



UNIVERSITY
of HAWAI'I*
SYSTEM

President
David McClain

December 10, 2007

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 the opportunity to comment on your draft report, "Systemwide Financial Audit of the University of Hawai'i System: Phase II."

We find the recommendations in the draft report to be unexceptional. Indeed, they reflect and recount actions we have already taken prior to the audit and the report. We will continue to make improvements in these and other areas.

Furthermore, as the report states, the audit was conducted from August 2006 through May 2007; more than six months ago. The findings regarding strategic planning refer to actions taken in 2001 and 2002 and the findings relating to tuition increases relate to the initial supplemental budget request for Fiscal Year 2006-07, which was developed in the spring of 2005. In the meantime, enhancements have been and continue to be made in the strategic planning and budgeting processes, a number of which were already in place during the period of the audit. It is unfortunate that time and energy has been spent reciting findings that are not only dated, but also reflect conditions that had previously been articulated by me, others at the University and our external auditors, and that have been or are currently being revised.

In addition, the report contains a number of errors and inaccuracies and findings where clarification is required.

The following sections of this letter provide our comments on the findings in the report by major headings.

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“The University of Hawai‘i’s Current Strategic Plan Has Limited Value and Does Not Promote Accountability”

The University’s current strategic plan was the culmination of a system-wide process conducted in 2001 and 2002. The audit report asserts that the system and campus plans are not clearly aligned. However, in their support of this assertion, they seem to require that goals “match”, be “identical” or be “one and the same”. If this were the case, there would be no need for campus strategic plans. The system strategic plan acknowledges that campuses have unique situations and different emphases. Accordingly, the system’s planning guidelines encouraged campuses to develop their own goals to reflect the institution’s unique strengths, weaknesses, opportunities and threats. At the same time, the guidelines made it clear that campuses were expected to arrive at plans that were consistent with the system plan. The campus plans were reviewed by the President’s Advisory Council on Plans and Priorities and the Board of Regents.

Specifically with regard to UH Hilo, the audit report references a report to the UH Hilo Faculty Congress and states the auditors “are unsure whether any formal actions were ever initiated as a result of the draft report.” Activities performed as a result of the report, which have not been noted by the auditors include:

- September 2006: The Vice Chancellor for Administrative Affairs issued a white paper tracking the alignment of the budget with the strategic plan. This document is available on the UH Hilo website at:
<http://www.uhh.hawaii.edu/uhh/vcadmin/documents/AligningBudgetwithStrategicPlan.doc>
- Spring 2007: The Chancellor commissioned a Strategic Plan Review Committee, which issued a forty-one slide, data-rich Powerpoint presentation in April of 2007, entitled the Strategic Plan Performance Indicators Update, detailing progress on each goal. This presentation was given to and discussed among the following groups last spring:
 - Chancellor’s Cabinet
 - Vice Chancellor’s Academic Council
 - UH Hilo Faculty Congress
 - The Chancellor’s Executive Committee. This committee comprises campus leadership responsible for passing down the information to their units.
- The UHH Strategic Planning Presentation is also available on the UH Hilo website at:
<http://www.uhh.hawaii.edu/uhh/iro/documents/UHHiloCampusUpdateonStrategicPlan2002-2010--Spring2007.pdf> .

With regard to priorities, as noted in the audit report, the current system leadership recognized the need for further analyses to identify the higher education needs of the state of Hawai‘i and to establish priorities in meeting those needs. The Second Decade Project was

launched by the President to inform the University's decisions as we move toward the second decade of the new century. Presentations on the Second Decade Project are posted on the University of Hawai'i System website at: <http://www.hawaii.edu/offices/app/seconddecade/> The project specifically identified regions of the state that need increased education and training based upon current and projected demographic data. The results of the project also made clear the State's general need for increased 1) education capital, 2) attention to workforce shortages, 3) diversification of the economy, 4) and services to the underserved regions and populations, particularly Native Hawaiians. These needs were confirmed through a series of community and campus meetings on every island. A number of performance indicators were chosen, and a brochure was disseminated that provided the current status of the University's progress on these indicators. This brochure is available on the University of Hawai'i System website at: <http://www.hawaii.edu/offices/app/opp/msn/>

The state of Hawai'i needs were used to prioritize campus requests in the 2007-2009 biennium budget request. Recognizing that there was a need to re-visit the system's 2002-2010 strategic plan, the President launched a strategic planning process under the leadership of the Vice President for Academic Planning and Policy in fall 2007. The purpose of the process was to determine whether the goals of the system plan needed to be revised, whether the action strategies needed to be up-dated, and whether measurable outcomes and timelines could be established. Open meetings were publicized and held on every campus; faculty, staff, students, and the public were invited to attend. Numbers in attendance and the results of their participation is posted on the University of Hawai'i System website at: <http://www.hawaii.edu/ovppp/uhplan/> Based on the input from the participants, it is clear that there is broad commitment to the goals and objectives of the current strategic plan. Participants did, however, indicate that the goals need to be simplified, made more explicit, and that measurable outcomes should be selected. Strategic priorities, measurable performance indicators, and timelines are now in review and will be disseminated to all campuses for further comment.

These system performance indicators will inform the campus plans as well as the 2009-2011 biennium budget proposal. The audit report states that campus goals are not aligned with the current system goals; the objective is, however, to have the campus plans align with the system strategic priorities and the measurable outcomes. That is, the system will provide the priorities for the campuses, and campuses will determine the strategies to attain those priorities in keeping with their mission. This alignment will allow the University's goals to be monitored for progress across the ten campuses.

Campus and system strategic plans are approved by the Board of Regents, and once the indicators are agreed upon by the campus communities, the system-level performance indicators will be shared with the Board as well. At that point the associated costs and funding sources will be determined, and the budget plans will be aligned with the strategic goals.

It should be clear from this description of current strategic planning efforts that the University has been working on the substance of the auditor's recommendations for the past year and more. It is unfortunate that taxpayer dollars were spent in auditors reviewing documents and processes that were already under revision.

“The University Needs to Improve Its Budgeting and Internal Financial Reporting Processes to Foster Accountability”

Exhibits 2.3 and 2.4 in this section of the draft audit report are erroneously titled. They both present information for the entire university system, rather than only Manoa.

In addition, Exhibit 2.5, University of Hawai‘i Approved Full-time Yearly Tuition Rates for Academic Years 2005-06 to 2011-12 (Resident and Non-resident) of the audit report incorrectly notes that "Tuition rates for University of Hawai‘i Community Colleges for academic years 2006-07 to 2011-12 were not available."

When the Board of Regents approved the current tuition schedule on May 19, 2005, increases to the community colleges per credit tuition were approved along with the increases for the other campuses. However, unlike the other campuses where the tuition is "capped" at 12 credits per semester (credits above the 12 credits are taken at no additional cost), community college students pay for each credit taken. For the purpose of this exhibit, the 24-credit per year equivalent should be reflected for the community colleges, as that is the full-time equivalent comparable to the other campuses. This data is presented below for academic years 2005-06 to 2011-2012.

**University of Hawai‘i - Community Colleges
 Approved Full-Time Yearly Tuition Rates for Academic Years 2005-06 to 2011-12**

| | FY 2006 | FY 2007 | FY 2008 | FY 2009 | FY 2010 | FY 2011 | FY 2012 |
|----------------------------|---------|---------|---------|---------|---------|---------|---------|
| <u>Resident</u> | | | | | | | |
| \$/Credit | 49 | 56 | 63 | 71 | 79 | 88 | 97 |
| 24 Credits/year | 1,176 | 1,344 | 1,512 | 1,704 | 1,896 | 2,112 | 2,328 |
| <u>Non-Resident</u> | | | | | | | |
| \$/Credit | 242 | 249 | 256 | 264 | 272 | 281 | 290 |
| 24 Credits/year | 5,808 | 5,976 | 6,144 | 6,336 | 6,528 | 6,744 | 6,960 |

Source: University of Hawai‘i Undergraduate and Graduate Per-Credit-Hour and Full-Time Semester Tuition Schedule approved by the Board of Regents on May 19, 2005

In addition, the audit report states that tuition revenue projections had not been prepared for UH Hilo and UH West Oahu prior to legislative request in December 2005. This is not true. The University Budget Office had been preparing projections of tuitions by campus for many years. In addition, UH Hilo and UH West Oahu prepared projections. These were not required to be included in either the executive or legislative budget submittals. However, when requested by the legislature, tuition revenue projections and related expenditure plans were provided.

Furthermore, the audit report cites events in 2005 while not recognizing that as of January 2006, even before the period the audit was conducted, the consideration of tuition revenues was included as an integral part of preparing the University's 2007-09 biennium budget request as noted in a memorandum dated January 31, 2006 from Howard Todo, Vice President for Finance/Chief Financial Officer and Linda Johnsrud, Interim Vice President for Academic Planning and Policy, to Chancellors and Senior Staff entitled "Biennium Budget Proposal Development". Campuses were required to document tuition and fee revenues as a means of financing for their base budgets as well as for any new initiatives.

With regard to the BLS system, since Phase I of the Systemwide Financial Audit, numerous improvements and enhancements have been made to the BLS system. Expenditure information for example, is now aggregated in 47 separate and unique expenditure categories thereby providing a much greater level of detail. Similar improvements are currently under development to provide the same level of detail for various revenue sources and should be in available during the first quarter of FY 2008-09. Another enhancement is the consolidated variance report that is now prepared centrally and provided to the campuses and Board of Regents on a regular basis. This report summarizes budget to actual variances for each means of financing at the campus level and includes narrative explanations for significant variances. The purpose of this report is to provide the Board of Regents and campus management with a source of basic consolidated financial and budgetary data necessary to effectively monitor operating unit performance and identify issues and problems for decision-making.

"Certain Policies and Procedures Over Contracts and Tuition Deadlines Are Not Clear or Enforced"

The audit report states that the contract with SunGard Higher Education Systems to implement the new Banner student information system was initially estimated at \$13.3M but incurred costs of \$18.8M and suggests that the University did not manage the contract to avoid these additional costs.

The opposite is true. The \$13.3M represented the estimated cost of the software implementation, including software licenses, modifications, consulting and all related expenses. That project was completed on time and under budget. Actual expenses for the implementation of the system were \$12.8M or \$.5M under budget.

The remaining expenses on the SunGard contract since implementation include all ongoing maintenance and support after the implementation project (\$2.4M) and two major upgrades of this complex enterprise software (\$3.8M). These expenses were anticipated and budgeted at project inception as the expected operational costs of the system once it was implemented. As a matter of cost management, ongoing expenses are appropriately and routinely managed through the same contract used for project implementation. Locking in of maintenance and support costs for a multi-year period in the initial contract is a normal and prudent means of controlling cost escalation and thereby obtaining best value for public dollars.

The audit report also alleges that the use of RCUH for assistance in financing the mainframe server was intended to circumvent established procedures, or even more illogically, to avoid the impending need to comply with the requirements of the Hawai'i Public Procurement Code. In fact, the University issued a full competitive RFP in October 2004 to furnish, deliver, install and maintain the mainframe server and the vendor for this project was selected through that public competitive process. The project was designed to be financed over a multi-year period, since the University knew it would be possible to both acquire and maintain a more powerful new server for no more than it was paying just to maintain the older mainframe the University owned. In order to maximize competition and make best use of public funds, the competitive RFP provided for two methods of award: outright purchase and lease. This allowed the University to select the best provider for the necessary hardware and services independent of the financing agreement used to spread the costs over a multi-year period. In addition to the financing options provided for in the RFP, the University examined the costs to use an existing contract with a commercial financing company. And since RCUH had financed previous IBM mainframe purchases for over 20 years, the University also requested that RCUH obtain proposals for financing for this project. Of all the financing options available, one of the proposals obtained by RCUH was the least expensive and was therefore accepted as the most economical use of public funds.

In addition, the audit report asserts in this section that in FY2005-06, the University had 63 encumbrances that had been outstanding for five years totaling approximately \$382,900 and that only 15 of these encumbrances in the total amount of \$129,400 related to valid existing contracts. Our records indicate that at the close of FY2005-06, 21 encumbrances totaling approximately \$155,500 had been outstanding for five years rather than the 63 totaling \$382,900 asserted by the auditors. Therefore, in reality, the valid existing contracts represented 83% of the encumbered amounts as opposed to the 34% claimed in the audit report. These contracts were primarily in the area of architectural/engineering design services and construction in which contracts may stay open for a number of years.

Also, the report fails to mention that State law, specifically HRS 40-90(b), provides that general fund encumbrances for contracts remain valid for five years from the end of the fiscal year in which the encumbrances were made. After five years, the University may request an exemption from the comptroller on a showing of sufficient justification to extend the contract encumbrance. General fund claims encumbrances (e.g. purchase orders, interdepartmental orders, authorizations for payments, etc.), in comparison, remain valid for only 6 months from the end of the fiscal year in which the encumbrance was entered and will be void after that time unless an extension is requested from DAGS. Responsibility for reviewing outstanding encumbrances on a day-to-day basis (and deleting any remaining portion of an encumbrance for which the University's financial commitment has been extinguished) is decentralized to the departmental fiscal officers who administer contracts for which the goods, services or construction have been requisitioned by their departments. Central offices such as OPRPM and Disbursing monitor contract encumbrances on a five year basis and claims encumbrances on an annual basis to insure that encumbrances relating to financial commitments which are still open are not voided under HRS 40-90 and to coordinate the submission of extension requests to DAGS on behalf of all University campuses on a systemwide basis.


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Finally, with regard to tuition deadlines and purge dates, since the date of the audit, the University has made significant strides in identifying and implementing common tuition payment deadlines and purge/disenrollment dates to accommodate the increasing flow of students registering at multiples campuses across the UH System. In the past, each campus set its own policy to meet the needs and unique characteristics of its students.

The University now imposes a tuition payment deadline for the fall semester and one for the spring semester that is common across nine campuses. Beginning in Fall 2008, all ten campuses will adhere to the same tuition payment deadlines. Likewise, with minor variation between the community college system and the baccalaureate campuses, the campuses will have common purge/disenrollment dates.

We appreciate 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,

A handwritten signature in black ink that reads "David McClain". The signature is written in a cursive, flowing style.

David McClain
President

c: Board of Regents