# EXECUTIVE SUMMARY

## Performance Audit of ‘Olelo Community Television DBA ‘Olelo Community Media

In April 2011, the Governor signed into law Act 19 (SLH 2011) which, among other things, requires the Department of Commerce and Consumer Affairs (DCCA), through its Cable Television Division (CATV), to conduct an annual performance audit, also known as a management audit, of each of the state’s four public, educational, and governmental (“PEG”) access organizations for the three years from July 1, 2011 through June 30, 2014. In response to the Act’s requirement, CATV contracted with the Certified Public Accounting firm of Merina & Company, LLP (MCO) to conduct the performance audits.

‘Olelo Community Television DBA ‘Olelo Community Media (‘Olelo) has been selected for the first management audit. MCO has organized their audit and reporting into five sections

- Introduction
- Management and Oversight
- Operations
- Financial
- Compliance

The performance audit was conducted in accordance with auditing standards generally accepted in the United States of America and the standards for performance audits contained in *Government Auditing Standards* (Yellow Book), issued by the Comptroller General of the United States.

The most significant comments and recommendations for improvement resulting from our audit are presented below.

Management and oversight significant comments and one recommendation include:

- For the period from January 1, 2006 through June 30, 2011:
    - The Board of Directors exercised due diligence in their governance.
    - ‘Olelo’s management team appears to have the appropriate experience and knowledge.
    - ‘Olelo’s executive leadership is proactive and not reactive to the changing environment.

  - ‘Olelo used experienced outside consultants to aid them as necessary.

- We recommend ‘Olelo develop a succession plan for when key employees leave the organization.

Operations significant comments and recommendations include:

Community Media Centers (CMC)

- Services provided by ‘Olelo are designed to meet a wide diversity of community needs across the Island, which ‘Olelo views as fulfilling of the organization’s core purpose.

- ‘Olelo has adapted well to changing user needs and the opportunities for service brought about by the Internet.

- ‘Olelo’s use of its facilities to meet Island informational and social needs is one of the positive marks of its particular character, and is arguably in line with its mission and what ‘Olelo sees as the organizations core purpose.

- While successful with ancillary social services, ‘Olelo needs to continue its focus on its primary purpose of cable casting which is essential to maintain.

Transition from Analog to Digital and High Definition (HD)

- The transition to digital and HD is necessary. It places ‘Olelo in a position to provide its services for the foreseeable future.

- The change in leadership in the technical services area comes during a period of exceptional activity during the transition from analog to digital and HD. While the new leadership appears equipped to manage the transition, the challenge will be to get up to speed quickly so that quality operations can be maintained and transition goals can be met.

Metrics: The Measurement of Results

- ‘Olelo has kept and reported operating statistics useful for regulators and management.

- ‘Olelo’s 2007 and 2008 Strategic Initiatives incorporates measurable operating outcomes for its major planned initiatives.

- The current sharpened emphasis on metrics should produce clearer and additional useful measures for management in the future.

- A challenge for ‘Olelo is to achieve a balance between operations and good business practices without stifling individual creativity.

- ‘Olelo should increase its level of effort at setting goals and measurable outcomes for the individual CMCs; perhaps with expanded development and reporting of statistics for each CMC.

Financial significant comments and recommendations include:

Financial Ratios

- The use of resources for services is exceeding the operating funds available. Either spending has to be brought in line with resources or funding has to be increased.

Budgets

- ‘Olelo would benefit from a Cash Flow budget.

Analysis of ‘Olelo’s February 23, 2009 Request to Remove Fee Cap

- ‘Olelo’s deficit spending cannot continue; it will eventually run out of Cash.

- ‘Olelo needs to decrease expenses and/or find new revenue sources (i.e. grants, fundraising, fees). The 2012-2015 Strategic Plan appears to address this issue.

Items Identified By ‘Olelo’s Independent External Auditors

- ‘Olelo has resolved the internal control deficiencies and management advisory comments noted by its external auditors, with the following exception:

    - As of November 4, 2011, ‘Olelo has not resolved the noncompliance issue with regards to their agreement with the DCCA to maintain separate bank accounts for operating funds and capital funds. On September 12, 2011, ‘Olelo opened separate bank accounts for the operating funds and the capital funds. As of November 4, 2011, ‘Olelo had not separated all of the operating funds and capital funds into their respective bank accounts.

Compliance significant comments and recommendations include:

- It appears that ‘Olelo is making a conscious effort to meet their reporting deadlines outlined in their December 24, 1998 agreement with DCCA and the December 22, 2003 letter from DCCA.

- As noted above under items identified by ‘Olelo’s independent external auditors ‘Olelo needs to comply with the requirement to maintain separate bank accounts for operating funds and capital funds. As of November 4, 2011, they have established separate bank accounts but they do not have all of the operating funds and capital funds in their respective bank accounts.

During the performance audit we found, the following significant subsequent events:

- In August 2011 ‘Olelo’s Board of Directors approved the 2012-2015 Strategic Plan which includes:

  - Catalyze community engagement, action and impact;

  - Cultivate community understanding and appreciation for ‘Olelo’s relevance; and

  - Achieve financial sustainability.

- In September 2011, ‘Olelo’s former Director of Technical Services left ‘Olelo to join DCCA as the new Cable Television Administrator. ‘Olelo promoted their Information Technology Manager, to the new Director of Technical Services. The new Director of Technical Services has a computer and Information Technology background, not a traditional video background. These changes raise some issues such as:

  - Whether some knowledge has been lost since his resignation.

  - If other key personnel involved in the conversion leave, the scheduled implementation dates for the conversion to digital and HD may need to be modified.

- As of November 4, 2011, ‘Olelo has established separate bank accounts but they do not have all of the operating funds and capital funds in their respective bank accounts.

## Response from ‘Olelo

**‘Ōlelo Community Media**
**Response to Merina & Company’s 2011 Performance Audit Report of ‘Ōlelo Community Television**
**November 18, 2011**

‘Ōlelo Community Media appreciates the opportunity to comment on Merina’s report. Generally, we find the report to be an accurate description of ‘Ōlelo ’s performance and we thank Merina for the favorable conclusions with respect to management’s performance in executing the PEG Access contract for O‘ahu.

We appreciate and agree with a number of comments and recommendations. We also have several specific responses which are listed below:

- **Recommendation:** We recommend ‘Ōlelo develop a succession plan for when key employees leave the organization.
  **Response:** ‘Ōlelo recognizes the value of having a plan of succession for key employees. It is something that we have begun working towards on an informal basis by identifying staff members that we feel have upward potential. These staff members are given new growth opportunities as they arise. A documented succession plan will be further developed once current pressing issues such as securing a permanent operating contract, resolving capital funding issues, and completing the initial phases of the transition to digital and HD technology are realized. We anticipate that these key issues will be largely resolved before the end of the first quarter in 2012. At that time, we will be able to devote more attention to management development and a roadmap for succession planning.

- **Comment:** The transition to digital and HD is necessary. It places ‘Ōlelo in a position to provide its services for the foreseeable future.
  **Response:** We fully agree with the comment and note that we are currently in arbitration with Time Warner Cable to secure adequate funding for this necessary transition.

- **Comment:** ‘Ōlelo would benefit from a cash flow budget.
  **Response:** We will work with our independent financial auditors to analyze the benefits and costs of implementing this suggestion.

- **Comment:** ‘Ōlelo’s deficit spending cannot continue, it will eventually run out of Cash.
  **Response:** We are working to resolve this situation by seeking additional revenues both through a new contract with the DCCA, as well as through grants, fees, donations and other revenue. Our projected shortfall in 2011 will be much smaller than in years past – largely a result of cost reductions. Additionally, it is ‘Ōlelo’s goal to achieve a balanced budget in 2012 and beyond.

- **Comment:** As of November 4, 2011, ‘Ōlelo has not resolved the noncompliance issue with regards to their agreement with the DCCA to maintain separate bank accounts for operating funds and capital funds. On September 12, 2011, ‘Ōlelo opened separate bank accounts for the operating funds and the capital funds. As of November 4, 2011, ‘Ōlelo had not separated all of the operating funds and capital funds into their respective bank accounts.
  **Response:** ‘Ōlelo plans to complete bifurcation of the operating and capital funds into separate bank accounts prior to year-end. The intervening time from now until then will be used to accurately identify the correct amounts. Regarding our investment funds, these continue to be co-mingled because the individual securities that compose the portfolio consist of both operating and capital funds. However, ‘Ōlelo continues to account for these funds separately. We have inquired with our investment advisors about segregation alternatives.

Table of Contents

**EXECUTIVE SUMARY**

Performance Audit of ‘Olelo Community Television DBA ‘Olelo Community Media ..... i
Recommendations and Response ..... ii

**Independent Auditor’s Report** ..... 1

**Chapter 1 – Introduction** ..... 2

**Chapter 2 – Management and Oversight**

Board of Directors, Management Team, and Oversight
Background ..... 4
Findings ..... 4
Board of Directors ..... 4
Management Team ..... 5
Oversight ..... 6
Subsequent Events ..... 6
Comments/Recommendations ..... 7

**Chapter 3 - Operations**

The Community Media Centers (CMCs)
Background ..... 8
Findings ..... 9
Subsequent Events ..... 10
Comments/Recommendations ..... 11

Transitions from Analog to Digital and High Definition
Background ..... 11
Findings ..... 11
Subsequent Events ..... 13
Comments/Recommendations ..... 13

Metrics: The Measurements of Results
Background ..... 14
Findings ..... 14
Comments/Recommendations ..... 16

Ownership of Real and Personal Property
Background ..... 17
Findings ..... 17

**Chapter 4 - Financial**

‘Olelo’s Financial Ratios
Background ..... 18
Findings ..... 21
Comments/Recommendations ..... 22

Budgets
Background ..... 22

Findings ..... 23
Comments/Recommendations ..... 23

Analysis of ‘Olelo’s February 23, 2009 Request to Remove a Fee Cap
Background ..... 24
Findings ..... 24
Subsequent Events ..... 24
Comments/Recommendations ..... 25

Items Identified by ‘Olelo’s Independent External Auditors
Background ..... 25
Findings ..... 26
Subsequent Events ..... 27
Comments/Recommendations ..... 27

**Chapter 5 – Compliance**

Analysis of ‘Olelo’s Compliance with Applicable Laws, Regulations, and its Contract with DCCA
Background ..... 28
Findings ..... 29
Subsequent Events ..... 31
Comments/Recommendations ..... 31

MERINA
& COMPANY, LLP
Certified Public Accountants and Consultants

CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

PARTNERS
JOHN W. MERINA, CPA • KAMALA K. AUSTIN, CPA • TONYA M. MOFFITT, CPA

## INDEPENDENT AUDITOR'S REPORT

We have completed the performance audit, also referred to as a management audit, of 'Olelo Community Television DBA 'Olelo Community Media ('Olelo) for the period January 1, 2006 through June 30, 2011. The purpose of the performance audit was to examine and report on the sufficiency of 'Olelo's organizational, planning, budget and operating documents, 'Olelo's compliance with applicable laws, regulations, and its contract with DCCA, and to analyze selected operational and financial parameters.

We conducted our performance audit as required pursuant to Act 19 (SLH 2011) which was passed by the Hawaii State Legislature in April 2011 and in accordance with auditing standards generally accepted in the United States of America and the standards applicable to performance audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Merina & Company, LLP

Merina & Company, LLP
December 19, 2011



5499 AMY STREET • WEST LINN, OREGON 97068 • PHONE: (503) 723-0300 • FAX: (503) 723-9946 WWW.MERINACPAS.COM

# Chapter 1

## INTRODUCTION

Section 1(h) of Act 19 (SLH 2011)[1] sets out audit requirements for each Public, Educational, and Governmental (PEG) access organization as follows:

> "The department [meaning DCCA] shall conduct an annual management and financial audit of the access organization designated under this section."

The first performance audit, also known as a management audit, has been completed. The PEG selected for this initial audit was 'Olelo Community Television dba 'Olelo Community Media ('Olelo). This performance audit does not include the financial audit called for in the HRS.

We performed the performance audit for the five years ended December 31, 2006 through December 31, 2010 plus the six months ended June 30, 2011. This time frame was selected because if only one year is audited it would most likely give an inaccurate picture of the organization. At a minimum, three years of data should be analyzed but five years of data provides a more accurate picture when analyzing trends. Due to the value added in capturing the most current status of the organization, this audit included the first two quarters of 2011.

The performance audit objectives, scope, and methodology are detailed below:

### Audit Objectives

The objectives of the performance audit were to:

- Assess the sufficiency of 'Olelo's organizational, planning, budget and operating documents
- Assess 'Olelo's compliance with applicable laws, regulations, and its contract with DCCA
- Document and report on selected operational and financial parameters
- Make recommendations as appropriate

[1] Hawaii Revised Statutes (HRS), codified as Chapter 440G §440G-8.3

## Audit Scope

The scope of the performance audit covered:

- Organizational and governing documents currently in place
- Laws, regulations, and Decisions and Orders currently in force
- Operational and financial data for the last five years

## Audit Methodology

Our audit was conducted between August and October 2011. We conducted interviews with 'Olelo personnel and representatives from the DCCA. We performed the majority of our procedures at 'Olelo's headquarters at its Mapunapuna facility.

We obtained support to substantiate interviewees' statements. Audit procedures also included examination of pertinent policies and procedures, strategic and operating plans, reports, agreements, and other documents to assess adherence to those policies and procedures as well as adherence to various governing authorities. We also obtained and read the Board of Directors' minutes and the Board of Directors' Committee minutes.

This audit was conducted in accordance with auditing standards generally accepted in the United States of America and the standards for performance audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objects. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

## Auditor's Access to Information

At the onset of our audit we submitted an information request detailing the documents and other pertinent information we would require. We timely received that information in hard copy as well as by e-mail. Our performance audit was conducted with the full cooperation of all parties involved. We had unfettered access to all information we deemed necessary to conduct the performance audit.

# Chapter 2

## MANAGEMENT AND OVERSIGHT

### Board of Directors, Management Team, and Oversight

#### Background

Since 1989, ‘Olelo has provided PEG access on O’ahu. ‘Olelo’s mission statement until May 2010 was to:

- “Promote lifelong learning through the creation, production and cablecasting of programs that are aimed at the preservation, development and enhancement of the diversity of thought, culture and heritage on O’ahu;

- Facilitate communication through electronic media technology for community empowerment; and

- Increase civic participation in the democratic process by promoting understanding and informed use of electronic media.”

‘Olelo’s current mission statement, adopted as of May 2010, is “to strengthen our island voices and advance community engagement through innovative media.”

#### Findings

***Board of Directors***

In November 2006 ‘Olelo amended its By-Laws to increase the number of Board of Director seats from nine to fifteen. The Board’s Nominations Committee appoints fourteen of the Directors and one Director is elected. ‘Olelo administers an election among the PEG users to fill the Elected Director position.

‘Olelo’s Board of Director Committees, which have been in place since 2006, include:

- Executive Committee;

- Nominations Committee;

- Program and Marketing Committee (formerly Programming Committee until 2007); and the

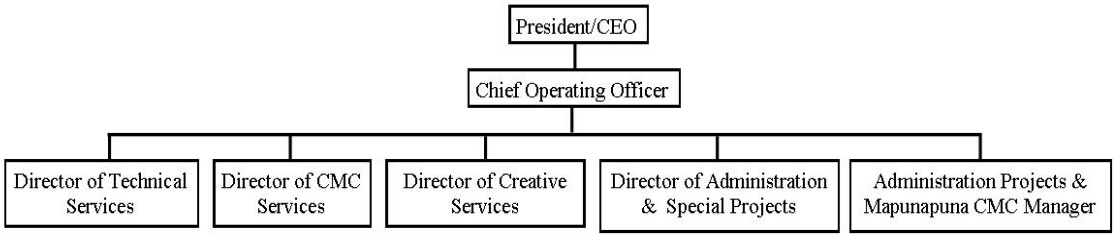
- Finance Committee.

The Executive Committee is vested with administrative powers of 'Olelo during the interim between Board meetings; except that it shall not have the power to take any action which is contrary to, or a substantial departure from, the direction for the policy of 'Olelo. The Nominations Committee develops the slate of individuals it recommends to the Board of Directors to fill the vacant Director Seats. The Program and Marketing Committee focuses on Community Media Center's (CMCs), programming, benchmarks and marketing. The Finance Committee focuses on operational and capital budget, unaudited and audited financial information, and review of the insurance, cash and investment policies.

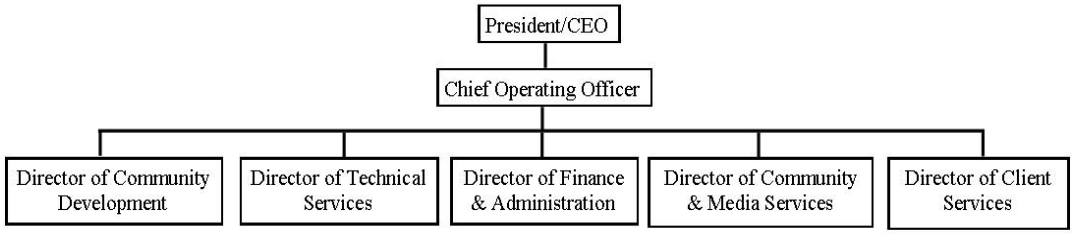
'Olelo's Board of Directors meets on a quarterly basis and the Board Committees meet on a regular basis and/or as needed.

***Management Team***

In 2011, 'Olelo changed its organizational structure. 'Olelo's Directors Group is comprised of 'Olelo's upper management. 'Olelo's former Directors Group organizational chart was:




'Olelo new Directors Group organizational chart is:




The changes to the Directors Group organizational chart and titles were to reflect and realign it with 'Olelo's new mission statement.

The personnel within the Directors Group have been relatively consistent during the period January 1, 2006 through June 30, 2011, although the titles and responsibilities may have changed on January 1, 2011. One significant change during that time period occurred when the former President/CEO left 'Olelo when she was appointed as the Director of DCCA in December 2010. The Chief Operating Officer became 'Olelo's interim President/CEO at that time and permanent President/CEO in May 2011. The Chief Operating Officer position was vacant as of June 30, 2011.

The Directors Group are also members of these Standing Committees. Other committee members include key employees and managers for each of the four areas. The Standing Committees meet once a month. ‘Olelo’s Standing Committees include:

- Strategic Planning Committee;
- Production Services Committee;
- Operations Committee; and
- Administrative Services and Revenue Enhancement Committees.

***Oversight***

‘Olelo developed a strategic plan in 2001 that they are currently following. In March 2006 and August 2008 ‘Olelo hired a consultant group to perform a needs assessment and analysis of activities and research. In October 2007, ‘Olelo created a Strategic Initiatives process that included diversity of voices, diversity of programming, informed and engaged community and viewers, and building community. In January 2006, November 2006, and May 2011, there were customer surveys sent to the cable subscribers. ‘Olelo’s executive leadership (i.e. Board of Directors and upper management) used these reports and surveys to aid them in developing goals for the organization and as a road map for where they are going. ‘Olelo recognized they needed to embrace the technology changes and what its constituents wanted them to be providing. In 2009, ‘Olelo Community Television became ‘Olelo Community Media, this was a strategic move to re-name and re-brand the organization. In May 2010, ‘Olelo revised its mission statement. Since 2010 ‘Olelo has been working with a consultant to help develop a strategic plan that is long-lived for the organization and involves community engagement. In January 2011, ‘Olelo updated its organizational structure to reflect its new mission statement. As of June 30, 2011 ‘Olelo’s Board of Directors had not approved the strategic plan.

## Subsequent Events

In August 2011 ‘Olelo’s Board of Directors approved the 2012-2015 Strategic Plan. The mission centric strategic priorities include:

- Catalyze community engagement, action and impact;
- Cultivate community understanding and appreciation for ‘Olelo’s relevance; and
- Achieve financial sustainability.

In September 2011, ‘Olelo’s former Director of Technical Services left ‘Olelo to join DCCA as the new Cable Television Administrator. The former Director of Technical Services had a key role in ‘Olelo’s conversion from analog to digital. This raises the

issue that some of his knowledge has been lost since his resignation. If other key managers or employees involved in the conversion to digital and HD leave ‘Olelo, the scheduled implementation dates for the conversion may need to be modified.

**Comments/Recommendations**

For the period from January 1, 2006 through June 30, 2011:

- ‘Olelo maintained detailed meeting minutes that show the Board of Directors due diligence and governance of the organization.

- ‘Olelo’s management team appears to have the appropriate experience and knowledge for the size of the PEG.

- ‘Olelo’s executive leadership is being proactive and not reactive to the changing environment.

- ‘Olelo’s executive leadership has used experienced outside consultants to aid them in its fiduciary responsibilities of oversight.

- ‘Olelo should consider developing a succession plan for when key employees leave the organization.

# Chapter 3

## OPERATIONS

### The Community Media Centers (CMCs)

#### Background

Since its incorporation in 1989, and through amendments to its articles of incorporation in 1990 and 2005, ‘Olelo has maintained as part of its stated core purpose the “preservation, development and enhancement of the diversity of thought, culture and heritage within Hawaii,” and with that, the facilitation of “lifelong learning and the community’s participation in the democratic process.” From a planning point of view, the current but evolving statement of how to achieve this purpose is contained in ‘Olelo’s Strategic Initiatives process, described in Chapter 2 of this report.

Operationally, ‘Olelo has sought to achieve its purposes, and carry out its strategic initiatives, through establishing a central operating facility in Honolulu, and then creating satellite facilities in other communities around the island of O’ahu. In this way, it attempts to provide its services according to the specific character and needs of particular local communities on the island, considering its diversity of social cultures, political traditions, economic situations, and ethnic makeup.

‘Olelo’s operational facilities on O’ahu are referred to as CMCs. This designation is consistent with the recent trend among many such facilities nationwide: PEG access centers now often adopt a name that reflects both their purpose of community involvement and their adaptation to utilizing the Internet and, in general, a wider range of media, along with the traditional television medium that was the only medium available to them in earlier times.

ʻOlelo's headquarters facility was established in 1989, at the time of initial incorporation. The rest of the CMCs were established in subsequent years:

| Name | Location | Year Established |
|---|---|---|
| Mapunapuna | ʻOlelo Headquarters | 1989 |
| Waiʻanae | Waiʻanae High School | 1998 |
| Kahuku | Kahuku High School | 1998 |
| Palolo/Kaimukī | Jarrett Middle School | 2004 |
| Windward | King Intermediate School | 2005* |
| Waipahu | Waipahu Intermediate School | 2007 |
| Wahiawā | Leilehua High School | 2009 |
| Legislative | State Capitol | 2009 |

*Windward CMC opened at Windward Community College in 2005 and relocated to King Intermediate in 2009.

## Findings

The CMCs provide traditional PEG access services, and have expanded the understanding and scope of their services to meet local needs and changing technology.

Thus, for example, at ʻOlelo, any member of the public or the representative of any social service agency may become trained in the use of production and editing equipment, and produce television programs intended for cable casting on local cable television channels. Government agencies may arrange for the use of ʻOlelo staff and equipment to record legislative or other meetings for cable casting on cable channels. The educational institutions on O'ahu work with ʻOlelo to air televised classes and other educational programs.

However, adaptation to local needs and changing technology has led to additional initiatives by ʻOlelo. For example, at Wai'anae, the perceived need to provide social and occupational opportunities for children in the community has led to the development of ʻOlelo activities that are particularly focused on social needs at that location.. The perceived need to interact with educators and students in specific communities has led to locating five of the satellite CMCs in educational facilities, where ʻOlelo can collaborate with the schools in various ways to serve educational purposes. The availability of technologies relating to the Internet has led to incorporating training in web-related skills at ʻOlelo, and the opportunity for users to develop programs meant both for cable casting on cable channels and for video streaming, with additional opportunities such as linking to social networks. The perceived need to provide a larger voice for mainstream social organizations has led to efforts at ʻOlelo to more actively

seek out and provide professional assistance to organizations that may have been missing available opportunities for being heard in the community.

Some of the specific services currently available at ‘Olelo, with the names ‘Olelo gives the services, include the following:

| Name | Description of Service |
|---|---|
| Vote! | Hosting forums for candidates during the political season |
| MiniStudio | Providing equipment and technical support for non-profits and community organizations to self-produce 30-minute live-to-tape programs for cablecasting |
| Island Info | Running a bulletin board on a cable channel, for the listing of local events |
| Summer Media Program | Showing middle school and high school students how to produce videos for subsequent cable casting |
| Executive Productions | Providing ‘Olelo staff and equipment to cover community events |
| Giving Aloha | Making studio production services available for discussion programs in which O’ahu non-profits may discuss and educate about their services |
| ‘Olelo Net | Transferring video programming to web-based video streaming, both live and in archived form, for a kind of video-on-demand for users with Internet access |
| Youth Xchange | Staging an annual student video competition |
| Capitol Commentary | Hosting commentary on public issues from government leaders, community groups and the public during each legislative session |

## Subsequent Events

To our knowledge, there are no new services offered at ‘Olelo that were not offered prior to June 30, 2011. However, some activities, consistent with the latest planning efforts, are receiving increased current attention. For example, as indicated above, in the area of “Executive Productions” there is increased activity in outreach to non-profit organizations to encourage them to use ‘Olelo’s services and, associated with that, increased efforts at planning and organizing so that staff can deliver an increased level of service to these users.

**Comments/Recommendations**

- The wide range of services provided by ʻOlelo, and the manner in which services are designed to meet a wide diversity of community needs across the Island, indicate an evident commitment to fulfilling what ʻOlelo sees as the organization's core purposes.

- ʻOlelo has adapted well to changing user needs and the opportunities for service brought about by the Internet.

- ʻOlelo's success in using its facilities to meet needs on the Island which are informational and also social, is one of the positive marks of its particular character, and is arguably well in line with its mission and what ʻOlelo sees as the organization's core purpose.

- While ʻOlelo has been successful with ancillary social services, it needs to continue to focus on its primary purpose of cable casting which will continue to be essential to maintain.

## Transition from Analog to Digital and High Definition

**Background**

ʻOlelo is in the midst of a major technology-based operational change. The organization is transitioning from using old analog equipment to using new equipment that processes electronic audio and video signals digitally, with the capability of transmitting video programming in High Definition (HD). Such a transition is now unavoidable for any organization providing the kind of services ʻOlelo provides. It would be practically necessary as a way of developing programming that would attract viewers increasingly accustomed to higher quality television on commercial channels. But even more critically, it has become virtually the only way for a PEG access organization to survive at all in this era, since equipment manufacturers are no longer making the analog equipment for recording, editing and playing back video programming. Even digital equipment designed for Standard Definition processing is being discontinued. Getting the old equipment serviced is also becoming difficult, if not impossible.

**Findings**

ʻOlelo has been using certain digital equipment at the CMCs for some time. During the period of 2004 to 2009, nearly 2/3 of ʻOlelo's capital was spent on upgrading to digital equipment at the CMCs, and by the end of that time, there were 142 digital camcorders and 97 non-linear editing systems in use at the CMCs. But the heart of ʻOlelo's programming operation is its master control and playback system at Mapunapuna, and

that remains an analog system. Programs made with digital cameras and editing equipment have had to be translated back to analog format for distribution on the PEG channels on the Oceanic cable system. Lacking the digital server-based playback system that could accommodate and process programming by means of available digital telecommunications paths, ʻOlelo has had to have tapes, DVDs, hard drives and thumb drives brought physically to the Mapunapuna facility for playback.

It should be noted that in order for the transition to HD programming to become fully effective, it needs to be complemented by Oceanic system upgrades to permit transporting HD signals between ʻOlelo and the Oceanic headend, and to accommodate transport of programming from the University of Hawaii, the Department of Education, Honolulu Hale, the State Capitol, and other current and future program origination sites.

ʻOlelo had tentatively planned for the installation of digital, HD-capable playback and associated equipment all at one time, and intended, at the end of 2011, to switch off the analog playback and switch on the digital and High Definition. Capital funding constraints got in the way of that plan, and the current plan involves a two-stage process in which the new equipment will be installed more piecemeal, respecting existing replacement schedules, with digital and analog playback operating simultaneously for a period. The full transition to digital and HD playback should come at the end of 2012.

During our visit, the evidence of the digital transition at ʻOlelo, and the upheaval that is part of it, was plain to see. In the playback area, new equipment in boxes stood side by side in hallways with old equipment recently unplugged. Racks capable of accommodating new equipment were being installed, as the old racks were pushed to the side. We examined the printouts of successive software-generated tries at transitioning a playback quality-check procedure from what worked for analog to what would work for digital. While some of this activity began or may have begun after the June 30, 2011 cutoff date for the period to be treated in our report, much of it was initiated before that date, determining the direction of the current developments.

The projected 2011 summary capital budget being used as part of current transition planning provides a snapshot of what is required this year for advancing the change at each of the CMCs:

## ‘Ōlelo Community Media
### 2011 CAPITAL BUDGET SUMMARY
**Pending Board Approval at October 27, 2010 Board Meeting**

| | |
|---|---|
| **2011 TWE Capital Fee Payment** | **To Be Determined** |
| **2011 Capital Budget Requests:** | **$3,901,020** |
| **Capital Reserve Net Gain (Loss)** | **To Be Determined** |

| | Total 2011 | HD Items | Non-HD |
|---|---|---|---|
| **All CMC's** | **$1,754,600** | **$1,357,800** | **$396,800** |
| Centrally-Pooled CMC Resources | $86,500 | $75,000 | $11,500 |
| Mapunapuna CMC | $541,700 | $466,200 | $75,500 |
| Wai`anae Community Media Center | $195,500 | $135,000 | $60,500 |
| Kahuku Community Media Center | $265,400 | $204,600 | $60,800 |
| Wahiawa/North Shore Community Media Center | $154,000 | $110,000 | $44,000 |
| Palolo/Kaimuki Community Media Center | $165,000 | $140,000 | $25,000 |
| Windward Community Media Center | $165,500 | $115,000 | $50,500 |
| Waipahu Community Media Center | $152,200 | $100,000 | $52,200 |
| Studio@Capitol | $28,800 | $12,000 | $16,800 |
| **CITY COUNCIL** | **$202,000** | **$202,000** | **$0** |
| **CENTRAL FACILITIES** | **$1,944,420** | **$1,725,300** | **$219,120** |
| Admin Services | $55,000 | $0 | $55,000 |
| Playback | $1,482,300 | $1,482,300 | $0 |
| Engineering | $243,000 | $243,000 | $0 |
| Information Technology | $143,120 | $0 | $143,120 |
| 1122 Mapunapuna Building | $21,000 | $0 | $21,000 |
| **TOTAL 2011 CAPITAL BUDGET** | **$3,901,020** | **$3,285,100** | **$615,920** |

## Subsequent Events

As indicated in the findings above, activity aimed at realizing the transition to digital and HD is currently at a high pitch at ‘Olelo. However, as also indicated, the bulk of today’s activity grows out of initiatives in planning, budgeting and staffing that fall within the time frame to be covered by our report. As noted above in September 2011, ‘Olelo’s former Director of Technical Services left ‘Olelo. ‘Olelo promoted its Information Technology Manager, to the new Director of Technical Services. The new Director of Technical Services has a computer and Information Technology background, not a traditional video background.

## Comment/Recommendations

- The transition to digital and HD has been entirely necessary, for reasons indicated in the background and findings above, and when it is completed will

place ʻOlelo securely in a position to continue to provide its services for the foreseeable future.

- The change in leadership in the technical services area comes at an awkward time for ʻOlelo, which is during a period of exceptional activity during the transition to digital and HD. The new leadership appears well equipped to manage the transition, but the challenge will be to get up to speed quickly and thoroughly, so that quality operations can be maintained and transition goals can be met in a timely manner.

## Metrics: The Measurement of Results

### Background

ʻOlelo has kept records of its activities since its inception. Measurement and reporting of results is an integral part of the management and operation of any organization. However, this process was sharpened when DCCA required ʻOlelo, as part of its contract, to provide a specific set of reports (i.e. an Annual Activity Report, a Year-End Activity Report, and an Executive Summary). In accordance with this requirement, ʻOlelo, among other efforts of accounting for its activities, has been keeping and annually reporting to DCCA detailed statistics on the following key elements of its operations:

- Total Hours of Programming: First Run, Repeat, and Submitted but Not Aired
- Programming by Origin: Locally Produced, Non-Locally Produced, and Bulletin Board
- Programming By Source: First Run Hours from PEG Sectors in the Categories of Dropped off for Play, PEG Trained and Certified Producers, and Hours Created by `Ōlelo (Open Mic and Created by PEG)
- Video Production Training: All Locations
- Number of Students Trained and Certified as Producers: All Locations

### Findings

As a result, it is possible to identify operating trends useful for ʻOlelo management to know as well as for regulators and other stakeholders. For example, the following information on trends could be constructed for analysis from some of the available statistics:

| | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|
| Total Hours of Programming | 51,600 | 52,560 | 52,704 | 52,560 | 52,560 |
| Hours of Locally Produced Programming | 22,659 | 23,684 | 22,429 | 23,916 | 18,994 |
| Students enrolled in video editing classes | 517 | 530 | 531 | 595 | 472 |

The reports provided to DCCA generally are based on the performance of all of the CMCs taken together. However, given ‘Olelo’s emphasis on diversifying its operations in multiple locations, it is a matter of interest how the CMCs perform individually in various areas. Thus, in accordance with our request in the course of preparing this report, ‘Olelo provided a sample breakdown of statistics in which they trace the number of hours that key items of equipment (i.e. mini-camera, non-linear editing equipment, mini-studio, studio, consumer camera, feather pack, take-home lap-top editing, linear editing, field units, and EFP van) were used at each CMC in each of the years 2006 through 2010, with projections for usage in 2011. With this information, much more detailed, location-specific information about important trends is available to management, regulators and other stakeholders. In this sample, the total hours of equipment usage broken down by CMC is as follows:

| | Actual Hours of Equipment Usage by Location | | | | | Projected Hours |
|---|---|---|---|---|---|---|
| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
| Kahuku/Wahiawa | 44,010 | 36,640 | 34,449 | 26,096 | 41,310 | 60,769 |
| Mapunapuna | 49,959 | 54,426 | 56,113 | 59,637 | 71,892 | 59,956 |
| Palolo | 38,995 | 40,891 | 53,987 | 55,900 | 75,313 | 74,073 |
| Wai'anae | 36,104 | 32,857 | 45,860 | 44,962 | 38,329 | 29,855 |
| LCC/Waipahu | 12,965 | 6,784* | 45,178 | 43,413 | 28,907 | 36,782 |
| Windward | 11,468 | 28,127 | 29,648 | 46,109 | 56,471 | 52,047 |
| Studio Capital | - | - | - | 1,611 | 1,497 | 581 |

*Significant decrease because 2007 was a transition year when ‘Olelo closed CMC at Leeward Community College (LCC) and opened at Waipahu Intermediate School. The drop in activity reflects the winding down of business at the LCC location and the ramp up associated with the new location at the school.

We found ‘Olelo’s focus on metrics (i.e. the measurement of key operational parameters) to be characteristic of both its recent past performance and of its planning for the future. It is evident in the consistency of its reporting to DCCA, in its regular use of surveys performed by external consultants to measure audience response to the work that it is doing, and in its ability to respond to our requests for quantitative data in a timely fashion. We saw it in ‘Olelo’s planning for the future, as represented in the Strategic Initiatives documents made available to us, including the comprehensive plans set forth in 2007 and 2008. There, the emphasis on setting goals and identifying “measurable outcomes” is pervasive, included as an integral part of the discussion of each planned initiative and the activities associated with it. When asked to sum up his approach to management, the new President/CEO, on board since January of 2011, summed it up in a single word: “metrics.”

The observable sharpening of emphasis on setting goals and identifying measurable operational outcomes at ‘Olelo has been part of the most recent major changes in leadership at the organization (i.e. new President/CEO), the institution of a new standing committee structure, the re-branding of departments and management titles to reflect the latest planning, etc. The new President/CEO was hired in January 2011, and some of these changes came directly thereafter. However, it should be noted that the new organizational changes discussed here were in a large part the result of planning efforts, including the use of a professional consultant, which came about beginning in 2009. In addition, while there is prominent new emphasis on metrics under the new regime, we saw wide evidence of its effective use under previous management as well.

**Comment/Recommendations**

- ‘Olelo has been successful in keeping and reporting statistics useful for both regulators and management in the past.
- In recent years, and notably in the Strategic Initiatives documents in 2007 and 2008, ‘Olelo’s planning incorporated measurable operating outcomes for virtually all its major planned initiatives. This development represents a qualitative advance for the organization, and a basis on which current management may build.
- The current sharpened emphasis on metrics under the new President/CEO should produce clearer and additional useful measures for management in the future.
- In an organization like ‘Olelo, naturally composed of many creative individuals, an emphasis on quantitatively measuring operational outcomes can serve as a necessary balance for guiding progress in a businesslike way. The challenge for ‘Olelo, as was acknowledged by the current President/CEO in an interview, is to achieve this balance without stifling the decisively valuable creativity of its people.

- Given the emphasis ‘Olelo puts on meeting diverse needs of the community through the operation of CMCs in diverse locations on O’ahu, it would be reasonable for the organization to develop an increased level of effort at setting goals and measurable outcomes for the individual CMCs, perhaps with expanded development and reporting of statistics for each CMC.

## Ownership of Real and Personal Property

### Background

Pursuant to past and current agreements with DCCA, ‘Olelo receives PEG funds (access operating fees and capital contributions) from the cable operators accordingly to franchise orders with DCCA. The capital contributions are restricted funds and can only be used to purchase capital assets as facilities and equipment. Per the Agreement between ‘Olelo and DCCA, entered into on December 24, 1998 (1998 Agreement) and all subsequent modifications to the 1998 Agreement to date, assets acquired after December 24, 1998 will revert to DCCA upon termination of the 1998 Agreement. Assets acquired prior to the 1998 Agreement may or may not revert to DCCA upon termination of the 1998 Agreement. The DCCA believes assets acquired prior to the 1998 Agreement should revert back to DCCA upon termination of the 1998 Agreement, and ‘Olelo believes that it should retain all rights and title to capital assets acquired prior to the 1998 Agreement upon its termination and that the contract with the DCCA prior to the 1998 Agreement was silent on the matter of asset ownership. The ownership of the real and personal property acquired prior to 1998 is currently in dispute and subject to further negotiation.

### Findings

MCO is not competent by training to state whether the real and personal property must be relinquished to the DCCA upon termination of the agreement between DCCA and ‘Olelo.

# Chapter 4

## FINANCIAL

This performance audit does not include a financial audit. A financial audit is the verification of the financial statements of an organization, with an expression of an audit opinion. This performance audit includes an analysis of ‘Olelo’s financial ratios, budgets, ‘Olelo’s February 23, 2009 request to remove a fee cap, and items identified by ‘Olelo’s independent external auditors and is not a verification of ‘Olelo’s financial statements.

## ‘Olelo’s Financial Ratios

### Background

Financial ratios are useful indicators of an organization’s performance and financial health. Financial ratios can be used to analyze and to compare an organization’s financials to those of similar organizations.

To be truly comparable, however, the organizations should be of similar size, age, located in the same area or locale, and have similar missions and programs. In the case of ‘Olelo, there is a lack of organizations in the same locale of similar size and with similar programs. ‘Olelo is much larger than the other three Hawaii PEGs and offers more and wider variety of programs than the other PEGs. In addition, due to the widely varying situations of PEG organizations with respect to local needs, franchise requirements, levels of volunteer activity and other factors, there exists no set of standards for comparison of PEGs which is commonly accepted in the national PEG arena. Accordingly, the analysis conducted for this report will be limited to tracking ‘Olelo’s performance and financial position over time relative to itself. Accordingly, the ratios developed for ‘Olelo include:

- Current Ratio

  The current ratio, also referred to as the working capital ratio, is current assets divided by current liabilities.

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

  A high current ratio is of particular interest to creditors since it tends to reduce their risk. On the other hand, a high current ratio may indicate that an organization is either overfunded or that it is accumulating assets for future expansion.

- Quick Ratio

  One drawback of the current ratio is that it includes inventory that may contain items that are used over several years or that are difficult to liquidate quickly or have uncertain liquidation values. The quick ratio is an alternative measure of liquidity that excludes inventory and prepaid expenses.

$$\text{Quick Ratio} = \frac{\text{Current Assets} - \text{Inventory} - \text{Prepaid Expenses}}{\text{Current Liabilities}}$$

  Accordingly, the current assets used in the quick ratio are cash, investments, current accounts receivable, and current notes receivable. The quick ratio is also referred to as the acid test.

- Cash Ratio

  The cash ratio is the most conservative of the liquidity ratios. It excludes all the current assets except the most liquid i.e. cash and cash equivalents, and investments (securities).

$$\text{Cash Ratio} = \frac{\text{Cash and Cash Equivalents} + \text{Investments}}{\text{Current Liabilities}}$$

  The cash ratio is an indication of the organization's ability to pay off its current liabilities if for some reason immediate payment were demanded.

- Liquid Funds Indicator

  The liquid funds indicator measures an organization's operating liquidity and is computed as follows:

$$\text{Liquid Funds Indicator} = \frac{(\text{Net Assets} - \text{Net Property and Equipment}) \times 12}{\text{Total Expenses}}$$

  A high liquid funds indicator could point to a lower cash funding urgency and excessive savings. A lowering of the liquid funds indicator over time is likely a sign of a planned capital equipment improvement program.

- Program Ratio

  The program ratio measures the relationship between direct program expenses and the organization's total expenses. Total expenses account for direct program expenses and management and general expenses (overhead).

$$\text{Program Ratio} = \frac{\text{Program Services Expenses}}{\text{Total Expenses}}$$

  Younger organizations will likely have lower program ratios than more mature organizations as they set up the infrastructure to deliver their services. Over time, organizations should see increasingly higher program services ratios. If not, their overhead may need to be examined.

- Savings Ratio

  The savings ratio revels the rate of a nonprofit's cash and investments accumulation by measuring the relationship between savings (cash and cash equivalents, and investments balances) and total expenses.

$$\text{Savings Ratio} = \frac{\text{Total Revenue} - \text{Total Expenses}}{\text{Total Expenses}}$$

  The savings ratio is an important factor in an organization's long term viability, high ratios may indicate excess funding. The savings ratio should be considered in conjunction with the liquid funds indicator. If the organization has low liquid funds indicator, a higher savings ratio would be desirable.

Most ratios by themselves are not particularly meaningful. They should be viewed as indicators, with several of them combined to paint a picture of an organization's situation. Ratios of non-profit organizations are, by their nature, typically limited to measures of liquidity, program expenditures, and overhead.

## Findings

We have computed the ratios described above for 'Olelo's fiscal years ended December 31, 2006 through 2010. The results are presented in the table below.

| | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|
| Current Ratio | 11.9 | 11.9 | 8.7 | 9.6 | 9.4 |
| Quick Ratio | 11.9 | 11.8 | 8.6 | 9.5 | 9.4 |
| Cash Ratio | 11.3 | 11.4 | 8.3 | 9.2 | 8.9 |
| Liquid Funds Indicator | 11.6 | 10.1 | 8.1 | 8.2 | 8.8 |
| Program Ratio | 0.5 | 0.5 | 0.7 | 0.7 | 0.7 |
| Savings Ratio | 0.0 | 0.0 | -0.1 | -0.1 | -0.1 |

The first three ratios, the Current Ratio, Quick Ratio, and Cash Ratio, are known as liquidity ratios. 'Olelo's three liquidity ratios demonstrate a uniform pattern of decline from 2006 through 2008 and a leveling off starting in 2008 and through 2010. This reflects the organization's migration to advanced technology and the opening of various CMC's in the earlier years. The rapid increase in facilities and related equipment was completed by 2008 as evidenced by decline in available liquid resources and eventual leveling off in the subsequent years.

The last three ratios, the Liquid Funds Indicator, Program Ratio, and Savings Ratio, are measures of 'Olelo's operating efficiency in terms of utilization of available resources to meet its perceived needs of the community as set out in its Mission Statement.

The liquid funds indicator shows a decline from 2006 through 2008 and then a fairly stable measure of performance for the year starting in 2008 and through 2010. This is consistent with the pattern exhibited by the three liquidity ratios.

The program ratio has been relatively constant over the years presented with a slight increase in 2008 and through 2010. This indicates that 'Olelo has been able to hold general and administrative expenses from increasing in relation to total expenses which leaves more resources available to further its goals and purpose.

The savings ratio presents some troubling trends. In short, the organization is spending money at a faster rate than it is earning it.

### Comments/Recommendations

- Overall, 'Olelo's financial metrics show a consistent pattern of use of available funds for facility expansion. The use of resources for services is exceeding the operating funds available. This cannot continue for much longer. Either its spending has to be brought in line with its available resources or the funding for the organization has to be increased.

## Budgets

### Background

There are a number of different types of budgets prepared by non-profit organizations. These include:

- Current annual operating budgets
- Long range budgets
- Capital equipment budgets
- Cash flow budgets
- Strategic plans

While strategic plans are not budgets, per se, they are an integral part of the budgeting process.

Budgeting is an integral part of running any organization efficiently and effectively. Budgets serve as a plan of action for managers and a point of comparison for those charged with governance (i.e. the Board of Directors). A primary objective of budgeting is to provide a base against which actual performance can be measured and compared. Accordingly, the comparison is worthwhile only if the budgets are realistic.

The most valuable part of reviewing budget vs. actual results is determining what has caused the difference between these two numbers (i.e. the variance portion of the analysis). Generally speaking, if the actual is within 5-10% of the budget, then there is typically no need for concern. This helps those charged with governance and managers quickly spot the most significant variances and, more importantly, understand why the variances exist and what can or should be done about them. In the end, however, no budget is completely accurate.

If an organization sees differences between its budget and its actual results, there are several steps it can take. The organization can choose to more closely examine activities with differences and see which line items did not perform according to expectations. If the variance is due to a reasonable factor, such as a downturn in the economy or another event, then the organization can compensate going forward. If the activity is suffering but should not be, the organization may change its practices or its

leaders. Lastly, the business can examine its forecasting ability to see if it missed an important factor and can improve in future years.

Current annual and long range budgets can be prepared under at least three different scenarios. These are budgeting for a:

- Surplus budget
- Break-even budget
- Deficit budget

## Findings

'Olelo has chosen to budget for operating deficits in its current budget. Its long range forecasts (per its February 23, 2009 letter to DCCA) also predict operating deficits through at least 2015.

'Olelo has prepared very detailed annual operating budgets. We obtained the budget to actual results for fiscal years 2006 through 2010. These budget to actual reports are monitored by management monthly and are reviewed quarterly by the Board of Director's Finance Committee. There were, as to be expected, a number of over and under variances from budget to actual which were monitored and discussed by the Finance Committee.

Not all line items were budgeted for. Line items missing budget numbers include Realized/Unrealized gain/loss on investments, Cost of Goods Sold, Miscellaneous Expenses, and Fixed Assets Dispositions.

In October 2010, 'Olelo prepared a financial projection for both operating and capital. The operating projection was for the fiscal years ending December 31, 2011 through 2015. The capital projection was for the fiscal years ending December 31, 2011 through 2018.
As of June 30, 2011 'Olelo was in the process of developing a strategic plan. A short-term, medium-term, and long-term Strategic Plan, is a necessary precursor for the development of meaningful longer term Operating, Capital Equipment and Cash Flow budgeting.

## Comments/Recommendations

- Overall, the organization is moving in the right direction with its development of a 2012-2015 Strategic Plan.
- Additionally, 'Olelo would benefit from a Cash Flow budget for the same reasons cited in the preceding paragraph.

## Analysis of ‘Olelo’s February 23, 2009 Request to Remove Fee Cap

### Background

On February 23, 2009, ‘Olelo requested that the DCCA remove the cap that limits the amount of PEG Access Operating Fees paid to ‘Olelo. The cap was put in place pursuant to Decision and Order No. 261. The request included a table that projected the Revenue, Expenses, and Operating Reserve Balance for 2009-2015. In addition, it projected that ‘Olelo’s operating reserves would be fully depleted by 2013 or 2014.

### Findings

‘Olelo's projections of Revenues, Expenses, and Operating Reserves for 2009 and 2010 appear to be fairly accurate compared to the actual results from the audited financial statements. The 2009 and 2010 Operating Reserve actual balances were $132,208 and $338,043 higher than the projections, respectively. Although the actual results were better than the projection, ‘Olelo still operated at a deficit (both before and after depreciation expense was considered) for 2009 and 2010. Assuming the projected revenues and expense included in the request are correct for 2011 through 2015, ‘Olelo will use up its Operating Reserve Balance in 2015 instead of 2014 as projected in the request.

In October 2010 ‘Olelo developed a five year operating and capital financial projection. ‘Olelo’s projected ending balance Operating Reserves and Capital are as follows:

| | FY 2011 | FY 2012 | FY 2013 | FY 2014 | FY 2015 |
|---|---|---|---|---|---|
| Projected Ending Operating Balance | $ 2,982,990 | $ 2,988,606 | $ 2,963,562 | $ 2,900,970 | $ 2,684,593 |
| Projected Ending Capital Balance | (878,112) | (3,540,172) | (5,718,846) | (6,905,956) | (7,031,336) |
| Total Projected Operating Reserve Balance | $ 2,104,878 | $ (551,566) | $ (2,755,284) | $ (4,004,986) | $ (4,346,743) |

Assuming the five year operating and capital financial projection from October 2010 is correct, ‘Olelo will deplete its Operating Reserve Balance in 2012 and will likely not be able to complete the conversion to digital and HD on the time line desired.

In 2011, ‘Olelo updated its organizational structure. The organization created a Director of Community Development. Part of this position’s function is to seek grants and additional funding above and beyond franchise fees. ‘Olelo also hired a subcontractor to help them develop an updated Strategic Plan. ‘Olelo, along with the subcontractor, was in the process of developing the 2012-2015 Strategic Plans as of June 30, 2011.

### Subsequent Events

As noted above, in August 2011 ‘Olelo’s Board of Directors approved the Strategic Plan. One of the strategic priorities is to achieve financial sustainability.

**Comments/Recommendations**

- Deficit spending is when the organizations revenues do not cover the expenses; therefore the excess spending is covered by cash and investments (i.e. Operating Reserve) or by borrowing. Short-term deficits can, but not always, represent an investment for future benefits. This does not appear the case for ‘Olelo. However, organizations cannot operate at a deficit long-term; they will eventually run out of Cash, Cash Equivalents and Investments.
- In order for ‘Olelo to not fully deplete its Operating Reserve ‘Olelo has to stop operating at a deficit. ‘Olelo needs to decrease expenses until they are in line with revenues and/or increase current revenues or find new revenue sources (i.e. grants, fundraising, fees). The 2012-2015 Strategic Plan’s priority to achieve financial sustainability appears to address this issue.

## Items Identified By ‘Olelo’s Independent External Auditors

**Background**

Independent external auditors who complete a financial statement audit consider the organization’s internal control over financial reporting (internal control) as a basis for designing auditing procedures for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the organizations internal controls. These financial statement audits are not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and therefore there can be no assurance that all such deficiencies have been identified.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. The two reportable deficiencies include:

- A material weakness is a deficiency or combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis.

- A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

External auditors of an entity’s financial statements are required to document, in writing, if they identify internal control deficiencies that are considered material weaknesses or significant deficiencies. These reports are required by Statement on Auditing Standards 112 or Statement on Auditing Standards 115 (SAS 112/115).

If an independent external auditor identifies any internal control deficiencies that do not rise to the level of a material weakness or a significant deficiency, they may issue management advisory comments. These comments are typically made in writing to those charged with governance (i.e. Board of Directors). They generally include comments, suggestions and/or recommendations that strengthen internal controls and foster operating efficiencies.

## Findings

For the period from January 1, 2006 through June 30, 2011 ‘Olelo received the following items from its independent external auditors:

- For the year ended December 31, 2006 ‘Olelo received a SAS 112/115 report with two significant deficiencies and two management advisory comments
- For the years ended December 31, 2007 and 2008 ‘Olelo did not receive a SAS 112/115 report or management advisory comments

- For the year ended December 31, 2009 ‘Olelo received a SAS 112/115 report with two significant deficiencies

- For the year ended December 31, 2010 ‘Olelo received four management advisory comments but no SAS 112/115 report

The items identified in the SAS 112/115 reports and management advisory comments for the years ended December 31, 2006 and 2009 have all been resolved by ‘Olelo. The items identified in the management advisory comments for the year ended December 31, 2010 will be reevaluated by ‘Olelo’s independent external auditor’s when they complete their financial statement audit for the fiscal year ending December 31, 2011.

One of the management advisory comments identified for the year ended December 31, 2010 was as follows:

> **ENSURE COMPLIANCE WITH CONTRACT STIPULATIONS RELATED TO COMMINGLING OF PUBLIC, EDUCATIONAL AND GOVERNMENT (PEG) FUNDS**
>
> During our [‘Olelo’s external auditors] review of the Organization’s agreement with the State of Hawaii (State) through its Director of Commerce and Consumer Affairs (DCCA) entered into on December 24, 1998 (Agreement), we [‘Olelo’s external auditors] noted certain contract stipulations related to commingling of PEG funds. These funds are contractually restricted for PEG access operations and acquisition of facilities and equipment.
>
> Section D, *PEG Funds*, of the Agreement states that ‘Olelo shall designate one account for operating and another account for capital (facilities and equipment).

ʻOlelo shall be responsible for administering the accounts, and shall not commingle operating funds with capital funds without prior written approval of the Director (DCCA).

The Organization currently has both the operating and capital funds together in accounts held in a financial institution and investment firm. The Organization was unable to provide written documentation of DCCA approval.

**Recommendation**

The Organization should maintain a separate bank account for the operating funds and another bank account for the capital funds to ensure these funds are not commingled and in compliance with contract stipulations.

## Subsequent Events

On September 12, 2011, ʻOlelo opened separate bank accounts for the operating funds and the capital funds. As of November 4, 2011, ʻOlelo had not separated all of the operating funds and capital funds into their respective bank accounts.

## Comments/Recommendations

- For the period from January 1, 2006 through June 30, 2011 ʻOlelo has resolved the SAS 112/115 internal control deficiencies and management advisory comments for the years ended June 30, 2006 and 2009. Neither of the SAS 112/115 reports had material weaknesses; they did, however, have significant deficiencies which are less severe than material weaknesses. Also, ʻOlelo did not receive the same comments in the years following the original comment. This indicates that ʻOlelo has been taking corrective action with regard to its auditor's comments.

- As of November 4, 2011, ʻOlelo has not resolved the noncompliance issue with regards to its agreement with DCCA. ʻOlelo needs to separate its operating funds and capital funds into their respective bank accounts. ʻOlelo will need to use the capital fund bank account when purchasing capital facilities or equipment and the operating fund bank account for noncapital purchases.

# Chapter 5

## COMPLIANCE

### Analysis of ‘Olelo’s Compliance with Applicable Laws, Regulations, and its Contract with DCCA

#### Background

On December 24, 1998 ‘Olelo entered into an agreement with the State of Hawaii through its DCCA. As part of the agreement, ‘Olelo is responsible for the management and operations of the O’ahu PEG access facilities and equipment including channels, facilities and equipment, training, marketing, support services, and insurance. On December 3, 2003 ‘Olelo agreed to some changes to the activity reports via a teleconference call with DCCA. These changes were summarized in a letter dated December 22, 2003, titled “Re: Renewal of Contracts and Changes to the Activity Report”.

In addition, ‘Olelo is required to file reports with DCCA in order for DCCA to monitor ‘Olelo’s compliance with the provisions of the agreement. The reporting requirements for the period January 1, 2006 through June 30, 2011 are as follows:

1. Amendments to the articles of incorporation and by-laws no later than 30 days after approval by the board of directors.

2. A roster of the board of directors and officers and their respective term of office no later than 30 days after ‘Olelo’s annual meeting or no later than 30 days after a change in board membership when the change occurs other than at the annual meeting.

3. Annual financial statements no later than 90 days following the close of each calendar year.

4. Annual audited financial statements no later than 30 days after acceptance by the board of directors.

5. An annual operational plan and budget on or before November 1.

6. ‘Olelo shall also develop and periodically update a strategic or long-range planning document for a period of not less than three years, and shall submit a copy of such document no later than 30 days after acceptance by the board of directors.

7. Complete equipment inventory upon execution of the Agreement, and thereafter an annual update on or before November 1 of each year.

8. An annual activity report due February 28 of each calendar year which shall include, but not limited to, the following information:

    a. Executive Summary

    b. Public Access Programming

    c. Governmental Programming

    d. Educational programming

    e. Summary of all channel outages from maintenance records including total hours and reasons therefor.

    f. Facility Use

    g. Training

    h. Summary of complaints including the nature of the complaints and the actions taken.

    i. Summary of outreach and marketing efforts.

    j. Summary of revenues from sources other than TCI and Oceanic including the amounts, sources, and purpose of funds.

9. An annual year end activity report due February 28 of each calendar year.

As described in Chapter 4 of this report ‘Olelo shall designate one bank account for operations and another account for capital acquisitions (facilities and equipment). ‘Olelo shall be responsible for administering the accounts, and shall not commingle operating funds with capital funds without prior written approval of the Director (DCCA).

**Findings**

As described in Chapter 1, ‘Olelo’s Board of Directors and their current and past management teams have taken their responsibility for the management and operations of the PEG access facilities and equipment including channels, facilities and equipment, training, marketing, support services, and insurance seriously.

‘Olelo’s compliance with its reporting requirements for the period January 1, 2006 through June 30, 2011 is summarized in the below:

1. All amendments to the articles of incorporation and by-laws were submitted no later than 30 days after approval by the board of directors.

2. All rosters of the Board of Directors and officers were submitted no later 30 days after Olelo’s annual meeting or no later than 30 days after a change in board membership with the following exceptions:

    a. The 2006 annual meeting was held on April 12, 2006 the roster of Board officers was submitted on April, 21, 2006 but the roster of the Board of Directors was not submitted to DCCA.

    b. The 2007 annual meeting was held on January 24, 2007 and the roster of the Board of Directors and officers was not submitted to DCCA.

3. All the annual financial statements were submitted no later than 90 days following the close of each calendar year with the following exception:

    a. The 2006 annual financial statements were submitted late on November 30, 2007.

4. All of the annual audited financial statements were submitted no later than 30 days after acceptance by the board of directors with the following exceptions:

    a. The 2006 annual audited financial statements were approved on July 18, 2007 but were submitted late on September 19, 2007.

    b. The 2007 annual audited financial statements were approved on May 21, 2008 but were submitted late on December 26, 2008.

5. All of the annual operational plans and budgets were submitted on or before November 1 with the following exceptions:

    a. For the 2007 annual operational plan and budget, ‘Olelo requested and was granted an extension until November 20, 2006. Olelo submitted it on November 14, 2006.

    b. The 2009 annual operational plan and budget was submitted late on November 14, 2008.

6. The board of directors did not approve any strategic or long-range planning documents during the period.

7. All of the equipment inventories were submitted on or before November 1 with the following exception:

    a. For the 2007 equipment inventory ‘Olelo requested and was granted an

extension until November 9, 2007. Olelo submitted it on November 9, 2007.

8. All of the annual activity reports were submitted by February 28 following the close of each calendar year with the following exceptions:

   a. For the 2005 annual activity report ‘Olelo requested and was granted an extension until March 17, 2006. Olelo submitted it late on March 18, 2006.

   b. The 2007 annual activity report was submitted late on February 29, 2008.

9. All of the annual year end activity reports were submitted by February 28 after the close of each calendar year with the following exceptions:

   a. For the 2005 annual activity report ‘Olelo requested and was granted an extension until March 17, 2006. Olelo submitted it late on March 18, 2006.

   b. The 2007 annual activity report was submitted late on February 29, 2008.

As described in Chapter 4, Items Identified by ‘Olelo’s Independent External Auditors, ‘Olelo was out of compliance with the requirement to maintain separate bank accounts for operating funds and capital funds.

During the performance audit nothing came to our attention to suggest that there were any other instances of non-compliance with laws or regulations.

## Subsequent Events

The Board of Directors approved a strategic or long-range planning document on August 31, 2011 and submitted it on time to DCCA on September 16, 2011.

As noted in Chapter 4 of this report ‘Olelo was not in compliance with the requirement to maintain separate accounts for operating funds and capital funds. On September 12, 2011, ‘Olelo opened separate bank accounts for the operating funds and the capital funds. As of November 4, 2011, ‘Olelo had not separated all of the operating funds and capital funds into their respective bank accounts.

## Comments/Recommendations

- It appears that ‘Olelo is making a conscious effort to meet its reporting deadlines outlined in its December 24, 1998 agreement with DCCA and December 22, 2003 letter from DCCA.

- As noted in Chapter 4 ‘Olelo needs to comply with the requirement to maintain separate bank accounts for operating funds and capital funds.