
Systemwide Financial Audit of the University of Hawai'i System: Phase I

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

Report No. 05-15
December 2005



THE AUDITOR
STATE OF HAWAI'I

Office of the Auditor

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

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

1. *Financial audits* attest to the fairness of the financial statements of agencies. They examine the adequacy of the financial records and accounting and internal controls, and they determine the legality and propriety of expenditures.
2. *Management audits*, which are also referred to as *performance audits*, examine the effectiveness of programs or the efficiency of agencies or both. These audits are also called *program audits*, when they focus on whether programs are attaining the objectives and results expected of them, and *operations audits*, when they examine how well agencies are organized and managed and how efficiently they acquire and utilize resources.
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.

Hawai`i'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 HAWAI`I

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OVERVIEW

Systemwide Financial Audit of the University of Hawai'i

System: Phase I

Report No. 05-15, December 2005

Summary

The Legislature initiated a systemwide financial audit of the University of Hawai'i through House Concurrent Resolution No. 213, 2005 Regular Session, because it was unable to obtain timely financial information from the university during the legislative session. We assessed the University of Hawai'i at Mānoa's process of strategic planning and actual cost per student for one academic year. We also engaged the certified public accounting firm of Nishihama & Kishida, CPA's, Inc., to review the Mānoa campus's accounting and use of general and tuition funds, and budget process. Audit reports on all other university campuses and the University of Hawai'i system are due to the 2007 Legislature.

Our audit found that the budget process and financial system of the Mānoa campus do not fully ensure fiscal accountability. The Mānoa campus's budget impedes the efficient and effective use of resources. The campus prepares its budget using an incremental approach, focusing attention on adjustments to the prior year's budget and taking previous appropriations for granted. For FY2005-06, the Board of Regents' approved budget for the Mānoa campus included approximately \$200 million in general funds, of which only about \$13 million required justification. Thus, the Mānoa campus's budget process results in a budget that is largely unfounded and is not based on results. Additionally, the campus did not effectively monitor the development of its 2005-2007 biennium budget as it was reviewed and adjusted by system administration, the Board of Regents, the governor, and Department of Budget and Finance. As a result, the Mānoa campus could not sufficiently justify its budget request to the Legislature. Furthermore, the campus has recently begun to restructure its budget process; however, it has not yet made the commitment necessary to implement such changes.

Although financial responsibility is delegated to unit personnel, the Mānoa campus lacks a formal mechanism for monitoring program use of funds, resulting in little assurance that the campus has an adequate understanding of its overall fiscal condition. The Mānoa campus made an effort to improve its internal financial reporting through the implementation of the Budget Level Summary (BLS) reporting system—a system of reports that compares budgeted, actual, and projected financial information. However, the Mānoa campus's BLS reports lack the detail needed to evaluate unit and program performance. Also, unit level BLS reports are not reconciled on a quarterly basis to the university's budget or financial information system, making the reliability of the reports questionable.

The Mānoa campus also lacks formal policies and procedures to ensure the proper use of general and tuition funds: 1) policies and procedures for the tuition funds dated May 2003 remain in draft form; 2) disbursement procedures for the new web based purchasing and payment processing system, implemented in July 2003, have



not been included in the university's Administrative Procedures Manual; 3) disbursements for small purchases are made without verification of proper approval; and 4) certain purchasing duties are not properly segregated. In FY2004-05, the Mānoa campus expended, on a cash basis, over \$213 million and \$72 million of general and tuition funds, respectively.

Also, during our review of disbursements of Mānoa campus funds, we noted several violations of procurement procedures and questionable uses of contract modifications. For example, a purchase for chemistry equipment contained no evidence that price quotations were obtained to ensure fair competition. A contract included a modification of \$120,000 for services that were not described in the original contract. Modifications to contracts should be used to extend services under existing contracts without materially modifying the scope of work or the related costs, and should not be used to circumvent normal procurement procedures.

Further, we found that the University of Hawai'i's calculation of the Mānoa campus's actual cost per student has limited value for decisionmaking because: 1) the lack of an industry standard for computing the actual cost per student and differences between institutions with respect to mission, resources, and structure limit the calculation's comparative value; and 2) the university's internal controls cannot ensure the reliability of data used in the calculation.

Recommendations and Response

We made several recommendations regarding the budget process and financial system of the University of Hawai'i at Mānoa. Among these, we recommended that the chancellor of the Mānoa campus ensure that: a process clearly linking the strategic plan to the budget is established and documented; the commitment necessary to restructure its budget process is made; and the campus's budget is monitored during the review process to provide the Legislature with the information needed for decisionmaking. We also made a number of recommendations to the University of Hawai'i's president, Office of Academic Planning and Policy, Budget Office, and chief information officer.

In its response to our draft report, the University of Hawai'i strongly disagreed with our overall conclusion, and questioned the quality of our work and several of our findings. The university concurred with several of our recommendations, despite its objections, and has begun implementing them, while disagreeing with others.

We spent considerable time reviewing documents, conducting interviews, and analyzing the campus's budget process and internal controls over the general and tuition funds. We believe the audit report presents an accurate and balanced analysis of the Mānoa campus's current finances.

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Conducted by

The Auditor
State of Hawai'i
and
Nishihama &
Kishida, CPA's, Inc.

Submitted by

THE AUDITOR
STATE OF HAWAI'I

Report No. 05-15
December 2005

Foreword

We performed this audit of the University of Hawai'i at Mānoa as requested in House Concurrent Resolution No. 213, 2005 Regular Session, which requires that the Office of the Auditor conduct a systemwide financial audit of the University of Hawai'i general funds and accounts and non-general funds and accounts. The resolution further requested that our office report any findings and recommendations regarding the University of Hawai'i at Mānoa to the 2006 legislative session; therefore the current audit, Phase I, focuses on the University of Hawai'i at Mānoa. Audit reports on all other campuses of the university and the University of Hawai'i system are to be submitted to the 2007 session.

We also engaged the certified public accounting firm of Nishihama & Kishida, CPA's, Inc., as our consultant to assist us by reviewing the University of Hawai'i at Manoa's use of general and tuition funds, system of accounting and internal controls related to these funds, and budget process.

We wish to express our appreciation for the cooperation and assistance extended to us by the administration and staff of the University of Hawai'i at Mānoa and the University of Hawai'i system.

Marion M. Higa
State Auditor

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Chapter 1

Introduction

The University of Hawai‘i is a postsecondary education system that comprises three university campuses, seven community colleges, an employment training center, and five education centers distributed across the state. During FY2004-05, the university was allocated over \$777 million for its operating costs. Although the university’s budget comprises nearly 10 percent of the entire executive branch’s budget, the Legislature was unable to obtain timely financial information from the university during the 2005 legislative session. As a result, the Legislature initiated a systemwide financial audit of the University of Hawai‘i general funds and accounts and non-general funds and accounts through House Concurrent Resolution No. 213, 2005 Regular Session.

House Concurrent Resolution No. 213 specifically requested our office to report on:

- the total amount of general and tuition funds received and expended by the University of Hawai‘i to advance its mission and goals, and the purposes for which the funds were expended;
- issues relating to the University of Hawai‘i’s financial records and its system of accounting and internal controls;
- issues relating to the University of Hawai‘i’s strategic and financial plan, its budget process, and its process of forecasting future financial needs;
- any and all other matters that the Auditor would normally undertake as necessary or appropriate in a systemwide financial audit; and
- the actual cost per undergraduate and graduate student for one academic year at each of the ten University of Hawai‘i campuses.

The resolution further requested that our office report any findings and recommendations regarding the University of Hawai‘i at Mānoa to the 2006 legislative session; audit reports on all other campuses of the university and the University of Hawai‘i system are to be submitted to the 2007 session.

Background

Effective July 1, 1998, the University of Hawai‘i autonomy bill—Act 115, Session Laws of Hawai‘i (SLH) 1998—paved the way for university autonomy by delegating substantially increased authority and decisionmaking power over the university’s internal structure, management, and operations to the university’s Board of Regents and administration. In November 2000, voters granted the university constitutional autonomy to allow the university’s Board of Regents greater freedom in governing the university’s internal matters. Accordingly, the university is now exempt from certain Hawai‘i Revised Statutes (HRS) that regulate other state agencies. For example, the university is authorized to transfer, without executive approval, general fund appropriations between programs and cost elements; make direct disbursements for operating expenses; and install its own accounting systems. Compared to other state agencies, the university also enjoys increased budgetary flexibility from “lump-sum” budgets, that is, budget appropriations in broad categories allowing the university more discretion to spend without detailed legislative and executive control.

The University of Hawai‘i has been striving toward even greater autonomy. However, along with greater autonomy comes greater responsibility to the people of Hawai‘i, to whom the Legislature ultimately remains responsible and accountable when public funds supporting an institution are involved. As such, prior to considering granting full autonomy to the University of Hawai‘i, the Legislature must be assured that the university has established policies and procedures as well as systems that provide a full accounting of general and tuition funds.

Mission and goals of the University of Hawai‘i

The common mission of the University of Hawai‘i system is to serve the public by creating, preserving, and transmitting knowledge in a multi-cultural environment. The systemwide purposes of the university are to:

- provide all qualified people in Hawai‘i with equal opportunity for high quality college and university education and training;
- provide a variety of entry points into a comprehensive set of postsecondary educational offerings, allowing flexibility for students to move within the system to meet individual educational and professional goals; and
- advance missions that promote distinctive pathways to excellence, differentially emphasizing instruction, research, and service while fostering a cohesive response to state needs and participation in the global community.

Nonetheless, the ten campuses, which are separately and regionally accredited, serve multiple missions in response to state needs.

To advance the University of Hawai‘i’s mission, the university plans to focus its attention and resources over the next five years on achieving key strategic goals:

- embrace a culture of excellence and performance as the hallmark of effective learning and student success;
- engage diverse elements of the university in intellectual capital formation that enables Hawai‘i to flourish;
- transform the international profile of the university as a distinguished resource in Hawaiian and Asian-Pacific affairs, positioning it as one of the world’s foremost multicultural centers for global and indigenous studies;
- recognize and invest in human resources as the key to success and provide them with an inspiring work environment; and
- acquire, allocate, and manage the resources needed to achieve success and exercise exemplary stewardship over university assets.

Detailed plans on implementation for the accomplishment of these goals are developed by the individual campuses of the University of Hawai‘i.

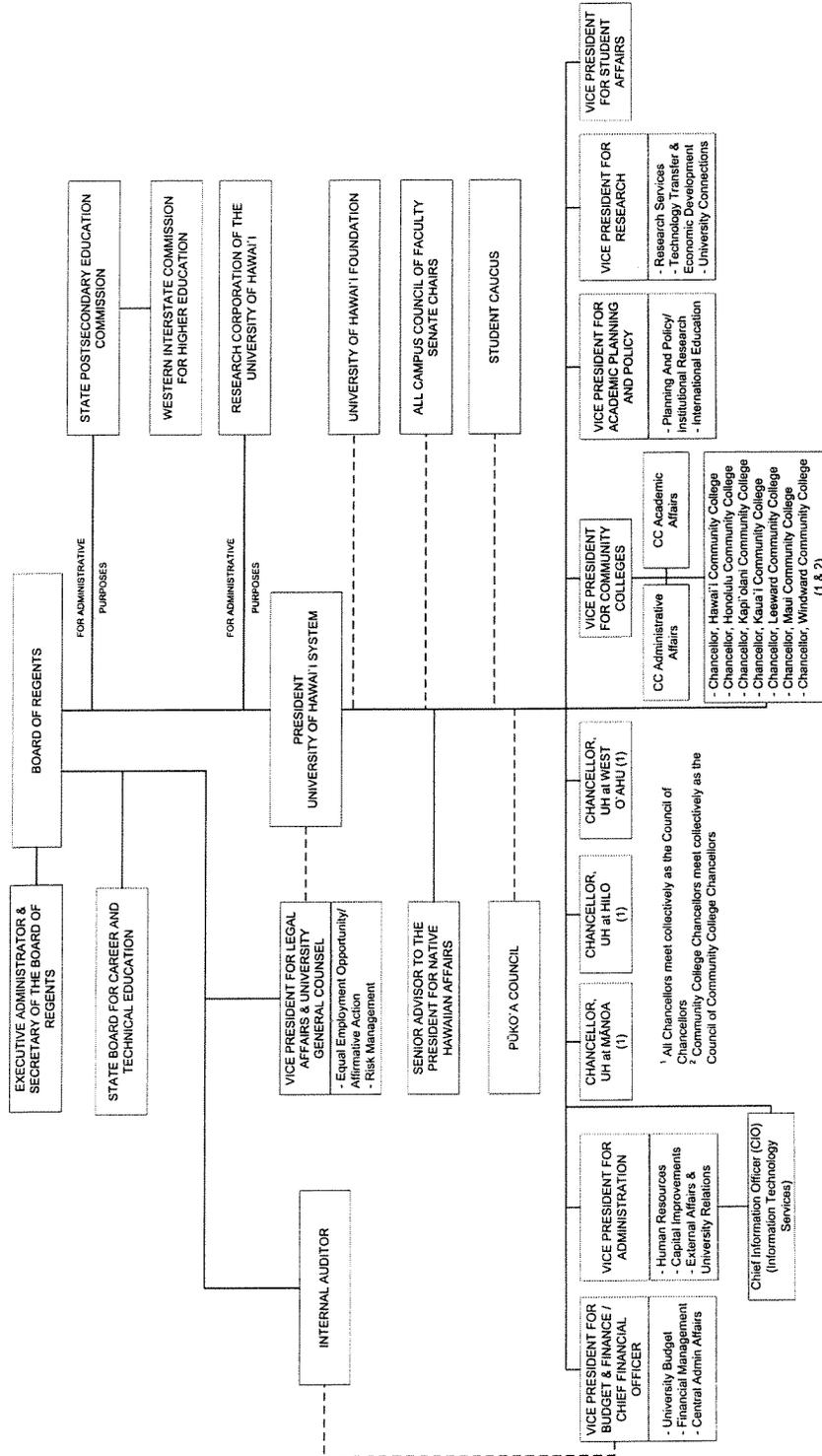
Organization

As Hawai‘i’s sole state public university system, the University of Hawai‘i is governed by a Board of Regents and is composed of graduate and research, baccalaureate, and community college campuses. In addition, the university operates an employment training center, three university centers, multiple learning centers, and extension, research, and service programs at more than 70 sites in the state. Exhibit 1.1 shows the existing organizational structure of the University of Hawai‘i.

University of Hawai‘i at Mānoa

The University of Hawai‘i at Mānoa, a research university of international standing, offers bachelor’s degrees in 87 fields of study, master’s degrees in 86 fields of study, doctorates in 53 fields of study, first professional degrees in architecture, law, and medicine, and various certificates. The University of Hawai‘i at Mānoa has been widely recognized for its strengths in tropical agriculture, tropical medicine, oceanography, astronomy, electrical engineering, volcanology,

Exhibit 1.1 Organizational Structure of the University of Hawai'i



Source: University of Hawai'i

evolutionary biology, comparative philosophy, comparative religion, Hawaiian studies, Pacific Islands studies, Asian studies, and Pacific and Asian regional public health.

University of Hawai‘i at Hilo

The University of Hawai‘i at Hilo is a comprehensive institution that offers baccalaureate liberal arts and professional and selected graduate degrees, including master’s degrees in education, Hawaiian language, tropical conservation biology and environmental science, and China-U.S. relations. The institution offers baccalaureate degrees in various fields of the humanities, natural sciences, and social sciences, and in agriculture, nursing, business, and computer science. Programs emphasize student-faculty collaboration, fieldwork, internships, and hands-on learning, and many are organized around the theme of “the island as a learning laboratory,” which draws upon the geological, biological, and cultural diversity of the island of Hawai‘i.

University of Hawai‘i - West O‘ahu

The University of Hawai‘i - West O‘ahu is an upper division institution. The University of Hawai‘i - West O‘ahu offers Bachelor of Arts degrees in business administration, humanities, public administration, and social sciences as well as certificate programs that address pressing social needs such as substance abuse and addiction studies, disaster preparedness and emergency management, and environmental studies. A schedule of day, evening, and weekend courses as well as distributed education options for students on all islands are provided to allow student accessibility.

University of Hawai‘i Community Colleges

The University of Hawai‘i community colleges are open-door, low-tuition institutions offering programs in liberal arts and various academic, technical, and occupational subjects:

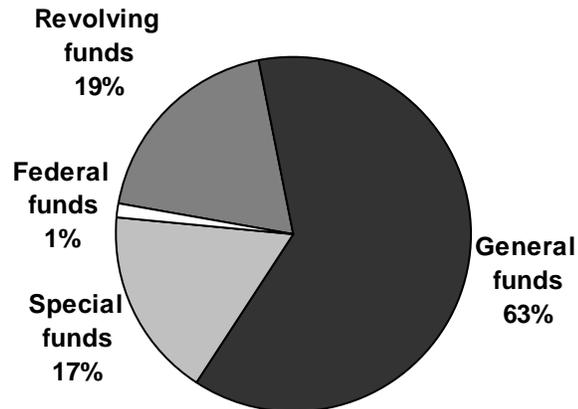
- Hawai‘i Community College offers a comprehensive career technical program for business, nursing, trades technology, hospitality, and public service careers.
- Honolulu Community College offers 22 technical-occupational programs, including programs that are unique to the campus, such as marine technologies, cosmetology, refrigeration and air conditioning, aeronautic maintenance, commercial aviation pilot training, and occupational and environmental safety management.

- Kapi‘olani Community College is a statewide leader in health services education with nine programs in allied health professions that are not offered at any other campus. The campus also offers the State’s only legal assisting program and an extensive food service and hospitality education program. Degree programs in emerging technology fields, including new media arts and biotechnology, as well as programs for educational paraprofessionals and fitness professionals in exercise and sport science, are also offered.
- Kaua‘i Community College offers career and technical education programs in response to community workforce needs and include programs in nursing, culinary arts, visitor industry, and information technology and electronics. The college is a university center and utilizes distance learning to provide access to baccalaureate and graduate level education for Kaua‘i County.
- Leeward Community College offers selected career and technical education subjects, and provides courses in 67 disciplines. Programs unique to the college include television production and information and computer sciences. Courses are also taught on-site in Wai‘anae, O‘ahu.
- Maui Community College offers a comprehensive career program for business, culinary arts, nursing, trade technology, and public service career fields. The college offers courses over the statewide cable system and interactive television system, providing instruction throughout the state.
- Windward Community College offers selected career educational programs such as business education and agriculture. The Employment Training Center at Windward Community College provides job training for “at risk” populations in high demand areas, including food service, auto repair, construction occupations, and office technology.

General and tuition funds

The university relies on both general fund and non-general fund support from the Legislature to support its programs and facilities. As shown in Exhibit 1.2, general funds represent almost two-thirds (63 percent) of the university’s total FY2004-05 appropriation. Special funds, such as the Tuition and Fees Special Fund, represents a little more than one-sixth (17 percent) of the total funds appropriated to the university.

Exhibit 1.2 University of Hawai'i Appropriations for Fiscal Year 2005



Source: Act 41, Session Laws of Hawai'i 2004

General fund

The general fund, as defined by Section 37-62, HRS, is “the fund used to account for all transactions which are not accounted for in another fund.” By definition, the general fund is used to account for the ordinary operations of state government that are financed from taxes and other general revenues. The amount of general fund support the university has received from the Legislature has steadily increased between FY2000-01 and FY2004-05. Exhibit 1.3 presents the total amount of general funds appropriated to the University of Hawai'i by the Legislature for FY2000-01 through FY2004-05.

Exhibit 1.3 University of Hawai'i General Fund Appropriation for Fiscal Years 2001 to 2005

<u>Program:</u>	<u>FY2000-01</u>	<u>FY2001-02</u>	<u>FY2002-03</u>	<u>FY2003-04</u>	<u>FY2004-05</u>
University of Hawai'i at Mānoa	\$172,793,693	\$174,483,204	\$172,483,484	\$186,086,473	\$186,638,524
University of Hawai'i at Hilo	18,225,468	17,677,813	19,089,013	20,449,410	20,569,410
Small Business Development	650,000	648,675	638,065	638,224	638,224
University of Hawai'i at West O'ahu	2,242,522	2,260,139	2,249,088	2,554,228	2,554,228
University of Hawai'i Community Colleges	67,389,595	68,315,584	69,168,341	75,920,657	76,228,754
University of Hawai'i System Wide Support	125,898,736	164,939,049	172,613,258	171,985,620	188,000,766
Total	<u>\$387,200,014</u>	<u>\$428,324,464</u>	<u>\$436,241,249</u>	<u>\$457,634,612</u>	<u>\$474,629,906</u>

Source: Session Laws of Hawai'i, 2000 and 2002 to 2004

Tuition and Fees Special Fund

In 1995, the Legislature made a commitment to provide the University of Hawai‘i with continued administrative and budget flexibility and fiscal autonomy. The Legislature recognized the university’s need to have authority to directly control its income and determine how revenues are expended in order to ensure all students have equal access to higher education. As a result, the Legislature gave the university the authority to retain student tuition and fees in a special fund to support its operations. Until 1995, tuition had been deposited into the State’s general fund.

Act 161, SLH 1995, created the Tuition and Fees Special Fund to provide the Board of Regents with the authority to establish mechanisms that would generate income. Special funds are defined by Section 37-62, HRS, as funds “dedicated or set aside by law for a specified object or purpose, but excluding revolving funds and trust funds.” Most special funds are designed to be self-sustaining through revenues earmarked for specific purposes.

The Tuition and Fees Special Fund accounts for all revenues collected by the university for regular, summer, and continuing education credit tuition; tuition-related course and fee charges; and any other charges to students. The tuition and tuition-related charges levied on students are used to maintain or improve university programs and operations. Additionally, Section 304-16.5(c), HRS, authorizes expenditures from the fund to the University of Hawai‘i Foundation for the purpose of generating private donations benefiting the university. Under the University of Hawai‘i’s current agreement with the University of Hawai‘i Foundation, the foundation is paid approximately \$3 million per year from the fund for fundraising, stewardship, and alumni relation services. The Tuition and Fees Special Fund’s financial data over the past five years are reflected in Exhibit 1.4. Further, Exhibit 1.5 shows the total amount of tuition funds awarded to the respective campuses for FY2003-04 and FY2004-05.

Previous Reports

As a result of the Legislature’s inability to obtain timely financial information from the University of Hawai‘i during the 2002 legislative session, the Legislature initiated a review of the university’s non-general funds, including the Tuition and Fees Special Fund. Our Report No. 03-04, *Review of Selected University of Hawai‘i Non-General Funds and Accounts*, found that the university had not adequately planned for or managed the fiscal autonomy provided by the Legislature. We found that the university failed to provide adequate oversight and controls over at least six of its non-general funds. We found that as a result of

Exhibit 1.4
University of Hawai'i Tuition and Fees Special Fund
Financial Data for Fiscal Years 2001 to 2005 (in thousands)

	<u>FY2000-01</u>	<u>FY2001-02</u>	<u>FY2002-03</u>	<u>FY2003-04</u>	<u>FY2004-05</u>
Beginning Fund Balance	\$ 33,004	\$ 31,438	\$ 25,595	\$ 8,715	\$ 4,970
Revenues	91,267	83,015	93,005	104,741	111,054
Interest	3,519	1,869	1,749	728	1,046
Expenditures	(80,227)	(86,133)	(108,803)	(102,032)	(103,128)
Transfers	(16,125)	(4,594)	(2,831)	(7,182)	(7,919)
Ending Fund Balance	\$ 31,438	\$ 25,595	\$ 8,715	\$ 4,970	\$ 6,023
Encumbrances	\$ 10,832	\$ 8,819	\$ 10,324	\$ 7,319	\$ 7,989

Notes:

1. We did not audit the financial data presented or reconcile the total amount of tuition funds awarded to the respective campuses shown in Exhibit 1.5, and it is provided only for informational purposes.
2. The financial data presented for FY2004-05 has not been audited by the university's external financial auditors and, as such, does not include any auditor adjustments.

Source: University of Hawai'i General Accounting and Loan Collections

Exhibit 1.5
University of Hawai'i Tuition and Fees Special Fund
Allocations and Expenditures for Fiscal Years 2004 and 2005

<u>Campus/Program:</u>	<u>FY2003-04</u>		<u>FY2004-05</u>	
	<u>Allocation</u>	<u>Expenditure</u>	<u>Allocation</u>	<u>Expenditure</u>
University of Hawai'i at Mānoa	\$ 64,895,194	\$ 72,020,923	\$ 68,660,180	\$ 67,865,797
University of Hawai'i at Hilo	7,905,237	7,684,038	9,719,377	9,519,312
University of Hawai'i at West O'ahu	2,155,000	1,112,698	1,982,500	1,229,097
Honolulu Community College	3,434,261	4,643,348	3,683,121	4,359,771
Kapi'olani Community College	6,999,683	4,758,359	7,514,170	4,518,713
Leeward Community College	4,556,905	3,076,944	4,910,783	3,190,973
Windward Community College	1,397,790	1,960,936	1,508,775	1,872,877
Hawai'i Community College	1,953,905	1,590,424	2,116,985	1,683,212
Maui Community College	2,459,812	2,613,985	2,655,121	3,230,448
Kaua'i Community College	970,027	1,630,297	1,047,047	1,638,784
Community College Systemwide	3,973,775	2,119,639	1,843,111	716,393
University of Hawai'i Systemwide	3,000,000	2,782,629	4,900,000	5,435,795
Total	<u>\$ 103,701,589</u>	<u>\$ 105,994,220</u>	<u>\$ 110,541,170</u>	<u>\$ 105,261,172</u>

Notes: We did not audit the amounts presented or reconcile the amounts to the financial data provided in Exhibit 1.4, and they are provided only for informational purposes.

Source: University of Hawai'i System

inadequate oversight and controls, in certain instances, the University of Hawai'i Foundation used student tuition and fees to pay for its employees' personal expenses. We also noted that several agreements funded by the Tuition and Fees Special Fund were either incomplete or executed in an untimely manner. Our audit also revealed that the university lacked written policies and procedures pertaining to the use and allocation of its Tuition and Fees Special Fund. Since the university lacked written policies and procedures to guide the use and allocation of this sizable fund, we questioned whether the university had the tools necessary to provide appropriate oversight and management of the fund. Further, the university had not assigned direct responsibility for its Tuition and Fees Special Fund to anyone.

During our *Review of Selected University of Hawai'i Non-General Funds and Accounts*, our work was limited in scope due to the University of Hawai'i Foundation's denial of access to pertinent information. As a result, our office initiated a follow up audit that focused on an agreement between the university and the foundation. The follow up audit, Report No. 04-08, *Audit of the University of Hawai'i Contract with the University of Hawai'i Foundation*, found that a vague fundraising contract between the university and the foundation provides little assurance that the services paid for by the university will be received and that donor interests are protected and the foundation's programs are maximized. The follow up audit also found that the foundation's inadequate and poorly enforced expenditure policies disregard donor intent, potentially jeopardizing donor confidence.

Objectives of the Audit

The objectives of the audit were to:

1. Assess the adequacy, effectiveness, and efficiency of the University of Hawai'i at Mānoa's systems and procedures for the financial accounting, internal control, and financial reporting of general and tuition funds and its process of strategic planning, budgeting, and financial forecasting.
2. Ascertain whether general and tuition funds received and expended are accounted for and used by the University of Hawai'i at Mānoa to achieve their intended purposes.
3. Determine the actual cost per undergraduate and graduate student for one academic year at the University of Hawai'i at Mānoa.
4. Make recommendations as appropriate.

Scope and Methodology

House Concurrent Resolution No. 213 required our office to report any findings and recommendations regarding the finances of the University of Hawai‘i at Mānoa to the 2006 Legislature and to do the same for all other campuses and the university system for the 2007 Legislature. Therefore, this audit looks at the University of Hawai‘i at Mānoa and focuses on FY2004-05 to the present, and previous years as necessary.

We reviewed planning documents, organizational and budget reports, and relevant policies and procedures. We also reviewed pertinent state laws and rules, audits, reports, studies, and documents. In addition, we interviewed university personnel involved in the planning and budgeting efforts of the Mānoa campus.

We examined documentation regarding the actual cost per undergraduate and graduate student for one academic year at the University of Hawai‘i at Mānoa. Administrative and technical staff were interviewed to obtain an understanding of the calculation and sources of data used by the University of Hawai‘i to determine the actual cost per student. Further, we assessed the soundness of the University of Hawai‘i’s calculation and effectiveness of the university’s internal controls over the related sources of data.

We procured the services of a certified public accountant, Nishihama & Kishida, CPA’s, Inc., to assist us by reviewing the University of Hawai‘i at Mānoa’s use of general and tuition funds, system of accounting and internal controls related to these funds, and budget process. The consultant reviewed the Mānoa campus’s financial records and transactions relating to the general and tuition funds for compliance with applicable laws, regulations, and policies and procedures. The consultant also examined the University of Hawai‘i at Mānoa’s existing system of accounting and internal controls for deficiencies and weaknesses. Additionally, the consultant reviewed the campus’s process of preparing, submitting, and reporting its budget and supporting financial forecasts.

Our audit was conducted from June 2005 through October 2005 according to generally accepted government auditing standards.

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Chapter 2

The University of Hawai‘i at Mānoa Cannot Fully Ensure Fiscal Accountability

The granting of greater administrative flexibility to the University of Hawai‘i has evolved over the years. Exempt from certain Hawai‘i Revised Statutes that regulate other state agencies, the university enjoys authorization to transfer general fund appropriations and budgetary flexibility that allow the institution more discretion to spend without detailed legislative and executive control. Still, the University of Hawai‘i’s aim is towards greater autonomy. As such, prior to considering granting full autonomy to the University of Hawai‘i, the Legislature must be assured that the university has established policies and procedures as well as systems to adequately manage its operations.

In the course of our audit, we identified issues within the budget process and financial system of the University of Hawai‘i, more specifically the University of Hawai‘i at Mānoa (hereinafter sometimes referred to as “Mānoa”), that do not fully ensure fiscal accountability. At Mānoa, these issues include an unsubstantiated base operating budget and a budget request that is not justified to the Legislature. Further, the campus does not have a formal mechanism for monitoring program use of general and tuition funds, resulting in little assurance that the campus has an adequate understanding of its overall fiscal condition. In addition, certain policies and procedures are in draft form or need to be updated, and contracts are not properly executed. We also found that the University of Hawai‘i’s calculation of the Mānoa campus’s actual cost per student has limited value for decisionmaking. Variations in the data among different institutions and the university’s inconsistent calculation of the actual cost per student and use of questionable data make analytical comparisons impractical. These points and their impacts are discussed further in the following sections.

Summary of Findings

1. The University of Hawai‘i at Mānoa’s budget lacks the detail and support necessary to ensure the efficient and effective use of resources.
2. The University of Hawai‘i at Mānoa’s management of its general and tuition funds results in little assurance that the university has an adequate understanding of its overall fiscal condition.

3. The University of Hawai'i's calculation of the University of Hawai'i at Mānoa's actual cost per student has limited value for decisionmaking.

The University of Hawai'i at Mānoa's Budget Is Not Adequately Funded

Legislators and the public want to know whether government resources are managed properly and used in compliance with laws and regulations. They also question whether government programs are achieving their objectives and desired outcomes and are being provided for efficiently and effectively. For this reason, in 1970, the Hawai'i State Legislature established a comprehensive program and financial management system based on the principles of planning, programming, and budgeting (also referred to as performance-based budgeting). The system's objectives were to provide legislators with a tool to measure programs' progress toward achieving their objectives, focus managers on attaining program objectives, and use systematic analysis to improve management. Essentially, in performance-based budgeting, policymakers link appropriations to outcomes by using performance information when making budget decisions and including such information in the actual budget document.

Budgets are used to articulate a plan and associated goals in financial terms, empower individual units (e.g., the university's schools, colleges, departments, and offices) to achieve the plan, and measure performance against goals. The budget is a quantitative representation of the institution's future plans and, as such, should be seamlessly linked to the strategic plan. In addition to reflecting the strategy and priorities of the institution's administration, the budget should also include the practical experience of the deans and directors familiar with the implications of the institution's plans. This ensures that all of the unit plans are consistent with the university's vision and mission, institutional goals, and strategic initiatives, and allows the academic priorities of the faculty to drive the university's goals and initiatives. To achieve the plan, deans and directors responsible for implementing plans and budgets need to have sufficient authority for determining the best financial means of accomplishing the objectives. Administrators, as well as deans and directors, also need information at a point that enables them to take corrective action if needed, and to understand the institution's full financial picture. Further, the budget is a means of measuring whether a plan has been achieved—particularly whether resources have been used in a manner that is consistent with the plan.

Our audit of the University of Hawai'i at Mānoa's budget process found that the budget impedes the efficient and effective use of resources. We found that Mānoa's base operating budget is not substantiated. The use of incremental budgeting focuses attention on additions or deletions to

the prior year's budget and takes previous appropriations for granted. We also found that Mānoa's 2005-2007 biennium budget request to the Legislature was not sufficiently justified. The University of Hawai'i at Mānoa did not effectively monitor the development of its budget as it made its way through the review process, and it was adjusted by system administration, the Board of Regents, the governor, and Department of Budget and Finance. As a result, the Mānoa campus could not readily provide a list of funding priorities to the Legislature. Furthermore, the institution has recently begun to restructure its budget process away from incremental budgeting; however, it has not yet made the commitment necessary to implement such changes.

The University of Hawai'i at Mānoa's base operating budget is not substantiated

The University of Hawai'i at Mānoa prepares its budget using an incremental approach. Incremental budgeting usually takes for granted previous appropriations and structure, focusing on year-to-year inflationary changes, and building by small increments on past budget decisions. As such, the previous year's budget becomes the current year's base operating budget and is presumed to be justified. Additionally, this approach guides budget decisions toward what money can buy, known as an input, versus the quality of the service that is provided, or an outcome. This practice fosters a business-as-usual attitude and ignores the quality of programs. Thus, the Mānoa campus's use of incremental budgeting results in a budget that is largely unfounded and is not based on results.

The budget is based on prior funding levels and program change requests

The University of Hawai'i at Mānoa's budget request generally consists of three categories of funding: current services, program change requests, and workload increases. Current services represent prior year's total budget, which serves as the current year's base operating budget. Program change requests and workload increases reflect current year costs in excess of prior year's budget. Program change requests and workload increases together represent the "increment" of the Mānoa campus's budget request, and are the only components for which justification is provided. For FY2005-06, the Board of Regents' approved budget for the University of Hawai'i at Mānoa included approximately \$200 million in general funds, of which only about \$13 million required justification.

Mānoa's current system of budgeting limits debate to only the incremental portion of the request. Thus, a significant portion of the funds requested avoids scrutiny. No information is provided on what was accomplished with this money in the previous year or what is expected to be accomplished with this money in the current year. As a

result, little accountability exists for much of the state funds the Mānoa campus receives. Ideally, the provision of state funds to the University of Hawai'i at Mānoa would ensure the achievement of certain outcomes, and these outcomes would reflect the state and university's highest priorities. However, state funding is not explicitly linked to the campus's actual performance.

Budgetary decisions are not results-oriented

Performance measurement focuses on setting goals and outcomes, designing the strategies needed to meet the goals, and measuring performance against goals. Subsequently, these performance goals help to provide a basis for assessing the efficiency and effectiveness of programs and are used to make resource allocation decisions. Future funding decisions should be based on program effectiveness, not on the preservation of existing programs and levels of spending. This approach requires that budgeting be directed at programs rather than at specific costs, that the goals of those programs be laid out in measurable terms, and that performance review becomes central to budget decisions.

Performance measurement provides the feedback that keeps the strategic plan on target, while the strategic plan defines performance to be measured. The University of Hawai'i at Mānoa's strategic plan, which was approved by the Board of Regents on November 22, 2002, is a result of an open and inclusive planning process. Mānoa's planning effort was part of a larger systemwide process involving all ten campuses of the University of Hawai'i. In addition to articulating the University of Hawai'i at Mānoa's mission, this plan also contains the vision statement, core commitments, and strategic imperatives that Mānoa believes will help to transform the campus. The strategic plan also includes a set of performance indicators to measure progress towards achievement of the campus's strategic imperatives.

However, in reviewing Mānoa's strategic plan, we found that some of the strategic imperatives do not have related performance indicators. We also found that the Mānoa campus indicated in its progress report that some of the performance measures had been achieved when the explanations provided to support their achievement were irrelevant. For example, the Mānoa campus indicated that a performance measure was achieved by averaging the percent increase over the years rather than reporting the percent change from year to year, as intended by the context of the performance measure.

Further, under the State's principles of planning, programming, and budgeting, outcome information should provide legislators with a basis for judging budget requests, which assist in establishing resource allocation priorities based on desired outcomes and related outputs. The

governor is responsible for issuing *The Multi-Year Program and Financial Plan and Executive Budget*, providing objectives and measures of effectiveness for each program established in the State's budgeting system. All programs, including the University of Hawai'i at Mānoa, report on their measures of effectiveness, the extent to which their programs' objectives have been achieved, and their projected performance in the subsequent six years. We found that the Mānoa campus has not been able to systematically analyze and use outcome data as part of the budget formulation process. In fact, a campus administrator essentially characterized these measures as useless for program-level decisionmaking. In addition, the measures of effectiveness are not used as management tools or used to assess achievement at the program level. Mānoa's administration admitted that it does not actively practice performance-based budgeting. These shortcomings contribute to the campus's inability to adequately account for its effectiveness to stakeholders, including the Legislature.

The University of Hawai'i at Mānoa could not sufficiently justify its budget request to the Legislature

As mentioned earlier, the University of Hawai'i at Mānoa prepares its biennium budget using an incremental approach, requiring justification for requests above the base operating budget. Consequently, Mānoa's biennium budget request consists of program change requests and workload increases. Our audit found that, despite a long internal review process, Mānoa's budget request to the Legislature lacked detail and support. The University of Hawai'i at Mānoa did not effectively monitor the development of its budget as it made its way through, and was adjusted by, its system administration, the Board of Regents, the governor, and the Department of Budget and Finance. As a result, the campus was unable to readily provide a list of funding priorities to the Legislature.

Without the necessary detail and support to properly justify budget requests, the Legislature does not have the information needed to make informed decisions and will have difficulty holding the Mānoa campus accountable for the use of state resources. The Mānoa campus also cannot ensure that its resources are being used efficiently and effectively and in support of its mission and goals. The inefficient and ineffective use of resources will cause the Legislature and public to doubt the institution's management abilities.

The budget request underwent a long, internal review process

In the initial, or "stocktaking" phase, the University of Hawai'i campuses and several systemwide units each presented their needs, proposals for financing these needs, and expected outcomes to help determine the budget priorities for the university's biennium budget. The purpose of this process was to align the plans and budget of each campus with the

university’s systemwide strategic plan. Chancellors, and invited faculty and student representatives attended the presentations. After “stocktaking” was completed, each unit within the University of Hawai‘i at Mānoa prepared a budget request, including a brief description of the request, related funding information, and the strategic plan objective met by the request. In addition, the unit numerically ranked the priority of each budget item. Mānoa’s Budget Office summarized the unit budget requests into a campus budget request and submitted it to the system Budget Office. The system Budget Office subsequently consolidated the budget requests of the various campuses into a single, systemwide budget request.

The University of Hawai‘i system budget request passed review and formal approval by the Board of Regents in September 2004. The governor and the Legislature received the university’s biennial budget request. The university’s governor-approved budget request was incorporated into the executive budget request for the State by the Department of Budget and Finance and then submitted to the Legislature for consideration and approval. Adjustments are made to the budget request throughout the review process; however, the University of Hawai‘i at Mānoa ultimately remains responsible for justifying its budget.

The University of Hawai‘i at Mānoa could not provide the Legislature with a list of funding priorities in a timely manner

During the 2005 legislative session, the University of Hawai‘i at Mānoa could not readily provide its funding priorities to the Legislature. We found that the budget requests of the University of Hawai‘i campuses were not prioritized during consolidation into the systemwide budget request. The various campus budgets were simply added together to form the university’s budget request. Thus, the university did not determine which of the items in the budget requests from the various campuses were most important and should receive funding first. Accordingly, when the governor decided to recommend a lump-sum appropriation of \$10 million in general funds for FY2005-06 to the University of Hawai‘i system (above the base operating budget), the university could not sufficiently explain to the Legislature exactly how these funds would be allocated to the different campuses. Prioritizing the budget requests of the campuses would have enabled the university to readily provide the Legislature with a list of funding priorities to justify the governor’s recommended appropriation.

The budget review process is complicated, requiring review by and approval from campus, system, and state officials. However, the University of Hawai‘i at Mānoa is responsible for monitoring the development of its budget request. Without proper monitoring, the

benefits from the time and effort spent on preparing unit budget requests will not be realized. Further, the University of Hawai'i at Mānoa's inability to provide a list of funding priorities makes it difficult for the Legislature to make informed budgetary decisions.

Efforts to restructure the University of Hawai'i at Mānoa's budget process is in its infancy

In preparing for the development of the 2005-2007 biennium budget, the University of Hawai'i at Mānoa recognized the need to improve its planning structures, change its budgeting and resource allocation processes, and move beyond incremental budgeting. As a result, it established the Mānoa Budget Advisory Group in December 2003 to recommend a new approach to budgeting and develop performance measures for making budgetary decisions. However, the advisory group's final report, dated June 2004, found that the University of Hawai'i at Mānoa did not have the information or reporting systems necessary to implement such budgetary changes.

Therefore, instead of recommending a new budgeting methodology, the advisory group's report outlines the fundamentals for budget reform and identifies related actions for developing the needed infrastructure. The advisory group's report reveals that, prior to restructuring its budget process, the University of Hawai'i at Mānoa needs to improve the information available for analyzing costs, implement a transparent process for making budgetary decisions, and develop a system for reporting unit performance. To establish these underlying budgetary principles, the report recommended the following actions:

1. Development of a web-based data information center. The web-based data information center would provide public access to student, faculty, staff, and revenue and expenditure data for each unit, and include information on the campus's budget development and allocation processes.
2. Participation in the Delaware Study. The Delaware Study is a national data-sharing consortium that allows for a comparative analysis of instructional costs and faculty productivity among peer institutions, i.e., benchmarking.
3. Establishment of a performance measurement model. Performance information is needed for: setting goals and objectives; planning program activities to accomplish these goals and objectives; allocating resources to units; monitoring and evaluating results to determine if progress is being made toward achieving the goals and objectives; and modifying program plans to enhance performance.
4. Development and maintenance of a data warehouse. The data warehouse would provide accurate and timely financial information,

allowing managers to aggregate and disaggregate data, select and manipulate variables, and explore exceptions.

5. Implementation of activity-based costing. Activity-based costing is an accounting system that measures the cost and performance of specific activities performed by an institution and provides the information needed to generate performance-based budgets.
6. Analysis of responsibility-centered management. Responsibility-centered management is a financial management philosophy that focuses on operational decentralization and is designed to emphasize the relationship between revenues and expenditures that provide a framework for linking decisions with consequences.

While the University of Hawai'i at Mānoa has accepted the recommendations to improve its budget process, it has not yet demonstrated the commitment necessary to implement the changes. The vice chancellor for administration, finance, and operations has been given the responsibility for addressing the advisory group's findings and recommendations. However, except for the web-based data information center, which is slated for completion by spring 2006, the Mānoa campus has not established a plan or timeline for its budget reform. The web-based data information center is only the first step in this process. Although restructuring the budget process will understandably take time, the University of Hawai'i at Mānoa needs to demonstrate its commitment to making these budgetary changes by developing and executing a plan with clearly defined goals and objectives. Until the campus is able to produce reliable data for assessing its units, it will not be able to move beyond incremental budgeting or ensure that resources are allocated in support of strategic initiatives.

The University of Hawai'i at Mānoa Cannot Present an Accurate Picture of its Overall Fiscal Condition

The level of autonomy granted to the University of Hawai'i by the Legislature carries great financial responsibility. The university is accountable for each of its campuses, and those campuses are subsequently accountable for each of its units. The University of Hawai'i at Mānoa is responsible for monitoring the performance and operations of each of its 42 units, and in turn, reporting campus-wide results to university administration. In order to accomplish this, the university must establish policies and procedures to ensure funds are used in support of unit and campus objectives. Additionally, a reliable reporting system must be in place to provide the Mānoa campus with a means of reviewing each unit's performance.

The administration of general and tuition funds, assigned primarily to the campus's units, necessitates that the Mānoa campus have a system

holding units fiscally accountable. However, our audit revealed that the university failed to establish a reliable financial reporting system for, and adequate policies and procedures over, the use of general and tuition funds. Exhibits 2.1 and 2.2, respectively, show that the Mānoa campus received \$187 million of general fund and \$96 million of tuition fund revenues in FY2004-05.

The University of Hawai'i's budget report is an inadequate management tool

The external auditors, PricewaterhouseCoopers LLP, found in their financial statement audit of the University of Hawai'i for FY1999-00 that the university's internal financial reporting system was inconsistent, inefficient, burdensome, and in need of improvement. The external auditors recommended that all campuses and their units work with university management to develop reports that provide accurate and reliable financial information. The external auditors further recommended that these reports be useful tools for assessing the performance of each reporting entity by university, campus, and unit management. In response, the university developed the Budget Level Summary (BLS) reporting system in FY2003-04. The BLS is a system of reports that compares budgeted, actual, and projected financial information, and it is employed throughout the university. For the Mānoa campus, BLS reports are prepared for each unit on a quarterly basis. Unit fiscal officers manually input approved budget amounts into the BLS system, as instructed by the Mānoa Budget Office, while actual expenditure data is extracted directly from the university's Financial Management Information System (FMIS). Quarterly BLS reports are then distributed to the respective units and the Mānoa Budget Office.

The Mānoa campus has made significant efforts to improve its internal financial reporting through the development and implementation of the BLS reporting system. However, the external auditors' concerns regarding the reporting system's ability to provide valid, useful financial information for monitoring and managing operations still remain. In our current audit, we found that Mānoa's BLS reports lacked the detail needed to assess unit and program performance and to help management make informed decisions. Also, unit level BLS reports are not reconciled on a quarterly basis to the university's budget or financial information system, and policies and procedures for correcting errors are nonexistent, making the reliability of the reports questionable.

The report's lack of detail diminishes its usefulness for program management

The BLS reporting system's inability to produce detailed, reliable financial information limits its value. The BLS reports are unable to report with any degree of accuracy budget-to-actual expenditure data by unit or program beyond the broad expense categories of payroll and non-

Exhibit 2.1
University of Hawai'i at Mānoa
General Fund Financial Data for Fiscal Year 2005 (cash basis)

Beginning Fund Balance	\$(21,545,713)
Revenues	187,180,749
Interest	-
Expenditures	(213,875,648)
Net Transfers	-
Ending Fund Balance	\$(48,240,612)
Encumbrances	\$ 6,365,689

Note: The financial data presented is not audited and has not been reconciled to the total amount of general funds appropriated to the University of Hawai'i.

Source: University of Hawai'i General Accounting and Loan Collections

Exhibit 2.2
University of Hawai'i at Mānoa
Tuition and Fees Special Fund Financial Data for Fiscal Year 2005 (cash basis)

Beginning Fund Balance	\$ (598,853)
Revenues	96,243,619
Interest	554,594
Expenditures	(72,360,560)
Net Transfers	(2,920,781)
Ending Fund Balance	\$ 20,918,019
Encumbrances	\$ 7,152,180

Note: The financial data presented is not audited and has not been reconciled to the total amount of tuition funds reported by the University of Hawai'i.

Source: University of Hawai'i General Accounting and Loan Collections

payroll. According to Mānoa Budget Office personnel, there is no assurance that account codes are properly established because the unit fiscal officers responsible for setting up the accounts are not properly trained in the university's account code and attribute standards. Additionally, there is a lack of oversight to ensure that account codes are properly assigned and attribute standards are properly followed. Improper assignment of accounts will cause expenditures to be reported under the incorrect unit or account, decreasing the value of BLS reports containing detailed expense information. Even if detailed actual expenditure information was reliable, there would be no budgetary information to compare it to because the Mānoa campus units are not required to submit budgets with expenditure detail.

Budget variance reports should contain detailed and reliable information in order to be useful monitoring and analytical tools. For example, unit deans or directors should have available reports that would allow them to determine quickly whether training costs have exceeded budgeted limits or to track expenditures for supplies over a period of time. A more detailed and accurate budget-to-actual report would also provide campus management the tool it needs to evaluate unit performance. However, this does not appear to be the purpose of the BLS reporting system, as the only categories of expenditures currently reported are payroll and non-payroll. In addition, the primary user of the Mānoa campus's BLS reports is the Mānoa Budget Office, which focuses on the allocation of general and tuition funds and not the monitoring of program or unit performance.

Information in the report is not reconciled to the university's budget and Financial Management Information System

One of the functions of the BLS reports is to provide Mānoa campus administration with explanations for variances between budgeted expenditures and actual results. However, the budget and financial information in the BLS reports are not reconciled by each unit quarterly, raising concerns about the reports' reliability. Reconciliations are critical to the integrity of the report. Without the timely reconciliation of the reports, misstatements or errors will go undetected and may lead administrators to make wrongful conclusions. The University of Hawai'i at Mānoa should continue to refine its internal reporting practices by ensuring that budgeted and actual expenditure information reported on the BLS reports reconciles to the university's annual budget and financial information system, respectively.

The University of Hawai'i at Mānoa does not have formal policies and procedures for correcting reporting errors

According to Mānoa campus personnel, BLS reporting errors are caused by clerical errors, the untimely input of data by fiscal officers, and the disassociation between various accounts used in the BLS reporting system and FMIS. As mentioned in the previous section, reconciling the reports to the university's annual budget and FMIS would help to detect reporting errors. However, the Mānoa campus does not require reconciliations to be performed. The campus also lacks formal policies and procedures that specify the individuals responsible for taking corrective action or the timeframe in which these actions are to be taken. Consequently, even if the Mānoa campus found a misstatement or error in the BLS reports, no formal process exists to make the correction.

Lax controls over the general and tuition funds may lead to inappropriate fund usage

The university has also been granted a great deal of autonomy involving its internal structure, management, and operations, which the university shares with its campuses. At the University of Hawai'i at Mānoa, deans and directors are responsible for meeting their unit objectives and ensuring the proper use of the resources provided. We found that, although the Mānoa campus has delegated financial responsibility to unit personnel, it has not established adequate procedures and financial reporting mechanisms to ensure that funds are properly expended. The Mānoa campus lacks formal policies and procedures to ensure the proper use of general and tuition funds: 1) policies and procedures for the tuition funds remain in draft form; 2) disbursement procedures for the new ePurchasing system have not been included in the university's Administrative Procedures Manual (APM); 3) disbursements for small purchases are made without verification of proper approval; and 4) certain purchasing duties are not properly segregated.

Policies and procedures for the tuition funds are in draft form while others need updating

In April 2004, *University of Hawai'i Non-General Funds and Accounts Report on Agreed-Upon Procedures*, by PricewaterhouseCoopers LLP, found that the policies and procedures related to the administration of the Tuition and Fees Special Fund were in draft form and had not yet been implemented. As of our audit, we noted that the policies and procedures dated May 2003 remained in draft form and have yet to be implemented. The Tuition and Fees Special Fund accounts for all university student tuition and fees received; therefore, it is critical to have formal policies and procedures governing its management. The use of draft policies and procedures indicates that university management does not consider important the use of internal controls to safeguard assets. This also increases the risk that these funds may not be used as intended—to maintain and improve university programs and operations.

Further, other policies and procedures do not to reflect current operating practices. In December 2001, the university began implementation of the first phase of ePurchasing, a web based purchasing and payment processing system. By April 2003, training on the system was substantially complete, and in July 2003, use of the ePurchasing system became mandatory for all university departments. A user's guide for the ePurchasing system was issued; however, the university's APM has not been updated to include disbursement procedures related to the new ePurchasing system's implementation. The APM is the approved university policy and procedure manual. The purpose of the manual is to, among other things, define personnel responsibilities, assure observance of legal and university requirements, aid in the exercise of budgetary and management controls, and provide financial information pertaining to the various functions of the university. There may be inconsistencies in the implementation of the new ePurchasing system and an increased risk of improper use of funds because the university has not updated its policies and procedures in a timely manner.

In addition, stemming from the university's failure to incorporate certain ePurchasing procedures into existing procedures under the APM, for purchases under \$25,000, payments can be processed without verification of proper authorization. Upon the university's implementation of ePurchasing, Mānoa campus units began to document the authorization for small purchases only on the requisition form. However, the units are required to submit only the purchase order, and not the requisition, to the Disbursing and Payroll Office, which then authorizes the disbursement. The Disbursing and Payroll Office simply assumes that small purchases are properly authorized since the purchase orders lack this documentation. This flaw in the design of current operating procedures could allow unit fiscal officers to bypass appropriate approvals for purchases of up to \$25,000.

Another key goal of effective policies and procedures is to establish proper segregation of duties, or the concept that no one individual should control more than one critical phase of a business process or transaction. Duties should be divided among personnel to reduce the possibility of both perpetrating and concealing errors and irregularities. However, during our review of Mānoa's administration of general and tuition funds, we found instances in which the requisitioner or initiator of a purchase also signed off as the approving authority. The functions of both initiating and approving a purchase should be segregated. When conflicts exist in segregation of duties, organizations can be exposed to significant risks from the inappropriate use of funds. The university's failure to update its policies and procedures increases the risk that the improper usage of funds will occur and go undetected.

There is no formal monitoring of program financial information

The University of Hawai'i at Mānoa's Office of the Chancellor is charged with promoting the effective and efficient use of resources throughout the campus. This would appear to be a difficult task, considering that the BLS reports are the primary means of reporting unit and program financial data to campus administration. As previously noted, BLS reports lack the reliability and detail to be valuable management tools. In practice, when financial information is requested from the Mānoa campus units and programs, it is often provided using what is internally referred to as "shadow systems." These systems are Excel spreadsheets maintained by some units and manually prepared using financial data obtained from FMIS. Some of these financial reports may be fairly standardized within a unit, while others are created to satisfy specific requests. In either case, these reports are not standardized across units, affecting comparability adversely. Also, without formal procedures to reconcile these reports back to FMIS and for supervisory review, little reliance can be placed on their accuracy.

Once again, no reliable, adequate system of internal financial reporting exists for the Mānoa campus. This makes it difficult for campus administration to monitor and evaluate unit and program performance, reducing accountability at those levels.

Programs are allowed to exceed their approved allotments

The FMIS system includes edits to prevent expenditures from exceeding approved quarterly allotments. Allotments represent the amount of funds made available, or budgeted, to each unit. While this system edit is operational at the campus level, it is disabled at the unit level for the Mānoa campus, allowing units to spend beyond their approved allotments. Therefore, if the Mānoa campus is allotted \$100 million in general funds, the system edit will not allow its total campus expenditures to exceed this limit. However, units within the campus could exceed their approved allotment since the edit is disabled at the unit level. This could ultimately result in a lack of funds for required costs for one unit because another unit overspent its allotment. This situation raises serious concerns over campus administration's commitment to ensuring the proper expenditure of general and tuition funds.

Without formal policies and procedures governing the administration of funds, including a financial reporting process from the campus units to the Mānoa campus management, improprieties may go undetected. Furthermore, without the proper controls and financial reporting tools in

place, the university will have difficulty identifying financial problems and addressing those problems in a timely manner.

Contracts are not properly executed and monitored

The university is responsible for establishing its own purchasing and contracting procedures that should incorporate the “spirit” of state procurement laws, which promote procuring quality goods and services at reasonable rates while fostering open and honest competition. Without these procedures, or a system to ensure compliance, there is no assurance of fair competition. During our review of specific disbursements of Mānoa’s funds, we noted several violations of procurement procedures and questionable uses of contract modifications. We also noted that the central office for maintaining university contracts lacked formal policies over the filing and monitoring of such contracts.

The University of Hawai'i at Mānoa cannot ensure the propriety of contracts and agreements reviewed

During our testing of 40 disbursements of general and tuition funds, which included 11 contracts, we found that the Mānoa campus violated established procurement and disbursement procedures and made questionable use of contract modifications. One purchase of \$3,650 by the College of Natural Sciences for chemistry equipment, made during June 2005, contained no evidence that price quotations were obtained. University procurement policies require purchases from \$2,500 to \$15,000 to have documentation of at least three verbal or written quotes to ensure fair competition. These small purchases, under \$25,000, require approval only at the Mānoa campus unit level.

Purchases over \$25,000, on the other hand, are primarily approved and executed through the university’s Office of Procurement and Real Property Management (OPRPM) and subject to greater scrutiny. However, in our sample of Mānoa campus disbursements, we noted one instance in which OPRPM approval was inappropriately bypassed. The Mānoa campus issued a \$60,650 payment to the University of Hawai'i Foundation, under an existing contract to cover 50 percent of unit based officer salaries for the campus’s law school, using the incorrect authorization form. This form does not require routing to OPRPM for approval. Contract progress payments are required to be approved by OPRPM to ensure propriety, as well as to monitor total disbursements made under the contract.

Another violation of procurement procedures occurred during December 2004, when the School of Medicine entered into a contract for building maintenance services totaling \$95,683, without completing OPRPM Form 74, Contracting for Services, prior to awarding the contract. This form is required to justify all service contracts. Without the required

form, the contract could be invalid as there is no confirmation that the contractor is eligible to conduct business with the university.

We also noted improper use of the emergency procurement method of contracting by the Mānoa campus. In November 2004, the university's Office of Auxiliary Services entered into a \$50,000 contract to assess and repair flood damage sustained by the University of Hawai'i at Mānoa. However, no justification for vendor selection was documented at that time and the contract violated university policy as it was approved only by the campus dean, inappropriately bypassing OPRPM. Further, the campus continued to pay for services beyond the scope of the original contract. During November 2004 to March 2005, the Mānoa campus paid a total of \$596,657 to the vendor. A request for emergency procurement form encompassing the entire expense was eventually completed in June 2005; over six months after services had begun. University procurement policies require the request for emergency procurement form to be completed as soon as reasonably possible.

We noted two additional instances that create greater concerns over Mānoa's use of contract modifications. During FY2002-03, the School of Medicine executed a \$700,000 contract with a medical library that allowed its students the use of the facilities. The initial contract was awarded under sole source provisions and in accordance with university policies. However, in FY2004-05, the campus extended the term of the contract to cover a subsequent period through a \$525,000 modification, without documenting the required consideration of whether the service still met the criteria for sole source procurement.

Another example illustrating the questionable use of contract modifications occurred with the university's annual financial statement audit contract with a public accounting firm, in July 2004. A modification to this audit contract was executed in May 2005 to attest to the university's student financial assistance information provided to the U.S. Department of Education. The modification, totaling \$120,000, was for services that were not described in the original audit contract.

The material difference in the price and scope of the two contract modifications described above raises questions about the use of modifications to deviate from standard procurement procedures. Section A8.275 of the Administrative Procedures Manual states that the use of contract modifications includes administrative changes, supplemental agreements, renewals, and notices of exercising an option and termination. Based on this guidance, it is questionable at best whether the two contract modifications noted above are in accordance with university policy. In theory, modifications to contracts should be used to extend services under existing contracts without materially modifying the

scope and timing of work or the related costs. Modifications should not be used out of convenience or as a means to circumvent the normal procurement procedures that foster competition.

Our sample of transactions tested included two disbursements to the Research Corporation of the University of Hawai'i (RCUH), one of which was found to be improper. The Research Corporation of the University of Hawai'i, which is attached to the university for administrative purposes, acts as a service bureau by hiring personnel and procuring goods and services on behalf of its clients, which include the university. Although a state agency, RCUH is exempt from certain state statutes such as those relating to procurement and personnel, allowing it to process transactions expeditiously. The university may use RCUH only under certain conditions or criteria as specified in the Internal Agreement, executed between the two parties, and university policies. The university may use RCUH for certain aspects of research contracts and grants, which must be substantiated using Internal Service Order Forms. However, RCUH cannot be used for purchases of \$100,000 or greater without approval from the Board of Regents. In essence, RCUH may not be used to circumvent state statutes.

The disbursement in question was made in January 2005 from the University of Hawai'i at Mānoa's School of Medicine in the amount of \$100,000 for infrastructure development. No valid justification for the use of RCUH or any applicable criteria was provided on the related Internal Service Order Form. Additionally, there was no evidence of approval by the Board of Regents. Responsible personnel indicated that time constraints were the primary driver for the use of RCUH, as its fiscal flexibility allowed for a more timely procurement. The service order was subsequently increased to \$500,000 in March 2005. It appears that this disbursement was processed through RCUH to circumvent standard procurement procedures believed to be too cumbersome. Specifically, the disbursement failed to substantiate the use of RCUH and exceeded established dollar limits.

The University of Hawai'i at Mānoa lacks formal procedures governing the maintenance and organization of contracts

The Office of Procurement and Real Property Management is responsible for executing and maintaining the files for all contracts of the university. During our review of Mānoa campus contracts, we noted that the office does not have established contract maintenance procedures. There is no central filing system or formal contract log that lists all contracts, including amounts, status, modifications, and file location. Without established procedures, the office's contract specialists have developed their own system for monitoring assigned contracts. During our testwork, we noted that the office did not have a consolidated listing of

contracts for the Mānoa campus. In response to our request, the office compiled a list of campus contracts from individual listings maintained by the various contract specialists. This made it nearly impossible for us to determine whether the contract list submitted represented a complete and accurate showing of all contracts of the Mānoa campus.

The lack of uniformity also made it difficult to account for and locate specific contract files. Office personnel had trouble locating many of the contract files or specific documents requested during our review. All files and documents requested were eventually located, but the lack of a centralized, standardized filing system reduces operational efficiency and increases the risk that required contract documents are incomplete or may be lost. This is especially critical should office personnel leave, as it is commonly known that they alone know the status and location of their respective contracts and files.

The University of Hawai'i's Calculation of the Mānoa Campus's Actual Cost Per Student Has Limited Value

The public's concerns about college costs and prices have a long history. In 1997, Congress found that the public overestimated tuition prices and was ill-informed about the governance, control, and financing of higher education. It responded by establishing the National Commission on the Cost of Higher Education to investigate this college "cost-price conundrum." In its final report, *Straight Talk About College Costs and Prices*, issued in January 1998, the commission recognized the need for fiscal transparency and called upon academic institutions to develop better consumer information about costs and prices and to increase their public accountability. The National Association of College and University Business Officers, which is the higher education industry's financial association, responded by initiating its Cost of College Project. The goal of the project was to develop a uniform methodology to assist institutions in calculating the annual cost of providing an undergraduate education, the efforts of which are presented in the report, *Explaining College Costs*, dated February 2002.

The National Commission on the Cost of Higher Education's report also influenced a study of higher education costs mandated by Congress in the 1998 Higher Education Act. As part of its report to Congress, the U.S. Department of Education's National Center for Education Statistics—the primary federal entity for collecting and analyzing data related to education in the U.S. and other nations—commissioned three studies that culminated in the final report, *A Study of Higher Education Instructional Expenditures: The Delaware Study of Instructional Costs and Productivity*, issued in 2003. This study focused on the instructional costs of academic disciplines, measured by the direct expense per student credit hour taught.

The reports of the National Association of College and University Business Officers and the National Center for Education Statistics mentioned above provide the basis for our assessment of the University of Hawai‘i’s calculation of the actual cost per student. In their reports, these organizations recognize that, as a result of disparate views on the definition and accounting treatment of key cost components, no single correct way exists to measure college costs across all types of institutions. The reports further acknowledge that the differences between institutions with respect to mission, resources, and structure impact expenditure patterns. Thus, variations in the data from dissimilar institutions would not lead to meaningful comparisons. The only types of comparisons that would be meaningful—assuming an institution keeps its own assumptions intact—would be its own annual comparisons over time.

The University of Hawai‘i’s calculation of Mānoa’s actual cost per student has limited value for decisionmaking because: 1) the lack of an industry standard diminishes the calculation’s use as a benchmark; 2) university spending is driven by institutional priorities and available resources; and 3) the university’s internal controls cannot ensure the reliability of data used in the calculation.

The lack of an industry standard diminishes the calculation’s use as a benchmark

Full cost models of higher education expenditures attempt to describe direct (e.g., instruction and student services costs) and indirect costs (e.g., overhead associated with administrative costs and costs associated with the operation and maintenance of the physical plant). Kent Halstead of Research Associates of Washington developed one of the oldest and most common of cost formulas used to annually publish the “full instructional cost per full time equivalent student” for each institution in the country. The formula equals the sum of direct costs for instruction and student services plus indirect costs. Indirect costs for this model are the total institutional and academic support and institutional support expenditures and plant expenditures less overhead for funded research and public service estimated at 33 percent of the expenditures for these two activities. Another nationally recognized cost model, by Gordon Winston of Williams College and the Williams Project on the Economics of Higher Education, is based on the assumption that a proportion of capital costs must be added to expenditures that are either clearly or only partially related to instruction. As such, the Halstead model excludes capital costs; the Winston model includes them. Both models demonstrate the difficulty in developing cost models for higher education—values for determining allocations of certain data and the selection of detailed cost figures are a matter of judgment.

The complexity and diversity of higher education makes it impractical to create a single method for accurately calculating college costs for all

types of institutions. Because an institution's methodology for calculating the annual cost per student relies on a fair amount of interpretation and judgment, the inconsistencies among the cost models limit the use of the data for comparative purposes. The only meaningful assessment of the data would be a comparison of the institution's data over time; however, the University of Hawai'i does not calculate the actual cost per student every year.

Each institution develops its own method of calculating the cost per student

Without a standardized methodology to explain and present how much it costs to provide an education and related services, each institution devises its own cost reporting system. An institution has the flexibility to determine the framework and elements of its methodology. However, differences in views on the definition and accounting treatment of key cost components will inevitably expose the institution's methodology to some degree of criticism.

As such, there is no single correct way to measure college costs across all types of institutions. The diversity of institutions poses technical and theoretical challenges in designing a common cost methodology. For example, varied institutional activities and governance structures of colleges and universities require the use of different accounting and financial reporting methods. Public and private institutions report their finances using specific and disparate accounting standards designed for their sectors. Consequently, public and private institutions have different views on the definitions of certain costs.

The Halstead and Winston models mentioned in the previous section illustrate another intricacy in developing a cost methodology for higher education. Institutions use different schemes to allocate indirect costs that are imprecise and dependent upon funding source and purpose of expenditure. As an example, the Halstead model assumes that the cost of overhead for research and public service is approximately 33 percent. The Winston model, on the other hand, uses a proportional allocation for these costs. The difficulty in accurately and systematically allocating indirect costs across disciplines and institution types is a longstanding and unavoidable obstacle in the development of cost models.

An institution also has the flexibility to determine its full-time equivalent enrollment. Essentially, the full-time equivalent measure converts part-time student attendance into the equivalent full-time basis. It is difficult to uniformly define a full-time equivalent student because of the wide variations in institutional practices and student bodies. One method of calculating an institution's full-time equivalent enrollment of undergraduates would be to add the number of full-time students and the

number of credit hours taken by part-time students in one academic year and divide by 24. However, institutions that do not use a credit hour system would encounter problems with this method. Another method involves dividing the amount of part-time students by three and adding the result to the amount of full-time students. This method assumes that part-time students take one-third the number of classes of full-time students. Other issues related to the determination of full-time equivalent enrollment involve the treatment of non-degree and noncredit students.

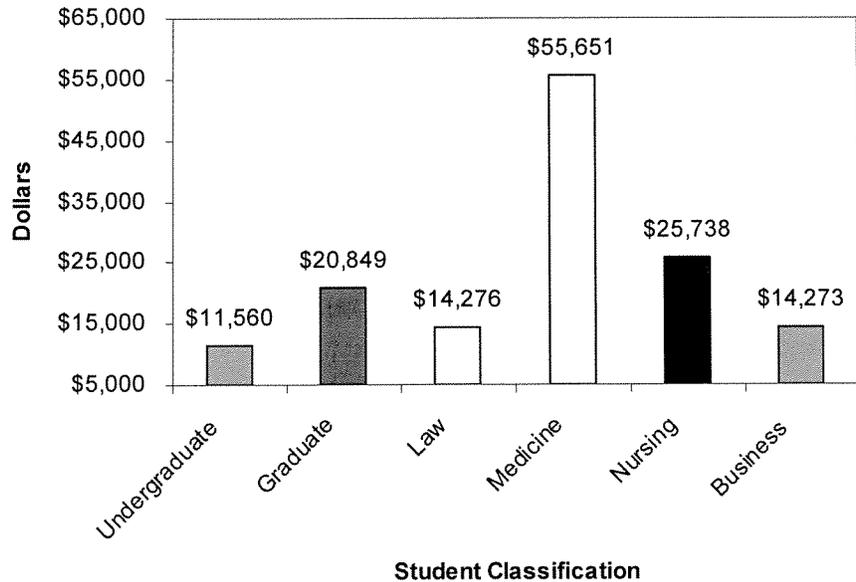
Institutions are allowed a fair amount of interpretation and judgment in developing their methodology for calculating the annual cost per student, creating inconsistencies that limit the use of the cost information for comparative purposes. Further, the flexibility of institutions to determine which elements to factor into the calculation may allow for the manipulation of results. Thus, any comparison or analysis of cost information without an understanding of the institution's structure, and definition and handling of key cost elements would be misleading. For this reason, cost data should always be accompanied by descriptive material to help stakeholders better understand the finances of higher education.

The University of Hawai'i divides total expenditures by the total full-time equivalent enrollment

The University of Hawai'i's calculation of the actual cost per student is an estimate used to guide tuition planning. University administration informed us that tuition paid by students accounted for approximately 30 percent of the cost to attend the University of Hawai'i at Mānoa. The remaining education costs are subsidized by state appropriations, or public funds. According to the University of Hawai'i, the Mānoa campus's actual cost per undergraduate and graduate student totaled \$11,560 and \$20,849, respectively, in academic year 2004. As shown in Exhibit 2.3, the University of Hawai'i also calculates the actual cost per student for other student classifications.

The University of Hawai'i's cost model includes expenditures from general funds and tuition revenues that are both clearly related (direct costs) and only partially related (indirect costs) to educating students. Direct costs (i.e., instruction) include faculty salaries and benefits, student assistant pay, and supplies and equipment. The university prorates these costs among the various student classifications based on the enrollment mix of each academic program. In contrast, indirect costs consist of student services (e.g., academic advising and registration); scholarships and fellowships; and a proportional allocation of academic support, institutional support (e.g., repair and maintenance), operations

Exhibit 2.3
University of Hawai'i at Manoa
Actual Cost Per Student for Academic Year 2004



Notes:

1. The figures presented are based on cost and student information from the University of Hawai'i's Expenditure Study and Academic Crossover Study, respectively, and the university's expenditure cost model.
2. The university uses the headcount enrollment instead of full-time equivalent enrollment to calculate the cost per student for law and medical students. According to the university, the use of headcount enrollment provides a more accurate estimate because law and medical students tend to take heavier course loads—headcount enrollment is smaller than full-time equivalent enrollment.

Source: University of Hawai'i Office of Academic Planning and Policy

and maintenance, and systemwide support costs related to instructional activities. The indirect cost per full-time equivalent student is computed at the campus-level and applied to the actual cost per student calculation for all student classifications.

The university's cost model also excludes costs from the calculation because the associated activities are either unrelated to instruction or self-sustaining. Excluded costs are those related to research, community service, summer programs, auxiliary services (e.g., campus bookstores, student housing, food services, and parking), and capital improvement projects. The formula for the actual cost per student equals direct costs per full-time equivalent student (relative to each student classification, except for the cost per law or medical student calculation, which uses

headcount enrollment) plus indirect costs per full-time equivalent student. The basic calculation for the University of Hawai'i at Mānoa's actual cost per undergraduate and graduate student is illustrated in Exhibit 2.4.

Exhibit 2.4 Basic Calculation of the Actual Cost Per Undergraduate and Graduate Student for Academic Year 2004

	<u>Undergraduate</u>	<u>Graduate</u>
Direct instructional costs	\$ 77,333,454	\$ 44,066,536
Number of FTE students	/ 11,785	/ 2,780
Total direct costs per FTE student	\$ 6,562	\$ 15,851
Total indirect cost per FTE student	+ 4,998	+ 4,998
Total cost per FTE student	<u>\$ 11,560</u>	<u>\$ 20,849</u>

Notes:

1. Full-time equivalent (FTE) undergraduate and graduate enrollments equal the total semester hours taken in all regular credit courses (excluding audited semester hours) divided by 15 and 12, respectively.
2. Indirect costs include student services; scholarships and fellowships; and a proportional allocation of academic support, institutional support, operations and maintenance, and systemwide support costs related to instruction.

Source: University of Hawai'i Office of Academic Planning and Policy

Although the calculation has potential as an internal management tool, we found that the University of Hawai'i does not consistently compute the actual cost per student. We requested the past five years of cost information for the University of Hawai'i at Mānoa; however, the university was only able to provide the actual cost per student for academic years 2004, 2001, and 2000. The University of Hawai'i provided the actual cost per undergraduate and graduate student for academic year 2004 based on its current cost model. The university used a slightly different methodology to calculate the actual cost per student for academic years 2000 and 2001. Moreover, the university did not use the cost model for academic years 2002 and 2003 and, therefore, did not provide the actual cost per student for these years. As a result, performing a trend analysis of Mānoa's actual cost per student calculation would be trivial.

University spending is based upon institutional priorities and available resources

College and university cost decisions represent institutional choices, values, and priorities. These decisions are in turn made within the constraints of available resources. Hence, differences between institutions with respect to mission, resources, and structure affect costs among institutions, further limiting the comparative value of the cost per student calculation.

Colleges and universities are differentiated in categories with respect to mission, including research, doctoral, comprehensive, or baccalaureate. Differences in faculty responsibilities provide a plausible explanation for the cost variances between institutional categories. For example, faculty at research universities, engaged in research activity, might teach fewer student credit hours at higher costs than faculty at comprehensive institutions.

Further, colleges and universities spend money depending on the amount of revenues they receive. The actual cost per student calculation is therefore a reflection of available revenues. As such, with enrollment constant, an increase in revenues may cause an increase in expenditures, raising the cost per student.

Most of the variance in costs across institutions is associated with the disciplinary mix within an institution. Therefore, it is possible to examine two research universities with dissimilar curricular emphases and find substantial differences between overall costs at the two institutions. These differences are associated with the cost variations between disciplines themselves. For example, disciplines satisfying general education requirements, such as English or math, are typically less costly than other disciplines because they serve a greater number of students, spreading out the cost of instruction. Although institutional aggregate data may be useful in making broad, general statements about higher education costs, the data may actually mask factors associated with expenditures and lead to erroneous conclusions.

Variations in costs across institutions prevent the use of cost per student data as a measure of the value or quality of the education provided by an institution. Considered alone, a high or low cost is neither good nor bad, but merely a description of the institution's cost structure. As such, any cross-institution comparison of costs without consideration of priorities and resources will be misleading.

The University of Hawai'i's internal controls cannot ensure the reliability of data used in the calculation

The University of Hawai'i uses data from three administrative systems to calculate the actual cost per student: the financial information system (FMIS), student information system (Banner), and human resources system (PeopleSoft). To ensure the accuracy and reliability of the data used in the calculation, general and application controls over these

systems must be designed properly and operating effectively. General controls are policies and procedures that apply to a number of information systems within an organization and help to safeguard data, protect application programs, prevent unauthorized access, and ensure continued operations. In contrast, application controls relate to individual computer systems or business processes. Application controls, including automated edits and validation of computer generated reports, ensure the accuracy and completeness of data as it is processed, maintained, and reported.

Our audit revealed weaknesses in the University of Hawai'i's internal controls over the calculation of the actual cost per student, raising concerns about the reliability of the calculation. We found that data used in the cost per student calculation is manually extracted and reported without regard for its reliability and accuracy. Further, although it is important for the calculation itself to be verifiable, it is also important that the systems from which it is derived produce verifiable data. Consequently, we found that general controls over the university's financial, student information, and human resources systems require improvement. We also found that the university does not have formal policies and procedures describing the application controls for the student information and human resources systems.

The university makes no effort to ensure the reliability of data used in the calculation

Using unreliable information as a basis for decisionmaking will result in wrongful conclusions. As a result, it is important to assess the accuracy and reliability of information to determine its usefulness. In reviewing the university's process for computing the actual cost per student, we found that the university does not make any effort to verify the data used in the calculation. The employees at the University of Hawai'i's Budget Office, who are responsible for calculating the actual cost per student, do not believe that it is important for the cost per student information to be accurate because it is meant to be an approximation and is not used for internal decisionmaking.

The data used to determine the actual cost per student is taken from two reports. One of the reports uses data taken directly from the student information system and provides the student enrollment figures needed for the calculation. The other report is developed using an Excel spreadsheet and provides expenditure information that is manually extracted from the university's financial information system, which includes financial data from the human resources system. Student enrollment and expenditure information taken from the two reports is then inputted into another Excel spreadsheet used to allocate and aggregate expenditures and calculate the actual cost per student by student classification.

Data quality controls help to ensure the reliability of data and include the following elements: data are reported accurately and properly, data and files are properly maintained, the agency has a review process prior to submitting its final numbers, and definitions of variables are used consistently. We found that the university does not have a review process to validate the data in the manually prepared expenditure report or the cost per student calculation. Rather, it is simply assumed that the information is accurate and reliable. Performing a secondary review of the data would help to detect errors. For example, during our review of the university's calculation of indirect costs, we found that the university used an estimated full-time equivalent enrollment figure, resulting in an overstatement of costs by \$318 per student. When we inquired about the discrepancy, we were informed that the estimated figure was not updated by the university's Budget Office when the actual enrollment amount became available. The corrected amounts are reflected in Exhibits 2.3 and 2.4.

We also found that the university does not have any formal guidelines or policies and procedures for the preparation of the expenditure report or calculation of the actual cost per student. This is especially disconcerting because there is only one employee at the university who prepares the report and performs the calculation, and the employee will retire next year. Without guidelines or policies and procedures, the university can not ensure the consistent calculation of the actual cost per student.

General controls for the financial, student information, and human resources systems require improvement

We reviewed two areas of general controls relating to data reliability and availability: physical safeguarding and continuity of operations. Physical safeguarding involves protecting information technology equipment against natural and man-made hazards. In turn, continuity of operations describes an organization's ability to provide information technology services in the event of disruptions.

Typical physical and environmental controls include: 1) locating servers in locked rooms to which access is restricted; 2) restricting server access to specific individuals; 3) providing fire detection and suppression equipment; 4) housing sensitive equipment, applications, and data away from environmental hazards such as low-lying flood plains or flammable liquid stores. We found that the university does not properly protect its information technology systems. The university's computing center is located in a building unsuited for housing information technology equipment. The structure was initially designed for classrooms and, as such, does not have the physicalities needed to protect the computing center. For example, because the computing center is located on the ground floor of the building, it is vulnerable to flooding.

When considering physical and environmental security, it is also appropriate to consider contingency planning, or disaster recovery planning. A business continuity plan should be based on the organization's risk assessment and service level agreements with application owners. The risk assessment involves identifying potential hazards and disruptions. Service level agreements are formally negotiated with application owners to establish criteria for system recovery. The business continuity plan should also be tested regularly. We found that the university does not have an overall information technology business continuity plan. There is no documentation of a risk assessment, and formal service level agreements have not been developed. Moreover, we found that the university has not tested its ability to recover its administrative systems since September 11, 2001. Although, the university tentatively planned to test these systems on November 11, 2005, it was unsure if the student information system would be included in this test.

The university has known about the physical and environmental vulnerabilities for some time as indicated in its *Strategic Plan for Information Technology 2000*, and recently approved funding to design a new information technology center in its supplemental Capital Improvements Program budget for FY2006-07. Thus far, the university's lack of commitment and resources to ensure data reliability and availability has left the computing center vulnerable to natural or man-made disruptions. As a result, important information maintained in the administrative information systems may not be accessible for extended periods of time. Also, without effective general controls, application controls are more easily circumvented or modified.

Application controls for the student information and human resources systems are not formalized

The objective of internal controls over application systems is to ensure that: 1) all input data is accurate, complete, authorized and correct; 2) all data is processed as intended; 3) all data stored is accurate and complete; 4) all output is accurate and complete; and 5) a record is maintained to track the process of data from input to storage and to the eventual output. University management's inattention to application controls places into question the reliability of the student information and human resource data used in the cost per student calculation.

Application controls require organizations to have formal policies and procedures for data entry, data integrity and accuracy, data validation, and error detection and correction. However, in reviewing the application controls over the student information and human resources systems, we found that the university does not have any such policies and procedures. The policies and procedures for the student information

system that were obtained during the audit, which were later retracted, were outdated—relating to a former system. Although university student registration and human resources officials were able to provide verbal explanations of the data processes for their respective systems, documented policies and procedures do not exist.

In addition, the university did not have documentation for these systems tracking the process of data from input to storage and to the eventual output such as a data flow diagram. The data flow diagram is a graphical illustration of the flow of data through a system—from input to storage and to the eventual output. In response to our request for such a document, the university created narrative descriptions of the student registration and human resource management processes. Documenting the flow of data through a system is useful for evaluating the effectiveness of computer processing and identifying deficiencies in internal controls.

While the actual cost per student calculation in itself is not vital to the ongoing operations of the University of Hawai'i at Mānoa, the data housed in the financial, student information, and human resources systems is. As such, the deficiencies that we noted in the general and application controls over these systems present problems that extend beyond concerns over the ability to validate data used in the actual cost per student calculation.

Conclusion

The University of Hawai'i at Mānoa is part of a postsecondary education system that relies on general fund and non-general fund support from the Legislature for its operations. Our audit found that the budget process and financial system of the University of Hawai'i at Mānoa do not fully ensure fiscal accountability. We found that Mānoa's budget does not have the detail and support necessary to ensure the efficient and effective use of resources and that the campus's management of its general and tuition funds results in little assurance that the university has an adequate understanding of its overall fiscal condition. We also found that the calculation of the University of Hawai'i at Mānoa's actual cost per student has limited value for decisionmaking.

Although the University of Hawai'i currently benefits from a considerable amount of administrative flexibility, it has been striving toward greater autonomy. However, along with greater autonomy comes greater responsibility to the people of Hawai'i and the need to be fiscally accountable. As such, future recommendations for further autonomy must be carefully thought through by the Legislature and university in

order to ensure that the appropriate resources and accountability mechanisms are available for the university to undertake added responsibilities.

Recommendations

1. The chancellor of the University of Hawai‘i at Mānoa should ensure that:
 - a. A process that clearly links the strategic plan objectives to the budget is established and documented;
 - b. Budgetary requests and decisions are based on the campus’s and University of Hawai‘i system’s strategic plans;
 - c. The commitment necessary to restructure its budget process is made, including the establishment of formal monitoring and reporting processes to properly evaluate program performance;
 - d. A process is established to track the Mānoa campus’s budget as it is adjusted by the University of Hawai‘i system administration, the Board of Regents, the governor, and Department of Budget and Finance to provide the Legislature with the information necessary to make informed decisions; and
 - e. Fiscal personnel receive the training necessary to develop, and build the knowledge, skills, and abilities that are needed to perform their jobs competently.
2. The president of the University of Hawai‘i should ensure that:
 - a. The financial reporting system is enhanced to provide well-designed, accurate, and timely data, allowing efficient monitoring, analysis, and decisionmaking;
 - b. Established policies and procedures are updated in a timely manner to reflect current operating practices;
 - c. Contract maintenance and administration procedures are developed to ensure that all contracts are well organized and related contract information is readily available for increased efficiency; and
 - d. Contracts and agreements are executed and monitored in accordance with university policies and procedures and the Hawai‘i Public Procurement Code.

3. The University of Hawai'i's Office of Academic Planning and Policy and Budget Office should ensure that:
 - a. Principles are established for determining costs applicable to the actual cost per student calculation;
 - b. The methodology used is documented, including a detailed analysis, considering all variables factored into the formula, and the actual cost per student is calculated consistently from year to year; and
 - c. The Legislature is provided with the methodology and variables used to calculate the actual cost per student, as well as the rationale to interpret the results.
4. The University of Hawai'i's chief information officer should ensure that:
 - a. An overall information technology business continuity plan is developed; and
 - b. The application controls for the student information and human resources systems are formalized and documented.

Responses of the Affected Agencies

Comments on Agency Responses

On December 14, 2005, we transmitted a draft of this report to the interim president and the Board of Regents of the University of Hawai‘i. A copy of the transmittal letter to the interim president is included as Attachment 1; a similar letter was sent to the chair of the Board of Regents. The university’s response is included as Attachment 2. The board did not respond separately.

In its response, the university provided both general and specific comments to the audit, and strongly disagreed with the report’s overall conclusion. The university’s general comments suggest that the University of Hawai‘i at Mānoa is fiscally accountable because the financial statements of the University of Hawai‘i have received an unqualified opinion from its external auditors. This response indicates that the university does not fully understand the scope of the financial statement audit.

In conjunction with their report on the university’s financial statements, the university’s external auditors issued the *University of Hawai‘i Internal Control and Business Issues Report - June 30, 2004*. This report clarifies that the external auditors only considered the university’s internal controls in order to determine their auditing procedures for the purpose of expressing an opinion on the consolidated financial statements and “not to provide assurance on internal control.” In fact, the external auditors’ report noted several internal control matters that came to their attention during the course of their audit—some of which are considered “high risk.” One of the “high risk” internal control matters identified by the university’s external auditors shares our concerns relating to the university’s Budget Level Summary (BLS) reporting system. The findings in our report are also consistent with two other internal control matters relating to the university’s oversight of special fund expenditures (e.g., Tuition and Fees Special Fund) and disaster recovery procedures for information technology.

Furthermore, the university expressed concern over the “quality of work” reflected in the draft report and does not concur with a number of our findings. Despite the university’s objections, it does agree that there is room for improvement and claims that it is continually striving to do better. The university concurred with several of our recommendations and has begun implementing them, while disagreeing with others. The University of Hawai‘i also provided clarifying information, some of which we included in the final report.

The basis for the university's concern relating to the quality of our work is its assertion that we failed to ask for the university's funding priorities before developing a finding stating that this information had not been provided to the Legislature. However, we sent a memorandum, dated July 1, 2005, to the university requesting "copies of reports submitted to the Governor and Legislature by the University of Hawai'i Administration during the 2005 legislative session, specifically relating to the university's general and tuition funds, system of accounting and related internal controls, strategic and financial planning, and budgeting process." A similar request was also made to the Manoa campus for reports submitted by its administration. Another memorandum, dated August 16, 2005, was sent to the university and Mānoa campus specifically asking for the "University of Hawai'i System and University of Hawai'i at Mānoa biennium priorities for the FY2005-2007 biennium budget." Our consultant also verbally requested all budget information provided to the 2005 Legislature from the university's Budget Office. In spite of our requests, we were not provided with the letter, dated March 14, 2005, communicating the university's budget funding priorities to the Legislature until after the audit exit conference on December 13, 2005.

In any case, the letter does not contradict our finding; rather, it appears to support it. Our audit found that the University of Hawai'i at Mānoa could not readily provide its funding priorities to the 2005 Legislature. The university was notified of the governor's lump-sum appropriation of \$10 million and instructed to revise its budget narratives to reflect this decision in a letter, dated December 1, 2004, from the director of finance. The governor's decision was reflected in the executive budget submitted to the Legislature in late December 2004. The university did not provide the Legislature with the letter listing its funding priorities for the \$10 million appropriation until March 2005.

Moreover, the Legislature's repeated requests for budget information and the university's inability to provide the Legislature with its funding priorities in a timely manner illustrates our conclusion that the University of Hawai'i at Mānoa could not sufficiently justify its budget request to the Legislature. Also, the reconvening of the university's Budget Biennium Committee to identify these budget funding priorities in the weeks prior to the March 2005 communication corroborates our conclusion that the biennium budget request submitted to the Legislature was not prioritized.

Our audit assessed the University of Hawai'i at Mānoa's process of strategic planning and budgeting, use of general and tuition funds, and actual cost per undergraduate and graduate student for one academic year. Information included in the report was obtained from the

University of Hawai‘i’s and University of Hawai‘i at Mānoa’s documents and administration and staff. We stand by the conclusions in our report.

More specific responses to the University of Hawai‘i’s comments can be found on the following pages.

Responses to the University of Hawai‘i's general comments:

1. University comment: *We are concerned by the quality of work reflected, for example, by the failure of your staff to ask for budget funding priorities which had clearly been provided to the Legislature, before developing a finding asserting that they had not been provided to the Legislature.*

Auditor’s response: **Our audit focused on the University of Hawai‘i at Mānoa’s process of strategic planning and budgeting, use of general and tuition funds, and actual cost per undergraduate and graduate student for one academic year. We conducted our audit in compliance with *Generally Accepted Government Auditing Standards* and reached conclusions that are supported and credible based on the Mānoa campus’s current finances.**

With regards to the university’s claim that we failed to ask for its funding priorities, we sent a memorandum, dated July 1, 2005, to the University of Hawai‘i’s vice president for administration requesting “copies of reports submitted to the Governor and Legislature by the University of Hawai‘i Administration during the 2005 legislative session, specifically relating to the university’s general and tuition funds, system of accounting and related internal controls, strategic and financial planning, and budgeting process.” A similar request was also sent to the University of Hawai‘i at Mānoa’s acting vice chancellor for administration, finance, and operations for reports submitted by the Mānoa campus administration. We sent another memorandum, dated August 16, 2005, to the vice president and acting vice chancellor specifically asking for the “University of Hawai‘i System and University of Hawai‘i at Mānoa biennium priorities for the FY2005-2007 biennium budget.” Our consultant, the certified public accounting firm of Nishihama & Kishida, CPA’s, Inc., also verbally requested all budget information provided to the 2005 Legislature from the university’s Budget Office. However, despite these requests for information, we were not provided with the budget funding priorities referred to by the university until after our exit conference on December 13, 2005.

2. University comment: *The financial statements of the University of Hawai‘i are audited annually by external auditors. The reports of those external auditors have reflected an unqualified opinion that the financial statements of the University are fairly stated in conformity with generally accepted accounting standards.*

Auditor’s response: **We agree that the University of Hawai‘i’s external auditors expressed an unqualified opinion on the university’s consolidated financial statements. However, the report on the university’s financial statements is accompanied by the external auditors’ report on the university’s internal controls—*University of Hawai‘i Internal Control and Business Issues Report - June 30, 2004*. This report explains that the external auditors only “considered its [the university’s] internal control in order to determine our [their] opinion on the consolidated financial statements and not to provide assurance on internal control.”**

Moreover, the external auditors’ report notes several internal control matters and makes recommendations to help the university “improve internal control and achieve operational efficiencies.” We would like to point out that our report shares the external auditors’ concerns relating to the university’s Budget Level Summary (BLS) reporting system, considered by the external auditors to be of “high risk,” oversight of special fund expenditures (e.g., Tuition and Fees Special Fund), and disaster recovery procedures for information technology.

Responses to the University of Hawai‘i’s specific comments:

p.3

University comment: *We disagree with this finding. Budget decisions are results oriented. The budget instructions issued to the units required the preparation of program plans as well as requests for funding. In the plans, units were required to address effectiveness with regard to achieving program objectives and as applicable, comparison with comparable organizations.*

Auditor’s response: **Although our report recognizes the university’s efforts to improve its budget process through “stocktaking,” we maintain that the Mānoa campus’s budget decisions are not results-oriented. Performance measurement focuses on setting goals and outcomes, designing the strategies needed to meet the goals, and measuring performance against goals. These performance goals are then used to assess the efficiency and effectiveness of programs and to make resource allocation decisions.**

We found that the University of Hawai‘i at Mānoa has not been able to systematically analyze and use outcome data as part of the budget formulation process. In fact, Mānoa campus administration admitted that it does not actively practice performance-based budgeting. The Mānoa campus does not currently have a system for reporting unit performance, as recognized in the Mānoa Budget Advisory Group’s report. Further, we were informed that the university has only recently begun to develop performance measures for allocating tuition revenues. Without a system for reporting unit performance, the Mānoa campus’s claims that its budget decisions are results-oriented are questionable.

University comment: *With regard to the statement that a campus administrator characterized these measures as useless for program level decision making, this needs to be clarified.*

Auditor’s response: **When asked about the effectiveness of the performance measures in *The Multi-Year Program and Financial Plan and Executive Budget*, a Mānoa campus administrator responded that the measures provide a broad overview of campus activities and “do not provide program specific measures.” The administrator further indicated that the outcome information in the program and financial plan is “not totally” useful in preparing and justifying the campus’s budget or determining its budget allocation because they are “general in nature.” These statements appear to characterize these measures as being essentially useless for program-level decisionmaking.**

p. 4

University comment: *The basis for this finding is the State Auditor Staff’s incorrect belief that budget funding priorities were not provided to the Legislature during the session. This came to our attention at the exit conference on December 13, 2005. We found at that time that they had not inquired whether these priorities had been submitted to the Legislature during the session.*

Auditor’s response: **As discussed in the section on the university’s general comments, despite our requests for information, we were not provided with the budget funding priorities referenced by the university. The letter, dated March 14, 2005, communicating these budget funding priorities to the Legislature was not provided to our office until after the audit exit conference. The presentation of this letter does not contradict our finding. In fact, the communication appears to be in support of our finding.**

Our report states that, “During the 2005 legislative session, the University of Hawai‘i at Mānoa could not readily provide its funding priorities to the Legislature.” The budget requests of the University of Hawai‘i campuses were not prioritized during consolidation into the systemwide budget request. As a result, the university could not readily provide the Legislature with a list of funding priorities to justify the governor’s recommended appropriation of \$10 million in general funds for FY2005-06 to the University of Hawai‘i system. The university was notified of the governor’s lump-sum appropriation of \$10 million and instructed to revise its budget narratives to reflect this decision in a letter, dated December 1, 2004, from the director of the Department of Budget and Finance. The governor’s decision was reflected in the executive budget, which was submitted to the Legislature in late December 2004. The university did not provide the Legislature with information to support the \$10 million appropriation until March 2005—via the March 14th letter.

The Legislature’s repeated requests for budget information and the university’s inability to provide the Legislature with its funding priorities in a timely manner illustrates our conclusion that the University of Hawai‘i at Mānoa could not sufficiently justify its budget request to the Legislature. Further, the reconvening of the university’s Budget Biennium Committee to identify these budget funding priorities appears to support our conclusion that the biennium budget request submitted to the Legislature was not prioritized.

University comment: *In addition, we do not agree with the conclusion in the finding that not providing funding priorities would result in “The insufficient and ineffective use of resources....”*

Auditor’s response: **As our report explains, budgets are used to articulate a plan and associated goals in financial terms. The budget is therefore a means for measuring whether resources have been used in an efficient and effective manner. Therefore, without the necessary detail and support to properly justify budget requests, the University of Hawai‘i at Mānoa cannot ensure the efficient and effective use of its resources; nor would the Legislature be able to make informed decisions and hold the Mānoa campus accountable for the use of state resources.**

Further, the use of the word “insufficient” in the draft report is a typographical error and has been changed to “inefficient” in the final report.

p. 5

University comment: *The finding that “...according to Mānoa Budget Office personnel, there is no assurance that account codes are properly established because unit fiscal officers responsible for setting up account are not properly trained in the BLS account code attribute standards” is taken out of context.*

Auditor’s response: **During our audit, we were informed by several personnel of the Mānoa campus that errors in account code set up occurred as a result of the lack of adequate training and the high turnover of fiscal officers.**

p. 7

University comment: *The draft report asserts that University’s Administrative Procedures Manual (APM) has not been updated to include procedures related to the new ePurchasing system’s implementation. We disagree with this finding.*

Auditor's response: **Although the procurement procedures related to the ePurchasing system are reflected in the university's APM, the related disbursement procedures have not been updated. During our testing of disbursements from the general and tuition funds, we inquired with university personnel regarding the policies and procedures governing the cash disbursement process, and were referred to the university's APM. Upon our review of Section A8.800 of the Administrative Procedures Manual, *Disbursing/Preaudit and Payroll*, we noted that many of the sections have not been updated since the mid-1990's. In addition, we noted that the disbursement forms referenced in the APM were outdated and did not reflect the university's current operations.**

University comment: *Another finding in the draft report that we disagree with relates to segregation of duties. Pursuant to University Administrative procedures (APM) A8.250.9.a, each purchase must be authorized by a responsible official, i.e., the approving authority, in charge of the applicable program to certify that the purchase is consistent with the program it is intended to support. APM attachment 150.2, item b.28) further states that the approving authority must be someone other than the Fiscal Officer/ Purchasing Officer certifying as to fund availability. Frequently, the approving authority and the requisitioner will be the same individual, especially in the case of federally funded purchases for which the approving authority should be the Principal Investigator.*

Auditor's response: **Our report states that the functions of both initiating and approving a purchase should be segregated to prevent the inappropriate use of funds. As the university's comments assert, this is required by the university's policies and procedures. However, the university sometimes places reliance on the fiscal officer to ensure that purchases are proper. As the university points out, the fiscal officer certifies as to the availability of funds and ensures that the purchase is in compliance with university policies and procedures. As fiscal officers may not be familiar with program requirements, they should not be placed in a position to review the appropriateness of purchases.**

p. 8

University comment: *We do not agree with this finding. There is financial monitoring at aggregate levels, by unit and fund. This enables the Vice Chancellor of Administration (VCA) to monitor how the allocations are being spent. Detailed expenditure information, unless needed for a specific purpose or to satisfy a specific request, is not necessary at the central administrative level. How much a unit spends for office supplies, equipment, etc. is not relevant to performance evaluation.*

Auditor's response: **The only campus-wide financial report regularly available to the University of Hawai'i at Mānoa is the BLS report, which the university claims "was not developed as a department-level management tool."**

As our report states, the university developed the BLS reporting system in response to its external auditors' recommendation that, all campuses and their units work with university management to develop reports that provide accurate and reliable financial information for analytical analysis and decisionmaking. The findings in our report regarding the BLS system echo the concerns of the university's external auditors. In the *University of Hawai'i Internal Control and Business Issues Report - June 30, 2004*, the external auditors recommended that the university continue to refine its internal reporting practices by ensuring that budgetary information reported on the BLS reports reconciles to the university's annual budget, and increasing the level of training provided to management and fiscal officers on how to effectively use BLS reports. The external auditors note that this training should "emphasize regular use of the BLS reports to make prudent business decisions."

p. 9

University comment: *The auditor noted one instance in which it asserts that the Office of Procurement and Real Property Management (OPRPM) was inappropriately bypassed. We disagree with the assertion regarding this situation.*

Auditor's response: **We stand by the statement made in the report. Ironically, despite the university's disagreement with this assertion, it details the corrective actions taken to ensure that this incident is not repeated.**

p. 10

University comment: *Of critical importance is the fact that the documentation oversight did not affect the validity of this sole source procurement action and it is misleading to suggest that this particular documentation oversight is a cause for great concern over Mānoa's overall use of contract modifications as the comment suggests.*

Auditor's response: **The fact remains that the contract modification was not performed in accordance with the university's policies and procedures. Internal controls over procurement were established by the university to ensure the proper use of state funds. Therefore, it is distressing that the university feels its noncompliance with its own policies and procedures, especially with a transaction of this amount (\$525,000), is not a cause for great concern.**

p. 11

University comment: *The audit comment is somewhat inaccurate, very misleading, and fails to consider the context and circumstances surrounding the reason for the service order. It is important to understand the circumstances which necessitated the use of RCUH to expedite the processing of transactions.*

Auditor's response: **The Internal Agreement between the university and the Research Corporation of the University of Hawai'i (RCUH) specifically states that RCUH may not be used merely to circumvent statutes, board policies, contracts, or regulations. As the university's comments repeatedly suggest, the university used RCUH to circumvent standard procurement procedures in order to expedite the project. In its comments, the university lists the conditions under which the use of RCUH is justified; however, none of the conditions make any reference to time constraints.**

p. 13

University comment: *The statement that UH does not consistently compute the cost per student is misleading.*

Auditor's response: **We disagree that the statement, "...the University of Hawai'i does not consistently compute the actual cost per student," is misleading. Our report explains that the university was only able to provide the actual cost per student for academic years 2004, 2001, and 2000 in response to our request for the past five years of cost information. As the university's comments to our draft report confirms, the cost model is performed only when needed for tuition planning purposes. Furthermore, our report provides that the university used a slightly different methodology to calculate the actual cost per student for academic years 2000 and 2001—academic year 2004 is based on the university's current cost model.**

University comment: *Contrary to this finding, efforts are made to ensure the reliability of data used for the calculation. While these efforts may appear to be minimal from an auditing standpoint, they are adequate to ensure that the reliability of the cost study is sufficient for its intended purpose. These efforts include matching expenditure data to year end fiscal reports which are subsequently audited.*

Auditor's response: **Our audit found that data used in the cost per student calculation is manually extracted and reported without regard for its reliability and accuracy: 1) employees responsible for the calculation do not believe that it is important for the cost per student information to be accurate; 2) the university does not have a review process to validate the data in the manually prepared expenditure report or the cost per student calculation; and 3) the university does not have any formal guidelines or policies and procedures for the preparation of the expenditure report or calculation of the actual cost per student.**

The university points out that the cost per student is calculated for "...the internal process of tuition setting." The university also indicated that the cost information was provided to the Legislature. As such, we believe that a review process to validate the data in, and formal guidelines for, the preparation of the expenditure report and calculation of the cost per student are important to ensure the calculation's reliability.

p. 14

University comment: *With regard to data from the student information system, these data undergo rigorous verification, and it is unclear how the auditor's [sic] arrived at the conclusion that "the University makes no effort to ensure the reliability of the data used in the calculation."*

Auditor's response: **According to the university's comments, the university appears to have misunderstood our conclusion. The report explains that the university uses data from two reports to determine the actual cost per student. One of the reports uses data taken directly from the student information system and provides student enrollment figures needed for the calculation. The other report is developed using an Excel spreadsheet and provides expenditure information that is manually extracted from the university's financial information system. Student enrollment and expenditure information taken from the two reports is then inputted into another Excel spreadsheet used to allocate and aggregate expenditures and calculate the actual cost per student. In reviewing this process, we found that data is manually extracted and reported without regard for its reliability and accuracy.**

University comment: *While we agree that documentation needs improvement, the statement that the University's management is inattentive to application controls is unfounded, with substantial evidence to the contrary.*

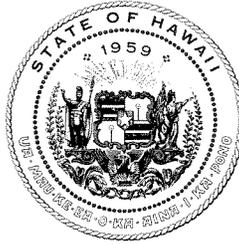
Auditor's response: **Application controls require organizations to have formal policies and procedures for data entry, data integrity and accuracy, data validation, and error detection and correction. However, in reviewing the application controls over the student information and human resources systems, we found that the university does not have any such policies and procedures. Thus, the university's inability to produce formalized application controls for these systems, years after their implementation, appears to be evidence of the university's inattentiveness.**

p. 15

University comment: *There is no evidence that any lack of documentation of the application control environment has compromised the integrity of any of the data referred to in the draft report.*

Auditor's response: **We acknowledge that the report does not contain any specific examples of data inaccuracies caused by the university's lack of formalized application controls for the student information and human resources systems. However, the absence of documented application controls can lead to an ad hoc, individual approach to ensuring data accuracy with very little consistency and integration across the organization. As such, the university cannot ensure the accuracy and completeness of the data processed, maintained, and reported by these systems.**

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

December 14, 2005

COPY

The Honorable David McClain
Interim President
University of Hawai'i
Bachman Hall
2444 Dole Street
Honolulu, Hawai'i 96822

Dear Dr. McClain:

Enclosed for your information are three copies, numbered 6 to 8, of our confidential draft report, *Systemwide Financial Audit of the University of Hawai'i System: Phase I*. We ask that you telephone us by Friday, December 16, 2005, 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 Monday, December 19, 2005.

The University of Hawai'i Board of Regents, Governor, and presiding officers of the two houses of the Legislature have also been provided copies of this confidential draft report.

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

Sincerely,

Marion M. Higa
State Auditor

Enclosures



UNIVERSITY OF HAWAII

David McClain
Interim President

December 19, 2005

The Honorable Marion Higa, State Auditor
State of Hawaii, Office of the Auditor
465 S. King Street, Room 500
Honolulu, Hawaii 96813-2917

RECEIVED

2005 DEC 19 PM 4:00

OFF. OF THE AUDITOR
STATE OF HAWAII

Dear Ms. Higa:

Thank you for the opportunity to comment on the findings and recommendations in your draft report, "Systemwide Financial Audit of the University of Hawaii System: Phase I."

We acknowledge your staff's effort to fulfill the purpose of the request made in House Concurrent Resolution No. 213, 2005 Regular Session.

We have attempted to address each of the findings and recommendations in the draft report in the three business days provided us. For ease of reference, we have maintained the order of the findings and recommendations as presented in the draft in presenting our responses. Where the facts presented in the findings are incorrect or incomplete, we have so indicated, and we request the information we have provided be used in the final form of your report. We are concerned by the quality of work reflected, for example, by the failure of your staff to ask for budget funding priorities which had clearly been provided to the Legislature, before developing a finding asserting that they had not been provided to the Legislature.

While we do not concur with a number of the findings and conclusions in the report, we do agree there is room for improvement. Indeed, we are continually striving to do better. This has been reflected in our reports to the Board of Regents and its Audit Committee on the numerous financial and compliance audits we undergo each year and our actions resulting from those audits. We appreciate those instances where our efforts and progress have been acknowledged in your report.

Notwithstanding the foregoing, **we strongly disagree with the draft report's overall conclusion** that "the University of Hawaii at Manoa cannot fully ensure fiscal accountability." The financial statements of the University of Hawaii are audited annually by external auditors. The reports of those external auditors have reflected an unqualified opinion that the financial statements of the University are fairly stated in conformity with generally accepted accounting standards. In addition, no material weaknesses in internal controls have been reported as a result of those audits, which have been performed in accordance with generally accepted auditing standards and Government Auditing Standards.

We also disagree with your summary findings. It is in fact the case that:

- The University of Hawaii at Manoa's budget **is** adequately founded.
- The University of Hawaii at Manoa **does** provide an accurate picture of its overall fiscal condition.
- The University of Hawaii calculation of cost per student **has substantial value** for the purposes for which it is intended.

The following sections of this letter provide our detailed responses to the findings and recommendations in the report.

"The University of Hawaii at Manoa's Budget Is Not Adequately Founded"

We do not agree with this conclusion. The University of Hawaii at Manoa's budget request documents that are submitted to the Governor and Legislature are prepared in strict compliance with Part IV. of Chapter 37, Hawaii Revised Statutes. As required by this statute, these documents are reviewed and approved by the Governor and the Department of Budget and Finance and incorporated into the Executive Budget Request that is submitted to the Legislature. In addition, HRS §304-4.5, requires the Board of Regents to establish additional performance measures in the form of benchmarks in order to monitor progress towards the achievement of certain state objectives established by the Legislature for the University. These objectives include the expansion and development of the University of Hawaii into "...a statewide campus that provides Hawaii with a higher education system designed to meet the future needs and demands of the citizens of the State, and to capitalize on the university's unique resources and location to become an international educational, research, and service center known both in the United States and throughout the Pacific/Asian countries." The University is also required to conduct "...a periodic review of all instruction, organized research, public service, academic support, student services, and institutional support programs at each campus to determine whether the programs are operating for the purposes originally established and not inconsistent with the benchmarks..." A report to the Legislature on the University's findings is required in the second year of each fiscal biennium. To the best of our knowledge, no other state department or agency is mandated to provide such an extensive array of performance and effectiveness measures in support of their current operations and budget requests to the Legislature and by extension, to the general public.

We do agree with the statement made in the report: "To achieve the plan, deans and directors responsible for implementing plans and budgets need to have sufficient authority for determining the best financial means of accomplishing the objectives."

"The University of Hawaii at Manoa's base operating budget is not substantiated"

As previously stated, the University complies with Hawaii Revised Statutes and the procedures set forth by the Department of Budget and Finance in preparing its budget.

While there was no in-depth review of the unit's current service base budgets, it is noted that for FY 2005, out of the \$194M general fund allocation, \$191M was expended for payroll. Constraints imposed by collective bargaining contracts make it difficult to reallocate funds within and between units. In FY 2005, tuition funds were only 23% of the total operating budget allocation and were used primarily to fund operational expenses such as utilities, R&M, office supplies, etc.

Other actions by the Executive and the Legislature such as restrictions which were subsequently made permanent, under-allocating collective bargaining requirements and assessment of efficiency savings have eroded the base budgets of the units, making reallocation difficult, if not impossible. Internal reallocation of funds were required of the units to meet the shortfalls caused by these adjustments. As a result, permanent positions were kept vacant to cover the shortfalls. In the FY 2005-07 biennium budget, 162 permanent FTE were cut from the Manoa base budget due to the lack of funds.

"The budget is based on prior funding levels and program change requests"

The budget instructions from the Executive do not require justification of the current service budget. What is received is a funding ceiling for current service which cannot be exceeded. The instructions from the Legislature do not require justification of the current service base, although, during the review of the budget by the higher education, finance and ways and means committees, numerous requests for information on specific aspects of the base are received and responded to.

In the internal Manoa budget preparation process for the FB 2005-07 Budget, instructions were issued by the Chancellors Office which required the units to submit their budget request in two levels, current services and workload /program change requests. As part of the preparation process, units were required to consider negative adjustments to the current service base for low programs for reallocation to higher priority programs before requesting additional funds and were informed that this process would be a part of the evaluation of the total requests.

"Budgetary decisions are not results oriented"

We disagree with this finding. Budget decisions are results oriented. The budget instructions issued to the units required the preparation of program plans as well as requests for funding. In the plans, units were required to address effectiveness with regard to achieving program objectives and as applicable, comparison with comparable organizations. They also were required to address operational efficiency. Program change requests had to include the intended objectives and outcomes, clientele to be served and operational efficiency.

The plans were not part of the budget preparation submittal requirements to the BOR, Executive and the Legislature. They were used only in the internal review of the budget. No requests were made by the Executive or the Legislature for these plans.

With regard to the objectives and measures of effectiveness that are included in the Multi-Year Program and Financial Plans and Executive Budget, Manoa did respond to questions from the Legislative Auditors Office in preparation of the audit. With regard to the statement that a campus administrator characterized these measures as useless for program level decision making, this needs to be clarified. Three questions were asked specifically about the measures:

- 1) how effective are the measures;
- 2) does the university consider the information useful in preparing and justifying its budget; and
- 3) is the outcome information used to determine the university's budget allocation.

The written response to these questions, provided by the VCA, were as follows:

- 1) The Program and Financial Plans allow a limited number of measures. Because there are so many programs and activities on the Manoa campus, the measures are general in nature and basically give a broad overview of campus activities. They do not provide program specific measures;
- 2) Not totally because they are so general in nature; and
- 3) Not totally because they are so general in nature.

The response was not that the measures are useless. Some of the measures, at an unaggregated level such as enrollment at the unit level are given consideration in the budget preparation and allocation process. Because there are so many units and subunits which are impacted by enrollment, it is not possible to include in the PFPs the data for each one.

“The University of Hawaii at Manoa could not sufficiently justify its budget request to the Legislature”

The basis for this finding is the State Auditor Staff’s incorrect belief that budget funding priorities were not provided to the Legislature during the session. This came to our attention at the exit conference on December 13, 2005. We found at that time that they had not inquired whether these priorities had been submitted to the Legislature during the session. We immediately sent to them that afternoon, prior to the issuance of the draft report the next day, copies of the communication with the University’s priorities that had been transmitted on March 14, 2005 to the Senate President, the Speaker of the House, the Senate Ways and Means Committee Chair, the House Finance Committee Chair and the Senate and House Higher Education Committee Chairs. We have again attached copies of this transmittal for your reference.

Based on the incorrect factual basis, we disagree with the finding. In addition, we do not agree with the conclusion in the finding that not providing funding priorities would result in “The insufficient and ineffective use of resources.....”

“The budget request underwent a long, internal review process”

We agree, and we appreciate the acknowledgement of our thorough and consultative process.

“The University of Hawaii at Manoa could not provide the Legislature with a list of funding priorities”

As previously indicated, we have provided evidence that a list of funding priorities was in fact provided to the Legislature during the session.

“Efforts to restructure the University of Hawaii at Manoa’s budget process is in its infancy”

We appreciate the acknowledgement of our efforts in this area and agree that there is more to be done. Implementation of budget reform at Manoa is on schedule and is proceeding according to the original plan. As presented at Manoa’s Planning Day Event (October 2005) and to the Board of Regents at their November 2005 meeting, implementing the recommendations

of the Manoa Budget Advisory Group would take place over several years beginning in January 2005. The goal during the first year was to achieve transparency in reporting. Towards that end we are now able to track expenditures and allocations through FMIS at the department level. The web based information center is in development and will be ready in time for our spring budget hearings. Personnel codes are being updated to reflect current organizational structure. More importantly, we are changing the way personnel information is inputted into our human resources system allowing us the ability to collect personnel data and financial data using FMIS codes. We have established a budgeting task force charged with developing performance metrics which can be used to allocate tuition revenue. We anticipate that Phase one of this project will be rolled out July 2006.

“The University of Hawaii at Manoa Cannot Present an Accurate Picture of its Overall Fiscal Condition”

We disagree with this conclusion. Manoa has the ability to examine allocations, expenditures and encumbrances at the Manoa level, at the School/College level and at the Department level for all fund sources.

“The University of Hawaii’s budget report is an inadequate management tool”

The BLS system was not developed as a department-level management tool. It was developed to provide system-wide budget to actual expenditure data, by source of funding, at the broad expense categories of payroll and non-payroll aggregated at the campus or college level only. Detailed expenses categories (i.e. equipment, supplies, etc.) account code information are rolled up in the BLS system to the payroll and non-payroll categories. The finding that “... according to Manoa Budget Office personnel, there is no assurance that account codes are properly established because unit fiscal officers responsible for setting up account are not properly trained in the BLS account code attribute standards” is taken out of context.

There is a difference between account codes and expenditure object codes. The account codes in BLS are the general/subsidiary ledgers to which expenditures are charged. These accounts are established by the unit fiscal personnel. The object of expenditure codes are those noted above, equipment, supplies, etc. The codes that were referenced by the Manoa Budget Office are the account codes not the objects of expenditure codes and related to errors that may be made in establishing the accounts which could result in improper mapping of expenditures to the correct account, not object.

To assess the overall status of expenditure of funds appropriated to Manoa at the central administrative level, the reports provided by BLS are sufficient. At the aggregate program and fund level, the information provided includes the program allocations, expenditures to date and projected expenditures for the balance of the year for the general and tuition funds. This is sufficient to determine how programs are expending. What they are expending on is not a consideration at this level.

The unit deans and directors were delegated the authority to manage their allocations, with the stipulation that expenditures shall not exceed them. The expenditure details at the object of expenditure level are kept by the unit fiscal personnel. As indicated previously in this report, “To achieve the plan, deans and directors responsible for implementing plans and

budgets need to have sufficient authority for determining the best financial means of accomplishing the objectives.”

From a system perspective, the recently implemented BLS system of reports and various financial reports and statements produced by the Financial Management Information System (FMIS) provides an appropriate amount of detail on the overall financial condition of the Manoa campus operations down to the major unit level for the system administration and Board of Regents to review and monitor each campus.

“Information in the report is not reconciled to the university’s budget and Financial Management Information System”

This finding is incorrect. Fiscal personnel reconcile the BLS expenditure data against FMIS summary reports, transaction reports, special summary files prepared by the accounting office, and for units that maintain one, data in their separate system. As discussed in the exit meeting, there is no formal requirement that the units document that the accounts were reconciled. The system does identify when the expenditure plans were last updated but that is not a confirmation that the accounts were reconciled. The variance component of BLS which requires an explanation of any significant variance is an indication of reconciliation but not confirmation. Without reconciling the expenditure data to ensure that it is correct, it would not be possible to accurately complete this requirement.

“The University of Hawaii at Manoa does not have formal policies and procedures for correcting reporting errors”

This finding is correct in that there are no written instructions stating what needs to be done. However, during their reconciliation, if errors are found, action is taken by the fiscal staff to correct them. If the errors are internal and correctable, i.e. expenditures are reflected in incorrect accounts, JVs are prepared to transfer the expenditure to the correct account. If it is a mapping problem, the ITS analyst and/or the Manoa Budget Office is contacted who in turn refers the fiscal officer to the appropriate person to rectify the problem, usually the University Budget Office or the ITS support analyst. These actions are done despite the lack of written policies or instructions.

“Lax controls over the general and tuition funds may lead to inappropriate fund usage”

We concur with certain of the following specific findings supporting this conclusion and disagree with others, as indicated in the specific responses below.

“Policies and procedures for the tuition funds are in draft form while others need updating”

The draft policies and procedures for the Tuition and Fees Special Fund will be formally implemented as soon as possible. However, it should be noted that in the absence of formal internal policies and procedures, the relevant statute (§304-16-5, HRS) would prevail. Therefore, the risk that funds may not be used as intended by law would not be significantly enhanced by the formal adoption of an internal policy that would in effect, merely restate permissible expenditures as specified in existing statute.

The draft report asserts that University's Administrative Procedures Manual (APM) has not been updated to include procedures related to the new ePurchasing system's implementation. We disagree with this finding. The University's ePurchasing system is an electronic processing tool which enables users to electronically generate standardized requisition and purchase order forms previously prepared on hard copy, carbon forms. Accordingly, the ePurchasing user guide, which is referenced in APM, Section A8.250, Provision No. 11, does not serve to provide any new or updated procurement policies or procedures but is primarily intended as an operator's/user guide. The procurement procedures set forth in the APM would still govern basic procurement responsibilities, controls and practices. The APM governing University purchases has been approved by the University Board of Regents.

In addition, the report notes that purchases under \$25,000 can be processed without proper authorization and stated that "This flaw in the design of current operating procedures could allow unit fiscal offices to bypass appropriate approvals for purchases of up to \$25,000."

The University is in compliance with its Administrative Procedures Manual with respect to processing payments under \$25,000 for departmental fiscal officers as summarized below.

University Executive Policy E8.107 Authority to Execute Contractual Documents for Procuring Goods, Services and Construction delegates to Vice Presidents and Chancellors authority to execute contractual documents for procuring goods, services, and construction in amounts designated therein. This authority has been further delegated to fiscal officers of departmental units under their direction and jurisdiction. Only University personnel specifically delegated purchasing authority as set forth above are authorized to commit the institution contractually and only within the limits of their purchasing authority.

Under this delegated authority Fiscal Officers and Program Managers (Approving Authority) are responsible to ensure that all encumbrance and payment transactions are in compliance with applicable Federal and State laws, rules, regulations, and University policies and procedures. Appropriate supporting documentation is to be maintained in office files. Fiscal Officers and Program Managers are responsible for fiscal transactions processed on all accounts under their purview.

Fiscal Officers and Program Managers (Approving Authority) are to review all encumbrance and expenditure reports to ensure that only appropriate transactions (no unauthorized charges) have been processed against accounts within their purview.

The Disbursing Office propriety/legality pre-audit review is directed toward the appropriateness of the payment in consideration of program or Legislative intent and applicable Federal and State laws, rules, regulations, and University policies and procedures. The Disbursing Office also conducts training/compliance reviews with Fiscal Officers to enhance the compliance effort and payment processing efficiency.

Another finding in the draft report that we disagree with relates to segregation of duties. Pursuant to University Administrative procedures (APM) A8.250.9.a, each purchase must be authorized by a responsible official, i.e., the approving authority, in charge of the applicable program to certify that the purchase is consistent with the program it is intended to support. APM attachment 150.2, item b.28) further states that the approving authority must be someone other than the Fiscal Officer/Purchasing Officer certifying as to fund availability. Frequently, the

approving authority and the requisitioner will be the same individual, especially in the case of federally funded purchases for which the approving authority should be the Principal Investigator. In accordance with APM 18.250.9.b. all purchases must be signed by a fiscal officer who will certify as to availability of funds to pay for the goods, services, or construction, and that the purchase is in accordance with applicable University policies and procedures. Therefore, departmental purchasing duties are, at minimum, divided between the approving authority, who certifies that the purchase is appropriate for the program, and the fiscal officer, who certifies that the purchase is in accordance with policies and procedures and that funds are available.

“There is no formal monitoring of program financial information”

We do not agree with this finding. There is financial monitoring at aggregate levels, by unit and fund. This enables the Vice Chancellor of Administration (VCA) to monitor how the allocations are being spent. Detailed expenditure information, unless needed for a specific purpose or to satisfy a specific request, is not necessary at the central administrative level. How much a unit spends for office supplies, equipment, etc. is not relevant to performance evaluation. If needed, this information is extracted from the FMIS data warehouse.

The VCA Office downloads financial information from the warehouse by unit, fund and object of expenditure. Historical data has been compiled in this format for all units. This information was extracted from FMIS, not BLS or the “shadow systems”.

“Programs are allowed to exceed their approved allotments”

This finding is correct. However, as noted in the finding, the control is implemented at the campus level. While FMIS has the capability to prevent expenditures from exceeding quarterly allotments, this is enabled only at the campus, not unit level. It was never intended that unit expenditures exactly match their projections, as they are estimates. Situations arise where unforeseen expenditures have to be made in addition to or in lieu of those projected. Generally, where some units exceed their projected expenditures, others will expend less than their projections. A situation where there is a lack of funds for required costs for one unit due to another unit overspending their allotment would arise only if the total allocation was exceeded, not the quarterly allocation. If this situation were to arise, action would be taken to have that unit reverse the over-expenditure.

“Contracts are not properly executed and monitored”

While we accept certain of the following specific findings below, we disagree with the overall conclusion.

“The University of Hawaii at Manoa cannot ensure the propriety of contracts and agreements reviewed”

The Auditor commented that the Manoa campus violated established procurement and disbursement procedures and made questionable use of contract modifications. Our comments with respect to these findings follow:

Natural Sciences purchase – The College of Natural Sciences was unsure of the status of the University's contract for scientific/laboratory products and supplies with a vendor which was entered into through competitive bidding. Previously, the College had requested that the University contract with the vendor for chemicals and laboratory supplies be extended. Although the University attempted to extend the vendor's contract, the contractor did not agree to the contract extension. In the meantime, the purchase in question was made by the College from the vendor based on pricing in place under the prior contract instead of obtaining new quotations.

Payment to University of Hawaii Foundation - The auditor noted one instance in which it asserts that the Office of Procurement and Real Property Management (OPRPM) was inappropriately bypassed. We disagree with the assertion regarding this situation. The UH Disbursing Office contacted OPRPM to confirm the existence of a contract before processing the payment. The University's APM Section A8.861, Authorization for Payment Forms states that Authorizations for Payment Forms (AFP) can be used to process direct payments and should not be used to circumvent established methods to procure goods and services through the use of the basic procurement documents such as the purchase order, services contract, formal contract, etc.

In the case of the aforementioned AFP payment to the University of Hawai'i Foundation, the Disbursing and Payroll Office confirmed that a formal contract had been properly executed by the Office of Procurement and Real Property Management (OPRPM) with the University of Hawai'i Foundation for the services specified, and that the AFP was appropriate to the terms and conditions of the contract. Furthermore, the Disbursing and Payroll Office ensured that the contract number was clearly referenced on the AFP form and the supporting invoice and documentation. Subsequently, in March 2005, after that single incident, Disbursing and Payroll Office took immediate action to ensure that any such payments made by other University programs for the services provided by the University of Hawai'i Foundation under this contract were to be processed in a consistent manner. Disbursing and Payroll Office has since rejected any additional AFP documents submitted for payment under the subject contract and has directed all programs to submit an FMIS Form 41, Contract Encumbrance and Payment Form to OPRPM for purposes of encumbrance and payment processing.

JABSOM building maintenance services - Because the finding fails to specify the particular form involving the service provider, we are unable to respond to the finding as drafted. In light of the fact that the University enters into many contracts with companies incorporated and located outside of Hawaii, we are puzzled by the reference to a form that would require a service provider to be incorporated in Hawaii as noted in the finding.

Emergency flood procurement contract – Actions relating to the subject contract to address the damage sustained from the October 2004 flood were overseen directly by the Vice President for Administration. Under Executive Policy E8.105, the Vice President for Administration has been delegated authority to carry out the responsibilities relating to the acquisition of goods, services, and construction which would include the approval of emergency procurements. The contract in question was approved by the Vice President for Administration prior to the contract being entered into by the Manoa campus.

JABSOM medical library – The subject contract was executed by the University to provide medical library services to the faculty and students of the College of Health Sciences and Social Work, and the Medical School for the period July 1, 2003 through June 30, 2004, with the option for the contract to be renewed annually for a total of five years. The modification cited above

was executed to exercise the option of extending the contract beyond the first year until March 31, 2005.

The failure to document whether the service still met the criteria for a sole source procurement was a documentation oversight based on an assumption by the Medical School that the sole source justification for the original contract applied to subsequent modifications provided that the nature of the service did not change.

Of critical importance is the fact that the documentation oversight did not affect the validity of this sole source procurement action and it is misleading to suggest that this particular documentation oversight is a cause for great concern over Manoa's overall use of contract modifications as the comment suggests. The key fact underlying this transaction is that circumstances supporting the sole source justification had not changed since the original contract was executed and, in fact, these circumstances have never changed over the life of the service which started in 1974. It was commonly known that this private entity was the principal source of medical reference material for the State of Hawaii and the only entity in the State that could provide the services and reference materials sufficient to ensure accreditation of the Medical School and other health science Schools in the University. This fact was the crux of the sole source justification provided with the original contract procurement documentation.

It should be noted that as of April 1, 2005 the University is now able to provide this service in-house and the private entity which previously provided this service has been dissolved. Thus, this service will no longer be contracted.

Audit contract modification - This finding refers to a contract managed by the UH System rather than Manoa. The U.S. Department of Education (ED) issued Preliminary Audit Determination Letters (PADL) to the University regarding Title IV Student Financial Assistance (SFA) findings reported in the PricewaterhouseCoopers OMB Circular A-133 compliance report for the years ended June 30, 2003 and June 30, 2004. The PADL required the University to provide additional documentation to ED by June 30, 2005 in order for ED to issue a Final Audit Determination and authorize continued participation in Title IV SFA programs. The PADL also required that PricewaterhouseCoopers attest to the accuracy and completeness of the information provided by each campus. Due to the stringent deadline of June 30, 2005 and the PADL requirement that PricewaterhouseCoopers perform the review, the University modified its current contract with PricewaterhouseCoopers for the additional audit work.

JABSOM disbursement to RCUH - The Internal Service Order Form for the \$100,000 transfer to RCUH did, in fact, have a justification for the use of RCUH. Documentation on the form is as follows:

"With the occupancy of Phase I of the Kaka`ako Campus in April 2005, infrastructure development, including telecom & other facilities-related infrastructure projects will commence. These projects are on-going and difficult to manage due to the continuous changes made to the scope of work on various projects. Construction in on-going and new projects related to the Phase I Admin/Education and Phase II Research buildings will continue to be developed and implemented. The use of RCUH will enable the School to meet the changing needs of various infrastructure development projects planned for the campus."

The documentation also referenced the back of the form which provides and excerpt of Article I of the internal agreement of July 1, 1996 between the University and RCUH, as follows:

**“ARTICLE I– APPROPRIATE UNDERTAKING and
SERVICES to be PROVIDED the UNIVERSITY by The CORPORATION**

As directed by the UNIVERSITY, the CORPORATION will provide certain services to be rendered in connection with a given research contract or grant. The conditions under which the UNIVERSITY may choose in any given project to utilize the services of the CORPORATION are:

- (a) Projects involving private organizations, or*
- (b) Projects in which there are unusual procurement problems, such as major items of special equipment, or complex equipment construction, or*
- (c) Projects in which much of the operation will lie outside the State, or*
- (d) Projects in which there are human resource problems which might be handled more effectively outside the State or UNIVERSITY personnel system, or*
- (e) Projects in which there is a substantial amount of shop operations, technical shop-type operations, computer services, etc., or*
- (f) Projects involving research facility management where any combination of the above mentioned problems exist, or*
- (g) Projects in which other special problems are present that may be better resolved through the services of the CORPORATION.”*

The documentation on the form referenced item (f) as stipulated above.

The audit comment is somewhat inaccurate, very misleading, and fails to consider the context and circumstances surrounding the reason for the service order. It is important to understand the circumstances which necessitated the use of RCUH to expedite the processing of transactions. The Manoa flood of October 2004 hastened all planning activity for Kakaako in order to ensure that the vast number of Medical School personnel that were dislocated from the Biomedical Sciences Building at Manoa due to the flood damage could be accommodated as soon as possible at the new Kakaako facilities. We had many dislocated people in temporary space in downtown, at Manoa, and even at their homes. The move-in schedule for Kakaako was pushed up to minimize the down time of research and educational activities as much as possible. At the same time, the University Office of Procurement and Real Property Management was severely back-logged because of all of the transactions that needed to be processed for the greater University's effort to address the needs of all Manoa flood victims and facilities. The bottom line is that we had to get the job done to avoid any further losses in productivity and maintain the integrity of our academic programs. It was imperative that we moved fast on a number of fronts to adequately prep for the operations of the new facilities and using RCUH for certain fiscal flexibility made it happen. It was an emergency situation and we responded in the most effective may we felt was possible.

Expenditures made out of the RCUH relate to preparing for the start-up of the operations of the new Kakaako facilities. We needed to move fast with procurement and personnel actions to have Kakaako ready and functioning at full capacity once people started moving in. The Medical School needed to fast track numerous projects like coordinating moves, space usage planning, addressing special requirements related to an EDA grant for biotech incubator space, and setting up of many other ancillary and facility services. Other activities involved building the administrative, operating, and information technology infrastructure to be ready to run the new Kakaako facilities once it was put in service.

The service order was later increased from \$100,000 to \$500,000 as additional funds were needed to support the ongoing activities described above as they progressed over time.

“The University of Hawaii at Manoa lacks formal procedures governing the maintenance and organization of contracts”

The Auditor also noted that The Office of Procurement and Real Property Management does not have established contract maintenance procedures and that the office did not have a consolidated listing of contracts for the Manoa campus.

The Office of Procurement and Real Property Management (OPRPM) maintains its files on a system-wide basis and not by specific campuses. All contracts (including procurement, concession, etc.) are logged and specific contract data may be extracted. In response to the auditor’s specific request for contract data, an OPRPM staff member did perform a query of all FMIS contract encumbrances made in FY 2005 and the resulting report was submitted to the auditor’s representatives. This report was not compiled from individual listings maintained by the various contract specialists as indicated in the audit report above.

Notwithstanding the above, the OPRPM will work toward a consolidated database dedicated only to the University’s contracts. A contract sub-module which will include contract numbering and tracking is included in the list of future enhancements to the ePurchasing system.

“The University of Hawaii’s Calculation of the Manoa Campus’s Actual Cost Per Student Has Limited Value”

We would agree with this conclusion with the clarification that the University’s cost study is sufficient for the purposes for which it was developed and the ways in which the University uses it, in particular, as part of the tuition setting process.

“The lack of an industry standard diminishes the calculation’s use as a benchmark”
“Each Institution develops its own method of calculating the cost per student”

We agree with the statement that each institution develops its own method. The state auditor’s report provides a thorough and timely discussion of the nationwide efforts to produce comparable information on the cost of education. Their conclusion that the “lack of an industry standard diminishes the calculation’s use as a benchmark,” is accurate. It is for this reason that the University does not use the costing model as a benchmark relative to other institutions. The use of the model is limited to the internal process of tuition setting. According to BOR policy, the share of the cost of education that is covered by tuition is one factor to be considered in the establishment of the tuition schedule. Thus, the cost model is run each time a new schedule is established but not on a routine basis.

Each of the issues raised by the auditors, (the proportional allocation for research and service, the calculation of full-time equivalents, and the elements included in the model) is clearly addressed in the documentation of the model provided to the auditors. It is the case that

approaches to these issues may vary by institution, but UH's approach is clear and has been consistent over time.

"The University of Hawaii divides total expenditures by the total full-time equivalent enrollment"

The description of the costing methodology used by UH provided in the auditor's report is accurate. The statement that UH does not consistently compute the cost per student is misleading. As noted above, the estimated cost per student is calculated each time a new tuition schedule is established in keeping with BOR policy. Because a five year schedule was approved for 2000-2005, and a six year schedule was approved for 2006-2012, the model was run as needed to establish those schedules. It is not run every year, because it is not needed for the purpose for which it is intended. In fact, running the model on an annual basis would likely produce modest variation. Instead, the expenditure study which provides the expenditures per student semester hour by unit is conducted annually by the Budget office. The definitions used in the study are provided and the study is posted on the web.

"University spending is based upon institutional priorities and available resources"

The auditor provides a thoughtful comment on the variances in expenditures that result from the differences in campus mission and the differences in expenditures demanded by the differences in disciplines, priorities, and resources. The differences in the cost per student by campus within the UH system demonstrates this variation; the variation within the Mānoa campus by discipline reveals equally substantial differences (as evidenced in the expenditure studies). The statement that cost alone does not reflect value or quality is a comment critical to understanding the University's expenditure patterns. The system administration, each Chancellor, each Dean/Director, and each department chair is charged with delivering the highest quality educational services possible given the revenues available. Differences in cost do, however, have implications for managing enrollments to ensure that higher education in the state of Hawai'i is both efficient and effective.

"The University of Hawaii's internal controls cannot ensure the reliability of data used in the calculation"

With respect to the extracted data used for the cost study, the same level of internal controls as is applied for data that will be ultimately be used for financial information to be presented to and relied upon by external third parties is not warranted or required. Control environments are designed and implemented in a manner that balances risks, efficiency and costs within the context of the system and organization relative to the purpose intended. The University believes that its process and methodology used to conduct the cost study is consistent with that of comparable institutions and adequately meets the need for reliable trend information for internal tracking and comparisons.

"The university makes no effort to ensure the reliability of data used in the Calculation"

Contrary to this finding, efforts are made to ensure the reliability of data used for the calculation. While these efforts may appear to be minimal from an auditing standpoint, they are

adequate to ensure that the reliability of the cost study is sufficient for its intended purpose. These efforts include matching expenditure data to year end fiscal reports which are subsequently audited.

With regard to data from the student information system, these data undergo rigorous verification, and it is unclear how the auditor's arrived at the conclusion that "the University makes no effort to ensure the reliability of data used in the calculation." Banner has system edit processes that check for valid data entry and will not allow entry of invalid data codes. Students are able to view their records on-line and notify University officials of any discrepancies.

Data from Banner flows to the Operational Data Store (ODS), the University's data mart, which is refreshed with Banner data nightly. Data critical to management and planning are extracted from the ODS, and ported to the UH student data warehouse. These data are checked for internal consistency against historical numbers, as well as checked for consistency between and among the data sets. Staff troubleshoot discrepancies, sometimes down to the unit record level, comparing the student data found in Banner against data in the ODS. Independent counts on headcount and student semester hours are taken from Banner and ODS by institution to ensure the numbers match.

"General controls for the financial, student information, and human resources systems require improvement"

We concur with this finding. General controls **always** need improvement. The University reviews its General IT Control Environment every year in the context of its A-133 audit conducted by an external auditor. Improvements are made every year in the highest risk areas, but there is always more that can be done in this area and the University is committed to an ongoing program of continuous improvement.

The Legislative Auditor makes two overall comments here:

- a) The University's IT Facilities are completely inadequate. The University agrees and the Board of Regents budget includes a request for funding to remedy this situation. The Legislative Auditor should urge the Legislature to fund this request as one of its Recommendations in this Report.
- b) The University's Business Continuity Plan needs to be improved. The University agrees, but notes that improving the University's IT Facilities as noted above will have far greater impact on business continuity since protection of primary operating modes will have the greatest impact on protecting business continuity.

Nonetheless, there is no evidence that the General IT Control environment has compromised the integrity of any of the data referred to in this Report.

"Application controls for the student information and human resources systems are not formalized"

While we agree that documentation needs improvement, the statement that the University's management is inattentive to application controls is unfounded, with substantial

evidence to the contrary. The University reviews its application controls every year in the context of its A-133 audit conducted by an external auditor. This report involves staff, management and is presented to the Board of Regents each year. Improvements are made every year in the highest risk areas, but there is always more that can be done in this area and the University is committed to an ongoing program of continuous improvement. No control environment is perfect and the University agrees that application controls could be improved with more formal documentation. However, the lack of documentation does not indicate a lack of effective controls.

There is no evidence that any lack of documentation of the application control environment has compromised the integrity of any of the data referred to in the draft report.

The following are our comments with respect to the recommendations in the draft report:

"1. The Chancellor of the University of Hawaii at Manoa should ensure that:"

- a. "A process that clearly links the strategic plan objective to the budget is established and documented;"

We do not see that this recommendation results from any of the findings. As indicated below, Manoa will continue ensure that the link between strategic plan objectives and budget is clearly articulated and communicated to all constituents.

- b. "Budgetary requests and decision are based on the campus and UH system strategic plan."

The instructions issued to the units for the preparation of the FB 2005-07 biennium budget included the requirement that " Program plans, should be driven by the goals, objectives and action strategies articulated in the University's system strategic plan and the more detailed priorities contained in the strategic (academic) plans of the Manoa Campus. As such, program plans and unit agendas should reflect specific goals and related actions planned for the 2005-2007 biennium and deemed essential to achieve the broader goals and objectives of the Manoa Strategic Plan."

In addition, budget objectives which are specified in the Stocktaking document, which were derived from the strategic plan goals and objectives were part of the instructions. The program change request form requirement specifically required that the strategic plan objectives and the budget objectives to which the request corresponds be clearly identified. All requests submitted for the biennium were related to a strategic plan and budget objective.

- c. "The commitment necessary to restructure its budget process is made, including the establishment of formal monitoring and reporting processes to properly evaluate program performance."

We concur. As indicated previously, implementation of this initiative is a long-term ongoing project.

- d. "A process is established to track the Manoa campus's budget as it is adjusted by the University of Hawaii system administration, the Board of Regents, the governor and Department of Budget and Finance to provide the Legislature with the information necessary to make informed decisions; and"

This has been done.

- e. "Fiscal personnel receive the training necessary to develop, and build the knowledge, skills, and abilities that are needed to perform their jobs competently."

The University's Financial Management Office conducts fiscal officer training once each quarter. Training sessions are three days long and cover topics such as budgeting, accounting, purchasing, property inventory, contract and grants, disbursing, payroll, treasury and cashiering. The training includes hands-on sessions on the use of the University's Financial Management System (FMIS). We also provide training to fiscal personnel on all new financial systems, or on major revisions to existing policy. Additionally, we offer "brown bag" training sessions on selected topics such as travel processing, property inventory, purchasing, etc., to address specific training interests of the University's fiscal community.

"2. The president of the University of Hawaii should ensure that:"

- a. "The financial reporting system is enhanced to provide well-designed, accurate, and timely data, allowing efficient monitoring, analysis, and decision-making;"

We concur.

- b. "Establish policies and procedures are updated in a timely matter to reflect current operating practices;"

We concur.

- c. "Contract maintenance and administration procedures are developed to ensure that all contracts are well organized and related contract information is readily available for increased efficiency; and"

We concur and will be addressing this issue in enhancements as part of a contract sub-module planned for the ePurchasing system.

- d. "Contracts and agreements are executed and monitored in accordance with university policies and procedures and the Hawaii Public Procurement Code."

We concur.

"3. The University of Hawaii's Office of Academic Planning and Policy and Budget Office should ensure that:

- a. Principles are established for determining costs applicable to the actual cost per student calculation;
- b. The methodology used is documented, including a detailed analysis, considering all variables factored into the formula, and the actual cost per student is calculated consistently from year to year; and
- c. The Legislature is provided with the methodology and variables used to calculate the actual cost per student, as well as the rationale to interpret the results”

The auditor’s report recommends that the model, its underlying principles, and methodology should be documented and provided to the Legislature. Legislative staff have requested and received documentation on the cost of education model; however, whether the cost of education model provides the kind of information useful to the legislature is a matter for further discussion. The current practice of running the model for tuition setting purposes is appropriate and sufficient for the University’s purposes. Before a decision is made to increase the time and effort spent on running the cost model, it should be determined what question we are seeking to answer and what the appropriate tools are to answer the question.

“4. The University of Hawaii’s chief information officer should ensure that:”

- a. “An overall information technology business continuity plan is developed; and”

As was shared with the State Auditor’s staff, efforts are underway to improve the University’s Business Continuity Plan. Funding the IT Facilities as requested in the current BOR budget request by the Legislature would assist in mitigating the single greatest risk to the University’s Business Continuity.

- b. “The application controls for the student information and human resources systems are formalized and documented.”

The University agrees that improved documentation of the application control environment would be helpful.

Thank you once again for the opportunity to respond to the draft report. If you have any questions or require further information, we would be happy to discuss them with you.

Sincerely,



David McClain
Interim President

Attachments

- c: Board of Regents