Oceanic reported to DCCA each year for each element of the franchise fee complied with the gross revenue definition applicable to that element of the fee.

- In its assessment of the 1998 through 2000 period, PricewaterhouseCoopers had identified franchise fee underpayments attributable to how Oceanic treated bad debt write-offs in the revenue reported to DCCA. DCCA directed Oceanic to remedy this underpayment in the "Carry-Forward Analysis". Oceanic has applied an adjustment, with interest, to correct for this underpayment retroactively to January 1, 1995 and extending through December 31, 2002.
- In its examination of the 2001 and 2002 period Merina & Company, LLP identified that Oceanic had included advertising revenue in the amount of revenue it reported to DCCA for 2001, although the applicable gross revenue definition had changed in 2000 (Decision and Order No. 261) to exclude advertising revenue. Oceanic has applied an adjustment, with interest, to correct for this 2001 overpayment.

**Conclusions and recommendation**

For the period January 1, 1995 through December 31, 2002 Oceanic collected more franchise fees from subscribers than it paid to the designated recipients. The results are summarized in the table below (adjusted to an accrual basis for the HPBA Fee due and paid in January 2003):

	Franchise Fee Element		
	Access Operating and HPBA	Administrative	Total
Over-collection of franchise fees from subscribers	\$ 430,323	\$ 53,436	\$ 483,759

Oceanic did not itemize franchise fees on subscriber bills by specific elements (Access Operating, HPBA, Administrative), but rather included one integrated franchise fee itemization. How the franchise fees collected have been assigned to the specific elements has been a matter of Oceanic's internal accounting conventions. Both the Access Operating Fee and the HPBA Fee apply the same definition of gross revenue, and now both are determined based on the previous year's revenues. For these reasons we believe it is reasonable to treat the cumulative over-collection of franchise fees assigned to the Access Operating and HPBA Fees on a combined net basis. As of December 31, 2002 the net combined Oceanic over-collection from subscribers for these two fee elements considered together was \$430,323.

The Administrative Fee, on the other hand, applies a different definition of gross revenue and its payment timing differs from the other two fees. Therefore, it is reasonable to consider this fee separately. The cumulative over-collection of franchise fees assigned to the Administrative Fee represents primarily a timing difference. It will drop each December and June as payments are made to DCCA, and then increase again until the time of the next payment. As of December 31, 2002 the over-collection of this fee was \$53,436.

We also evaluated whether Oceanic paid the recipient entities the franchise fee amounts that they were due under the DCCA decisions and orders applicable during the January 1, 1995 through December 31, 2002 period. On the one hand there was an underpayment attributable to Oceanic's bad debt allocation procedure through the period (applicable to all three fee elements), but there was also an overpayment attributable to the inclusion of advertising revenue in 2001 (applicable only to the Access Operating Fee and the HPBA Fee). The table below reflects the cumulative net overpayments or underpayments to the recipient entities considering both the bad debt and advertising adjustments. Oceanic has overpaid the Access Operating Fee and the HPBA Fee, and underpaid the Administrative Fee (which was affected by the bad debt adjustment but not by the advertising overpayment).

	Franchise Fee Element			
	Access Operating	HPBA	Administrative	Total
Net payment due to (from) recipient entities	\$(139,297)	\$ (46,378)	\$3,718	\$(181,957)

We recommend that DCCA accept the Oceanic "Carry-Forward Analysis." Merina & Company's opinion letter on the analysis is attached to this letter. The analysis applies only to Oceanic's franchise for the Island of Oahu.

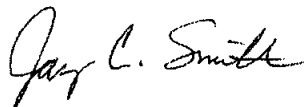
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Please contact John Merina at 503-723-0300 or Jay Smith at 503-287-7273 if you have questions about this letter.

Sincerely,



John Merina  
Merina & Company, LLP



Jay C. Smith  
Public Knowledge, Inc.



**Merina & Company, LLP Procedures Performed to Assess Oceanic  
Cablevision's Carry-Forward Analysis for the January 1995 through  
December 31, 2002 Period**

We have issued our Independent Accountants' Review Report on the "Carry-Forward Analysis" prepared by Oceanic Cablevision for its cable television franchise on the Island of Oahu, covering the period January 1, 1995 through December 31, 2002. Our report is dated December 19, 2003 and expresses an unqualified opinion on the Statement.

Our procedures covered three periods of time. These periods were selected to apply to best advantage work previously completed for the Hawaii Department of Commerce and Consumer Affairs (DCCA) by another public accounting firm.

1. Calendar years 1995 through 1997
2. Calendar years 1998 through 2000 (covered by previous PricewaterhouseCoopers' report)
3. Calendar years 2001 and 2002

We applied the same procedures all three elements of the franchise fees: the Access Operating Fee, the Hawaii Public Broadcasting (HPBA) Fee, and the Administrative Fee.

**Procedures performed for 1995 through 1997**

1. The balances at January 1, 1995 were stipulated by the Department of Commerce and Consumer Affairs (DCCA) to be the beginning balances for purposes of determining the current carry-forward (C/F) balances. Accordingly, the balances at January 1, 1995 are the starting point for our test work. In the absence of correspondence or other documentation identifying the balances when the stipulation was made, we relied on analytical procedures to satisfy ourselves as to the reasonableness of the balances at January 1, 1995. These procedures included:
  - a. Reviewing the monthly customer billings for franchise fees during calendar 1995, 1996, and 1997 for month-to-month consistency. (1996 and 1997 customer billings were separately tested).

- b. Calculating the revenues that would have been necessary to result in the billed franchise fees and agreeing those revenues to the certified annual 1995 Revenue Statement.
  - c. Agreeing 1995 franchise fee payments made to the General Ledger detail account analysis.
  - d. Relating the December 31, 1995 balances to the balances at December 31, 1994 and December 31, 1995, 1996, and 1997 to determine if 1995 fit the pattern of receipts and disbursements.
  - e. Concluding that the balances at January 1, 1995 were properly stated.
2. For the calendar years 1995 through 1997 we:
- a. Proved the mathematical accuracy of the C/F analysis.
  - b. Determined that franchise fee payments made agreed to check copies.
  - c. Determined the adjustments for overpayment of estimated franchise fees to O'lelo were based on the actual revenues subject to the fee and were calculated correctly.
  - d. Agreed revenues used to compute actual franchise fee payable to the Annual Revenue Statement.
  - e. Concluded the C/F balance at December 31, 1997 was properly stated.

#### **Procedures performed for 1998 through 2000**

1. An agreed-upon procedures engagement was performed by another firm of Certified Public Accountants who issued their report dated April 6, 2001. Our procedures for this period were:
  - a. To read the CPAs' *Independent Accountants' Report in Connection with Certain Agreed-upon Procedures*.
  - b. To determine if the procedures were sufficient to either 1) conclude the revenues and resulting franchise fee computation were correctly stated or 2) identify errors in computing revenues subject to franchise fees and the resulting calculation of such fees.
2. We concluded the procedures performed by the other CPA firm were sufficient to determine if revenues were computed properly in accordance with decisions and orders and rules in affect at the time. The *Independent Accountants' Report in*

*Connection with Certain Agreed-upon Procedures* identified instances of excluding certain revenues from the base of revenues subject to the franchise fee.

3. We concluded that the work performed by the other firm of CPAs was of sufficient scope and their findings were sufficiently detailed to allow us to accept the results of their report in our analysis of the C/F balances.
4. For the calendar years 1998 through 2000 we:
  - a. Proved the mathematical accuracy of the C/F analysis.
  - b. Determined that 1998, 1999 and 2000 franchise fee payments made agreed to check copies.
  - c. Determined the adjustments for overpayment of estimated franchise fees to O'lelo were based on the actual revenues subject to the fee and were calculated correctly.
  - d. Agreed revenues used to compute actual franchise fee payable to the Annual Revenue Statement.
  - e. Concluded the C/F balance at December 31, 1997 was properly stated.

#### **Procedures performed for the period 2001 and 2002**

1. For the calendar years 2001 and 2002 we determined we should perform procedures on Oceanic's "Revenue Reports" submitted to DCCA to determine that the revenue base used to calculate the franchise fees was in accordance with the applicable decisions and orders and rules. We employed procedures we customarily use in other reviews of franchise fee compliance.
  - a. Documented the revenue definition in the applicable Decision and Order.
  - b. Identified applicable franchise fee rates.
  - c. Determined the operator has complied with all reporting requirements on a timely basis.
  - d. Documented the operator's policies and procedures for preparing the Annual Revenue Report.

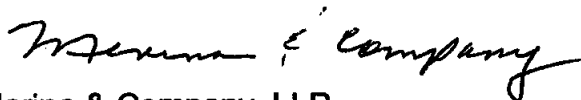
- e. Meet with management to:
    - i. Determine management's interpretation of the franchise fee calculation, including the definition of revenue.
    - ii. Inquire if any adjustments have been made between amounts reported in Oceanic's accounting records and the "Revenue Reports" submitted to DCCA.
  - f. Traced amounts used in the franchise fee computation to the books of account.
  - g. Through inquiry or a scan of the detail general ledger, determined if any revenues were recorded as an offset to an expense rather than as a credit to revenues. Examples include:
    - i. Launch fees
    - ii. Marketing co-op payments
    - iii. Advertising/marketing fees net of commissions
  - h. Inquired if certain other potential revenue sources, such as employee discounts, were excluded from the franchise fee computation.
2. For the calendar years 2001 and 2002 we:
- a. Proved the mathematical accuracy of the C/F analysis.
  - b. Determined that 2001 and 2002 franchise fee payments made agreed to check copies.
  - c. Determined the adjustments for certain overpayments of franchise fees were based on the actual revenues subject to the fee and were calculated correctly.
  - d. Agreed revenues used to compute actual franchise fee payables to the "Revenue Statements" submitted to DCCA
  - e. Concluded the C/F balance at December 31, 2002, as adjusted for discrepancies identified, was properly stated.

## **Independent Accountants' Report**

We have examined the accompanying Revenue Statements for the years ended December 31, 2001 and 2002, as prepared by Time Warner Entertainment Co., LP, dba Oceanic Cablevision (Oceanic), covering Oceanic's operations under the regulation of the Hawaii Department of Commerce and Consumer Affairs (DCCA) on the Island of Oahu. DCCA Decision and Order No. 261 and Administrative Rule ¶ 16-132 define how gross revenues are to be determined for the purpose of calculating franchise fees. Oceanic's management is responsible for the company's compliance with those requirements. Our responsibility is to express an opinion on management's assertion about Oceanic's compliance based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence about Oceanic's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion. Our examination and this report is not a legal opinion on Oceanic's compliance with specified requirements.

In our opinion, management's assertion that Oceanic has complied with the aforementioned requirements during the years ended December 31, 2001 and 2002 is fairly stated in all material respects.



Merina & Company, LLP  
West Linn, Oregon  
December 19, 2003

**Time Warner Entertainment Co., LP,  
dba  
Oceanic Cablevision**

**Revenue Statements**

**For the Year Ending December 31, 2001**

	<u>PEG</u>	<u>Hawaii Public Broadcasting Authority</u>	<u>Admin</u>
Total Revenues	\$ 165,221,995	\$ 165,221,995	
Basic Revenues			\$ 85,830,388
Less: Revenues from military franchises	(14,151,208)	(14,151,208)	
Less: Roadrunner Revenues	(25,137,161)	(25,137,161)	
Less: Advertising Revenue	(5,199,525)	(5,199,525)	
Revenues subject to Access Operating Fee	120,734,101	120,734,101	85,830,388
Rate	3%	1%	1%
Access Operating Fee Due	<u>\$ 3,622,023</u>	<u>\$ 1,207,341</u>	<u>\$ 858,304</u>

**For the Year Ending December 31, 2002**

	<u>PEG</u>	<u>Hawaii Public Broadcasting Authority</u>	<u>Admin</u>
Total Revenues	\$ 180,506,280	\$ 180,506,280	
Basic Revenues			\$ 91,301,090
Less: Revenues from military franchises	(15,435,317)	(15,435,317)	
Less: Roadrunner Revenues	(36,057,876)	(36,057,876)	
Revenues subject to Access Operating Fee	129,013,087	129,013,087	91,301,090
Rate	3%	1%	1%
Access Operating Fee Due	<u>\$ 3,870,393</u>	<u>\$ 1,290,131</u>	<u>\$ 913,011</u>

See Independent Accountants' Report

## **Independent Accountants' Report**

We have reviewed the statement of Carry-Forward Analysis for the period January 1, 1995 through December 31, 2002, as prepared by Time Warner Entertainment Co., LP, dba Oceanic Cablevision (Oceanic), covering Oceanic's operations under the regulation of the Hawaii Department of Commerce and Consumer Affairs (DCCA) on the Island of Oahu. This statement is the responsibility of Oceanic's management.

Our review was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. A review is substantially less in scope than an examination, the objective of which is the expression of an opinion on the Carry-Forward Analysis statement. Accordingly, we do not express such an opinion.

Our review included consideration of prior work done by another firm of certified public accountants and their report dated April 6, 2001. We also performed procedures we considered appropriate in the circumstances, applicable to subsequent calculations made by of Oceanic. The purpose of these procedures was to test the accuracy of Oceanic's calculation, proper assessment, collection, and payment of franchise fees for its Oahu operations.

Based on our review, and with the exception that, under Oceanic's interpretation of DCCA Decision and Order No. 154, certain amounts received by Oceanic were not considered revenues for purposes of franchise fee calculation, nothing came to our attention that caused us to believe that the statement of the Carry-Forward Analysis is not presented, in all material respects, in conformity with the criteria established by the State of Hawaii, Department of Commerce and Consumer Affairs, Cable Television Division.

*Merina & Company*

Merina & Company, LLP  
West Linn, Oregon  
December 19, 2003

**OCEANIC CABLEVISION**  
**Carry-Forward Analysis**  
**December 31, 2002**

	<u>PEG and HPTF</u>	<u>Admin</u>	<u>Total</u>
Previously submitted cash basis overcollected balances	\$ 1,856,625	\$ 100,676	\$ 1,957,301
Adjustment for bad debt write-off's not previously charged against customer billings	<u>(321,846)</u>	<u>(43,522)</u>	<u>\$ (365,368)</u>
Restated cash basis overcollected balances	1,534,779	57,154	\$ 1,591,933
Bad debt write-offs not allocated to military franchises resulting in additional fees due	(30,230)	(3,718)	\$ (33,948)
Advertising revenues included in 2001's Revenue Report, resulting in overpayment of fees	<u>215,905</u>	<u>-</u>	<u>\$ 215,905</u>
Adjusted cash basis overcollected balances	1,720,454	53,436	\$ 1,773,890
Accrual basis conversion 2002 HPTF fees due 1/31/03	<u>(1,290,131)</u>	<u>-</u>	<u>\$ (1,290,131)</u>
Accrual basis (over/under) collected balances	<u>\$ 430,323</u>	<u>\$ 53,436</u>	<u>\$ 483,759</u>