

## **MINUTES**

### **BOARD OF REGENTS' COMMITTEE ON INDEPENDENT AUDIT MEETING**

**MAY 12, 2015**

#### **I. CALL TO ORDER**

Committee Chair Ben Kudo, called the meeting to order at 10:10 a.m. on Tuesday, May 12, 2015, at the University of Hawai'i Campus Center Ballroom, 2465 Campus Road, Honolulu, Hawai'i 96822.

Committee members in attendance: Committee Chair Ben Kudo; Committee Vice Chair Coralie Matayoshi; Regent Jeffrey Portnoy; Regent Helen Nielsen.

Others in attendance: Regent's Chair Randy Moore; Regent's Vice Chair Eugene Bal; Regent Simeon Acoba, Regent Lee Putnam (ex officio committee members); President David Lassner; Vice President for Academic Affairs Risa Dickson; Vice President for Administration Jan Gouveia; Vice President for Legal Affairs and University General Counsel Darolyn H. Lendio; Vice President for Community Colleges, John Morton; Vice President for Research Vassilis Symos; Vice President for Budget & Finance/Chief Financial Officer Kalbert Young; Interim UH Mānoa (UHM) Chancellor Robert Bley-Vroman; UH West O'ahu UH Hilo (UHH) Chancellor Don Straney; (UHWO) Chancellor Rockne Freitas; Hawai'i Community College (HawCC) Chancellor Noreen Yamane; Executive Administrator and Secretary of the Board of Regents Cynthia Quinn; and others as noted.

#### **II. APPROVAL OF THE MINUTES OF THE FEBRUARY 12, 2015 MEETING**

Committee Vice Chair Matayoshi moved and Regent Portnoy seconded the motion to approve the minutes of the February 12, 2015 meeting, which was unanimously approved.

#### **III. PUBLIC COMMENT PERIOD**

Executive Administrator and Secretary of the Board Cynthia Quinn announced that the Board Office received no written testimony, and no individuals signed up to testify.

#### **IV. AGENDA ITEMS**

##### **A. Review and Acceptance of the following Office of Internal Audit Reports:**

##### **1. Report on H-Zone Comments and Observations**

Director of the Office of Internal Audit Glenn Shizumura explained that the Sales Audit of the H-Zone was presented at the February meeting. H-Zone is the successor of Rainbowtique and University of Hawai'i (UH) logo items are sold there. This was the first year of H-Zone operations and during the course of the audit they noted opportunities for

improvement with respect to inventory management and financial reporting and analysis. This report relates to follow up and corrective action on recommendations made by the Office of Internal Audit (IA).

The first observation related to the Retail Management System. H-Zone had difficulties providing IA with reports needed in connection with the sales audit. H-Zone personnel need to become more familiar with certain functionalities and capabilities of the system to improve operations, and facilitate subsequent sales audits. The Athletics Department is currently implementing training on the system that is expected to remediate problems in the future.

The second observation related to contract compliance and addresses two contracts, one related to merchandise provided to a third party vendor in connection with UH home games, and a corporate partner agreement. The third party vendor did not provide the Athletics Department with a recap of sales after each home game per the terms of the agreement, and settling of merchandise sales that was due in fall of last year did not occur until March of this past year. The Athletics Department acknowledged that they did not enforce compliance with the agreement, and will do so going forward. The second contract regarding a Corporate Partner Agreement in which UH received merchandise in exchange for free advertising and tickets to sporting events involved lack of inventory control. They received \$30,000 worth of merchandise and purchased additional merchandise during the year, but as of December 31, 2014 the amount sold did not exceed the original merchandise that had been received at no charge. He added that inventory needs to be managed at a more detailed and broader level.

The third observation related to inventory management and found that the majority of inventory acquired was in back stock and not on the sales floor. These issues relate to how inventory is actually managed and the need to more closely monitor and purchase inventory as required.

The fourth observation related to financial report and analysis. H-Zone had difficulties producing financial reports for the sales audit, and there were inventory valuation issues where certain costs were not included, and certain inventory that was unsalable was not written down to net realizable value. The Athletics Department is now familiar with these processes and they will do so going forward.

The last observation related to untimely recordation of sales in the Kuali Financial System (KFS). There was a lag in August and September such that those sales were not recorded until October. IA has looked at subsequent deposits and sales and everything appears to be in order. The Athletics Department will now make deposits from proceeds on a daily basis.

He noted that in the materials is the Athletics Department response and corrective action plan. IA reviewed this plan and agreed with how issues are being addressed.

Regent Portnoy commented about how the report was very distressing and that the kinds of errors, mistakes, and failures at H-Zone in the first six to eight months are not to be tolerated. To have it discovered during the course of an audit is not the way these

things should be addressed. To have this kind of mismanagement at H-Zone on basic retail issues is beyond comprehension and will not be permitted to continue in the future. He wanted to send a message to H-Zone that even though they have come up with corrective actions, he requested the committee be provided a report no later than 60 days from today on each item contained in the report and the status on all issues that have been addressed.

Committee Chair Kudo commented about his understanding that this particular venture started off with several people quitting and the lack of retail experience and knowledge being part of the reason for the shaky beginning. John McNamara, Associate Athletic Director for External Affairs, introduced Felix Calvo, the new H-Zone Director, who has been on the job for two months. AAD McNamara said Mr. Calvo had extensive retail experience and took the lead on corrective actions. Mr. Calvo said the inventory issues were addressed; they are working with the financial department to ensure proper approvals are in place prior to vendors shipping products to the stores, and that inventory is put on the floor for sale as soon as possible. They are working with the financial department to ensure sales and gross margins are done on a monthly basis, and deposits made on a weekly basis.

The committee had questions on how financial performance had been for the last six months; and what was the basic rationale for establishing H-Zone, if there were any projections in a business plan regarding what receipts should be, and what was the likelihood of success.

Mr. Calvo responded that H-Zone was about \$79,000 in the black right now, with all expenses paid. He agreed to come back to the committee in a couple of months and provide a report on corrective actions. AAD McNamara added H-Zone was developed through conversations with the previous chancellor and athletics director on revenue opportunities for the department by utilizing merchandising to help with the department's deficit. Going into this year, a business plan was developed based on minimizing upfront costs that included an extensive corporate partnership agreement with the Howard Hughes Corporation, the owner of Ward Centre, who offset \$110,000 of lease related costs. Trade deals were done with other corporate partners in terms of prepping the store with carpeting & flooring, painting, business-related wiring, telephone, internet, and security, which took close to \$108,000 worth of expenses off the books to help ensure they had the most efficient net at the end of the year. Rainbowtique had several tough years prior to being taken over. The goal for the first year was to generate black ink. There have been about \$1 million in sales this year, they are looking at a net right now based on projections of \$79,000, and going forward they anticipate increasing that figure by 22% next year, a goal they feel is very attainable. He added that they had six months to prepare for this launch and knew there would be challenges, they appreciate the recommendations and observations of IA, every single one of those issues will be corrected, and they are confident about the future of H-Zone.

**2. Update on Status of Corrective Action for Kapi'olani Community College and Leeward Community College Culinary Arts Programs**

Director Shizumura said last spring IA performed an evaluation of both Kapi'olani Community College (KapCC) and Leeward Community College (LeeCC) culinary programs in connection with the Fiscal Year 2013 Audit Plan. They evaluated the status of addressing the recommendations of Internal Audit. Both programs were still in the process of addressing most of the recommendations, so IA deferred performing additional procedures, and subsequently performed more extensive procedures during the winter of 2014. This report summarizes what those procedures were and combines the two reports.

The report contains background information regarding what was previously done by IA and objectives, and the overview section summarizes the evaluation of both programs and where they currently stand on implementation of recommendations. Subsequent pages provide detail on prior issues and a status of corrective actions for each campus. Page 3 pertains to inventory, and is one of the more significant areas that IA audited. It was noted in initial reports that both programs were not segregating and managing inventory for instruction and sales separately, and were uncertain how much inventory was being purchased and used, or sold in connection with the retail establishment. IA recommended that inventory be managed at a closer level, separated and tracked, compared to projections, and monitor if there was any pilferage or spoilage.

Currently, both programs have made substantial progress. KapCC implemented the majority of recommendations, problems with the inventory system persists regarding valuation that was corrected last month. LeeCC improved inventory management, and are installing a system that will be integrated with their point of sale system.

Regarding financial operations, historically neither program measured the financial operations of their food operations from either an instructional or retail standpoint. Financial reports were not really being produced, and the reports that were produced contained unsubstantiated numbers. IA recommended the programs work with their business office to implement recommendations. Things have improved except for reconciliation of financial information to KFS, and IA has stressed the importance of working with the business office to address this issue and fully implement the recommendations.

KapCC had issues regarding collecting outstanding accounts receivables. They continue to improve for the last three years, but work is still needed to collect on the older receivables that remain outstanding. A large amount of receivables that remain outstanding involve the catering operations. For the last two years, the catering program generated \$1.7 million of revenues. More oversight at the dean or chancellor level is recommended regarding fee waivers, security deposits, menu price adjustments from published amounts, and ensuring revenues from catering operations are reported. Other issues related to gift certificates at KapCC, the lease with Subway at LeeCC, and timely rental payments at KapCC Farmers' Market have all been resolved.

The last comment related to Sales and Cash Receipts Process and Controls. KapCC corrected segregation of duties and controls with the General Cashier, but still outstanding is incompatible reconciliation and separating control duties between the chair of the culinary program, and the business office. LeeCC had issues with tips and

donations at The Pearl restaurant not being handled in accordance with the policy. The issue has since been corrected, however, the individual at LeeCC who oversees this activity needs to ensure receipts are being deposited into the University of Hawai'i Foundation account and used for intended purposes.

The committee expressed comments and concerns on how the issues in the audit were basic business 101, and it was very distressing to have tens of thousands of dollars uncollected given the tremendous pressure the university was under to look at expenses and figure out a budget; that the campus should pursue the accounts receivables and not write them off, when would the additional liability insurance be triggered, and if there was additional liability insurance for the KapCC Farmers' Market; that the students and chefs should not be blamed, as the functions should be at the campus level; the culinary programs were economic producers at the university and why it took an audit to discover these basic financial problems; the culinary programs produce an excellent product and have an excellent reputation that they should be able to cover instructional inventory through retail operations; if the Adaco inventory management system is workable; and if the Uluwehi Café at LeeCC program was run by students.

Director Shizumura responded that the programs are following up on accounts receivables. The additional liability insurance is being looked at right now as the university is self insured to a certain level, requiring purchasing third party insurance to supplement coverage. The university does not want to assume the risk at the lower level because that should be incurred by whoever is running the operation. He added that the KapCC Farmers' Market organization needs to acquire its own insurance.

Associate VP for Administrative Affairs Mike Unebasami added that there are courses related to inventory control and management. It has become apparent they need to do a better job running the food service and culinary programs like a business, especially at the fine dining operations and also the cafeteria operations because those are run as service units and not instructional units. To some degree the culinary chefs have been tasked with running a business, and the university is working on providing assistance in this area, by getting the business offices involved in reconciliation and management of financial resources, and addressing inventory management of both the sales and instructional side, utilizing KFS to do a better job in reconciliation and job reconciling things and ensuring separation of duties and responsibilities. The Office of the Vice President for Community Colleges is monitoring the programs to ensure everything is properly done from a financial perspective, and will apply this information to other operations on other campuses. They are looking at all programs (credit and non credit) that generate income to ensure things are being done properly from a financial perspective.

Regarding covering instructional inventory through retail operations, AVP Unebasami concurred, given the success of the programs, especially the high end programs. They are currently looking into separating the instructional program from the service side (e.g., KapCC culinary program handling food service in cafeteria), and assessing how to better accommodate the food service needs to the general population on campuses while maintaining the level of instruction for the culinary programs.

AVP Unebasami explained that the Adaco system was selected by the culinary programs for managing inventory, and the lack of training and turnover of personnel resulted in the system not being utilized to its full potential. Improved training is underway to run the program properly and the issues with extension of costs have been resolved. They plan to assess performance to determine if an alternate system is required.

Regarding Uluwehi Café at LeeCC, it is not run by students to separate the culinary instructional side from the cafeteria food service side. Many mainland universities that have culinary programs have separated/contracted out food service operations. They are looking at different ways to do that, but have run into Safe Harbor tax issues because the facilities are tax exempt revenue bonded.

Committee Chair Kudo requested, and AVP Unebasami agreed, that they will report back to the committee in 90 days on exactly what types of measures have been instituted to address the IA issues, especially cash reconciliation and inventory control.

Chair Moore asked what the general procedure was for ensuring audit findings get resolved. Director Shizumura responded that to the extent there are pending matters, IA will go back and determine within a year or two if there is compliance.

### **3. Report on Correction Action – Auditee Status**

Director Shizumura said this was a compilation of four reports issued last year on the KapCC Office of Continuing Education & Training; UHWO Operational & Financial Review; UHM Associated Students of the University of Hawai'i (ASUH); and Revenue Bond Post-Issuance Compliance.

KapCC Continuing Education business plan. The Office of Continuing Education & Training (OCET) at KapCC prepared a new business plan for 2016-2021 but requires a plan for managing and auditing the achievements of goals and objectives in the 2013-2015 period. The report has not yet been approved by the chancellor, and IA is recommending there be a plan for measuring and monitoring going forward. IA will work with AVP Unebasami on monitoring progress. From an operational standpoint, more work is needed on written guidelines and policies regarding decisions on course offerings; classification of instructors, hiring independent contractors and casual hires; and performance evaluations for instructional faculty. IA is still evaluating the corrective action plan put together in last year. From a financial standpoint, there are still questions with respect to the completeness and accuracy of their Student Information System (SIS), and IA recommended OCET compare and reconcile revenues between the SIS and the university's general ledger. In terms of the operational questions and performance evaluation matters, all recommendations have been implemented. The business plan and reconciliation of financial information still need more work.

UHWO Operational and Financial Review. This review of certain strategic, operational, and financial areas was done at the request of the UHWO chancellor. IA found that from a strategic standpoint the response rate for completing the conflict of interest forms improved dramatically, and UHWO created a new strategic plan that was accepted by the Western Association of Schools & Colleges (WASC) resulting in

accreditation being extended. Operationally IA's concern about the IT disaster recovery plan has been mitigated. Performance evaluations for Administrative, Professional & Technical (APT) employees have improved substantially; however, evaluations of civil service employees are still outstanding probably related to the increase in civil service employees as the campus expanded. UHWO understands they need to closely monitor whether supervisors are performing evaluations. From a financial standpoint, IA had some questions on first year operations because of how certain costs were being classified. UHWO will be consulting the financial management office for guidance to ensure proper classification of complex, non-routine transactions.

ASUH. IA conducted operational audits of specific areas at the request of ASUH. In the past three years, ASUH instituted many policies, revised practices, and addressed the concerns and recommendations made by IA.

Post-bond issuance compliance. The university engaged consultants BLX Group LLC to assist with drafting policies and evaluating the structures in financing revenue bonds. IA feels the issues have been adequately resolved. All bonds that have been issued have no private business use issues and the policies that have been drafted will address all concerns going forward.

The committee asked what the significance of private use was and Director Shizumura responded that if they exceed the 10% threshold for private use the revenue bonds becomes taxable.

## **B. For Information:**

### **1. Next Steps towards Development of the Cancer Center Business Plan**

UHM Chancellor Bley-Vroman gave an update on the status of the business plan. Dr. Jerris Hedges, the new interim director, was tasked with working on the business plan going forward. The Center is in a challenging situation, and like the Athletics Departments, has chronic problems that need to be solved, and both departments have new leadership. This was a preliminary plan which contains a conservative realistic analysis of the problem being faced at the Center and how to address things going forward.

Another important contribution of the plan is the emphasis on the value proposition for the Center and the importance of the Center and the National Cancer Institute (NCI) designation to the future of the Center. At the urging of the board, Director Hedges consulted with members of the community with expertise in developing the plan with input beyond the Center. The plan is a work in progress that needs a complete business plan moving forward that includes a proposal, sustainable and revenue generating. He and President Lassner are collaborating on developing a Request for Proposal (RFP) with external consultants to procure a group of both local and national experts, which will be tasked with reviewing the figures to ensure credible analysis of the present situation and a proposal to move the Center forward. They understand the urgency of having a viable plan and plan to bring it back to the committee as soon as possible.

He acknowledged that a viable, credible, long-term plan was necessary to generate support from the Cancer Center consortium other hospitals, and the Legislature, especially if the Center is going to request more funding. He added that the philanthropic area of the plan needs more development.

The committee had the following comments and concerns: the plan and discussions to date do not include any viable alternatives to fundraising at a time when the university's budget scenario is precarious at best; the plan did not explore all options because it started with the premise that the Center was needed and the only options presented were continuing with/without NCI designation; the apparent self interest of the plan's author in keeping the center and making it part of the John A. Burns School of Medicine (JABSOM); reiterated the need for an unbiased look at the full complement of options moving forward; that others that were recommended to consult on the development of the plan were not contacted; that the report fell very short of expectations, resulting in further delay to redo the plan; and that it was premature to publicly release the plan before administration performed a third party review.

Committee Chair Kudo requested administration to come back to the committee once they have an idea of what will be done and before any contracts are released, to let the committee know exactly how they are proposing to proceed. Discussion ensued on scheduling consideration as the RFP may be ready to issue in a few weeks, and the importance to get input.

The committee agreed with Chair Moore's suggestion that administration work closely with the Chair and Vice Chair of the Committee on Independent Audit to ensure the appropriate points are covered in the RFP before it is issued.

Regent Acoba highlighted the benefits of the original that plan touched upon the three primary actions of continuing the Center and under what conditions; the impact of not continuing the Center; and the feasibility of aligning UH with an institution that would have NCI designation. It provides for the record the positions of those people closest to the medical school and the Center.

Committee Chair Kudo clarified that the plan itself has useful information but it falls short of expectations to provide options available given the length of time it took to produce. They would be farther ahead if things that were laid out at the February meeting had been done and vetted in April as originally expected.

President Lassner concurred that they need options that include a clear understanding of revenue opportunities and more detail (public and private, philanthropy, intellectual property), including if there are any revenue opportunities from the clinical trials program optimizing on the utilization of the building and assets which both the board and Legislature have made inquiries about; and a third party review of costs to provide credibility. It is clear that investment is needed, but can only be supported with an understanding of the whole package being vetted and the opportunities over time.

Committee Chair Kudo said from his perspective any study starts with the penultimate question of whether you actually need it, and if the answer is yes, then you look at various



options and feasibility. The problem with this plan is it started with the premise that we need the Center, without analysis or justification. The regents have the fiduciary duty to look at all options for all programs and buildings in order to be responsible to this institution. There is a logical way of proceeding and he hopes the RFP starts with the penultimate question, and not an assumption that we need it. Regent Portnoy noted that the second question should be whether we can afford it. Committee Vice Chair Matayoshi added that even if the Center is needed, how are they going to pay for it and is it realistic; it is very important to have a third party assess the feasibility of the plan.

**C. Recommendation to Approve Selection of External Auditor and Delegation of Authority to the President to Finalize Agreement Fee Schedule**

VP Young noted pursuant to Hawai'i Revised Statutes (HRS) §304A-321, it is within the authority and purview of the Committee on Independent Audit to select the external auditors for the University of Hawai'i System. The existing contract with the current auditors for the previous fiscal year has concluded, so they need to procure the next external auditor. He gave a presentation that covered: the selection process for auditor procurement; the external audit services selection committee; selection criteria; selection results; background information on Accuity LLP, the selected bidder; the approval request; the scope of external audit services and fees; notes to the fee table; and what Accuity LLP fees would be without assistance from IA.

The committee had comments and concerns on: the number of other bidders; how the other bids compared in terms of cost; if anyone submitted a financial bid, and why that was not a consideration; what was the value to the university of having an independent audit of the Athletics Department; if the fee proposed by Accuity LLP is in line with the market and with their past services; what was the total number of criteria points and the differential between the top bidders; if blind proposals were submitted; how long Accuity LLP has work with UH; that the criteria appeared to favor companies with established relationships with the auditee; if the Securities & Exchange Commission advisory about rotating audits was taken into consideration during evaluations of proposals; and what the university would be responsible for if it cancelled the contract with 30 days notice.

Susan Lin, Director of Financial Management & Controller and chair of the selection committee said they did not go out for cost bid for the other competitors based on HRS rules and instead followed the state procurement process. They asked for a proposal and went through criteria to determine which company received the highest points based on the criteria. There were six firms that submitted proposals and Accuity LLP had the highest points, with a 31 point difference between them and the next highest competitor. Under procurement rules, companies are asked to provide proposals based on their experience, past performance, and company resources, without financial information or costs. VP Young added that under the procurement statutes for certain types of services there is a request for qualifications process, auditing services being one of those services. The review is for qualitative reasons of selection, which was the process used here to select the external auditor. After selection is made, the price is negotiated with the selectee and if no conclusion on price is reached, they are free to go to the next selected company.

VP Young said the independent agreed upon procedures audit of the Athletics Department was a National Collegiate Athletic Association (NCAA) requirement. Ms. Lin said the selection committee consulted with the Athletics Department and it was a management decision of the department to continue to have an external audit of their financial reports and provide official statements back to the board and the university. Chair Moore noted that essentially all the profit from the H-Zone goes towards auditing costs.

In terms of Accuity's fee being in line with market, VP Young said based on the services provided, the historical amounts charged for the exact same audits, compared to auditing services done at the county level (e.g., neighbor island counties with similar budget sizes to UH) and state level, these fee rates are in line with what should be expected, and are slightly less than he would have anticipated based on historical rates for UH. He felt the rates being asked are well within alignment.

VP Young said the based on the selection scoring criteria and the number of selection committee members, the maximum total points available equaled 80 to 100, and the 31 point difference between Accuity LLP and the next highest firm is a significant difference in the qualitative assessment. They knew the bidders, which is typical of many of these types of professional services throughout the state. Experience does weigh heavily in scoring and strong consideration is given to familiarity of contractor with operations. Ms. Lin added that each firm provides recommendation letters from organizations for whom they have done audits that are taken into consideration by the selection committee.

Ms. Lin said that UH has worked with Accuity LLP for 8 years. The criteria are dictated by the HRS, and the points placed on the experience criteria, but the committee's concern that the criteria appears to favor companies with established relationships with UH was well taken. She felt they were aligned with rules, and by selecting Accuity LLP and rotating partners they meet the rules. She indicated that the rotation requirement was not a requirement under the procurement code in the HRS. VP Young added that there was not a way to penalize or exclude a contractor because they had previously done work for the state. It is best practice to rotate auditors, and the SEC has generally said it is a good idea to see auditor rotation, but there is no requirement, especially in the public sector.

VP Young said the contract going forward with Accuity LLP is less than previous years. Mr. Kubota explained that Accuity LLP made a conscious decision to decrease the proposed fee amounts taking into account some new efficiencies. For example, university's implementation of KFS has greatly improved financial reporting capabilities, and UH earned the deduction in fees because Accuity LLP is spending less time working with the legacy financial management system. In terms of Accuity LLP providing value to the contract going forward, he felt they were objective from the beginning of the relationship with the university and noted they have professional standards they have to abide by. They see the importance of the university's place in the state economy, the university being the steward of educating Hawai'i's future, and the sheer volume of dollars the university spends from the federal government. They take their job seriously and spend thousands of hours performing the various university audits. If there are issues they raise them, they are accountable to the regents and the Committee on Independent

Audit.

Regarding terminating the contract, Mr. Kubota said all state contracts are subject to availability of funds and can be terminated at will. As a contractor, Accuity LLP is entitled to seek compensation for the time they have incurred to the point of contract termination. However, the process of negotiating a three year agreement is to essentially determine the price for the next three years, but the service itself is up to the university and the Committee on Internal Audit to decide to continue retaining Accuity LLP.

Regent Nielsen moved that the committee recommend the board approve selection of the external auditor and delegation of authority to the president to finalize the agreement fee schedule. Committee Chair Matayoshi seconded the motion and the motion carried upon unanimous approval.

## **V. ADJOURNMENT**

There being no further business, on the motion of Committee Vice Chair Matayoshi and second by Regent Portnoy and with unanimous approval, the meeting was adjourned at 11:48 a.m.

Respectfully Submitted,

/S/

Cynthia Quinn  
Executive Administrator and  
Secretary of the Board of Regents