

UNIVERSITY OF HAWAII

OFFICE OF THE VICE PRESIDENT FOR COMMUNITY COLLEGES

MEMORANDUM

August 9, 2005

TO: CC Chancellors

SUBJECT: Financial Audit of UH Community Colleges

Transmitted for your information is a letter from Barbara Beno, President of the Accrediting Commission for Community and Junior Colleges (ACCJC), regarding the level of financial audits required to adequately meet ACCJC's accreditation standards. Following discussions with her and the chair of the Task Force on Financial Management, we agreed that "... the presentation of a combined balance sheet and income statement of the community college system as supplemental information to the University's consolidated financial statements with an opinion on such supplemental information" will be accepted as documentation of audit of the UH Community Colleges for a period of two years. We will review the effectiveness of this documentation after two years and make changes as required.

This is good news for the University of Hawai'i as, while meeting the accreditation standards, it is the least expensive alternative as presented by PricewaterhouseCoopers. We are grateful to Kent Tsukamoto, Managing Partner, and Cory Kubota, Senior Manager of PricewaterhouseCoopers for preparing a summary of the various types of financial audits and audit-related engagements which clearly outlines the alternatives. We will proceed with incorporating this in the scope of the contract with PricewaterhouseCoopers for the FY 2005 audit and beyond.

As Barbara indicated, the Task Force on Financial Management, of which I am a participating member, will be meeting in late September on this and other financial management issues as they relate to the accreditation standards.

Should you have any questions, please feel free to call me at 956-6280.

Michael T. Unebasami
Associate Vice President for
Community College Administration

Attachment

- c Vice President John Morton
- Vice President Sam Callejo
- Director Russell Miyake
- ✓ Director Michael Yoshimura
- CC Vice Chancellors/Directors of Administrative Services
- Mr. Kent Tsukamoto
- Mr. Cory Kubota



**ACCREDITING
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JUNIOR COLLEGES**

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TOM LANE

July 19, 2005

Mr. Michael Unebasami
Associate Vice President for Administration
University of Hawai'i
2327 Dole Street
Honolulu, Hawai'i 96822

Dear Vice President Unebasami:

I'm writing in response to your request that the ACCJC help the University identify which of several audit alternatives it might use to facilitate the ability of the UH Community Colleges to meet ACCJC accreditation standards and reporting requirements. Thank you for sending the alternatives prepared for the University of Hawai'i by PriceWaterhouseCoopers.

The Commission needs to be even handed in applying its requirements to all of the institutions it accredits. Accordingly, the Task Force on Financial Management has been meeting to identify the key variables or indicators of sound fiscal health and management, and will continue its work this fall. At this point, I believe that option three on page two of your letter from PriceWaterhouseCoopers would be effective in providing the Commission and visiting teams with appropriate information if it was provided *in addition to the UH audit*. That option is as follows:

“... the presentation of a combined balance sheet and income statement of the community college system as supplemental information to the University's consolidated financial statements with an opinion on such supplemental information in relation to the University's consolidated financial statements taken as a whole. This alternative would eliminate the need to prepare a statement of cash flows and the related footnotes, however yields a lower level of assurance to financial statement users. Audit procedures performed would be limited to transactions and balances considered material in relation to the University's consolidated financial statements.”

I therefore advise you that for a period of two years, the Commission will accept the above documentation of audit. The Commission and the UH Community Colleges will review the effectiveness of this documentation in two years and determine if it needs to be altered.

Thank you for your patience in awaiting this decision. I understand you'll bring some sample UH CC college schedules and forms to the Financial Review Task Force meeting that is planned for August or September, and we can review these with the group.

Sincerely,

A handwritten signature in cursive script that reads "Barbara A. Beno".

Barbara A. Beno
President

March 4, 2005

Mr. Michael Unebasami
Associate Vice President for Administration
University of Hawaii
2327 Dole Street
Honolulu, Hawaii 96822

Dear Mr. Unebasami:

Pursuant to your request, we have prepared a summary of various types of financial audits and audit-related engagements that may be of interest to the University of Hawaii (the "University") and its system of seven community colleges. Based on our discussions with you, the University may be interested in the following types of engagements:

1. Audit of financial statements of each community college.
2. Audit of combined financial statements of the community college system.
3. Audit of combining balance sheet and income statement of the community college system presented as supplemental information to the University's consolidated financial statements.
4. Review of financial statements of each community college.
5. Review of combined financial statements of the community college system.

The following discussion describes financial audits and reviews in more detail, the varying levels of effort required for such engagements, and possible fee ranges the University could expect to pay for such engagements.

Financial Statement Audits

The University's financial statements are prepared in accordance with Government Accounting Standards ("GASB") principles, which establish standards for external financial reporting for public colleges and universities. The University's annual financial statements are comprised of the following components:

- Statement of Net Assets (Balance Sheet)
- Statement of Revenues, Expenses and Changes in Net Assets (Income Statement)
- Statement of Cash Flows
- Notes to Financial Statements

In an audit of financial statements, an auditor must plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of *material* misstatement, and form an opinion on the financial statements taken as a whole. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation.

Materiality represents the magnitude of an omission or misstatement of accounting information that, in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement. An auditor must use professional judgment when assessing materiality based on the perceived needs and expectations of the financial statement users.

Audits of financial statements of individual community colleges would require an independent assessment of materiality for each campus, which may vary significantly between campuses. For example, the materiality threshold for Kapiolani or Honolulu, two campuses with large financial statement balances, would be higher than campuses with small financial statement balances such as Windward or Kauai. In general, the lower the materiality threshold, the more detailed audit testing and larger sample sizes would be required. In addition, separate audits would require preparation of full financial statements for each community college, including the balance sheet, income statement, statement of cash flows and related footnotes. The hours required to audit individual community college financial statements could range between 2,200 and 2,500 hours, excluding internal University personnel time. The audit fees could range between \$260,000 and \$300,000.

Another alternative would be an audit of the combined financial statements of the community college system, which would result in a higher materiality threshold, decreased detailed audit testing and smaller sample sizes. An audit of combined financial statements would require preparation of only one set of financial statements and related footnotes as opposed to seven. The hours required to audit combined financial statements could range between 1,000 and 1,300 hours, excluding internal University personnel time. The audit fees could range between \$120,000 and \$160,000.

Another alternative would be the presentation of a combining balance sheet and income statement of the community college system as supplemental information to the University's consolidated financial statements with an opinion on such supplemental information in relation to the University's consolidated financial statements taken as a whole. This alternative would eliminate the need to prepare a statement of cash flows and the related footnotes, however yields a lower level of assurance to financial statements users. Audit procedures performed would be limited to transactions and balances considered material in relation to the University's consolidated financial statements. The hours required to audit a supplemental combining balance sheet and income statement could range between 400 and 700 hours, excluding internal University personnel time. The audit fees could range between \$50,000 and \$85,000.

Financial Statement Reviews

A review engagement consists of applying certain limited procedures to financial statements, principally comprised of inquiry with management and analytical procedures, as a basis for expressing limited assurance that there are no material modifications that should be made to the financial statements to be in conformity with generally accepted accounting principles. This limited assurance is less than the assurance provided by an audit.

The objective of a review differs significantly from the objective of an audit of financial statements. A review does not provide a basis for expression of an opinion because a review does not contemplate obtaining an understanding of internal control or testing of accounting records. While a review may bring to an accountant's attention significant matters affecting the financial statements, it does not provide assurance that the accountant will become aware of all significant matters that would be disclosed during an audit.

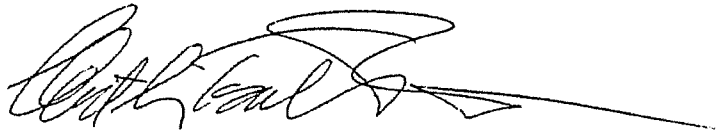
Reviews of financial statements of individual community colleges would require an independent assessment of materiality for each campus, similar to audits, however materiality would be used as a gauge to develop inquiries and apply analytical procedures, not as a basis for developing audit tests. Separate reviews would require preparation of full financial statements for each community college, including the balance sheet, income statement, statement of cash flows and related footnotes. A review engagement must be performed for a full set of financial statements and cannot be performed for incomplete or partial financial information. The hours required to review individual community college financial statements could range between 1,000 and 1,300 hours, excluding internal University personnel time. The review fees could range between \$120,000 and \$160,000.

Another alternative would be to review combined financial statements of the community college system, which would result in a higher materiality threshold for development of inquiries and application of analytical procedures. A review of combined financial statements would require preparation of only one set of financial statements and related footnotes as opposed to seven. The hours required to review combined financial statements could range between 600 and 800 hours, excluding internal University personnel time. The review fees could range between \$70,000 and \$100,000.

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As you can see, there are a variety of audit and audit-related engagements that can be performed for the University and its community colleges depending on the desired level of assurance and needs of financial statement users. Should you have any questions regarding the differences between the types of engagements discussed, please feel free to call me at (808) 531-3462 or Cory J. Kubota at (808) 531-3611.

Sincerely,



Kent K. Tsukamoto
Managing Partner

KKT:cjk