Review of Selected University of Hawaii Non-General Funds and Accounts

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

Report No. 03-04
March 2003

THE AUDITOR
STATE OF HAWAII

Office of the Auditor

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

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

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

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

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

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

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

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

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

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

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

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

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OVERVIEW

Review of Selected University of Hawaii Non-General Funds and Accounts

Report No. 03-04, March 2003

Summary

The University of Hawaii is a postsecondary education system that comprises three university campuses, seven community colleges, an employment training center, and five education centers distributed across six islands throughout the state. Although $660 million was appropriated to the university during FY2001-02, representing nearly 10 percent of the entire executive branch's budget, the Legislature was unable to obtain timely financial information from the university during the 2002 legislative session.

Our review found numerous accounts of mismanagement by the university for six of its non-general funds. We found that lax monitoring has led to the inappropriate use of funds in at least two non-general funds. For example, the Research and Training Revolving Fund, which was statutorily created to facilitate university research and training, has been used for other purposes. We found that this fund was used to pay for aesthetic improvements to a library and to cover a shortfall in funds for the utility expenses of new facilities. We also found that the university misused its $57 million Endowment Fund. Funds endowed to the university to further marine and atmospheric research have been used by a dean to pay for personal entertainment expenses.

The university also lacks documented policies and procedures for the use and allocation of its Research and Training Revolving Fund and its Tuition and Fees Special Fund. Without allocation guidelines for the research fund, the campuses, departments, and schools that might receive allocations are unable to plan for future research initiatives. In addition, university administrators were unable to tell us how $8.5 million of the total $21.7 million research and training allocation for FY2002-03 would be used. The lack of policies and procedures for the Tuition and Fees Special Fund is especially concerning because the fund collected over $439 million and expended over $400 million since FY1997-98. This concern is exacerbated by the fact that the university has not assigned responsibility for this significant source of revenue to anyone.

We also found that outdated procedures may contribute to the university's inability to provide adequate loans to qualified students from its State Higher Education Loan Fund. This loan program has about $8.99 million in loans outstanding to students with 31 percent ($2.85 million) of that considered past due or delinquent. Other universities we contacted reported such delinquency rates as low as 2 and 15 percent.

The university has also disregarded sound contracting practices by allowing contractors to render services before contracts were fully and properly executed. We found several agreements funded by the Tuition and Fees Special Fund that were either incomplete or executed in an untimely manner. We also found lease

agreements relating to the Real Property and Facilities Use Revolving Fund were not updated or modified in a timely manner.

From 1997 through October 2002, the university contracted with the University of Hawaii Foundation to provide fundraising and stewardship services at an annual cost of $1 million. In October 2002, the university entered into a new contract with the foundation for $2.35 million annually. As allowed by law, these contracts have been paid with moneys in the university's Tuition and Fees Special Fund. However, the university has failed to adequately monitor these contracts. In fact, the current tuition-funded contract does not allow the university to adequately monitor the foundation's services. Furthermore, although the State Auditor is statutorily authorized to conduct postaudits of state or public fund expenditures, the foundation prevented access to information needed to thoroughly assess the university's state-funded contract with the foundation.

Despite the limitations imposed by the foundation, we were still able to identify a number of questionable foundation expenditures made under the guise of fundraising. For example, a number of social events and functions attended by foundation employees such as football games, holiday luncheons, and community fundraisers, were not justified as fundraisers for the university and do not appear to benefit the institution. We also found that student tuition-funded contract funds were used to entertain foundation employees. For example, foundation employees' tickets for a rock concert were paid with state contract funds. State contract funds were also used to pay for at least two foundation employees' farewell parties at a local restaurant and museum. Finally, we found that the university president used public contract funds to purchase a personal gift. Although the amount of the questionable expenditures we identified may not be significant to the total operation of the foundation, we believe the prevalence of improper usage of student tuition and fees warrants further attention.

Recommendations and Response

We made a number of recommendations to the president of the University of Hawaii, the University of Hawaii Board of Regents, and the Legislature. In its written response to our draft report, the university questioned the "materiality" of our findings yet concurred with our recommendations that the university strengthen its internal oversight and accountability over the non-general funds we reviewed. The university did not agree with all our findings; however, it reported that it has taken steps to address many of them.

Similarly, the Board of Regents agreed with our recommendation for stronger reporting requirements and indicated that changes were being made to address this concern. Finally, although the foundation did not agree with all of our findings, it reported that it has created a separate account to manage its university contract funds and is in the process of reviewing its expenditure policies.

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Review of Selected University of Hawaii Non-General Funds and Accounts

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

Submitted by

THE AUDITOR
STATE OF HAWAII

Report No. 03-04
March 2003

Foreword

This is a report of our review of selected University of Hawaii non-general funds and accounts. This review was conducted pursuant to Act 177, Session Laws of Hawaii 2002, and Section 23-4, Hawaii Revised Statutes (HRS). Act 177 specifically requested a review of the State Higher Education Loan Fund, Research and Training Revolving Fund, University Parking Revolving Fund, Real Property and Facilities Use Revolving Fund, and Tuition and Fees Special Fund. In addition and pursuant to Section 23-4, HRS, we also reviewed the university's Endowment Fund and the university's contract with the University of Hawaii Foundation, which is funded by the Tuition and Fees Special Fund.

We wish to express our appreciation for the cooperation and assistance extended to us by the administrators and staff of the University of Hawaii, other organizations, and individuals whom we contacted during the course of our review.

Marion M. Higa
State Auditor

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Chapter 1
Introduction

The University of Hawaii is a postsecondary education system that comprises three university campuses, seven community colleges, an employment training center, and five education centers distributed across six islands throughout the state. During FY2001-02, the Legislature appropriated over $660 million to the university for its operating costs. Although the university's budget comprises nearly 10 percent of the entire executive branch's budget, the Legislature was unable to obtain timely financial information from the university during the 2002 legislative session. As a result, the Legislature initiated a review of the university's non-general funds through Act 177, Session Laws of Hawaii (SLH) 2002.

Act 177 specifically requested a review of the following non-general funds:

- State Higher Education Loan Fund,
- Research and Training Revolving Fund,
- University Parking Revolving Fund,
- Real Property and Facilities Use Revolving Fund, and
- Tuition and Fees Special Fund.

In addition, and pursuant to Section 23-4, Hawaii Revised Statutes (HRS), we reviewed the university's Endowment Fund and the University of Hawaii Foundation's contract with the university, which is funded by the Tuition and Fees Special Fund.

Background

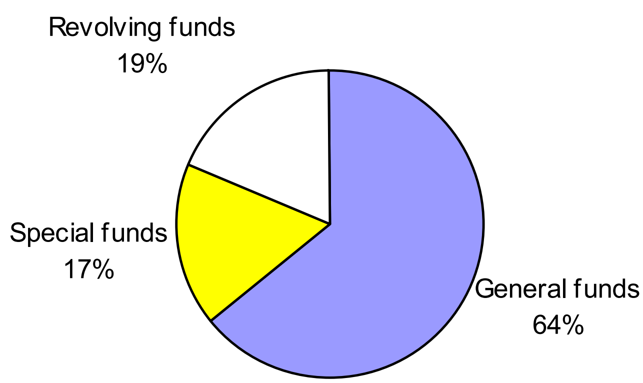
Previous audit reports have identified over 60 revolving, special, and trust funds utilized by the university. Our *Update of the 1992 Summary of Special and Revolving Funds,* Report No. 01-12, identified 53 special and revolving funds maintained by the university. Our *Review of Revolving Funds, Trust Funds, and Trust Accounts of the Department of the Attorney General, the Department of Business, Economic Development and Tourism, and the University of Hawaii,* Report No. 00-07, noted eight trust funds and two trust accounts that were also maintained by the university.

Section 37-62, HRS, defines special funds 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. Revolving funds are defined by Section 37-62, HRS, as any fund "from which is paid the cost of goods and services rendered or furnished to or by a state agency and which is replenished through charges made for the goods or services or through transfers from other accounts or funds." A trust fund, as defined by Section 37-62, HRS, is "a fund in which designated persons or classes of persons have a vested beneficial interest or equitable ownership, or which was created or established by a gift, grant, contribution, devise or bequest that limits the use of the fund to designated objects or purposes."

The university system receives significant non-general fund support

In addition to the general fund support the university receives from the Legislature, it also relies on non-general funds to support its programs and facilities. During FY2001-02, the university received about $237.4 million in appropriated revolving and special funds. As shown in Exhibit 1.1, this represented more than one-third (36 percent) of the university's total FY2001-02 appropriation of general, special, and revolving funds.

Exhibit 1.1
University of Hawaii Appropriations, FY2001-02



Source: Act 259, Session Laws of Hawaii 2001.

The FY2001-02 ending fund balances of the six non-general funds we reviewed totaled over $124.7 million. Over 90 percent of this balance was from only three funds. They were: the Endowment Fund, with $57.7 million; the Research and Training Revolving Fund, with $31 million; and the Tuition and Fees Special Fund, with $25.6 million.

Endowment Fund

This trust fund was created in 1925 to supplement the university's funding sources and provide various scholarships to students. Donors may provide funds for various purposes to specific departments such as the School of Medicine or the College of Engineering. The Board of Regents also has designated scholarships from this fund, including the presidential and regents scholarships for Hawaii's top high school graduates.

Currently, the University of Hawaii Foundation holds all new endowment funds unless a donor specifically asks the university to hold the endowment and the Board of Regents subsequently accepts the endowment. For example, the university directly accepted a $1 million endowment from a donor in November 2000 to support faculty development and enrichment at the community colleges. Gifts to existing endowment accounts are accepted by the university after being processed by the University of Hawaii Foundation. The foundation currently charges a 2 percent administrative fee to process endowment gifts for the university.

The Endowment Fund's financial data over the past five years is reflected in Exhibit 1.2. The fund's financial data is reported at fair market value, in accordance with accounting standards. Fund balances from prior reports will not match balances in current reports because previous reports were reported at cost. Negative revenues reported for FY2000-01 and FY2001-02 were due to realized and unrealized losses on investments.

Exhibit 1.2
Endowment Fund
Financial Data for Fiscal Years 1998 to 2002 (in thousands)

	FY1998	FY1999	FY2000	FY2001	FY2002
Beginning Fund Balance	$49,716	$61,965	$68,314	$75,799	$65,536
Revenues	12,849	7,523	8,979	(8,980)	(7,532)
Interest	1,400	1,362	1,352	1,440	1,280
Expenditures	0	0	0	0	0
Transfers	(2,000)	(2,536)	(2,846)	(2,723)	(1,625)
Ending Fund Balance	$61,965	$68,314	$75,799	$65,536	$57,659
Encumbrances	$0	$0	$0	$0	$0

Source: University of Hawaii General Accounting and Loan Collections

Real Property and Facilities Use Revolving Fund

Act 115, SLH 1998, established this revolving fund to account for revenues collected by the university for the use of university facilities. Those who use the facilities must pay room usage fees, commercial filming fees, and deposits. In turn, these fees and deposits are used to maintain the facilities. Moneys may be expended for maintenance, administrative expenses, salaries, wages, employee benefits, contractor services, supplies, security, furnishings, equipment, janitorial services, insurance, utilities, and other operational expenses. The fund was amended in 2000 to authorize the depositing of revenues derived from the sale or lease of university real property.

The Real Property and Facilities Use Revolving Fund's financial data over the last four years is shown in Exhibit 1.3. The positive amount reported as an expenditure during FY2001-02 was related to deposits for building keys received during the year.

Exhibit 1.3
Real Property and Facilities Use Revolving Fund
Financial Data for Fiscal Years 1999 to 2002 (in thousands)

	FY1999	FY2000	FY2001	FY2002
Beginning Fund Balance	$0	$37	$78	$137
Revenues	36	48	64	47
Interest	1	4	7	0
Expenditures	0	(11)	(12)	8
Transfers	0	0	0	(21)
Ending Fund Balance	$37	$78	$137	$171
Encumbrances	$0	$0	$0	$0

Source: University of Hawaii General Accounting and Loan Collections

Research and Training Revolving Fund

This revolving fund was created in 1974 to fund research and training that may result in additional grants and contracts, and to facilitate research and training at the university. Moneys deposited into the revolving fund are from federal reimbursements for indirect overhead costs (e.g., electricity, telephone, and other facility expenses) incurred by the university in connection with federal research projects and grants. Faculty and staff receive research seed money, training, and travel grants through the revolving fund. In addition, a portion of the fund's revenues may be deposited into the Discoveries and Inventions Revolving Fund and the University of Hawaii Housing Assistance Revolving Fund.

During FY2001-02, the Research and Training Revolving Fund awarded over $17.9 million to university faculty and staff for research services and projects, training, and travel. Exhibit 1.4 reflects the amounts awarded by various categories.

Exhibit 1.4
Research and Training Revolving Fund
Awards Distributed by Category, FY2001-02

Category Name	Amount
Facilitating Services	$8,497,588
Project Development Fund Awards	4,469,059
Research Infrastructure	4,395,258
Faculty Travel to Professional Conferences	328,000
Seed Money Awards	116,230
Research Relations Fund Awards	79,695
Special Projects Funds	19,365
Total	$17,905,195

Source: University of Hawaii Report to the 2003 Legislature

Section 304-8.1, HRS, requires 100 percent of the total amount of indirect overhead revenues generated by the university from research and training programs to be deposited into the fund. However, our prior audit, Report No. 01-12, noted that only 84 percent of indirect overhead costs reimbursed from federal contracts and grants were being deposited into the fund. The remaining 16 percent is deposited into other funds. The Research and Training Fund's financial data over the last five years is reflected in Exhibit 1.5.

Exhibit 1.5
Research and Training Revolving Fund
Financial Data for Fiscal Years 1998 to 2002 (in thousands)

	FY1998	FY1999	FY2000	FY2001	FY2002
Beginning Fund Balance	$4,385	$7,725	$21,036	$25,617	$26,971
Revenues	8,233	18,798	13,756	14,879	21,396
Interest	0	138	(138)	0	0
Expenditures	(4,893)	(5,625)	(9,037)	(13,525)	(17,327)
Transfers	0	0	0	0	(37)
Ending Fund Balance	$7,725	$21,036	$25,617	$26,971	$31,003
Encumbrances	$1,168	$1,283	$1,886	$2,002	$5,245

Source: University of Hawaii General Accounting and Loan Collections

State Higher Education Loan Fund

This revolving fund was created through Act 230, SLH 1969, to provide low-interest, long-term deferred repayment loans to qualified students of the university. Loan eligibility requirements include enrollment at least as a half-time student in a degree program; evidence of financial need; residence in the State of Hawaii for at least one year; and willingness to repay the loan. The university's administrative rules set the maximum loan amount for a student's undergraduate and graduate study at an amount equivalent to those established for the Perkins Loan Program which is currently $4,000 and $6,000 per academic year, respectively. The university charges students 5 percent simple interest on the loan amount. The university can also charge late fees and reasonable collection costs. Repayment of principal and interest begins nine months after graduation or when a borrower is no longer enrolled at least as a half-time student. All interest and principal payments received are deposited to this revolving fund. Repayments are canceled upon the borrower's death or permanent total disability.

The revolving fund was started with $500,000 in general fund seed money. Our Report No. 01-12 noted that the need for additional general fund appropriations had decreased each fiscal year and the fund was an appropriate financing mechanism. The fund's financial data over the last five years is reflected in Exhibit 1.6. The positive amount reported as an expenditure in FY1997-98 was related to bad debt adjustments for a financial reporting change.

Exhibit 1.6
State Higher Education Loan Fund
Financial Data for Fiscal Years 1998 to 2002 (in thousands)

	FY1998	FY1999	FY2000	FY2001	FY2002
Beginning Fund Balance	$6,701	$6,977	$7,365	$7,173	$7,572
Revenues	2	351	31	138	29
Interest	169	176	189	195	181
Expenditures	71	(139)	(412)	(129)	(331)
Transfers	34	0	0	195	0
Ending Fund Balance	$6,977	$7,365	$7,173	$7,572	$7,451
Encumbrances	$0	$0	$0	$0	$0

Source: University of Hawaii General Accounting and Loan Collections

Tuition and Fees Special Fund

This special fund was created through Act 161, SLH 1995, to provide the Board of Regents with the authority to establish mechanisms that would generate income. The 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. Section 304-16.5(c), HRS, also authorizes expenditures from the fund to the University of Hawaii Foundation for the purpose of generating private donations benefiting the university. For FY2001-02, $1 million was paid to the foundation from the fund for fundraising and stewardship services.

The Tuition and Fees Special Fund's financial data over the past five years is reflected in Exhibit 1.7.

Exhibit 1.7
Tuition and Fees Special Fund
Financial Data for Fiscal Years 1998 to 2002 (in thousands)

	FY1998	FY1999	FY 2000	FY2001	FY2002
Beginning Fund Balance	$13,267	$18,177	$27,541	$33,004	$31,438
Revenues	85,854	88,240	90,898	91,267	83,015
Interest	1,793	1,715	2,960	3,519	1,869
Expenditures	(81,348)	(80,542)	(72,620)	(80,227)	(86,133)
Transfers	(1,389)	(49)	(15,775)	(16,125)	(4,594)
Ending Fund Balance	$18,177	$27,541	$33,004	$31,438	$25,595
Encumbrances	$10,166	$11,574	$13,101	$10,832	$8,819

Source: University of Hawaii General Accounting and Loan Collections

University Parking Revolving Fund

Section 308-2, HRS, establishes the University Parking Revolving Fund to collect parking-related fees, fines, and other money. Act 3, SLH 1964, allows for the construction of adequate parking facilities from the deposit of all parking fees. Allowable expenditures from the fund also include towing, storage, and other costs connected to the sale of vehicles towed from within the university's jurisdiction. Pursuant to Section 306-10, HRS, the University Parking Revolving Fund for Manoa is part of the University Bond System and is reported with the University Revenue-Undertakings Fund. The University Parking Revolving Fund for Manoa is being used to pay off revenue bonds issued to finance a parking structure on that campus.

The University Parking Revolving Fund's financial data over the past five years is reflected in Exhibit 1.8. Financial data is reported separately for the University of Hawaii at Manoa, the University of Hawaii at Hilo, and the University of Hawaii community colleges. The community colleges parking fund had a zero fund balance as of June 30, 2002 because the community colleges now record parking fees and other auxiliary revenues in a separate Community College Special Fund.

Exhibit 1.8
University Parking Revolving Fund
Financial Data for Fiscal Years 1998 to 2002 (in thousands)

University of Hawaii at Manoa

	FY1998	FY1999	FY2000	FY2001	FY2002
Beginning Fund Balance	$1,627	$2,195	$1,720	$1,977	$2,445
Revenues	4,626	4,289	4,361	4,195	4,176
Interest	246	291	336	449	297
Expenditures	(3,193)	(3,025)	(2,949)	(3,013)	(3,189)
Transfers	(1,111)	(2,030)	(1,491)	(1,163)	(910)
Ending Fund Balance	$2,195	$1,720	$1,977	$2,445	$2,819
Encumbrances	$1,555	$836	$1,498	$189	$1,937

Source: University of Hawaii General Accounting and Loan Collections

University of Hawaii at Hilo

	FY1998	FY1999	FY2000	FY2001	FY2002
Beginning Fund Balance	$176	$129	$55	$2	$18
Revenues	135	136	153	144	157
Interest	9	6	3	4	0
Expenditures	(191)	(216)	(209)	(132)	(150)
Transfers	0	0	0	0	0
Ending Fund Balance	$129	$55	$2	$18	$25
Encumbrances	$57	$51	$111	$109	$108

Source: University of Hawaii General Accounting and Loan Collections

University of Hawaii Community Colleges

	FY1998	FY1999	FY2000	FY2001	FY2002
Beginning Fund Balance	$189	$130	$97	$56	$20
Revenues	95	85	84	0	0
Interest	8	6	2	(1)	0
Expenditures	(162)	(124)	(127)	0	0
Transfers	0	0	0	(35)	(20)
Ending Fund Balance	$130	$97	$56	$20	$0
Encumbrances	$5	$13	$3	$0	$0

Source: University of Hawaii General Accounting and Loan Collections

The University of Hawaii Foundation was formed to benefit the university

In 1955, the University of Hawaii Foundation (foundation) was formed to encourage private support for the University of Hawaii. The foundation is a non-profit corporation designated by the Internal Revenue Service as a 501(c)(3) organization, legally separate from the University of Hawaii and all university affiliates. The foundation's purpose is to solicit, manage, and serve as the steward of gifts donated by individuals, corporations, foundations, and other entities solely for the benefit of the university's teaching, research, and service functions. If the foundation dissolves, its assets transfer to the university's Board of Regents. Under the university's tuition-funded contract, the foundation provides fundraising services for all university campuses and provides stewardship services for more than 2,000 gift accounts. In addition, the foundation has a ten-year lease agreement through December 2008 with the university for the use of its offices located in Bachman Hall and Bachman Annexes on the University of Hawaii at Manoa campus. The annual cost of the lease is $10. The university provides water, electricity, and janitorial services at no additional cost to the foundation.

In October 2002, the university signed an agreement with the foundation to provide private fundraising, stewardship, and alumni relation services for $2.35 million each year through December 31, 2007. As allowed by Section 304-16.5, HRS, this agreement is paid from the Tuition and Fees Special Fund. Under the agreement, the university also reimburses the foundation for 50 percent of the salaries, benefits, and taxes for development officers who are specifically assigned to a college, campus, or area of the university system.

The foundation also receives revenue through a 2 percent administrative assessment it makes on all incoming gifts received for the benefit of the university, endowment gifts accepted for a university-related purpose, and other non-gift income. In addition, the foundation assesses another 2 percent annual fee against its endowment fund pool to pay for third party costs (e.g., investment manager fees, audit fees, and fiscal management costs). The fee is calculated at the end of each quarter at 0.5 percent of the endowment's market value.

Objectives of the Review

1. Determine the degree to which the State Higher Education Loan Fund, Research and Training Revolving Fund, University Parking Revolving Fund, Real Property and Facilities Use Revolving Fund, Tuition and Fees Special Fund, and Endowment Fund achieve their original purposes.

2. Assess whether the University of Hawaii Foundation is providing the University of Hawaii with university-funded fundraising, stewardship, and alumni relation services effectively and efficiently.

3. Make recommendations as appropriate.

Scope and Methodology

Our review of the Endowment Fund, Real Property and Facilities Use Revolving Fund, Research and Training Revolving Fund, State Higher Education Loan Fund, Tuition and Fees Special Fund, and University Parking Revolving Fund included a review of their legislative histories, administrative rules, policies and procedures, financial audit reports, and other related documents, including contracts. Fiscal and program staff were interviewed to obtain an understanding of the fund's current operation. We also reviewed the selected fund's expenditures and revenues for appropriateness for FY2001-02 and prior years as necessary.

Our assessment of the University of Hawaii Foundation's fundraising services under its contract with the university included a review of the foundation's fundraising expenditures for FY2001-02 and the first quarter of FY2002-03. We were not able to access the foundation's endowment or gift information, which hampered our ability to assess the contracted stewardship services of the foundation. We will continue to pursue access to this information in order to complete our review of the university's contract with the foundation. Also, the alumni relation service has not been moved to the foundation, so no assessment of it can be performed at this time.

We did not audit the selected funds' financial data for the past five fiscal years that was provided by the university. This data is provided for informational purposes only.

The review was conducted from August 2002 through January 2003 in accordance with generally accepted government auditing standards.

Chapter 2

The University Cannot Ensure That Its Non-General Fund Resources Are Being Used Efficiently and Effectively

In 1995, the Legislature made a commitment to provide the University of Hawaii 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 then, tuition had been deposited into the State's general fund. Among other things, this special fund has been used to pay for a contract with a non-profit organization—the University of Hawaii Foundation—to provide private fundraising and stewardship services. The university also has a number of other special and revolving funds that it relies on to support its statewide operations and provide financial support to needy students.

Our review found, however, that the university has 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, though they represent a significant revenue source for the university. During FY2001-02, these six funds recorded revenues and interest in excess of $104 million, expenditures of $107 million, and fund balances totaling over $124 million at June 30, 2002. As a result of inadequate oversight and controls, we found instances of student tuition and fees being used by the foundation to pay for its employees' personal expenses, endowment funds entrusted to the university being misused by a dean to host parties at his personal residence, and untimely collection of loans that hinder the university from awarding additional loans to needy students.

Summary of Findings

1. The University of Hawaii's mismanagement of its non-general funds results in little assurance that the university has an adequate understanding of its overall fiscal condition.

2. Although the University of Hawaii Foundation provided limited access to information needed to assess the university's contracts with the foundation, questionable expenditures were identified.

Inadequate oversight and control by the university over expenditures of student tuition and fees are allowed under the guise of fundraising.

The University's Mismanagement of its Non-General Funds Results in an Inability To Present an Accurate Picture of its Overall Fiscal Condition

Appropriate and adequate management guards against abuse of resources and ensures that such resources are used efficiently and effectively. Proper management over non-general funds includes, but is not limited to, developing sound policies and procedures, monitoring and assessing fund expenditures, executing timely contracts, and ensuring appropriate deposits of revenues. However, our review found numerous instances of mismanagement by the university for six of its non-general funds. As a result, the resources available through these non-general fund sources are not being maximized. Moreover, the university has apparently abused some of the funds.

Lax expenditure monitoring leads to inappropriate fund usage

Without appropriate oversight, the risk of misuse or abuse of public funds increases. The Research and Training Revolving Fund was statutorily created to facilitate research and training at the university. However, because the university has not provided for adequate management over the fund, it has been used for purposes unrelated to research or training. Although the amount in questionable expenditures may not be significant to the total fund, the prevalence of improper usage indicates the lack of oversight for the fund and its expenditures. We also found that the Endowment Fund, which holds moneys entrusted to the university, has been misused. By accepting various endowments, the university assumes a fiduciary responsibility to ensure that such assets are used solely for the donors' intended purposes.

The Research and Training Revolving Fund is not being used as originally intended

In 1974, the Legislature established the Research and Training Revolving Fund to fund research and training that may result in additional research and training grants and contracts. Over the past five years, revenues for university research and training have increased by 160 percent—from $8 million in FY1997-98 to $21 million in FY2001-02. Although this fund is a significant revenue source for the university and has carried a balance in excess of $25 million over the past several years, we found that no one has been assigned responsibility for the fund. As a result, the university was unable to demonstrate that revolving funds allocated for project development were used appropriately.

Project development funds should be used to support enterprise infrastructure research, facilitate research and training in new or developing fields, provide matching funds for research equipment, and promote participation in professional organizations. We found that the revolving fund has been used for questionable purposes. Without a fund monitor, such dubious expenditures have gone undetected or unchallenged.

For example, over the past four years, the University of Hawaii at Manoa's Hamilton Library underwent construction and renovation. We found that the Research and Training Revolving Fund was used to pay for aesthetic improvements to the library. Such improvements included restoration and framing of a painting, new koa frames, new carpeting, and new entry doors to match walls. Despite Hamilton's classification as a research library, we question how these cosmetic enhancements directly facilitate research or training.

We also found that the revolving fund has been used as a "backup" source to pay for expenses for which the university inadequately planned. For example, due to poor planning, the university lacked appropriate funds to pay for the utility expenses of new facilities. As a result, the university used $453,000 intended for project development purposes to pay for utility costs.

This contrasts sharply with previous project development awards to the College of Natural Sciences for genome sequencing, the School of Nursing for a study of battered women, and the Department of Microbiology for microbial genomic research.

Finally, the university was unable to explain how its chancellor and vice chancellor distributed $30,000 in revolving funds intended for project development. We could not therefore determine whether the $30,000 was awarded in a timely manner, or whether it was in fact used for project development.

When asked about these questionable expenditures, the university's chief financial officer stated that the revolving fund's intended purpose is very broad. The officer clarified his belief that any expenditure could be related to research and training, except for expenditures pertaining to athletics. Although the fund's original purpose is broad, we believe that the fund should be used for expenditures that *directly* relate to research or training. For example, funds should be used for faculty to travel to conferences and meetings to present their research results and for seed money to initiate research—endeavors which resulted in $12.4 million in additional research grants for the university during FY2001-02. However, the university has instead exploited the fund's broad statutory purpose to justify a number of questionable expenditures.

Some endowment funds were misused by a university dean

The university has over 70 separate endowment accounts with an aggregate value of more than $57 million to monitor in its Endowment Fund. While most endowment accounts have been established to provide for scholarships or grants-in-aid, some accounts were established for a variety of specific purposes, such as promoting volcanology research or supporting faculty development and enrichment at community colleges. Regardless of an account's purpose, the university has a fiduciary responsibility to ensure that endowment funds are used for the purposes for which they were entrusted to the university.

However, we found that funds endowed to the university for the purpose of furthering marine and atmospheric research have been misused. Among other things, the endowment should be used for university investigators to collaborate on developing projects, to fund scientific retreats and other forms of meetings with scientists, or to provide bridge funding for promising scientific projects. Instead, we found that a university dean appears to have used the endowment to fund personal entertainment expenses.

For example, the dean held a catered dinner "meeting" at his home for ten people to discuss "avenues of funding and cooperative research opportunities . . . particularly in the areas of ocean and marine science." The university president, dean, and their spouses attended the "meeting." Other attendees included an entrepreneur, the chief executive officer of an audio corporation, the chief executive officer of a real estate investment company, and their spouses. Although the endowment permits expenditures related to logistical support of events, including meals and refreshment, we do not believe that a dinner catered and staffed by an executive chef, sous chef, and waiter at $163 per person was an appropriate use of the endowment. In addition, funding approval for the event was sought *after* the "meeting" was held.

This same dean held an "event" at his home for about 60 guests and charged the same endowment account for food, beverages, and valet parking. According to the dean, the "event" was held to "foster SOEST (School of Ocean and Earth Science and Technology) marine and atmospheric research initiatives and projects." However, the valet service invoice—which was attached to the payment authorization form—designated the "event" as a Christmas party. Furthermore, although guests included university faculty and administrators, others on the guest list included local entertainers and a former food editor for a local newspaper. There were also a number of other individuals on the guest list with no indication of their professional affiliation. Finally, the dean requested reimbursement for food and refreshment expenses for the party but failed to provide appropriate receipts or invoices to document that the amounts requested were accurate. These expenditures appear inappropriate and indicate that the university has not fulfilled its fiduciary responsibility.

Policies and procedures are lacking for several funds

One of the characteristics of a sound organizational structure is carefully articulated policies and procedures. Policies establish general guidelines for decision-making and procedures provide a process for handling day-to-day or routine activities like recording deposits. However, the university lacks written policies and procedures pertaining to the use and allocation of its Research and Training Revolving Fund and its Tuition and Fees Special Fund. The university also lacks written procedures relating to the Endowment Fund and the Real Property and Facilities Use Revolving Fund.

We found that the university does not have a written policy or procedure regarding allocation of funds from the Research and Training Revolving Fund to the various research units, which generate the fund's revenues. For example, during FY2000-01, $3.3 million (20 percent) of the total $16.9 million revolving fund allocation was used for general administrative expenses (e.g., management fees, audit costs, telecommunications, etc.) and $9 million (53 percent) was divided among the research units. In comparison, for FY2001-02, the amount allocated for general administrative expenses increased to $5.1 million (29 percent) of the total $17.7 million allocation, while the proportion allocated to the research units decreased to $8.5 million (48 percent). As a result, individual campuses, departments, and schools that receive allocations are unable to plan for future research initiatives because they do not know how much they will be allocated in any given year.

In addition, the university could not tell us how $8.5 million of the total $21.7 million FY2002-03 allocation will be used. Of the $8.5 million, $4 million has been allocated to the University of Hawaii at Manoa chancellor. However, the university could not specifically tell us how the chancellor's $4 million allocation will be used. The university has also not specified how it will allocate $4.5 million for FY2002-03. Although the university plans to allocate a total of $21.7 million from the Research and Training Fund during FY2002-03, it has accounted for only $17.2 million of that allocation.

During the final stages of our fieldwork, the university's chief financial officer began to organize a Research and Training Revolving Fund task force. A draft policies and procedures document for the revolving fund was given to our office; however, it too, did not describe the allocation process in detail.

The university also lacks written policies and procedures for the use and allocation of its Tuition and Fees Special Fund. Students' tuition and tuition-related charges are used to maintain or improve the university's programs and operations. Expenditures from this fund range from a $2.2 million periodical subscription for Hamilton Library to the $2.35 million contract with the University of Hawaii Foundation. This fund has collected over $439 million in student tuition and fees and expended over $400 million for operating costs since FY1997-98. Without written policies and procedures to guide the use and allocation of this sizable fund, we question whether the university has the tools necessary to provide appropriate oversight and management of the fund.

In addition, we also found that the university has not assigned direct responsibility for its Tuition and Fees Special Fund to anyone. Although the university's central budget office allocates special fund amounts to the various university programs in accordance with legislative appropriations, it is not responsible for managing this fund. In fact, the central budget office does not know the exact amounts allocated within each campus or how much is expended from those appropriations. To obtain that information, we had to contact each campus budget office separately. This leaves little assurance that university management has an adequate understanding of the budget and funding needs of each of its campuses.

The university's FY2001-02 Tuition and Fees Special Fund allocation and expenditures by campus and program are reflected in Exhibit 2.1.

Exhibit 2.1
Tuition and Fees Special Fund Allocations and Expenditures, FY2001-02

Campus/Program	Allocation	Expenditure
University of Hawaii at Manoa	$47,786,676	$45,359,815
University of Hawaii at Hilo	N/A	6,353,976
University of Hawaii at West Oahu	1,216,434	1,157,006
Honolulu Community College	4,627,870	4,613,644
Kapiolani Community College	3,885,750	3,823,529
Leeward Community College	3,080,126	2,926,897
Windward Community College	1,732,550	1,605,079
Hawaii Community College	1,402,709	1,327,319
Maui Community College	2,526,958	2,622,554
Kauai Community College	1,638,182	1,546,432
Employment Training Center	170,787	163,001
Community College System-Wide	1,703,174	1,441,719
TOTAL	**$69,771,216**	**$72,940,971**

Note: An allocation amount was unavailable for the University of Hawaii at Hilo. University of Hawaii at Hilo information does not include payroll expenditures.

Source: University of Hawaii at Manoa Budget Office; University of Hawaii at Hilo Business Office; Office of the Chancellor for Community Colleges; and University of Hawaii at West Oahu Business Office

We also found that the University of Hawaii at Manoa campus programs could exceed their Tuition and Fees Special Fund allocation. The reporting system utilized by the Manoa campus does not provide the information necessary to detect whether program expenditures from the Tuition and Fees Special Fund have exceeded a program's total allocation. The Manoa campus budget office receives quarterly expenditure plans and year-end reports from the programs and departments; however, this reactive approach to monitoring would not prevent over-expenditures from occurring.

The university maintains general and investment policies for its Endowment Fund, but has not developed procedures to ensure that moneys deposited in the fund are properly recorded. Moneys received by the university for an existing endowment account are charged a 2 percent administrative fee by the University of Hawaii Foundation, which receives and processes all donations. For example, if an individual were to donate $10,000 to an existing university endowment account, the university would receive only $9,800 because the foundation would retain $200 in administrative fees. In accordance with generally accepted accounting principles, the university should record the full amount of the donation ($10,000) on its books and record the administrative fee ($200) as an endowment expense. Instead, the university records $9,800 on its books. Therefore, the amount of donations recorded by the university has been continuously underreported.

Finally, although the university has general provisions regarding its land and physical facilities, we found deficiencies regarding procedures for recording deposits made for borrowing facility keys. These deficiencies result in the university overstating the fund's actual balance. When contractors work on a university facility, the program collects a deposit for the facility's key. The university records such deposits as "negative expenditures." This means that if the total amount of deposits received exceeds actual program expenditures during a given year, the fund may record a negative expenditure. This method of reporting makes it appear that the fund has more to spend than it actually does because deposits are often returned to the contractor who worked on the facility.

Non-general funded contracts are not executed in a timely manner

Sound contracting practices do not allow contractors to render services before contracts are fully and properly executed. However, the university has disregarded this practice. When the university does not execute contracts properly, it fails to ensure that the roles and responsibilities of the university and contractors are clearly delineated. This practice promotes confusion or misunderstanding.

We found several agreements funded by the Tuition and Fees Special Fund that were either incomplete or executed in an untimely manner. For example, an agreement between the College of Business Administration and the Research Corporation of the University of Hawaii to provide services for the college's executive MBA program did not specify the fee to be paid to the research corporation from the Tuition and Fees Special Fund. This provides little assurance that student tuition and fees are being efficiently used. We also found that contract modifications extending a $247,000 contract were signed after the extensions were in effect. Moreover, the current contract modification expired on June 30, 2002 and, to date, a new modification has not been signed. Even without a current contract in place, services are still being rendered.

We also found lease agreements relating to the Real Property and Facilities Use Revolving Fund were not updated or modified in a timely manner. For example, there was no evidence that the university agreed to a rental rate being paid for a Maui property. Although the current rental rate is the same amount paid from November 1993 through October 1998, no lease document reflecting the rental rate after October 1998 exists. Without a current lease document evidencing the agreement, there is no assurance that the university is receiving an appropriate rental amount or is maximizing all potential revenue.

Delinquent outstanding loans hinder the university's ability to award loans to needy students

The intent of the State Higher Education Loan Fund is to provide qualified students with low-interest and long-term deferred repayment loans. However, in order to continue to provide loans to qualified students, outstanding loans must be collected in a timely manner. We found that the university has a high delinquency rate that prevents it from assisting additional students with needed financial support.

Currently, the State Higher Education Loan program has an estimated $8.99 million in loans outstanding to students. We found that approximately 31 percent, or $2.85 million, of that amount is considered past due or delinquent. This rate is higher than that of some other universities' state or institutional loan fund programs. One Utah institutional state loan fund reported it has issued approximately $32 million in loan funds and has a delinquency rate of 2 percent. Another university in Montana reported its institutional loan program has a delinquency rate of 15 percent.

The University of Hawaii's loan program administrator admitted that the current policies and procedures need to be reassessed. The absence of updated procedures may contribute to delays in account collection and impair the fund's ability to provide adequate loans to qualified students. Over the past five years, the loan program has issued $5.2 million in loans but collected only $4.1 million in repayments. In addition, more than $300,000 in loans was either canceled due to death or permanent disability, or written off as uncollectible. Although the loan program may grant qualified undergraduate students a maximum of $4,000 in loans per academic year, the Manoa campus has not provided the maximum amount. Instead, the campus awards partial loans in order to accommodate as many students as possible.

Inadequate Oversight by the University Has Resulted in Questionable Use of Student Funds by the University of Hawaii Foundation

Since 1997, the university has contracted with the University of Hawaii Foundation to provide fundraising and stewardship services at an annual cost of $1 million. However, the university has failed to adequately monitor these contracts with the foundation. This is especially concerning because funds deposited in the Tuition and Fees Special Fund and used to pay for the foundation's contracts are derived from tuition and fees collected from university students. We found no evidence that the university's administration or the Board of Regents has ever received a detailed accounting of how the foundation has used its $1 million per year contract for fundraising or stewardship over the past five years. Instead, the foundation has provided only broad, narrative reports indicating that the $1 million annual contract has enabled the foundation to "develop fundraising materials" and to "support the university."

The foundation's inability to provide specific information is due in part to its improper practice of commingling its public contract funds with other private funds it receives. Notwithstanding the dearth of specific information, we found a number of questionable fundraising expenses by the foundation and several other expenses that lacked proper supporting documentation.

The scope of our review included an assessment of the university's fundraising and stewardship contracts with the foundation because they are funded by the Tuition and Fees Special Fund. Although we were provided access to information relating to the foundation's fundraising services, the foundation barred our access to information needed to assess its stewardship services. As a result, we were unable to complete our review as intended; however, we are continuing to pursue the information through legal measures.

The foundation's practice of commingling university contract funds precludes accountability

The Council for Advancement and Support of Education (CASE) is a professional organization for advancement professionals who work in alumni relations, communications, and development. Foundation staff are members of this organization. CASE advises foundations that accept or hold public funds received from federal, state, or local government agencies to keep public and private funds separate. In no event should a foundation commingle public funds with private funds unless it is required to do so by statute. During a 2001 CASE conference, it was noted that "private money can become public money at any time, but public money can never become private money."[1]

The foundation receives public and private funds to maintain its operations. Although CASE stresses that the two types of funds should be kept separate, the foundation's president, chief financial officer, and board chairperson all admitted that the foundation commingles its public contract funds with its private funds. In fact, there was no way to determine how public contract funds for fundraising and stewardship were specifically used. The foundation could only report that it spent $10 million on direct fundraising over the past five years and $5 million of that amount could be attributed to contract funds received from the university.

To assist us with our assessment of contract fundraising expenditures, the foundation provided line-item expense reports for FY2000-01, FY2001-02, and the first quarter of FY2002-03 detailing its fundraising expenditures for those periods. However, because the foundation commingles its public and private funds, the chief financial officer informed us that any line-item expenditure could be assessed as a contract-funded expenditure.

This commingling of funds violates one of the basic principles set forth by professional organizations such as CASE and prevents the foundation from properly monitoring and reporting the use of public funds for fundraising purposes.

The foundation prevented access to records needed by the Office of the Auditor to conduct a thorough review of the university's contract with the foundation

Since May 1997, the university has used money from its Tuition and Fees Special Fund to enter into contracts with the foundation to provide fundraising and stewardship services. From May 1997 to June 2002, the university paid the foundation $5 million in student tuition and fees to provide those services. On October 1, 2002, the university entered into a new contract with the foundation to provide alumni relation services in addition to its fundraising and stewardship services. This contract is valued at over $2.35 million annually. Because these contracts are funded from the university's Tuition and Fees Special Fund, the State Auditor is authorized to assess the contract to ensure state funds are being used appropriately.

In addition, the foundation is recognized as an integral component of the university system and exists solely for the benefit of the university. Hence, we requested records regarding the foundation's fundraising and stewardship services. Stewardship services include prudent endowment and gift management to ensure that private donations entrusted to the foundation are used only in accordance with each donor's provisions.

The foundation disagreed with our authority to assess its contracted services and withheld all information regarding stewardship services. Therefore, no assessment can be made. We were given only restricted access to the foundation's fundraising expenses.

The Auditor has statutory authority to conduct post audits of the foundation

The foundation asserts that the State Auditor is attempting to "exceed her legitimate authority" to review the foundation's records. However, Section 23-4, HRS, requires the auditor to "conduct postaudits of transactions, accounts, programs, and performance of all departments, offices, and agencies of the State and its political subdivisions." Section 23-1, HRS, defines "departments, offices, and agencies" to include quasi-public institutions that handle state or public funds. Section 23-4, HRS, also requires the auditor to determine the validity of expenditures of state or public funds. During FY2001-02, the university used $1 million of public funds from the Tuition and Fees Special Fund to pay the foundation for contracted fundraising and stewardship services. Therefore, the Auditor has implicit authority to review the foundation's records for fundraising and stewardship services performed under the contract to ensure that public funds were used appropriately.

Government accounting standards' recognition of the foundation as an integral component of a state agency reinforces the Auditor's authority to audit the foundation

Although the foundation was established as a legally separate non-profit corporation, it is reported as an integral component of the university in the university's financial statements. In accordance with the Governmental Accounting Standards Board (GASB), the university has incorporated the foundation's financial information with its own to ensure that the university's financial statements are not misleading or incomplete. In fact, "in some circumstances, the GASB believes that although a component unit is legally separate from the primary government, it is simply an extension of the primary government."[2] In this case, the component unit is the University of Hawaii Foundation and the primary government is the University of Hawaii.

The foundation recorded questionable expenditures for "fundraising" activities

The foundation categorizes its fundraising activities into four major categories: (1) major gifts, (2) annual giving, (3) planned gifts, and (4) development research. During FY2001-02 and the first quarter of FY2002-03, we found a number of questionable expenditures in each major category. Although the amount of these questionable expenditures is not significant to the total operation of the foundation, we believe the prevalence of incidents of improper usage of student tuition and fees warrants attention.

Expenditures lacked adequate justification

Although the foundation has policies to guide how it administers accounts on behalf of the university, we found that it has failed to follow those policies. For example, the foundation's policies require that events or charitable functions paid for with foundation funds must be justified by benefits to the university. However, we found a number of events and functions that were paid for by the foundation that lacked adequate justification and did not appear to benefit the university.

For example, the foundation paid $1,425 for 50 university football tickets without justifying how the purchase benefited the university. The attendee list included the names of only 26 individuals and did not indicate why those individuals' attendance at a football game would benefit the university. We could not determine how the remaining 24 tickets were used or who might have benefited from them. We also found that a foundation employee was reimbursed $450 for two tickets to a community fundraiser benefiting the Honolulu Symphony. We could not ascertain who attended the symphony fundraiser and there was no justification of how the ticket purchase benefited the university. In fact, because the tickets were purchased in a foundation employee's name, that employee may have received a $250 personal tax deduction from the purchase made with public funds.

We also found that foundation employees attended various events and functions that were paid for with public funds. For example, the foundation paid $500 for a benefit table for eight foundation employees and two university employees to attend a holiday luncheon. The foundation failed to justify how a holiday luncheon attended by its own employees would benefit the university. We also found that the interim foundation president purchased two tickets to attend a $400 fundraising dinner for the Military Aviation Museum of the Pacific. Once again, there was no explanation of how attendance at this event benefited the university. Finally, we found that the foundation paid over $700 in catering, party supplies, and valet service for an event that two private individuals hosted to honor the current university president. It is unclear how the foundation could justify this as an acceptable expenditure of student tuition and fees.

Parties, alcohol, and other personal expenses were paid for with university funds

Entertaining foundation employees with money from fundraising accounts does not benefit the university or promote its goals. The foundation would derive greater benefit from hosting potential donors than from entertaining its own employees. We found that the foundation paid for holiday, farewell, and thank-you parties, as well as concert tickets for its employees. We found a $409 reimbursement to a foundation employee for six tickets for employees of the university and the foundation, a spouse, and a guest to attend a rock concert. There was no indication of how attending this concert raised money for the university. In addition, the foundation used university contract funds to pay for a pre-concert buffet for 31 individuals—of which 23 were university and foundation employees and their spouses, family members, and guests. There was also a payment of over $230 for a farewell party for a foundation employee at a local restaurant; the payment included alcoholic purchases. Another foundation party included a $600 farewell party at a museum for the interim foundation president.

While we agree that it is important for an organization to recognize its employees for their contributions, we do not believe that the foundation should spend public funds to recognize its own employees. We found a $992 payment for 11 thank-you plaques given to foundation employees. Although appreciation gifts are allowed, it does not appear appropriate that public funds intended for fundraising were instead spent on $90 plaques for employees performing their jobs.

We also found that the current university president used public contract funds to purchase personal gifts. For example, the foundation used its university contract funds to pay for a $300 wedding gift that the president gave to a donor. Although the foundation's expenditure policy allows for celebratory gifts, they should be limited to $100 and must be reasonable under the circumstances. We found this expenditure to be neither reasonable nor appropriate.

We found a number of other inappropriate or questionable expenditures using public funds. For example, the interim foundation president charged the foundation's fundraising account for his tuxedo rental. This type of charge appears to be a personal expense. We also found that public fundraising contract funds are being used to pay for one foundation employee's rental apartment, two parking stalls, and an auto allowance. These expenditures seem particularly inappropriate given that the employee is paid an annual salary in excess of $100,000.

Fundraising and related activities routinely include business meals and entertainment expenditures like lunch and dinner meetings and receptions. During our review we found that many of the receptions and meals included alcoholic beverages. For example, a $400 foundation press box reception for 12 people included beer and wine in the bar package. Also, a $1,200 donor dinner with the university president included $320 for alcohol. A Las Vegas alumni reception dinner included approximately $300 for alcoholic beverages. Alcoholic beverages purchased with student tuition and fees do not appear to be a prudent use of funds.

A poorly written contract impedes adequate monitoring of the foundation

The university has entered into a poorly written contract that does not allow it to adequately monitor the foundation's use of student tuition and fees for fundraising, stewardship, or alumni relation services. The $2.35 million per year tuition-funded contract requires an accounting from the foundation by November 1 of each year but does not specify the level of detail required in the report. A properly written contract would specify the type of reports the university should receive and allow university access to endowment and gift records to ensure university oversight of the stewardship services. Currently, the university does not monitor endowments held by the foundation for the university's benefit. Similarly, the university does not verify whether the foundation properly deducts the annual 2 percent fee from its endowment accounts or the 2 percent administrative fee from all incoming gifts.

Conclusion

The University of Hawaii is a postsecondary education system that relies on non-general funds for some of its operations. Our review found many instances of mismanagement of several of the university's non-general funds. We found the university does not appropriately monitor expenditures within the Research and Training Revolving Fund and the Endowment Fund. The Tuition and Fees Special Fund ($25 million) and the Research and Training Revolving Fund ($31 million) lack policies and procedures for the allocation and use of the funds. In addition, neither fund has a direct responsible party assigned to oversee the corpus of the funds. We found that the lack of procedures to record transactions for the Endowment Fund and the Real Property and Facilities Use Revolving Fund leads to erroneous fund reporting. We also found many contracts have been executed in an untimely manner, leaving the university in a fiscally unsound position.

Our review of the tuition-funded contract with the University of Hawaii Foundation for fundraising and stewardship services was limited in scope due to the foundation's refusal to provide access to pertinent information regarding its stewardship services. We were given access only to fundraising expenditures. Our limited review uncovered numerous instances of inappropriate expenditures of state funds by the non-profit foundation. To complete our review, we are vigorously pursuing access to records relating to the foundation's stewardship services through legal measures.

Recommendations

1. The president of the University of Hawaii should ensure that:

    a. Adequate written policies and procedures are developed for the Research and Training Revolving Fund to ensure that the fund is used as originally intended;

    b. Adequate written policies and procedures are developed for the Tuition and Fees Special Fund to ensure that revenues are appropriately allocated, expended, and monitored;

    c. The State Higher Education Loan Fund's written policies and procedures are reevaluated to ensure that loan collections are maximized;

    d. A responsible party is designated to oversee the Tuition and Fees Special Fund and the Research and Training Revolving Fund;

   e. Endowment Fund expenditures are adequately monitored to ensure that the endowment fund accounts are being used as originally intended;

   f. Contracts and agreements funded by the Tuition and Fees Special Fund, Real Property and Facilities Use Revolving Fund, and State Higher Education Loan Fund are executed, monitored, and enforced in a timely manner;

   g. The University of Hawaii Foundation contract to provide fundraising, stewardship, and alumni relation services is amended to require the foundation to adhere to its expenditure policies; and

   h. The University of Hawaii Foundation contract is amended to ensure that the university has the express authority to monitor and review the foundation's services and expenditures.

2. The Board of Regents should institute the following reporting requirements:

   a. Regular reports from the university president on non-general fund revenues and expenditures; and

   b. Monthly reports from the University of Hawaii Foundation detailing specific contract expenditures and a description of how those expenditures directly benefited the university.

3. The Legislature should request an external financial and management audit of the University of Hawaii Foundation to determine whether the foundation is fulfilling its fiduciary responsibility over gifts and donations intended to benefit and support the university.

Notes

Chapter 2

1. Dr. Gary Ransdell, CASE-SIRF Conference for Institutionally Related Foundations, *Planning for Challenges to Records Privacy*, April 26, 2001.

2. Larry P. Bailey, *Miller Governmental GAAP Guide*, New York, New York, Aspen Law & Business, 2002, p. 4.24.

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Response of the Affected Agency

Comments on Agency Response

We transmitted drafts of this report to the University of Hawaii on March 11, 2003. Drafts of the report were also made available to the university's Board of Regents and the University of Hawaii Foundation. A copy of the transmittal letter to the university is included as Attachment 1. The responses of the Board of Regents, University of Hawaii, and University of Hawaii Foundation are included as Attachment 2, 3, and 4, respectively.

In its response, the university concurred with our recommendations for stronger internal oversight and accountability for the non-general funds we reviewed. Recognizing the need for better oversight and coordination of its statewide research activities, the university reported that it recently appointed a Vice President for Research to oversee the Research and Training Revolving Fund. The university also agreed that the Tuition and Fees Special Fund does not have consolidated procedures and accountability and noted that the budget director would have such procedures in place by May 2003. The university also agreed that non-general funded contracts are not executed in a timely manner and reported that it is pursuing stronger contract monitoring practices.

Notwithstanding the university's agreement with many of our recommendations, it believes that all of our findings are "immaterial" to the university as a whole. We disagree. With over $104 million in revenues and interest during FY2001-02, the six non-general funds we reviewed represent a significant revenue source for the university. Therefore, we believe that the lack of internal oversight and accountability that we found indeed make our findings "material." Without adequate internal oversight and accountability, the university cannot provide reasonable assurance that it is operating effectively and efficiently, that its financial reports are reliable, or that it is in compliance with applicable laws and regulations.

Although the university disagreed with our finding that a university dean misused endowment funds, it did agree with our recommendation that endowment funds be adequately monitored. The university also disagreed with our finding that endowment contributions are reported incorrectly. As noted in our report, if a contribution to an existing endowment is not recorded by the university in full, the university's total gift income will be underreported by the amount of the University of Hawaii Foundation's administrative fee assessed on the gift.

The Board of Regents agreed with our recommendation that the board institute specific non-general fund and University of Hawaii Foundation reporting requirements. The board indicated that it would begin to receive financial reports with revenues and expenditures for all funds beginning April 2003. The board also stated that it would instruct the university's administration to amend the existing University of Hawaii Foundation contract requiring information on how specific contract expenditures directly benefit the university.

The University of Hawaii Foundation did not agree with all of our findings but indicated that it welcomes recommendations related to its policies and procedures. The foundation also reported that it has established a separate account to manage the funds received from the university. According to the foundation, this segregation of funds will ensure that alcohol served at special events is not purchased with public funds. The foundation also indicated that many of its fundraising expenditures are for "donor cultivation" which is meant to build relationships with the community. However, the foundation stated that it would review and revise its expenditure policies to ensure closer scrutiny of such activities.

Finally, the foundation asserted that it was reluctant to provide our office with endowment account information because it wanted to protect the confidentiality of its donors. We repeatedly informed the foundation that our workpapers are confidential under Section 23-9.5, HRS, and that it is our policy to abide with any confidentiality agreement the foundation has with donors. Despite these assurances, the foundation continues to deny access to information needed to assess its state-funded contract with the university.

ATTACHMENT 1

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

MARION M. HIGA
State Auditor

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

March 11, 2003

COPY

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

Dear Dr. Dobelle:

Enclosed for your information are 18 copies, numbered 6 to 23, of our confidential draft report, *Review of Selected University of Hawaii Non-General Funds and Accounts*. Three of those copies are for the University of Hawaii, 12 copies for the Board of Regents, and 3 copies for the University of Hawaii Foundation. We ask that you telephone us by Thursday, March 13, 2003, on whether or not you intend to comment on our recommendations. If you wish your comments to be included in the report, please submit them no later than Monday, March 17, 2003. If the University of Hawaii Foundation wishes its comments to be included in the report, we ask that they be submitted to the University of Hawaii prior to their submittal to our office on March 17, 2003.

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

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

Sincerely,

Marion M. Higa
State Auditor

Enclosures

University of Hawai'i Board of Regents

March 17, 2003

RECEIVED
MAR 18 8 19 AM '03
OFC. OF THE AUDITOR
STATE OF HAWAII

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

Dear Ms. Higa:

The Board of Regents agrees with the two recommendations of the Legislative Auditor that the Board should institute (1) regular reporting for non-general fund revenues and expenditures and (2) monthly reports from the University of Hawai'i detailing specific contract expenditures and a description of how those expenditures directly benefitted the University.

1. Since July of 2002, members of the Board of Regents have worked with the University Administration to develop the templates for financial reporting to the Board. As a result of these meetings, financial reports with revenues and expenditures for all funds will be instituted beginning in April of 2003.

2. The Board will instruct the University Administration to amend the existing contract with the University of Hawai'i Foundation to provide for specific contract expenditures and a description of how those expenditures directly benefitted the university.

For your information, the Board amended its bylaws at its January 17, 2003 meeting to establish a Committee on University Audits. The Audit Committee will:

1. Review and monitor the University's financial, management, internal controls and audit processes.

2. Review and monitor the University's compliance with policies, statutes, and regulations.

3. Secure external auditors and determine the disposition of all resulting audit findings and reports.

Sincerely,

Bert A. Kobayashi

Bert A. Kobayashi
Chairperson

2444 Dole Street
Bachman Hall 209
Honolulu, Hawai'i 96822
Tel: (808) 956-8213
Fax: (808) 956-5156

UNIVERSITY OF HAWAI'I

VICE PRESIDENT FOR ADMINISTRATION
AND CHIEF FINANCIAL OFFICER

RECEIVED
MAR 16 8 19 AM '03
OFC. OF THE AUDITOR
STATE OF HAWAII

March 15, 2003

The Honorable Marion Higa
State Legislative Auditor
465 South King Street, Room 500
Honolulu, HI 96813

Dear Ms. Higa:

Thank you for the opportunity to comment on the findings and recommendations in your draft report, "Review of Selected University of Hawaii Non-General Funds and Accounts."

We do not concur with all of the findings detailed in your report. A detailed response to those areas where we disagree is below.

Your report, however, does provide valuable insight and objective analysis as we develop more stringent oversight policies and procedures to monitor the use, expenditure, and allocations of the six non-general funds covered by the report. We do concur with the recommendations calling for more internal oversight and accountability of the funds. Please know that during the past several months, the University has been developing oversight procedures that strengthen and improve fiscal accountability. We share the same goal, insuring the citizens of Hawai'i that the financial resources, be they public dollars or private funds, are used wisely and appropriately. Finally, we appreciate the work of your office along with the specific recommendations. They will assist us greatly in our efforts to insure that we remain fiscally responsible. Also, please find attached a response form the University of Hawai'i Foundation.

1) The draft report states that the University's mismanagement of its non-general funds results in an inability to present an accurate picture of its overall fiscal condition.

Response:
The University does not concur with this statement.
Over the period the state auditor focused on, and for years before, the University has undergone full annual audits by an outside firm and at least five other outside audits of various areas including those covered by the legislative audit. On every audit, the university received an "unqualified" opinion. This means that the financial statements the university maintains are

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"fairly stated in all material respects in relation to the financial statements taken as a whole." All these audits have findings – issues to address. The key point is the accounting principle of "materiality." Are the findings substantial enough to affect the entity as a whole? None of the findings in the report constitute "materiality".

2) The draft report states that the Research and Training Revolving Fund is not being used as originally intended and that no one has been assigned responsibility for the fund.

Response:
The University recognized last June the need for better oversight and coordination of all its research activities at all campuses. The position of Vice President for Research was created at system level and filled three weeks ago and assigned to be accountable for this fund. The university also has been revising and drafting procedures over the past several months to ensure that the guidelines for use of funds are clearly defined. The procedures will be completed by May, 2003. The university constantly examines the use of these funds and will continue to do so.

3) The draft report refers to the misuse of Endowment funds by a University dean.

Response:
Based on the documents provided, events held at the Dean's home were judged to be in compliance with the specific purpose of the endowment as both events were intended to discuss, promote, or foster research initiatives and projects in the areas of ocean and marine sciences. The University's School of Ocean and Earth Science and Technology (SOEST) is ranked number 3 in the nation in Ocean Sciences research and has brought in over $500 million dollars in contract and grant funding to the state and University. The University agrees with the report's recommendation that the Endowment funds be adequately monitored. We will reevaluate the guidelines regarding the use of the fund.

4) The draft report questioned whether the University has the tools necessary to provide appropriate oversight and management of the Tuition and Fees Special Fund.

Response:
The University has ample administrative policies and practices to control and manage use of this fund. The Auditor is correct about the absence of consolidated procedures and accountability. The Budget Director is the accountable person and will have procedures completed by May 1, 2003.

5) The draft report states that in accordance with generally accepted accounting principles, the university should record the full amount of the donation ($10,000) on its

books and record the administrative fee ($200) as an endowment expense. Instead, the university records $9800 on its books. Therefore, the amount of donations recorded by the university has been continuously underreported.

Response:
We disagree with the finding. Endowment contributions are being properly reported. The foundation is a component unit of the university for financial reporting purposes and their financial information is blended with the university for the fiscal year end financial reports.

6) The report states that non-General funded contracts are not executed in a timely manner. The auditor found several agreements funded by the Tuition and Fees Special Fund and lease agreements relating to the Real Property and Facilities Use Revolving Fund that were either incomplete or executed in an untimely manner.

Response:
We agree and find this practice unacceptable. It is an historical systemic problem and we are pursuing stronger contract monitoring practices.

7) The draft report states that currently, the State Higher Education Loan Fund has an estimated $8.99 million in loans outstanding to students. We found that approximately 31 percent, or $2.85 million, of that amount is considered past due or delinquent.

Response:
We agree that the current delinquency rate is high both here in Hawaii and across the country. We will implement a more aggressive collection effort. In awarding loans according to state law, the student's ability to repay the loan is not a factor for consideration. This, more than any other factor, curtails prompt repayment. Currently, the amount of loans considered past due is $2.6 million. $2.5 million of the total delinquency has been assigned to a private collection agency for collection. It should be noted that the State Higher Education Loan Program is the only state funded loan program that allows access to higher education for students who would have otherwise been denied access because of financial constraints. The University will conduct a review of its loan collection program and implement changes as deemed appropriate.

8) The draft report states that Research and Training Revolving Fund has been used as a "backup" source to pay for expenses for which the university inadequately planned. For example, due to poor planning, the university lacked appropriate funds to pay for the utility expenses of new facilities. As a result, the university used $453,000 intended for project development purposes to pay for utility costs.

Response:
The university consistently plans for electricity costs for new buildings in its biennial and supplemental budget requests. If those requests are not approved, other internal sources of funds are used to meet these costs, including RTRF. The university considers this appropriate because: funded research activities consume a very significant portion of electricity; utilities along with other infrastructure facilitates research and the use of RTRF monies for facilitating purposes is allowable under HRS 304-8.1, paragraph a., section (2); and the use of RTRF monies for indirect overhead costs such as electricity, directly links

expenditures from the RTRF to the source of income for the RTRF that is, reimbursements for indirect overhead.

The University welcomes and appreciated the recommendations cited in this report and will work diligently to implement them.

Sincerely,

James R. W. Sloane
Chief Financial Officer
University of Hawaii

UNIVERSITY OF HAWAI'I
FOUNDATION

RECEIVED
MAR 18 8 19 AM '03
OFC. OF THE AUDITOR
STATE OF HAWAII

March 17, 2003

Ms. Marion Higa, State Auditor
State of Hawaii, Office of the Auditor
465 S. King St., Room 500
Honolulu, HI 96813-2917

Re: Draft Audit Report Regarding University of Hawaii Non-General Funds

Dear Ms. Higa:

Thank you for the opportunity to comment on the findings and recommendations in your draft report, "Review of Selected University of Hawaii Non-General Funds and Accounts" as it applies to the University of Hawaii Foundation. While we do not agree with all of the findings, we welcome recommendations related to Foundation policies and procedures to insure that all fees paid to the Foundation under its service contract with the University of Hawaii are efficiently and effectively utilized to support the University; its students, faculty and programs. We have been working on the improvement of our policies and procedures over the last year and we appreciate the auditor's recommendations as they assist us in these continuing efforts.

What follows are more detailed responses to specific items outlined in the report and deals with those matters relating to the University of Hawaii Foundation and the funds provided by the University from non-general funds.

Background

The University of Hawaii Foundation is a nonprofit organization recognized as tax-exempt under Internal Revenue Code Section 501(c)(3), the Foundation's mission is to act as the primary vehicle to solicit and receive donations from private sources essential to the future of the University of Hawaii system. From 1997 through 2002 the Foundation raised \$134 million in new gifts.

- Over 96% of the Foundation's gifts are restricted for a specific use as designated by the donor - these are not used for the Foundation's operations.
- \$32.2 million of the \$134 million was designated for student aid.

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- University funding provided less than 25% of the Foundation's operating budget during this period.
- For every dollar received from the University during this period, the Foundation received over $26 in private donations for the benefit of UH students, faculty and programs.

Response

Overview

The Foundation Board and its staff are happy to provide information directly related to the fees paid under the University contract in a gesture of good faith and as a community partner in the efforts of the State of Hawaii to improve all its programs and practices - though the Foundation is not a "department, office or agency of the State or its political subdivisions". The Foundation has provided substantially all the information requested when requested, including access to voluminous background documents and detail relating to nearly $10 million in expenditures for the five fiscal years from 1997 through 2002 (of which only $5 million was funded by the University).

Request for Access to Donor Records

In the Report, the Auditor cites that, "The Foundation prevented access to records needed to conduct a thorough review of the university's contract with the foundation." In this case, the Foundation was not able to provide requested information related to the names of individual donors on endowment accounts. The Foundation understands that review of stewardship of the endowment is important and to this end undertakes an external audit of all its accounts each year, an annual review of all its investment activities and issues an annual report to its donors. In addition, the Foundation offered to open its endowment records if names were deleted or a guarantee of confidentiality was provided by the Legislative Auditor's office. The Auditor continued to ask for individual names and was unable to guarantee confidentiality. Therefore the Foundation could not provide access to the endowment account information for review by the Auditor's staff.

The Foundation Board of Trustees decided not to provide individual donor names as they felt that personal financial information had been provided by donors with the understanding that it would not become public. In addition there was general consensus that even the potential release of donor names would harm the efforts of the Foundation to benefit the University of Hawaii—which is its sole mission.

The Foundation is fully accountable to the proper regulatory authorities and its constituencies, its community-based Board of Trustees, its donors, the Board of Regents, the Internal Revenue Service, the State Department of Commerce and Consumer Affairs and appropriate regulators of charitable organizations with experience in this area, such as the State Attorney General's office. The Foundation's financials are audited annually by an independent accounting firm.

Reporting to the University of Hawaii Board of Regents

To provide more oversight of the Foundation by the University, the Auditor's report recommends more detailed reporting to the University and Board of Regents about how the funds from the University are used by the Foundation. With the change in leadership at the Foundation last Fall, additional reporting to the University and Board of Regents has already begun. First, a comprehensive written report was provided in November 2002 regarding the expenditures for the five fiscal years from 1997 through 2002. Second, on a monthly basis the President of the Foundation and the Vice President of Development provide both written and orals reports on fundraising activities for the month and year-to-date. Third, on a quarterly basis, the Vice President for Administration/Chief Financial Officer provides both written and oral reports explaining the details of how the money from the University was spent by the Foundation for fundraising.

Segregation of University Fees

The Auditor's report indicates the Foundation commingles the funds from the University with the funds from other sources to pay for the cost of operations. This is because the funds from the University only partially support the Foundation's fundraising costs--less than 25% of our operating budget during the five fiscal years, 1997 through 2002, was received under our contract with the University. Consequently the University funds were previously combined with other funds to effectively and efficiently administer the payroll and expense payment process. This is why the Foundation allowed the Auditor to review ***all*** the costs associated with our fundraising.

However, to keep the University funds separate, the Foundation has already established a separate account for the funds from the University. The amount in this account will be applied to the specific departments responsible for our fundraising activities.

Fundraising Expenditures

The Foundation adheres to best practices and procedures for fundraising including NACUBO (National Association of College and University Business Officers), AFP (Association of Fundraising Professionals), CASE (Council for Advancement and Support of Education), and NCPG (National Committee on Planned Giving). The Auditor's staff was given access to documentation on more than $9.9 million in expenditures. The Report notes that the amount of expenses is "non significant to the total operation of the Foundation..."

Noted below are the specific fundraising expenditures identified by the Auditor along with our comments.

1. The Report identified several situations where the expenditures seemed to lack adequate justification.

   - Tickets to University athletic events are purchased by the Foundation.

     Providing tickets to these events has long been an excellent way to develop a relationship with potential new donors and enhance our relationship with existing donors. In fact, the new administration of the Foundation has implemented a practice whereby existing donors are now paying to attend these events.

   - A benefit table was purchased for a holiday luncheon; two tickets were purchased for a fundraising dinner; and funds were used to pay part of a private reception to honor the current president.

     Participating in special events within the community is a common practice for fundraising organizations which support institutions of higher education. These are an appropriate way to make certain our Development Officers and senior staff is out in the community building relationships that will turn into fundraising opportunities. The fundraising profession refers to this as "donor cultivation". Building relationships, explaining what the University does, and how a gift can provide a benefit is what we do. However, the Foundation will review and revise expenditure policies to insure closer scrutiny of all of these activities.

   - Two tickets were purchased for a Honolulu Symphony fundraiser.

     The documentation for this expenditure provided to the Auditor's staff noted the name of the attendees. The Foundation staff attended in order to cultivate prospective donors. As a result of this activity, a substantial gift was received; this information was noted on the documentation. In the future we will be more descriptive of titles and purpose. The Report indicates the employee may have taken this item as a personal tax deduction. This did not occur.

2. The Report noted that University funds were used for parties, alcohol and other personal expenses.

- Funds were used to buy tickets to a rock concert and pay for a pre-concert buffet.

  This was an event that included several major donors. Funds were used to buy 6 of the 31 tickets and food and refreshments during the event.

- Expenditures were made for two farewell parties, employee appreciation plaques and a tuxedo rental.

  These items occurred before the current change in the Foundation's senior staff. Expenditures for these types of activities will be limited in the future as new accountability standards are implemented.

- The report commented on the compensation package of an employee of the Foundation.

  There are many ways to compensate employees. We believe the overall package for this employee is appropriate, reasonable and at fair market value.

- The Report noted instances of service of alcohol at special events with the suggestion that this is not a prudent use of funds.

  To the extent these events are important fundraising activities, it seems that alcoholic beverages served in moderation are not inappropriate. The segregation of University fees into a separate account will insure that these costs will not be paid for by non-general funds in the future.

Conclusion

Once again, the single mission of the University of Hawaii Foundation is to support the increasing levels of excellence in teaching, learning and research at the University of Hawaii including all of its campuses and programs. We will continue to work on improving all policies and procedures to insure that the highest level of service can be provided to the University of Hawaii. We believe that the University is one of the cornerstone institutions of the State of Hawaii and will, in partnership with the State Legislature, bring new economic benefits to all the people of Hawaii.

Very truly yours,

William R King

William R King, Vice President for Administration/CFO