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# **Follow-Up Report on an Audit of the Research Corporation of the University of Hawaii**

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



**THE AUDITOR**  
STATE OF HAWAII

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## The Office of the Auditor

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

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

1. *Financial audits* attest to the fairness of the financial statements of agencies. They examine the adequacy of the financial records and accounting and internal controls, and they determine the legality and propriety of expenditures.
2. *Management audits*, which are also referred to as *performance audits*, examine the effectiveness of programs or the efficiency of agencies or both. These audits are also called *program audits*, when they focus on whether programs are attaining the objectives and results expected of them, and *operations audits*, when they examine how well agencies are organized and managed and how efficiently they acquire and utilize resources.
3. *Sunset evaluations* evaluate new professional and occupational licensing programs to determine whether the programs should be terminated, continued, or modified. These evaluations are conducted in accordance with criteria established by statute.
4. *Sunrise analyses* are similar to sunset evaluations, but they apply to proposed rather than existing regulatory programs. Before a new professional and occupational licensing program can be enacted, the statutes require that the measure be analyzed by the Office of the Auditor as to its probable effects.
5. *Health insurance analyses* examine bills that propose to mandate certain health insurance benefits. Such bills cannot be enacted unless they are referred to the Office of the Auditor for an assessment of the social and financial impact of the proposed measure.
6. *Analyses of proposed special funds* and existing *trust and revolving funds* determine if proposals to establish these funds and existing funds meet legislative criteria.
7. *Procurement compliance audits* and other *procurement-related monitoring* assist the Legislature in overseeing government procurement practices.
8. *Fiscal accountability reports* analyze expenditures by the state Department of Education in various areas.
9. *Special studies* respond to requests from both houses of the Legislature. The studies usually address specific problems for which the Legislature is seeking solutions.

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



## THE AUDITOR STATE OF HAWAII

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Submitted by

**THE AUDITOR**  
STATE OF HAWAII

**Marion M. Higa**  
State Auditor

Report No. 95-9  
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## Introduction

The Office of the Auditor issues a wide variety of reports and studies recommending improvements in government operations. In response to growing interest in the impact of our audits, we have expanded our follow-up program to include a systematic review of selected findings and recommendations of previous audit reports. We revisit the subject agencies to verify and assess any progress made in addressing prior audit findings and recommendations. Government auditing standards require an audit follow-up process to determine whether an auditee has taken timely and appropriate corrective actions on findings and recommendations from previous audits.

The purpose of this report is to describe actions taken by the Research Corporation of the University of Hawaii (RCUH) with respect to certain recommendations in our October 1993 *Audit of the Research Corporation of the University of Hawaii*, Report No. 93-10. We hope that the information provided in this report will assist policy makers in ensuring effective, efficient, and accountable programs.

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## Background

The Legislature created RCUH to make the University of Hawaii (UH) more competitive in obtaining research grants. RCUH plays a vital role in administering and expediting university and state research contracts and grants. Receiving no appropriations from the State, RCUH relies on management fees it charges the university and state agencies.

Because of the importance of RCUH to both the State and the university, the State Auditor in 1993 initiated an audit of its operations and management. Our 1993 report found a lack of accountability and oversight in RCUH's operations, financial management, and contract administration. RCUH also lacked clear policies, criteria, and management controls for contracts with state agencies. Finally, we found that RCUH's management fee structure for state agencies was arbitrary and not linked to services provided. Based upon our findings, we made recommendations to the Legislature, RCUH, the university, and the governor.

This follow-up report focuses on actions taken on recommendations we directed to RCUH, the university, and the governor. However, our 1993 report also made a recommendation to the Legislature: it should require

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a report from the university on its plans to restructure the RCUH-UH relationship, including how the university will hold RCUH accountable, the role and function of the RCUH Board of Directors, and RCUH's relationship to other university research activities. We note that RCUH and the university are working on a reorganization plan, and that Senate Resolution 139, S.D. 1 of 1994 asks the university to make a final report to the 1995 session on implementation of this reorganization.

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## **Approach to Follow-Up**

As a follow-up of our 1993 recommendations to the agencies, we reviewed RCUH's letter to the Auditor of October 28, 1994, the university's letter of November 2, 1994, and the Department of Budget and Finance's (B&F) letter of October 24, 1994, which provided information on actions taken. We then conducted fieldwork at RCUH to gather additional information necessary for this report. Our work was performed from January 1995 through February 1995.

The following is our overall assessment of progress made by RCUH, followed by a description of our previous recommendations, actions reported by RCUH, the university, and B&F in their 1994 letters to us, and the results of our recent fieldwork.

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## **Summary of Follow-Up**

Our overall assessment is that RCUH has initiated steps to implement the recommendations from our 1993 audit. These steps include RCUH's accurately reporting revenues and expenses, capitalization and annual depreciation expenses of fixed assets, and investment income and total expenses for research assistantships. In addition, RCUH has drafted a proposed master agreement for RCUH and state agencies to establish the terms and conditions under which state agencies and the RCUH may enter into contractual arrangements.

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## **Recommendation from 1993 Report**

In our 1993 report, we recommended that RCUH accurately report revenues and expenses in its financial statements. We maintained that RCUH should adhere to both its written policy and generally accepted accounting principles in its treatment of fixed assets.

## ***Implementation as reported in RCUH's letter***

In its October 1994 letter to the Auditor, RCUH reported that effective with statements issued for FY1992-93, its audited financial statements report the capitalization of the administrative fixed assets and the annual depreciation expense of these fixed assets. In addition, RCUH identifies the quasi-endowment fund as "investments" on the balance sheet and

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separately states income and expenses for investments and research assistantships on its statement of revenues and expenses.

***Results of our  
fieldwork***

In our follow-up fieldwork, we reviewed RCUH's financial statements for the years ending June 30, 1994 and 1993. RCUH properly identifies investments at the University of Hawaii Foundation and shows fixed assets on the balance sheet. The statement of revenues and expenses for RCUH also properly reports investment incomes, total expenses for research assistantships, and fixed assets depreciation expense.

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**Recommendation  
from 1993 Report**

We recommended that the University of Hawaii ensure that RCUH:

- a. develops clear policies, criteria, and guidelines for the types of projects RCUH will accept from state agencies;
- b. develops management controls and a monitoring program to ensure that state projects do not circumvent state laws and contracts; and
- c. formalizes policies for a management fee for RCUH contracts with state agencies based on its administrative costs, and defines the use of revenues derived from the fees.

***Implementation as  
reported in the  
university's letter***

The university's November 1994 letter to the Auditor said that RCUH was addressing the recommendation by developing a master agreement with the State for RCUH services. The agreement will include the criteria under which state agencies may contract for RCUH services and the guidelines under which RCUH may accept such contracts. The university as an ex-officio member of the RCUH Board of Directors will continue to monitor RCUH's progress. In a subsequent letter to the Auditor's staff, RCUH said it was waiting for the governor's signature on the agreement. If a master agreement is not approved, RCUH said it will enter into individual agreements with state agencies based upon the draft master agreement.

Concerning a management fee, the university's November 1994 letter said that RCUH is working on a policy that ensures that the indirect cost rate for state projects will provide full recovery of RCUH administrative expenses, will support working capital requirements, and will not exceed the negotiated federal overhead rate.

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***Results of our  
fieldwork***

We reviewed the proposed master agreement between RCUH and the governor on behalf of state agencies. The agreement establishes criteria that state agency projects must meet before seeking RCUH's services. For example, the project must exceed the existing capacity of the state program manager and must be inappropriate for private sector assistance. The agreement also establishes guidelines under which RCUH may accept state projects. For example, the project must involve research facility management and must utilize temporary personnel. In addition, the agreement establishes management controls, including monitoring and periodic review of projects, to assure that projects adhere to agreement guidelines and criteria.

However, we found in the proposed master agreement that RCUH continues to compute management fees for state agency contracts using a standard percentage of total project costs (indirect cost).

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**Recommendation  
from 1993 Report**

We also recommended in 1993 that the governor develop policies for the executive branch that identify the conditions and criteria under which the state agencies may contract with RCUH and establish a system for reviewing requests for contracting with RCUH.

***Implementation as  
reported in B&F's letter***

In its October 1994 letter to the Auditor, B&F reported that RCUH was drafting the proposed master agreement with comments from B&F and the attorney general. The agreement will provide conditions and criteria that RCUH, the governor, and state agencies will use to determine if proposed contracts are appropriate under Chapter 307, HRS, which establishes RCUH.

***Results of our  
fieldwork***

Our review of the draft master agreement found that it sets conditions and criteria that all parties will use to determine if the specific project is acceptable to RCUH.

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**Conclusion**

We conclude that since our 1993 audit, the Research Corporation of the University of Hawaii has made progress in implementing our recommendations. RCUH has improved its financial reporting. In addition, RCUH has drafted a proposed master agreement governing contractual arrangements between RCUH and state agencies. This agreement, which is awaiting the governor's signature, implements many of our 1993 recommendations.

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However, it appears that RCUH will continue to compute management fees for state agency contracts using a standard percentage of total project costs (indirect cost). Our recommendation intended that contract administration fees be based on actual costs incurred for administering a specific contract. An RCUH official observed that determining the actual cost of individual projects is not feasible because the specific data to determine costs is not available. However, we continue to recommend a fee structure based on actual administration costs because there is little relationship between total project moneys and actual administration costs for a project.



