Financial Audit of the John A. Burns School of Medicine of the University of Hawaii

A Report to the Governor and the Legislature of the State of Hawaii

Report No. 03-02
May 2002

THE AUDITOR
STATE OF HAWAII

Office of the Auditor

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

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

1. *Financial audits* attest to the fairness of the financial statements of agencies. They examine the adequacy of the financial records and accounting and internal controls, and they determine the legality and propriety of expenditures.

2. *Management audits*, which are also referred to as *performance audits*, examine the effectiveness of programs or the efficiency of agencies or both. These audits are also called *program audits*, when they focus on whether programs are attaining the objectives and results expected of them, and *operations audits*, when they examine how well agencies are organized and managed and how efficiently they acquire and utilize resources.

3. *Sunset evaluations* evaluate new professional and occupational licensing programs to determine whether the programs should be terminated, continued, or modified. These evaluations are conducted in accordance with criteria established by statute.

4. *Sunrise analyses* are similar to sunset evaluations, but they apply to proposed rather than existing regulatory programs. Before a new professional and occupational licensing program can be enacted, the statutes require that the measure be analyzed by the Office of the Auditor as to its probable effects.

5. *Health insurance analyses* examine bills that propose to mandate certain health insurance benefits. Such bills cannot be enacted unless they are referred to the Office of the Auditor for an assessment of the social and financial impact of the proposed measure.

6. *Analyses of proposed special funds* and existing *trust and revolving funds* determine if proposals to establish these funds are existing funds meet legislative criteria.

7. *Procurement compliance audits* and other *procurement-related monitoring* assist the Legislature in overseeing government procurement practices.

8. *Fiscal accountability reports* analyze expenditures by the state Department of Education in various areas.

9. *Special studies* respond to requests from both houses of the Legislature. The studies usually address specific problems for which the Legislature is seeking solutions.

Hawaii's laws provide the Auditor with broad powers to examine all books, records, files, papers, and documents and all financial affairs of every agency. The Auditor also has the authority to summon persons to produce records and to question persons under oath. However, the Office of the Auditor exercises no control function, and its authority is limited to reviewing, evaluating, and reporting on its findings and recommendations to the Legislature and the Governor.

THE AUDITOR
STATE OF HAWAII
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OVERVIEW

Financial Audit of the John A. Burns School of Medicine of the University of Hawaii

Report No. 03-02, February 2003

Summary

The Office of the Auditor and the certified public accounting firm of Deloitte & Touche LLP conducted a financial audit of the John A. Burns School of Medicine of the University of Hawaii for the fiscal year July 1, 2001 to June 30, 2002. The audit examined the financial records and transactions of the school; reviewed the related systems of accounting and internal controls; and tested transactions, systems, and procedures for compliance with laws and regulations.

We found deficiencies in the internal control practices of the school. The school's administration and management of its contracts with health care organizations that provide training and medical services are deficient. The contracts require the organizations to reimburse the school for salary, fringe benefit, and professional malpractice insurance premium costs of faculty providing medical services for the respective organizations while conducting training.

We found that all of the contracts, 28 during FY2001-02, were signed and executed subsequent to the contract start date. School faculty provided services for at least four months and approximately $2.3 million in expenses were incurred, before the health care organizations could be billed. As a result, the school's cash flow was negatively impacted and interest that could have been earned on the amounts outstanding was lost. Also, the performance of services in the absence of executed contracts could expose the school to potential disagreements with the health care organizations and legal risks.

We also found that the school does not complete final reconciliations of the amounts due from the health care organizations in a timely manner. As of mid-October 2002, the final reconciliations for FY2001-02 were not completed, and bills that would cover the final month of service, as well as any necessary adjustments, had not been sent out. Here also, the school's cash flow was negatively impacted as funds remained outstanding for about four months and any potential interest income was lost.

Finally, we found that the school does not comply with University of Hawaii policies and procedures regarding conflict of interest situations involving school faculty. University faculty are encouraged to promote the state's cultural and economic development by utilizing their special abilities and skills in research, teaching, or other areas over and above their university positions. However, limits are placed on such outside employment to ensure that employment does not interfere with the faculty's primary obligation to the university.

University faculty are required to submit disclosure forms and outside employment forms. We found that a significant portion of these forms were either not

completed or were not submitted in a timely manner. We also found that the policies and procedures were not enforced by school administrators. By not enforcing the requirement for submitting disclosure forms and outside employment forms, potential conflict of interest situations which interfere with an employee's obligation to the school may not be identified or adequately resolved. Employees could spend too much time supplementing their income with outside activities at the expense of their responsibilities to the school. Also, in cases where research is funded by non-university sources, the sponsor may even sanction the university, if appropriate, because of a conflict of interest.

Recommendations and Response

We recommend that the school revise the way it handles contract negotiations with health care organizations, and commence services only after contracts are finalized and executed. The school should also review the process used to prepare the final contract reconciliations and ensure that the final bills are sent out in a timely manner.

We also recommend that the school enforce policies, procedures, and deadlines for completion and submission of the annual disclosure forms and outside employment forms.

The university agrees with our recommendations and responded that it has already taken steps to implement some of our recommendations.

Marion M. Higa
State Auditor
State of Hawaii

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Financial Audit of the John A. Burns School of Medicine of the University of Hawaii

A Report to the Governor and the Legislature of the State of Hawaii

Conducted by

The Auditor
State of Hawaii
and
Deloitte & Touche LLP

Submitted by

THE AUDITOR
STATE OF HAWAII

Report No. 03-02
February 2003

Foreword

This is a report of the financial audit of the John A. Burns School of Medicine of the University of Hawaii for the fiscal year July 1, 2001 to June 30, 2002. The audit was conducted pursuant to Section 23-4, Hawaii Revised Statutes, which requires the State Auditor to conduct postaudits of all departments, offices, and agencies of the State and its political subdivisions. The audit was conducted by the Office of the Auditor and the certified public accounting firm of Deloitte & Touche LLP.

We wish to express our appreciation for the cooperation and assistance extended by officials and staff of the John A. Burns School of Medicine of the University of Hawaii.

Marion M. Higa
State Auditor

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Chapter 1

Introduction

This is a report of our financial audit of the John A. Burns School of Medicine of the University of Hawaii. The audit was conducted by the Office of the Auditor and the independent certified public accounting firm of Deloitte & Touche LLP. The audit was undertaken pursuant to Section 23-4, Hawaii Revised Statutes (HRS), which requires the State Auditor to conduct postaudits of the transactions, accounts, programs, and performance of all departments, offices, and agencies of the State of Hawaii (State) and its political subdivisions.

Background

The John A. Burns School of Medicine (school) is part of the University of Hawaii's College of Health Sciences and Social Welfare. The University of Hawaii (university) is a statewide system of postsecondary education, comprised of two four-year campuses and one upper-division campus, seven community colleges, research institutes, experimental stations, and a cooperative working arrangement with the federally supported East-West Center. The university was established by the state Constitution.

The School of Medicine was established in 1965 as a two-year program of basic medical sciences, and enrolled its first students in 1967. It became a four-year degree-granting program in 1973. Since then, nearly 1,600 individuals have received their M.D. degrees from the school, and approximately 60 percent of practicing physicians in the state are graduates of the M.D. program or one of its residency programs. The school also offers advanced degrees in public health and basic sciences.

The school's original purpose was to provide a previously unavailable opportunity for a medical education to residents of Hawaii and other Pacific nations. Currently, the school's primary focus is to teach and train students to become quality physicians, biomedical scientists, and allied health workers to improve health care in Hawaii and the Pacific region.

Two unique features of the school's programs include its problem-based learning curriculum and community-based medicine program. Traditional education systems emphasize teacher-directed learning, passive student participation, and memorization of large quantities of information. In a problem-based learning approach, students are self-directed and responsible for their own learning. According to the school, students are trained to think critically and evaluate new information and research data. They are also required to apply their new knowledge to current problems and situations. The school further states that instead of merely listening in crowded, impersonal lecture halls, students discuss health-related issues with a faculty member in small group settings.

The school also uses a community-based medicine program. It does not own a university teaching hospital, but bases its clinical instruction in affiliated community hospitals and clinics. According to the school, this approach has many benefits: it is more economical, students are placed into the real world of day-to-day clinical activity from the start of their medical training, and it involves extensive participation of community physicians and other health professionals in the training of future physicians. The first two years of medical school activities take place in community health sites and the Biomedical Sciences Building on the campus of the University of Hawaii at Manoa. The second two years of instruction consist primarily of advanced clinical instruction and take place in affiliated community hospitals and clinics.

Autonomy

Effective July 1, 1998, the University of Hawaii autonomy bill – Act 115, Session Laws of Hawaii (SLH) 1998 – paved the way for university autonomy in matters involving its internal structure, management, and operations. In November 2000, voters granted the university constitutional autonomy to allow the university's Board of Regents greater freedom in governing its internal matters. Accordingly, the university is now exempt from certain Hawaii Revised Statutes that regulate other state agencies.

Mission

The school's mission is to educate students to become outstanding physicians, scientists, and other health care professionals; and to conduct research in areas of specific interest to the region and community.

Hospital affiliations

Due to the lack of its own teaching hospital, the school maintains affiliations, both formal and informal, with the following community hospitals and medical facilities for medical student and resident training: Kapiolani Medical Center for Women and Children, Kapiolani Medical Center at Pali Momi, St. Francis Medical Center, St. Francis Medical Center-West, The Queen's Medical Center, Tripler Army Medical Center, Straub Clinic and Hospital, Kuakini Medical Center, Shriners' Hospital, Kaiser Medical Center, Wahiawa General Hospital, Waianae Coast Comprehensive Health Center, Kalihi-Palama Health Center, Rehabilitation Hospital of the Pacific, Leahi Hospital, U.S. Veteran Affairs Outpatient Clinic, and the Hawaii State Hospital.

Organization of the John A. Burns School of Medicine of the University of Hawaii

The school is headed by a dean. The dean reports to the chancellor of the University of Hawaii at Manoa, who in turn reports to the president as shown in Exhibit 1.1. The school is organized into offices, departments, and divisions.

Five offices provide support to the school in both academic and non-academic areas:

1. The Office of the Dean provides both academic and non-academic support to the school and includes the Office of Medical Education, the Imi Hoʻola, ecology and health, and geriatrics programs;

2. The Office of Public Health Studies consists of the Department of Public Health Sciences and Epidemiology, graduate program, and the Center on Aging, along with support functions for its own admissions, student services, medical library, and administrative services;

3. The Office of Student Affairs provides non-academic student support in areas such as admissions, financial aid, and other student programs;

4. The Office of Administrative Services provides fiscal and personnel support for the school; and

5. Instructional Resources provides information technology and other non-academic support to the school.

Each department and division within the school is organized by discipline, which includes both basic and clinical sciences. Most departments and divisions are headed by a chairperson, who reports directly to the dean.

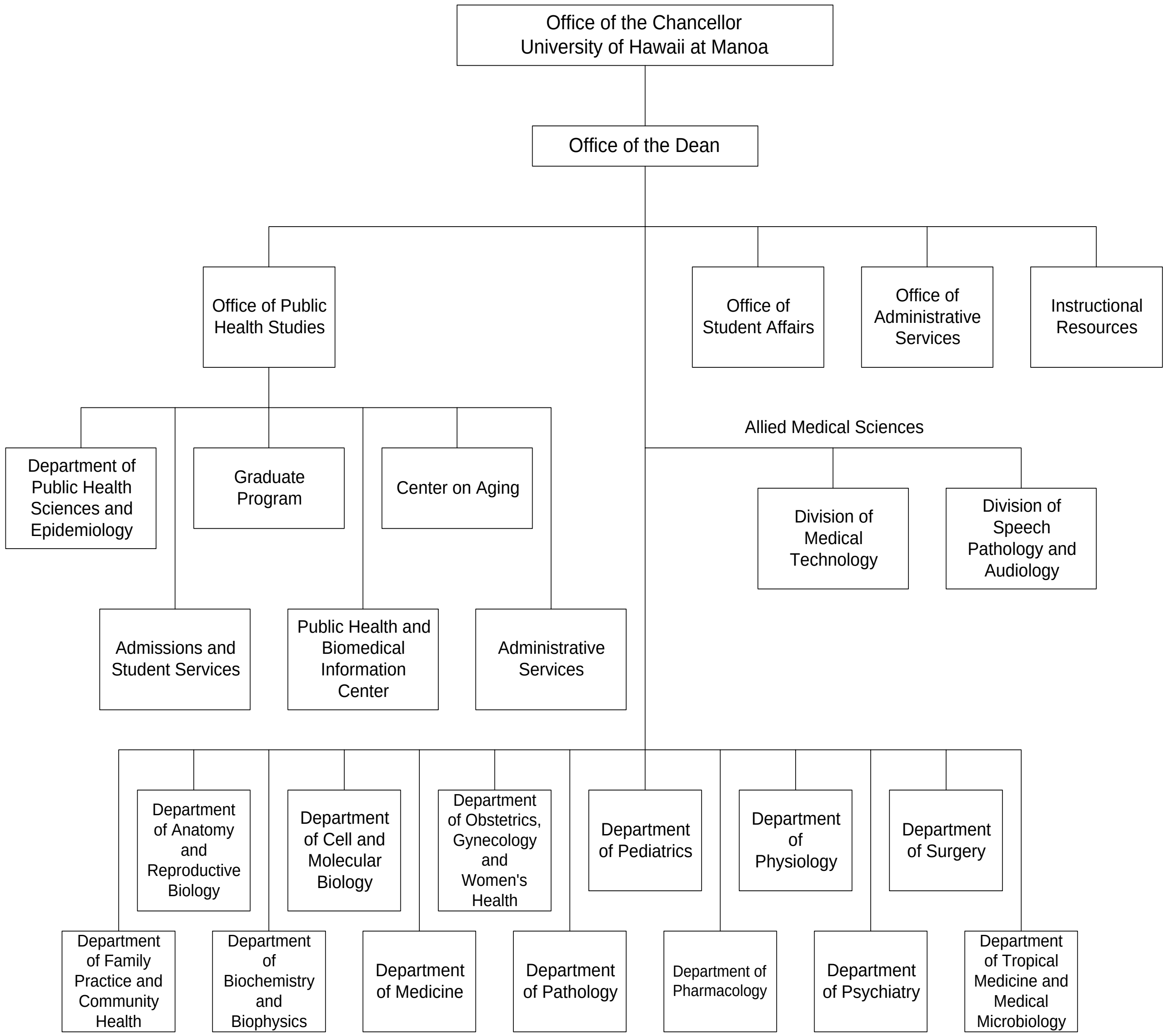
Other Entities Involved with the Medical School

As part of the larger University of Hawaii system, the school works closely with other offices and agencies that are part of, or related to, the university system. Three offices in particular—the Office of Research Services, University of Hawaii Foundation, and the Research Corporation of the University of Hawaii—have significant interaction with the school.

Office of Research Services

The Office of Research Services provides administrative and technical support for research and contracts at the university level. The Office of

Exhibit 1.1
Organization Chart of the John A. Burns School of Medicine of the University of Hawaii



Source: John A. Burns School of Medicine of the University of Hawaii.

Research Services is the focal point for submission of new, continuing, and supplemental proposals, as well as for post-award administration, including ensuring compliance with numerous federal and other requirements. The Office of Research Services is also responsible for billing and collecting funds generated by research projects, and works closely with the medical school.

The Office of Research Services also performs reviews of non-research related contracts and other agreements for compliance with university administrative requirements, and executes such contracts and agreements on behalf of the school.

University of Hawaii Foundation

The University of Hawaii Foundation is a private, non-profit corporation designated by the Internal Revenue Service as a 501(c)(3) organization. The University of Hawaii Foundation is the central fundraising agency for the university. It conducts campaigns for university priorities and provides central services to raise funds, manage assets, and administer gift accounts for the university. Its mission is to advance the university's goals by raising and stewarding gifts, including those for the medical school.

Research Corporation of the University of Hawaii

The Research Corporation of the University of Hawaii is a state agency, established by the Legislature in 1965, and attached to the university for administrative purposes. The fundamental mission of the Research Corporation of the University of Hawaii is to support research and training programs of the university and to enhance research, development, and training in Hawaii. The corporation is similar to a service bureau, in that it hires personnel and procures goods and services on behalf of its clients, the university being its major client.

Because of its exemption from state statutes such as those relating to procurement and personnel, the corporation has the flexibility to function more like a business. Accordingly, the corporation has its own personnel, payroll, accounting, and disbursing systems, independent of the state and university systems. This makes it possible for the corporation to process transactions expeditiously, which in turn makes it possible for researchers to focus more of their efforts on research rather than administrative activities. The university pays an administrative fee to the corporation based on the volume of services provided.

Objectives of the Audit

1. To assess the adequacy, effectiveness, and efficiency of the systems and procedures for the financial accounting, internal control, and financial reporting of the John A. Burns School of Medicine of the

University of Hawaii; to recommend improvements to such systems, procedures, and reports; and to report on the financial statements of the school.

2. To ascertain whether expenditures or deductions and other disbursements have been made and all revenues or additions and other receipts have been collected and accounted for in accordance with federal and state laws, rules and regulations, and policies and procedures.

3. To make recommendations as appropriate.

Scope and Methodology

We audited the school’s financial records and transactions and reviewed its related systems of accounting and internal controls for the fiscal year July 1, 2001 to June 30, 2002. We tested financial data to provide a basis from which to report on the fairness of the presentation of the financial statements. We also reviewed the school’s transactions, systems, and procedures for compliance with applicable laws, regulations, and contracts.

We examined the school’s existing accounting, reporting, and internal control structures and identified deficiencies and weaknesses therein. We made recommendations for appropriate improvements including, but not limited to, the school’s administration of contracts and compliance with policies and procedures relating to conflicts of interest.

In addition, we reviewed the extent to which recommendations made in the school’s previous external financial audits and agreed-upon procedures reports have been implemented. Where recommendations have not been, or have been only partially, implemented, the reasons for these were evaluated.

The independent auditors’ opinion as to the fairness of the school’s financial statements presented in Chapter 3 is that of Deloitte & Touche LLP. The audit was conducted from July 2002 through October 2002 in accordance with generally accepted government auditing standards.

Chapter 2

Internal Control Deficiencies

Internal controls are steps instituted by management to ensure that objectives are met and resources are safeguarded. This chapter presents our findings and recommendations on the financial accounting and internal control practices and procedures of the John A. Burns School of Medicine of the University of Hawaii (school).

Summary of Findings

1. The administration and management of the John A. Burns School of Medicine of the University of Hawaii's contracts with health care organizations to provide training and medical services are deficient. As a result, the school provided services for at least four months without the protection of signed contracts and incurred approximately $2.3 million in expenses before the health care organizations could be billed for services provided. In addition, the school is delinquent in its final reconciliations of its contracts. These deficiencies are primarily the result of untimely planning and inefficient processes.

2. The school does not comply with certain university policies and procedures regarding conflict of interest situations involving school faculty. As a result, conflict of interest situations may not be identified or adequately resolved. These situations may jeopardize a faculty member's ability to perform his or her duties and responsibilities to the school, and any resulting negative publicity may undermine the public's confidence in the school. The primary cause of this noncompliance is the lack of enforcement of established monitoring programs due to the school administration's failure to take seriously the consequences of failing to disclose a conflict of interest situation.

The Administration and Management of Contracts Are Deficient

The administration and management of the medical school's contracts with health care organizations are deficient. Because the school does not have a teaching hospital, it contracts with various health care organizations to provide training and medical services to its students in a clinical setting. These contracts require the organizations to reimburse the school for salary, fringe benefit, and professional malpractice insurance premium costs of faculty providing medical services for the respective organizations while conducting training. We found that contracts are not executed in a timely manner, the resulting delays in contract execution negatively impact the school's cash flow, and final contract reconciliations are not performed in a timely manner. These deficiencies result from poor planning and inefficient processes.

The school is responsible for contract negotiation and execution

The school has numerous contracts with federal, state, and private agencies to provide research, training, and medical services. Normally, the university's Office of Research Services and Office of General Counsel assist the university's departments or divisions with drafting or reviewing contracts to ensure compliance with laws, rules, regulations, and university administrative policies and procedures. However, because of the specialized nature of salary and fringe benefit agreements that the school has with various health care organizations, the school retains primary responsibility for the contracts. For these contracts, the Office of Research's and Office of General Counsel's involvement is normally limited to providing assistance on an as-needed basis, such as in the event significant changes are required to be made to the contract terms.

The departments and divisions of the school are responsible for negotiating the applicable scope of services to be rendered, timing of services, and amount of fees to be charged. Fees are normally set at amounts approximating salary and fringe benefits to be paid to the particular faculty members covered under the contracts. However, such fees are often subject to negotiation with the health care organizations, especially if the amounts exceed the organizations' budgeted amounts. These negotiations can often be time-consuming. Once the negotiations are finalized, the Office of Research Services executes the contracts on behalf of the school.

Contracts are not executed in a timely manner

We examined all 28 contracts that the school had with health care organizations during FY2001-02 for salary and fringe benefit reimbursements for services rendered by school faculty. We found that in *every* instance, services had commenced prior to contract execution. In almost all cases, the school submitted the contracts to the health care organizations for their review and execution about 30 days before the start of the service period. However, we calculated that, on average, the health care organizations took about 113 days to perform their review of the contracts, and the school took another 32 days to finalize the contracts. Thus, the school provided services to the health care organizations for an average of four months prior to contract execution.

Contract delays negatively impact the school

The school cannot bill for services rendered by its faculty without a properly executed contract. Accordingly, in the case of salary and fringe benefit contracts with health care organizations, the school incurred—and paid out of its general funds—expenses for approximately four months before it could bill for these services and receive reimbursement. With an average monthly billing of $587,000 for medical services, approximately $2.3 million of services were provided by the school before bills could be sent. This situation negatively impacts the school's cash flow. Funds that should be available to the school remain outstanding for several months and interest income on the amounts outstanding is lost. The health care organizations, on the other hand, have the benefit of using or investing the cash during the period.

In addition, the lack of an executed contract exposes the school to potential disagreements with health care organizations about the nature, extent, and timing of medical services, and the amount of reimbursement it is to receive. Although the school attempts to obtain either written or verbal authorization from the health care organizations to continue services at an agreed-upon level during the contract-negotiation period, it is nevertheless a poor business practice to perform services without an executed contract in place; and furthermore, it exposes the school to unnecessary legal risk.

Final reconciliations are not performed on a timely basis

The school bills the health care organizations an estimated monthly amount, which is computed as one-twelfth of the contract amount. At fiscal year-end, a reconciliation is performed to determine the actual costs incurred for the individuals covered under the salary and fringe benefit agreements. Any adjustments from the estimated amount to the actual amount are incorporated into the final bill. As of the date of our testing in mid-October 2002, the school still had not completed all of its final reconciliations for FY2001-02, and accordingly, still had not sent out its final bills that would cover the final month of service, as well as any necessary adjustments. As a result, the school was unable to access these funds for over three months and lost any potential interest that could have been earned on the money during the period.

Poor planning and inefficient processes delay contract execution and administration

Delays in the execution of contracts and performance of final reconciliations are primarily the result of untimely planning and inefficient processes. Salary and fringe benefit agreements with health care organizations are, for the most part, renewed annually with few or no changes to the language in the agreement. However, the budget schedules, which are included as attachments to the contract and which list the covered faculty and their respective salary and fringe benefit amounts, change from year to year. Although the school begins the process of accumulating budget information within 90 days prior to the commencement date of the contracts, past experience indicates that this timing is insufficient to negotiate the terms of the contracts with the health care organizations and to finalize the contracts prior to the required start date for the provision of services. This situation clearly reflects the school's poor planning in ensuring the timely execution of the contracts.

In addition, there are inefficiencies in the way the final contract reconciliations are processed. The data accumulation required for the reconciliation is performed manually, and requires a significant amount of resources to compile.

Recommendations

The school should revise its planning for contract negotiations by allowing more time for contract negotiation and execution, such that services commence only after the contracts have been finalized and executed. In addition, the school should review the process used to prepare the final contract reconciliations to ensure that the final bills are sent out in a timely manner.

The School Does Not Comply with University of Hawaii Policies and Procedures Regarding Conflict of Interest Situations

The university has policies and procedures relating to various personnel matters, including those pertaining to conflict of interest situations involving faculty employment. We found that the school did not comply with many of these conflict of interest policies and procedures.

Conflict of interest situations may not be identified or adequately resolved

University faculty are encouraged to promote the state's cultural and economic development by utilizing their special abilities and skills in research, teaching, or other areas over and above their university positions. However, the Board of Regents' policies and the University of Hawaii Professional Assembly collective bargaining agreement include limits on such outside employment to ensure that they do not interfere with the faculty's primary obligation to the university.

The university executive policy regarding conflicts of interest notes that "a potential or actual conflict of interest exists when commitments and obligations to the university are likely to be compromised by a person's other interests or commitments, particularly if those interests or commitments are not disclosed."

The university monitors potential conflicts of interest by requiring its faculty members to submit disclosure forms and outside employment forms. We found that, out of a total of 419 school employees involved in either teaching or research, 49, or 12 percent, had not completed the forms. Accordingly, potential conflict of interest situations could exist without timely detection.

These conflict of interest situations may jeopardize a faculty member's ability to carry out his or her duties and responsibilities to the school. In addition, any negative publicity relating to the existence of such conflict of interest situations could undermine the public's confidence in the university and the school.

Disclosure forms are not submitted in a timely manner

University executive policy requires faculty, certain staff, and administrators to complete a university disclosure form and to submit it to their supervisor (respective department chairperson, unit director, or dean) by April 15 of each year. Part I of the form requires disclosure of:

- Whether the individual has any ownership interests in any organization in his or her field;
- Whether the individual held any officer or other positions in any organization;
- Whether the individual received income from an outside source;
- Whether the individual employed students or staff outside the university; and
- The existence of other transactions or facts.

Any affirmative responses in Part I of the form require completion of Part II of the form. Part II then requires specific information regarding the ownership, position, or activity described. The form must be reviewed and signed by the individual's supervisor, who certifies that, to his or her knowledge, the individual either does not have any conflicts of interest, or has reported and resolved any existing conflicts. Any conflicts of interest that cannot be resolved by the individual's supervisor must be taken to the next higher level of administration. While university policy describes procedures for gathering information regarding potential conflicts of interest, it does not provide guidance on procedures for resolving conflicts of interest.

Department chairpersons or unit directors must compile an annual report summarizing the data on disclosure forms for their respective departments or units, and submit it to the dean by April 15 of each year. The summary report includes the following information about the employees reporting to them:

- The number and percentage who filled out the form;
- The number and percentage who answered questions in Part I affirmatively;
- The number and percentage who completed Part II;
- The number and percentage whose conflicts of interest were resolved;
- The number and percentage whose conflicts of interest were not resolved; and
- Details of recommended actions to resolve any outstanding conflicts of interest.

The dean must submit to the chancellor an annual summary for the entire school by June 30 of each year.

To test compliance with this policy, we examined 127 individual disclosure forms and noted the following discrepancies:

- 44 forms (35 percent) were signed by employees after the April 15 deadline. Of these, five forms were completed after we requested access to the forms during our fieldwork in September 2002; and
- 65 forms (51 percent) were not reviewed or approved by a supervisor before the April 15 deadline, and forms for all nine individuals in one department remained unsigned through September 2002.

We also examined departmental annual summary reports and noted the following discrepancies:

- 17 of the 33 departments (52 percent) did not prepare the annual summary report;
- Five of the 33 departments (15 percent) prepared their annual summary reports after the April 15 deadline;
- 15 of the 28 supervisors (54 percent) who report directly to the dean did not submit their individual disclosure forms to the dean; and

- The dean's annual summary report was submitted to the interim chancellor for the University of Hawaii at Manoa after the June 30 deadline, and included only 24 of the 33 departments (73 percent).

Outside employment forms are not being completed

University administrative procedures require faculty seeking outside employment to complete university Form 50, "Record of Outside Employment," and obtain approval at least one week in advance of any outside compensated employment. In addition, the university's Board of Regents' policies restrict faculty to a maximum of eight hours of outside employment per week.

The record of outside employment form requires employees to attach a complete description of their outside employment activities, together with the amount of time spent on each. The form requires the employee's signature confirming that he or she has read the applicable policies contained in the collective bargaining agreement and the Board of Regents' policies. The department chairperson, unit director, or dean must endorse the request by checking a box and signing the form. The dean or designee indicates his or her approval by also checking a box and signing the form.

Based on a review of the conflict of interest disclosure forms previously discussed, we identified at least 48 individuals, from a total of 370 forms completed, who disclosed that they had outside remunerative activities from which they received income in excess of 1 percent of their salary from the school, as required by the conflict of interest disclosure form. These activities consisted primarily of private practices, consulting practices, positions with hospitals or nursing homes as medical directors, and outside research. These individuals should have also completed a record of outside employment form. However, we were informed that these individuals, along with the rest of the school's faculty, did not complete *any* record of outside employment forms for FY2001-02. Accordingly, it is not possible to determine how many faculty members were in violation of university and Board of Regents' policies during FY2001-02.

Although university conflict of interest disclosure forms address whether an employee has outside employment, the record of outside employment form must also be completed because: 1) the university disclosure form is an after-the-fact disclosure of income received from outside sources, whereas the record of outside employment form must be completed prior to involvement in any non-university compensated activity. Accordingly, proper use of the record of outside employment form can prevent any actual or apparent conflict of interest situation from arising;

and 2) the disclosure form shows only the name and nature of the organization from which an employee received compensation. It does not indicate the nature of the outside activity or time spent on such activity. (Although university policies state that the department head may request additional information regarding outside activities, we did not see any evidence that such was requested.) Thus, the disclosure form alone does not provide sufficient information to determine whether time spent on an outside activity exceeds the allowable limit or whether it interferes with an employee's primary obligation to the school.

Adherence to university's policies and procedures is not enforced by school administration

We found a lack of compliance and enforcement of policies and procedures at all levels within the school, from faculty and staff to upper management, including the dean. Our discussion with the school's administration indicated that those officials were aware of the disclosure form and outside employment form requirements, but did not enforce compliance with the same. For example, we examined correspondence from the school's administration to applicable supervisors providing detailed guidelines on completion of the forms. However, the school's administration had not followed up on uncompleted or late forms until after we had requested access to the forms on file.

The school's administration does not take seriously the consequences of failing to disclose a conflict of interest situation. A university executive policy states that failure to disclose a potential conflict of interest "is a violation of university policy, can result in charges of scientific misconduct, and may result in administrative or other sanctions as appropriate, including the suspension of funding." Because the requirement for submitting disclosure forms and outside employment forms is not enforced, a conflict of interest situation that interferes with an employee's obligation to the school may not be identified or adequately resolved. Failure to monitor or control conflict of interest situations could potentially lead to employees spending too much time supplementing their income with outside activities at the expense of their responsibilities to the school. In cases where research is funded by non-university sources, the sponsor may even sanction the university, if appropriate, because of a conflict of interest.

Recommendation

The school should take more seriously the consequences of not identifying conflict of interest situations on a timely basis and enforce policies, procedures, and deadlines for completion and submission of the annual disclosure forms and outside employment forms.

Chapter 3
Financial Audit

This chapter presents the results of the financial audit of the John A. Burns School of Medicine of the University of Hawaii, as of and for the fiscal year ended June 30, 2002. This chapter includes the independent auditors' report and the report on compliance and internal control over financial reporting based on an audit of financial statements performed in accordance with *Government Auditing Standards* as they relate to the school. It also displays the school's financial statements together with explanatory notes.

Summary of Findings

In the opinion of Deloitte & Touche LLP, based on their audit, the financial statements present fairly, in all material respects, the financial position of the school as of June 30, 2002, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. Deloitte & Touche LLP noted that the school has not presented the management's discussion and analysis information that the Government Accounting Standards Board has determined is necessary to supplement, although not required to be part of, the basic financial statements. Deloitte & Touche LLP also noted that the results of its tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Independent Auditors' Report

The Auditor
State of Hawaii:

We have audited the statement of net assets of the John A. Burns School of Medicine of the University of Hawaii (school) as of June 30, 2002, and the related statements of revenues, expenses, and changes in net assets and of cash flows for the year then ended. These financial statements are the responsibility of the school's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial 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 reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements of the school are intended to present the financial position, and the changes in financial position and cash flows of only that portion of the activities of the University of Hawaii that are attributable to the transactions of the school. They do not purport to, and accordingly do not, present fairly the financial position of the University of Hawaii as of June 30, 2002, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the school as of June 30, 2002, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the financial statements, the school has implemented a new financial reporting model, as required by the provisions of the Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and Governmental Accounting Standards Board Statement No. 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*, as of June 30, 2002.

The school has not presented the management's discussion and analysis information that the Governmental Accounting Standards Board has determined is necessary to supplement, although not required to be part of, the basic financial statements.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 28, 2002 on our consideration of the school's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

/s/Deloitte & Touche LLP

Honolulu, Hawaii
October 28, 2002

Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

The Auditor
State of Hawaii:

We have audited the financial statements of the John A. Burns School of Medicine of the University of Hawaii (school) as of and for the year ended June 30, 2002, and have issued our report thereon dated October 28, 2002. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining a reasonable assurance about whether the school's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards.*

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the school's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Auditor, State of Hawaii, and the management of the school and is not intended to be and should not be used by anyone other than these specified parties.

/s/Deloitte & Touche LLP

Honolulu, Hawaii
October 28, 2002

Description of Financial Statements

The following is a brief description of the financial statements audited by Deloitte & Touche LLP, which are presented at the end of this chapter.

Statement of Net Assets (Exhibit 3.1)

This statement presents the assets, liabilities, and net assets of the school at June 30, 2002.

Statement of Revenues, Expenses, and Changes in Net Assets (Exhibit 3.2)

This statement presents the revenues, expenses, and changes in net assets for the school for the year ended June 30, 2002.

Statement of Cash Flows (Exhibit 3.3)

This statement presents the cash flows from operating, non-capital financing, capital and related financing, and investing activities of the school for the year ended June 30, 2002.

Notes to Financial Statements

Explanatory notes that are pertinent to an understanding of the financial statements and financial condition of the school are discussed in this section.

Note 1 - Summary of Significant Accounting Policies

General

The John A. Burns School of Medicine of the University of Hawaii (school) was established in 1965 originally as a two-year medical school with two primary objectives:

- To provide opportunities for Hawaii’s citizens to have access to careers in medicine equivalent to those available in other states; and

- To add to the stature, academic quality, and research potential of the University of Hawaii (university).

The school converted to a four-year M.D. degree-granting institution and graduated its first class in 1975. The school's major emphasis is to train students to a high level of competence as physicians for the state and region and to conduct cutting-edge biomedical research, with the goal of improving health care in Hawaii and the Pacific area. The school offers an innovative and progressive problem-based curriculum, called the "M.D. Program," which is designed to integrate relevant basic science with clinical material using actual cases.

The school operates administratively as a unit of the university's Manoa campus. The school is a community-based medical school that does not own its own teaching hospital, but bases its clinical instruction in affiliated community hospitals and clinics across the state of Hawaii.

Financial Reporting Entity and Basis of Presentation

Under the provisions of Governmental Accounting Standards Board (GASB) Statement No. 14, *The Financial Reporting Entity*, the university is considered a component unit of the State of Hawaii, its primary government, and is included in the state's basic financial statements. However, the university is also its own reporting entity in accordance with GASB Statement No. 14, and has determined that the Research Corporation of the University of Hawaii (RCUH) and the University of Hawaii Foundation (foundation) are its component units, included in the university's financial statements. The basic criterion for determining whether a potential component unit should be reported within a reporting entity is financial accountability. Other criteria, including fiscal dependency and the nature and significance of the relationship, are such that exclusion would cause the financial statements to be misleading.

GASB Statement No. 14 is applicable to the following types of governmental entities:

- Primary governments;
- Governmental joint ventures;
- Jointly governed organizations;
- Stand-alone governments; and
- Component units.

The school is a part of the University of Hawaii and is not one of the governmental entity types subject to the provisions of GASB Statement No. 14. However, for consistency with the university's financial statements, the school has elected to apply the general provisions of GASB Statement No. 14 in defining its reporting entity for its stand-alone financial statements. Certain financial information related to the school's activities is reflected in accounts under RCUH and the foundation. This information has been blended in the accompanying financial statements. Financial information of the Office of Public Health Studies (formerly known as the School of Public Health Studies prior to being organizationally consolidated under the school in FY2000-01) and of certain school research project accounts managed administratively by the university's Pacific Biomedical Research Center has also been blended in the accompanying financial statements.

In November 1999 and June 1999, GASB issued its Statement No. 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities,* and Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, respectively, which became effective for the university for the fiscal year ended June 30, 2002. These statements significantly changed the reporting requirements for public colleges and universities in the United States. Under the provisions of these statements, the university is permitted to report as a special-purpose government engaged only in business-type activities (BTA reporting), because it is financed in part by fees charged to external parties for goods and services. BTA reporting requires the presentation of only basic financial statements (fund financial statements are not required) and required supplementary information for enterprise funds, which includes:

- A statement of net assets;
- A statement of revenues, expenses, and changes in net assets;
- A statement of cash flows;
- Notes to the financial statements;
- Management's discussion and analysis; and
- Required supplementary information other than management's discussion and analysis (if applicable).

Significant changes in reporting to comply with the new reporting model include: recording depreciation on capital assets; reporting revenues net of discounts and allowances; eliminating interfund activities; classifying activities as either operating or non-operating; and classifying assets and liabilities as current or non-current. The BTA reporting model provides that all GASB pronouncements, as well as Financial Accounting Standards Board pronouncements (except those that conflict with GASB pronouncements or are intended to be applicable specifically to not-for-profit organizations or issues primarily concerning such organizations), be implemented.

Applicability of the new statements extends to state and local governments as well as public colleges and universities. Reporting standards are written from the perspective of general-purpose governments such as states, cities, counties, towns, and villages, but also provide specific financial reporting standards for special-purpose governments such as colleges and universities reporting under the BTA reporting model. As the medical school is a part of the university and not a separate governmental entity, the provisions of these statements do not specifically apply to it. However, for consistency with the university's financial statements, the school has elected to apply the general provisions of the BTA reporting model in preparing the school's stand-alone financial statements, except for including a Management's Discussion and Analysis section as required supplementary information.

The school implemented the provisions of the new reporting model effective for the fiscal year ended June 30, 2002. The effect of the changes resulting from implementation of GASB Statement Nos. 34 and 35 has been reflected as a prior period adjustment. Such adjustment had the effect of reducing net assets at the beginning of the year and net capital assets by $3,517,473, representing accumulated depreciation to that date.

Basis of Accounting

The school's financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned and expenses are recorded when a liability is incurred.

Revenue Recognition and Classification

Operating revenues of the school result primarily from providing services to external parties, and generally have the characteristics of exchange transactions. Included in operating revenues are contract and grant revenue from federal, state, and local governments, as well as private sources and student tuition and fees. In addition,

- Grant and contract revenues and receivables are recorded as soon as all eligibility requirements imposed by the grantor or contractor have been met; and

- Student tuition and fee revenues are recognized when earned, and are reported in the accompanying financial statements net of scholarship discounts and allowances.

Non-operating revenues of the school are normally generated through non-exchange transactions such as state appropriations, gifts, and investment income. Specifically,

- State appropriations to the school are allocated by the university annually. Revenue is recognized by the school based on total expenditures and commitments made in the year that the funds are available;

- Gift revenue and contributions receivable is recognized net of estimated uncollectible amounts when all eligibility requirements are met;

- The university collects and later allocates school revenues from tuition and from the facilities and administrative cost recovery component of grants and contracts. A university allocation is reported as non-operating revenue equal to the amount allocated by the university to the school in excess of these school operating revenues; and

- Investment income (or loss) is comprised of unrealized and realized gains and losses, interest, dividend, and investment fees allocated by the university and foundation investment pools.

Cash and Cash Equivalents

The school considers all highly liquid debt instruments, including short-term cash investments, purchased with an original maturity of three months or less to be cash equivalents.

The carrying amounts reported in the statement of net assets for cash and cash equivalents approximate fair value due to the short maturity of these instruments.

All school cash is held either by the State Treasury or pooled with other university, foundation, or RCUH cash balances.

Accounts Receivable

Accounts receivable consists primarily of amounts due to the school from the federal government, state and local governments, and private sources in connection with the reimbursement of allowable expenditures made pursuant to contracts and grants. Accounts receivable are reported net of estimated uncollectible amounts.

The school uses the specific identification method to record its allowance for doubtful accounts.

Prepaid Expenses

Prepaid expenses are amounts paid to vendors or suppliers as of the fiscal year-end prior to receipt of the associated goods or services.

Investments

Investments of the school consist primarily of endowment investments that are stated at fair value, as determined by quoted market prices, or amounts determined by management if quoted market prices are not available. The net change in the fair value of investments is recognized as a component of investment income or loss.

Investments of the school's endowment funds are combined in investment pools with the university and foundation, unless required by the donor to be separately invested. Individual endowments subscribe to or dispose of units in the pools on the basis of a per unit valuation of the pool fair value. Gains or losses on sales of investments are retained or absorbed by the endowment principal. Cost of securities sold is determined using the first-in, first-out method.

The Board of Regents of the university and the Board of Directors of the foundation (collectively, the "boards") are responsible for management of the school's endowment investments. The boards establish investment goals and comprehensive guidelines to ensure the preservation of capital and adequate growth and income. The boards and appointed investment managers perform regular monitoring of investment performance. Title to investment securities is vested in the name of the Securities and Exchange Commission registered brokerage firms in New York representing the various investment managers of the university and the foundation.

The university's and foundation's policies provide for the distribution to the school of up to 5 percent of the preceding year's endowment fair value. If a donor has not provided specific instructions, state law permits the boards to authorize for expenditure the net appreciation of the investments of the endowment funds. Any net appreciation spent is required to be used for the purposes for which the endowment was established.

Capital Assets

Capital assets are recorded at cost on the date of acquisition, or if donated, at appraised value on the date of donation. The school's policy is to capitalize tangible, non-expendable personal property having an estimated useful life of more than one year and an acquisition cost of $5,000 or more per item. Items with acquisition costs under $5,000 are reflected as equipment expenses on the statement of revenues, expenses, and changes in net assets. Depreciation on the school's capital assets is computed using the straight-line method over the estimated useful lives of the assets. The school's capital assets are mainly comprised of furniture, fixtures, and equipment with useful lives ranging from three to ten years. Capital assets retired or otherwise disposed of are removed from the appropriate asset and related accumulated depreciation accounts. Gains and losses on disposals are reflected as non-operating income or expense.

Certain capital assets held under capital lease are amortized using the straight-line method over the lease term, and the related obligations are reported as liabilities in the statement of net assets. Lease amortization is included in depreciation expense.

Land and buildings on which school facilities are located and related infrastructure assets are not reflected in the financial statements of the school, but are reported in the university's financial statements.

Accounts Payable

Accounts payable represent the cost of goods or services received that have not been paid for as of year-end.

Deferred Revenues

Deferred revenues are reported as liabilities on the statement of net assets and include amounts primarily received for grants and contracts that have not yet been earned as of year-end.

Due to University of Hawaii

Amounts due to the university are comprised of advances made by the university to finance the cost of the school's extramurally sponsored projects for which funds are received from sponsoring agencies on a cost reimbursement basis. Pay down of this balance is generally recorded simultaneously with the receipt of the school's outstanding accounts receivable from sponsoring agencies.

Net Assets

The school's net assets are classified as follows:

Invested in Capital Assets, Net of Related Debt
This component of net assets represents the school's total investment in capital assets, net of accumulated depreciation and outstanding debt obligations related to those capital assets.

Restricted Net Assets – Nonexpendable
Nonexpendable restricted net assets include endowments and similar type assets that are subject to externally imposed constraints and required to be maintained in perpetuity.

Restricted Net Assets – Expendable
Expendable restricted net assets include resources whose use is legally or contractually subject to externally imposed constraints.

Unrestricted Net Assets
Unrestricted net assets represent all other net assets not classified as restricted or invested in capital assets. These resources are derived primarily from student tuition and fees, state appropriations, and gifts.

When an expense is incurred for purposes for which both restricted and unrestricted net assets are available, resources are generally applied proportionate to the benefit realized. For instances in which such a determination is not feasible or if there are cost compliance issues, unrestricted resources are applied first.

Internal Activities

All amounts and account balances resulting from activities occurring among the school, RCUH, foundation, and university have been eliminated from the accompanying financial statements.

Management's Estimates

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

Note 2 - Cash and Cash Equivalents

All school cash and cash equivalents are held either by the State Treasury or pooled with other university, foundation, or RCUH cash balances.

At June 30, 2002, information related to the insurance and collateral of funds deposited with the State Treasury was not available, since such information is determined on a statewide basis and not for individual departments. Cash deposits with the State Treasury are either federally insured or collateralized with obligations of the state or U.S. government. All securities pledged as collateral are held either by the State Treasury or by the State's fiscal agents in the name of the State.

School cash balances held by the university are pooled with other university funds and are either federally insured or covered by collateral held by the state director of finance in the name of the university. School cash balances held by the foundation and RCUH are also pooled with their other cash balances and amounts in excess of federally insured limits are uncollateralized. The school's cash and cash equivalents at June 30, 2002 are held as follows:

University of Hawaii	$	9,322,927
University of Hawaii Foundation		2,738,880
State Treasury		554,966
Research Corporation of the University of Hawaii		135,486
	$	12,752,259

At June 30, 2002, the school held cash amounts of $7,270,179 that were subject to externally imposed purpose restrictions and are reported on the statement of net assets as restricted cash and cash equivalents.

Note 3 - Receivables

The composition of accounts receivable at June 30, 2002 is summarized as follows:

Federal government	$	2,622,636
State and local governments		3,413,974
Nongovernmental		2,283,674
	$	8,320,284
Less allowance for doubtful accounts		(729,426)
Accounts receivable, net	$	7,590,858

The school operates the state's Hyperbaric Treatment Center out of a local hospital. At June 30, 2002, $770,554 of outstanding Hyperbaric Treatment Center receivables due from patients and third party insurance providers were included in nongovernmental accounts receivable; $556,687 of this balance has been outstanding for more than 180 days and is also included in the allowance for doubtful accounts. The school's total bad debt expense for FY2001-02 of $159,974 was due to the increase in the balance of the allowance for doubtful Hyperbaric Treatment Center accounts receivable from the prior year.

Student loans receivable is reported separately on the statement of net assets in the amount of $55,110, net of an allowance for doubtful accounts of $1,050 as of June 30, 2002. The school's student loan receivable accounts are administered under the foundation.

Contributions receivable is also reported separately in the statement of net assets in the amount of $251,034 as of June 30, 2002. There was no allowance for doubtful accounts associated with this balance.

Note 4 - Investments

At June 30, 2002, school endowment investments with fair values of $4,112,174 and $6,371,539 were held in investment pools in the university and the foundation, respectively. Therefore, specific information about the type of investments that comprise the school's endowment investment balance was not available. The university and foundation's endowment investment pools at June 30, 2002 were comprised of the following investment types:

	University of Hawaii	University of Hawaii Foundation
Corporate stocks	71%	51%
Bonds	13	14
U.S. government obligations	16	9
Other	0	26
	100%	100%

The cumulative appreciation in fair value of donor-restricted endowments that are available for expenditure amounted to $306,487 at June 30, 2002 and is reflected in restricted expendable net assets at year-end.

At June 30, 2002, the school had $235,038 of short-term endowment investments that were held by the foundation outside of the investment pool to comply with donor restrictions. This balance was comprised mainly of investments in domestic equities.

During FY2001-02, the school's endowment investments (including investments bought, sold, and held during the year) depreciated in value by $1,483,114.

Note 5 - Capital Assets

Capital asset activity for the year ended June 30, 2002 was as follows:

	Beginning Balance	Additions	Retirements	Ending Balance
Furniture, fixtures, and equipment	$ 4,900,512	$ 833,638	$ (225,918)	$ 5,508,232
Less accumulated depreciation	(3,517,473)	(399,498)	217,887	(3,699,084)
Capital assets, net	$ 1,383,039	$ 434,140	$ (8,031)	$ 1,809,148

Depreciation expense amounted to $381,858 in FY2001-02. The difference of $17,640 between depreciation reported and total additions to accumulated depreciation reflected above is due to the transfer of a fully depreciated asset from another university unit in FY2001-02.

The loss on retirement of capital assets amounted to $8,031 in FY2001-02 and is reflected in the statement of revenues, expenses, and changes in net assets as a non-operating expense.

The net capital asset balance at June 30, 2002 includes capital assets held under capital leases with a total net book value of $61,660.

Note 6 - Payroll Fringe Benefit Costs

Payroll fringe benefit costs related to employee salaries funded from state appropriated general funds are paid directly by the State and not imposed on the school. In FY2001-02, this cost amounted to approximately $2,335,600 and is reflected as fringe benefit expense and included in state appropriation revenue in the statement of revenues, expenses, and changes in net assets.

Note 7 - Employee Benefits

Pension Benefits

Substantially all eligible employees of the school are members of the Employees' Retirement System of the State of Hawaii (ERS), a cost-sharing, multiple-employer, public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits. Section 88, Hawaii Revised Statutes, establishes and amends benefit provisions. Prior to June 30, 1984, the plan consisted of only a contributory option. In 1984, legislation was enacted to add a new, noncontributory option for members of the ERS who are also covered under social security. Persons employed in positions not covered by Social Security are precluded from the noncontributory option. The noncontributory option provides for reduced benefits and covers most eligible employees hired after June 30, 1984. Employees hired before that date were allowed to continue under the contributory option or to elect the noncontributory option and receive a refund of employee contributions. All benefits vest after five and ten years of credited service under the contributory and noncontributory options, respectively. Most members of the contributory plan are required to contribute 7.8 percent of their salary.

The ERS provides basic pension benefits to individuals receiving pensions. Employer contributions to the ERS are comprised of normal cost plus level annual payments required to liquidate the unfunded accrued liability of the ERS.

For the year ended June 30, 2002, total salaries for school employees covered by the ERS and total salaries for all school employees were approximately $27,977,600 and $33,843,300, respectively. The university and school are periodically required to contribute an actuarially determined amount to the ERS. The university and school were not required to contribute to the ERS in FY2001-02.

The ERS issues a Comprehensive Annual Financial Report that includes financial statements and required supplementary information, which may be obtained by writing to the Employees' Retirement System of the State of Hawaii, 210 Merchant Street, Suite 1400, Honolulu, Hawaii, 96813.

The following data was obtained from the disclosures contained in the Comprehensive Annual Financial Report for the year ended June 30, 2001:

Number of employers as of March 31, 2001:

State	1
Counties	4
Total employers	5

Basis of Accounting

The financial statements of the ERS are prepared using the accrual basis of accounting. Employer and member contributions are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due and payable in accordance with the plan's terms.

Method Used to Value Investments

Plan investments are reported at fair value. Where appropriate, the fair value includes disposition costs. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Mortgages are valued on the basis of future principal and interest payments, and are discounted at prevailing interest rates for similar instruments. The fair value of real estate investments and real estate owned are based on independent appraisals and estimated values.

Other Benefits

All regular employees, with certain exceptions, earn vacation leave at the rate of one and three-quarters working days for each month of service. Employees who are entitled to annual vacation may accumulate for the succeeding year or years up to 15 working days of their annual vacation allowance, provided that the total accumulation shall not exceed 90 working days at the end of the calendar year. Accumulated vacation leave, earned but not taken, is reflected as an accrual in the statement of net assets and classified as current or noncurrent based on the estimated payment date. When termination of services takes place, employees are paid for their vacation allowance in a lump sum.

Sick leave accumulates at the rate of one and three-quarters working days for each full month of service without limit, but can be taken only in the event of an illness and is not convertible to pay upon termination of employment. Accordingly, accumulated sick leave, earned but not taken, is not reflected as an accrual in the accompanying financial statements. Employees who retire with 60 days of unused sick leave are entitled to three months of service credit in the system. For each additional 20 days or major fraction thereof of unused sick leave they have in excess of 60 days, their service period is increased by one month.

The school's regular employees may enter into deferred compensation arrangements directly with authorized insurance companies or agencies through a payroll deduction plan. Accordingly, the school has no deferred compensation or withholding payable.

Note 8 - Post-Retirement Health Care and Life Insurance Benefits

In addition to providing pension benefits, the state provides certain health care and life insurance benefits to all eligible employees who retire from the school on or after age 62 with at least ten years of service or age 55 with at least 30 years of service under the noncontributory option, and on or after age 55 with at least five years of service under the contributory option. Retirees credited with at least ten years of service, excluding sick leave credit, qualify for free medical insurance premiums; however, retirees with less than ten years must assume a portion of the monthly premiums. All disability retirees who retired after June 30, 1984 with less than ten years of service also qualify for free medical insurance premiums. Free life insurance coverage and dental coverage for dependents under age 19 are also available. Retirees covered by the medical portion of Medicare are eligible to receive a reimbursement of basic medical coverage premiums. Contributions are based upon negotiated collective bargaining agreements, and are funded by the state as accrued. The school's share of post-retirement health care and life insurance benefits expenses for the year ended June 30, 2002 was approximately $541,150.

Note 9 - Lease Obligations

Capital Leases

Capital leases of equipment are recorded at the lower of the present value of the minimum lease payments or the fair market value of the asset at acquisition. Interest rates on capitalized leases vary from 10.5 percent to 12.3 percent. Future minimum lease payments as of June 30, 2002 are as follows:

Year ending June 30,		
2003	$	21,615
2004		18,205
2005		13,863
2006		10,710
2007		2,741
Total minimum lease payments	$	67,134
Less amount representing interest		(12,565)
Present value of future lease payments	$	54,569

Operating Leases

The school leases space for certain research and training activities, including a hyperbaric treatment center and a geriatric teaching center. These non-cancelable operating leases expire at various dates through FY2003-04.

Future minimum lease payments under these operating leases are as follows:

Year ending June 30,		
2003	$	241,260
2004		90,920
Total minimum lease payments	$	332,180

Note 10 - Long-Term Liabilities

Long-term liability activity for the year ended June 30, 2002 was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Accrued vacation	$ 1,134,279	$ 516,276	$ (326,372)	$ 1,324,183	$ 699,698
Capital lease obligations	21,322	41,522	(8,275)	54,569	15,393
Total long-term liabilities	$ 1,155,601	$ 557,798	$ (334,647)	$ 1,378,752	$ 715,091

Note 11 - State Appropriation Revenue

By statutory provision, the university prepares a biennium budget for its programs. Budgeted expenditures are derived primarily from Act 259, Session Laws of Hawaii (SLH) 2001, as amended, and from other specific appropriations acts in various Session Laws of Hawaii.

The school's share of state appropriations amounted to $15,612,246 in FY2001-02, including $1,346,893 allocated by the university specifically for the Office of Public Health Studies. This amount is combined with non-imposed fringe benefits of approximately $2,335,600 and reported as non-operating state appropriation revenue on the statement of revenues, expenses, and changes in net assets.

Note 12 - Commitments and Contingencies

The school purchases commercial insurance directly from an insurance agent for professional medical malpractice coverage. In addition, the school administers the Medical Malpractice Self-Insurance Reserve Fund to fund costs arising from the defense and settlement of malpractice claims. The reserve was established in 1977 by the Hawaii State Legislature as a special fund account. The net assets related to this reserve amounted to $431,768 at June 30, 2002. No expenditures were made out of this reserve in FY2001-02.

The state risk pool and university-purchased commercial insurance policies cover school exposure to various risk of loss related to general tort, education-related tort, theft, damage, errors and omissions, injuries to employees, and natural disasters.

The school participates in the university's self-insurance program for unemployment and workers' compensation claims. In FY2001-02, the school was assessed a premium based on a percentage (1.45 percent and .2 percent for workers' compensation and unemployment insurance, respectively) of the salaries of covered employees that are compensated for at least 50 percent time. In return, the university assumes the risk of loss for all current and future claims by school employees. In accordance with GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, as the school does not retain the risk of loss, no liability for unpaid claims has been recorded in the accompanying financial statements.

Liabilities related to losses are reported when it is probable that the losses have occurred, the amount of those losses can be reasonably estimated, and the risk of loss is retained with the school. No such liabilities have been reported for the school as of June 30, 2002.

There have been no reductions in insurance coverage from coverage in prior years or settlements in the past three fiscal years that were in excess of the school's insurance coverages.

An encumbrance system is used by the school to record outstanding purchase orders and other commitments. This system is used for budget control purposes and no expenses or liabilities are recorded in the school's financial statements until the related goods or services have been received. At June 30, 2002, unrestricted and restricted net assets of approximately $375,000 and $4,190,000, respectively, were reserved in the school's encumbrance system for commitments. To the extent that state appropriated funds are not encumbered at year-end or are encumbered but not paid by a specified period of time after year-end, these funds generally lapse and are returned to the state.

As of June 30, 2002, various sponsoring agencies had awarded the school research and training contracts and grants for which the school had yet to meet the associated eligibility requirements that would enable revenue recognition in the accompanying financial statements. Most of the eligibility requirements deal with incurring the appropriate expenses allowed for under the contracts and grants in the appropriate time period. At June 30, 2002, the school held an estimated $72.5 million in contract and grant funds available to be spent in varying time periods ranging from one to five years. Approximately $4,391,765 of this balance is reported as a deferred revenue liability to reflect the unearned revenue associated with funds received in advance from sponsors. The following comprises the deferred revenue balance at June 30, 2002:

Federal government	$	809,010
State and local governments		2,323,329
Nongovernmental		1,259,426
Total deferred revenues	$	4,391,765

Note 13 - Related Parties

Both the university and the State of Hawaii provide certain accounting and general administrative services and facilities to the school. The costs of some of these services and facilities are not reflected in the accompanying financial statements.

The University Clinical, Education, and Research Associates, Inc. (UCERA – formerly known as University Health Care Associates, Inc.) is a separately incorporated not-for-profit corporation, which contributes to the school's goal of improving the health care status of the citizens of Hawaii and Pacific area by supporting the academic mission of the school. The organization functions as a practice plan for faculty of the school, providing a vehicle by which clinical revenues can be generated on a limited scale during their non-university, private practice time. The financial information of UCERA has not been included in the accompanying financial statements because the school and university are not financially accountable for this entity. Contracts for professional services are regularly entered into between the school and UCERA. In FY2001-02, total expenditures to UCERA under these agreements amounted to $196,940, including $67,066 in extramurally funded expenditures. Total receipts from UCERA amounted to $111,023 in

FY2001-02. Amounts due to UCERA at June 30, 2002 amounted to $233,530 and have been included in accounts payable. There were no amounts due from UCERA at June 30, 2002.

The Hawaii Residency Program, Inc. is a separately incorporated not-for-profit corporation that coordinates the administration of Hawaii's residency training programs through a joint effort between the school and several of Oahu's major hospitals and medical centers. The goal of this coordinated effort is to minimize the aggregate cost of conducting residency training programs while maximizing the benefits and quality of the educational experience for the residents. The financial information of the Hawaii Residency Program, Inc. has not been included in the accompanying financial statements because the school and university are not financially accountable for this entity. The school contracts with the Hawaii Residency Program, Inc. to provide training services. In FY2001-02, total school expenditures to the Hawaii Residency Program, Inc. amounted to $865,964, including $809,222 in extramurally funded expenditures. Amounts due to the Hawaii Residency Program, Inc. at June 30, 2002 amounted to $145,611 and have been included in accounts payable. There were no amounts due from the Hawaii Residency Program, Inc. at June 30, 2002.

UCERA's financial statements were examined by separate independent auditors whose audit report has been provided to the school. The school obtained unaudited financial statements from the Hawaii Residency Program, Inc. as it was not audited in FY2001-02.

The following is a condensed summary of the combined financial statements for these organizations based solely upon the financial information provided to the school (unaudited):

Assets		
Current Assets	$	6,710,668
Noncurrent Assets		202,596
Total Assets	$	6,913,264
Liabilities		
Current Liabilities	$	3,325,556
Noncurrent Liabilities		--
Total Liabilities	$	3,325,556
Net Assets		
Restricted Net Assets	$	15,858
Unrestricted Net Assets		3,571,850
Total Net Assets	$	3,587,708
Revenues, Expenses, and Changes in Net Assets		
Total Operating Revenues	$	15,866,434
Total Operating Expenses		(16,293,717)
Operating Loss	$	(427,283)
Nonoperating Revenue, net		183,796
Decrease in Net Assets	$	(243,487)
Net Assets – Beginning of year		3,831,195
Net Assets – End of year	$	3,587,708

Note 14 - New Biomedical Science Campus

The university is in the process of constructing a new biomedical science research and education campus, which will house major components of the school's operations. The new campus site is comprised of 9.1 acres in the Kakaako Waterfront area of Oahu. The project is currently in phase one, which includes the construction of an education and administration building and a biomedical research building. The buildings will comprise over 317,000 net square feet of space. The education and administration building will include:

- Educational classrooms,
- Simulation and distance learning center,
- Auditorium,
- Bookstore,
- Faculty and staff offices, and
- Cafeteria and dining area.

The biomedical research building will include:

- Research labs,
- Animal research facility,
- Research support offices,
- Mechanical equipment, central power plant, and loading docks,
- Materials management, and
- Child care and fitness center.

Under Act 281, SLH 2000, the Hawaii State Legislature appropriated $875,000 for a project feasibility study. Under Act 251, SLH 2001, the Legislature appropriated $13 million to fund costs of architectural engineering services, design services, and the relocation of displaced tenants. Act 14, SLH 2001, Third Special Session, authorized the university to issue $150 million in revenue bonds to finance the construction of a new biomedical science campus and pledged the support of the State tobacco settlement funds to pay the bonds. The bonds are also backed by the assets of the university.

Demolition and site work began on September 15, 2002 and October 24, 2002, respectively. The education and administration building is expected to be completed in September 2004 and the research building is expected to be completed in July 2005.

The school has assumed fiscal and administrative responsibility to support these construction activities, but has not capitalized the construction in progress costs or the associated debt in the accompanying financial statements. These costs are reported on the university's financial statements, and amounted to approximately $10.3 million as of June 30, 2002. These amounts include approximately $7.1 million for the relocation of displaced tenants.

Exhibit 3.1

John A. Burns School of Medicine
of the University of Hawaii

Statement of Net Assets
June 30, 2002

Assets

Current Assets:	
Cash and cash equivalents (Note 2)	$ 5,482,080
Restricted cash and cash equivalents (Note 2)	7,270,179
Short-term endowment investments (Note 4)	235,038
Accounts receivable, net (Note 3)	7,590,858
Contributions receivable (Note 3)	251,034
Student loans receivable, net (Note 3)	55,110
Prepaid expenses	118,845
Other assets	9,999
Total current assets	$ 21,013,143
Noncurrent Assets:	
Endowment investments (Note 4)	$ 10,483,713
Capital assets, net (Note 5)	1,809,148
Total noncurrent assets	$ 12,292,861
Total assets	$ 33,306,004

Liabilities

Current Liabilities:	
Accounts payable (Notes 12 and 13)	$ 1,642,916
Accrued payroll and fringe benefits	768,623
Accrued vacation, current (Notes 7 and 10)	699,698
Deferred revenues (Note 12)	4,391,765
Capital lease obligations, current (Notes 9 and 10)	15,393
Due to University of Hawaii	5,807,117
Due to Research Corporation of the University of Hawaii	96,523
Other accrued liabilities	248,635
Total current liabilities	$ 13,670,670
Noncurrent Liabilities:	
Accrued vacation, noncurrent (Notes 7 and 10)	$ 624,485
Capital lease obligations, noncurrent (Notes 9 and 10)	39,176
Total noncurrent liabilities	$ 663,661
Total liabilities	$ 14,334,331

Commitments and contingencies (Notes 9 and 12)

Exhibit 3.1 (continued)

Net Assets

Invested in capital assets, net of related debt	$ 1,747,488
Restricted for:	
Nonexpendable:	
Scholarships and fellowships	8,228,642
Research	104,771
Instructional department uses	232,919
Other	1,429,317
Expendable:	
Scholarships and fellowships	660,515
Research	366,207
Instructional department uses	1,011,983
Loans	104,001
Other	817,548
Unrestricted	4,268,282
Total net assets	$ 18,971,673

See accompanying notes to financial statements.

Exhibit 3.2

John A. Burns School of Medicine
of the University of Hawaii

Statement of Revenues, Expenses, and Changes in Net Assets
For the Year Ended June 30, 2002

Revenues:	
Operating revenues:	
Sponsored research and training: (Notes 12 and 13)	
Federal contracts and grants	$ 18,300,971
State and local contracts and grants	3,867,359
Nongovernmental contracts and grants	2,047,029
Medical services:	
Nongovernmental contracts	6,690,897
State contracts	4,398,479
Federal contracts	233,832
Student tuition and fees (net of scholarship allowances of $122,832)	3,663,003
Other operating revenues	10,229
Total operating revenues	$ 39,211,799
Expenses:	
Operating expenses: (Notes 12 and 13)	
Salaries (Note 7)	$ 33,843,312
Fringe benefits (Notes 6 and 8)	5,402,415
Professional and contract services	9,833,939
Supplies and other services	2,246,534
Scholarships and fellowships	1,079,106
Travel	1,054,173
Equipment expense	615,588
Utilities	485,762
Rental expense (Note 9)	450,581
Insurance	426,614
Depreciation (Note 5)	381,858
Repairs and maintenance	229,025
Bad debt expense (Note 3)	159,974
Other operating expenses	635,340
Total operating expenses	$ 56,844,221
Operating loss (forward)	$ (17,632,422)

Exhibit 3.2 (continued)

Operating loss (forwarded)	$	(17,632,422)
Nonoperating revenues (expenses):		
State appropriations and transfer for fringe benefits (Notes 6 and 11)	$	17,947,818
Gifts		600,408
University allocation		97,560
Net investment loss (Note 4)		(1,324,521)
Interest expense		(8,874)
Loss on disposal of capital asset (Note 5)		(8,031)
Other nonoperating expenses		(23,222)
Net nonoperating revenues	$	17,281,138
Loss before other revenues	$	(351,284)
Additions to permanent endowments	$	188,901
Decrease in net assets	$	(162,383)
Net assets:		
Net assets - beginning of year		
As previously reported		22,651,529
Adjustment for implementation of GASB Statement Nos. 34 and 35 (Note 1)		(3,517,473)
As restated	$	19,134,056
Net assets - end of year	$	18,971,673

See accompanying notes to financial statements.

Exhibit 3.3

John A. Burns School of Medicine
of the University of Hawaii

Statement of Cash Flows
For the Year Ended June 30, 2002

Cash Flows from Operating Activities:	
Received for research and training grants and contracts	$ 26,378,676
Received for medical services	11,137,385
Tuition and fees	3,663,003
Payments to employees	(36,747,709)
Payments to suppliers	(16,301,474)
Scholarships and stipends to students	(1,079,106)
Other payments	(38,036)
Net cash used in operating activities	$ (12,987,261)
Cash Flows from Noncapital Financing Activities:	
State appropriations	$ 15,589,025
Advances from University, net	643,303
University allocation	97,560
Advances from RCUH, net	74,969
Private gifts for endowment purposes	813,334
Net cash provided by noncapital financing activities	$ 17,218,191
Cash Flows from Capital and Related Financing Activities:	
Purchases of capital assets	$ (774,475)
Principal paid on capital lease	(8,275)
Interest paid on capital lease	(4,076)
Net cash used in capital and related financing activities	$ (786,826)
Cash Flows from Investing Activities:	
Distributions from investment pool	$ 515,844
Deposits to investment pool	(204,829)
Net cash provided by investing activities	$ 311,015
Net Increase in Cash	$ 3,755,119
Cash and cash equivalents, Beginning of Year	8,997,140
Cash and cash equivalents, End of Year	$ 12,752,259

Exhibit 3.3 (continued)

Cash Flows from Investing Activities:	
Distributions from investment pool	$ 515,844
Deposits to investment pool	(204,829)
Net cash provided by investing activities	$ 311,015
Net Increase in Cash	$ 3,755,119
Cash and cash equivalents, Beginning of Year	8,997,140
Cash and cash equivalents, End of Year	$ 12,752,259

Reconciliation of Net Operating Loss to Net Cash Used in Operating Activities	
Net Operating Loss	$ (17,632,422)
Adjustments to Reconcile Net Operating Loss to Net Cash Used in Operating Activities:	
Transfer for non-imposed fringe benefits	$ 2,335,572
Depreciation	381,858
Bad debt expense	159,974
Changes in assets and liabilities:	
Receivables, net	31,968
Prepaid expenses and deferred charges	238,251
Loans receivable, net	(4,530)
Accounts payable	(562,169)
Accrued payroll and fringe	42,905
Accrued vacation	119,541
Deferred revenue	1,945,526
Other liabilities	(43,735)
Total adjustments	$ 4,645,161
Net Cash Used in Operating Activities	$ (12,987,261)

Supplemental Schedule of Non-Cash Investing, Capital, and Financial Activities:	
Unrealized loss on endowment investments	$ 1,558,545
Capital lease obligations incurred	41,523

See accompanying notes to financial statements.

Response of the Affected Agency

Comments on Agency Response

We transmitted a draft of this report to the University of Hawaii on February 19, 2003. A copy of the transmittal letter to the university is included as Attachment 1. The response of the university is included as Attachment 2.

The university agrees with our recommendations and has begun to address the deficiencies noted in the audit. In its response, the university stated that the internal control deficiencies related to the John A. Burns School of Medicine's administration and management of contracts with health care organizations resulted mainly from the highly manual and time-consuming nature of preparing budgets and reconciliations, and the high turnover of personnel. The university noted that the school of medicine has already taken steps to ensure that the timing of the execution and reconciliation of its contracts will be significantly improved in the near future.

Regarding our audit finding on the school of medicine's non-compliance with the university's policies and procedures governing conflict of interest situations, the university responded that the medical school will be more stringent and aggressive in ensuring compliance with the established policies and procedures.

Finally, the university responded that it appreciates our recommendations and will work diligently to correct the audit deficiencies.

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

MARION M. HIGA
State Auditor

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

February 19, 2003

COPY

The Honorable Evan S. Dobelle
President
University of Hawaii
Bachman Hall
2444 Dole Street
Honolulu, Hawaii 96822

Dear President Dobelle:

Enclosed for your information are three copies, numbered 6 to 8 of our confidential draft report, *Financial Audit of the John A. Burns School of Medicine of the University of Hawaii.* We ask that you telephone us by Friday, February 21, 2003, on whether or not you intend to comment on our recommendations. If you wish your comments to be included in the report, please submit them no later than Wednesday, February 26. 2003.

The Governor, and presiding officers of the two houses of the Legislature have also been provided copies of this confidential draft report.

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

Sincerely,

Marion M. Higa

Marion M. Higa
State Auditor

Enclosures

UNIVERSITY OF HAWAI'I

VICE PRESIDENT FOR ADMINISTRATION
AND CHIEF FINANCIAL OFFICER

February 26, 2003

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

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OFC. OF THE AUDITOR
STATE OF HAWAII

Dear Ms. Higa:

We appreciate the opportunity to comment on the recommendations in your draft report, *Financial Audit of the John A. Burns School of Medicine of the University of Hawaii.* We were pleased to find that the audit resulted in an unqualified opinion on the School's financial statements for the year ended June 30, 2002. We were also pleased to note that there were no reported instances of non-compliance with laws, regulations, contracts, and grants and no material weaknesses in internal controls over the School's financial reporting and operations.

The draft report disclosed two internal control deficiencies related to the School's administration and management of contracts with health care organizations and the School's lack of enforcement of monitoring programs to identify and resolve conflict of interest situations. Our comments below are limited to your recommendations for these deficiencies.

For the internal control deficiency related to the School's administration and management of contracts with health care organizations, the following was recommended:

"The school should revise its planning for contract negotiations by allowing more time for contract negotiation and execution, such that services commence only after the contracts have been finalized and executed. In addition, the school should review the process used to prepare the final contract reconciliations to ensure that the final bills are sent out in a timely manner."

We agree with the recommendations in this area. We believe that the main factors that contributed to the deficiencies cited were the highly manual and time-consuming nature of preparing and editing budgets and final reconciliations and the unusually high recent turnover of personnel assigned to the administration of these contracts. The School has

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already taken the following steps to ensure that the timing of contract execution and reconciliation will significantly improve in the near future:

- The School recently completed the design specifications for a simple, but effective, reporting information system that is expected to greatly reduce the time spent preparing and editing budgets, thereby allowing more time for contract negotiation and execution. The system will also enable a monthly automated reconciliation process which will reduce the lag in preparing the final reconciliations and billings.

- As part of the School's current internal fiscal staff reorganization, the staffing structure is being designed to support the continuity of highly qualified personnel responsible for this area, thereby further reducing the amount of planning time required and reducing the amount of time needed to negotiate contracts. The fiscal staff provide support for the department chairpersons during the planning and contract negotiation phases by preparing and editing budgets and by providing administrative oversight to ensure that the negotiation and execution process does not become stalled. This change will also reduce the amount of time involved in preparing the final reconciliations.

We are confident that the information system and staffing changes described above will enable the school to successfully and fully address the deficiencies you reported in this area. In the interim before these changes are fully implemented, the School has redirected personnel resources to this area and has implemented a semi-automated process that has enabled the School to be current on all of its billings and to reconcile these contracts on a monthly basis for the fiscal year 2002-2003. The timing of the preparation of the final reconciliations for the fiscal year 2002-2003 and the timing of contract negotiation and execution for the fiscal year 2003-2004 is expected to significantly improve with this interim measure.

Additionally, the School has taken corrective action to ensure that the reconciliations and final billings for the fiscal year 2001-2002 contracts that remained outstanding at the time of the audit have since been completed. Our records indicate that there were two required contract reconciliations that were not completed as of the date of the audit testing in mid-October. The two reconciliations have since been completed and a final billing of approximately $6,200 which was required for one of the two contracts, was also completed.

For the internal control deficiency related to the School's non-compliance with University of Hawaii policies and procedures pertaining to conflict of interest situations, the following was recommended:

"The school should take more seriously the consequences of not identifying conflict of interest situations on a timely basis and enforce policies, procedures, and deadlines for completion and submission of the annual disclosure forms and outside employment forms."

We agree with the recommendation in this area. The School's Dean will issue reminders annually to emphasize the importance of complying with the University's conflict of interest policies and procedures as well as the potential consequences of non-compliance to all levels of personnel within the School. The School will also be more stringent in requiring that the appropriate forms are filled out in accordance with existing University policies. Department chairpersons and units directors will be held directly responsible for ensuring that disclosure forms, disclosure summary reports, and outside employment forms are filled out appropriately and in a timely manner and this expectation will be a part of their annual performance reviews. The School's personnel office will be responsible for monitoring the overall process and will aggressively follow-up to ensure full and timely compliance for disclosure forms, disclosure summary reports, and outside employment forms. The School's administration will also ensure that disclosed instances of potential conflict of interest situations are appropriately resolved and will involve the University General Counsel's Office when needed.

We appreciate your recommendations and School management will work diligently in taking corrective action.

Sincerely,

Rennie W. Murphy

for James R. W. Sloane
Vice President for Administration
and Chief Financial Officer