Audit of the University of Hawaii Contract with the University of Hawaii Foundation

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

Report No. 04-08
May 2004

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

Audit of the University of Hawaii Contract with the University of Hawaii Foundation

Report No. 04-08, May 2004

Summary

The University of Hawaii Foundation was established in 1955, primarily to support the University of Hawaii's goals through fundraising. It is a non-profit corporation, legally separate from the university. It seeks to generate gifts, build and manage relationships, provide leadership for the fundraising process, and manage assets to generate competitive returns.

In October 2002, the university signed an agreement with the foundation to provide fundraising, stewardship, and alumni relation services for $2.35 million each year through FY2007-08. The university also agreed to reimburse the foundation for 50 percent of its unit-based development officers' salaries, benefits, and applicable taxes, at a projected cost exceeding $700,000 annually. The total university support, therefore, is estimated to be more than $3 million for each full contract year. The contract is paid for by the Tuition and Fees Special Fund. This agreement succeeded a similar contract for $1 million per year to conduct the university's 1997-2002 fundraising campaign. That 1997 contract provided operating funds for the foundation that were lost when donors objected to a six percent administrative fees on all donations. The fee was lowered to two percent—a rate that the foundation is currently seeking to raise.

The fundraising contract between the university and the foundation was not based on well-founded plans or well articulated expectations. It lacks clear definitions for contracted services, performance standards, and measurable deliverables that would allow proper monitoring of the foundation's performance. Insufficient up-front planning prior to contract execution has caused the parties to seek amendments and added resources for unanticipated costs.

Even though the contract bypassed the university's usual sole source contracting process, the Board of Regents, the body responsible for the university's fundraising activities, approved this contract with little scrutiny.

We found that the foundation authorized questionable, even abusive, expenditures from donated funds because of vague guidelines, poorly defined account purposes, and lenient interpretations of the foundation's expenditure policies. These expenditures include private club memberships, numerous instances of meals and alcoholic beverages, and bidding at a charity auction. In addition, the foundation has shown a bias for maintaining distributions from endowment accounts whose values have fallen below the original gift amount, due to investment losses, without donor's consent. Furthermore, instances of poorly handled donor relations point to a need for greater scrutiny of the foundation's stewardship of donor interests.

During our audit, we identified several issues worth further scrutiny, including fundraising by groups operating independently from the foundation, fund transfers between expendable accounts, and spending for administrative and fundraising purposes from donated funds.

Recommendations and Response

We recommended that the Board of Regents and the university administration ensure that contracts for fundraising services conform to appropriate university procedures and sound contracting practices; include clearly stated services to be performed, clearly defined performance standards and measurable outcomes, the method(s) of evaluation for service performance, and penalties or remedies for failure to perform; and clarify their mutual intent regarding the relationship between the 2002 fundraising contract and the 1997 memorandum of understanding outlining their respective roles and responsibilities relating to fundraising.

We also recommended that the Board of Regents develop policies and guidelines for fundraising activities applicable to all university fundraising organizations, including the foundation; assume responsibility for contracting financial and performance audits of fundraising activities; develop a capacity for monitoring fundraising activities, including utilizing the university's internal audit function, which should report directly to the board; ensure that the foundation's expenditure policies over donated funds are strengthened and enforced; ensure that purposes and spending limitations for all accounts, including unrestricted expendable accounts, properly reflect donor expectations; and ensure that donor intent is faithfully fulfilled.

The foundation, its Board of Trustees, the university, and the Board of Regents acknowledged the value of some of our findings and recommendations but raised a number of concerns and objections. These disagreements include our representation of the effect of limitations placed on our access to information, our finding of bias for payouts to programs at the expense of donor interests, and the recommended Board of Regents oversight over audits.

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

Submitted by

THE AUDITOR
STATE OF HAWAII

Report No. 04-08
May 2004

Foreword

For this report, we continued work begun for Report No. 03-04, *Review of Selected University of Hawaii Non-General Funds and Accounts,* requested by the 2002 Legislature through Act 177, Session Laws of Hawaii (SLH) 2002. Specifically, we reviewed the university's contract with the University of Hawaii Foundation, which is funded by the Tuition and Fees Special Fund.

The audit was conducted pursuant to Section 23-4, Hawaii Revised Statutes, which requires the Auditor to conduct postaudits of the transactions, accounts, programs, and performance of all departments, offices, and agencies of the State and its political subdivisions.

We wish to express our appreciation for the cooperation and assistance extended to us by the University of Hawaii Foundation, the University of Hawaii, and others whom we contacted during the course of the audit.

Marion M. Higa
State Auditor

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Chapter 1

Introduction

This audit continued work begun for our Report No. 03-04, *Review of Selected University of Hawaii Non-General Funds and Accounts,* requested by the 2002 Legislature through Act 177, Session Laws of Hawaii (SLH) 2002. In that report, we reviewed a 1997 contract between the University of Hawaii (university) and the University of Hawaii Foundation (foundation). Our work, however, was limited in scope due to the foundation's denial of access to pertinent information. Despite the limited access afforded to us, we identified several areas of concern, including poorly worded contract provisions and inadequate contract monitoring.

We also reviewed a 2002 contract between the university and the foundation to provide alumni relation services in addition to fundraising and stewardship services. However, at the time our prior report was issued, staff assigned to the University of Hawaii Alumni Association had not yet transferred to the foundation. As a result, we were unable to complete the work pertinent to alumni relation services expenditures.

We initiated this audit to fulfill our obligation to the 2002 Legislature. Specifically, we set out to review the university's contracts with the foundation, which are funded from the Tuition and Fees Special Fund. Our work was conducted pursuant to Section 23-4, Hawaii Revised Statutes (HRS), which requires the office to conduct postaudits of the transactions, accounts, programs, and performance of all departments, offices, and agencies of the State and its political subdivisions.

Background

The foundation was established in 1955 to encourage private support for the university. It is a non-profit corporation that was created exclusively for the purpose of supporting the university through fundraising and related activities. As an Internal Revenue Service 501(c)(3) corporation, it is legally separate from the university and all university affiliates. Yet, because all university fundraising is under the oversight of the university Board of Regents as directed by Section 304-7, HRS, the foundation is intertwined with the university. In fact, for financial reporting purposes, the foundation must be reported as a component unit of the university as required by the Governmental Accounting Standards Board. The foundation's mission is to advance the university's goals through fundraising. The foundation achieves its mission by utilizing available resources to generate gifts, build and manage relationships, provide leadership for the fundraising process, and manage assets to generate competitive returns.

The foundation receives cash gifts, pledges, non-cash gifts (securities, real property, equipment, etc.) and gift premiums (goods or services are provided in return for a gift) on behalf of university programs. It also receives non-gift revenues, such as royalty payments, fundraising event proceeds, eligible research funds, membership dues from university-affiliated associations, and sales from education materials.

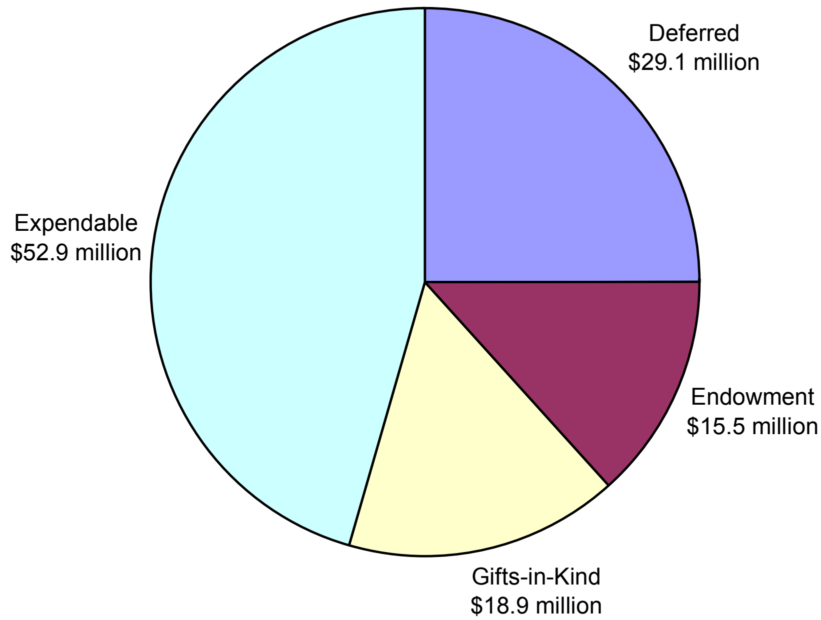
Individual gifts are held in accounts, each with a defined purpose and specified spending restrictions. The foundation established three types of accounts: endowment, quasi endowment, and expendable. Endowment accounts receive gifts from donors who have limited the use of their gift to earnings on the gift corpus (principal). Quasi endowment accounts represent expendable moneys that are invested by the foundation. Expendable accounts receive gifts or other income that may be spent according to the purpose of the accounts. The interest earned on expendable accounts is used to support the foundation's operations. As of January 2003, the foundation reported managing more than 3,100 accounts with about 98 percent restricted by donor designations. Approximately 550 of these are endowment accounts.

The foundation's revenues derive from the university's payments under the fundraising contract, a 2 percent administrative fee assessed on all new gifts and non-gift revenues, and the interest earned on expendable accounts. An administrative fee of 3 percent per year is also charged on balances in the endowment fund pool to pay for third party costs, such as investment manager fees, audit fees, and fiscal management costs.

In May 1997, the university contracted with the foundation to provide fundraising and stewardship services for the university at a cost of $1 million each year for five years. This agreement enabled the foundation to reduce the administrative gift fee assessment against each gift from 6 percent to the current 2 percent, thereby making more funds available to donor-designated university programs and addressing donor concerns that fees were exorbitant. Contract fees are paid from the Tuition and Fees Special Fund as permitted by Section 304-16.5, HRS. This special fund's revenues come from regular, summer, and continuing education credit tuition and related charges to students.

The 2002 fundraising, stewardship, and alumni relation services contract, which is the subject of our audit, succeeded a similar 1997 agreement for the university's first ever campaign that according to the foundation raised $116 million for the university. Exhibit 1.1 shows the $116 million by contribution type. Exhibit 1.2 summarizes the foundation's financial information for the past six fiscal years beginning with FY1997-98.

Exhibit 1.1
University of Hawaii Foundation
$116.4 Million Raised during Campaign under 1997 Contract by Type of Contributions



Source: University of Hawaii Foundation

Exhibit 1.2
University of Hawaii Foundation
Financial Data for Fiscal Years 1997-98 through 2002-03 (in thousands)

	FY1997-98	FY1998-99	FY1999-2000	FY2000-01	FY2001-02	FY2002-03
Beginning Fund Balance	$93,671	$108,050	$116,791	$139,997	$140,921	$126,985
Revenues	32,666	25,440	40,261	18,115	6,090	20,894
Expenditures	(18,287)	(16,699)	(17,055)	(17,191)	(20,026)	(20,854)
Ending Fund Balance	$108,050	$116,791	$139,997	$140,921	$126,985	$127,025

Source: University of Hawaii Foundation

In October 2002, the university signed its current agreement with the foundation to provide fundraising, stewardship, and alumni relation services for $2.35 million each year through the contract end date of December 31, 2007. The university also agreed to reimburse the foundation for 50 percent of its unit-based development officers' salaries, benefits, and applicable taxes, at a projected cost exceeding $700,000 annually. The total university support, therefore, is estimated to be more than $3 million for each full contract year.

The foundation has a ten-year lease agreement terminating on December 31, 2008 with the university for the use of offices located in Bachman Hall on the University of Hawaii at Manoa campus for an annual sum of $10. The university provides water, electricity, and janitorial services at no additional cost to the foundation. Although the foundation has substantially increased the space it occupies at Bachman Hall, the lease agreement was not modified to reflect this change.

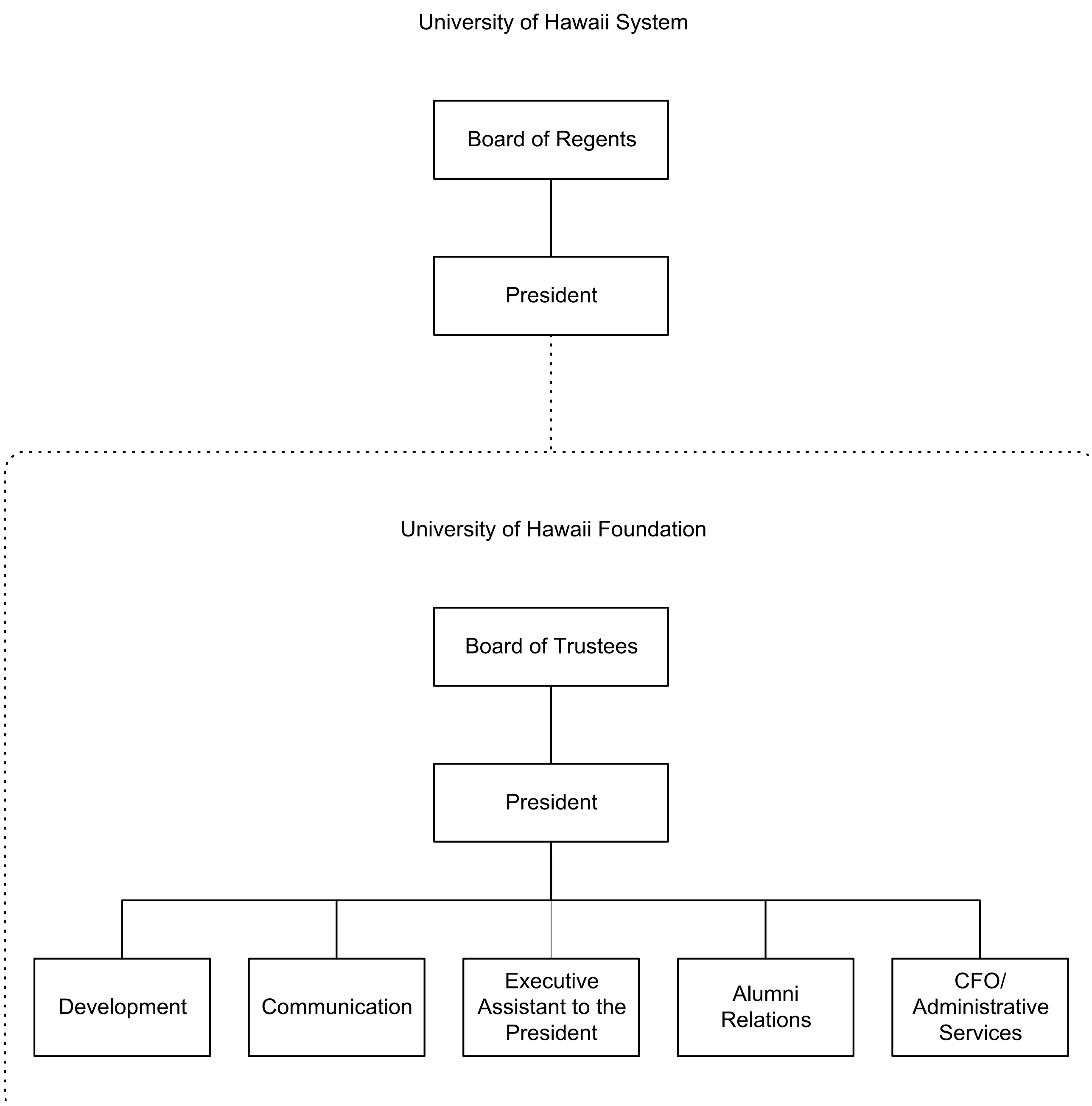
Organization

The foundation's bylaws require establishing a Board of Trustees comprised of at least 20 persons and a maximum of 35 persons. Four board members are ex officio members, which include the president of the university, the president of the foundation, the chairperson of the university Board of Regents, and the president of the University of Hawaii Alumni Association. The Board of Trustees is a self-perpetuating board, as its members select and appoint candidates to its ranks. Trustees other than ex-officio members serve three-year terms and can serve a maximum of two successive terms. However, upon losing eligibility for reappointment after six years, trustees can, and do, re-join the board after a one-year hiatus. The chairperson of the Board of Trustees is elected at the annual general meeting and has the power to appoint members and chairs to the boards' committees. Exhibit 1.3 illustrates the foundation's organizational and authority structure.

Alumni relations

Formally organized in 1988, the University of Hawaii Alumni Association is a system-wide, non-profit organization for all university related alumni groups. Its goal is to generate support for the university by encouraging interaction among the graduates or friends of the university. The association, which is governed by a board of directors, has a nationwide network of 37 affiliated alumni groups. The foundation has assumed personnel previously assigned to the association and will provide alumni relation services. However, the foundation's duties and responsibilities are not specified in the contract and the parties were still in the process of determining their respective roles at the time of our fieldwork.

Exhibit 1.3
Organizational Chart of the University of Hawaii Foundation



Source: University of Hawaii

Prior reports of the Office of the Auditor

Our Report No. 03-04, *Review of Selected University of Hawaii Non-General Funds and Accounts,* found that the university entered into a poorly written contract that did not provide for adequate monitoring of the foundation's use of student tuition and fees for fundraising, stewardship, and alumni relation services. The foundation's broad, narrative reports provided no specific information on how the university's funds were used during the five years of the contract for fundraising and stewardship services. The foundation's inability to provide specific information was due in part to its improper practice of commingling its public contract funds with other private funds it receives. In addition, we reported numerous questionable expenditures in the foundation's fundraising activities, including paid events and charitable functions that lacked explanations of their benefit to the university. We also found that the foundation paid for holiday, farewell, and thank-you parties, as well as concert tickets for its employees. The foundation also purchased alcoholic beverages with these public funds derived from student tuition and fees.

Objectives of the Audit

The objectives of this audit were to:

1. Assess whether the University of Hawaii is effectively and efficiently overseeing the following contractual services provided by the University of Hawaii Foundation:

    a. Solicitation of outright and deferred private gifts;

    b. Management of outright and deferred private gifts to ensure that those gifts are being used to fulfill donor specifications; and

    c. Completion of an alumni relations plan and implementation of new alumni outreach and communications programs.

2. Review the accountability for the use of contract funds for development officers.

3. Make recommendations as appropriate.

Scope and Methodology

This audit examined the University of Hawaii's fundraising and related services contracts with the University of Hawaii Foundation.

We interviewed key personnel and representatives from the university and the foundation. We also examined applicable laws and administrative rules, pertinent documents and reports, and the legislative history related to the university and the foundation. We reviewed fiscal records and judgmentally selected a sample of expenditures from endowment and expendable accounts to determine whether expenditures were appropriate according to donor instructions and foundation policy.

We also requested appropriate financial reports and other accountability related documents but not all requested information was provided by the foundation. The foundation's initial refusal and eventual limited cooperation to allow us access to information and staff hindered our audit work and required us to modify our audit procedures. Although we were generally able to meet our audit objectives, the foundation limited our ability to obtain and review documentation and verify information to our customary standards. As a result, some of our conclusions have been qualified. These qualifications are placed in the appropriate sections of the report.

Our work was conducted from June 2003 through March 2004 according to generally accepted government auditing standards, except where we qualified our conclusions as explained above.

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Chapter 2

Stronger Oversight over the University of Hawaii Foundation's Activities Is Needed to Mitigate Threats to University Donor Confidence

The University of Hawaii (university) entered a five and one-half year contract with the University of Hawaii Foundation (foundation) for fundraising, stewardship, and alumni relation services at a cost of approximately $3 million per year. The contract is vague and lacks definitions of mutual responsibilities and adequate measures to assess the foundation's performance. Consequently, it provides little assurance that the best interests of the university's donors and its programs are maximized. Moreover, the contract was processed by the university and approved by the Board of Regents in a complacent manner uncharacteristic of responsible parties to a contract worth more than $15 million over five-plus years. Finally, instances of abusive expenditures from donated funds point to a need for greater accountability and stronger policies and enforcement.

In June 2003, we informed the university's president, the university's Board of Regents, the foundation's Board of Trustees, and the foundation's president of our intention to audit the university's contract with the foundation for fundraising and related services. The foundation vigorously objected to our work, citing concern for donor confidentiality as its justification for denying access to information and foundation staff needed to do our work. The threat of our subpoena for records and the resulting prospect of negative publicity that might damage donor confidence prompted the foundation to provide us with qualified and limited access. However, this delayed critical phases of our audit more than five months. Pressed by time constraints and our desire to complete the now overdue project, we modified our audit plan and limited the transactions selected for review to accommodate continued constraints the foundation placed upon us. Despite our inability to gain unfettered access, we obtained sufficient information to determine that the foundation's practices in discharging its contractual obligations warrant greater scrutiny from the Board of Regents. Furthermore, audits are needed to shed light on some troubling practices that are not aligned with donor intent.

Summary of Findings

1. The vague fundraising contract between the University of Hawaii and the University of Hawaii Foundation provides little assurance that the services paid for will be received and that donor interests are protected.

2. The foundation's inadequate and poorly enforced expenditure policies disregard donor intent and may jeopardize donor confidence.

The University's Vague Fundraising Contract Lacks the Means to Assure That Services Paid for Are Performed and Donor Interests Protected

The fundraising contract between the university and the foundation was not based on well-founded plans or specific expectations. It also lacks clear definitions for contracted services and performance standards and measurable deliverables that would allow proper monitoring of the foundation's performance. Insufficient up-front planning prior to contract execution has caused the parties to seek amendments and added resources for unanticipated costs.

This multiplicity of problems, in light of the long association between the university administration and the foundation, suggests that the contract was not negotiated at arm's length and that the cozy relationship between the university and the foundation breeds complacency. Lack of objectivity and distance between the parties to a contract undermine confidence that contract services performed on behalf of the university and its financial supporters will be adequate and provide for optimal use of the $3 million paid from fees collected from university students. The overly comfortable relationship is underscored by the university having bypassed its established procurement practices for sole source contracts in processing its agreement with the foundation.

Even though the contract bypassed the usual process, the Board of Regents, the body responsible for fundraising activities, approved this contract with little scrutiny. The Board of Regents is responsible for accountability of all organizations raising funds in the university's name. In addition to the foundation, there are approximately 150 fundraising organizations affiliated with various university programs. Despite accountability responsibilities, the board lacks control over audits of these programs. For example, audits of all financial and operational activities of the foundation should logically and properly be placed under the university's Board of Regents' direct oversight because the foundation's fundraising activities are conducted on behalf of the university. The Board of Regents is responsible for protecting the university's name. However, the foundation's audits are currently administered by its Board of Trustees.

The university's contract with the foundation reflects a cozy relationship between the parties

The fundraising contract between the university and the foundation lacks definitions of contractual responsibilities, adequate descriptions of deliverables, and how results are to be reported and monitored. The contract, signed in October 2002, is supposed to define the foundation's fundraising, stewardship, and alumni relation services to support the university's five-plus year fundraising campaign. The October 2002 contract succeeded an essentially identical five-year contract that ended on June 30, 2002, but was extended for several months until the new agreement took effect.

The vague contract terms and the casual manner in which the agreement was processed are not consistent with an arm's length transaction. The parties to the contract exhibited a surprising lack of knowledge of a critical contractual term and were unable to provide documentation of any comprehensive plans that provide a basis for the services and resources needed. Inadequate planning is in part responsible for the need to modify the contract and boost resources while still in its start-up phase. Furthermore, the contract, a sole source transaction, was negotiated and processed outside the university's procurement process and in violation of the university's own procurement requirements.

Contract terms are ill-defined and lack adequate means to assess service performance

The critical components defining services to be performed under the fundraising contract between the university and the foundation are the scope of services, time of performance, and compensation and payment schedules. We included a copy of these items as Appendix A. Aside from a $200-250 million overall goal for the campaign, the descriptions of the services to be delivered are vague and lack measurable criteria and the means to assess performance.

First, neither the foundation nor the university could define "stewardship" and the nature of the "stewardship services" the foundation will provide. This precludes any opportunity to assess these services because the parties to the contract do not appear to know what the term means. When asked to define the term "stewardship," the foundation's president declined and called the term "very nebulous." A former university administration official who was involved with the development of the 1997 contract admitted that not much thought was placed on a definition of the services covered by "stewardship." Even the university general counsel and the university's chief of staff could not provide a definition.

Second, in a properly conceived contract the responsibilities of the parties should be clearly stated, which is not the case in the fundraising agreement. We were informed that a 1997 memorandum of understanding signed by the parties governs these issues; however, the contract contains no reference to this memorandum, raising doubt whether the parties intended for it to be included. We were further informed that a proposed revision of the current contract would incorporate this memorandum of understanding to better define the mutual responsibilities of the contracting parties. Considering that the university's legal counsel referred to the memorandum as a "feel-good, aspirational agreement," it is not likely to address the lack of specificity in the contractual provisions. Inadequate descriptions of the mutual responsibilities make it difficult to assess the foundation's performance and may complicate resolution of any unforeseen disagreements. Compounding the lack of clarity of the parties' intentions is the contract's confusing performance schedule. The schedule states that the contract term is five and a half years. Yet, the beginning and ending dates—October 1, 2002 and December 31, 2007—reflect a term of five and a quarter years. The same schedule also states that alumni relation services are to be performed over five and three quarter years.

Third, fundraising drives are made up of a number of component efforts, such as annual giving, planned giving, and major giving. The current contract provides no indication of how these or any other component efforts contribute to the contract's $200-250 million financial goal and no means for the university to assess whether the foundation effectively directs its resources to maximize returns or compare the foundation's performance with comparable campaigns elsewhere. Consequently, the contract demands little if any accountability by the foundation.

Finally, the contract's overly general reporting requirements compound the lack of accountability. The contract merely requires that "the contractor shall provide university with regular reports...." Thus, reports submitted by the foundation provide little insight beyond updates on the funds raised and activities undertaken during a reporting period. Experts in the fundraising field who call for greater accountability suggest, for example, detailed reports broken down by fundraising activity—not only of funds raised but also of resources used.

Best practices in contracting for services, such as those promulgated by the National State Auditors Association, suggest that contracts should contain specific measurable deliverables, reporting requirements, and a process for monitoring performance. We find none of these essential elements in this contract. University and foundation officials' attempts to explain the apparently cavalier manner in which this contract was conceived point to the long historical relationship between the parties and the university's desire not to micromanage the foundation. Our analysis, however, leads us to conclude that the contract demonstrates an alarming degree of complacency by both the university and the foundation. This unfocused approach to the contract neither builds nor reinforces confidence in the university's and the foundation's ability to safeguard and properly manage donor funds.

After-the-fact determination of needed services requires revisions to the contract

The contract and supporting information do not indicate that the parties involved had a clear idea of the services the foundation would provide for $3 million per year. For example, the information submitted to the Board of Regents shows no breakdown or plan for how the fundraising goal of $200-250 million was determined and would be reached. The contract also lacked information to judge whether that goal was realistic, ambitious, or modest. Some board members understood that the university president had promised to raise $150 million for the School of Medicine alone. Given that the previous campaign yielded $116 million, a goal of $200-250 million would appear less than ambitious. Nevertheless, the board exercised little scrutiny and approved the contract.

According to the foundation's president, its fundraising program was 10-12 years behind comparable programs on the mainland at the time she assumed her responsibilities in February 2002. Despite this fact, the parties agreed to essentially identical fundraising and stewardship services under the new contract, except for elevating the fundraising goal to $200-250 million. Neither the contract nor information submitted in its support included a clear plan of where the fundraising program was, where it needed to go, and what it would take to get there, including what resources would be needed. According to the National State Auditors Association, a clear plan is a prerequisite for best practices contracting for services.

During the start-up phase of the current fundraising campaign, the foundation reoriented its focus to design a program more in line with best practices and to exploit previously ignored opportunities. In the process, however, the foundation found that the available resources would not suffice to finance the effort, resulting in a drive to increase the administrative fee from 2 percent to 3 percent. This occurred after the university added $2 million per year to the foundation's budget. Ironically, the original reason for subsidizing the foundation with university funds was to lower administrative fees and assuage donor concerns over diversion of their gift for the foundation's use.

Additionally, the foundation received payments in the amount of $350,000 annually for alumni relation services but could not provide us with a plan specifying what exactly these services entail. We were informed that negotiations were still in progress with the alumni association to determine the exact form of these services. Again, the vague language in the contract shows a lack of advance planning. It would have been difficult to determine, for example, how much these services should be worth without some concept of the responsibilities involved.

Not surprisingly, the foundation's president informed us that the university and the foundation are in the process of modifying the contract to correct its flaws and to better define the parties' responsibilities.

The contract does not meet university procurement requirements

The university president's office directly executed the contract with the foundation. According to the university's Office of Procurement, Real Property and Risk Management, this is the only contract known to have bypassed its involvement and controls to ensure proper processing. According to that office, which has system wide responsibility for oversight over procurement, the contract does not comply with the university's sole source procurement policies and procedures. In reviewing the master file for this contract, we found fundamental requirements for university sole source contracts missing. For example, the request for sole source, the determination of cost and price reasonableness, the notice of sole source procurement form, and the designation of an individual assigned to monitor the contract had been bypassed. In addition, the contract lacks a "contractor's acknowledgement," a required notarized verification of the contractor's signing authority. The president's office's lax contracting practices do not comply with the university's established sole source procurement process. Perhaps more importantly, contracting outside the procurement process shows a willingness on the part of both contracting parties to circumvent formal processes for convenience and to ease contract terms and responsibilities.

The Board of Regents has not fulfilled its statutory oversight responsibility for the university's fundraising contract

The Board of Regents is the body authorized by Section 304-7, HRS, to receive gifts to the university. The board is also responsible to ensure that fundraising organizations are held accountable for their activities. In authorizing this vague contract with little oversight, the board was remiss in its responsibility as it could not have had adequate knowledge of the services to be received and how the foundation would account for its performance.

In order to assume the responsibility for fundraising and related accountability assigned by Section 304-7, HRS, the Board of Regents must provide guidelines for establishing and operating fundraising activities on behalf of the university and create a means of monitoring compliance with those guidelines. The board's responsibility should include assuming control over audits of fundraising activities.

The contract received little scrutiny

The Board of Regents received only cursory information for its approval deliberations on the university's new contract with the foundation in 2002. Board minutes reflect only minimal review of the request to approve the contract and the supporting information. This follows a history of the board's past practice to give the university administration and the foundation a free hand. The board's substantial comfort level with the fundraising contract and its parties resulted in minimal questioning or scrutiny. However, this practice is not consistent with its responsibility to demand accountability from fundraising organizations in general, and the foundation as a recipient of university funding in particular.

The Board of Regents has no policies guiding the foundation's fundraising activities

Section 304-7, HRS, authorizes the Board of Regents to receive gifts and assigns it the responsibility to ensure accountability. However, we found that the board's policies do not include any guidelines for establishing and operating fundraising organizations acting in the university's name. The foundation, therefore, is the de-facto policy maker for its own activities, for which the Board of Regents is responsible.

In addition, about 150 other organizations raised funds for university programs. The university encourages use of the foundation as the university system's central administrative and accounting facility for all fundraising organizations. If utilized, the foundation's administrative process provides a measure of control through its policies and procedures. Some organizations, however, have chosen not to involve the foundation and operate independently. Neither the university nor the Board of Regents has a process to actively ensure full accountability from those organizations. Foundation and board officials have acknowledged concerns that the lack of guidelines and oversight over these organizations may place the university's reputation at risk. Examples of potential pitfalls from inadequate oversight include tax compliance violations, inappropriate tactics, illegal contributions, fraud, and clashes between fundraising efforts.

The Board of Regents shirks its responsibility to properly oversee fundraising activities

The Board of Regents has not developed a mechanism to ensure that all fundraising organizations affiliated with university programs, including the foundation, properly account for their activities. For example, the foundation contracts for and oversees its own operational and financial audits. Although the Board of Regents receives copies of the foundation's financial audits, the foundation has not shared an operational audit report with the board. Operational audits focus on issues such as quality of management, compliance with laws, and comparison with best practices in the industry, which are important factors in assessing the quality of the foundation's operations. Given that Section 304-7, HRS, assigns responsibility for accountability of fundraising activities to the Board of Regents, the board should be more proactive and require periodic financial and operational audits of significant fundraising operations, including the foundation. To ensure that the board improves and sustains its oversight responsibility over fundraising operations, additional scrutiny from independent auditors, including our office, is warranted.

Inadequate, Poorly Enforced Expenditure Policies and Disregard of Donor Intent May Jeopardize Donor Confidence

We found that the foundation authorized questionable, even abusive, expenditures from donated funds. These problems result from vague guidelines, poorly defined account purposes, and lenient interpretations of the foundation's expenditure policies. In addition, the foundation made distributions from endowment accounts even when account values had fallen below the principal amount originally donated and without the permission of the donors. This practice may conflict with standards set by Chapter 517D, the Uniform Management of Institutional Funds Act, which provides guidelines for the management of endowment funds. Furthermore, some donors' negative experiences with the foundation's administration of their gift raise questions about the foundation's dedication to protecting donor interests and preserving donor intent.

The foundation has created about 3,100 accounts. Approximately 550 are endowment accounts and 2,600 are expendable accounts. Endowment accounts are established to account for gifts that are generally intended to remain intact indefinitely. Funds in endowment accounts are invested to generate income and capital appreciation, which is then either added to the principal in part to counteract inflationary effects on the purchasing power of a gift or distributed to university programs according to the directions specified by the donor in the gift instrument. Expendable accounts are established to collect gifts or income from endowment accounts, which generally may be expended currently for the purposes specified by the donors. The foundation has adopted administrative policies complementing donor instructions in guiding expenditures from expendable accounts.

Inadequate spending policies and interpretations result in abuse and violate donor intent

The foundation's current administrative policies guiding expenditures from donor accounts are interpreted to require "some direct benefit to the university" for expenditure from donated funds. Our review of these policies and a sample of expenditures show that this vague concept insufficiently defines propriety of expenditures and that the foundation's policies need strengthening and stricter enforcement.

Existing policies need strengthening to curb questionable and abusive spending from funds entrusted by donors. During our audit, we identified expenditures that are clearly abusive, extravagant, or raise questions about consistency with use of public funds, where personal gain may exceed the benefit the university receives. For example, a university employee was reimbursed for annual membership fees to two private business clubs and initiation fees and annual membership to a golf and country club at a total cost of over $19,000. A piece of art, described as a $2,000 limited edition print, was purchased at a charity auction to decorate a university employee's office and reimbursed with donor funds.

Meal reimbursements also raised concerns, including frequent meals at upscale restaurants and lavish entertainment. On one occasion, a $664 luncheon for a visiting dignitary was followed by a reception and dinner with community and academic leaders for the same dignitary at a faculty member's residence, where the cost of wine alone exceeded $650. On another occasion, a dinner party for four university academicians and their spouses at the home of a university employee was also reimbursed. The six-course dinner was prepared by a chef, with the wine bill exceeding $100. The purpose of this dinner was documented as, "discuss cancer matters."

Such excesses could be effectively curbed if the foundation broadens the application of an existing policy. The policy, which requires that expenditures be appropriate under the circumstances, reasonably necessary for the conduct of university business, and compatible with the foundation's status as a publicly supported entity, currently applies to certain expenditures from protocol funds only.

A currently limited policy requiring adoption of the lowest reasonable available option for expenditures should be expanded and applied to all expenditures to ensure that donor funds are spent wisely. We found, for example, that the foundation paid for a table at the Honolulu Symphony Ball costing $4,000, or $400 per person, for a group of university employees and their spouses. In itself an expenditure of questionable value to the university, it was also a more expensive choice than an alternative table option costing $2,250. Currently, adopting the lowest reasonable cost option is only required for travel arrangements. We believe this requirement but should apply universally to all expenditures from donated funds.

Because our sample size was limited, we were unable to determine the prevalence of abusive and questionable spending from the foundation's 2,600 expendable accounts. However, the discovery of these examples among our limited sample justifies closer scrutiny of the foundation's stewardship over expenditures from donated funds.

Poorly defined purpose statements for accounts facilitate abuse

A number of accounts we reviewed lacked an adequately defined purpose statement, providing opportunities for funds to be spent at the program's administrator's discretion. We found that donors' expectations do not always coincide with such open ended spending authority. In one instance, the purpose of an account for the Cancer Research Center of Hawaii states that the fund is "for donations with no specific instructions for use in the Cancer Center of Hawaii program — to be used at the director's discretion." However, correspondence from donors whose donations were placed into this account, and the center's acknowledgments sent to donors, indicate an intended and acknowledged restriction on the scope of use of these donations. While instructions from donors may not be "specific," their expectation for the use of their gift is abundantly clear from the correspondence we found in the file for this account. A sample of correspondence from donors conveys their expectation, such as: "our goal was to raise funds for research, so that someday, our children will live in a cancer-free world"; "in accordance with [donor's] desire to further cancer research"; and "...towards exploring the benefits and use of healing touch on patients with ovarian cancer."

Donor expectations were reinforced by the cancer center's and the foundation's responses, which included nurturing language apparently aligned with donor intent, including: "Your gift is powerful. It will help change the lives of our students – and create a better future for all of us."

Other responses provide even greater assurance for the prudent use of donor funds:

> ... [your gift] will assist our researchers and health professionals in developing a greater understanding of cancer.... Contributions are an important part of the financial needs of the Cancer Research Center. They provide flexible funds which allow us to respond to emergencies or take advantage of special opportunities to maintain a quality cancer research center in Hawaii. **We will do our very best to use these funds wisely.** (emphasis added)

These communications illustrate that donors have a clear expectation of how their funds will be spent and are encouraged to believe that the primary use for their gifts is cancer research. We are unable to reconcile these expectations with our finding that of $145,852 in donor gifts received in FY2002-03, at least $70,800 (49 percent) were spent on expenditures related to administrative activities, including at least $40,000 (27 percent) on meals and entertainment. We identified expenditures for valet service; $20,000 paid to a fundraising company; approximately $18,000 to catering companies; $1,465 to a wine merchant; $1,500 for a gala dance attended by five university employees and their spouses; and numerous expenditures for lunches and dinners at clubs and restaurants. These expenditures were made from donations that were already assessed a 2 percent administrative fee charged by the foundation at the receipt of the gift.

Endowment management favors funding programs over donor interests

The foundation's mission according to its charter emphasizes fundraising as its exclusive purpose, making no mention of fostering the interests of the university's donors as a focus of its efforts. Promoting donor interests is considered an important part of best practices in fundraising. In practice, the foundation has maintained distributions from impaired accounts (where the value of a donation has fallen below the donor's original gift) in the face of investment losses, interpreted donor instructions to favor greater distributions, and pursued an aggressive investment policy for its endowment fund. These factors illustrate the foundation's bias for maximizing distributions to university programs at the expense of donor interests. The foundation's practice of making distributions from accounts whose values had fallen below the original principal amount donated without express permission from donors is questionable, especially where donors have indicated a preference for preservation of capital. It even raises a question whether such practices are at odds with the Uniform Management of Institutional Funds Act, Chapter 517D, HRS.

The foundation's investment strategy for endowment funds has been aggressive

The foundation's 2001 financial statements indicate that almost 80 percent of the endowment was invested in equities as of June 30, 2001, in accordance with the foundation's investment policy. The policy allows the equities component (made up primarily of relatively risky company stock investments) to represent an even larger 85 percent portion of its endowment portfolio. Such large positions in equities are considered aggressive for a fund of this type with experts suggesting a 60 percent equity allocation as being more appropriate. The university's Board of Regents, for example, sets a 70 percent maximum for the equity component of university controlled endowment funds. The foundation's president acknowledged that the aggressive investment strategy and the risky equity position of the foundation's portfolio was not consistent with a *prudent man* standard, adding that concern about the risky investments was partially responsible for a change in investment managers. However, the policy is the responsibility of the foundation and its Board of Trustees. According to the foundation's chief financial officer, the foundation's investment policies are being revised.

Distributions continue when values fall below principal

Endowment accounts are intended to have the donor's original gift (principal) maintained in perpetuity. The foundation's endowment procedures, however, suggest that standard language for gift instruments (the documents containing a donor's instructions) should provide for continued distributions if an account's market value falls below the principal amount. This position is not universally agreeable to donors as we have found a number of accounts where the donor specifically prohibited any distributions from the principal.

As of June 30, 2003, approximately 38 percent of the foundation's 500 permanent endowment accounts' value had fallen below the principal amount due to investment losses. Some account balances had fallen as much as 30 percent. Some accounts' values had been even lower in the previous year, caused by poor stock market returns during the three-year bear market starting in the year 2000. Notwithstanding impaired account balances, the foundation continued to make distributions from the income earned on these endowment accounts for two years before deciding to seek donor permission.

For the FY2003-04, the foundation sent letters to about 1,000 of its 17,000 donors, requesting approval for continuing distributions if the principal amount of their account had been impaired. Two of the eleven donors whose impaired endowment accounts we reviewed refused to give that permission, indicating that the foundation's distributions in preceding years may have been contrary to their wishes.

In addition, the letter informed donors that unless a response was received by a given date, the foundation would assume that the donor had agreed to continue distributions. This assumption by the foundation articulates its bias for making distributions and reveals a questionable commitment to donors' wishes. It is also in stark contrast with the actions of other educational foundations we contacted. Some of these other foundations froze all distributions from any impaired account unless the donors had given written permission to continue distributing income. The distribution policy for the University of Alaska Foundation, for example, allows distributions only from earnings and gains accumulated that exceed the original principal amount. Therefore, an impaired account balance, where the accumulated earnings and gains are negative, will automatically freeze any further distributions.

The University of Hawaii Foundation's distribution practices may also reflect a departure from investment management standards of Chapter 517D, HRS, the Uniform Management of Institutional Funds Act. Section 517D-9, HRS, provides that releases from donor restrictions are permitted only with written consent from the donor. Having distributed income from all accounts with market values less than the original gift for as long as two years and having continued distributions from some impaired accounts based on presumed permission, the foundation's practices appear to be misaligned with Section 517D-9, HRS.

The limits placed on our audit work did not permit us to collect enough information to assess the pervasiveness of conflict between donor instructions and distribution practices. However, we found at least one case where distributions currently continue from an impaired account that specifically prohibits paying out any part of the principal amount without the donor's written consent.

Donor interests are poorly handled

The foundation's top managers agree that it is generally recognized in the fundraising field that faithful execution of donors' intent and interests are of utmost importance to maintain the fundraising capability of a university. Because of the limitations placed upon us, we were unable to specifically assess the foundation's stewardship of donor interests. During our audit we did, however, identify two examples where lapses in protecting donor interests have occurred, pointing to a need for greater scrutiny in this area.

First, the foundation unilaterally suspended spending income from an endowment fund established for scholarships. The decision was based on the challenging stock market climate of recent years, which had resulted in insufficient income to cover the specified scholarships and the loss of some of the principal. Upon learning of the suspension, the donor unequivocally affirmed a commitment to maintain the full scholarship schedule and harshly criticized the foundation for usurping the donor's decision without advance consultation. In addition, the donor also conveyed what appeared to be a loss of confidence in the foundation's investment management, expressing a strong preference for preservation of the endowment's principal.

Another unhappy donor invested in a pooled income fund, a deferred gift, where the foundation pays interest on the principal amount donated during the life of the donor, with the principal amount lapsing to the foundation upon the donor's death. Due to an error that remained undetected for several years, the investor suffered a loss of principal that affected the donor's interest earnings. The foundation admitted to the donor that a breach of fiduciary duty had occurred; yet it took three years and persistent demands from the donor before a satisfactory solution was proposed. The donor, of advanced age and exasperated from years of actively but unsuccessfully demanding redress, suspected the foundation of delaying a resolution in the hope that the donor's death would relieve the need to address the problem.

Issues for Further Study

During our audit, we identified several issues worth further scrutiny. We were unable to pursue these issues either because they were outside the scope of the audit or time constraints did not permit a thorough examination. We recommend that these issues be made part of future audits.

Independently operated fundraising groups

While most fundraising is accounted for through the foundation, some organizations supporting university programs operate independently. Officials at the foundation and the Board of Regents have expressed concerns about a lack of oversight and associated risk to the university's reputation from these groups. The Board of Regents lacks policies to guide fundraising and receives inadequate information from these groups to effectively monitor their fundraising activities. We recommend a review of whether the Board of Regents has fulfilled its responsibility to protect the university from adverse effects caused by independently operated fundraising groups' misconduct.

Fund transfers

Fund transfers between expendable accounts offer an opportunity for deliberate or accidental circumvention of restrictions if funds are moved from a more restrictive account to one that is less restricted. The review of such transfers was outside the scope of this audit. We recommend a review of such transfers and test for adherence to restrictions in successor accounts.

Duplicate administrative expenditures

In 1997, the foundation reduced its administrative fees on new gifts from 6 percent to 2 percent and obtained its $1 million contract from the Tuition and Fees Special Fund to compensate for the revenue reduction. Donors had objected to the higher fees as excessive. Donor sensitivity to the use of gifts for administrative purposes should, therefore, be self-evident. However, administrative and fundraising spending in excess of the 2 percent fee charged occurs, possibly without the knowledge of donors. For example, the foundation looks to the leaders of beneficiary units of its efforts, such as university deans, as integral players in the fundraising process. Some of these units spend significant amounts of donated funds on additional fundraising, administrative, and developmental expenditures. These expenditures are in addition to the 2 percent charged to each gift for administrative services by the foundation. Further audit work is suggested to determine the significance of fundraising and administrative spending from donated funds and whether this practice may be a covert way to increase fundraising resources normally paid from the foundation's budget—a budget that contains the contract revenue from the tuition fund.

Conclusion

The vague $3 million fundraising contract between the foundation and the university administration lacks definitions of mutual responsibilities and adequate measures to assess the foundation's performance. This contract does not foster maximization of the donors' best interest or the university's programs. Rather, it indicates complacency in the dealings between the responsible parties. Excessive and abusive expenditures from donated funds point to a need for greater accountability, stronger policies, and active enforcement. Finally, greater scrutiny and control over audits of fundraising organizations, including the foundation, are warranted to enable the Board of Regents to fulfill its statutory responsibility for fundraising and accountability.

Recommendations

1. The Board of Regents and the university administration should ensure that contracts for fundraising services conform to appropriate university procedures and sound contracting practices.

2. The contract for fundraising services with the University of Hawaii Foundation should, at a minimum, include clearly stated services to be performed, clearly defined performance standards and measurable outcomes, the method(s) of evaluation for service performance, and penalties or remedies for failure to perform.

3. The university and the foundation should clarify their mutual intent regarding the relationship between the 2002 fundraising contract and the 1997 memorandum of understanding outlining their respective roles and responsibilities relating to fundraising.

4. The Board of Regents should:

    a. Develop policies and guidelines for fundraising activities applicable to all university fundraising organizations, including the foundation;

    b. Assume responsibility for contracting for financial and performance audits of fundraising activities;

c. Develop a capacity for monitoring fundraising activities, including utilizing the university's internal audit function, which should report directly to the board;

d. Ensure that the foundation's expenditure policies over donated funds are strengthened and enforced;

e. Ensure that purposes and spending limitations for all accounts, including unrestricted expendable accounts, properly reflect donor expectations; and

f. Ensure that donor intent is faithfully fulfilled.

Appendix A

Selected Pages from the Contract Between the University and the Foundation which Define the Services to be Performed and the Responsibilities of the Parties

EXHIBIT A
Attachment 1

SCOPE OF SERVICES

The CONTRACTOR shall provide private fundraising, stewardship and alumni relations services for the UNIVERSITY. These services shall include, but not be limited to, the solicitation of private gifts, outright and deferred and the stewardship of the gifts to insure they are used to fulfill the specifications of the donor. The CONTRACTOR shall provide the necessary services to be the central organization for private fundraising for officers on all campuses. It will conduct a $200 million to $250 million fundraising campaign for the UNIVERSITY, focusing its efforts on priorities established by the UNIVERSITY.

The CONTRACTOR shall provide UNIVERSITY with regular reports relating to the services provided hereunder.

EXHIBIT A
Attachment 2

TIME OF PERFORMANCE

This agreement shall be for a term of FIVE AND ONE-HALF years commencing on October 1, 2002 and ending on December 31, 2007. The following efforts are estimated to occur within the following time frames:

Fund Raising Services:

1. Campaign organizing and recruitment: July 2002 – March 2003

2. Leadership Gift Campaign: July 2002 – December 2003

3. Major Gifts Campaign: January 2004 – December 2007

4. Campaign wrap-up and review: January 2008

Alumni Relations Services:

1. Complete alumni relations plan and meet with each alumni association: October 2002 – December 2002

2. Implement new alumni outreach and communications programs: January 2003 – June 2008

EXHIBIT A
Attachment 3

COMPENSATION AND PAYMENT SCHEDULE

Subject to the continued availability of funding, UNIVERSITY agrees to compensate CONTRACTOR for providing the services hereunder the sum of TWO MILLION DOLLARS ($2,000,000) for fundraising services and THREE HUNDRED FIFTY THOUSAND DOLLARS ($350,000) for alumni relations services, and reimbursement for fifty percent of unit-based development officers' salaries and benefits, plus applicable taxes, annually. In YEAR ONE, the fee for fundraising services will be TWO MILLION DOLLARS minus three months' payment, equaling ONE MILLION FIVE HUNDRED THOUSAND ($1,500,000) for fundraising and the fee for alumni relations services will be THREE HUNDRED FIFTY THOUSAND minus three months' payment, equaling TWO HUNDRED SIXTY TWO THOUSAND FIVE HUNDRED DOLLARS ($262,500). Payments will be made for FIVE AND ONE-HALF (5½) fiscal years starting with the fiscal year beginning October 1, 2002 in two equal installments, in advance, for each fiscal year.

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Responses of the Affected Agencies

Comments on Agency Responses

We transmitted drafts of this report to the University of Hawaii Foundation, its Board of Trustees, the University of Hawaii, and its Board of Regents. A copy of the transmittal letter to the Board of Regents is included as Attachment 1. Similar letters were sent to the other three entities. Copies of the responses of the Board of Regents, University of Hawaii, and University of Hawaii Foundation and its Board of Trustees are included as Attachments 2, 3, and 4, respectively.

The foundation, in a joint response with its board, agreed with our finding that oversight over separate fundraising organizations needs improvement but took issue with our characterization of the level of the foundation's cooperation with our audit. The response also asserted that many of the other concerns we raised have been or are in the process of being addressed. In addition, the foundation cited several examples and data aimed at defusing our finding that its payout policies have favored funding programs over donor interests. Finally, the foundation expressed opposition to the recommendation that the Board of Regents oversee financial and performance audits of the foundation.

We stand by our findings. The issue of delays in obtaining access and the limitations placed upon us is explained in detail in the report. The foundation's actions hindered our work and necessitated the drawn-out negotiations for access to information. In the end, the limitations caused us to modify our audit procedures. With respect to the recommended audit oversight by the Board of Regents, we disagree with the foundation and maintain our position that the board, as the entity legally responsible for fundraising, is the appropriate body for ensuring accountability. Accountability and the protection of donor identity are not mutually exclusive. Even though the foundation is a legally separate entity from the university, it nonetheless receives $3 million per year of public funding through its fundraising contract and in-kind support in the form of office facilities, utilities, and janitorial services.

The University of Hawaii administration, while acknowledging that the report provides insights and analyses of value, also disagreed with some of our conclusions. The university claimed that the fundraising contract is an exempt procurement, yet we were unable to find any indicia of such exemption. Exempt purchases are required to include a statement of exemption, "Exempt purchase, pursuant to APM Section A8.220.10, Exemption No. (the exemption number)." We could not find the required statement in the contract. In fact, the contract did not meet any of the 44 criteria listed in Section A8.220.10 of the university's procurement procedures. Also, the organizational chart cited as misleading was adapted from the university's own organizational chart as approved by the Board of Regents. Finally, we made a minor revision for clarity based upon the university's response.

The Board of Regents, while recognizing the value of much of the report, sought to clarify its role in the approval of the fundraising contract. It stressed the continuing nature of the contract and that proper procedures were followed. In support of its position, the board referred to its meeting minutes and pointed out that a number of questions about the contract had been asked. A review of board minutes leading to the contract approval **was** included in our audit work. However, we found that the queries from the board were more general in nature and did not identify or address the flaws we found in the contract. The documents provided by the Board of Regents show that the majority of detailed questioning related to the transfer of the alumni relations function to the foundation. They do not reflect, for example, concern about the lack of a detailed plan that shows the components of the fundraising goal and when and how these component parts will be delivered during the contract term. Should, for instance, the $150 million promised to be raised for the medical school be part of the $250 million goal? Without clearly defined services and measures for what is to be performed, it is not possible to determine whether the contract represents a good value for the amount paid and assess the foundation's performance throughout the fundraising campaign.

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

April 23, 2004

COPY

The Honorable Patricia Y. Lee, Chair
Board of Regents
University of Hawaii
2444 Dole Street
Honolulu, Hawaii 96822

Dear Dr. Lee:

Enclosed for your information are 13 copies, numbered 6 to 18, of our confidential draft report, *Audit of the University of Hawaii Contract with the University of Hawaii Foundation.* We ask that you telephone us by Tuesday, April 27, 2004, on whether or not you intend to comment on our recommendations. Please distribute a copy to each member of the board and to Mr. David Iha, Executive Administrator and Secretary. If you wish your comments to be included in the report, please submit them no later than Wednesday, April 28, 2004.

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

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

Sincerely,

Marion M. Higa

Marion M. Higa
State Auditor

Enclosures

ATTACHMENT 2

University of Hawai'i Board of Regents

April 28, 2004

RECEIVED

APR 29 11 55 AM '04

OFC. OF THE AUDITOR
STATE OF HAWAII

2444 Dole Street
Bachman Hall 209
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Tel: (808) 956-8213
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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:

Thank you for providing the Regents the opportunity to comment on your draft "Audit of the University of Hawai'i Contract with the University of Hawai'i Foundation." As you are aware, this follow-up report comes at a crucial time, since as a result of your March 2003 report, the Board of Regents is presently revising the existing Agreement for Services between the University and the Foundation. Please be assured that your recommendations will be carefully considered as the new agreement is written.

While we found much in your report that can assist us, I do want to comment on certain observations you make concerning the role of the Regents in approving the October 2002 University of Hawai'i Agreement for Services. In conducting your audit, your staff may not have reviewed all the documents pertaining to your ultimate assessment that the Regents gave minimal scrutiny and asked few questions when first presented with the proposal resulting in this agreement for services. For your consideration, I am enclosing copies of Board committee minutes and correspondence bearing on this issue, with the hope that you will review these documents before you finalize your audit report.

As you know, the first Agreement for Services between the University and the Foundation was for five years, ending on June 30, 2002. In June 2002, the Administration requested and the Board approved a one-month extension of the contract. The purpose of the one-month extension was to give the University and the Foundation more time to develop fully the second Agreement for Services. Following the June meeting, questions regarding the second Agreement for Services were raised by the Board staff. At the July 2002 Board meeting, the Administration and the UH Foundation presented a Report on the Planned Fund Raising Activities to be undertaken by the University of Hawai'i Foundation on behalf of the University of Hawai'i. At the same Board meeting, the Regents granted a two-month extension of the contract.

At the September 12, 2002 meeting of the Regents' Committee on Finance and Facilities, the Regents discussed and approved for full Board review the request from the Administration to enter into the second major agreement for services between the University and the Foundation. Please note that prior to and in preparation for that committee meeting, the Chairperson of the Board of Regents requested clarification from the President on eight items. A copy of that internal memorandum dated September 9, 2002 is enclosed.

As the enclosed minutes to that September 12, 2002 committee meeting indicate, several Regents actively questioned the proposal on issues such as the deficit in the Foundation, the gift percentage, the reimbursement for development officers' salaries, and the scope of alumni relations services. The contract was then approved by the full Board at the Board meeting on September 13, 2002.

As a follow-up to the approval, the then Chairman of the Board wrote to the President on September 23, 2002 requesting a monthly report on the Foundation fund raising efforts along with a full accounting of how the service fees are being spent. A copy of this memorandum is enclosed for your consideration. Prior to this request, the Foundation had apparently not provided any reports for the prior year.

During the past year, the Board has sought to exercise greater oversight of the University of Hawai'i Foundation by requiring additional information from the Foundation and holding extra meetings with the Foundation staff. Enclosed is a copy of a letter to the UH Foundation dated July 30, 2003 in which the Board Chairperson requested extensive reports on a number of Regents' requests. The Regents only received the Foundation's response on December 8, 2003. The Regents have constantly stressed the need for more information than what is currently presented during the Foundation's monthly reports.

The Board is reviewing a request to increase the gift assessment fee. On page 13, the requested administration fee should read that the increase is from 2 percent to 5 percent using a tiered schedule with all gifts below $500,000 assessed at 5 percent.

Yours very truly,

Patricia Y. Lee

Patricia Y. Lee
Chairperson

attachment

houses astronomy-related programs of the University of Hawai'i at Hilo. The facility, located at the University Research Park in Hilo, was funded through appropriations by the State Legislature.

Under Board policy, the authority for the naming of buildings, other than for functional designations, rests with the Board. Functional designations may be made by the chancellor of each campus. *Kūkahau'ula* is the original name given to the highest point on Mauna Kea. The Historic Preservation division of the State Department of Land and Natural Resources believes that the name refers to the cluster of cinder cones which merge and collectively form the summit of Mauna Kea. Translated, it means *"the god Kū of the red hued snow."* Kū is associated with the building of canoes, and the reference to red hued snow is associated with the sacredness of the highest places in the islands.

The proposed name symbolizes the reverence for Hawai'i's cultural heritage and was reviewed by the community organization Kahu Ku Mauna, the Office of the Chancellor of UH-Mānoa, the Office of Chancellor of UH-Hilo, as well as scholars from the Hawaiian Studies sector.

Regent Kurisu moved to authorize the naming of the Institute for Astronomy building in the University Research Park in Hilo Kūkahau'ula followed by the functional building designations *"University of Hawai'i Institute for Astronomy"* and *"Mauna Kea Operations Center."* The motion was seconded and unanimously carried.

Report on the Performance of the Fundraising Campaign by the University of Hawai'i Foundation

Mr. Robin Campaniano, Chairman of the University of Hawai'i Foundation Board provided an overview of the Foundation's performance, highlighting the recently completed campaign. He indicated that the Foundation will need additional funds in order to raise its sights for the coming years, explaining that nationally, around 11 cents is spent for every dollar raised for university development.

Approval of One-Month Extension to Existing Agreement for Services Between the University of Hawai'i and the University of Hawai'i Foundation

The University of Hawai'i Foundation President Betsy Sloane requested that the Committee grant an extension of the current Agreement for Services between the University of Hawai'i (UH) and the University of Hawai'i Foundation (dated May 21, 1997) for one month commencing July 1, 2002 at the same prorated compensation. This would maintain the status quo and provide time for the Foundation and UH to negotiate an agreement to plan, implement, and support a five-year $250 million fund raising campaign.

The existing Agreement between the Foundation and UH will expire on its own terms on June 30, 2002. The Agreement provides a portion of the Foundation's operating funds. The Foundation and the UH administration are currently discussing a six-year arrangement by which the FOUNDATION will manage a major centennial fund raising campaign and handle other services. To avoid any funding gaps, program dislocation, or personnel loss, a temporary "bridging" extension of one month was requested.

Compensation paid by UH to the Foundation would be at the current annual rate of $1 million per year, prorated to one month. All other terms and conditions remain unchanged.

Regent Kurisu moved to authorize the extension of the current Agreement for Services between the University of Hawai'i and the University of Hawai'i Foundation for one month commencing July 1, 2002 at the same prorated compensation. The motion was seconded and unanimously carried.

<u>Transfer of Additional Season Tickets to 'Ahahui Koa Anuenue and Establishment of Individual Football and Wahine Volleyball Ticket Prices for the 2002 Season</u>

Interim Chancellor Neubauer requested that the Committee authorize the transfer of additional season tickets for all sports to 'Ahahui Koa Anuenue. Season tickets will be made available to members of the general public by 'Ahahui Koa Anuenue as part of its fund-raising efforts for the athletic department through its reorganized membership program. The number of seats to be transferred will be determined by the Athletic Department but shall not exceed 23,594 seats.

The Athletic Department further requests authorization to establish individual football and wahine volleyball game ticket prices for the 2002 season. However, the Athletic Department will retain season ticket prices at their existing levels.

The University of Hawai'i Athletic Department has been involved in reorganizing its booster organization, 'Ahahui Koa Anuenue (AKA) through meetings with all stakeholders involved with UH Athletics (i.e. representatives of the booster organizations, student-athlete group, business community, donors, faculty, etc.) From this group of 65 representatives, a consensus was reached to collectively work with AKA to restructure its organization including its board of directors. One of the primary objectives is to increase revenues for the athletic department. The reorganized AKA Board held their initial meetings and agreed to support the athletic department's initiative to reconstruct the "Premium Seat Donation", currently in place from previous years.

If approved, this process would take effect beginning with the 2002 football and wahine volleyball seasons. For all other sports, the AKA Board will be working with the athletic department to develop a similar program for "Premium Seat Donations". This

David Iha

Date sent: Fri, 28 Jun 2002 10:20:18 -1000
From: Prescott Stewart <prescott@hawaii.edu>
Subject: BOR
To: David Iha <diha@hawaii.edu>
Copies to: Betsy Sloane <betsy.sloane@uhf.hawaii.edu>, Mariko Miho <Mariko.Miho@uhf.hawaii.edu>, Wick Sloane <wsloane@haw Jan Gouveia <jgouveia@hawaii.edu>, kirimits@hawaii.edu

David,

To confirm the questions you asked and wanted addressed regarding the UHF action memo:

1. What is the justification for an increased service fee?
2. How will the funds be used by the UHF?
3. How was the $1M existing fee used during the prior campaign?
4. What percent of the total UHF revenue stream does the $1M represent?
5. Where will the UH funds come from?
6. How does the UHF plan to report on gifts and expenses to the BOR?

Are these the questions you need answered? If you can reply to me and all those copied, I would appreciate it.

Prescott

Prescott Stewart
Executive Assistant to the President
University of Hawaii
(808) 956-7038
(808) 956-5286/ fax
(808) 779-9086/ cell
prescott@hawaii.edu

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Re-6?

UNIVERSITY OF HAWAI'I

Board of Regents

September 9, 2002

TO: Evan S. Dobelle, President
University of Hawai'i

FROM: Bert A. Kobayashi, Chairperson

SUBJECT: Request to Approve the Contract for Services Between the University of Hawai'i and the University of Hawai'i Foundation

In your proposal to approve a contract for services between the Foundation and the University of Hawai'i you mention that the Alumni Relations functions will be transferred to the Foundation. Please provide the following additional information relative to this matter:

1. The Board requires an organizational chart showing the removal of this function from the University.

2. What will happen to the Alumni positions currently under the University Relations office.

3. You indicate that the operating budget of the Alumni Affairs Department is currently $15,000 and includes two full-time alumni relations staff and two part-time professionals. The two full-time alumni relations staff alone would amount to more than triple this amount. Consequently, please clarify this figure of $15,000 and if incorrect, explain what will be happening to these monies once the function is turned over to the Foundation.

4. Where will the funds to pay for this function come from once it goes to the Foundation. Will it come out of the $2 million requested in service fee. Please include an organizational chart of the Alumni Affairs unit under the Foundation.

5. It is the Board's understanding that until approved, the reorganization of the Office of University Relations and transfer of alumni relations to the Foundation should not be implemented.

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6. Who conducted the "thorough review" of the Alumni Relations program and please provide the Board with a copy of that review.

7. Has this reorganization been approved by the Alumni Affairs Advisory Board/Council.

8. Where is the money coming from to pay for the development officers assigned to the various University units. If it is to come from the campuses, doesn't it increase the amount of service fees.

c: Members, Board of Regents

Subjects:

1. Contract for Services Between the University of Hawai'i and the University of Hawai'i Foundation

2. University of Hawai'i Endowment Fund - Performance Evaluation Reports of Quarters Ending March 31, 2002 and June 30, 2002

3. UH-West O'ahu Site Selection

4. Report on Public Hearings on Proposed Amendments to Hawai'i Administrative Rules Governing Delinquent Financial Obligations and the State Higher Education Loan Fund

Contract for Services Between the University of Hawai'i and the University of Hawai'i Foundation

Mr. Stewart requested that the Committee approve the proposed contract for services between the University of Hawai'i (UH) and the University of Hawai'i Foundation ("Foundation") for the period October 1, 2002 until December 31, 2007. He explained that the proposed agreement would enable the Foundation to plan, implement, and support a five-year fundraising campaign to raise between $200-$250 million for the benefit of the University of Hawai'i, focusing its efforts on the priorities established by the University. In addition, the Agreement will enable the Foundation to plan, implement, and support alumni relations and athletic services for the benefit of the University.

There has been a dramatic rise in private giving to public universities in the 1990's. In 1989, the 16 top public universities in the US raised a total of $950 million a year. By 2000, those same public universities raised a total of $2.5 billion a year but did not develop special alumni or major gift programs except for athletic clubs and independent alumni associations to engage in fundraising beyond what was needed to support their particular activities.

The first big public university campaigns began with UCLA in 1982 with most public institutions soon following with dramatic success. Success of the first campaigns led to second campaigns and today all of the top 16 public universities have just completed or are in the midst of a $1 billion campaign. Fundraising costs range from 6 cents to 28 cents per new dollar raised with a median cost of 11 cents. At UH, it cost 9.6 cents for every new dollar raised during the first comprehensive campaign. $11.2 million was spent by the UH Foundation to raise $116 million.

Private fundraising patterns at UH are comparable to the top 16 public universities. However, independent efforts resulted in a highly decentralized approach with 130 separate 501(c)(3) organizations supporting a wide array of university programs. In 1997, the UH President asked that funding at UH be centralized under the UH Foundation for the first comprehensive campaign. The majority of these separate accounts did not transfer to the Foundation though some of these nonprofit organizations make "gifts" to restricted accounts at the UHF periodically.

The First Comprehensive Campaign resulted in $116 million in cash, pledges, deferred gifts and gifts-in-kind to UH. The intended outcomes of the Centennial Fund Campaign are:

- Provide the resources necessary to move UH to the next level of excellence in teaching, learning, and research
- Broaden and deepen the partnership between the UH Foundation, the University, UH Alumni Relations, UH Athletics, and the Community-at-large for successful fundraising now and in the future
- Build long-term capacity of UHF to support the new level of academic endeavor at the University

The goals of the Centennial Fund Campaign are:

- Significantly raise annual level of current and future gifts from an average of $23-$33M to between $35M and $45M by June 2008
- Raise at least $200M in total giving to the UH system between August 1, 2002 and June 30, 2008
- Broaden alumni support from 10% to 18% systemwide

To accomplish these goals will require increasing the Foundation staff from 57 to 82 full-time and part-time staff over an 18-month period and a $9 million annual operating budget. In addition the Foundation is requesting that the service fee paid by the University be increased to $2 million annually, up from $1 million. A new fee for alumni relations services would add an additional $350,000 to the annual amount paid to the Foundation under the proposed Agreement of Services contract. The Foundation is also asking the University to reimburse them for 50% of unit-based development officers' salaries and benefits plus applicable taxes.

Mr. Stewart added that the Foundation would raise approximately $15 for every $1 the University invests in fundraising. The reason for the increase in fees is the larger goal necessitating an increase to the Foundation's staff. The administration and Foundation is also looking to bring Alumni Relations into the Foundation in order to not duplicate the data base and efforts. The cost for this would be about $350,000 per annum, however, this move would not be made until the unions have been appropriately consulted. The proposed agreement would be for 5.5 years at a cost of $14.6 million, with an additional $1.8 million for Alumni Affairs for a total of $16.4 million in fees. He added that there are funds in the budget to accommodate these fees.

Regent Kurisu asked about the deficit in the Foundation. Mr. King said that it was due to the market, however, much of the deficit would be covered by funds from previous years.

Regent Lee inquired about the percentage from gifts. Mr. King explained that approximately 2% or about $250,000 were derived from gift surcharges last year. Regent Lee noted that half of the cost for development officers would have be paid, under the new agreement, by the respective departments whereas in the past the entire amount was paid from Foundation funds. She asked if the department had no money what would happen. The administration will provide a more comprehensive answer but President Dobelle assured that no department in need of a development officer would go without one.

Regent McElrath stated that she was not clear about the reorganization of Alumni Relations and preferred to defer that portion of the proposal for now. Ms. Desha, representing Hawai'i Government Employees' Association (HGEA), stated that the Board was asked by the administration to approve earlier reorganizations involving the Mānoa Chancellor's Office and subsequently the Office of the Capital Improvement Director, both of which were done prior to obtaining full good-faith consultation with HGEA. She expressed that it is the University's responsibility to present a position and proposal for consultation prior to the Board being asked to consider that reorganization. She therefore asked if the same infraction would be happening in this case. Regent Kurisu stated that unfortunately, the Board was being asked to consider the matter at that time.

Regent Kawakami moved to approve the proposed service contract between the University of Hawai'i and the University of Hawai'i Foundation. The motion was seconded followed by discussion. Ms. Desha asked for a clarification as to whether this would take place prior to consulting with the union. Regent Kurisu, in response, stated that, unfortunately the matter had been brought to the Committee by the administration for action. He assured that the Alumni Affairs portion would not be implemented until HGEA had time to respond. Upon call the motion was unanimously carried.

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UNIVERSITY OF HAWAI'I

Board of Regents

September 23, 2002

MEMORANDUM

TO: Evan S. Dobelle, President
University of Hawai'i

FROM: Bert A. Kobayashi, Chairperson

SUBJECT: Follow-up Items

Here is a list of items from the Regents' meetings held on September 12 and 13, 2002, requiring a response or follow-up:

1. Provide a report on the high number of resignations in the School of Nursing. (requested by Regent McElrath)

2. Please provide an explanation as to what the administration will do to insure that departments have development officers even if they do not have sufficient funds to pay for half of the cost as per the new agreement with the Foundation. (requested by Regent Lee)

3. There is an opportunity to acquire property adjacent to Māui Community College through an exchange. (Information provided by Regent Dowling)

4. Students at the Moloka'i Education Center feel that the present parcel is not large enough to accommodate the full development of the complex. The University has first right of refusal from Moloka'i Ranch for an additional 15 acres. Does the administration have any plans to acquire the additional land?

5. The Moloka'i students also expressed the need for more lecturers, additional HITS classrooms, better access to library material, need for full-time academic support services, and the possibility of using retired professors to teach classes. In addition they are concerned over the technical problems associated with SkyBridge, prompting

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uhra

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one student to question whether she is receiving a comparable education for her tuition. Is it possible to provide additional support services to Moloka'i Education Center.

6. The past agreement with the University of Hawai'i Foundation required monthly reports from the Foundation. This past year, the Board did not receive a single report on the Foundation's performance despite the $1 million service fee. In approving the new agreement, the Board expects a monthly report on the Foundation's fund raising efforts along with a full accounting of how the service fees are being spent. In addition the Board would like a financial report on how the $1 million per year was spent over the past five years.

7. In approving the contract for services between the University of Hawai'i and the University of Hawai'i Foundation, the Board instructed that no funds for alumni affairs are to be transferred to the University of Hawai'i Foundation until the re-organization is approved. The representative from HGEA mentioned that during the July Board meeting and the September Board meeting, the Regents acted on agenda items prior to meaningful consultation with the bargaining unit. In the future, the Board should not be placed in a position of approving an agenda item which requires prior consultation with the appropriate bargaining units or faculty organizations.

8. The re-organization of the Office of the President of the University of Hawai'i requires meaningful, good faith consultation with the appropriate campus constituencies (faculty senates, etc.) and bargaining units. Please insure that the consultation process is adhered to prior to any recommendations being forwarded to the Board. The Board staff has been instructed to forward to the administration all comments and concerns from the Regents relative to the proposed re-organization of the Office of the President.

9. There is an opportunity to work with the Department of Education and community to develop an integrated P-20 educational facility for the residents of Lāna'i.

10. The Board wishes to remind the administration that all proposals along with relevant materials must be submitted to the Board in accordance with the posted deadlines. Materials on the proposed re-

organization of the Office of the President and the presentation on the University of Hawai'i Foundation were sent to the Regents the Tuesday before the board meeting on Thursday, and therefore, some Regents failed to receive the new material or had very little time to digest the new information. In addition the materials on the finance and budget briefing was distributed at the meeting. All materials for the board meetings must be available for distribution no less than eight (8) days before the board meeting.

11. Based on the report from the Board's third party monitor, the administration is to inform Bishop Street Capital Management of their status based on their performance during the past two quarters. They are to appear before the Committee on Finance and Facilities upon receipt of the third party monitor's third quarter report.

In addition to the above follow-up items I would appreciate a status report on the following items requested earlier by the Board's Chairperson:

1. A detailed explanation on who is paying for the maintenance repair and general upkeep of the Lab School (Charter School) buildings on the recently approved agreement. (Memo dated July 17, 2002)

2. At the June Board meeting, the Regents approved the football ticket price increase and the allocation of approximately 20,000 seats to Koa Anuenue. At that time, the administration assured that within 90 days, an agreement between the University of Hawai'i, The University of Hawai'i Foundation, and Koa Anuenue would be forwarded to the Board of Regents for approval. What is the status of this request.

3. The Board had requested for information on the Endowment Fund: amount of funds available for payout; funds allocated and spent; clarification of the payout policy; availability of funds for Hilo athletic scholarships. To date there has been no response. (Memo dated July 15, 2002)

I would appreciate a response no later than October 18, 2002. Thank you for your assistance in responding to these follow-up items.

University of Hawai'i Board of Regents

July 30, 2003

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

Mr. Howard Karr, Chairperson
University of Hawai'i Foundation
2444 Dole Street
Bachman Hall, Room 105
Honolulu, Hawai'i 96822

Dear Mr. Karr:

Subject: Request for Information, Gift Fee and Endowment Fee

Congratulations on being named Chairperson of the University of Hawai'i Foundation. We look forward to a healthy governing board - foundation board relationship. Enclosed is a publication of the Association of Governing Boards of Universities and Colleges (AGB) entitled: Governing and Foundation Board Relationships. We may consider implementing some of the suggestions listed in the publication and would be happy to discuss them with you.

During the Board's recent meetings, several questions and requests were posed relating to the University of Hawai'i Foundation. During our May Board meeting, Regent Kurisu requested a comparison of the effectiveness of the previous UH Foundation campaign with the present fund-raising efforts. During this period the University increased its support of the University of Hawai'i Foundation from $1 million/year to nearly $3 million/year. In addition Regent Hong requested a copy of the University of Hawai'i Foundation Form 990. The initial request for information was made on May 30, 2003. Our Board Secretary received an email dated June 10th from Kristen Blanchfield stating that Betsy Sloane had requested that all the Board of Regents' requests be submitted from our Board to the University of Hawai'i Foundation's Board of Trustees (copy of email attached). There was some confusion on whether our Board had to formally request the information because Betsy Sloane did inform the Board Secretary that the Form 990 was on its way to the Board Office.

In following up on Regent Kurisu's inquiry, it is requested that the comparative reports from the University of Hawai'i Foundation for the Fiscal Year ending June 30, 2003 be provided to the Board of Regents. At the minimum, the report should include: a) Gross contributions, broken down by major source categories and fund-raising initiatives so that an "apple to apple" comparison can be made; b) percent fees on gross contributions deducted by UH Foundation; c) fund-raising services fee paid and expenditures by UH to the Foundation; d) Alumni Affairs fees paid and expenditures by UH to the Foundation; e) 50% reimbursement of UH Foundation salaries paid by UH to the Foundation; and f) any other monies paid to the Foundation by UH.

The comparative report should include year-by-year actual numbers for the past five years. It should also show, on a year-by-year basis, what the projected numbers is for the remainder of the contract with the UH Foundation. The projection for the current FY03-04 year is of particular interest.

Regent Kurisu also inquired about the flow of funds from Koa Anuenue, UH Mānoa Athletic Department to the University of Hawai'i Foundation. Please provide a narrative explanation on the flow of funds from UH Mānoa Athletics through the Foundation and the fees charged by the University of Hawai'i Foundation on any revenues generated by the UH Mānoa Athletics.

It is also requested that a copy of the University of Hawai'i Foundation Form 990 be made available to the Board.

Our Board has also requested that a separate reporting category be included in the monthly development report to the Regents that will state the amount of funds raised toward $150 million goals for the construction of a new medical school facility in Kakaako.

In response to the two recommendations made by the Legislative Auditor in her report of March 2003, our Board instructed the Administration to amend the existing contract with the Foundation to provide for specific contract expenditures and a description of how those expenditures directly benefitted the university. Our understanding is that the University of Hawai'i Administration is still reviewing the existing contract and will be recommending changes to the contract.

A major issue recently brought to the Board's attention is the matter of fees. According to Article IV, paragraph two, in the Memorandum of Understanding signed on November 12, 1997, the Foundation may charge reasonable service fees which shall be <u>mutually agreed upon by the parties</u>. According to the University of Hawai'i Foundation minutes, your board has approved a gift fee increase from 2% to 5% and an increase in the endowment fee from 2% to 3%. Our understanding is that these service fees have <u>not</u> been mutually agreed to by the parties that signed the Memorandum of Understanding.

Please do not hesitate to call me regarding any of the items listed above. Again we look forward to working with the Foundation in our mutual endeavor of forwarding the University's mission.

Sincerely,

Pat Y. Lee

Patricia Y. Lee
Chairperson

attachment
c: Members, Board of Regents
President Evan S. Dobelle
UHF President Betsy Sloane

UNIVERSITY OF HAWAI'I

Chief of Staff
Office of the President

April 28, 2004

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OFC. OF THE AUDITOR
STATE OF HAWAII

Ms. 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, "Audit of the University of Hawai'i Contract with the University of Hawai'i Foundation."

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

Your report, however, does provide valuable insight and objective analysis as we finalize the Amended and Restated Service Agreement with the UH Foundation. We share the same goal, insuring the citizens of Hawai'i that the financial resources of the University of Hawai'i 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.

1) *". . . the foundation is operationally intertwined with the university." See also organizational chart, p. 5 of the draft report.*

This is not an accurate statement, and the organizational chart is misleading. The operations of the foundation are not intertwined with the university. The foundation employs its own staff who are not University employees. The foundation has its own management structure which is not part of the University's management structure. The foundation has its own governing board which is legally different from the governing board for the University. The foundation's operating budget is not a part of the University's operating budget.

2) *"Second, in a properly conceived contract the responsibilities of the parties should be clearly stated, which is not the case in the fundraising agreement. We were informed that a 1997 memorandum of understanding signed by the parties governs these issues; however, the contract contains no reference to this memorandum, raising doubt whether the parties intended for it to be included. We were further informed that a proposed revision of the current contract would incorporate this memorandum of understanding to* *better define the mutual responsibilities of the contracting parties. Considering that the university's legal counsel referred to the memorandum as a 'feel good, aspirational agreement,' it is not likely to address the lack of specificity in the contractual provisions."*

There are two pertinent documents describing the relation between the University and the Foundation. The first document is an overall statement of the parties' goals and aspirations and a general description of the relationship. This is the November 12, 1997, Memorandum of Understanding. The Memorandum of Understanding itself states that it is "designed to describe the relationship between the parties and the services provided by the Foundation for the benefit of the University."

The parties anticipate that their relationship will last indefinitely (see Memorandum, Article IV, Paragraph 5 "It is anticipated that the Foundation will provide development services to the University as the official fundraising entity for the University indefinitely, and that this MOU will continue until a new MOU is executed.")

Where the parties anticipate a mutually beneficial relationship of an indefinite duration, it is not unusual that their expectations are memorialized in a document often called a statement of principles or a memorandum of understanding. Because of the nature of the anticipated relationship, the statement or memorandum of principles are aspirational rather than obligatory, general rather than specific, mutually supportive (or "feel-good") rather than adversarial, and relational rather than operational. This statement or memorandum sets the stage and provides the context. The details and specific obligations are often set forth in a second, complementary document, as is contemplated by the Memorandum. See Memorandum, Article III, "The Foundation and University will negotiate a contract for services agreement, from time to time, which will delineate the level of compensation and the specific performance requirements." Thus, from time to time, the University and the Foundation have entered into a services agreement with a limited term and with specific levels of funding.

The October 2002 services agreement was the second major services agreement contemplated by the Memorandum of Understanding and covers the second major multi-year fundraising campaign.

The two documents, together but not exclusively, guide the parties in reaching their common objectives.

3) The draft report states that ". . . the contract, a sole source transaction, was negotiated and processed outside the university's procurement process and in violation of the University's own procurement requirements."

The October 2002 contract for services was processed in a manner similar to that for the first major fundraising agreement with the Foundation which commenced in July 1997. While the contract with the Foundation was not processed by the University's Office of

Procurement and Real Property Management and instead was executed directly by the President, the contracting authority exercised by that office and others at the University is based on authority delegated from the President. Moreover, the contract was entered into pursuant to HRS 304-16.5(c) which authorizes expenditures from the University's tuition and fees special fund for the purpose of generating private donations in support of the University; this statutory authority further provides that such expenditures are not subject to the State procurement code. As provided in HRS 304-16.5(c), the contract was statutorily exempt from the requirements of the State procurement code and would have been recognized as an exempt procurement under the University's procurement procedures. The contract did not fall within the requirements of a sole source procurement as noted in the report.

Thank you for your evaluation and recommendations. We will continue to work diligently towards finalizing the amended and restated contract to provide better oversight of the UH Foundation and require more detailed and complete reports.

Sincerely,

Sam Callejo
Chief of Staff

UNIVERSITY OF HAWAI'I
FOUNDATION

April 28, 2004

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OFC. OF THE AUDITOR
STATE OF HAWAII

HAND DELIVERY

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

Re: Draft of Audit Report Regarding University of Hawaii Contract with University of Hawaii Foundation

Dear Ms. Higa:

Thank you for the opportunity to comment on your draft audit report entitled "Audit of the University of Hawaii Contract with the University of Hawaii Foundation" (the "Report") as it applies to the University of Hawai'i Foundation (the "Foundation"). While we do not agree with all of the findings in the report, we recognize your office's efforts to better understand the unique and vital role of private institutionally-related foundations. At the outset, please note that as we were provided the draft report with little notice shortly before the close of business Friday, April 23, 2004, and given only five calendar days (including Saturday and Sunday) to respond--an inadequate time to convene our Board of Trustees ("Board") or to allow our Board to respond-- we must reserve the right to make further comments on the Report.

As the principal vehicle for private support of the University of Hawai'i (the "University"), the Foundation welcomes constructive and informed suggestions as to how it can better serve the University and ultimately the State of Hawai'i. Nonetheless, as noted below, we believe the Report fails to recognize the Foundation's cooperation with your office to reach an agreement on reasonable parameters for your audit of the operations of a private entity that holds sensitive donor information. Disregarding the fact that the Foundation provided broad access to records relating to all of the Foundation's endowed and expendable accounts for the audit period, subject only to redaction to protect donor identities and other personal information as agreed upon with your office last year, your Report leaves the reader with mistaken impressions regarding the Foundation's operations.

We believe that many of the concerns cited in your Report relate to practices and procedures that the Foundation either already addressed or was in the process of addressing prior to your office's commencing its work in late 2003. At the same time, we note a consistent lack of citation to experts for many of the concerns cited. In at least one instance, your Report criticizes the Foundation's procedures when in fact the Foundation conformed those very

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procedures to the best practices suggested by nationally-recognized organizations which study governance in education and fundraising such as the Council for Advancement and Support of Education ("CASE") and the Association of Governing Boards ("AGB").

We are also concerned about what appears to be a continued lack of understanding of the purpose of private institutionally-related foundations that raise funds for public universities. The suggestion that operational and financial audits of the Foundation be undertaken by the University's internal audit function of the Board of Regents effectively ignores the distinction between the Foundation and the University to the peril of not only the Foundation's donors and their privacy rights, but the future of private philanthropic support for the University. Nonetheless, the Foundation intends to continue its dialogue with the University administration and the Board of Regents on the proposed amendments to the contracts pending before the Board and how fundraising for the University can be better coordinated to maximize private support for the University.

The Foundation is proud of its fundraising record and will continue to strive to improve. We look forward to taking the University another major step forward with the next campaign.

1. The Report Mischaracterizes the Level of Cooperation with the Auditor's Office

We were disappointed that the Foundation's cooperation with your office in reaching a reasonable compromise on access to information was not mentioned in the Report. Instead the Report cites denial of "unfettered access" to the Foundation's records and "continual constraints" on access to information and implies that the Foundation's efforts to cooperate were the result of "the threat of our subpoena for records and the resulting prospect of negative publicity that might damage donor confidence...." (Report, p. 9).

State auditor review of a private institutionally-related foundation in this detail is unusual. The record is clear that the Foundation took the lead in consistently proposing a method pursuant to which your staff could complete their broad assignment. After some months, the Foundation was pleased to learn, in our November, 2003 meeting, that its approach of offering broad access to records, subject to redaction only to protect donor identities and other personal information, was finally acceptable. While we understand that your office experienced staff turnover, we do not believe faulting the Foundation for delays in the completion of the Report is a fair representation.

We are troubled that your Report does not affirmatively describe what access was provided. For the record, in this audit, in addition to the access to thousands of documents made available in the last audit, your office was provided access to all of the Foundation's endowment and expendable account records for FY 2002 and FY 2003, including records relating to the formation of and expenditures from such funds. The majority of the documents examined by your staff appeared to relate to what are considered by private institutionally-related foundations as the most challenging funds to administer, unrestricted program support funds which support various University units and departments. Unlike the majority of the Foundation's accounts such as scholarships, endowed chair funds or other funds which comprise 77% of the Foundation's endowment and expendable accounts, these funds by their terms have fewer specific instructions from donors so as to provide maximum flexibility to meet University needs.

As provided in the current Memorandum of Understanding ("MOU"), "the University retains responsibility for appropriately and prudently expending gift funds received by the Foundation…." (MOU Section 10). Nonetheless, the Foundation recognizes its own responsibility to also monitor the use of funds provided to support the University. The Foundation welcomes further work with the University administration and the Board of Regents to strengthen policies applicable to the use of such funds.

2. The Foundation Had Already Addressed Many Concerns Cited in the Report and In One Instance is Faulted for Adherence to Best Practices to Insure Donor Intent is Fulfilled

Many of the instances you cite where you believe the Foundation could improve its practices are concerns that had either already been addressed at the time your work began or were in the process of being addressed. For example, on page 19 of your draft Report it's noted that the Foundation's investment strategy had been aggressive, describing the Foundation's equity investments (at least as of June 30, 2001) as being "made up primarily of relatively risky company stock investments." We believe this characterization of our equity investments is incorrect. Further, prior to your work on this audit, the Foundation engaged one of the leading nationally recognized consultants on charitable endowment management, Cambridge Associates LLC, to assist the Board in a review of the Foundation's portfolio and the investment policies, and began revising these policies and asset allocations in the Summer of 2003 to reflect the best practices and standards for private institutionally-related foundations.

We are unable to comment on many of the statements made in the first section of your report relating to the manner in which the Agreement for Services (the "Contract") was approved by the University, but note that a number of presentations were made to the Board of Regents prior to the Contract's execution in October, 2002. We note that the Foundation is currently renegotiating the Contract and MOU in part to address concerns related to your last report issued last year. The purpose of the proposed amendments were to, among other things, clarify the intent of the MOU and Contract, increase reporting requirements and, at the suggestion of the Foundation, eliminate the open-ended nature of the University's agreement to reimburse one-half of the Foundation's development officers' salaries and benefits. The

Foundation intends to continue its work with the University administration and the Board of Regents on this important project.

Additionally, the Report faults the Foundation for not adhering to donor intent in connection with its spending policy. The Foundation believes it has taken appropriate, and what have been described as legally conservative steps, to make sure donor intent is followed in instances where, due to market conditions, a particular endowment fund may have fallen below its original gift value or "historic dollar value."

We highlight the Report's failure to mention the considerable disagreement among peer institutions and experts over the past few years regarding the interpretation of the Uniform Management of Institutional Funds Act ("UMIFA") upon which Hawaii's HRS Chapter 517D is based, particularly how the terms "historic dollar value" and "fund" are to be interpreted given recent decline in market values. The Report faults the Foundation for delay in contacting donors to determine their intentions with respect to endowment funds which may have fallen below "historic dollar value," yet the Foundation undertook exactly such a project shortly after presentations and studies clarifying best practices in this area were presented by both CASE and AGB in early 2003. In fact, the Foundation instituted a prompt response to these presentations and studies through its proactive approach of contacting donors. A recent study of many institutions holding endowments by Cambridge Associates LLC notes:

> Another legally conservative, although difficult means for addressing spending constraints is to contact donors asking their permission to either release limitations that make the assets permanently restricted or to spending to continue within limits should the gift value fall below historical value. Only 13% [16 of 123 in the study] of institutions have either contacted or are considering contacting donors, while at least one institution is doing so on a selective basis.

Cambridge Associates LLC, *Spending Policy Practices*, p. 6 (2004).

The Report also faults the Foundation for the method by which donor intentions were determined by citing the practice of the University of Alaska Foundation, yet it fails to note that Alaska is one of only three states that has not adopted UMIFA. The Foundation in fact followed an approach presented by the University of Iowa Foundation at a CASE conference in April, 2003.

Finally, we note that the drafters of the currently contemplated revisions to UMIFA, which are being undertaken by the National Conference of Commissioners on Uniform State Laws, have proposed a complete elimination of the "historic dollar value" concept in favor of a more general standard of prudence to provide more flexibility in their most recent draft.

(See Discussion Draft of Uniform Management of Institutional Funds Act dated March 3, 2004 which can be found at http://www.law.upenn.edu/bll/ulc/umoifa/Mar2004CircDraft.htm).

3. It Is Inappropriate for the Board of Regents to Assume Responsibility for Contracting for Financial and Performance Audits of the Foundation

The Report recommends that the Board of Regents, among other things, assume the responsibility of contracting for financial and performance audits of the Foundation's fundraising activities. The Report even suggests the possibility of using the University's internal audit function to conduct such reviews. (See Recommendations 4.b and 4.c.) These recommendations are fundamentally at odds with the concept of a separate private institutionally-related foundation and reflect a misunderstanding of the relationship between a public university and its private institutionally-related foundation.

Separate boards of directors or trustees govern private institutionally-related foundations like the Foundation. The Internal Revenue Service and the State Attorney General also play an important role in oversight and such entities are accountable to their donors. If the University assumes the Foundation Board's governance role, the Foundation's trustees would be left with no reason to continue volunteering their time and talents to govern the Foundation, not to mention providing their financial support.

To the extent the Foundation Board's functions are assumed by the Board of Regents, it becomes apparent that there simply is no reason for the Foundation to continue to exist as a separate entity and provide all of the benefits that this proven and time tested fundraising model provides to public universities throughout the country. If such were to occur, the loss of private support for the University would be immeasurable, as donors have choices--including supporting competing public and private institutions that can guaranty confidentiality. As noted recently by a leading expert in the field, David Bass, Director of the National Center for Institutionally Related Foundations at CASE:

> Donors contemplating the endowment of a scholarship or a faculty chair, or the contribution of funds for a major construction project, often prefer to make their gift to a private entity, governed by independent trustees, than to a public institution. Foundation boards typically include individuals with extensive financial and business expertise who may be in a better position to take a long-term perspective than are staff members and trustees of a public institution, who face a variety of pressures for short term results

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> Given the many real concerns that donors may have about invasions of privacy by the news media and exposure to unwanted charitable and business solicitations, foundations need to be able to reassure potential donors that their privacy will be respected.

Bass, *Protecting Donor's Privacy is a Matter of Good Ethics and Good Business*, The Chronicle of Higher Education, Volume 50, Issue 33, Page B15 (April 23, 2004).

We are in agreement with your Report with respect to the comments noting that various separate charitable organizations are engaging fundraising activities on behalf of the University and its programs. This is and has been a concern of the Foundation and we welcome further dialogue with the Board of Regents and the University administration to find ways to effectively centralize these functions with the Foundation to better coordinate fundraising for the benefit of the University.

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Thank you again for the opportunity to comment on the Report. The Foundation looks forward to moving ahead with the Centennial Campaign while continuing, as always, to improve its practices and procedures to ensure increasing levels of excellence in teaching, learning and research at the University of Hawai'i including all of its campuses and programs.

Very truly yours,

Howard H. Karr
Chairman of the Board of Trustees
The University of Hawai'i Foundation

Donna Vuchinich
Acting President
The University of Hawai'i Foundation

cc: University of Hawai'i Foundation Board of Trustees