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

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

Report No. 07-08
December 2007



THE AUDITOR
STATE OF HAWAII

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 HAWAII

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OVERVIEW

Systemwide Financial Audit of the University of Hawai'i

System: Phase II

Report No. 07-08, December 2007

Summary

The Legislature initiated a systemwide financial audit of the University of Hawai'i through H.C.R. No. 213, 2005 Regular Session, because it was unable to obtain timely financial information from the university during the 2002 and 2005 legislative sessions. The resolution requested the systemwide financial audit be conducted in two phases. The first phase focused on the University of Hawai'i at Mānoa and was conducted in Fall 2005, with our findings and recommendations presented in Report No. 05-15, *System Financial Audit of the University of Hawai'i System: Phase I*. The second and current phase focused on the University of Hawai'i System and the remaining campuses.

We engaged the certified public accounting firm of Nishihama & Kishida, CPA's, Inc., to review the accounting and use of general and tuition funds, and strategic planning, budgeting, and forecasting processes for University of Hawai'i at Hilo, University of Hawai'i-West O'ahu, Hawai'i Community College, University of Hawai'i Center-West Hawai'i, Maui Community College, University of Hawai'i Center Maui, Honolulu Community College, Kapi'olani Community College, Leeward Community College, Windward Community College, Kaua'i Community College, University of Hawai'i Center-Kaua'i, and the University of Hawai'i System.

This second phase of our audit found a theme consistent with the first phase—that the university struggles to demonstrate accountability. We found that the university's current strategic plan has limited value and does not promote accountability. Owing to unclear planning and a lack of guidance, the *University of Hawai'i System Strategic Plan 2002-2010* and related campus plans are disjointed. There is no clear link between the various plans as to how they support each other. The university also did not understand or effectively define the requisite elements of a useful plan, resulting in system and campus plans that largely lack measurability. Specific goals and objectives are generally vague and do not identify specific targets and timelines.

For example, the system goal of "Educational Effectiveness" has a related objective, "to achieve a shared institutional culture that makes student learning and success the responsibility of all," and a related action strategy to "design and implement an effective enrollment management plan to improve the entry, retention, and success of diverse student populations, especially Native Hawaiians." While these are admirable goals, there is no way to objectively measure progress towards these goals.

We further found that the university should improve its budgeting and internal financial reporting. The Board of Regents approved the institutions' largest ever tuition increase in May 2005. Despite this significant increase in its revenue base,



the university did not include the increased tuitions in the FY2006-07 supplemental budget request until prompted by the Legislature. We also found that certain campuses have developed effective internal financial reporting processes; however, these processes were not consistent across campuses. The university's community college system effectively utilizes the Budget Level Summary (BLS) reporting system to prepare useful and informative financial reports. Other campuses, however, viewed use of the BLS as more of a required task than a useful management tool.

Finally, we found that certain policies and procedures over tuition deadlines are not clear or enforced. The university should build upon efforts driven by the first phase of our systemwide financial audit and continue to improve contract maintenance. The university recently modified its contract database but essential information is still missing, including modifications, change orders, renewal dates, encumbrances, and expenditure details. We also noted that some contract administration functions are decentralized, such as initiating the retirement of contracts, which is currently the responsibility of the respective departments. As a result, during FY2005-06, the university unnecessarily had approximately \$253,500 tied up in 48 contracts that were completed or expired. We further noted that tuition deadlines across campuses create confusion and problems in determining whether tuition payments are timely.

Recommendations and Response

We made several recommendations regarding the strategic planning and budgeting processes and financial system of the University of Hawai'i. Among these, we recommended that the president of the university review all existing strategic plans, and ensure future plans contain requisite elements and a systematic approach for assessment is developed. We also made a number of recommendations to the University of Hawai'i and the Office of Procurement and Real Property Management.

In its response to our draft report, the University of Hawai'i strongly criticized the timing and relevance of our findings and recommendations, primarily those relating to its strategic plan. It is puzzling that the university holds this view considering that, as recently as late November 2007, it was asking its faculty, students, and the public whether its system goals need to be updated or revised. Our audit points out specific elements of the various system and campus strategic plans of the university that need to be enhanced in order to contribute to the development of any successful, future plans.

The university also attempts to clarify several errors and inaccuracies contained in our audit findings. However, the university's arguments are generally based on a misreading of the facts presented. We did modify several financial exhibits based on the university's response, none of which affect our findings and overall conclusions.

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Hawai'i

Conducted by

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

Submitted by

THE AUDITOR
STATE OF HAWAI'I

Report No. 07-08
December 2007

Foreword

We performed this audit of the University of Hawai'i System 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 the audit be conducted in two phases. The first phase focused on the University of Hawai'i at Mānoa and was conducted in Fall 2005, with our findings and recommendations presented in Report No. 05-15, *System Financial Audit of the University of Hawai'i System: Phase I*. The second phase focused on the University of Hawai'i System and the remaining university campuses. Phase I was conducted by the Office of the Auditor with assistance from the certified public accounting firm of Nishihama & Kishida, CPA's, Inc. Phase II was conducted entirely by Nishihama & Kishida. The results of Phase II are presented in this report.

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 Hilo, University of Hawai'i-West O'ahu, Hawai'i Community College, University of Hawai'i Center-West Hawai'i, Maui Community College, University of Hawai'i Center Maui, Honolulu Community College, Kapi'olani Community College, Leeward Community College, Windward Community College, Kaua'i Community College, University of Hawai'i Center-Kaua'i, 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 constitutes 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 Legislature further requested the systemwide financial audit be conducted in two phases. The first phase focused on the University of Hawai‘i at Mānoa and was conducted in Fall 2005, with our findings and recommendations presented in Report No. 05-15, *Systemwide Financial Audit of the University of Hawai‘i System: Phase I*. The second phase focused on the University of Hawai‘i System and the remaining university campuses. The first phase of the systemwide financial audit was conducted by the Office of the Auditor with assistance from the

certified public accounting firm of Nishihama & Kishida, CPA's, Inc. The second phase was conducted entirely by Nishihama & Kishida. The results of the second phase of the systemwide financial audit are presented in this report.

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 decision-making 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. 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 of institutions 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.

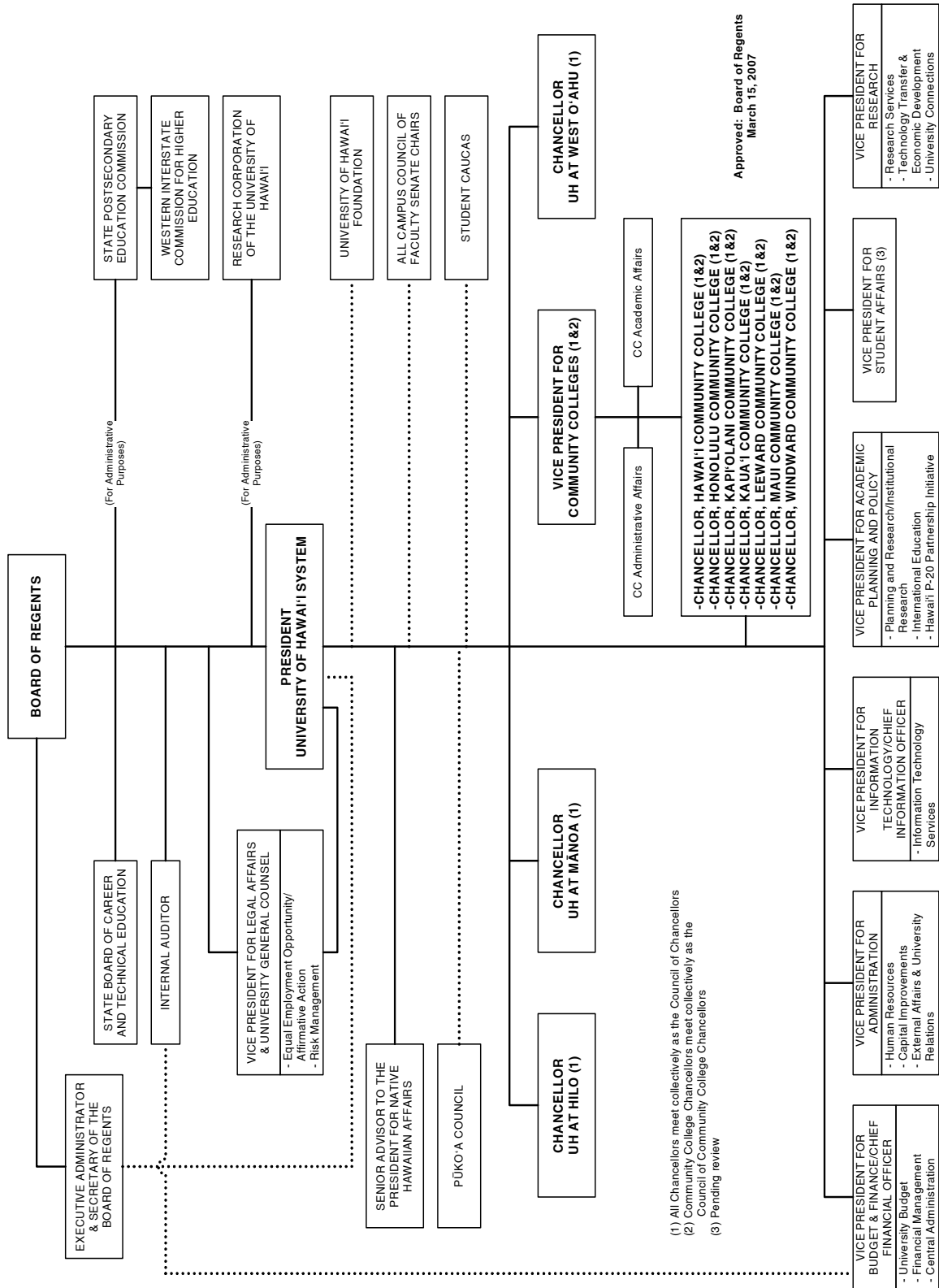
Organization

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,

**Exhibit 1.1
Organizational Structure of the University of Hawai'i**



Approved: Board of Regents
March 15, 2007

(1) All Chancellors meet collectively as the Council of Chancellors
 (2) Community College Chancellors meet collectively as the Council of Community College Chancellors
 (3) Pending review

Source: University of Hawai'i

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, 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, counseling psychology, and China-U.S. relations. The institution offers baccalaureate degrees in various fields of the humanities, natural sciences, and social sciences, as well as 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

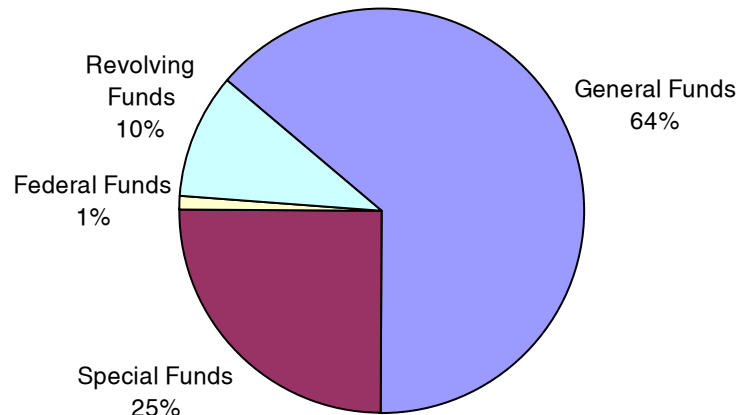
conditioning, aeronautic maintenance, commercial aviation pilot training, and occupational and environmental safety management.

- 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, which 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 that includes 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 (64 percent) of the university's total FY2006-07 appropriation. Special funds, such as the Tuition and Fees Special Fund, represent one-fourth (25 percent) of the total funds appropriated to the university.

Exhibit 1.2
University of Hawai'i Appropriations
Fiscal Year 2007



Source: Act 160, Session Laws of Hawai'i 2006

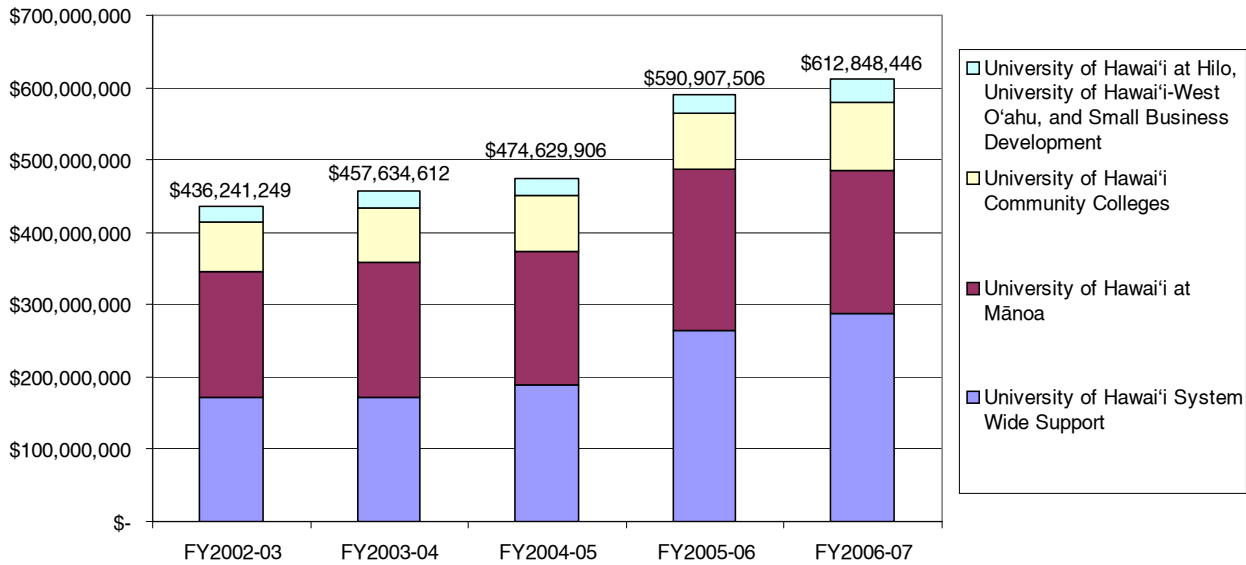
General fund

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 significantly increased between FY2002-03 and FY2006-07. Exhibit 1.3 presents the total amount of general fund appropriations allocated to the University of Hawai'i by the Legislature for the fiscal years of 2003 through 2007.

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.

**Exhibit 1.3
University of Hawai'i General Fund Appropriations Fiscal Years 2003 to 2007**



Source: Session Laws of Hawai'i, 2002 to 2006

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 the fiscal years ended June 30, 2005 and 2006.

Exhibit 1.4**University of Hawai'i Tuition and Fees Special Fund Financial Data for Fiscal Years 2002 to 2006 (in Thousands)**

| | FY2001-02 | FY2002-03 | FY2003-04 | FY2004-05 | FY2005-06 |
|------------------------|-----------|-----------|-----------|-----------|-----------|
| Beginning Fund Balance | \$ 32,040 | \$ 22,761 | \$ 8,715 | \$ 4,970 | \$ 5,841 |
| Revenues | 84,192 | 93,005 | 104,759 | 111,054 | 116,262 |
| Interest | 1,863 | 1,749 | 710 | 1,045 | 1,486 |
| Expenditures | (90,906) | (105,969) | (102,002) | (103,309) | (100,464) |
| Transfers | (4,428) | (2,831) | (7,212) | (7,919) | (12,909) |
| Ending Fund Balance | \$ 22,761 | \$ 8,715 | \$ 4,970 | \$ 5,841 | \$ 10,216 |
| Encumbrances | \$ 8,865 | \$ 10,324 | \$ 7,319 | \$ 7,989 | \$ 6,778 |

Note: 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.

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 2005 and 2006**

| Campus/Program: | FY2004-05 | | FY2005-06 | |
|-------------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| | Allocation | Expenditure | Allocation | Expenditure |
| University of Hawai'i at Mānoa | \$ 68,660,180 | \$ 67,865,797 | \$ 77,028,309 | \$ 73,040,837 |
| University of Hawai'i at Hilo | 9,719,377 | 9,519,312 | 9,843,644 | 9,573,400 |
| University of Hawai'i at West O'ahu | 1,982,500 | 1,229,097 | 1,983,000 | 1,353,825 |
| Honolulu Community College | 3,683,121 | 4,359,771 | 3,631,502 | 2,867,766 |
| Kapi'olani Community College | 7,514,170 | 4,518,713 | 8,511,964 | 7,109,622 |
| Leeward Community College | 4,910,783 | 3,190,973 | 5,328,502 | 4,256,892 |
| Windward Community College | 1,508,775 | 1,872,877 | 1,625,179 | 1,169,394 |
| Hawai'i Community College | 2,116,985 | 1,683,212 | 2,415,689 | 1,818,238 |
| Maui Community College | 2,655,121 | 3,230,448 | 2,872,489 | 2,340,509 |
| Kaua'i Community College | 1,047,047 | 1,638,784 | 1,039,521 | 545,911 |
| Community College Systemwide | 1,843,111 | 716,393 | 545,396 | 443,354 |
| University of Hawai'i Systemwide | 4,900,000 | 5,435,795 | 5,058,536 | 5,564,919 |
| Total | <u>\$ 110,541,170</u> | <u>\$ 105,261,172</u> | <u>\$ 119,883,731</u> | <u>\$ 110,084,667</u> |

Note: We did not audit the amounts presented herein 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

Previous Reports

The Legislature initiated a review of the university's non-general funds, including the Tuition and Fees Special Fund, because of the university's inability to provide timely financial information during the 2002 legislative session. Our Report No. 03-04, *Review of Selected University of Hawaii 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 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.

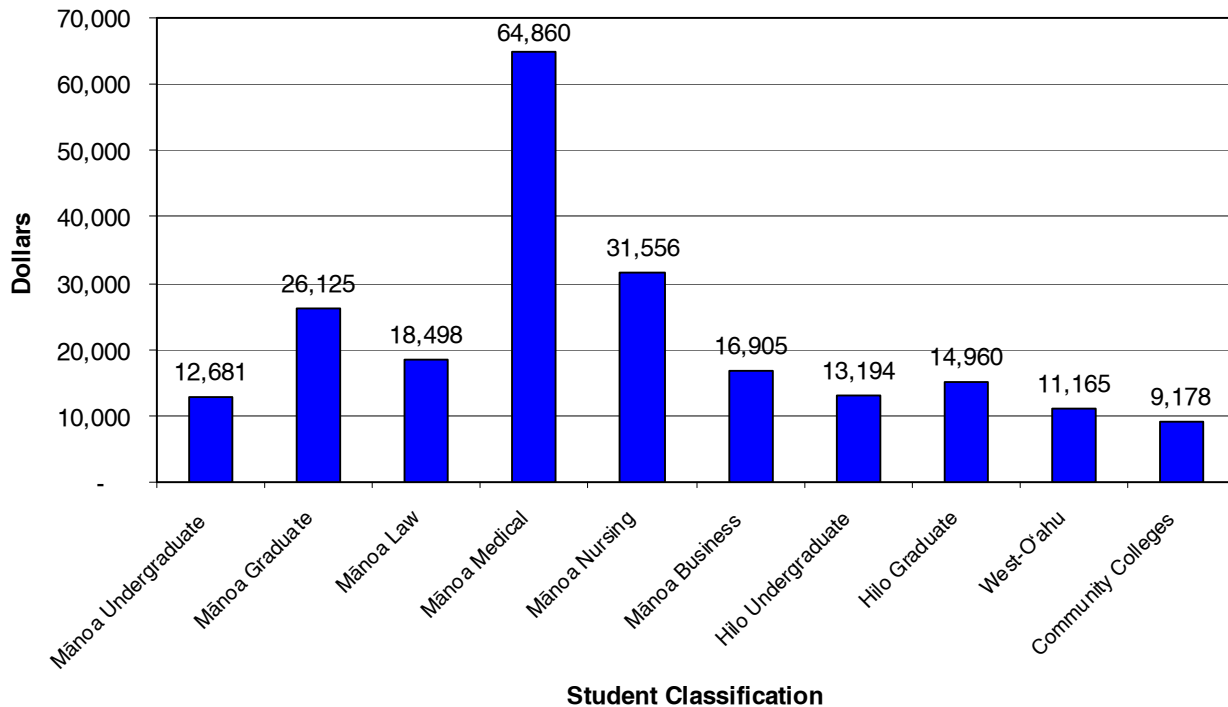
During our *Review of Selected University of Hawaii Non-General Funds and Accounts*, our work was limited in scope due to the University of Hawai'i Foundation's denial of access to pertinent information. As a result, our office initiated a follow-up audit that focused on an agreement between the university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

In December 2005, we issued the results of the first phase of this audit in Report No. 05-15, *Systemwide Financial Audit of the University of Hawaii System: Phase I*. The audit focused on the University of Hawai'i at Mānoa and revealed that the Mānoa campus could not fully ensure fiscal accountability. The Mānoa campus prepares its budget using an incremental approach, focusing attention on adjustments over the prior budget while leaving much of the current budget unfounded. The Mānoa campus also did not effectively monitor the development of its own 2005-2007 biennium budget and was unable to justify it to the Legislature. Efforts by the Mānoa campus to restructure its budgeting

process were still in its infancy. We further found that the Mānoa campus lacks a formal process for monitoring program use of funds. The Budget Level Summary reporting system was implemented to improve internal financial reporting; however, we found that these reports lack the detail needed to be an effective tool for evaluating unit and program performance and were not being properly reconciled at the unit level. We further found the Mānoa campus lacks formal policies and procedures to ensure proper use of general and tuition funds, including several violations of procurement procedures and questionable uses of contract modifications.

Finally, we reviewed the University of Hawai'i's calculation of the actual cost per undergraduate and graduate student for one academic year for the Mānoa campus and found that the lack of an industry standard combined with unreliable data limit the value of the calculation. For the second phase of this audit we were requested to review the actual cost per student calculations for the remaining university campuses; however, we found that the actual cost per student is calculated in the same manner for all university campuses. Therefore, our findings applicable to the actual cost per student calculation for the Mānoa campus, as noted above, would be applicable to the calculations for all university campuses. As a result, we did not perform a detailed review of the actual cost per student calculations during our current audit, but we do present the university's calculation of actual cost per student for all campuses in Exhibit 1.6.

Exhibit 1.6
University of Hawai‘i Actual Cost per Student for Academic Year 2006



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

Objectives of the Audit

The objectives of the audit, relating specifically to the University of Hawai‘i at Hilo, University of Hawai‘i-West O‘ahu, Hawai‘i Community College, University of Hawai‘i Center-West Hawai‘i, Maui Community College, University of Hawai‘i Center Maui, Honolulu Community College, Kapi‘olani Community College, Leeward Community College, Windward Community College, Kaua‘i Community College, University of Hawai‘i Center-Kaua‘i, and the University of Hawai‘i System, were to:

1. Assess the adequacy, effectiveness, and efficiency of the respective 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 respective campuses and system to achieve their intended purposes.
3. Make recommendations as appropriate.

Scope and Methodology

This audit looked at the University of Hawai‘i at Hilo, University of Hawai‘i-West O‘ahu, Hawai‘i Community College, University of Hawai‘i Center-West Hawai‘i, Maui Community College, University of Hawai‘i Center Maui, Honolulu Community College, Kapi‘olani Community College, Leeward Community College, Windward Community College, Kaua‘i Community College, University of Hawai‘i Center-Kaua‘i, and the University of Hawai‘i System, and focuses on FY2005-06 to the present, and previous years as necessary.

We procured the services of a certified public accountant, Nishihama & Kishida, CPA’s, Inc., to conduct the audit. The auditors reviewed the planning documents, organizational and budget reports, and relevant policies and procedures. The auditors also reviewed pertinent state laws and rules, audits, reports, studies, and documents. In addition, the auditors interviewed university personnel involved in the planning and budgeting efforts of the respective campuses and system.

The auditors reviewed the respective campuses’ and system’s use of general and tuition funds, systems of accounting and internal controls related to these funds, and budget processes. The consultant also reviewed the respective campuses’ and system’s process of preparing, submitting, and reporting its budget and supporting financial forecasts. Additionally, the consultant reviewed the respective campuses’ and system’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 respective campuses’ and system’s existing system of accounting and internal controls for deficiencies and weaknesses.

The audit was conducted from August 2006 through May 2007 according to generally accepted government auditing standards.

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Chapter 2

The University of Hawai‘i Continues Its Struggle To Demonstrate Accountability

Our Report No. 05-15, *Systemwide Financial Audit of the University of Hawai‘i System: Phase I* focused on the University of Hawai‘i at Mānoa (Mānoa). We found that the Mānoa campus budget process and financial system did not ensure fiscal accountability. Furthermore, the Mānoa campus lacked a formal mechanism to monitor use of its funds, resulting in little assurance that the campus is effectively and efficiently utilizing its resources. Phase II of the university systemwide financial audit focused its review on all other campuses and the university system office. In the course of our current audit, we identified deficiencies in the strategic planning and internal financial reporting processes that impede accountability. Furthermore, we found that the organization and monitoring of contracts should be further improved in order to ensure the best interest of the university. We also found systemwide functions lacking in systemwide policies and procedures that resulted in some operational inefficiencies.

Summary of Findings

1. The University of Hawai‘i’s current strategic plan has limited value and does not promote accountability.
2. The university needs to improve its budgeting and internal financial reporting processes in order to foster accountability.
3. Certain policies and procedures over contracts and tuition deadlines are not clear or enforced.

The University of Hawai‘i’s Current Strategic Plan Has Limited Value and Does Not Promote Accountability

Strategically focused institutions base fiscal decisions on a well defined mission and core values, and are more effective and efficient as a result. Strategic planning is the process of setting priorities and goals based on an entity’s mission and core values, and then defining strategies and actions to realize those goals. The resulting plan links the mission and strategic directions to fiscal decisions.

During our review of the University of Hawai‘i’s strategic planning process, we found that due to a lack of coordination, the current university system strategic plan and the campus level plans are not clearly aligned. And while the university system strategic plan builds on

its mission and core values and provides a broad vision for the university, it does not provide the specific direction and action needed to achieve its goals. Furthermore, the university's strategic plan is not formally assessed or adequately evaluated for progress. As a result, the university's strategic plans have little practical value, leaving stakeholders unable to gauge the performance of the university in relation to the goals and objectives stated in the university system strategic plan, and prompting university reliance on other sources to support funding requests.

Unclear planning instructions led to disjointed system and campus strategic plans

In Fall 2001, the university embarked on a systemwide strategic planning process. The University of Hawai'i System (university system) is comprised of four main units—University of Hawai'i at Mānoa, University of Hawai'i at Hilo, University of Hawai'i-West O'ahu, and University of Hawai'i Community Colleges (comprised of seven individual community college campuses and collectively referred to as the "community colleges system"). For planning purposes, a strategic plan was prepared for the university system as well as for each of its four main units. In addition, individual strategic plans were developed for each community college campus for a total of 12 strategic plans. The plans were intended to span the period from 2002-2010.

The university system and each of its campuses dedicated significant time and effort to developing their respective plans. To varying degrees, the campuses took steps that included creating planning committees, assessing capabilities, soliciting stakeholder input, setting goals, and developing action steps. The process ultimately produced strategic plans for the university system and each of its units. However, despite the university's significant investment of resources into planning, the lack of coordination and guidance from the university system resulted in system and campus plans that are not clearly aligned and that lack key elements, making assessment difficult.

The university's strategic planning process was not a well coordinated effort

The planning process was informally communicated by the university system to campus administrators in Fall 2001, under the tenure of the previous university president. As a result, many of the campuses, such as the community college system and Hilo campus, began the planning process in Fall 2001. However, it was not until February 2002 that the university system's planning priorities and general planning guidelines including suggested templates for unit strategic plans were distributed. Unclear instructions from the start led to some campuses starting the planning process before others, and without the benefit of planning priorities and guidelines. In fact, the community college system had

already completed a draft of its strategic plan when the university system issued its guidelines in February 2002. A message on the cover of the Leeward Community College (CC) campus plan from its chancellor states, "Our College had started earlier than most campuses back in Summer 2001 to develop our Strategic Plan, and the ending date of 2010 subsequently selected by the UH System . . . was not known until we were fairly well advanced into our own strategic planning process." As a result, the Leeward CC strategic plan spans the period 2002-2007 and does not coincide with the university system plan's timeframe of 2002-2010.

System and campus plans are not clearly aligned, limiting overall value

A review of each campus' goals demonstrates the impact of an uncoordinated planning effort. The West-O'ahu campus' plan is the only main unit with goals clearly aligned with those of the university system, while the Hilo campus' plan goals do not match those of the university system. The community college system goals do not match the university system goals verbatim, but they do hold many of the same concepts. However, only four out of seven community college campus plans demonstrate cohesion by sharing identical goals with the community college system. Of the remaining community college campuses, Kapi'olani CC adopted goals that are a blend of the university system and the community college system, while Leeward CC adopted goals that mirror neither the university system nor the community college system strategic plans. Maui CC did not adopt the community colleges system goals and instead chose goals identical to those of the university system. The University of Hawai'i Community Colleges associate vice president for academic affairs explained that because of the reorganization of the community college system, whereby each community college reported directly to the university system office, Maui CC chose to adopt the university system goals in order to demonstrate alignment. If the university system and community college system goals were properly aligned, it would not be necessary for campuses to decide which system's goals fit its needs best, as they would be one and the same. Exhibits 2.1 and 2.2 compare the system and unit strategic plans of the university.

Exhibit 2.1
University of Hawai'i
Comparison of System and Unit Strategic Plans

| Unit: | University of Hawai'i System | Hilo Campus | West-O'ahu Campus | Community Colleges System |
|---|-------------------------------------|--|--|--------------------------------------|
| Timeframe | 2002-2010 | 2002-2010 | 2002-2010 | 2002-2010 |
| Date issued | June 2002 | Nov 2002 | Nov 2002 | Sept 2002 |
| Are goals aligned with UH System? | NA | No | Yes | Some (3 of 5 are) |
| Are objectives measurable (specific, deadlines, responsibility, costs)? | No | No | No | No |
| Are key performance indicators (KPIs) included? | No | Yes (linked to objectives and most are measurable) | Yes (but vague and not linked to specific goals) | Yes (linked to goals and measurable) |
| Most recent plan update | None | None | None | None |
| Most recent plan assessment | 2006 (biennially) | None | None | None |

Note: The University of Hawai'i at Mānoa has a strategic plan, but it was not included in the scope of our current audit.

Source: Respective University of Hawai'i System and Campus Strategic Plans

Exhibit 2.2
University of Hawai'i Community Colleges System
Comparison of Campus Strategic Plans

| Campus: | Hawai'i | Honolulu | Kapi'olani | Kaua'i | Leeward | Maui | Windward |
|---|---|---|------------------------------|---|---|-----------------------------|---|
| Timeframe | 2002-2010 | 2003-2010 | 2003-2010 | 2003-2010 | 2002-2007 | 2003-2010 | 2002-2008 |
| Date issued | Nov 2002 | Fall 2003 | Oct 2002 | Fall 2003 | Oct 2002 | May 2003 | May 2003 |
| Are goals aligned with Community College System? | Yes | Yes | No (blend of UH & CC system) | Yes | No (only two goals are aligned) | No (aligned with UH system) | Yes |
| Are objectives measurable (specific, deadlines, responsibility, costs)? | Yes (but strategies do not assign responsibility) | Yes (goals & strategies not measurable but activities include participants, dates, and costs) | No | No (but projected goal FTEs and costs are provided) | Yes (prioritized action plans accompany each objective) | No | No (timeframes and responsibility is provided but strategic direction not measurable) |
| Are KPIs included? | No | No | No | No | No | No | No |
| Most recent plan update | None | March 2006 | None | None | 2004 | April 2005 | None |
| Most recent plan assessment | April 2007 | March 2006 | None | None | 2005 (annually) | April 2005 | None |

Source: Respective University of Hawai'i Community College System and Campus Strategic Plans

Correspondence dated February 2, 2002, accompanying the strategic planning guidelines sent to the campus chancellors states, “. . . it is not only logical but also critical to provide a template to guide each unit; otherwise each unit will do its own thing, and the task of integrating and consolidating, and then aligning with financial plans (to allow implementation), will be nearly impossible.” However, given that these guidelines, templates, and priorities were received by many campuses at the same time that they were issuing draft plans, it does seem nearly impossible that campus plans could be clearly aligned with system plans. Further, a memorandum accompanying the 2006-2007 budget recommendations dated August 31, 2005, from the interim university president to the Board of Regents, in reference to the university system strategic plan states, “This plan is the basis for the supplemental budget.”

While goals need not be identical in order to be aligned, the inconsistencies demonstrate the confusion and lack of coordination between the university system and the campuses throughout the planning process. While efforts were made after the fact to coordinate the unit plans with the university system strategic plan, the result was that unit goals did not clearly support university system goals, making their achievement difficult.

The university system goals are broad enough (i.e., “educational effectiveness and student success”) that the unit goals could fit under the umbrella of the plan goals. However, to be useful a strategic plan needs to be more clearly aligned by establishing a link to unit goals and defining how each campus will contribute toward accomplishing those goals. Plan alignment should be clearly demonstrated through defined roles for each campus. Furthermore, a strategic plan should provide direction through the use of priorities and long-term and short-term goals which should help link the strategic plan with the annual budget. Without these critical components, the university strategic plan has limited value.

The university did not consistently set measurable goals or establish a process for assessment

Strategic Finance: Planning and Budgeting for Boards, Chief Executives, and Finance Officers, written by Kent Chabotar and published by the Association of Governing Boards of Universities and Colleges, notes that

evaluating strategic planning efforts consist of two steps: first, identifying the specific strategic (or performance) indicators that effectively will measure how well the institution is accomplishing its stated objectives, and second, assessing whether the plan is on time and on budget.

However, our audit revealed that most of the university’s strategic plans do not have concrete and measurable objectives and indicators to assess their achievement. Moreover, there is no formal, systemwide mechanism in place to evaluate the progress of the strategic plans.

Lacking specific objectives and performance indicators, progress of most campus and system plans are difficult to measure

The various university strategic plans generally did not include measurable objectives and were inconsistent in incorporating performance indicators to assess progress. The Hilo and West-O‘ahu campuses’ and community college system’s strategic plans contain objectives that are vague or broad but do include performance indicators. However, many performance indicators were deficient in various respects. For example, the Hilo campus stated the following goal and related objective, strategy, and performance indicator:

| University of Hawai'i at Hilo Strategic Plan | | |
|--|--|--|
| Goal I: Maintain a well-rounded mix of liberal arts and professional programs, while distinguishing ourselves by taking full advantage of the extraordinary natural environment and cultural diversity afforded by our island setting. | | |
| Objective 1 | Strategy 1 | Performance Indicator |
| Emphasize studies of the environment, cultures, and societies of Hawai'i, the Pacific, and East Asia and make full use of Hawai'i Island, from the tops of the mountains to the bottom of the ocean, for hands-on learning and as a research laboratory. | Establish a stronger process for approval of new programs, with clear requirements for demand analysis, budget plans, and relevance to the university mission and strategic plan goals, but flexible enough to allow UH Hilo to take advantage of opportunities as they arise. | Percent of classes and programs offering studies of the environment, cultures, and societies of Hawai'i, the Pacific, and East Asia. |

Several key elements are missing from these plan components—the objective is broad with no timeframe, and the strategy is vague and does not assign responsibility or address funding. The performance indicator is measurable and relevant; however, it lacks a target, and the campus further indicated that this information is not presently collected. Additionally, performance indicators only help measure the *progress toward* achievement of objectives. Regardless of any action or inaction, it would be difficult to determine whether or not this objective was actually achieved. Ultimately, there is no connection between planning and action.

The West-O'ahu campus' plan also included general critical success factors and key performance indicators, but they were generally vague and not linked to specific goals or objectives. An example of a key performance indicator is an “increased number of international exchange agreements and study/work abroad programs.” The indicator did not include a goal of a specific number of agreements or time sensitive milestones (such as one agreement per year and a total of eight by 2010). As the indicator is presented now, a stakeholder is unable to determine what goal or objective this measure relates to and whether the campus is making any progress.

The use of measurable goals and performance indicators among community colleges varied greatly, with most (four of seven campuses) not including either. The Hawai'i and Honolulu Community Colleges did develop some goals and outcomes that included measurable elements such as specific targets, deadlines, participants, and costs. Leeward CC did the best job of building accountability into its plan. While the goals and objectives are not necessarily measurable, each is accompanied with prioritized action plans that include assigned responsibility, specific tasks, timeframes, fiscal impact, and sources of funding. Below is an example of a Leeward CC prioritized action plan:

| Leeward Community College Strategic Plan | | | | |
|--|----------------------|---|---|--|
| Goal A, Objective 1: Provide life-long learning and development of essential skills | | | | |
| Rationale | Division/Unit | What to Accomplish | Fiscal impact | Funding Source |
| Develop technology proficient students | EMC | 5 faculty members will each develop at least one course considered "Technology Intensive" each year | Assigned time for faculty and instructional designer designing course=21 credits (3 cr for each faculty, 6 cr for designer) | LEI Aloha Grant (ETEC Dept at U Mānoa) |

While the campus level performance measures have their deficiencies, the university system strategic plan contained no performance measures at all. The university system plan lists five goals, each with two to three objectives per goal, and each objective supported by several action strategies. Below is a typical example of this:

It is impossible to determine what specific tasks will contribute to accomplishing this goal and objective, which individuals are responsible for carrying out the strategies, and how individual campuses will support the goal and objective. Most importantly there is no way to evaluate progress toward the objective and goal and if they were actually met.

| University of Hawai'i System Strategic Plan | | |
|--|---|--|
| Goal I: Educational Effectiveness—Embrace a culture of excellence and performance as the hallmarks of effective learning and student success. | | |
| Objective 1 | Action Strategy (1) | Sub-strategy (1) |
| To achieve a shared institutional culture that makes student learning and success the responsibility of all. | Design and implement an effective enrollment management plan to improve the entry, retention, and success of diverse student populations, especially Native Hawaiians and underrepresented ethnic groups. | Ensure that students experience a transforming education by: providing access to a fully articulated, integrated, and comprehensive liberal arts foundation. |

There is no formal, systemwide assessment of strategic plans

Compounding the university's deficiencies in performance indicators is the fact that currently there is no formal, coordinated process to evaluate the implementation of the university's strategic plans. At the campus level, the community college system evaluates its plan as part of the annual budget preparation process. Statistical data is compiled and used to measure performance outcomes. The statistical data is then posted on the community college system's website. However, the key performance indicators dated November 10, 2005, while more comprehensive than other units, were still incomplete. Certain performance indicators had incomplete or no data because the information was unavailable from the university system office. The report also lacked documentation of analysis, with no further explanation or conclusions on the data

presented. And while the University of Hawai'i Community Colleges associate vice president for academic affairs indicated that many of these questions and decisions are addressed during the annual review of the plan, he also agreed that there is a lack of formal documentation of this review process.

In 2006, the UH Hilo campus performed its first formal review of the strategic plan four years after its inception in 2002. In February 2006, a draft of the report summarizing the review of the strategic plan strategies and performance indicators was submitted to the University of Hawai'i at Hilo Congress Executive Committee. Conclusions, recommendations and actions included: 1) indicating whether objectives were met, not met, or partially met (when information was available); 2) adding objectives or indicators that appeared crucial to reaching a strategic goal; 3) and, eliminating two indicators that appeared meaningless. The review revealed valuable, but untimely information. As of December 2006, the draft report still had not been finalized. Therefore, we are unsure whether any formal actions were ever initiated as a result of the draft report. This type of information needs to be known earlier than mid-way through the plan timeframe. A strategic plan should undergo a formal review and progress evaluation at least once a year.

The university prepares a systemwide biennium report, *University of Hawai'i: Measuring Our Progress*, which presents general measures of performance and benchmarks. Originally, the report was produced by the university as required by Act 161 of the 1995 legislative session, mandating that the university adopt and use benchmarks for the development of budget and tuition schedules and for the review of programs, and to report results to the Legislature in the second year of each fiscal biennium.

The introduction to *Measuring Our Progress 2006* states that the progress report “demonstrates the importance the University places on measuring the University’s progress on the goals of the University of Hawai'i System Strategic Plan: Entering the University’s Second Century, 2002-2010.” However, we were unable to establish a meaningful relationship between the university system strategic plan goals and the performance measures and indicators presented in the biennial report. Furthermore, since measurable outcomes were never defined in the strategic plan, there was no way to determine whether desired outcomes were achieved. *Measuring Our Progress 2006* does provide general measures of performance at a given point in time or over time, and against benchmarks when applicable. However, it does not actually measure progress or indicate whether goals and objectives defined in the university system strategic plan were met.

We reviewed *Measuring Our Progress* and found it to be a compilation of various data and statistics that, although organized by strategic plan goals, did not specifically measure the university's progress toward meeting its strategic goals and objectives. For example, under the system strategic goal of "educational effectiveness and student success," the progress report includes a graph of the historical and projected enrollment, by unit, for the period of 1907 through 2012. While certainly interesting and relevant to the university as a whole, there is no apparent link between enrollment and measuring student success. There is no connection in the progress report with the goal's objectives and action strategies as detailed in the university system strategic plan. Furthermore, the data provides no insight as to actual progress, simply by presenting historical and projected data. Unanswered questions include: *Is the trend/projection good or bad? Will projected enrollment meet expectations? What policy decisions has the university made to influence trends/projections?*

Plan inadequacies prompted the Second Decade Project

The suggested unit strategic plan templates provided by the university system office include the following elements and questions to be answered:

- 1) Situation Analysis: Where are we today?
- 2) Goals: Where do we wish to be/to go?
- 3) Objectives in support of each goal: Objectives should be specific and prescriptive.
- 4) Strategies: How should we get there?
- 5) Key initiatives: What exactly do we have to do in order to get there?
- 6) Resource requirements: Can we afford to get there?
- 7) Critical success factors;
- 8) Key performance indicators: How will we know when we've arrived?

Our review of the university system strategic plan entitled *University of Hawai'i Strategic Plan: Entering The University's Second Century, 2002-2010* revealed that many of these elements were excluded and many questions remained unanswered.

The university systemwide vice president for academic planning and policy described the university system strategic plan as providing the vision and values of the university, but not the specific priorities or direction needed. In response to the shortcomings of the current strategic plan, the university initiated its Second Decade Project. The Second Decade Project seeks to identify the State's higher education needs in the next decade, determine applicability of those needs to specific campuses, and develop a set of priorities that will enable the university to plan for

the next decade (2011-2020). While the Second Decade Project is not officially the strategic plan, it functions as the primary basis for the university's 2007-2009 biennium budget request. In an October 3, 2006 memo addressed to the Department of Budget and Finance and the Legislature, the university president cites the Second Decade Project as providing the major components of the planning process, including the institutional priorities for the development of the 2007-2009 biennium budget request.

The University Needs To Improve Its Budgeting and Internal Financial Reporting Processes To Foster Accountability

During the 2005 legislative session, the Legislature had difficulty obtaining timely information from the university. These difficulties have resulted in a strained relationship between the Legislature and the university. Accountability assumes responsibility for actions, decisions, policies and performance, including the administration, governance and implementation of the university's strategic plan. The university has the obligation of accountability to stakeholders for resulting consequences. The university has been granted a great deal of autonomy involving its internal structure, management, and operations. While the university still desires greater autonomy, it has been unable to demonstrate its ability to be accountable to stakeholders for its actions, decisions, and performance. In order to accomplish this, the university must improve its budgeting and internal financial reporting processes.

The university did not adequately account for tuition increases in preparing its initial 2007 supplemental budget request

The funding of the university is a shared responsibility of the university and the State. Major sources of funding for the university come via general funds and tuition funds. Exhibits 2.3 and 2.4, respectively, show that the university received a total of \$575 million of general fund and \$116 million of tuition fund revenues in FY2005-06. In May 2005, the University of Hawai'i Board of Regents approved the largest tuition rate increase in the history of the institution. This tuition rate increase went into effect at the beginning of FY2006-07 and will be spread over the next five fiscal years. Additional revenues are projected to be approximately \$400 million through FY2011-12. With the increase, tuition revenue will become a larger part of the university's funding base. Shortly after the tuition increase, in August 2005, the university's recommended FY2006-07 supplemental budget request was submitted to the Board of Regents. One month later it was submitted to the governor and the Legislature for their approval. However, the FY2006-07 supplemental budget request did not take into account the expected increase in tuition.

Exhibit 2.3
University of Hawai'i
General Fund Financial Data for Fiscal Year 2005-06 (Cash Basis)

| | <u>Mānoa</u> | <u>Hilo</u> | <u>West-O'ahu</u> | <u>Systemwide</u> | <u>Community Colleges</u> | <u>Total</u> |
|------------------------|------------------------|-----------------------|---------------------|-----------------------|---------------------------|-------------------------|
| Beginning Fund Balance | \$ (19,973,448) | \$ (2,454,295) | \$ (338,565) | \$ (4,606,551) | \$ (9,804,770) | \$ (37,177,629) |
| Revenues | 215,570,780 | 25,003,774 | 3,136,719 | 244,231,876 | 86,882,549 | \$ 574,825,698 |
| Interest | - | - | - | - | - | \$ - |
| Expenditures | (285,831,195) | (32,241,579) | (4,221,765) | (35,178,928) | (112,610,440) | \$ (470,083,907) |
| Net Transfers | <u>65,878,961</u> | <u>7,129,311</u> | <u>990,553</u> | <u>(208,639,790)</u> | <u>25,601,222</u> | <u>\$ (109,039,743)</u> |
| Ending Fund Balance | <u>\$ (24,354,902)</u> | <u>\$ (2,562,789)</u> | <u>\$ (433,058)</u> | <u>\$ (4,193,393)</u> | <u>\$ (9,931,439)</u> | <u>\$ (41,475,581)</u> |
| Encumbrances | \$ 1,165,397 | \$ 181,066 | \$ - | \$ 1,530,422 | \$ 663,154 | \$ 3,540,039 |

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 2.4
University of Hawai'i
Tuition and Fees Special Fund Financial Data for Fiscal Year 2005-06 (Cash Basis)

| | <u>Mānoa</u> | <u>Hilo</u> | <u>West-O'ahu</u> | <u>Systemwide</u> | <u>Community Colleges</u> | <u>Total</u> |
|------------------------|---------------------|---------------------|-------------------|-------------------|---------------------------|----------------------|
| Beginning Fund Balance | \$ 1,203,326 | \$ 3,445,323 | \$ 465,818 | \$ 1,308,472 | \$ (581,486) | \$ 5,841,453 |
| Revenues | 79,710,777 | 10,302,866 | 1,420,671 | 170,310 | 24,657,008 | 116,261,632 |
| Interest | 897,153 | 200,451 | 37,298 | 38,962 | 312,504 | 1,486,368 |
| Expenditures | (73,436,260) | (9,545,745) | (971,595) | (3,427,979) | (13,082,016) | (100,463,595) |
| Net Transfers | <u>(7,012,633)</u> | <u>(913,499)</u> | <u>(318,009)</u> | <u>2,386,195</u> | <u>(7,051,460)</u> | <u>(12,909,406)</u> |
| Ending Fund Balance | <u>\$ 1,362,363</u> | <u>\$ 3,489,396</u> | <u>\$ 634,183</u> | <u>\$ 475,960</u> | <u>\$ 4,254,550</u> | <u>\$ 10,216,452</u> |
| Encumbrances | \$ 3,653,179 | \$ 717,100 | \$ 4,950 | \$ 26,237 | \$ 2,376,764 | \$ 6,778,230 |

Note: The financial data presented is not audited and has not been reconciled to the total amount of Tuition reported by the University.

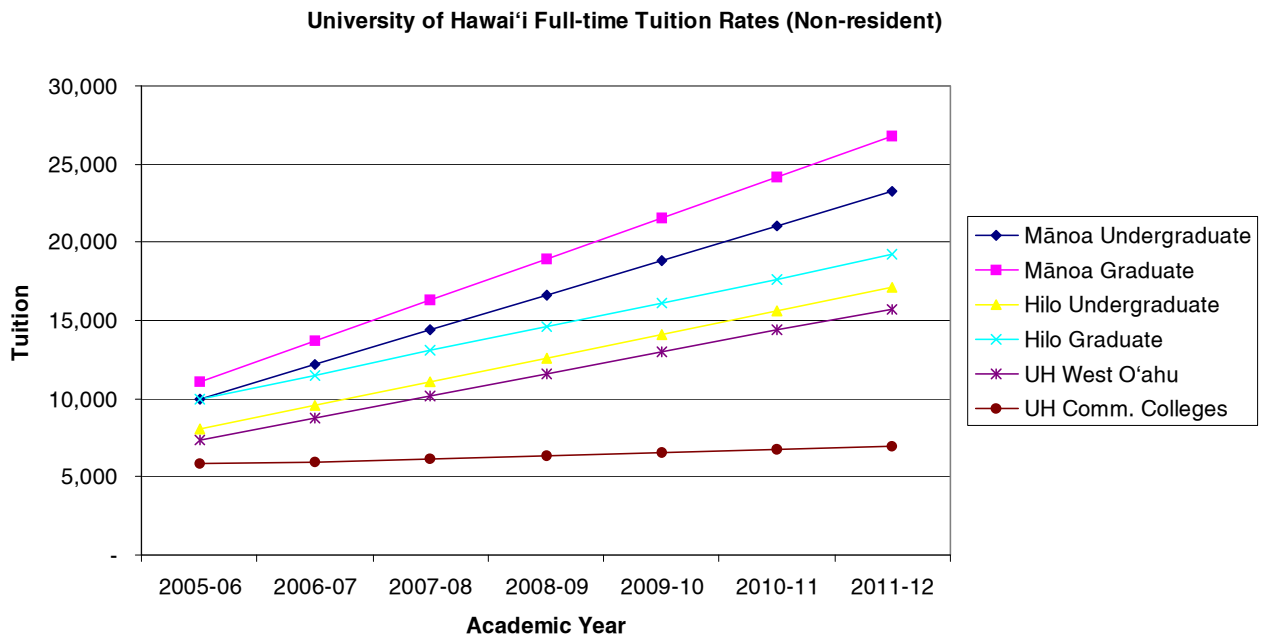
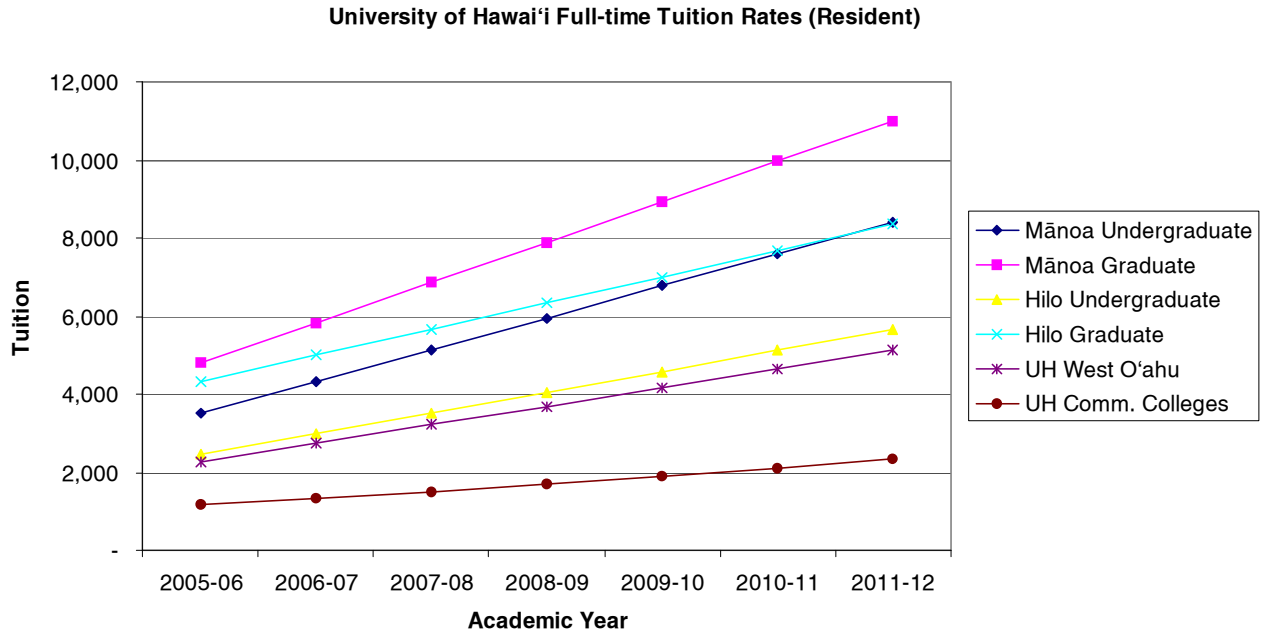
Source: University of Hawai'i General Accounting and Loan Collections

In December 2005, a briefing with the Legislature prompted a request for additional information including a projection of additional tuition revenue for FY2006-07 and the expected uses of that tuition revenue. Budget personnel for UH Hilo and West O'ahu indicated that tuition revenue projections had not been prepared prior to this legislative request. Only the community college system prepared a projection and related expenditure plan prior to the legislative request. Because the community college system was timely with its projections of revenue and expenditures, simultaneous to supplemental budget request submission, it also submitted to the systemwide University Budget Office a request for an increase in the expenditure ceiling for the Tuition and Fees Special Fund (TFSF) in order to accommodate the tuition rate increase.

Discussions with the systemwide University Budget Office revealed that it prepares an annual tuition revenue projection. However, upon the legislative request there were disagreements between the systemwide budget office and the various campuses on the revenue projection to be submitted to the Legislature. Ultimately, each campus submitted its own tuition projection and expenditure plan. Tuition revenue projections and the related expenditure plans should have been prepared prior to submission of the supplemental budget request to prevent subsequent disagreements. The tuition increase remains a controversial issue and stakeholders will demand assurances that the university will be accountable not just for the use of state funds, but for tuition funds as well.

In light of the above circumstances, it appears the university initially prepared its supplemental budget request without considering all sources of additional revenue. Total university tuition and fee revenue for FY2005-06 was approximately \$136 million. The FY2006-07 increase in tuition and fees is projected to be approximately \$23 million, amounting to a 17 percent increase over the previous year. The resident undergraduate tuition at Mānoa will increase from \$3,504 per year in academic year 2005-06 to \$8,400 per year in academic year 2011-12, representing a 140 percent increase over six years. The systemwide increases in tuition rates are expected to generate over \$400 million of additional tuition revenues over the next six years. Exhibit 2.5 displays the approved tuition rates for the various university campuses for academic years 2005-06 through 2011-12.

Exhibit 2.5
University of Hawai'i
Approved Full-time Yearly Tuition Rates for Academic Years 2005-06 to 2011-12 (Resident and Non-resident)



Note: Tuition rates for University of Hawai'i Community Colleges is calculated assuming 24 credit-hours per year to be equivalent to full-time status. Non-resident full-time tuition for the community colleges is calculated using the low-end of the cost per credit-hour range that is applicable at six of the seven campuses.

Source: University of Hawai'i

Without properly accounting for the tuition increase, the university's initial budget request to the Legislature did not accurately reflect the true resources and needs of the university. As a result, the public will question whether the rate increase was justified and the Legislature will question whether the state funding request is warranted. Although tuition rate increases were eventually factored into the university's budget request, the fact that it had to be prompted to include such a significant source of revenues and that there still remained confusion as to how to project those revenues perpetuates the perception that the university's budget request is a "wish list" and an attempt to garner as much state funding as possible.

Systemwide internal financial reporting should be strengthened

The Budget Level Summary (BLS) reporting system was designed as a high level management tool to provide campus administrators with relevant data to manage available resources and serve as a reporting mechanism to key stakeholders of the financial status of individual campus funds throughout the year. The BLS system projects the current fiscal year end financial status of each fund based on current cash balances, projected current year expenditures and encumbrances, projected current year revenues, and other relevant factors. During our prior year's audit, we found that the BLS reporting system was an inadequate management tool for the university's Mānoa campus. However, during our current audit we found mixed results among the rest of the university's units with respect to internal financial reporting.

Reporting efficiencies should be shared across units

During our current review we found that the community college system was able to demonstrate the value of the BLS system. As a source of financial data, the BLS system should be used to compile financial reports for management review, analysis, and explanation. Although input was received from all the campuses, the community college system was instrumental in the actual development of the BLS system.

As a result, the community college system is able to utilize the BLS system most effectively. The community college system's internal financial reports are compiled using data from various systems including BLS and the university's general ledger system known as the Financial Management Information System (FMIS). Extensive reconciliation procedures are documented and performed by the community college system campuses on a quarterly basis to ensure that accurate and reliable information is being used for decision-making. The BLS system projects the current fiscal year end financial status of each fund based on current cash balances, projected current year expenditures and encumbrances, projected current year revenues, and other relevant factors. The community colleges use this information to monitor budget execution

and cash balances of each fund, prepare state required reports, and to assist in the planning for future expenditures or the reallocation of funds, if necessary.

However, the value obtained from the BLS as a management tool at other campuses is less clear. For the University of Hawai'i's Hilo and West O'ahu campuses, the BLS is seen as more of a required task than a management tool. The primary use of the BLS for these campuses is to assist in preparation of the State Accounting Form A-19 submitted to the Department of Budget and Finance. Fiscal operations at these two campuses are much less complicated; therefore, each campus has developed its own set of reports to manage and monitor its finances. Ideally, a standard set of reports should be used to report financial results, which would enhance comparability and analytical value at the systemwide level and ease consolidation processes.

The university does not take advantage of available financial reporting resources

In an effort to improve internal financial reporting, the university made its initial presentation of the University of Hawai'i Funding Overview to the Board of Regents in April 2006. The funding overview, which is compiled quarterly by the community college system office, presents systemwide consolidated data on Appropriated Operating funds (BLS data), Capital Improvements Program funds, Federal and Trust Extramural funds, and other non-appropriated funds (endowment, loan, bond, and agency). We recognize that this is a step in the right direction, however further improvement is needed.

For example, for the fiscal year ended June 30, 2006, we were able to obtain general fund and tuition and fee special fund cash basis schedules of revenues and expenditures by source and object codes for all ten campuses and both the university system and community college system offices. This information is not normally produced and utilized by the university, but we believe it could be a valuable campus and system level monitoring and analytical tool. The key element to an analytical tool's usefulness is its ability to allow compilation of comparative historical and budgetary data with the same level of detail to allow for variance analysis to be performed.

The cash basis schedules of revenues and expenditures were produced using the Financial Data Mart (Data Mart) and Oracle Discoverer (Discoverer) reporting tools. The Data Mart is a repository of data captured from FMIS. It functions as a database and contains the following types of data: account attributes, account balances, transaction history, open commitment, sponsored project, payroll, and check reconciliation. The data are automatically refreshed at least three times a

week with some information being refreshed daily. Discoverer is a data access tool that allows users to extract information from the Data Mart to produce ad hoc reports and run queries for management analysis, future planning, and projections. These data can be exported into Excel or to an HTML file for web presentation. Users should be able to utilize these tools to eliminate the need for departmental “shadow systems,” which are spreadsheets maintained by some units using financial data obtained from FMIS.

While the use of available resources should be the norm, the university is not fully realizing the benefits that Data Mart and Discoverer have to offer. Lack of training, employee turnover, and varying levels of proficiency of fiscal personnel in using Data Mart and Discoverer result in the inconsistent use of a valuable reporting tool. The use of “shadow systems” is prevalent, resulting in financial reports that are not standardized. From a system standpoint, the use of various financial reports depending upon the unit decreases the comparability and the value of the reports as a tool for monitoring, analysis, and decision-making.

Certain Policies and Procedures Over Contracts and Tuition Deadlines Are Not Clear or Enforced

The responsibility of procurement and management of contracts for the university and its ten campuses is challenging and complicated. Well written policies and procedures along with compliance with those policies and procedures serve as an important component of internal controls. They are critical to achieving effective and efficient operations and compliance with applicable laws and regulations. One important factor that can influence the effectiveness of an internal control is the extent to which individuals or entities recognize that they will be held accountable. One way to develop an environment of accountability is through monitoring and back-end controls that will detect non-compliance. Monitoring activities such as independent evaluations, supervisory reviews, and self assessments will help foster accountability. During our audit we noted that the university needs to consistently adhere to policies governing procurement actions and tuition collections.

Further improvement is needed in managing contracts to ensure that they are in the best interest of the university

The Hawai'i Public Procurement Code, Chapter 103D, HRS, sets standards for all state agencies regarding the acquisition and maintenance of goods and services. The intent is to ensure the best interest of the State while promoting fair and honest competition. During our review we noted the need for continued improvement over the university's maintenance and organization of contracts, violations of procurement procedures, and examples of poor procurement practices.

The university must continue to build upon recent efforts to improve contract management

The university's Office of Procurement and Real Property Management (OPRPM) is responsible for procuring, executing, and processing contract payments, as well as for maintaining the contract files of the university. The issue of the need for formal policies and procedures governing OPRPM's maintenance and organization of contracts and the need for a central contract log was raised in a prior year's audit. In response, OPRPM modified the previous contract database to include campus and account code information. However, the contract database still does not have all of the information needed to be an effective monitoring tool. Modifications, change orders, renewal dates, encumbrances, and expenditure detail are not available. In addition, the database is currently updated at the time of contract execution, is not updated during the contract period, and is only revisited when the contract is retired. So, while it appears that OPRPM is working toward creating procedures to organize and archive retired files, much more improvement is needed.

The functions of procuring, executing, and processing payments on contracts are centralized, falling under the responsibility of OPRPM. However, many of the other functions of contract administration are decentralized. For example, there is no one party held accountable for all facets of contract administration. The retirement of contracts is initiated by the respective department fiscal officer. Therefore, while OPRPM is responsible for executing and maintaining the university's contract files, the office is not responsible for and does not monitor the timely retirement of contracts. The lack of standardized contract maintenance policies and procedures increases the risk of mismanaged contracts and reduces operational efficiency. It leaves the university open to the possibility of overlapping or lost contracts, and the inability to locate information.

Monitoring contracts is an essential function of any business operation. A comprehensive contract database could serve as a useful monitoring tool. Currently, the Department of Accounting and General Services (DAGS) provides a report detailing the university's old encumbrances. This is the only monitoring in place to ensure proper retirement of contracts. A memo from DAGS states,

Pursuant to Section 40-90(b), Hawai'i Revised Statutes, "[a]ll encumbrances for contracts shall become void after five years from the end of the fiscal year of the original encumbrance; provided that the comptroller may grant an exemption from this subsection if the comptroller finds that there is sufficient justification to extend a contract encumbrance.

In FY2005-06, DAGS notified the university of 63 encumbrances that had been outstanding for five years totaling approximately \$382,900. Upon review of the listing, the university requested that 15 encumbrances totaling approximately \$129,400 be extended, meaning that only 24 percent of the total contracts and 34 percent of the total encumbered balance on the DAGS' listing was related to valid, existing contracts. We further note that, because the DAGS' listing is only for contracts older than five years, it is possible the university has additional funds encumbered under dormant contracts. At this time, however, we are unable to quantify all outstanding encumbrances that should be retired.

Essentially, the university had \$253,500 tied up in 48 contracts that it was unaware were completed or expired, until prompted by DAGS. These funds could have been released to other programs or back to the state general fund. Better contract monitoring and maintenance would allow the OPRPM to identify and close out completed contracts on a timely basis, freeing up resources to deal more effectively with active contracts.

Certain procurement practices are not consistent with Administrative Procedures Manual

Proper contract procurement is essential to ensure that executed contracts are in the best interest of the university. When procuring contracts, good business practice dictates that a reasonable estimate of total costs be projected to help prevent unanticipated expenses. During our testing of 61 disbursements of general and tuition funds, which included 39 contracts, we found the following instances of noncompliance with the university's Administrative Procedures Manual (APM) and examples of poor procurement practices.

- Pursuant to APM A8.230, OPRPM Form 74 is required to be completed at the initiation of every contract to provide a timely written request for services. We encountered 23 instances in which OPRPM Form 74 "Contracting for Services" was not completed and filed in the contract file. OPRPM staff indicated that the information contained in the required form is now generally included in the actual contract document, rendering the use of the form unnecessary. However, the university's APM still requires OPRPM Form 74 to be completed and authorized for every service contract. OPRPM staff agreed that the APM should be updated to reflect the changes made to the contracting procedures.

- Pursuant to APM A8.305, regarding long-term use of non-university facilities, an explanation justifying the use of space other than university property should be submitted to the OPRPM at least two months prior to the desired date of use. We noted one instance in which documentation of the required information was not found. According to OPRPM, the required information regarding use of non-university space and facilities is obtained during fact-finding discussions with the contracting program or department. However, no documentation was found evidencing this fact.
- We noted one contract awarded to a vendor for approximately \$13 million for a seven-year period from April 11, 2002 to April 10, 2009. The scope of the services included the implementation of the Banner Student Information System and continuing maintenance through the termination of the contract. The total amount encumbered and expended as of August 16, 2006 was approximately \$18.8 million. Less than two-thirds of the way through the life of the contract, the university has already exceeded the original contract amount by 44 percent. The university's inability to accurately estimate contract amounts raises questions about the motivations behind some executed contracts. Additionally, large increases to contract amounts are difficult to budget for and, thus, may cause shortfalls in other operational areas, as funds will have to be transferred to cover the unexpected expenditures.

Our testing also revealed the improper use of the Research Corporation of the University of Hawai'i (RCUH). RCUH is attached to the university for administrative purposes and acts as a service bureau by hiring personnel and procuring goods and services on behalf of its clients. 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. While the University of Hawai'i is RCUH's main client, the university may only use RCUH under applicable university policies and certain conditions or criteria as specified in the Internal Agreement executed between the two parties. RCUH may also be used for certain aspects of research contracts and grants, which must be substantiated using Internal Service Order Forms. However, RCUH cannot be used for purchases greater than \$100,000 without approval from the Board of Regents. The Research Corporation of the University of Hawai'i must not be used as a means to circumvent state statutes.

Our sample of transactions tested included four disbursements to RCUH, one of which is questionable. The university's APM A8.930 establishes guidelines and procedures that govern the undertakings and services that

may be directed to RCUH including the review and approval process. It states that services may be provided by RCUH in “[o]n-going or contingency situations that cannot be readily anticipated and which require immediate action for the successful completion of the program or activity.” At the June 3, 2004 Board of Regents meeting, the university obtained approval to allow the budget-neutral competitive procurement of the mainframe server. The university did not obtain authorization from the Board of Regents to use the services of RCUH. However, the university and RCUH engaged in an arrangement, as evidenced by a financing agreement dated December 29, 2004, for the purchase of a computer mainframe server.

Under the arrangement, RCUH purchased the server for \$442,850 and then leased it to the university for a total of \$471,276, paid over 36 months. This transaction raises questions on the use of RCUH for this procurement, validating criticism that the university uses RCUH regularly to circumvent established procurement and purchasing procedures. Also of interest is the timing of the agreement. Effective January 1, 2005, the university was no longer exempt from the Hawai‘i Public Procurement Code (Chapter 103D, Hawai‘i Revised Statutes). Besides the questionable use of RCUH, the timing conveniently avoided the need to comply with the requirements of state procurement.

Lack of systemwide tuition policies and procedures results in inefficiencies

In its FY2002-03 annual financial audit, the university’s external auditors noted the need to improve “the consistency of policies and procedures over admissions, student registration, billing, and application of financial aid across the university, with the implementation of the SCT Banner Student Information System (Banner System).” We noted similar problems in our current audit. The university has centralized functions that require the need for systemwide policies and procedures to be consistently enforced. Certain university functions such as student registration and student billing were centralized, but the establishment and enforcement of policies and procedures governing these processes were left up to the individual campuses.

When we reviewed the university’s cash receipt processes, we noted that each campus may have a different tuition due date and may independently determine when and which students it “purges” from the system. “Purging” refers to the process that drops a student who is enrolled in a class due to delinquent tuition payments. The university’s Banner System allows students to register and pay for classes at any campus regardless of the location of attendance. However, the accounts receivable system does not allow delinquent notifications to be customized to identify a specific campus. The accounts receivable system will show only a single outstanding balance that does not differentiate between campuses. Because of the varying due dates, only

a portion of the balance may truly be delinquent. This creates difficulties when trying to send delinquent notifications. These inconsistencies also diminish the usefulness of the accounts receivable listing. It creates additional inefficiencies, since administratively the cashier's office needs to check with each campus before sending delinquent notifications. Moreover, while a student might be purged from one campus, certain campuses may choose not to purge a student at all, allowing that student to continue attending a class at another campus.

Without establishing and enforcing systemwide policies and procedures, the university's operational efficiency is negatively impacted, and the ability to effectively monitor compliance is severely hindered. In addition, the inconsistencies between campuses also negatively affects the university's ability to serve its customers because a student's ability to attend multiple campuses and transition from one campus to another is also negatively impacted.

Conclusion

As noted in our prior audit of the Mānoa campus, the University of Hawai'i is dependent on general fund and non-general fund support from the Legislature. Our current audit revealed that the university as a whole needs to improve its ability to account for this support to the Legislature and, consequently, the citizens of Hawai'i. Specifically, we found that the university devoted considerable resources to its planning efforts but ultimately produced strategic plans that lacked cohesion and measurability. Further hindering transparency is the failure to include all expected revenues in budget requests without legislative prompting, and inconsistent internal financial reporting. Finally, the university should improve the monitoring of contracts to ensure proper use of funds.

Recommendations

With respect to strategic planning the president of the University of Hawai'i should:

1. Review all university strategic plans to determine their practical utility. This process could include determining whether the plans are used to guide operational decisions and support funding requests, goals, and objectives and whether progress towards goals and objectives can truly be measured. The president should further determine whether the existing plans are serving their intended purpose or should be revised;

2. Ensure that future planning efforts are well-coordinated, with clear and timely guidance provided by the university system to all units and campuses to ensure that their plans and strategies support that of the system. All plans should contain specific fundamental planning elements, including specific timelines, assignment of responsibility, associated costs and anticipated funding sources, and measurable goals and performance indicators. The president should also require university system approval of unit and campus plans to ensure that system planning guidance has been followed; and
3. Develop a systematic approach to periodically reevaluating strategic plans as well as measuring progress towards plan goals and objectives.

With respect to budgeting and internal financial reporting, the university should:

4. Ensure that all sources of revenues, including expected tuition increases, and expected uses of those revenues, are clearly accounted for in the budgetary requests;
5. Explore the uses and benefits the community colleges system derives from use of the Budget Level Summary reports to determine how these efficiencies can be shared by the university's other units and campuses; and
6. Ensure that fiscal personnel receive the training necessary to develop and build the knowledge, skills, and abilities needed to fully utilize the Data Mart and Discoverer reporting tools available.

With respect to procurement and contract maintenance:

7. The university's Office of Procurement and Real Property Management (OPRPM) should:
 - a. Continue its efforts to create a comprehensive contract database by including additional relevant information, including details regarding contract modifications, change orders, renewal dates, encumbrances, and expenditures. Policies should be implemented for periodic database updates and reviews for accuracy;
 - b. Develop procedures to ensure that completed or expired contracts are properly communicated from the university's units and campuses. Periodic (i.e. annual) reviews of outstanding encumbrances should also be performed to determine validity; and

- c. Review current procurement practices and compare those to the Administrative Procedures Manual to determine if updates are necessary. Proper procurement procedures and required forms should be communicated systemwide.

With respect to tuition deadlines:

- 8. The university should establish consistent policies and procedures for systemwide functions such as admissions, student registration, billing, and student financial aid.

Responses of the Affected Agencies

Comments on Agency Responses

On November 28, 2007, we transmitted a draft of this report to the president and the Board of Regents of the University of Hawai'i. A copy of the transmittal letter to the 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 criticized the timing of our audit and relevance of our findings and recommendations. The university's general comments suggest that the University of Hawai'i System has already identified and/or addressed our audit findings relating to strategic planning and budgeting and internal financial reporting. While we commend any recent efforts of the university, its response indicates a failure to understand past problems and likelihood to repeat them.

The university admittedly recognized a need to revisit its current strategic plan and launched a process to revisit the plan in Fall 2007. The university held meetings during September 12, 2007, to November 26, 2007, to solicit feedback from faculty, students, and the public on the existing strategic plan. The purpose of this process was to answer basic and preliminary questions, including whether the system goals need to be revised. As such, we do not understand why the university considers our draft audit report (delivered on November 28, 2007) to be "dated" and a waste of taxpayer dollars. Further, in its response to our audit, the university indicates that it is currently reviewing strategic priorities, measurable performance indicators, and timelines—making our findings and recommendations regarding strategic planning quite opportune.

The university's response indicates that it is well aware of the problems we cite with its strategic plan and asserts that it is well into the process of revising the plan, thus rendering our audit findings moot. However, the university's website states that the Fall 2007 strategic plan update efforts resulted in "the creation of a companion piece to the strategic plan that assigns performance measures to strategic outcomes and extends the plan to 2015." Despite known problems with the foundation of its strategic plan, the university does not even appear to be revising the plan itself. Moreover, the December 2007 strategic outcomes and performance measures fall victim to the same problem the existing plan goals and objectives suffer—a lack of measurability and accountability. Below is an example of one of the university's newly proposed strategic outcomes and related performance measures:

Strategic Outcome #1: To position the University of Hawai‘i as one of the world’s foremost indigenous-serving universities by supporting the access and success of Native Hawaiians.

Performance Measures:

- Increase the number of Native Hawaiians in STEM degree programs.
- Increase the transfer rates of Native Hawaiians from two-year to four-year institutions.
- Increase the college going rate of Native Hawaiians.
- Increase the retention and completion rates of Native Hawaiians.

A key finding of our audit is that the university did not consistently establish measurable goals or a process for assessment. University objectives and performance indicators were generally vague and, consistent with the updated measures above, did not provide specific targets and timelines necessary for measuring progress. The new performance measures all beg the question—how much will *it* increase and by when? While the university makes clear it has already identified and addressed the findings contained in our audit report, it also appears poised to repeat these mistakes, which would be a true waste of resources.

The university disagreed with many other statements in our report; however, its arguments are generally based on a misreading of the facts presented.

For example, the university claims our audit states that tuition revenue projections had not been prepared for the University of Hawai‘i Hilo and West-O‘ahu campuses prior to the December 2005 legislative request. The university further notes that this is untrue as the University Budget Office has been preparing tuition projections by campus for many years. Our audit specifically acknowledges the efforts of the University Budget Office; however, the projections prepared by the budget office were not submitted to the Legislature. The tuition projections prepared by the Hilo and West-O‘ahu campuses, which were prepared subsequent to the legislative request, were submitted to the Legislature. Further, the university notes that our audit does not recognize that the consideration of tuition revenues was included in its 2007-09 biennium budget. However, this was done only because of legislative criticism, which is a point of our finding.

Relating to contract management, our audit criticizes the university for allowing a \$13 million, seven-year contract for a student information system to go severely over-budget, as \$18.8 million has been encumbered or expended with over two-and-a-half years remaining on the contract. The university responds that the project is actually under budget as \$6.2 million was expended for ongoing maintenance and

support and for two major upgrades, all of which were known and budgeted at project inception but inexplicably not included in the initial encumbrance.

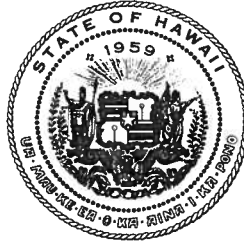
The university further criticizes our audit by defending its use of the Research Corporation of the University of Hawai'i (RCUH) to purchase a mainframe server by noting its efforts to ensure fair competition and pricing. However, our finding simply and plainly states that the university improperly used RCUH for the purchase, as approval from the university's Board of Regents was not obtained as required by the university's own policies.

The university also disagreed with our finding regarding contract encumbrances. However, the university elected to dispute the amount of encumbered moneys tied up in expired or completed contracts based only on general funded contracts, while our audit finding is based on both general and special funded contracts.

We did modify several financial exhibits contained in our report based on the university's response.

ATTACHMENT 1

STATE OF HAWAI'I
OFFICE OF THE AUDITOR
465 S. King Street, Room 500
Honolulu, Hawai'i 96813-2917



MARION M. HIGA
State Auditor

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

November 28, 2007

COPY

The Honorable David McClain, President
University of Hawai'i
Bachman Hall, Room 202
2444 Dole Street
Honolulu, Hawai'i 96822

Dear President McClain:

Enclosed for your information is copy number 6 of our confidential draft report, *Systemwide Financial Audit of the University of Hawai'i System: Phase II*. We ask that you telephone us by Friday, November 30, 2007, 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 10, 2007.

The Board of Regents, Vice President for Budget and Finance/CFO, 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,

A handwritten signature in cursive script, appearing to read "Marion M. Higa".

Marion M. Higa
State Auditor

Enclosure

President
David McClain



UNIVERSITY
of HAWAII^o
SYSTEM

December 10, 2007

RECEIVED

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

2007 DEC 10 PM 2:46

OFC. OF THE AUDITOR
STATE OF HAWAII

Dear Ms Higa:

Thank you for the opportunity to comment on your draft report, "Systemwide Financial Audit of the University of Hawai'i System: Phase II."

We find the recommendations in the draft report to be unexceptional. Indeed, they reflect and recount actions we have already taken prior to the audit and the report. We will continue to make improvements in these and other areas.

Furthermore, as the report states, the audit was conducted from August 2006 through May 2007; more than six months ago. The findings regarding strategic planning refer to actions taken in 2001 and 2002 and the findings relating to tuition increases relate to the initial supplemental budget request for Fiscal Year 2006-07, which was developed in the spring of 2005. In the meantime, enhancements have been and continue to be made in the strategic planning and budgeting processes, a number of which were already in place during the period of the audit. It is unfortunate that time and energy has been spent reciting findings that are not only dated, but also reflect conditions that had previously been articulated by me, others at the University and our external auditors, and that have been or are currently being revised.

In addition, the report contains a number of errors and inaccuracies and findings where clarification is required.

The following sections of this letter provide our comments on the findings in the report by major headings.

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An Equal Opportunity/Affirmative Action Institution

“The University of Hawai‘i’s Current Strategic Plan Has Limited Value and Does Not Promote Accountability”

The University’s current strategic plan was the culmination of a system-wide process conducted in 2001 and 2002. The audit report asserts that the system and campus plans are not clearly aligned. However, in their support of this assertion, they seem to require that goals “match”, be “identical” or be “one and the same”. If this were the case, there would be no need for campus strategic plans. The system strategic plan acknowledges that campuses have unique situations and different emphases. Accordingly, the system’s planning guidelines encouraged campuses to develop their own goals to reflect the institution’s unique strengths, weaknesses, opportunities and threats. At the same time, the guidelines made it clear that campuses were expected to arrive at plans that were consistent with the system plan. The campus plans were reviewed by the President’s Advisory Council on Plans and Priorities and the Board of Regents.

Specifically with regard to UH Hilo, the audit report references a report to the UH Hilo Faculty Congress and states the auditors “are unsure whether any formal actions were ever initiated as a result of the draft report.” Activities performed as a result of the report, which have not been noted by the auditors include:

- September 2006: The Vice Chancellor for Administrative Affairs issued a white paper tracking the alignment of the budget with the strategic plan. This document is available on the UH Hilo website at:
<http://www.uhh.hawaii.edu/uhh/vcadmin/documents/AligningBudgetwithStrategicPlan.doc>
- Spring 2007: The Chancellor commissioned a Strategic Plan Review Committee, which issued a forty-one slide, data-rich Powerpoint presentation in April of 2007, entitled the Strategic Plan Performance Indicators Update, detailing progress on each goal. This presentation was given to and discussed among the following groups last spring:
 - Chancellor’s Cabinet
 - Vice Chancellor’s Academic Council
 - UH Hilo Faculty Congress
 - The Chancellor’s Executive Committee. This committee comprises campus leadership responsible for passing down the information to their units.
- The UHH Strategic Planning Presentation is also available on the UH Hilo website at:
<http://www.uhh.hawaii.edu/uhh/iro/documents/UHHiloCampusUpdateonStrategicPlan2002-2010--Spring2007.pdf> .

With regard to priorities, as noted in the audit report, the current system leadership recognized the need for further analyses to identify the higher education needs of the state of Hawai‘i and to establish priorities in meeting those needs. The Second Decade Project was

launched by the President to inform the University's decisions as we move toward the second decade of the new century. Presentations on the Second Decade Project are posted on the University of Hawai'i System website at: <http://www.hawaii.edu/offices/app/seconddecade/> The project specifically identified regions of the state that need increased education and training based upon current and projected demographic data. The results of the project also made clear the State's general need for increased 1) education capital, 2) attention to workforce shortages, 3) diversification of the economy, 4) and services to the underserved regions and populations, particularly Native Hawaiians. These needs were confirmed through a series of community and campus meetings on every island. A number of performance indicators were chosen, and a brochure was disseminated that provided the current status of the University's progress on these indicators. This brochure is available on the University of Hawai'i System website at: <http://www.hawaii.edu/offices/app/opp/msn/>

The state of Hawai'i needs were used to prioritize campus requests in the 2007-2009 biennium budget request. Recognizing that there was a need to re-visit the system's 2002-2010 strategic plan, the President launched a strategic planning process under the leadership of the Vice President for Academic Planning and Policy in fall 2007. The purpose of the process was to determine whether the goals of the system plan needed to be revised, whether the action strategies needed to be up-dated, and whether measurable outcomes and timelines could be established. Open meetings were publicized and held on every campus; faculty, staff, students, and the public were invited to attend. Numbers in attendance and the results of their participation is posted on the University of Hawai'i System website at: <http://www.hawaii.edu/ovppp/uhplan/> Based on the input from the participants, it is clear that there is broad commitment to the goals and objectives of the current strategic plan. Participants did, however, indicate that the goals need to be simplified, made more explicit, and that measurable outcomes should be selected. Strategic priorities, measurable performance indicators, and timelines are now in review and will be disseminated to all campuses for further comment.

These system performance indicators will inform the campus plans as well as the 2009-2011 biennium budget proposal. The audit report states that campus goals are not aligned with the current system goals; the objective is, however, to have the campus plans align with the system strategic priorities and the measurable outcomes. That is, the system will provide the priorities for the campuses, and campuses will determine the strategies to attain those priorities in keeping with their mission. This alignment will allow the University's goals to be monitored for progress across the ten campuses.

Campus and system strategic plans are approved by the Board of Regents, and once the indicators are agreed upon by the campus communities, the system-level performance indicators will be shared with the Board as well. At that point the associated costs and funding sources will be determined, and the budget plans will be aligned with the strategic goals.

It should be clear from this description of current strategic planning efforts that the University has been working on the substance of the auditor's recommendations for the past year and more. It is unfortunate that taxpayer dollars were spent in auditors reviewing documents and processes that were already under revision.

“The University Needs to Improve Its Budgeting and Internal Financial Reporting Processes to Foster Accountability”

Exhibits 2.3 and 2.4 in this section of the draft audit report are erroneously titled. They both present information for the entire university system, rather than only Manoa.

In addition, Exhibit 2.5, University of Hawai‘i Approved Full-time Yearly Tuition Rates for Academic Years 2005-06 to 2011-12 (Resident and Non-resident) of the audit report incorrectly notes that "Tuition rates for University of Hawai‘i Community Colleges for academic years 2006-07 to 2011-12 were not available."

When the Board of Regents approved the current tuition schedule on May 19, 2005, increases to the community colleges per credit tuition were approved along with the increases for the other campuses. However, unlike the other campuses where the tuition is "capped" at 12 credits per semester (credits above the 12 credits are taken at no additional cost), community college students pay for each credit taken. For the purpose of this exhibit, the 24-credit per year equivalent should be reflected for the community colleges, as that is the full-time equivalent comparable to the other campuses. This data is presented below for academic years 2005-06 to 2011-2012.

**University of Hawai‘i - Community Colleges
 Approved Full-Time Yearly Tuition Rates for Academic Years 2005-06 to 2011-12**

| | FY 2006 | FY 2007 | FY 2008 | FY 2009 | FY 2010 | FY 2011 | FY 2012 |
|----------------------------|---------|---------|---------|---------|---------|---------|---------|
| <u>Resident</u> | | | | | | | |
| \$/Credit | 49 | 56 | 63 | 71 | 79 | 88 | 97 |
| 24 Credits/year | 1,176 | 1,344 | 1,512 | 1,704 | 1,896 | 2,112 | 2,328 |
| <u>Non-Resident</u> | | | | | | | |
| \$/Credit | 242 | 249 | 256 | 264 | 272 | 281 | 290 |
| 24 Credits/year | 5,808 | 5,976 | 6,144 | 6,336 | 6,528 | 6,744 | 6,960 |

Source: University of Hawai‘i Undergraduate and Graduate Per-Credit-Hour and Full-Time Semester Tuition Schedule approved by the Board of Regents on May 19, 2005

In addition, the audit report states that tuition revenue projections had not been prepared for UH Hilo and UH West Oahu prior to legislative request in December 2005. This is not true. The University Budget Office had been preparing projections of tuitions by campus for many years. In addition, UH Hilo and UH West Oahu prepared projections. These were not required to be included in either the executive or legislative budget submittals. However, when requested by the legislature, tuition revenue projections and related expenditure plans were provided.

Furthermore, the audit report cites events in 2005 while not recognizing that as of January 2006, even before the period the audit was conducted, the consideration of tuition revenues was included as an integral part of preparing the University's 2007-09 biennium budget request as noted in a memorandum dated January 31, 2006 from Howard Todo, Vice President for Finance/Chief Financial Officer and Linda Johnsrud, Interim Vice President for Academic Planning and Policy, to Chancellors and Senior Staff entitled "Biennium Budget Proposal Development". Campuses were required to document tuition and fee revenues as a means of financing for their base budgets as well as for any new initiatives.

With regard to the BLS system, since Phase I of the Systemwide Financial Audit, numerous improvements and enhancements have been made to the BLS system. Expenditure information for example, is now aggregated in 47 separate and unique expenditure categories thereby providing a much greater level of detail. Similar improvements are currently under development to provide the same level of detail for various revenue sources and should be in available during the first quarter of FY 2008-09. Another enhancement is the consolidated variance report that is now prepared centrally and provided to the campuses and Board of Regents on a regular basis. This report summarizes budget to actual variances for each means of financing at the campus level and includes narrative explanations for significant variances. The purpose of this report is to provide the Board of Regents and campus management with a source of basic consolidated financial and budgetary data necessary to effectively monitor operating unit performance and identify issues and problems for decision-making.

"Certain Policies and Procedures Over Contracts and Tuition Deadlines Are Not Clear or Enforced"

The audit report states that the contract with SunGard Higher Education Systems to implement the new Banner student information system was initially estimated at \$13.3M but incurred costs of \$18.8M and suggests that the University did not manage the contract to avoid these additional costs.

The opposite is true. The \$13.3M represented the estimated cost of the software implementation, including software licenses, modifications, consulting and all related expenses. That project was completed on time and under budget. Actual expenses for the implementation of the system were \$12.8M or \$.5M under budget.

The remaining expenses on the SunGard contract since implementation include all ongoing maintenance and support after the implementation project (\$2.4M) and two major upgrades of this complex enterprise software (\$3.8M). These expenses were anticipated and budgeted at project inception as the expected operational costs of the system once it was implemented. As a matter of cost management, ongoing expenses are appropriately and routinely managed through the same contract used for project implementation. Locking in of maintenance and support costs for a multi-year period in the initial contract is a normal and prudent means of controlling cost escalation and thereby obtaining best value for public dollars.

The audit report also alleges that the use of RCUH for assistance in financing the mainframe server was intended to circumvent established procedures, or even more illogically, to avoid the impending need to comply with the requirements of the Hawai'i Public Procurement Code. In fact, the University issued a full competitive RFP in October 2004 to furnish, deliver, install and maintain the mainframe server and the vendor for this project was selected through that public competitive process. The project was designed to be financed over a multi-year period, since the University knew it would be possible to both acquire and maintain a more powerful new server for no more than it was paying just to maintain the older mainframe the University owned. In order to maximize competition and make best use of public funds, the competitive RFP provided for two methods of award: outright purchase and lease. This allowed the University to select the best provider for the necessary hardware and services independent of the financing agreement used to spread the costs over a multi-year period. In addition to the financing options provided for in the RFP, the University examined the costs to use an existing contract with a commercial financing company. And since RCUH had financed previous IBM mainframe purchases for over 20 years, the University also requested that RCUH obtain proposals for financing for this project. Of all the financing options available, one of the proposals obtained by RCUH was the least expensive and was therefore accepted as the most economical use of public funds.

In addition, the audit report asserts in this section that in FY2005-06, the University had 63 encumbrances that had been outstanding for five years totaling approximately \$382,900 and that only 15 of these encumbrances in the total amount of \$129,400 related to valid existing contracts. Our records indicate that at the close of FY2005-06, 21 encumbrances totaling approximately \$155,500 had been outstanding for five years rather than the 63 totaling \$382,900 asserted by the auditors. Therefore, in reality, the valid existing contracts represented 83% of the encumbered amounts as opposed to the 34% claimed in the audit report. These contracts were primarily in the area of architectural/engineering design services and construction in which contracts may stay open for a number of years.

Also, the report fails to mention that State law, specifically HRS 40-90(b), provides that general fund encumbrances for contracts remain valid for five years from the end of the fiscal year in which the encumbrances were made. After five years, the University may request an exemption from the comptroller on a showing of sufficient justification to extend the contract encumbrance. General fund claims encumbrances (e.g. purchase orders, interdepartmental orders, authorizations for payments, etc.), in comparison, remain valid for only 6 months from the end of the fiscal year in which the encumbrance was entered and will be void after that time unless an extension is requested from DAGS. Responsibility for reviewing outstanding encumbrances on a day-to-day basis (and deleting any remaining portion of an encumbrance for which the University's financial commitment has been extinguished) is decentralized to the departmental fiscal officers who administer contracts for which the goods, services or construction have been requisitioned by their departments. Central offices such as OPRPM and Disbursing monitor contract encumbrances on a five year basis and claims encumbrances on an annual basis to insure that encumbrances relating to financial commitments which are still open are not voided under HRS 40-90 and to coordinate the submission of extension requests to DAGS on behalf of all University campuses on a systemwide basis.

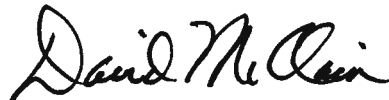
The Honorable Marion Higa
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Finally, with regard to tuition deadlines and purge dates, since the date of the audit, the University has made significant strides in identifying and implementing common tuition payment deadlines and purge/disenrollment dates to accommodate the increasing flow of students registering at multiples campuses across the UH System. In the past, each campus set its own policy to meet the needs and unique characteristics of its students.

The University now imposes a tuition payment deadline for the fall semester and one for the spring semester that is common across nine campuses. Beginning in Fall 2008, all ten campuses will adhere to the same tuition payment deadlines. Likewise, with minor variation between the community college system and the baccalaureate campuses, the campuses will have common purge/disenrollment dates.

We appreciate 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,

A handwritten signature in black ink that reads "David McClain". The signature is written in a cursive, flowing style.

David McClain
President

c: Board of Regents