



UNIVERSITY OF HAWAII

David McClain
Interim President

December 19, 2005

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

Dear Ms. Higa:

Thank you for the opportunity to comment on the findings and recommendations in your draft report, "Systemwide Financial Audit of the University of Hawaii System: Phase I."

We acknowledge your staff's effort to fulfill the purpose of the request made in House Concurrent Resolution No. 213, 2005 Regular Session.

We have attempted to address each of the findings and recommendations in the draft report in the three business days provided us. For ease of reference, we have maintained the order of the findings and recommendations as presented in the draft in presenting our responses. Where the facts presented in the findings are incorrect or incomplete, we have so indicated, and we request the information we have provided be used in the final form of your report. We are concerned by the quality of work reflected, for example, by the failure of your staff to ask for budget funding priorities which had clearly been provided to the Legislature, before developing a finding asserting that they had not been provided to the Legislature.

While we do not concur with a number of the findings and conclusions in the report, we do agree there is room for improvement. Indeed, we are continually striving to do better. This has been reflected in our reports to the Board of Regents and its Audit Committee on the numerous financial and compliance audits we undergo each year and our actions resulting from those audits. We appreciate those instances where our efforts and progress have been acknowledged in your report.

Notwithstanding the foregoing, **we strongly disagree with the draft report's overall conclusion** that "the University of Hawaii at Manoa cannot fully ensure fiscal accountability." The financial statements of the University of Hawaii are audited annually by external auditors. The reports of those external auditors have reflected an unqualified opinion that the financial statements of the University are fairly stated in conformity with generally accepted accounting standards. In addition, no material weaknesses in internal controls have been reported as a result of those audits, which have been performed in accordance with generally accepted auditing standards and Government Auditing Standards.

We also disagree with your summary findings. It is in fact the case that:

- The University of Hawaii at Manoa's budget is adequately founded.
- The University of Hawaii at Manoa does provide an accurate picture of its overall fiscal condition.
- The University of Hawaii calculation of cost per student has substantial value for the purposes for which it is intended.

The following sections of this letter provide our detailed responses to the findings and recommendations in the report.

"The University of Hawaii at Manoa's Budget Is Not Adequately Founded"

We do not agree with this conclusion. The University of Hawaii at Manoa's budget request documents that are submitted to the Governor and Legislature are prepared in strict compliance with Part IV. of Chapter 37, Hawaii Revised Statutes. As required by this statute, these documents are reviewed and approved by the Governor and the Department of Budget and Finance and incorporated into the Executive Budget Request that is submitted to the Legislature. In addition, HRS §304-4.5, requires the Board of Regents to establish additional performance measures in the form of benchmarks in order to monitor progress towards the achievement of certain state objectives established by the Legislature for the University. These objectives include the expansion and development of the University of Hawaii into "...a statewide campus that provides Hawaii with a higher education system designed to meet the future needs and demands of the citizens of the State, and to capitalize on the university's unique resources and location to become an international educational, research, and service center known both in the United States and throughout the Pacific/Asian countries." The University is also required to conduct "...a periodic review of all instruction, organized research, public service, academic support, student services, and institutional support programs at each campus to determine whether the programs are operating for the purposes originally established and not inconsistent with the benchmarks..." A report to the Legislature on the University's findings is required in the second year of each fiscal biennium. To the best of our knowledge, no other state department or agency is mandated to provide such an extensive array of performance and effectiveness measures in support of their current operations and budget requests to the Legislature and by extension, to the general public.

We do agree with the statement made in the report: "To achieve the plan, deans and directors responsible for implementing plans and budgets need to have sufficient authority for determining the best financial means of accomplishing the objectives."

"The University of Hawaii at Manoa's base operating budget is not substantiated"

As previously stated, the University complies with Hawaii Revised Statutes and the procedures set forth by the Department of Budget and Finance in preparing its budget.

While there was no in-depth review of the unit's current service base budgets, it is noted that for FY 2005, out of the \$194M general fund allocation, \$191M was expended for payroll. Constraints imposed by collective bargaining contracts make it difficult to reallocate funds within and between units. In FY 2005, tuition funds were only 23% of the total operating budget allocation and were used primarily to fund operational expenses such as utilities, R&M, office supplies, etc.

Other actions by the Executive and the Legislature such as restrictions which were subsequently made permanent, under-allocating collective bargaining requirements and assessment of efficiency savings have eroded the base budgets of the units, making reallocation difficult, if not impossible. Internal reallocation of funds were required of the units to meet the shortfalls caused by these adjustments. As a result, permanent positions were kept vacant to cover the shortfalls. In the FY 2005-07 biennium budget, 162 permanent FTE were cut from the Manoa base budget due to the lack of funds.

"The budget is based on prior funding levels and program change requests"

The budget instructions from the Executive do not require justification of the current service budget. What is received is a funding ceiling for current service which cannot be exceeded. The instructions from the Legislature do not require justification of the current service base, although, during the review of the budget by the higher education, finance and ways and means committees, numerous requests for information on specific aspects of the base are received and responded to.

In the internal Manoa budget preparation process for the FB 2005-07 Budget, instructions were issued by the Chancellors Office which required the units to submit their budget request in two levels, current services and workload /program change requests. As part of the preparation process, units were required to consider negative adjustments to the current service base for low programs for reallocation to higher priority programs before requesting additional funds and were informed that this process would be a part of the evaluation of the total requests.

"Budgetary decisions are not results oriented"

We disagree with this finding. Budget decisions are results oriented. The budget instructions issued to the units required the preparation of program plans as well as requests for funding. In the plans, units were required to address effectiveness with regard to achieving program objectives and as applicable, comparison with comparable organizations. They also were required to address operational efficiency. Program change requests had to include the intended objectives and outcomes, clientele to be served and operational efficiency.

The plans were not part of the budget preparation submittal requirements to the BOR, Executive and the Legislature. They were used only in the internal review of the budget. No requests were made by the Executive or the Legislature for these plans.

With regard to the objectives and measures of effectiveness that are included in the Multi-Year Program and Financial Plans and Executive Budget, Manoa did respond to questions from the Legislative Auditors Office in preparation of the audit. With regard to the statement that a campus administrator characterized these measures as useless for program level decision making, this needs to be clarified. Three questions were asked specifically about the measures:

- 1) how effective are the measures;
 - 2) does the university consider the information useful in preparing and justifying its budget; and
 - 3) is the outcome information used to determine the university's budget allocation.
- The written response to these questions, provided by the VCA, were as follows:

- 1) The Program and Financial Plans allow a limited number of measures. Because there are so many programs and activities on the Manoa campus, the measures are general in nature and basically give a broad overview of campus activities. They do not provide program specific measures;
- 2) Not totally because they are so general in nature; and
- 3) Not totally because they are so general in nature.

The response was not that the measures are useless. Some of the measures, at an unaggregated level such as enrollment at the unit level are given consideration in the budget preparation and allocation process. Because there are so many units and subunits which are impacted by enrollment, it is not possible to include in the PFPs the data for each one.

"The University of Hawaii at Manoa could not sufficiently justify its budget request to the Legislature"

The basis for this finding is the State Auditor Staff's incorrect belief that budget funding priorities were not provided to the Legislature during the session. This came to our attention at the exit conference on December 13, 2005. We found at that time that they had not inquired whether these priorities had been submitted to the Legislature during the session. We immediately sent to them that afternoon, prior to the issuance of the draft report the next day, copies of the communication with the University's priorities that had been transmitted on March 14, 2005 to the Senate President, the Speaker of the House, the Senate Ways and Means Committee Chair, the House Finance Committee Chair and the Senate and House Higher Education Committee Chairs. We have again attached copies of this transmittal for your reference.

Based on the incorrect factual basis, we disagree with the finding. In addition, we do not agree with the conclusion in the finding that not providing funding priorities would result in "The insufficient and ineffective use of resources....."

"The budget request underwent a long, internal review process"

We agree, and we appreciate the acknowledgement of our thorough and consultative process.

"The University of Hawaii at Manoa could not provide the Legislature with a list of funding priorities"

As previously indicated, we have provided evidence that a list of funding priorities was in fact provided to the Legislature during the session.

"Efforts to restructure the University of Hawaii at Manoa's budget process is in its infancy"

We appreciate the acknowledgement of our efforts in this area and agree that there is more to be done. Implementation of budget reform at Manoa is on schedule and is proceeding according to the original plan. As presented at Manoa's Planning Day Event (October 2005) and to the Board of Regents at their November 2005 meeting, implementing the recommendations

of the Manoa Budget Advisory Group would take place over several years beginning in January 2005. The goal during the first year was to achieve transparency in reporting. Towards that end we are now able to track expenditures and allocations through FMIS at the department level. The web based information center is in development and will be ready in time for our spring budget hearings. Personnel codes are being updated to reflect current organizational structure. More importantly, we are changing the way personnel information is inputted into our human resources system allowing us the ability to collect personnel data and financial data using FMIS codes. We have established a budgeting task force charged with developing performance metrics which can be used to allocate tuition revenue. We anticipate that Phase one of this project will be rolled out July 2006.

"The University of Hawaii at Manoa Cannot Present an Accurate Picture of its Overall Fiscal Condition"

We disagree with this conclusion. Manoa has the ability to examine allocations, expenditures and encumbrances at the Manoa level, at the School/College level and at the Department level for all fund sources.

"The University of Hawaii's budget report is an inadequate management tool"

The BLS system was not developed as a department-level management tool. It was developed to provide system-wide budget to actual expenditure data, by source of funding, at the broad expense categories of payroll and non-payroll aggregated at the campus or college level only. Detailed expenses categories (i.e. equipment, supplies, etc.) account code information are rolled up in the BLS system to the payroll and non-payroll categories. The finding that "... according to Manoa Budget Office personnel, there is no assurance that account codes are properly established because unit fiscal officers responsible for setting up account are not properly trained in the BLS account code attribute standards" is taken out of context.

There is a difference between account codes and expenditure object codes. The account codes in BLS are the general/subsidiary ledgers to which expenditures are charged. These accounts are established by the unit fiscal personnel. The object of expenditure codes are those noted above, equipment, supplies, etc. The codes that were referenced by the Manoa Budget Office are the account codes not the objects of expenditure codes and related to errors that may be made in establishing the accounts which could result in improper mapping of expenditures to the correct account, not object.

To assess the overall status of expenditure of funds appropriated to Manoa at the central administrative level, the reports provided by BLS are sufficient. At the aggregate program and fund level, the information provided includes the program allocations, expenditures to date and projected expenditures for the balance of the year for the general and tuition funds. This is sufficient to determine how programs are expending. What they are expending on is not a consideration at this level.

The unit deans and directors were delegated the authority to manage their allocations, with the stipulation that expenditures shall not exceed them. The expenditure details at the object of expenditure level are kept by the unit fiscal personnel. As indicated previously in this report, "To achieve the plan, deans and directors responsible for implementing plans and

budgets need to have sufficient authority for determining the best financial means of accomplishing the objectives."

From a system perspective, the recently implemented BLS system of reports and various financial reports and statements produced by the Financial Management Information System (FMIS) provides an appropriate amount of detail on the overall financial condition of the Manoa campus operations down to the major unit level for the system administration and Board of Regents to review and monitor each campus.

"Information in the report is not reconciled to the university's budget and Financial Management Information System"

This finding is incorrect. Fiscal personnel reconcile the BLS expenditure data against FMIS summary reports, transaction reports, special summary files prepared by the accounting office, and for units that maintain one, data in their separate system. As discussed in the exit meeting, there is no formal requirement that the units document that the accounts were reconciled. The system does identify when the expenditure plans were last updated but that is not a confirmation that the accounts were reconciled. The variance component of BLS which requires an explanation of any significant variance is an indication of reconciliation but not confirmation. Without reconciling the expenditure data to ensure that it is correct, it would not be possible to accurately complete this requirement.

"The University of Hawaii at Manoa does not have formal policies and procedures for correcting reporting errors"

This finding is correct in that there are no written instructions stating what needs to be done. However, during their reconciliation, if errors are found, action is taken by the fiscal staff to correct them. If the errors are internal and correctable, i.e. expenditures are reflected in incorrect accounts, JVs are prepared to transfer the expenditure to the correct account. If it is a mapping problem, the ITS analyst and/or the Manoa Budget Office is contacted who in turn refers the fiscal officer to the appropriate person to rectify the problem, usually the University Budget Office or the ITS support analyst. These actions are done despite the lack of written policies or instructions.

"Lax controls over the general and tuition funds may lead to inappropriate fund usage"

We concur with certain of the following specific findings supporting this conclusion and disagree with others, as indicated in the specific responses below.

"Policies and procedures for the tuition funds are in draft form while others need updating"

The draft policies and procedures for the Tuition and Fees Special Fund will be formally implemented as soon as possible. However, it should be noted that in the absence of formal internal policies and procedures, the relevant statute (§304-16-5, HRS) would prevail. Therefore, the risk that funds may not be used as intended by law would not be significantly enhanced by the formal adoption of an internal policy that would in effect, merely restate permissible expenditures as specified in existing statute.

The draft report asserts that University's Administrative Procedures Manual (APM) has not been updated to include procedures related to the new ePurchasing system's implementation. We disagree with this finding. The University's ePurchasing system is an electronic processing tool which enables users to electronically generate standardized requisition and purchase order forms previously prepared on hard copy, carbon forms. Accordingly, the ePurchasing user guide, which is referenced in APM, Section A8.250, Provision No. 11, does not serve to provide any new or updated procurement policies or procedures but is primarily intended as an operator's/user guide. The procurement procedures set forth in the APM would still govern basic procurement responsibilities, controls and practices. The APM governing University purchases has been approved by the University Board of Regents.

In addition, the report notes that purchases under \$25,000 can be processed without proper authorization and stated that "This flaw in the design of current operating procedures could allow unit fiscal offices to bypass appropriate approvals for purchases of up to \$25,000."

The University is in compliance with its Administrative Procedures Manual with respect to processing payments under \$25,000 for departmental fiscal officers as summarized below.

University Executive Policy E8.107 Authority to Execute Contractual Documents for Procuring Goods, Services and Construction delegates to Vice Presidents and Chancellors authority to execute contractual documents for procuring goods, services, and construction in amounts designated therein. This authority has been further delegated to fiscal officers of departmental units under their direction and jurisdiction. Only University personnel specifically delegated purchasing authority as set forth above are authorized to commit the institution contractually and only within the limits of their purchasing authority.

Under this delegated authority Fiscal Officers and Program Managers (Approving Authority) are responsible to ensure that all encumbrance and payment transactions are in compliance with applicable Federal and State laws, rules, regulations, and University policies and procedures. Appropriate supporting documentation is to be maintained in office files. Fiscal Officers and Program Managers are responsible for fiscal transactions processed on all accounts under their purview.

Fiscal Officers and Program Managers (Approving Authority) are to review all encumbrance and expenditure reports to ensure that only appropriate transactions (no unauthorized charges) have been processed against accounts within their purview.

The Disbursing Office propriety/legality pre-audit review is directed toward the appropriateness of the payment in consideration of program or Legislative intent and applicable Federal and State laws, rules, regulations, and University policies and procedures. The Disbursing Office also conducts training/compliance reviews with Fiscal Officers to enhance the compliance effort and payment processing efficiency.

Another finding in the draft report that we disagree with relates to segregation of duties. Pursuant to University Administrative procedures (APM) A8.250.9.a, each purchase must be authorized by a responsible official, i.e., the approving authority, in charge of the applicable program to certify that the purchase is consistent with the program it is intended to support. APM attachment 150.2, item b.28) further states that the approving authority must be someone other than the Fiscal Officer/Purchasing Officer certifying as to fund availability. Frequently, the

approving authority and the requisitioner will be the same individual, especially in the case of federally funded purchases for which the approving authority should be the Principal Investigator. In accordance with APM 18.250.9.b. all purchases must be signed by a fiscal officer who will certify as to availability of funds to pay for the goods, services, or construction, and that the purchase is in accordance with applicable University policies and procedures. Therefore, departmental purchasing duties are, at minimum, divided between the approving authority, who certifies that the purchase is appropriate for the program, and the fiscal officer, who certifies that the purchase is in accordance with policies and procedures and that funds are available.

"There is no formal monitoring of program financial information"

We do not agree with this finding. There is financial monitoring at aggregate levels, by unit and fund. This enables the Vice Chancellor of Administration (VCA) to monitor how the allocations are being spent. Detailed expenditure information, unless needed for a specific purpose or to satisfy a specific request, is not necessary at the central administrative level. How much a unit spends for office supplies, equipment, etc. is not relevant to performance evaluation. If needed, this information is extracted from the FMIS data warehouse.

The VCA Office downloads financial information from the warehouse by unit, fund and object of expenditure. Historical data has been compiled in this format for all units. This information was extracted from FMIS, not BLS or the "shadow systems".

"Programs are allowed to exceed their approved allotments"

This finding is correct. However, as noted in the finding, the control is implemented at the campus level. While FMIS has the capability to prevent expenditures from exceeding quarterly allotments, this is enabled only at the campus, not unit level. It was never intended that unit expenditures exactly match their projections, as they are estimates. Situations arise where unforeseen expenditures have to be made in addition to or in lieu of those projected. Generally, where some units exceed their projected expenditures, others will expend less than their projections. A situation where there is a lack of funds for required costs for one unit due to another unit overspending their allotment would arise only if the total allocation was exceeded, not the quarterly allocation. If this situation were to arise, action would be taken to have that unit reverse the over-expenditure.

"Contracts are not properly executed and monitored"

While we accept certain of the following specific findings below, we disagree with the overall conclusion.

"The University of Hawaii at Manoa cannot ensure the propriety of contracts and agreements reviewed"

The Auditor commented that the Manoa campus violated established procurement and disbursement procedures and made questionable use of contract modifications. Our comments with respect to these findings follow:

Natural Sciences purchase – The College of Natural Sciences was unsure of the status of the University's contract for scientific/laboratory products and supplies with a vendor which was entered into through competitive bidding. Previously, the College had requested that the University contract with the vendor for chemicals and laboratory supplies be extended. Although the University attempted to extend the vendor's contract, the contractor did not agree to the contract extension. In the meantime, the purchase in question was made by the College from the vendor based on pricing in place under the prior contract instead of obtaining new quotations.

Payment to University of Hawaii Foundation - The auditor noted one instance in which it asserts that the Office of Procurement and Real Property Management (OPRPM) was inappropriately bypassed. We disagree with the assertion regarding this situation. The UH Disbursing Office contacted OPRPM to confirm the existence of a contract before processing the payment. The University's APM Section A8.861, Authorization for Payment Forms states that Authorizations for Payment Forms (AFP) can be used to process direct payments and should not be used to circumvent established methods to procure goods and services through the use of the basic procurement documents such as the purchase order, services contract, formal contract, etc.

In the case of the aforementioned AFP payment to the University of Hawai'i Foundation, the Disbursing and Payroll Office confirmed that a formal contract had been properly executed by the Office of Procurement and Real Property Management (OPRPM) with the University of Hawai'i Foundation for the services specified, and that the AFP was appropriate to the terms and conditions of the contract. Furthermore, the Disbursing and Payroll Office ensured that the contract number was clearly referenced on the AFP form and the supporting invoice and documentation. Subsequently, in March 2005, after that single incident, Disbursing and Payroll Office took immediate action to ensure that any such payments made by other University programs for the services provided by the University of Hawai'i Foundation under this contract were to be processed in a consistent manner. Disbursing and Payroll Office has since rejected any additional AFP documents submitted for payment under the subject contract and has directed all programs to submit an FMIS Form 41, Contract Encumbrance and Payment Form to OPRPM for purposes of encumbrance and payment processing.

JABSOM building maintenance services - Because the finding fails to specify the particular form involving the service provider, we are unable to respond to the finding as drafted. In light of the fact that the University enters into many contracts with companies incorporated and located outside of Hawaii, we are puzzled by the reference to a form that would require a service provider to be incorporated in Hawaii as noted in the finding.

Emergency flood procurement contract – Actions relating to the subject contract to address the damage sustained from the October 2004 flood were overseen directly by the Vice President for Administration. Under Executive Policy E8.105, the Vice President for Administration has been delegated authority to carry out the responsibilities relating to the acquisition of goods, services, and construction which would include the approval of emergency procurements. The contract in question was approved by the Vice President for Administration prior to the contract being entered into by the Manoa campus.

JABSOM medical library – The subject contract was executed by the University to provide medical library services to the faculty and students of the College of Health Sciences and Social Work, and the Medical School for the period July 1, 2003 through June 30, 2004, with the option for the contract to be renewed annually for a total of five years. The modification cited above

was executed to exercise the option of extending the contract beyond the first year until March 31, 2005.

The failure to document whether the service still met the criteria for a sole source procurement was a documentation oversight based on an assumption by the Medical School that the sole source justification for the original contract applied to subsequent modifications provided that the nature of the service did not change.

Of critical importance is the fact that the documentation oversight did not affect the validity of this sole source procurement action and it is misleading to suggest that this particular documentation oversight is a cause for great concern over Manoa's overall use of contract modifications as the comment suggests. The key fact underlying this transaction is that circumstances supporting the sole source justification had not changed since the original contract was executed and, in fact, these circumstances have never changed over the life of the service which started in 1974. It was commonly known that this private entity was the principal source of medical reference material for the State of Hawaii and the only entity in the State that could provide the services and reference materials sufficient to ensure accreditation of the Medical School and other health science Schools in the University. This fact was the crux of the sole source justification provided with the original contract procurement documentation.

It should be noted that as of April 1, 2005 the University is now able to provide this service in-house and the private entity which previously provided this service has been dissolved. Thus, this service will no longer be contracted.

Audit contract modification - This finding refers to a contract managed by the UH System rather than Manoa. The U.S. Department of Education (ED) issued Preliminary Audit Determination Letters (PADL) to the University regarding Title IV Student Financial Assistance (SFA) findings reported in the PricewaterhouseCoopers OMB Circular A-133 compliance report for the years ended June 30, 2003 and June 30, 2004. The PADL required the University to provide additional documentation to ED by June 30, 2005 in order for ED to issue a Final Audit Determination and authorize continued participation in Title IV SFA programs. The PADL also required that PricewaterhouseCoopers attest to the accuracy and completeness of the information provided by each campus. Due to the stringent deadline of June 30, 2005 and the PADL requirement that PricewaterhouseCoopers perform the review, the University modified its current contract with PricewaterhouseCoopers for the additional audit work.

JABSOM disbursement to RCUH - The Internal Service Order Form for the \$100,000 transfer to RCUH did, in fact, have a justification for the use of RCUH. Documentation on the form is as follows:

"With the occupancy of Phase I of the Kaka'ako Campus in April 2005, infrastructure development, including telecom & other facilities-related infrastructure projects will commence. These projects are on-going and difficult to manage due to the continuous changes made to the scope of work on various projects. Construction in on-going and new projects related to the Phase I Admin/Education and Phase II Research buildings will continue to be developed and implemented. The use of RCUH will enable the School to meet the changing needs of various infrastructure development projects planned for the campus."

The documentation also referenced the back of the form which provides and excerpt of Article I of the internal agreement of July 1, 1996 between the University and RCUH, as follows:

**“ARTICLE I– APPROPRIATE UNDERTAKING and
SERVICES to be PROVIDED the UNIVERSITY by The CORPORATION**

As directed by the UNIVERSITY, the CORPORATION will provide certain services to be rendered in connection with a given research contract or grant. The conditions under which the UNIVERSITY may choose in any given project to utilize the services of the CORPORATION are:

- (a) Projects involving private organizations, or*
- (b) Projects in which there are unusual procurement problems, such as major items of special equipment, or complex equipment construction, or*
- (c) Projects in which much of the operation will lie outside the State, or*
- (d) Projects in which there are human resource problems which might be handled more effectively outside the State or UNIVERSITY personnel system, or*
- (e) Projects in which there is a substantial amount of ship operations, technical shop-type operations, computer services, etc., or*
- (f) Projects involving research facility management where any combination of the above mentioned problems exist, or*
- (g) Projects in which other special problems are present that may be better resolved through the services of the CORPORATION.”*

The documentation on the form referenced item (f) as stipulated above.

The audit comment is somewhat inaccurate, very misleading, and fails to consider the context and circumstances surrounding the reason for the service order. It is important to understand the circumstances which necessitated the use of RCUH to expedite the processing of transactions. The Manoa flood of October 2004 hastened all planning activity for Kakaako in order to ensure that the vast number of Medical School personnel that were dislocated from the Biomedical Sciences Building at Manoa due to the flood damage could be accommodated as soon as possible at the new Kakaako facilities. We had many dislocated people in temporary space in downtown, at Manoa, and even at their homes. The move-in schedule for Kakaako was pushed up to minimize the down time of research and educational activities as much as possible. At the same time, the University Office of Procurement and Real Property Management was severely back-logged because of all of the transactions that needed to be processed for the greater University's effort to address the needs of all Manoa flood victims and facilities. The bottom line is that we had to get the job done to avoid any further losses in productivity and maintain the integrity of our academic programs. It was imperative that we moved fast on a number of fronts to adequately prep for the operations of the new facilities and using RCUH for certain fiscal flexibility made it happen. It was an emergency situation and we responded in the most effective way we felt was possible.

Expenditures made out of the RCUH relate to preparing for the start-up of the operations of the new Kakaako facilities. We needed to move fast with procurement and personnel actions to have Kakaako ready and functioning at full capacity once people started moving in. The Medical School needed to fast track numerous projects like coordinating moves, space usage planning, addressing special requirements related to an EDA grant for biotech incubator space, and setting up of many other ancillary and facility services. Other activities involved building the administrative, operating, and information technology infrastructure to be ready to run the new Kakaako facilities once it was put in service.

The service order was later increased from \$100,000 to \$500,000 as additional funds were needed to support the ongoing activities described above as they progressed over time.

"The University of Hawaii at Manoa lacks formal procedures governing the maintenance and organization of contracts"

The Auditor also noted that The Office of Procurement and Real Property Management does not have established contract maintenance procedures and that the office did not have a consolidated listing of contracts for the Manoa campus.

The Office of Procurement and Real Property Management (OPRPM) maintains its files on a system-wide basis and not by specific campuses. All contracts (including procurement, concession, etc.) are logged and specific contract data may be extracted. In response to the auditor's specific request for contract data, an OPRPM staff member did perform a query of all FMIS contract encumbrances made in FY 2005 and the resulting report was submitted to the auditor's representatives. This report was not compiled from individual listings maintained by the various contract specialists as indicated in the audit report above.

Notwithstanding the above, the OPRPM will work toward a consolidated database dedicated only to the University's contracts. A contract sub-module which will include contract numbering and tracking is included in the list of future enhancements to the ePurchasing system.

"The University of Hawaii's Calculation of the Manoa Campus's Actual Cost Per Student Has Limited Value"

We would agree with this conclusion with the clarification that the University's cost study is sufficient for the purposes for which it was developed and the ways in which the University uses it, in particular, as part of the tuition setting process.

"The lack of an industry standard diminishes the calculation's use as a benchmark"
"Each Institution develops its own method of calculating the cost per student"

We agree with the statement that each institution develops its own method. The state auditor's report provides a thorough and timely discussion of the nationwide efforts to produce comparable information on the cost of education. Their conclusion that the "lack of an industry standard diminishes the calculation's use as a benchmark," is accurate. It is for this reason that the University does not use the costing model as a benchmark relative to other institutions. The use of the model is limited to the internal process of tuition setting. According to BOR policy, the share of the cost of education that is covered by tuition is one factor to be considered in the establishment of the tuition schedule. Thus, the cost model is run each time a new schedule is established but not on a routine basis.

Each of the issues raised by the auditors, (the proportional allocation for research and service, the calculation of full-time equivalents, and the elements included in the model) is clearly addressed in the documentation of the model provided to the auditors. It is the case that

approaches to these issues may vary by institution, but UH's approach is clear and has been consistent over time.

"The University of Hawaii divides total expenditures by the total full-time equivalent enrollment"

The description of the costing methodology used by UH provided in the auditor's report is accurate. The statement that UH does not consistently compute the cost per student is misleading. As noted above, the estimated cost per student is calculated each time a new tuition schedule is established in keeping with BOR policy. Because a five year schedule was approved for 2000-2005, and a six year schedule was approved for 2006-2012, the model was run as needed to establish those schedules. It is not run every year, because it is not needed for the purpose for which it is intended. In fact, running the model on an annual basis would likely produce modest variation. Instead, the expenditure study which provides the expenditures per student semester hour by unit is conducted annually by the Budget office. The definitions used in the study are provided and the study is posted on the web.

"University spending is based upon institutional priorities and available resources"

The auditor provides a thoughtful comment on the variances in expenditures that result from the differences in campus mission and the differences in expenditures demanded by the differences in disciplines, priorities, and resources. The differences in the cost per student by campus within the UH system demonstrates this variation; the variation within the Mānoa campus by discipline reveals equally substantial differences (as evidenced in the expenditure studies). The statement that cost alone does not reflect value or quality is a comment critical to understanding the University's expenditure patterns. The system administration, each Chancellor, each Dean/Director, and each department chair is charged with delivering the highest quality educational services possible given the revenues available. Differences in cost do, however, have implications for managing enrollments to ensure that higher education in the state of Hawai'i is both efficient and effective.

"The University of Hawaii's internal controls cannot ensure the reliability of data used in the calculation"

With respect to the extracted data used for the cost study, the same level of internal controls as is applied for data that will be ultimately be used for financial information to be presented to and relied upon by external third parties is not warranted or required. Control environments are designed and implemented in a manner that balances risks, efficiency and costs within the context of the system and organization relative to the purpose intended. The University believes that its process and methodology used to conduct the cost study is consistent with that of comparable institutions and adequately meets the need for reliable trend information for internal tracking and comparisons.

"The university makes no effort to ensure the reliability of data used in the Calculation"

Contrary to this finding, efforts are made to ensure the reliability of data used for the calculation. While these efforts may appear to be minimal from an auditing standpoint, they are

adequate to ensure that the reliability of the cost study is sufficient for its intended purpose. These efforts include matching expenditure data to year end fiscal reports which are subsequently audited.

With regard to data from the student information system, these data undergo rigorous verification, and it is unclear how the auditor's arrived at the conclusion that "the University makes no effort to ensure the reliability of data used in the calculation." Banner has system edit processes that check for valid data entry and will not allow entry of invalid data codes. Students are able to view their records on-line and notify University officials of any discrepancies.

Data from Banner flows to the Operational Data Store (ODS), the University's data mart, which is refreshed with Banner data nightly. Data critical to management and planning are extracted from the ODS, and ported to the UH student data warehouse. These data are checked for internal consistency against historical numbers, as well as checked for consistency between and among the data sets. Staff troubleshoot discrepancies, sometimes down to the unit record level, comparing the student data found in Banner against data in the ODS. Independent counts on headcount and student semester hours are taken from Banner and ODS by institution to ensure the numbers match.

"General controls for the financial, student information, and human resources systems require improvement"

We concur with this finding. General controls **always** need improvement. The University reviews its General IT Control Environment every year in the context of its A-133 audit conducted by an external auditor. Improvements are made every year in the highest risk areas, but there is always more that can be done in this area and the University is committed to an ongoing program of continuous improvement.

The Legislative Auditor makes two overall comments here:

- a) The University's IT Facilities are completely inadequate. The University agrees and the Board of Regents budget includes a request for funding to remedy this situation. The Legislative Auditor should urge the Legislature to fund this request as one of its Recommendations in this Report.
- b) The University's Business Continuity Plan needs to be improved. The University agrees, but notes that improving the University's IT Facilities as noted above will have far greater impact on business continuity since protection of primary operating modes will have the greatest impact on protecting business continuity.

Nonetheless, there is no evidence that the General IT Control environment has compromised the integrity of any of the data referred to in this Report.

"Application controls for the student information and human resources systems are not formalized"

While we agree that documentation needs improvement, the statement that the University's management is inattentive to application controls is unfounded, with substantial

evidence to the contrary. The University reviews its application controls every year in the context of its A-133 audit conducted by an external auditor. This report involves staff, management and is presented to the Board of Regents each year. Improvements are made every year in the highest risk areas, but there is always more that can be done in this area and the University is committed to an ongoing program of continuous improvement. No control environment is perfect and the University agrees that application controls could be improved with more formal documentation. However, the lack of documentation does not indicate a lack of effective controls.

There is no evidence that any lack of documentation of the application control environment has compromised the integrity of any of the data referred to in the draft report.

The following are our comments with respect to the recommendations in the draft report:

"1. The Chancellor of the University of Hawaii at Manoa should ensure that:"

- a. "A process that clearly links the strategic plan objective to the budget is established and documented;"

We do not see that this recommendation results from any of the findings. As indicated below, Manoa will continue ensure that the link between strategic plan objectives and budget is clearly articulated and communicated to all constituents.

- b. "Budgetary requests and decision are based on the campus and UH system strategic plan."

The instructions issued to the units for the preparation of the FB 2005-07 biennium budget included the requirement that " Program plans, should be driven by the goals, objectives and action strategies articulated in the University's system strategic plan and the more detailed priorities contained in the strategic (academic) plans of the Manoa Campus. As such, program plans and unit agendas should reflect specific goals and related actions planned for the 2005-2007 biennium and deemed essential to achieve the broader goals and objectives of the Manoa Strategic Plan."

In addition, budget objectives which are specified in the Stocktaking document, which were derived from the strategic plan goals and objectives were part of the instructions. The program change request form requirement specifically required that the strategic plan objectives and the budget objectives to which the request corresponds be clearly identified. All requests submitted for the biennium were related to a strategic plan and budget objective.

- c. "The commitment necessary to restructure its budget process is made, including the establishment of formal monitoring and reporting processes to properly evaluate program performance."

We concur. As indicated previously, implementation of this initiative is a long-term ongoing project.

- d. "A process is established to track the Manoa campus's budget as it is adjusted by the University of Hawaii system administration, the Board of Regents, the governor and Department of Budget and Finance to provide the Legislature with the information necessary to make informed decisions; and"

This has been done.

- e. "Fiscal personnel receive the training necessary to develop, and build the knowledge, skills, and abilities that are needed to perform their jobs competently."

The University's Financial Management Office conducts fiscal officer training once each quarter. Training sessions are three days long and cover topics such as budgeting, accounting, purchasing, property inventory, contract and grants, disbursing, payroll, treasury and cashiering. The training includes hands-on sessions on the use of the University's Financial Management System (FMIS). We also provide training to fiscal personnel on all new financial systems, or on major revisions to existing policy. Additionally, we offer "brown bag" training sessions on selected topics such as travel processing, property inventory, purchasing, etc., to address specific training interests of the University's fiscal community.

"2. The president of the University of Hawaii should ensure that:"

- a. "The financial reporting system is enhanced to provide well-designed, accurate, and timely data, allowing efficient monitoring, analysis, and decision-making;"

We concur.

- b. "Establish policies and procedures are updated in a timely matter to reflect current operating practices;"

We concur.

- c. "Contract maintenance and administration procedures are developed to ensure that all contracts are well organized and related contract information is readily available for increased efficiency; and"

We concur and will be addressing this issue in enhancements as part of a contract sub-module planned for the ePurchasing system.

- d. "Contracts and agreements are executed and monitored in accordance with university policies and procedures and the Hawaii Public Procurement Code."

We concur.

"3. The University of Hawaii's Office of Academic Planning and Policy and Budget Office should ensure that:

- a. Principles are established for determining costs applicable to the actual cost per student calculation;
- b. The methodology used is documented, including a detailed analysis, considering all variables factored into the formula, and the actual cost per student is calculated consistently from year to year; and
- c. The Legislature is provided with the methodology and variables used to calculate the actual cost per student, as well as the rationale to interpret the results"

The auditor's report recommends that the model, its underlying principles, and methodology should be documented and provided to the Legislature. Legislative staff have requested and received documentation on the cost of education model; however, whether the cost of education model provides the kind of information useful to the legislature is a matter for further discussion. The current practice of running the model for tuition setting purposes is appropriate and sufficient for the University's purposes. Before a decision is made to increase the time and effort spent on running the cost model, it should be determined what question we are seeking to answer and what the appropriate tools are to answer the question.

"4. The University of Hawaii's chief information officer should ensure that:"

- a. "An overall information technology business continuity plan is developed; and"

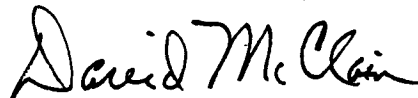
As was shared with the State Auditor's staff, efforts are underway to improve the University's Business Continuity Plan. Funding the IT Facilities as requested in the current BOR budget request by the Legislature would assist in mitigating the single greatest risk to the University's Business Continuity.

- b. "The application controls for the student information and human resources systems are formalized and documented."

The University agrees that improved documentation of the application control environment would be helpful.

Thank you once again for the opportunity to respond to the draft report. If you have any questions or require further information, we would be happy to discuss them with you.

Sincerely,



David McClain -
Interim President

Attachments

c: Board of Regents