MINUTES

BOARD OF REGENTS COMMITTEE ON INDEPENDENT AUDIT MEETING

NOVEMBER 27, 2018

I. CALL TO ORDER

Committee Chair Michael McEnerney called the meeting to order at 8:46 a.m. on Tuesday, November 27, 2018, at the University of Hawai‘i Mānoa Innovation Center, Presentation Room, Suite #173, 2800 Woodlawn Drive, Honolulu, Hawai‘i 96822.

Committee members in attendance: Committee Chair Michael McEnerney; Committee Vice Chair Wayne Higaki; Regent Simeon Acoba; Board Vice Chair Jeffrey Portnoy; Regent Douglas Shinsato.

Others in attendance: Board Chair Lee Putnam (ex-officio voting member); Regent Brandon Marc Higa; Regent Ernest Wilson Jr. (ex officio committee members); Vice President for Community Colleges John Morton; Vice President for Legal Affairs/University General Counsel Carrie Okinaga; Vice President for Academic Planning and Policy Donald Straney; Vice President for Research and Innovation Vassilis Syrmos; Vice President for Information Technology/Chief Information Officer Garret Yoshimi; Vice President for Budget and Finance/Chief Financial Officer Kalbert Young; Executive Administrator and Secretary of the Board of Regents (Board Secretary) Kendra Oishi; and others as noted.

II. APPROVAL OF MINUTES OF THE OCTOBER 4, 2018, MEETING

Committee Vice Chair Higaki moved to approve the minutes of the October 4, 2018, meeting, seconded by Regent Shinsato, and the motion carried unanimously.

III. PUBLIC COMMENT PERIOD

Board Secretary Oishi announced that the Board Office received no written testimony, and no individuals signed up to provide oral testimony.

IV. AGENDA ITEMS

A. For Review and Acceptance:

Committee Chair McEnerney recommended reordering the agenda to take up the intercollegiate athletics report first. There were no objections.

2. University of Hawai‘i at Mānoa Intercollegiate Athletics Audit Reports for the Year Ended June 30, 2018

External auditor Cory Kubota of Accuity LLP summarized the University of Hawai‘i at Mānoa (UHM) Intercollegiate Athletics National Collegiate Athletic Association (NCAA) mandated reports for the year ended June 30, 2018, on Agreed-Upon Procedures and
Internal Control and Business Issues, for acceptance by the committee. One item in the Agreed-Upon Procedures Report related to discrepancies in athletic student financial aid was noted where there were two exceptions out of the 40 students sampled. The issues are not considered systemic and are related to a rather new compliance requirement for athletic programs. No other exceptions were noted. The UHM athletics department ended fiscal year 2018 with a net loss of approximately $1.9 million.

A question was raised regarding internal quality review and control procedures. UHM Associate Athletics Director for Administrative Services (AADAS) Carl Clapp responded that the department has 3 full-time compliance officers that review financial aid for compliance with the NCAA standards. There are also resources available at the conference office and NCAA offices. The two exceptions identified occurred due to an internal paperwork issue. External auditor Kubota clarified that the two exceptions did not result in any NCAA non-compliance. The department is working to ensure this does not reoccur.

It was noted that progress has been made in decreasing the UHM athletics department deficit over the years with the university lending the department $11 million in 2018 and $7.4 million in 2017. A question was raised regarding whether the $1.9 million net loss in 2018 was covered by the university. External auditor Kubota clarified that the department receives a formal allocation as part of the budget process, but if expenses exceed revenues, those expenses are covered by the university. VP Young added that the current budget request included funding for fringe benefits of approximately 30 athletics department personnel, which could save $1.5 million in operating expenses and help reduce the shortfall.

External auditor Kubota indicated there were three comments in the Internal Control and Business Issues Report related to ‘Ahahui Koa Ānuenue (AKA) fundraising activities, athletic student aid reporting, and the fiscal deficit, none of which are new items and should be considered updates on prior comments. Background was provided on how AKA used to be under the UH Foundation (UHF), but is now a separate organization. There have been leadership changes at AKA and AD Matlin has been more involved in working with AKA. AKA’s mission is to provide financial support to the athletics department and is critical to the department’s success, so Accuity continues to monitor their activity.

Several questions were raised related to AKA including whether it is considered an affiliate of the university, why it had not conducted any substantial fundraising activities in recent years, and salary and other financial information. External auditor Kubota explained that AKA is considered an affiliate of the athletics department. Prior to AKA separating from UHF, the major fundraising activity and revenue stream was the premium seat and parking program. AKA separated from UHF in 2015 so it could produce large fundraising events; however, no large events have been held in the past four years. Salaries and expenses have remained fairly constant during the last four years, and the revenues raised by AKA have gone towards operations and approximately $2.5 million is provided to the UHM athletics department annually.
A question was raised regarding the estimated amount the athletics department needs as a subsidy to continue operating in a competitive manner. AADAS Clapp responded that the athletics department had made requests to the Legislature for as much as $5 million per year, and the athletics department has undertaken initiatives to generate additional revenue. VP Young referenced Appendix I of the materials and clarified that the athletics department received $12.98 million in direct institutional support from UHM and $2.7 million in direct government support from a specific legislative appropriation. Even with these revenues, the UHM athletics department still ended fiscal year 2018 with a $1.88 million net loss. AADAS Clapp added that of the $12.98 in direct institutional support, $8.5 million was used for scholarship reimbursements. Although a net loss is reported, funds are reallocated within UHM to ensure that expenses are paid.

A question was raised regarding whether there was an assumption that the athletics department had to be self-supporting. VP Young explained that the interim UHM Chancellor has directed the athletics department to eliminate the net loss and be fully self-supporting, which may include UHM revenue allocations to the athletics department.

A question was raised regarding whether other UHM units received allocations to help cover shortfalls and VP Young indicated there probably were. He noted that allocations might be moved from a unit with surplus to another unit. These allocations are done in a "loan" mode in that at some point in the future all of these balances from individual units return to break even and no unit allowed to run a negative deficit in perpetuity.

A question was asked regarding how much of the $12 million that the previous chancellor provided to the athletics department in 2014 had been repaid. Administration agreed to provide that information to the regents.

Board Vice Chair Portnoy moved to accept the University of Hawai‘i at Mānoa Intercollegiate Athletics Audit Reports for the Year Ended June 30, 2018, seconded by Committee Vice Chair Higaki, and the motion carried unanimously.

1. University of Hawai‘i Audited Financial Reports for the Year Ended June 30, 2018

External auditor Kubota summarized the required auditor communications, revenue trends, EB-5 loan status, tax-exempt lease purchase agreements, pension and other post-employment benefit (OPEB) obligations, and the issuance of series 2017 bonds. Upon acceptance, the finalized UH audited financial statements will be incorporated into the State of Hawai‘i financial statements for the year ended June 30, 2018, which are expected to be issued in mid-December.

External auditor Kubota clarified that the consolidated financial statements rely on audited financial statements provided by the UHF which commissions its own audits. The implementation of Governmental Accounting Standards Board “GASB” Statement No. 75, relating to accounting and financial reporting for post-employment benefits other
than pensions, resulted in an increase of the university’s net OPEB liability of approximately $1 billion. Previously, government agencies did not report on retirement liabilities. There were no identified material weaknesses or significant deficiencies in internal control over financial reporting. Other matters involving internal control and its operation will be communicated in Accuity LLP’s Internal Control and Business Issues Report in January 2019.

More detail was requested regarding the university’s Perkins loan liability owed to the federal government being reclassified as noncurrent. External auditor Kubota explained that the Perkins loan program is a longstanding federal loan program that the federal government is likely to discontinue. The university is proactively trying to exit the Perkins loan program in an expeditious manner, which requires compiling and submitting paperwork to the federal government for review and acceptance, and returning remaining funds. The shut down of the Perkins loan program is expected to take one to two years.

A question was raised regarding the impact of GASB Statement No. 75 on future university bond ratings. VP Young speculated that GASB Statement No. 75 would have similar effect across the governmental bond issuer industry. OPEB was previously identified as a risk factor in the university’s credit, similar to the State of Hawai’i because Hawai’i has a relatively high rate of unfunded OPEB liability. The reflection of the liability on the university’s financial statements will likely have a negative impact on the university’s bond rating and may result in higher interest rates. The state is now prefunding OPEB, which is expected to result in an improved financial condition over the next 30 years.

Committee Chair McEnerney mentioned a recent article that identified Hawai’i as one of the four worst states in the nation with regard to unfunded liabilities. This appears on the financial statement as an allocation of portion of the state’s OPEB obligation attributed to the university. External auditor Kubota referenced the $1.65 billion of noncurrent net pension liability and the $1.79 billion of OPEB on the Statements of Net Position, and the difference between the ending obligations in 2018 and 2017. For both pension and OPEB, the university is a part of the state of Hawai’i, so the obligation is calculated and measured at the primary government level (state as a whole) and that allocation is allocated by the state based on covered payroll. The university has a significant portion of the state’s covered payroll, which was approximately 30% in 2018. Covered payroll does not include part-time or student employees who are not eligible to participate.

External auditor Kubota referenced footnote 14, related to post-employment health care and life insurance benefits, and explained how the actuarial assumptions are calculated based on demographics of the employee population and estimates of life expectancy. The 7% discount rate used to measure the university’s net OPEB liability is comparable to private industry plans. He explained that liabilities move in an inverse direction from discount rates; an increase in the discount rate will result in a decrease in liability. A sensitivity analysis on page 70 of the financial statements shows the impact on the university’s portion of the state’s OPEB obligation. The state realizes the pay-as-you-go method of administering this type of benefit plan is not sustainable and there is
law in place requiring the state to contribute to fund this plan annually. If the state as a whole can adequately fund the plan, the obligation will decrease even if discount rates go down.

A question was raised regarding the university’s policy for reviewing and analyzing accounts receivables, and determining which receivables have a high probability of becoming uncollectible. External auditor Kubota explained that the university has polices regarding accounts receivables and procedures in place to monitor the aging of accounts receivables and follow-up. The majority of receivables relate to student accounts receivables. The university does not want to write-off a student account receivable balance in the event that a student needs to clear obligations in order to re-enroll or to obtain transcripts. Keeping the receivables on record allows the university to monitor obligations.

External auditor Kubota referenced footnote 18, related to litigation, other contingent liabilities and commitments, and explained there is ongoing litigation between the Office of Hawaiian Affairs (OHA) and other state agencies, and this footnote has been reflected in every state agency’s financial statements for more than a decade. It relates to ceded land revenues remitted by the university. OHA disputes the calculation and sufficiency of these remittance amounts.

Committee Chair McEnerney referenced the schedule of proportionate share of the net pension liability and VP Young noted the significant drop in the net position as a percentage of the total pension liability. He explained the drop coincided with the time when the Employees’ Retirement System (ERS) board lowered the assumed rate of return from 7.45% to 7.0% instantly, which increased the total unfunded portion of the liability and resulted in the university being responsible for a larger portion of the total liability. Prior to this schedule and before 2014, the ERS board lowered the assumed rate of return incrementally over the course of three years so the impact was not as great.

Committee Vice Chair Higaki moved to accept the University of Hawai‘i Audited Financial Reports for the Year Ended June 30, 2018, seconded by Regent Acoba, and the motion carried unanimously.

3. Annual Report to the Legislature on Material Weaknesses and Fraud

Internal auditor Glenn Shizumura explained that this report is required by law and that no instances of material weaknesses in internal control over financial reporting or instances of fraud or illegal acts were detected per Accuity LLP’s findings.

Board Vice Chair Portnoy moved to accept the Annual Report to the Legislature on Material Weaknesses and Fraud, seconded by Committee Vice Chair Higaki, and the motion carried unanimously.

V. ADJOURNMENT
There being no further business, Committee Vice Chair Higaki moved to adjourn, and Board Vice Chair Portnoy seconded, and with unanimous approval, the meeting was adjourned at 10:15 a.m.

Respectfully Submitted,

/S/

Kendra Oishi
Executive Administrator and Secretary
of the Board of Regents