

SPECIAL BOARD MEETING MINUTES
BOARD OF WATER SUPPLY
Monday, November 19, 2012

The Board of Water, County of Kaua'i, met in a special meeting at its office in Līhu'e on Monday, November 19, 2012. Chairperson Daryl Kaneshiro called the meeting to order at 9:09 a.m. On roll call, the following answered present:

BOARD: Mr. Daryl Kaneshiro, Chairperson
Mr. Clyde Nakaya
Mr. Randall Nishimura
Mr. Ray McCormick
Mr. Michael Dahilig

Quorum was achieved with 5 members present at roll call.

EXCUSED/ABSENT: Mr. Larry Dill
Mr. Roy Oyama

STAFF: Mr. David Craddick
Ms. Fay Tateishi
Ms. Anne Parrott
Mr. Dustin Moises
Mr. Aaron Zambo
Mr. Val Reyna
Ms. Cherrisse Zaima
Ms. Sandi Nadatani-Mendez
Deputy County Attorney Andrea Suzuki

GUESTS: Mr. James Nakayama, KMH LLP
Agent's Manager for DOW's Annual Financial Statement Audit

ACCEPTANCE OF THE AGENDA:

Mr. Nishimura moved to accept the agenda as circulated; seconded by Mr. Dahilig; with no objections, motion was carried with 5 Ayes.

NEW BUSINESS:

Re: Draft Annual Audit

BACKGROUND:

Mr. James Nakayama presented the draft Annual Audit and financial statements on the internal control for financial reporting and compliance of other matters for the year ending June 30, 2012.

Financial Audit and Audit Scope of Work

No single audit was required this year because the Department expended less than \$500,000 in federal funds for 2012.

Page 3 (hard copy), Independent Auditor's Report

In 2012 the auditors provided a clean opinion with no exceptions on the audit.

4th paragraph – Last year there was a qualification and not an exception to the auditor's opinion. A technicality on the other post-employment benefits (OPEB) trust which was set up with EUTF on how the treatment of contributions to the EUTF were done for accounting purposes. The technicality was resolved in 2011 and 2012 which was unqualified and clean.

Page 10, Statement of Revenues, Expenses and Changes in Net Assets

The increase in water sales for 2012 at \$21.3M was compared to 2011 water sales at \$19.8 M. This was due to a rate increase in January 1, 2012. The Change in Net Assets line reflects \$21.2 M which is a large part of capital contributions at \$22M. Capital contributions will fluctuate year to year. The loss increased from (\$416,322) last year to (\$832,812) for the current year.

Page 21 – Footnote 6, Bonds Payable, 3rd paragraph

The Department of Water (DOW) issued through the County \$5.1M in general obligation bonds to refund the 2001 Series bonds to take advantage of interest rates.

Page 37 - Footnote 14, New Pronouncement for Financial Reporting, 1st paragraph

Mr. Nakayama explained how the new accounting pronouncements that relates in the Governmental Accounting Standards Board (GASB) and to the DOW. The GASB was issued Statement No. 68, Accounting and Reporting for Pensions. This will significantly impact to the Department's financial statements to be implemented in June 2015. Mr. Nakayama will work with management to implement these changes to insurance compliance to the new standards.

All governments will see significant changes from the last three years. The health care cost is the last significant change related to the OPEB. The accounting for the pension retirement system will not impact the budget. This highlights a significant liability on the accounting books for the DOW and all state entities if it is not funded adequately.

In the Findings Sections the Board will continue monitoring the controls on the accounting software. The target completion date is June 30, 2015. Mr. Dahilig asked if the current recommendation has any relation to Footnote 14 and if the Board should recommend to the Administration to push a change the software sooner. Mr. Nakayama commented that GASB 68 is a significant accounting change, but not a systemic change that would cause the Board to stop or go faster to make system decisions.

Page 41 – Independent Auditor's Report – GAGAS Report (not an opinion)

Any control deficiencies are considered to be material weaknesses and significant deficiencies would require a written report to the Board.

Page 43 - Finding No. 2012-01 Inadequate Use of Accounting Software – Material Weakness

The 2012 audit had three (3) findings with no instances of material non-compliance.

1. The accounting audit for the prior year relating to the inadequate use of the accounting software was a carryover finding. Management has made progress but the finding is still open and considered a material weakness.
2. Page 44 - Finding No. 2012-02 – Timely Reconciliation of Sales Entries – Significant Deficiency
This is a current year finding of significant deficiencies relating to reconciling certain accounts relating to sales entries. Improvements need to be worked with the impending billing changes by the Honolulu Board of Water Supply (HBWS) in the next fiscal year.
3. Page 44 & 45 - Finding No. 2012-03 – Inventory – Book to Physical Adjustments – Significant Deficiency
This new finding relates to the Department's inventory control. Inventory accounts were larger than normal during the audits. Management was not able to explain the variances. Management was recommended to pursue the source of the differences and to make changes to the process.

Management's draft responses to all three findings are included in the draft audit.

Page 46 – Summary Schedule of Prior Audit Findings

In the last year, the Department had five findings: three material weakness and two significant deficiencies with two findings still open.

DISCUSSION:

In Finding No. 2012-01, Mr. Nishimura inquired if the three year span is a reasonable timeframe to resolve the accounting weakness. Mr. Nakayama stated if it is a significant issue, it should be resolved as soon as possible which affects the Department's closing process. The Board will work with management to determine a reasonable time frame and discuss the material weaknesses that have persisted the past two fiscal years.

Under the Conditions, cause and context category, Mr. Nakaya wanted to know when did the issue first come up. Mr. Nakayama did not know exactly when this persisted. There may have been a transition of personnel that had a system in place. The information may not have been transferred to the current staff which made it harder to take over the system to identify the issues. The current staff is reassessing if they need a new system or to redesign the current system. The DOW and the Honolulu Board of Water Supply (HBWS) will transition from a bi-monthly billing to monthly billing in a January 2013.

Mr. Dahilig inquired if the criteria in the findings are part of the Standard Operating Procedure (SOP) or part of the transition of the monthly billing system. Manager Craddick stated the actual water consumption is not known until after two months when the bill is received. Mr. Dahilig acknowledged that the HBWS will require reconciliation of monthly billings. He questioned when was the SOP for the DOW determined to input into the HBWS on a monthly basis.

The sales entry from a billing perspective is bi-monthly. Cash comes in daily and adjustments are reconciled on a regular basis. The billing cycle will not change this but it would create a different reporting system. Mr. Dahilig concluded that Best Practice was not being followed in the SOP. Mr. Nakayama added the transition to the new billing system will occur soon and the

Department should perform its reconciliation on a more timely basis. Manager Craddick understood that the reconciliation is not done on a monthly basis because exact flows cannot be determined monthly. Manager Craddick was not aware if the Department has an SOP for reconciling.

Mr. Dahilig questioned if the Department has the information to comply with the findings and is the Department ready for the monthly billing in January 2013? Manager Craddick stated flows will match when the Department goes to the monthly billings.

Manager Craddick commented that Ms. Yano does provides the Board monthly graphs to show bi-monthly reconciliation. At the end of the year, Ms. Yano presents a final reconciliation. Manager Craddick preferred to wait until Ms. Yano returns from leave to answer the reconciliation questions for the Board. Mr. Dahilig would like this issue resolved in the next audit cycle.

There is a potential contingency on a contractor who has a claim against the DOW. Mr. Nakayama is working with Manager Craddick and Deputy Attorney Andrea Suzuki to get the facts relating to the claim.

The Audit was simplified because the Department was not expending federal funds over \$500,000. By contract there is a difference in the fee amounts in a single audit portion. Additional testing needs to be done related to the funds being spent. This is separated within the contract and there is no single audit of what the fee would be.

The BAB funds are bonds and not a grant from the federal government.

Item III. Other Required Communication

- a. Today's meeting discussion will be documented in a letter for the Board. A second letter will be addressed to the Board after the final report has been issued. Highlights of the letter to the Board will include:
- b. A full listing of the audit adjustments will be attached to the letter for the Board to review. The adjustments proposed by the auditors decreased from 33 from the prior year to 17 in the current year. Seven out of 17 of these were normal routine entries (not errors that the Department staff had made).
- c. Prior to the 2012 audit there was a concern from a DOW staff regarding procurement matters. One potential matter was brought to Manager Craddick's attention for further investigation and final determination. The issue is insignificant and is not required to be included in the report. However, we wanted to inform the Board of our discussion with Manager Craddick.
- d. Difficulties encountered in performing the audit in previous years have been the challenges of the audit completion time frame due to the length of the Department's annual procurement process. Improvements were made by management but there was still a three week delay to meet the auditor's contractual deadlines. It was recommended that more improvements need to be made to get the audit completed by the contractual deadline.

Mr. Nakayama thanked the Board and especially Ms. Yano and her staff for their hard work in getting the audit done.

Mr. Nishimura moved to receive the draft Annual Audit report with a copy to be forwarded to the Administration; seconded by Mr. Nakaya, motion carried with 5 Ayes.

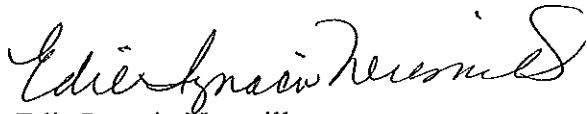
EXECUTIVE SESSION:

None

ADJOURNMENT:

There being no further business, Chair Kaneshiro adjourned the Special meeting at 9:48 a.m.; with no objections, motion was carried.

Respectfully Submitted,



Edie Ignacio Neumiller
Commissions Support Clerk

Approved,



Randall Nishimura
Secretary – Board of Water Supply