Washington State Auditor's Office

Troy Kelley

Integrity • Respect • Independence

Audit Of The University Of Washington

Higher Education Dedicated Local Funds And Operating Fee Accounts

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Executive Summary

The University of Washington (the University) was established by the Legislature of the Washington Territory in 1861 with the "aim and purpose" of providing students with a liberal education. After more than 150 years, the University has evolved into a major research University operating 16 colleges and schools, a School of Medicine, three hospitals, Airlift Northwest, and UW's share of two joint ventures.

In 2013, the University enrolled more than 53,000 students on its three campuses. During the same period, the University operated on an adopted budget of $5.9 billion, of which slightly over $1 billion represented core operations, which include State appropriations and student tuition. State appropriations in 2013 were $209 million of the total $1 billion core operations shown below ($253 million in 2014 respectively). The components of the University's budget were as follows (*in millions)*:

Budgetary Area	2014 Proposed	2013 Adopted	Difference*
Core Operations	$1,138	$1,053	$85
Research	$1,090	$1,165	($75)
Medical Operations	$2,835	$2,763	$72
Other	$982	$924	$58
TOTAL OPERATING BUDGET	**$6,045**	**$5,905**	**$140**

**dollars in millions*

Although the University is technically an agency of the State of Washington (the State), the University operates with considerable autonomy and discretion compared to conventional State agencies in its educational and business activities. This is due in part to the fact that the University receives only a small portion of its support from State appropriations. Tuition, fees, grants, contracts, gifts, and operations of its hospitals generate the vast majority of the University's operating support.

Clarity and transparency called for in Higher Education Accounting

During spring of 2014, the Washington State Legislature passed ESSB 6002, requiring an audit of two of Higher Education's major accounts. The bill mandated a review of all expenditures, revenues, transfers and fund balances for the previous six fiscal years. The requested audit called for clarity and transparency in the accounting and use of these funds. Subsequent action by the Governor focused the scope of the audit on only the University of Washington.

The audit identified different financial statement reporting models as a factor creating a lack of clarity and transparency in understanding the University's accounting. Current accounting standards require state governments and universities to report using different accounting rules. Governmental Accounting Standards permit universities to maintain accounts and create financial statements similar to a commercial business; however, when these accounts and transactions are merged with the rest of state government for the statewide financial statements, they lose much of their distinct identity.

The report explains that 21 universities defined as peers are reflected in their state wide financial statements differently than the State of Washington presents the University of Washington. These peer universities are included in the state's financials as separate columns. Colleges and Universities in Washington are not reported in a separate single column on the State's financials. Rather, they are blended across all relevant funds in the State's financials with other Agencies. In particular, the report by Sjoberg Evashenk suggests that the blending of the University of Washington's financials with other agencies creates a lack of transparency to the readers of the State's financials.

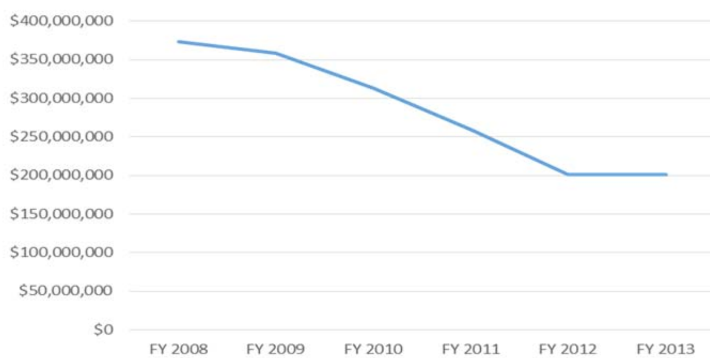
Another contributing factor is the University's large and extensive operations, of which only a minimal amount is "State" business. This means a portion of University's financial activities are not captured in the State's financial system and statements. For example, Harborview Medical Center, a major operation managed by the University, is not a State hospital and although accounted for in the University's accounting system, is not reflected in the financial statements of the State. Further aggravating the issue are the required differing reporting formats which confuse and restrict the ability of the legislators and stakeholders to understand the University's financial information.

Higher Tuition with decreased State Appropriations

The two accounts selected by legislators for review consisted of Fund 148 and Fund 149. Of these two accounts, Fund 149 contains tuition, net operating fees, though non-appropriated this fund is subject to some State budgetary oversight (e.g. allotment procedures). Fund 148, on the other hand, is the University's central depository and clearing account for the University. As such, many of the funds deposited into this account are not "State" funds. The University receives nearly all its funds into Fund 148 and later transfers the monies as required.

Fund 149 - The review of tuition operating fees found that in the six years under audit, both enrollment and tuition rates at the University have steadily increased as State appropriations have decreased. From 2008 to 2013, State's appropriations have decreased by 46 percent, while tuition operating fee revenues have increased 99 percent. The overall effect of these changes was an increase in revenue from $277 million in 2008 to $550 million in 2013. Approximately 80 percent of monies in Fund 149 were for compensation-related expenses. The audit found moderate increases in compensation-related expenses and the number of personnel, and an overall increase in Fund 149 spending of nearly 14 percent during the six years under audit.

AFRS Account 001 State Appropriation



Fund 148 - The analysis of Fund 148, the University's "clearing account," showed a more moderate increase in revenues, from $415 million in 2008 to $592 in 2013. On the other hand, despite the more modest increase in in revenues, the spending related to these accounts have decreased from 98 percent of revenues generated in 2008 to 82 percent in 2013. As noted previously, due to the nature of this account, thousands of transfers in and out of Fund 148 were made to place funds and expenditures to appropriate pools. A high-level review of these transfers found the transfers to be reasonable and for allowable purposes.

Summary Recommendations:

Although only requested to review the University in regard to the two State accounts, the report by Sjoberg Evashenk determined that the issues of contention between the State and University were more far reaching and therefore provided additional analysis and recommendations to assist both the State and University.

1. Since the University and State are required to follow different accounting guidelines and both have aging financial systems, the University often has difficulty meeting the State's deadline for year-end financial reporting. The University should work more closely with the State to develop processes that will meet the State's needs for timely financial information.

2. The State, legislative staff, and University each follow different processes. The different parties need to discuss the different tools used to forecast and budget for operating fees, such as tuition. The lack of consistency and different models used by the various parties undermine the accuracy and credibility of the data.

3. The Legislature and the State are not using useful, complete, or reliable University data. The University issues audited financial statements following a business type activities format. The report suggests that a "wealth of information can be gleaned" by the State and Legislature reading the University's statements rather than relying on the statewide financials alone.

4. The University does not have a centralized resource for fiscal policies. The University should consolidate policies, procedures, guidance, and tools online.

5. The University has decentralized fiscal information. The University should create a central repository of key fiscal records.

Washington State Auditor's Office
Audit of the University of Washington
Higher Education Dedicated Local Funds and Operating Fee Accounts

The Washington State Auditor (SAO) engaged Sjoberg Evashenk Consulting, Inc. to conduct an audit of two major State accounts—Higher Education Dedicated Local Account (148 Account) and the Operating Fee Account (149 Account). This audit, as a proviso of the 2014 supplemental budget, ESSB 6002, focuses on the University of Washington (UW) and its three campuses—Seattle, Tacoma, and Bothell. The legislative intent of the audit is to gain insight into the use of the funds in these accounts—particularly ensuring that funds collected for tuition and other fees are used as intended and that State funds are spent appropriately. The Legislature directed that the audit examine the accounting for the two accounts, determine and provide clarity in the use of these funds, and to make recommendations for improvements that will afford greater transparency and clarity and ensure the appropriate accounting for the related revenues and expenses.

Introduction

Sjoberg Evashenk Consulting conducted the field work for this audit of AFRS Account 148 and AFRS Account 149 over a four-month period beginning in July 2014. The results of our work is presented in this report. We have organized the results in nine sections—each addressing a key question, as highlighted in the following:

- Section 1. University of Washington—The Entity: This section addresses the background, overall structure, and fiscal operations of UW.
- Section 2. Higher Education Operating Fees Account (AFRS Account 149) and Higher Education Dedicated Local Account (AFRS Account 148): This section introduces the nature of the two accounts under audit.
- Section 3. AFRS Account 149 Revenues and Expenses: We describe the results of our audit work to identify and assess the revenues and expenses included in this AFRS account.
- Section 4. AFRS Account 148 Revenues and Expenses: We describe the results of our audit work to identify and assess the revenues and expenses included in this AFRS account.
- Section 5. Revenue and Cost Transfers: In this section, we describe the purposes and nature of these transfers relating to both accounts.

- Section 6. Use of FAS Fund 148 as University Operating Cash Account: We describe how FAS Fund 148 is used for "central paymaster" purposes and how monies are tracked and accounted.

- Section 7. Internal Lending Program: Pertinent to our audit of AFRS Accounts 149 and 148 is UW's program for capital project internal lending. In this section we discuss the program and its impact on the two accounts.

- Section 8. AFRS Accounts 149 and 148 Fund Balances: In this section we provide the results of our analyses of the contents of the two fund balances as well as reconciling the ending fund balances between UW and State accounting records at June 30, 2013.

- Section 9. Conclusions and Recommendations.

As required by auditing standards, the views of the University of Washington are presented at the end of this report.

Scope and Methodology

The scope of the project includes the three fiscal biennia beginning with 2007-2009 through 2011-2013. SAO required that this engagement be conducted in accordance with generally accepted government auditing standards, GAGAS, more commonly known as Yellow Book standards.

SAO and the legislation identified the following to be accomplished within the audit:

> *For the 2007-2009 through the 2011-2013 fiscal biennia, a thorough examination of the accounting, as required by governmental accounting standards board requirements that govern accounting functions of the Office of Financial Management (OFM), of:*
>
> - *All revenue into these accounts;*
> - *All expenditures out of these accounts;*
> - *All transfers to, from, and within these accounts.*

Further, the audit is to include:

> "*A narrative summary of the management and uses of these accounts by the institutions of higher education, including an explanation of the reserve policies implemented by the institutions of higher education that govern the fund balances in these accounts."* Additionally, the audit will provide "*recommendations to improve current practices that will support the ongoing clarity, transparency, and accurate accounting of the use of these accounts in a manner that satisfies the governmental accounting standards board requirements that govern accounting functions of the Office of Financial*

Management and that aligns with the Legislature's intended use of these accounts."

We conducted an audit of the two accounts, AFRS Accounts 148 and 149, and provided the State Auditor's Office with a proposed project plan on July 30, 2014. In concert with the approved project plan, we applied a variety of audit tools and techniques to address the audit objectives that included:

- Gaining an understanding of UW's financial environment by reviewing financial policies and procedure manuals; previous audits and management studies; relevant organization charts; and other background information.
- Reviewing and analyzing State rules, regulations, and guidance pertinent to the two accounts.
- Interviewing key UW staff, including staff from internal audit, office of planning and budgeting, treasury, financial management, financial accounting, and State relations. We also interviewed management from the State's Office of Financial Management (OFM).
- Determining UW's policies related to the two accounts; identified core and ancillary business activities and internal controls, and completed walk-throughs of relevant revenue and expenditure operational cycles and methods used in accounting for and reporting financial activities.
- Obtaining documentation and other evidentiary materials for the two accounts for the 2007-2009 through 2011-2013 fiscal biennia, including:
    - ✓ Operating budgets and spending plans
    - ✓ Revenue and expenditures
    - ✓ Revenue and cost transfers
    - ✓ Course fees
    - ✓ Fund balance data and related reserve policies
    - ✓ Approvals and authorizations required and used in accounting and reporting revenues, expenditures, and transfers
    - ✓ Internal lending program information and data
- Gathering and analyzing volumes of on-line data and statistics from UW and the State of Washington relating to fund classifications, account classifications, OFM and UW guidance, electronic budgeting systems, annual and biennial budgets, tuition and fee factors, enrollment, staffing, etc.
- Performing analyses to address the audit questions, including:
    - ✓ UW and State systems and processes to budget and account for UW's activities within AFRS Accounts 149 and 148 and processes to monitor and control utilization of funds
    - ✓ Generation and utilization of revenues and expenditures associated with AFRS Accounts 149 and 148

- ✓ Revenue and cost transfers that occurred within AFRS Accounts 148 and 149 and determined the reasonableness of such activity
- ✓ Use of UW's FAS Fund 148 as the University Operating Cash Account
- ✓ The nature of UW's Internal Lending Program and determined any corresponding impact on AFRS accounts 148 and 149
- ✓ AFRS Accounts 148 and 149 fund balances and associated reserve policies
- ✓ Various GASB, National Association of College and University Business Officers, National Association of State Budget Officers information and other provisions relating to higher education accounting and reporting, specifically analyzed relevant GASB pronouncements that are used in managing the two accounts

We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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SECTION 1. University of Washington – The Entity

Before addressing the key provisos outlined by the Legislature, the unique and complex nature of University of Washington financial, budget, and accounting activities need to be understood. In this section, we describe:

- Governance and Operating Components
- Accounting and Financial Systems
- Fiscal Policies and Procedures
- Funds and Accounts Structure
- GASB Requirements
- Comparing Government and Business Activities Reporting

Finally, we provide the relationship of UW accounting to the State's financial repository and the difficulties and challenges that the differences between the two systems create.

Governance and Operating Components

UW was founded in 1861 by a private gift of 10 acres in what is now the heart of downtown Seattle. Under provisions of State code, UW is a State university[1] with the "aim and purpose" to provide a "liberal education in literature, science, art, law, medicine, military science, and other such fields…"[2] After more than 150 years, UW has developed into a multi-campus research university with locations in Seattle, Tacoma and Bothell. Further, in addition to its 16 colleges, schools, and administrative units, the University's audited financial statements include the operations of three hospitals, associated physicians and clinics, Airlift Northwest, and UW's share of two joint ventures. It also manages the Harborview Medical Center, owned by King County, and is related to several other nonprofit organizations.

UW is governed by a 10-member Board of Regents, which includes one student. Their role includes broad responsibilities—to supervise, coordinate, manage, and regulate the University under provisions of State statute. Regents are gubernatorial appointments and serve six-year terms, with the exception of the student regent who serves a one-year term. UW's president leads the administration and the provost-executive vice president serves as the chief academic and budgetary officer. Chancellors at both Tacoma and Bothell are responsible to the President and Provost for all academic and educational matters on those campuses.

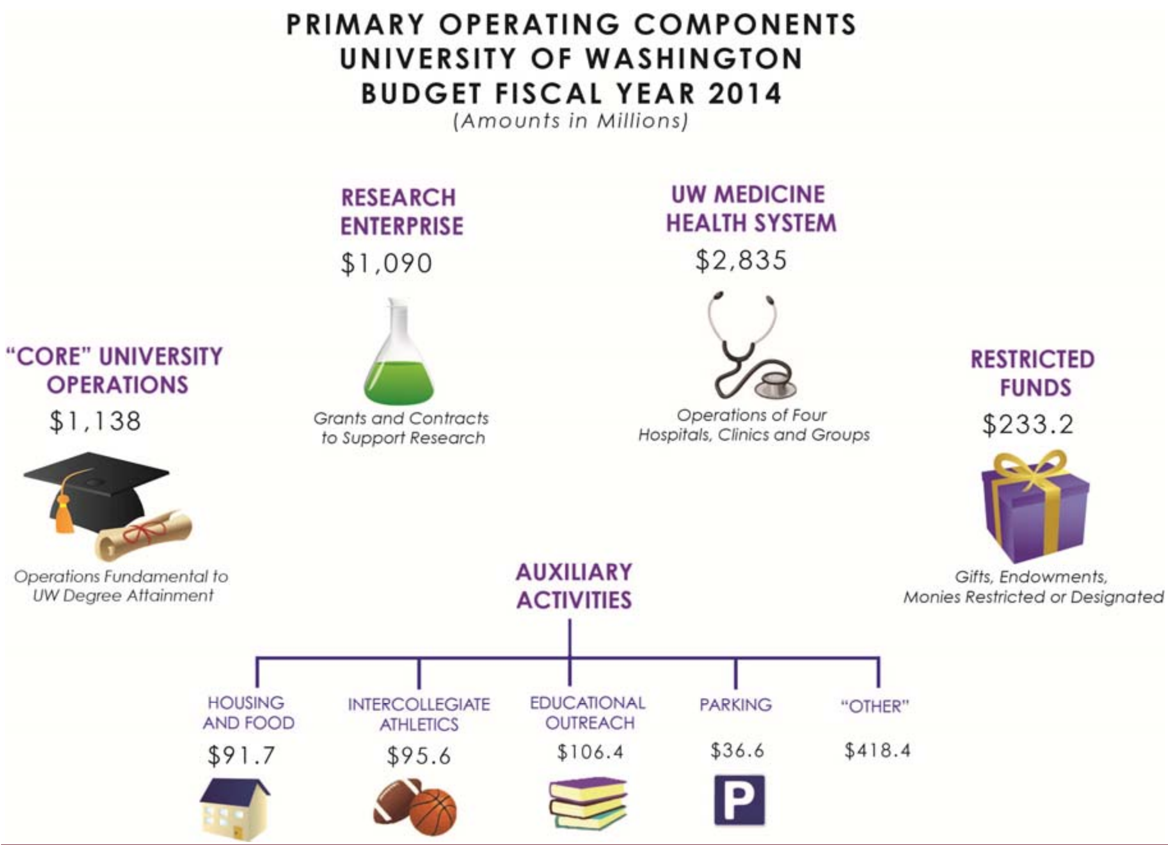
[1] RCW 28B.20.010
[2] RCW 28B.20.020

In the fall of 2013, UW enrolled nearly 38,000 traditional undergraduate students and more than 15,000 graduate and professional students in its 280 programs. UW reports that 76 percent of its undergraduate students are residents of Washington. Additionally, UW's Educational Outreach program hosts more than 42,600 students in fee-based (self-sustaining) summer, certificate, on-line, international, and other lifetime learning courses and conferences.

Although it is an agency of the State of Washington, UW, under the governance of the Board of Regents, is afforded much autonomy and discretion in its educational and business activities. UW is the third largest non-military employer in the State of Washington with a diversified revenue base.

Like many large research public universities, UW's operations and activities are broad-reaching and complex. As illustrated in Exhibit 1, in 2014, UW presented the budget of its UW enterprise using five general areas: "core" University operations, research enterprises, UW Medicine Health System, restricted funds (including gifts and endowments), and auxiliary enterprises that includes a variety of operations including educational outreach, parking, intercollegiate athletics, and housing and food service activities.

Exhibit 1. UW Major Operating Components



Most of the funds within the scope of this audit fall under the core University operations budget, which represents about 19 percent of the overall UW budget or $1.138 billion of the total $6.045 billion. One additional element outside of core University operations that is also related to this audit is within the University's Auxiliary Activities budget. Educational Outreach, offering a variety of self-sustaining and fee-based programs, represents about two percent of the overall UW budget or $106.4 million.

Similar to many public universities operating in today's economic environment, UW receives only a small portion of its support from the State budget. Overall, for Fiscal Year 2014, State funds provided $253.9 million or approximately four percent of the university-wide annual budget. As tuition, fees, grants, contracts, gifts, and operations of its hospitals and other medical clinics and groups generate the vast majority of operating revenue, UW operates following business principles, whereas governmental departments and agencies are typically appropriated the majority of operating funding and the attention is focused on the expenditure-side of administering and delivery of services and programs.

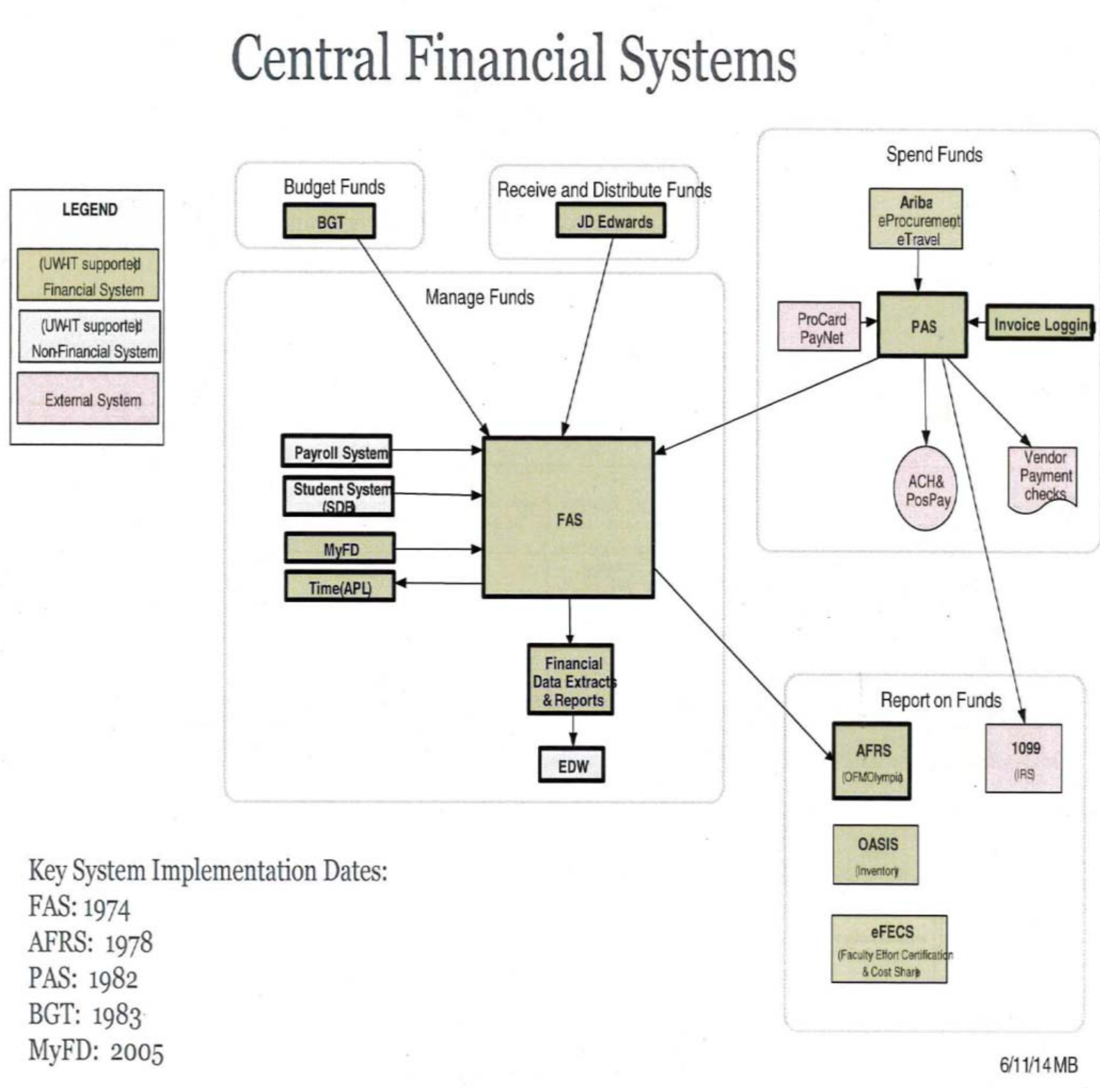
The Washington State Legislature approves allotments to support certain UW operations. As discussed later in this report, UW draws down these State funds on a monthly basis as reimbursement for expenses incurred—primarily in support of direct costs for academic activities. Because it is an agency of the State, all of UW's financial operations are "merged" into the State's financial system.

Accounting and Financial Systems

Both the State and UW operate using legacy accounting systems; UW's system is dubbed FAS—Financial Accounting System and the State's system is AFRS—Agency Financial Reporting System administered by the State's Office of Financial Management. These systems are not integrated and operate in separate and distinct environments. UW employs a system of accounting and financial reporting following fund accounting—nearly 100 funds are employed to manage and track its diverse activities. However, its legacy system is not aligned or set up similar to mirror the State's AFRS legacy system, nor is FAS set up to support the University's GASB reporting requirements.

UW's financial systems are comprised of a variety of separate systems that have been integrated. UW's FAS system (its primary financial accounting system) was implemented in 1974 and is Cobol-based. Subsequently, UW-IT has supplemented its functionality with a variety of systems. The various systems and their interrelationships are reflected on Exhibit 2. UW has supplemented its core FAS system with a number of "front-end" or auxiliary systems to meet internal budget, grant management, procurement, accounting, and reporting purposes.

Exhibit 2. UW Financial Systems



Source: UW Financial Management

UW's financial systems that are key to this audit include:

- FAS—Financial Accounting System is UW's mainframe accounting system. All financial transactions flow through it even when the transaction originated in another system such as eProcurement. Systems such as the Enterprise Data Warehouse (EDW) and MyFinancial.desktop (MyFD) consume information from FAS to produce financial reports.

- FIN—Financial Index Network is a component of FAS, and is a set of on-line Financial Accounting screens that allow the user to view financial accounting information that originates in FAS and financial indexes that are an integral part of FAS processing. This provides read-only access to revenue and expenditure transactions, index of budget numbers, and links to data on encumbrances, financial coding, and payroll load rates.

- BGT—A legacy system, implemented in 1983, Budget System (BGT) is supported by UW-IT, is an online budget building and monitoring tool. Defined by UW as "collection of budget transactions maintained throughout the biennium to keep budgeted levels current."

- MyFD—MyFinancial.desktop is a web interface for the University of Washington's Financial Accounting System. MyFD provides users a means for monitoring budget balances and reconciling transactions. Additionally, MyFD users can build custom reports, use the budget worksheet to plan for future budget activity and transfer posted salary and non-salary expenses online. MyFD also includes a project cost accounting (PCA) system that allows UW departments to monitor expenditures, report revenue, and track a variety of other data.

- PAS—Purchasing & Accounts Payable System—An online purchasing and payment system that works in conjunction with eProcurement. Establishes purchase orders, requisitions competitive contracting, subcontracting, sole source, and a variety of purchases requiring authorization and/or signed contracts. The system allows for Procurement Desktop Reports that can review and track orders and payments, resolve issues, and allows for reviewing and approving invoices. Ariba facilitates eProcurement and other purchases and travel expense reports.

- JD Edwards—Grant & Contract Accounting—JD Edwards (JDE) was implemented in November 2004 to manage accounts receivable, accounts receivable aging, and cash management for sponsored funding. Its purpose was to enhance the billing process, improve cash flow, and increase productivity. JDE is integrated with FAS (budget information, expenditure transactions), BGT (award amounts), HEPPS (address book), and FASTRANS (uploads to FAS).

Although these components fulfill various UW needs, the primary financial system overall is nearly forty years old and lacks the functionality found in more contemporary systems. Some reports and data we requested for this audit proved to be difficult for UW staff to prepare. While management was cooperative and responsive to our requests, we understand that our data requests required pulling information from a variety of sources and combining and verifying the various data elements—processes that were sometimes manually driven. Staff rely upon numerous off-line resources such as electronic spreadsheets and databases to obtain needed information.

As an example, Financial Accounting management explained that due to the age and changes in accounting and reporting provisions, closing UW's books at year-end requires data to be manually captured and analyzed to prepare entries to close its FAS books. These efforts are outside of those required to transmit and complete additional entries for alignment to the State's AFRS system. Specifically, monthly and at year-end UW accounting and financial management staff oversee the electronic transmission of accounting data, including the financial data for AFRS accounts 148 and 149, and transmit it to align with the State's legacy system. Finance managers from both the University and the State's OFM noted that any changes in either legacy system require much manipulation and coordination to accomplish the reporting requirements.

FISCAL POLICIES AND PROCEDURES

Our tasks included reviewing the laws, rules, regulations, and policies and procedures related to UW's fiscal operations and administration. UW has a body of policies covering the Board of Regents Governance, Presidential Orders, Faculty Code and Governance, and Student Governance and Policies. Additionally, its "Rules Coordination Office" oversees the University's rule-making process, including the review, creation, amendment, and repeal of UW's Administrative Code rules (Title 478 WAC)[3]. We noted in addition to these sets of policies, UW has Employment and Administrative Policies. UW's *Administrative Policy Statements* provide policies and guidance in eight areas, one being Financial Management. This fiscal matters related guidance addresses a number of specific areas such as "State Sales and Use Tax," "User Fee Approval Policy," and "Standards for Acceptance of Gifts in Place" among others. We also located a number of other pieces of guidance on the webpages of specific functions and activities such as accounting adjustments or procurement.

Although UW has established a central point for rules, in our research to locate the body of UW's policies and procedures, we noted that neither this site nor another contain a comprehensive set of the institution's policies and procedures. In addition, we could not locate an index that would direct a user to where other guidance can be located. Many of the policies and rules we found were focused on completing particular tasks and activities. The guidance we reviewed often cited or directed the user to the underlying State rules and code. During our work, nothing came to our attention that places UW guidance in conflict with State provisions. Further, we did not conduct an evaluation of internal controls. We did note during our reviews of policies, procedures, and protocols of activities included in our review that UW's fiscal policies refer to and cite State and OFM guidance.

UW has decentralized much of the responsibility for financial transactions. Unit financial officers are delegated responsibility for budgets and spending. Many units are involved in revenue collections and spending activities. There are varying levels of spending delegation, and UW has set entity-wide parameters for such

[3] http://www.washington.edu/rules/

transactions, but much discretion is afforded to individual departments. Further, we noted that the University has established some high level guidance to support its financial operations such as online links for the Administrator's Toolkit and Awareness Toolkit; however, these resources are broad and non-specific in nature.

Overall, we could not find a consolidated comprehensive set of guidance and protocols for its fiscal operations. Such a set of policies, rules and regulations would allow staff from around the large, complex entity a central resource guiding the conduct of critical activities that would help ensure that these functions are completed in a uniform and deliberative manner.

Further, due to the decentralized structure for fiscal operations, data and supporting documents related to transactions are not maintained in a central repository or system. For example, a number of units may post journal vouchers or other transactions to book an accounting entry and the underlying supporting documents are retained at the source and such information must be specifically requested. Additionally, while tools exist to identify the source department of the journal voucher to obtain a copy, these documents may lack detail to provide needed understanding. This process to obtain the journal voucher and support is cumbersome and requires much human intervention.

In the absence of a fully-integrated enterprise-wide information management system, centralized policies, procedures, rules, and protocols would assist users in determining the source of and nature of data, tools, and rules for accessing the data and other useful information. Further, a centralized and comprehensive set of guidance tools would not only ensure that the full body of direction exists, but is coordinated and in concert across the institution, as well as facilitating the update and maintenance of these rules.

Funds and Accounts Structure

UW currently uses 13 Fund Groups in FAS that include 94 funds to track University activities. UW groups its 94 FAS funds into 13 Fund Groups, as reflected in Exhibit 3.

Exhibit 3. UW FAS Fund Groups

FAS Fund Groups
10 Education & General Reg Local & appropriated operational funds including self-sustaining units, tuition, internal service units.
11 Hospital UWMC, UWM ITS operations and courtesy budgets for ALNW & NWH for intercompany transactions.
14 Auxiliary Enterprise Operations of auxiliary enterprises such as Housing & Dining, ICA, Parking, Recreational Sports, non-HFS student housing (Radford Court, Commodore Duchess & Nordheim Court)
15 Self Insurance Funds to record transactions related to the Self-Insurance fund and UW's insurance company.
20 Grant, Contract, Std, Aid Funds to record activity on Sponsored projects, Gifts, Royalties, Scholarships & Fellowships and discretionary budgets.
30 Loans Student loan fund.
40 Endowment Fund where investments managed by State Investment Board & CEF is recorded. Also includes the Metrotract.
45 Life Income/Annuity Annuity & Life: Donors/beneficiaries agreements in which they receive income for their lifetime or for a stated term, with the University receiving the remaining principal. The University records an asset related to these agreements at fair market value.
62 Unexpended Plant Fund Unexpended plant – Funds set aside for creation of capital assets. These are where CPO's 40 budgets are and the new intangible asset project budgets will be.
66 Bond Retirement Fund used to repay some external debt not in the ILP – Law school bonds, MolE, IMA bonds.
68 Invested In Plant Fund where the completed capital asset, related accumulated depreciation and debt (external debt for capital leases & internal debt from ILP) is recorded.
70 Agency Activity of entities that utilize UW systems for payroll, purchasing, etc. that are not UW. Largest agency is Harborview, an entity owned by King County and managed by UW.
81 Internal Lending Program Internal lending program that aggregates financing needs for capital projects for UW departments and securitizes them in a General Revenue Bond sold on the bond market. The ILP that enters into agreements with the departments to finance capital projects.

For State reporting purposes, UW's 94 FAS funds map into 42 State AFRS accounts—the majority of which are shared with other Washington State colleges and universities. (See Exhibit 4)

Exhibit 4. Mapping FAS Funds into State's AFRS Accounts

State Account	UW Fund	Governmental Funds						Proprietary				Fiduciary	General Cap Assets LT Debt
		General Fund	Special Revenue			Perm Funds	Capital Projects	Enterprise		Internal Service Fund		Agency	
			Wildlife	Higher Ed	Central Admin	Hi Ed Endow	State Facilities	High Ed Student Svcs Fd	Workers Comp	Higher Ed Revolv	General Services	Clearing Fund	General Cap Assets
001	001	✓											
02R	02R		✓										
08A	08A			✓									
09R	09R	✓											
12P	12P	✓											
15M	15M		✓										
173	174		✓										
607	607					✓							
608	608+								✓				
609	609+								✓				
774	774			✓									
148	**143**			✓									
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	150												
	372												
149	**149**			✓									
145	145+			✓									
403	403+									✓			
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440	961										✓		
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450	444+									✓			
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505	505+							✓					
522	522+							✓					
528	528+							✓					
570	570+							✓					
573	573+							✓					
840	840											✓	
846	846			✓									
849	849+			✓									
857	857					✓							
859	858+					✓							
860	860			✓									
057	057						✓						
064	064						✓						
173	173		✓										
252	250+						✓						
253	258	✓											
387	387			✓									
FH2	701+							✓					
997	997												✓
999	Multiple												✓

Key: + Indicates more than one FAS fund is included, but not listed.

Monthly, UW submits revenues and expense data to the State through summary file transfer. To complete this transfer, UW data must be converted from the legacy FAS system into the State AFRS accounts by program and object codes. This process collapses and consolidates FAS transactional data and the figures reflected on the State's financial records are net amounts for each of the categories reported. All transactional detail and definition remains on UW financial system. UW submits balance-sheet data into AFRS on an annual basis, for State year-end and GASB financial reporting purposes. Since UW a State agency, OFM combines its activities into the State's government wide-activities. At year-end, UW must first complete closing and adjusting entries for the institution's financial reporting purposes and then must prepare and remit balance sheet data as well as complete dozens of other closing entries to align its fiscal activities with the State's reporting needs.

Exhibit 4 illustrates that UW's financial activities expand far beyond AFRS Accounts 148 and 149. Specifically, of the 94 FAS funds used internally by UW, just seven relate to this audit (highlighted in Exhibit 4) and funnel into the two AFRS accounts under review:

- One FAS fund (149) maps to AFRS Account 149 Institutions of Higher Education—Operating Fees Account (tuition-based support).
- Six FAS funds (143, 144, 147, 148, 150[4], and 372[5]) map to AFRS Account 148 Institutions of Higher Education—Dedicated Local Account (locally generated support).

As such, reviewing only a few of UW's funds provides only a small portion of the University's financial activities. Further, in order to understand and place in context many of UW transactions, other funds and accounts should also be considered.

Exhibit 5 provides explanations of UW and State funds relevant to this audit.

[4] Fund 150 is only applicable to FY 2012 and FY 2013

[5] Fund 372 is only applicable to FY 2008 and FY 2009. This fund no longer exists.

Exhibit 5. UW FAS Funds Included in the State's AFRS Accounts 148 & 149

UW Fund	AFRS Account	Fund Name	Purpose	Comments
149	149	Operating Fees	Net tuition operating revenue[6]	• General operations of the University to support delivery of instruction, student support, research, public service, and maintenance of physical plant. • Revenue accounted for within this fund is allocated throughout UW following the University's budgeting process.
143	148	Student Technology Fee (STF)	Provides funds for the improvement of technology used by students at UW campuses.	• An STF Committee (student led[7]) determines the spending of these fees is directed by student committee.
144	148	Designated Operating	Funds included are composed of indirect cost recovery, institutional overhead, investment income, miscellaneous fees, UW Bothell & UW Tacoma administrative overhead, administrative allowances, etc.	• Indirect Cost Recovery (ICR) funds generated by grants and contracts to cover overhead costs related to facilities and administrative activities. • Miscellaneous fees include fees for applications, late payments, registration, trademarks/licensing, etc. • Overhead or indirect costs are those incurred for common or joint objectives and not identified readily and specifically with a project or instructional activity. • Holds reserves for Husky Promise, ILP interest stabilization plan, and major emergencies. • Summer Quarter Operating Fee Revenue
147	148	Dedicated Local Fund 2	Fund used to record suspense accounts	
148	148	Dedicated Local Fund	University clearing budgets, Summer Quarter expenses, and academic self-sustaining activities such as WWAMI, medical residents, dental clinics.	• FAS Fund 148 acts as a central banking fund for the University. Although monies from many funds "flow through" this fund, revenue and expense activities are posted and maintained in the fund and program related to each transaction and not recorded in this fund. • There are over 2,200 self-sustaining budgets University-wide in this fund. • WWAMI is the regional medical education network of UW School of Medicine and involves four other states aiming to provide graduates that will deliver health care to the region.
150	148	University of Washington Educational Outreach Operations	Educational Outreach — Fee based and self-sustaining programs	• EO supports numerous fee-based educational programs that generally do not receive State General Fund operating support. These programs are intended to be largely self-sustaining. In addition to degree programs, these programs include credit and non-credit offerings in the form of certificates, standalone courses, and specialized courses.
372	148	Retire Indebt – Fund 144	Fund used to track repayment of long-term debt using resources received in FAS Fund 144	• Fund was used to pay long-term debt for "Global Health Project". No activity after Fiscal Year 2008.

[6] Net tuition operating revenue represents the actual tuition and fee revenue received by the University, less tuition waivers and financial aid and building fees. See section three of this report for details.
[7] Student led STF Committee allocates the funds pursuant to RCW 288.15.051.

GASB REQUIREMENTS

In 1999, the Governmental Accounting Standards Board adopted GASB 34, which significantly changed the manner that governmental entities account for and report financial activities. The objective is to "enhance the understandability and usefulness of the general purpose external financial reports of state and local governments to the citizenry, legislative and oversight bodies, and investors and creditors…"[8]. This GASB pronouncement emphasized that "Governments' duty to be accountable include providing financial information that is useful for economic, social, and political decisions."[9] The State of Washington reports in accordance with GASB 34. With the focus being *government-wide* reporting on the government as a whole, financial statements under GASB 34 include the "primary government and its component units, except for the fiduciary funds of the primary government and component units that are fiduciary in nature."

Important to UW is GASB 35 – *Basic Financial Statements—and Management's Discussion and Analysis—For Public Colleges and Universities,* issued shortly after GASB 34. This statement established definitions for the basis of how these institutions are to report. Under GASB 35, UW is a "special purpose government" and affords reporting financial activities as "business-type activities."[10]

REPORTING MODELS

Governmental activities are generally defined as those that are financed through taxes, intergovernmental revenues, and other "non-exchange" activities (generally meaning that the government receives value, such as public monies, without *directly* providing value, such as a good or service.) Thus, the State of Washington falls under this definition. Governmental-type activities reports are intended to allow users to assess how the governmental entity obtained and used resources, determine the level of services that can be provided with available resources, and to determine whether the results of the operations improved or worsened the governmental entity's financial position at the end of the reporting period[11]. The structure of the financial reports convey financial information by high-level government program and function—reflecting how much is collected or generated in "program revenues" and identifying which programs and functions use/spend the money.

These financial reports also break down revenues and expenses by major fund "types" which are used to classify and segregate funds for "the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations,"[12] thus, allowing the user to identify which

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[8] GASB 34, Paragraphs 1 and 2
[9] GASB 34, Paragraphs 1 and 2
[10] GASB 35, Paragraph 26
[11] GASB: CS-1, par 78.
[12] NCGA-1(Governmental Accounting and Financial Reporting Principles)

pools of money are available for general purpose spending and which have special purposes or restrictions.

In contrast, "business type activities" are generally defined as those financed in whole or in part by fees charged to external parties for goods and services. Universities and colleges, including UW, generate revenues from services (tuition, course or program fees, contracts and grants, medical patient services, etc.) and meet the GASB criteria for financial reporting following the Business-Type Activity (BTA) format.

UW applies BTA reporting that treats its financial activities similar to a commercial enterprise and presents its financial information reflecting performance and activities using elements aligned more closely to a conventional "profit and loss" enterprise than a government. BTA reporting separates revenues and expenses into two major categories—operating and non-operating. Operating revenues show the results of revenue generation from major sources, such as tuition, patient services, grants and contracts, or sales and services. Those revenues are matched to the expenses that deliver those services. Non-operating activities show revenues that are not related to services provided such as State appropriations and gifts as well as expenses not directly attributable to the delivery of services such as investment expenses or interest payments on capital debt.

Although UW is an agency of the State of Washington, as reflected later in Exhibit 6, like other universities we researched, it issues separate audited financial reports annually following BTA reporting. FAS, UW's accounting and reporting system, is set up to facilitate meeting standards for university business reporting. However, as an agency of the State of Washington, UW's BTA financial information must be translated into the State's AFRS accounting structure.

Comparing Government-type and Business-Type Activities Reporting

As stated earlier, governmental activities, generally, are financed through taxes, intergovernmental revenues, and other non-exchange revenues. Business-type activities (BTA), like colleges and universities, are financed in whole or in part by fees charged to external parties for goods and services. Therefore, for a governmental entity like the State of Washington, its financial statements remain fund based—that is, information is captured and presented by major fund type and collapsed into major government-related classifications. As a result, a user can see how much the major fund types collect in taxes and other revenues, and how the assets of the government were spent by major category of government activity, such as transportation, education, or human services. Overall, the financial statements show whether the entity has sufficient assets to cover its short- and long-term liabilities.

In contrast, BTA statements, like those prepared by the University of Washington and other state universities and colleges, are intended to show the performance of the institution's business activities—the revenues generated from its various "services" to students and others as well as how these monies were spent—i.e. salaries, benefits, scholarships, utilities, etc.; with the intent being that the financial statement user can determine the bottom line results of these operations as well as identifying those activities considered non "operational" such as State appropriations, gifts, capital projects, etc.

ILLUSTRATIONS OF ACCOUNTING TREATMENT DIFFERENCES BETWEEN THE TWO BASES OF REPORTING

At year-end, UW's financial activities are summarized and translated into the AFRS accounts that flow into the State's government-type and fund-level financial statements. GASB has established rules for the treatment of financial activities for each basis of reporting. For example, UW's financial statements are prepared in a consolidated manner—all the funds are put together—whereas the State reports show funds and fund type. In the following we offer two examples of the different treatment of expenses under BTA reporting (showing amounts in a consolidated matter) versus the governmental-fund reporting model.

- **Leave accounting**: At year-end, both the State and UW must post expenses and liabilities for employee leave that has accrued, but not been used. Under BTA reporting, UW calculates this amount for all employees across the University and the transaction is posted as a single entry. Conversely, for State reporting, UW must separate the leave accruals into the functional areas used in governmental financial statements (separated by fund) within which employees are paid.

- **Depreciation**: Depreciation is also a year-end posting. For UW, depreciation is posted for the University overall; all depreciable assets are recorded on the balance sheet of UW in total and depreciation is recorded in the same manner. On the State side, UW must provide appropriate detail to allow the depreciation to be included as a direct expense of the function and state fund that the State associates with that capital outlay.

Differing treatments are also required for long-term liabilities. Under BTA reporting, UW includes all long-term liabilities (including Internal Lending Program (ILP) loans relating to State General Obligation "GO" bonds, UW General Revenue Bonds, Certificates of Participation, etc.) within its financial statements. However, when transferring this data for the State's reporting purposes, UW must separate out the ILP loan activity. Specifically for ILP loans relating to UW General Revenue Bonds, activity must be moved from AFRS Accounts 148 and 149 to AFRS Account 999. Further, ILP loans related to State "GO" bonds must be removed entirely as the State already accounts for these liabilities. As discussed in Section 8 of this report, this reclassification for reporting purposes results in significant differences between FAS and AFRS fund balances at the year-end for these two funds.

These are just some examples of significant adjustments that must take place at each fiscal year-end and create differences and variations between FAS and AFRS reporting as discussed further in the Fund Balance section of this report. Yet, these adjustments are necessary to properly account for activity, and to offset or record transactions to the appropriate State funds, and comply with State, audit, and accounting standards.

RELATIONSHIP OF UW TO THE STATE FOR FINANCIAL REPORTING

Another factor that contributes to the differences in State and UW financial reporting relates to the definition of the "financial reporting entity." GASB requires that a government determine its "financial reporting entity" – the parts of the overall governmental unit to be included in the financial statements. This is accomplished by applying a number of tests relating to fiscal dependency, governance, autonomy, and relationship of "benefits" or liabilities.[13] A primary government (State of Washington) must determine which parts of the overall government unit are to be included. This determination also dictates how particular units are presented—within the primary government; as a blended component unit, or other blended component unit (legally separate entities that are part of the government's operations in substance); discrete component units (legally separate entities that primarily serve or benefit those outside the government); or not included at all as they do not meet the tests for inclusion.

For the State of Washington, "colleges and universities are legally part of the State, and their financial operations, including their blended component units, should be reported in the State's financial statements using the fund structure prescribed by GASB." In essence, all of UW's financial activity is mixed with the State's other educational entities and cannot be uniquely identified. Some of UW and other State University expenditures are reflected in the two major governmental "higher education" funds within the State's financial reports.

While we did not analyze the State's determination to include UW within the primary government of the State's "financial reporting entity," the State's financial statements are audited annually for compliance with GASB. We noted that the reporting relationship between the State and universities in Washington is different than that of other universities we used for benchmarking. As illustrated in Exhibit 6, we identified 21 public universities that either UW deem as peers or that deem UW as a peer. Our research found, as illustrated in Exhibit 6, that of the 21 benchmarked institutions, 19 report using BTA and the other two are non-profit corporations and follow "business" reporting rules promulgated by the Financial Accounting Standards Board (FASB).

[13] GASB 14

Exhibit 6. Comparison of UW to 21 "Peer" Universities—GASB Financial Entity and Basis of Reporting

Institution	University Reporting Basis	State Presentation of Reporting for the University
University of Washington	**BTA**	**Blended throughout the statements of the primary government**
Ohio State University	BTA	Discretely presented Component Unit
Penn State University	FASB[14]	Completely excluded
University of Iowa	BTA	Proprietary/Enterprise
University of Alabama at Birmingham	BTA	Discretely presented Component Unit
University of Arkansas	BTA	Proprietary Fund
University of Colorado	BTA	Proprietary Fund
University of Kentucky	BTA	Major Component Unit
University of Michigan	BTA	Completely Excluded
University of Nebraska	BTA	Discretely presented Component Unit
University of New Mexico	BTA	Proprietary Fund
University of North Carolina Chapel Hill	BTA	Major Component Unit discretely presented
University of Utah	BTA	Discretely Presented Component Unit
University of Virginia	BTA	Discretely presented Component Unit
Purdue University	BTA	Discretely presented Component Unit
University of Texas System	BTA	Proprietary Fund column and individually in Supplemental Information
University of Arizona	BTA	Component Units separately conveyed
University of Minnesota	BTA	Discretely presented Component Unit
University of Missouri	BTA	Discretely presented Component Unit
University of Pittsburgh	FASB[15]	Completely Excluded
Florida State University	BTA	Discretely Presented Component Unit
Georgia Institute of Technology	BTA	BTA Activities/Enterprise Fund column

Further, none of the 21 universities were reported in a similar fashion as OFM reports UW financial activities. We found that each of the 21 universities are classified differently than UW in relation to the state government. As previously noted, 19 of the 21 universities follow business-type activity reporting model like the University of Washington.

[14] Pennsylvania State University is an instrumentality of the Commonwealth of Pennsylvania and is organized as a non-profit corporation.

[15] University of Pittsburgh is a non-profit corporation and is an instrumentality of the Commonwealth of Pennsylvania. The University is completely excluded from the state entity for reporting purposes.

YEAR-END UNIVERSITY AND STATE FINANCIAL REPORTING

UW is a significant agency within the State's financial entity due to its size and complexity. Therefore, the State's process to complete its financial statements and obtain its audit opinion can be hampered if UW does not provide its financial data on a timely basis. The OFM has established year-end "cut-off" policies and procedures and annually sets timeframes for the submission of year-end data. These timeframes are designed to enable the State to complete and issue its Comprehensive Annual Financial Report (CAFR) on a timely basis. In 2013, OFM adjusted this approach to be two-phased, with adjustments to the timing requirements for disclosure information.

Additionally, over the period of our audit, OFM moved certain key dates with a goal to issue the CAFR sooner after year-end. Specifically, in 2009 a proposal by the Securities and Exchange Commission (SEC) sought to have municipal bond issuers (such as the State of Washington) to submit annual financial information to the municipal bond clearinghouse[16] within 120 days of the year end. The State Treasurer and other leaders worked to meet those goals. Since 2009, the State has continuously issued its CAFR at an earlier date. In 2009 the CAFR was issued December 23, 2009—the following year it was issued November 30, 2010 more than three weeks sooner. In each of the subsequent three years, the CAFR was issued a week earlier than the prior year—in 2013 it was dated November 8, 2013.

Moreover, many governments seek to earn a *Certificate of Achievement for Excellence in Financial Reporting* from the Government Finance Officers Association that is "evidence [of] the spirit of transparency and full disclosure" of its financial health and completeness of its financial reports.[17] In addition to completing a full CAFR that includes audited financial statements, one of the primary requirements is for the government to issue this report within six months after the end of its fiscal year. Washington State has earned this certificate in each of the six years of our review.

Up until 2014, UW has been unable to meet the OFM's timeframes for data submission; these delays are factors that have inhibited the State's financial statement preparation and Washington State Auditor's audit processes. UW uploads its revenue and expense data into AFRS on a monthly basis but many activities must occur at year-end as described below. UW has established internal scheduling to accomplish year-end closing but these processes remain challenging and include:

- Closing entries for its revenue and expense data including accruals.
- Posting all its balance sheet data. Due to its age and lack of needed functionality, FAS does not produce data that would enable UW to submit

[16] The Clearinghouse includes the Securities and Exchange Commission (SEC), Municipal Securities Rulemaking Board (MSRB), and Electronic Market Assess System (EMMA).
[17] www.gfoa.com/coa

balance sheet information on a monthly basis. Moreover, year-end balance sheet data must be translated from BTA reporting into fund accounting reporting which requires additional effort. The challenges with balance sheet reporting is recognized by both OFM and UW; UW finance officials stated that in order to automate this it would either need to implement an updated financial system or invest significant resources (labor and funds) to reconfigure FAS.

- Translating its financial data from BTA reporting to government fund basis reporting.
- Obtaining the audited financial statements from its component units and joint ventures. UW's entity includes several organizations such as the Association of University Physicians, Neighborhood Clinics, and real estate financing entities. Financial information from these other entities must be included in UW financial reports and added into the State's system as well. The timeliness of the submission of these reports to UW also impacts its ability to comply with State timelines.

Since 2009, OFM and UW have worked together to improve communication and submission of year-end data. Gradually, UW has improved the timing of its submissions and OFM reports UW incrementally came closer to meeting the State's reporting timelines but had not met the September deadlines set for state universities until 2014. According to OFM, UW was given an extended deadline and met this extended deadline; however, this deadline was later than other State agencies, including the other State Universities. The deadlines for the other State agencies and Universities was September 7th but UW's deadline was September 19th. Both OFM and UW stated that the most significant strides have occurred in the past two years. UW hired two additional individuals to lead and undertake the related tasks and processes relating to year-end reporting. Further, UW convened a "CAFR Lean" workshop with OFM and key UW units in the spring of 2014 to collaboratively develop processes and agreements for streamlining year-end efforts and improving data transmission. In 2014, UW submitted year-end information three weeks earlier than the prior year.

SECTION 2. Higher Education Operating Fees Account (AFRS Account 149) and Higher Education Dedicated Local Account (AFRS Account 148)

What are the Higher Education Operating Fees Account and Higher Education Dedicated Local Account in Relation to UW? How are Funds within These Accounts Budgeted and Monitored?

Critical to understanding the flow of funds to and from the AFRS 149 and 148 accounts is their relationships to the various core operations of UW and the process to budget and monitor the funds within the accounts.

Description of AFRS Accounts 149 and 148

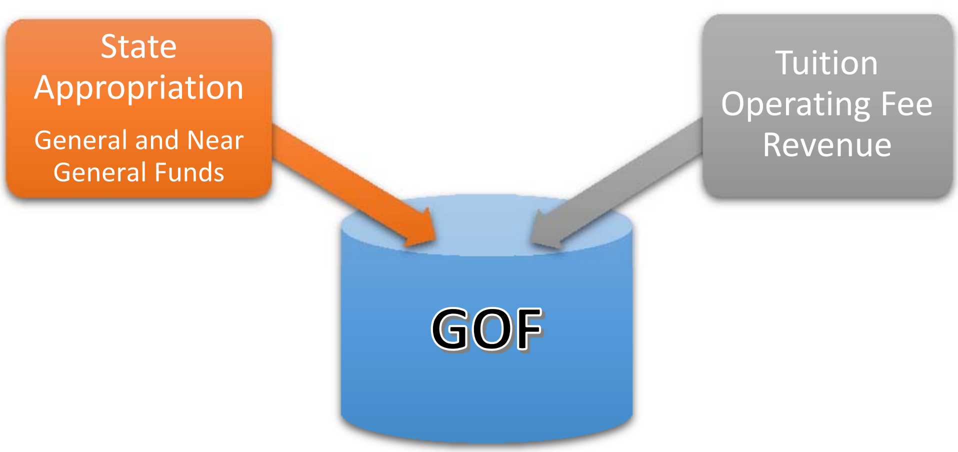
There are two "pools" of funds and revenues that provide the majority of the support for operations related to the University's core operating budget:

- Tuition and State Appropriation Support via General Operating Funds (GOF)
- Locally Generated Support via Designated Operating Funds (DOF)

GOF — State and Tuition-Based Support

As shown in Exhibit 7, GOF is comprised of two primary sources—State General Funds (that includes AFRS Accounts 001-General Funds and Account 08A-Education Legacy Trust Account) and Tuition Operating Fee revenue (AFRS Account 149). The Tuition Operating Fee revenue portion of GOF is budgeted and tracked through AFRS Account 149—Higher Education Operating Fees Account.

Exhibit 7. Components of General Operating Funds



Tuition operating revenue, the primary revenue source in AFRS Account 149, is the portion of tuition charged to students that relates directly to instructional and administrative support (as opposed to building fees and other charges for student activities or services). Tuition operating revenue covers instruction-related expenses.[18] There are a number of rate categories for this fee that relate to type of student, area of study, and whether the student is a State resident; many charging different amounts. Other types of fees charged to students are administered through other FAS funds.

The State's support to UW is appropriated through the State's budget process and funds originate from the State's General Fund and its "Near General Fund[19]." The State requires the University to provide a spending plan (discussed later in this section) for the State's support of UW, which is considered an allotment. State General Fund support is not initially administered through AFRS Account 149; rather, the University must submit a spending plan to draw down these funds into AFRS Account 149 on a reimbursement basis.

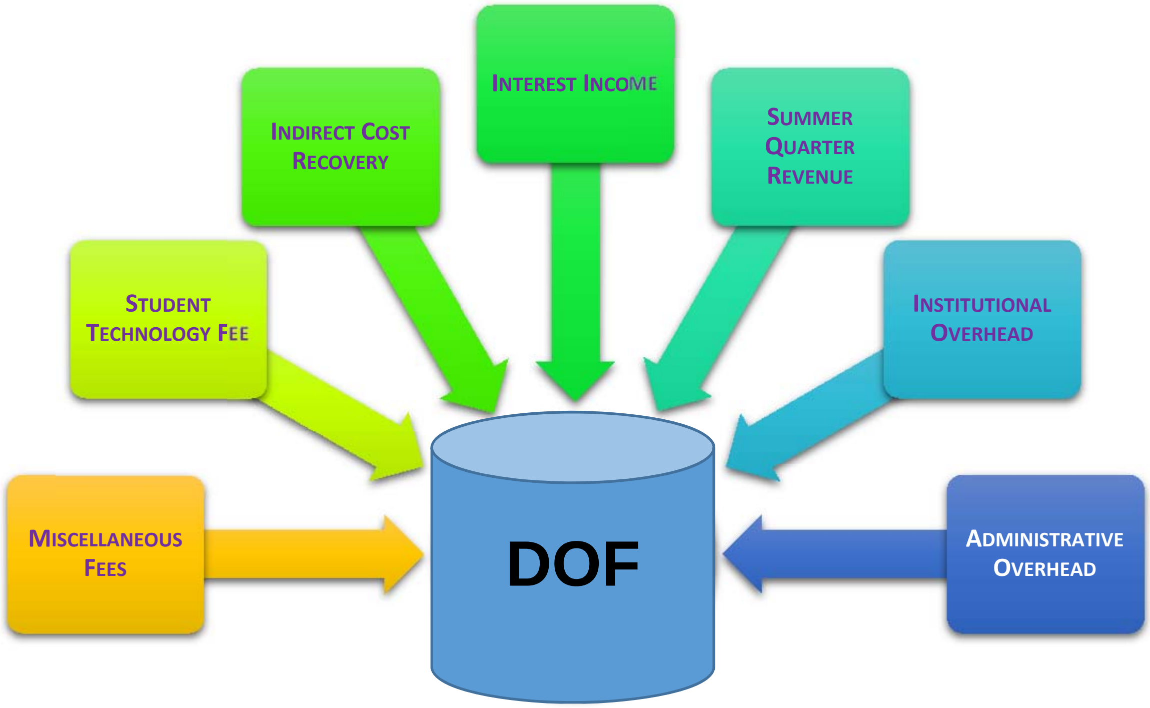
DOF — Locally Generated Support

The second primary component of UW's core operating resources relates to Designated Operating Funds (DOF), which are locally generated monies budgeted and tracked through AFRS Account 148—Institutions of Higher Education-Dedicated Local Account.

[18] RCW 28B.15.031

[19] Includes funds defined as Education Legacy Trust Account.

Exhibit 8. Components of Designated Operating Funds



As illustrated in Exhibit 8, the local funding generated by DOF University activities include:

- Indirect Cost Recovery—charges to grants and contracts to compensate for UW costs relating to facilities and building maintenance, libraries, centralized administrative costs of managing the grants and programs, and departmental administrative costs. ICR funds are negotiated percentages of contract and grant amounts and are generally accounted for separate and distinctly from the direct charges. The receipts from these charges are allocated through UW's budget process.

- Interest Income—investment of UW operating funds.

- Summer Quarter Revenue—fees charged for summer programs and courses. During the Summer Quarter, the fee paid by students is equivalent to the tuition that students pay during each of the autumn, winter, and spring quarters.

- Student Technology Fees—collected with tuition from each student as part of the required student fees; amounts are recorded in a separate UW FAS fund included in AFRS Account 148, but spending is controlled by a student committee. These fees are determined directly by students and cannot be used for general operations.

- ADMINISTRATIVE OVERHEAD—charges to the Tacoma and Bothell campuses for central services provided by the Seattle campus.

- INSTITUTIONAL OVERHEAD—charges to self-supporting and fee-based programs.

- MISCELLANEOUS FEES—variety of fees such as administrative fees for registration or late payments and literally hundreds of course fees ranging from $4 to $2,538. We found that the average course fee charged in Fiscal Year 2013 was $134; however, about 87 percent of students paid fees of $100 or less per course. Most of these fees are to be used in direct support of that instructional effort.

Although the University can exercise discretion in the use of DOF funds, these funds must be expensed in compliance with State laws. Further, through internal policy, UW may place restrictions on their use.

Additionally, the University also generates fees through a multitude of self-sustaining and fee-based activities that are considered "non-DOF" but included in AFRS Account 148, described as:

- SELF-SUSTAINING AND FEE-BASED ACTIVITIES—A variety of fee-based programs offered by Educational Outreach (as discussed in detail in Section 4) as well as fee charges for lab medicine, dental clinic service fees, and medical resident program revenue associated with those schools (does not involve the University's medical hospital system.)

AFRS ACCOUNTS 149 AND 148 BUDGETING AND MONITORING PROCESSES

In order to fully understand the budgeting and monitoring of GOF and DOF funds, the budget process for the entire University must be considered. The allocation and monitoring of GOF and DOF funds are included in the budget process and remain identifiable throughout the processes. The University's budget process for its core operations is multidimensional and layered. According to UW, "The UW's budget process is centered on the school/college and administrative unit level… [T]he UW is a large enterprise; as such, units have a great deal of autonomy in making budgetary decisions at the Dean, Vice Provost, and Vice President level."

While UW has to monitor and account for State appropriations and tuition funds, it combines these funds for operating budget purposes. Although UW Provost is responsible for coordinating, overseeing, and monitoring the budget, each operational unit (department) is charged with and accountable for developing, managing, and controlling its budget and financial resources.

University policies[20] convey that:

- Senior leaders are responsible for all aspects of the unit or department's financial health. They are accountable for all resources "entrusted to them, including funding, facilities and staffing, even if they have delegated budget and accounting responsibilities to their staff."

- All funds must be spent in accordance with UW policy and units must operate within the limitations of available budget; the University does not budget separate funds to cover deficits so any deficit that occurs must be covered within a department's or dean's reserve. Officials with responsibilities related to self-sustaining programs are charged with the financial performance of these programs including compliance with UW budget and financial policies.

- Units are responsible for internal financial management, and development of budgeting, financial reporting, and management practices. While UW's internal budgeting, accounting, procurement and banking systems include many control features, each unit is encouraged to develop additional oversight processes following best practices.

- Each unit is required to practice periodic financial reporting and monitoring. Using tools found in "MyFinancialDesktop," managers may monitor and reconcile funding sources, spending, commitments, and reserves.

The budget process includes elements involving projecting amounts of funding resources, determining operational needs, determining and refining tuition rate, ensuring alignment of funding to allowable uses, allocating resources, and monitoring and oversight of spending.

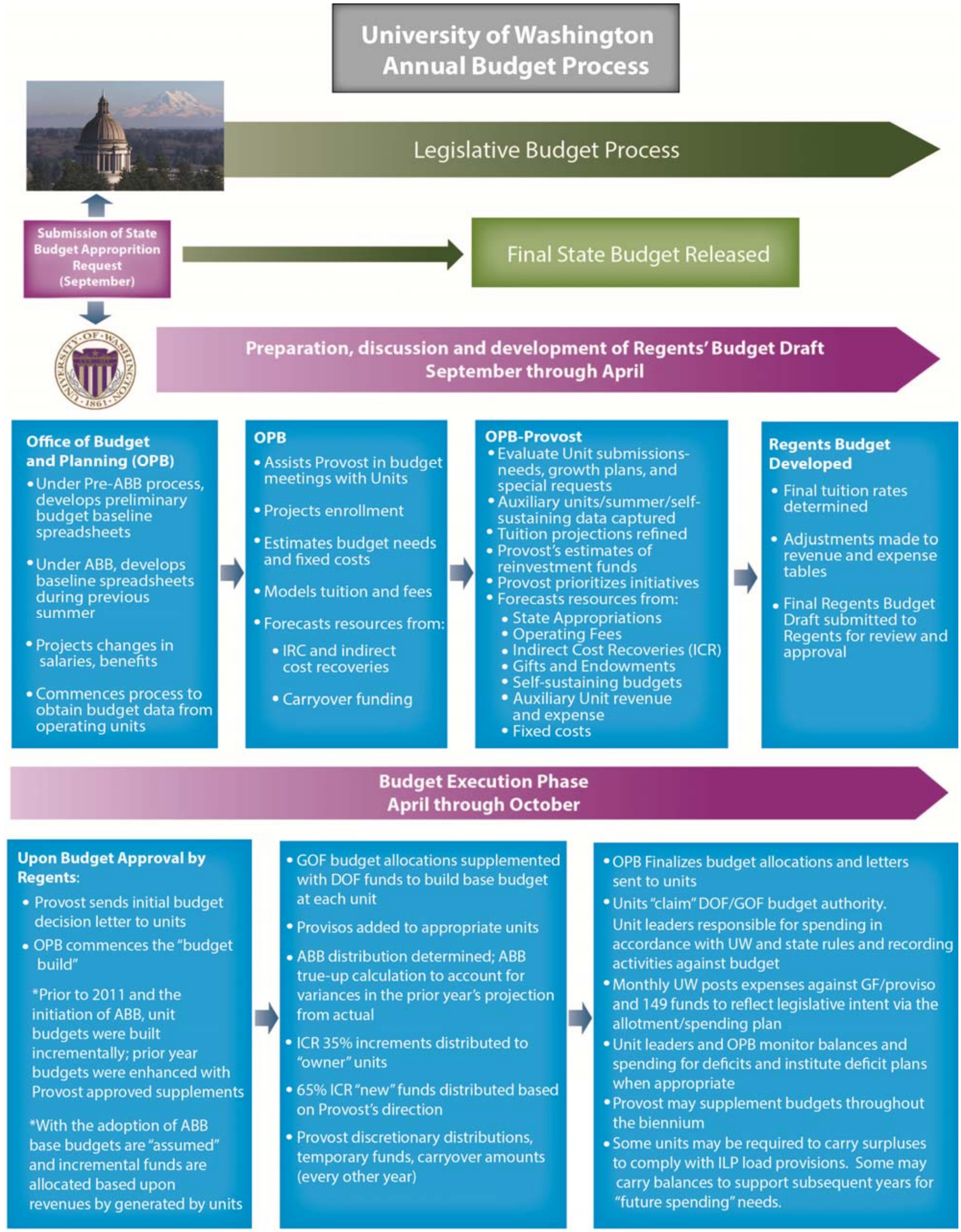
The budget involves determining the amount and "type" of funds likely to be available for allocation to support the core operations. Unlike traditional State agencies where most budgetary decision-making involves the expending of the appropriated funds, because UW generates the majority of its operating revenue from external sources—students (its "customers"), indirect cost recoveries generated from grants, contracts, and agreements negotiated and "serviced" from its research enterprises, revenues from self-supporting and other enterprise activities, and other fees—it must also forecast revenues. Thus, while State appropriations are essential to its fiscal stability, these resources are just part of the pool of funds that needs to be projected.

UW's budget process is a year-long cycle involving information requests, meetings with the Provost and stakeholder groups, and ultimately, action by the Board of Regents. Exhibit 9 provides a graphic depiction of the annual budget cycle.

[20] Finance and Budget Management/Administrator's Toolkit

After the University's budget building and deliberation process is complete and the Regents act on the budget, the Office of Planning & Budgeting (OPB) produces allocation tables at the school, college, and administrative unit level to set out the budgets. This process has remained largely in place for years; however, in Fiscal Year 2012, UW transitioned to an Activity Based Budgeting (ABB) model, whereby the allocation of incremental funds from tuition revenue, State funding, indirect cost recovery revenue, and some fees are allocated on the basis of specific methodology. Important to note is that ABB applies only to distribution of State support and "tuition- based" support and does not apply to self-sustaining fee-based programs.

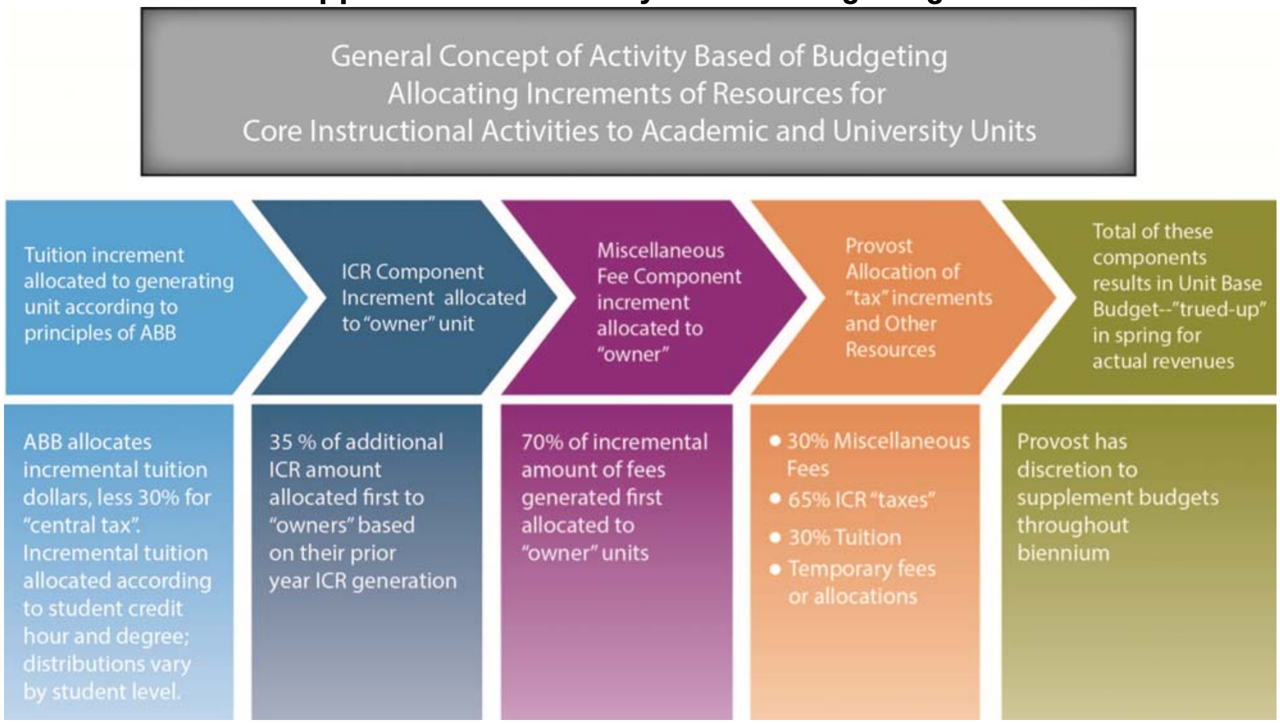
Exhibit 9. Diagram of UW's Budget Process



ACTIVITY BASED BUDGETING

Under Activity Based Budgeting (see Exhibit 10), available increments of budgetary resources are distributed based upon type: tuition revenue (undergraduate and graduate), research funding, centrally allocated funds, and other fees.

Exhibit 10. UW's Application of Activity Based Budgeting



As depicted in Exhibit 10 and described in detail below, there are several core components of funding allocation as a part of ABB.

❖ TUITION

Under ABB, net operating fee (tuition) revenues for the upcoming year are calculated using modeling formulas that consider projected enrollment by tuition and residency category, considering number of credits to be taken, and reduced by the required and mandated waivers and financial aid provisions. Once the net operating fee revenue is projected, it is compared against prior year revenues and the difference becomes the basis for the distribution of this incremental fee revenue to each unit. Provisions stipulate that the incremental operating fees are 'taxed' at 30 percent—thus, essentially 70 percent of the total increment is available for distribution to units/colleges, with the 30 percent tax amount of the increment allotted to the Provost to fund administrative units, provide supplemental funding, and support central initiatives.[21]

[21] Activity Based Budgeting Decision Summaries, October 2011

Distribution to colleges/units is generally based upon:

- The proportion of total student credit hours per each tuition category generated by each college (unit)
- The proportion of undergraduate degree majors produced by each college/unit
- The proportion of graduate and professional students attributed to each college/unit[22]

❖ Research Funding—Indirect Cost Recovery Funds

Facilities and Administrative rates ("F&A" or indirect costs) are negotiated with the U.S. Department of Health and Human Services, or specified by the awarding agency. These rates are intended to reimburse the University for indirect or support costs such as infrastructure, administration, and other costs not directly charged to a grant or contract. UW charges grants and contracts for direct costs, as well as for related facilities and administrative costs, which are separately tracked to the "owner" units. The resulting F&A recovery, or Indirect Cost Recovery (ICR) is "taxed" at 65 percent with the remaining 35 percent directly allocated to the "owner" units. The 65 percent is retained by the Provost for future distributions. The ICR distribution calculation is based on the grant or contract activity occurring from April through March of the prior year.

❖ Centrally Allocated Funds

General Operating Fund (GOF) and Designated Operating Fund (DOF) funding have historically supported both academic and administrative functions. Under ABB, as previously discussed, tuition, ICR as well as other "locally generated funds" increments will be allocated to the units generating the revenues. The "taxes" generated from tuition and ICR, as well as other assessments of indirect cost or administrative cost recovery (institutional overhead and other central revenue sources) assessed within UW, combined with State appropriations, are expected to wholly fund UW central administrative functions (including facilities and utilities). They are also to be used as necessary to supplement the revenue units generate under ABB to ensure that UW's missions and goals are met and to fund new strategic initiatives.[23]

The Provost is charged with allocating these resources through UW budget processes and to ensure that funds relating to State appropriations, provisos, salary bills, or appropriations for benefits are spent in accordance with legislative intent.

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[22] University of Washington, *Activity Based Budgeting Tuition Revenue Distribution Manual*

[23] Activity Based Budgeting Decision Summaries, October 2011

Application of UW's Budget Process To AFRS Accounts 149 and 148

The University's budgeting process involves a multitude of revenue sources and funds. Specifically, budgeting for AFRS Account 149 (tuition operating fees) is combined with funding support related to State appropriations (AFRS Account 001) in the University's budgeting processes—in other words, tuition and state appropriations are budgeted together as GOF funding. We found that tuition and appropriations are tracked separately for spending and alignment with the State's spending plan requirements. The spending plan/allotment process, like UW's budget process, involves estimates and projections; thus, over the biennium the amounts will mostly reconcile in total. As explained later in this section, we noted the amounts related to the State's spending plan reconciled with the funds drawn from the State's General Fund and other provisos.

Yet, we found the amounts budgeted in total for GOF at UW differed immaterially when compared to AFRS Account 149 estimates reflected in the State's budgets. According UW, "because OFM [Office of Financial Management], the Legislature, and the public monitor actual spending against allotments, we do our best to match spending levels against what was allotted…State appropriated funds should match exactly [which is the case in our testing], but AFRS Account 149 (net operating fee) allotments—which are essentially planned expenditures—will always vary from actual expenditures."

In regard to AFRS Account 148, we understand that there are more than 5,400 discrete budgets that are captured and posted to this account. The major programs, such as Summer Quarter, develop budgets that are included in Educational Outreach and are monitored centrally as part of that program. Many other of these activities are relatively low dollar (such as course fees) yet are self-sustaining and are not individually budgeted or monitored outside of the unit level. Budget data are not always collected—some operate within the unit budgets of the "owner" department/unit/college and thus are indirectly included within the higher-level reporting in the budget process.

Budgeting and Monitoring of State Funds

The budget includes elements involving projecting amounts of funding resources, determining operational needs, determining and refining tuition rates, ensuring alignment of funding to allowable uses, allocating resources, and monitoring and oversight of spending. The University prepares and manages its budget in concert with meeting State budget and allotment requirements. UW must comply with the State's requirements for budget submissions and related OFM guidance and rules.

The State's budget includes two primary components related to UW: appropriated funds which are comprised mostly of State general funds, and very modest amounts sourced from a half-dozen or so other State funds; and, non-appropriated funds which relate to operating-fee revenue generated from tuition. The Legislature may, at any time, specify restrictions on State budgeted funds and require spending plans for these expenditures. However, appropriated amounts are set and limited—agencies are not allowed to overspend appropriations. Non-appropriated funds are still monitored and overseen by OFM and the Legislature; but, at UW these amounts are expected revenues and expenditures of the operating fees, and actual amounts will vary because the figures included in the budget are estimates.

State budget process protocols require agencies, including UW, to submit budget requests for the State support and the operating fees late in the summer prior to the next biennium with amendment requests for the second fiscal year the following summer. UW submits its State allocation request premised upon preliminary projections and discussions with OFM and legislative staff, and the final amount is determined during legislative hearings and deliberations.

The submissions that relate to non-appropriated amounts include early estimates of a multitude of factors that influence and drive these tuition/operating fee revenues. While UW includes a number of reports and schedules conveying the assumptions and projections related to these amounts, this late summer allocation packet is a first step in UW budgetary process. As described later in this section, the University's process spans the entire school year and culminates in the Regents' budget which is submitted for approval just after the Legislature passes the budget bill. Concurrent, but independent of UW's budgeting and forecasting processes, the Legislature deliberates the appropriated and non-appropriated funds for the University.

In forecasting its revenues and expenses, UW must consider and model tuition rates and revenues for at least 46 tuition categories. For each, UW develops projections and analyses that must consider a multitude of factors such as expected enrollment; market and competition; affordability and elasticity of tuition rates; local, state, and national economic trends and environment; and, costs of services. As the various milestones in the admissions and enrollment process occur, these projections are refined and recast. In the spring, the various tuition rates are set and included in the Regents' budget for approval.

Tuition rates for resident, undergraduate students is one of the primary concerns of the Legislature in its deliberation of UW budget. These tuition rates are determined considering estimated amounts of State funding and support communicated during the State's budget session. In academic year 2013, resident, undergraduate students comprised approximately 62 percent of the student body of UW, while their tuition comprises about 44 percent of net operating fees. Thus, the other 45 tuition categories strongly influence the amount of operating funds UW will generate and need for the upcoming biennium.

The late summer allocation submission is an early iteration of the operating budget; as described above, these early estimates will change a number of times over the period. We understand that OFM and the Legislature apply different models and assumptions in their predictive models. However, the deliberative processes of UW, OFM, and legislative staff do not include formal or agreed upon "reconciliation" points to compare assumptions, projections, and amounts. As a result, the amounts included for operational fees in the State budget and in the OFM's spending plan systems do not agree with UW's figures. Our review of the amounts reflected in the State's budget for the three biennial periods for AFRS Account 149 (designated as "Inst of Hi Ed-Operating Fees Acct – Non-Appropriated" in the State's budget document) differ from the figures approved by the Regents for the same periods, as illustrated in Exhibit 11.

Exhibit 11. Comparison of UW to State Budget for AFRS Account 149

Fiscal Biennium	AFRS Account 149 Budgets	
	UW Budget	State Budget
2007-2009 Biennium	$567,500,000	$561,929,900
2009-2011 Biennium	$700,455,000	$719,981,000
2011-2013 Biennium	$980,894,000	$911,404,001

Information suggests that these differences are due to the unconnected paths that the OFM, legislative staff, and UW follow. Each party applies ongoing refinements as the cycle progresses.

Within the State's budgetary process, approved appropriations form the basis for the required "spending plans" that OFM uses to oversee State department spending. Although "non-appropriated" funds are not subject to the spending limitations that apply to "appropriated" funds, agencies are required to provide spending plans for these funds for monitoring, oversight and transparency purposes. Because the AFRS Account 149 amounts that are used for budgetary and spending plan purposes have traditionally differed significantly from those determined by UW, the ability for the OFM, Legislature, and public to have an accurate picture of UW's activities in this regard is imperfect.

By establishing certain milestones and checkpoints during the winter and spring budget deliberations, the three entities could collaborate to share assumptions and forecasts and ensure that the data each are applying are in concert and current. Spending plans used by the OFM and UW should be reconciled and reflect the most accurate budget that UW will follow.

UW's Budget Processes

The University is supported in part by State "General Operating Funds"[24] characterized by UW as "State Funds." Although UW has significant discretion over the use of State Funds, by policy it assigns these funds to instructional costs—

[24] http://UCS.admin.washington.edu/MyFD/GlossaryDetails.aspx?id=455

primarily salaries, benefits, and related expenses of providing instruction to University students.

Appropriated funds, because they are subject to State budgetary controls and processes, are budgeted and monitored differently than other university operational funding. Through the budget process the State provides legislative appropriations to the University that consists of funding from certain sources. For the 2011-2013 and 2013-2015 fiscal biennia, "account" sources were:

- 001 General Fund-Basic Account-state
- 08A Education Legacy Trust Account-state[25]
- 09R Economic Development Strategic Reserve Account-state
- 15M Biotoxin Account-state
- 608 Accident Account-state
- 609 Medical Account-state
- 12P Geoduck Aquaculture Research-state

While the vast majority of funding for operating the University is "non-appropriated" and exempt from allotment controls, the GOF funding sources listed above are considered "Appropriated Funds" in the State's budget and subject to the State's allotment controls.

According to UW, "Both executive and legislative staff monitor actual spending compared to allotments. UW is required to submit allotments (monthly spending plan by appropriation index code cast to program code and object code) for both state appropriations (AFRS Account 001, AFRS Account 08A and all provisos in separate funds) and net operating fee revenue (AFRS Account 149). In addition, UW must use separate appropriation codes to plan spending for provisos."

UW provides a spending plan to the State that identifies the types of expenses and activities to be funded using the GOF (state support and tuition) monies. UW first expends funds from the AFRS Account 149 and then monthly it prepares a journal voucher to charge appropriate expenses to State AFRS Account 001.

In meetings with UW budget and finance staff, we were told that during the three biennia of our scope, UW in cooperation with OFM, agreed to take a different approach to drawing down the state appropriated funds. In the early years of our audit period, UW's practice was to first utilize the State's funds or to divide amounts by 12 and draw-down funds each month equally distributed. The State refined its approach and required universities to match the draw-down of State funds to match the use of these funds. Starting in Fiscal Year 2011, a new process commenced having all expenses first charged to AFRS Account 149 (unappropriated funds) and

[25] ELT account also included in "Near General Fund "

on a monthly basis, these expenses are moved to (or drawn from) AFRS Account 001 by journal voucher.

Our testing reveals that UW applies this basic agreement by first expending from AFRS Account 149 fully and then drawing down general funds only to the extent of actual expenses and not to exceed the amount allotted for the month, which is pre-approved by OFM. This change in approach was apparent in the OFM allotment worksheets we reviewed for the 2011-2013 fiscal biennium. We did note that in Fiscal Year 2011 the pattern of expenditures did not always follow this policy directive perfectly; UW management noted that this was because "we were still getting accustomed to the change. However, generally, this is how it should work and why it was important that we pulled org level expenditures from [AFRS Account] 001 and [AFRS Account] 149 for FY08, FY09, FY10 and FY11."

Our review of the spending plan documents as well as the FAS figures support this newly adopted approach. We noted that while the amounts per month by fund differ across the years, the ultimate spending for each fund ties-out and is consistent to the plans; moreover, expenses charged are primarily for instruction salaries and related expenses. Our testing found that in each biennium UW operated in agreement with the OFM approved spending plan; expenditures for each appropriated fund traced and reconciled between FAS and the OFM allotment documents; and we noted no exceptions or reportable issues.

What is the Nature of Revenue and Expenses Associated with the Higher Education Operating Fees Account (AFRS Account 149)?

To understand AFRS Account 149 revenues and expenses, one must understand AFRS Account 149's relationship with the University of Washington's General Operating Fund (GOF). Specifically, GOF is funded through a combination of State and tuition-based support:

- State Appropriations (tax revenue) and
- Operating Fee Revenue (tuition).

The State appropriations portion of GOF is accounted for in the State's AFRS Fund 001 as the University is reimbursed for approved expenses, largely salaries.

The operating fee revenue portion (tuition) of GOF is accounted for through the State's AFRS Account 149 and UW's FAS Fund 149. Activity is posted to FAS Fund 149 as operating fee revenue is received and expenses are incurred. FAS Fund 149 operating fee revenues are received via student payments through the University's Student Fiscal Services office within Finance and Facilities Financial Management Division.

AFRS Account 149 Operating Fee Revenue: Student Tuition

UW relies heavily on student tuition, or "operating fee" revenue to support its operating expenses. UW also relies, to a lesser extent, on State appropriation support for some operating expenses; this activity is recorded in the State's general fund (AFRS Account 001) and is not recorded through the University's AFRS Account 149, which is the focus of this audit. However, State appropriations and operating fees are combined as GOF by UW to support its operations

While operating fee revenue is the amount of revenue actually recorded in AFRS Account 149, operating fee revenue does not equal gross tuition and fees charged to students or reflect what *should be* generated based upon the enrollment. Some tuition and fees are not recorded in AFRS Account 149. Specifically, some tuition is waived (not collected)—this revenue is considered foregone revenue as it simply reduces a student's tuition bill. Other tuition and fee amounts are collected, but set-aside in different AFRS accounts by legislative mandate for financial aid and other purposes. Simply stated, operating fee revenue is the amount of revenue recorded in AFRS Account 149 after reducing tuition and fees by the following specific factors[26]:

[26] University of Washington, *Activity Based Budgeting Tuition Revenue Distribution Manual*

- Waivers—foregone revenue: some students are entitled, based upon University policy or Washington statute, to have some portion of their tuition "waived." As these are funds that "could have been collected," but were not, these are considered foregone revenue. UW cites waivers granted to graduate teaching assistants and veterans as examples of those granted waivers.

- University policy also dictates that 4 percent of the "total resident portion of tuition charged be used to pay for tuition waivers rather than for operations." This four percent is to be split to afford 3 percent of these funds for need-based waivers and 1 percent for those demonstrating merit.

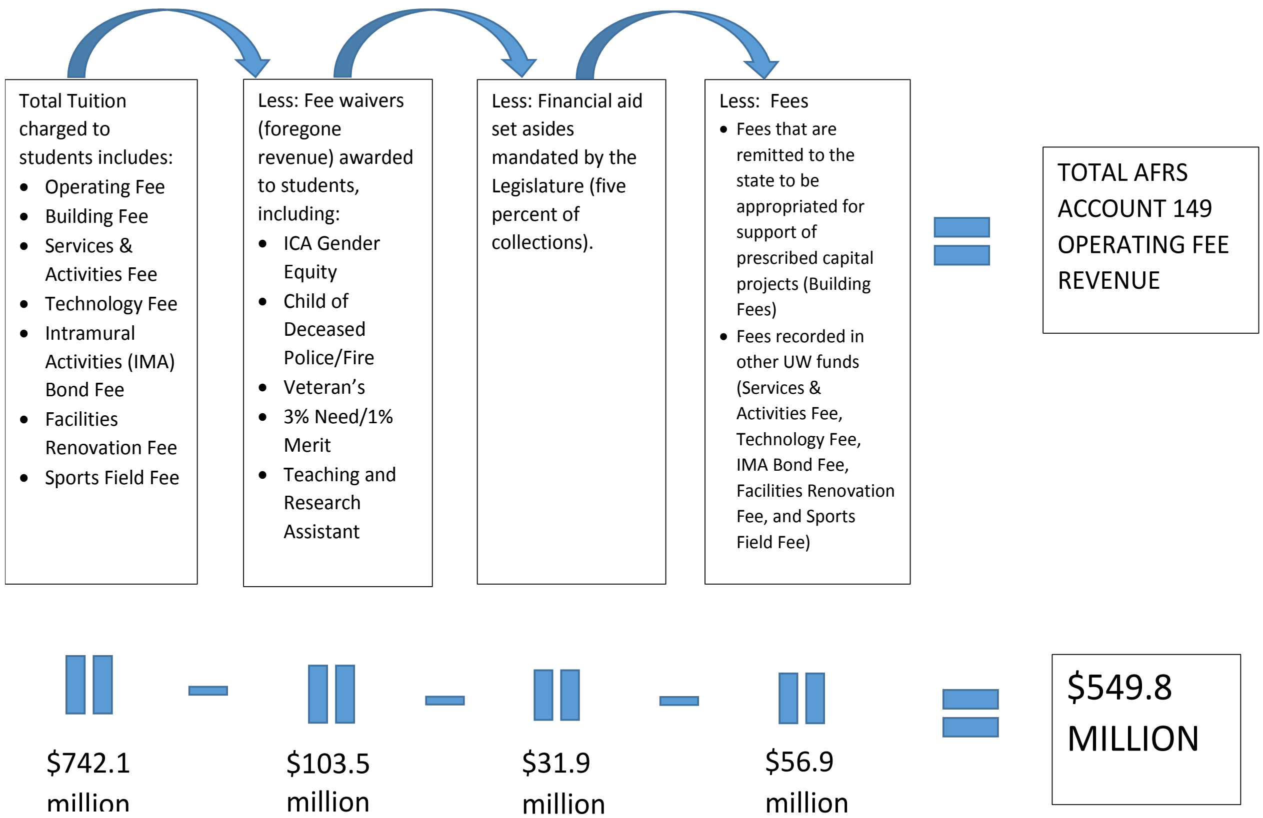
- Financial Aid: In compliance with State Code[27], UW sets aside 5 percent of net collections for financial aid to students demonstrating need. These set asides reduce actual tuition collections as these are cash assistance (financial commitments) awarded to students and thus, not available for University support and not recorded through AFRS Account 149.

- Fees: Certain fees charged to students, such as the building fee, services and activities fee, technology fee, etc. are collected and either remitted to the State to be appropriated back to the University later for support of capital projects or are recorded in other UW Funds; thus, these collected fees are not recorded through AFRS Account 149.

Exhibit 12 provides an example of how total Fiscal Year 2013 tuition and fees charged to students resulted in the amount of operating fee revenue ultimately recorded for the year in AFRS Account 149.

[27] RCW 28B.15.820 and RCW 28B.15.031.

Exhibit 12. Calculation of AFRS Account 149 Fiscal Year 2013 “Operating Fee Revenue”



AFRS Account 149 Operating Fee Revenue Trends

The University’s AFRS Account 149 operating fee (tuition) revenue has significantly increased over the last three biennia—almost a 100 percent increase from $276.6 million in Fiscal Year 2008 to $549.8 million in Fiscal Year 2013, as reflected in Exhibit 13. Operating fee revenue has grown largely as a result of increases related to resident and non-resident undergraduate student enrollment as well as increases to tuition rates, as reflected in Exhibits 14 and 15. Collectively, for all three campuses, undergraduates accounted for about 78 percent of student enrollment and 76 percent of collected tuition during academic year 2013.

While overall student enrollment has increased 12 percent and total undergraduate enrollment has increased nearly 16 percent from academic years 2008 to 2013, non-resident undergraduate enrollment, students paying higher tuition rates, has increased 78 percent during the same period.

Exhibit 13. Operating Fee Revenue as Reflected in FAS 149 for Reporting to AFRS Account 149

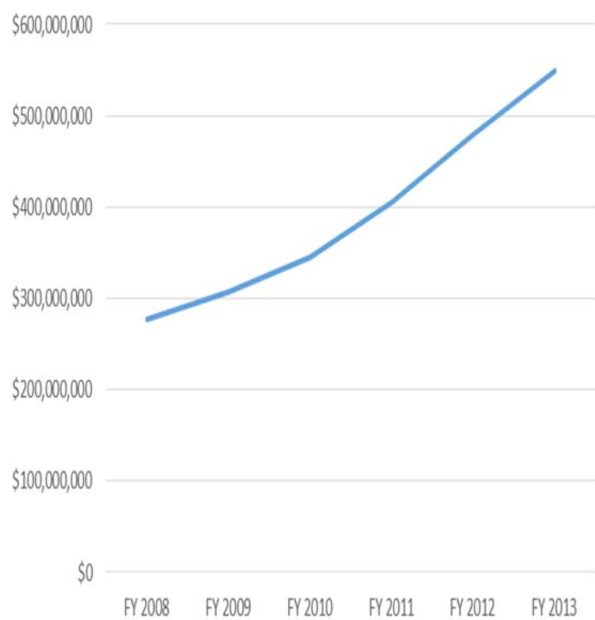


Exhibit 14. Undergraduate Tuition Rates Academic Years 2008 – 2013

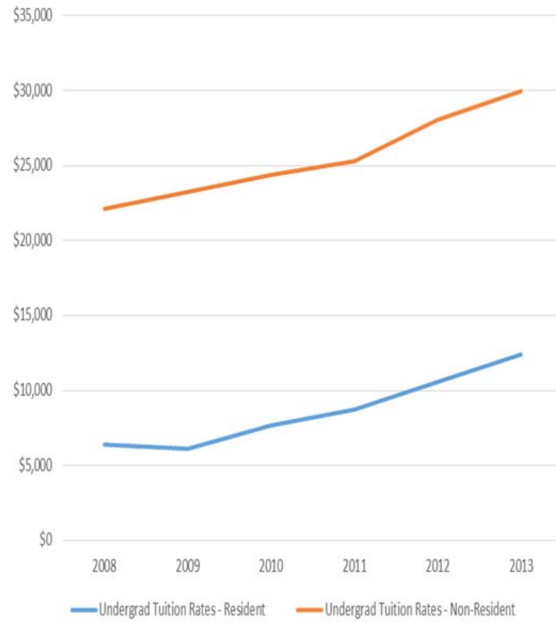
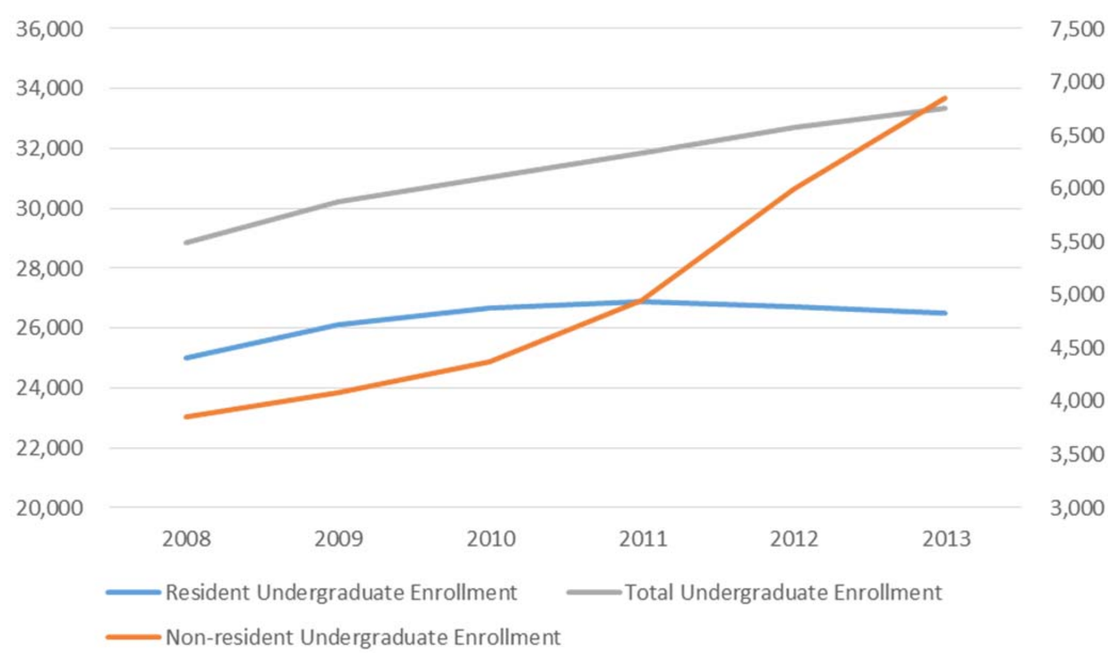
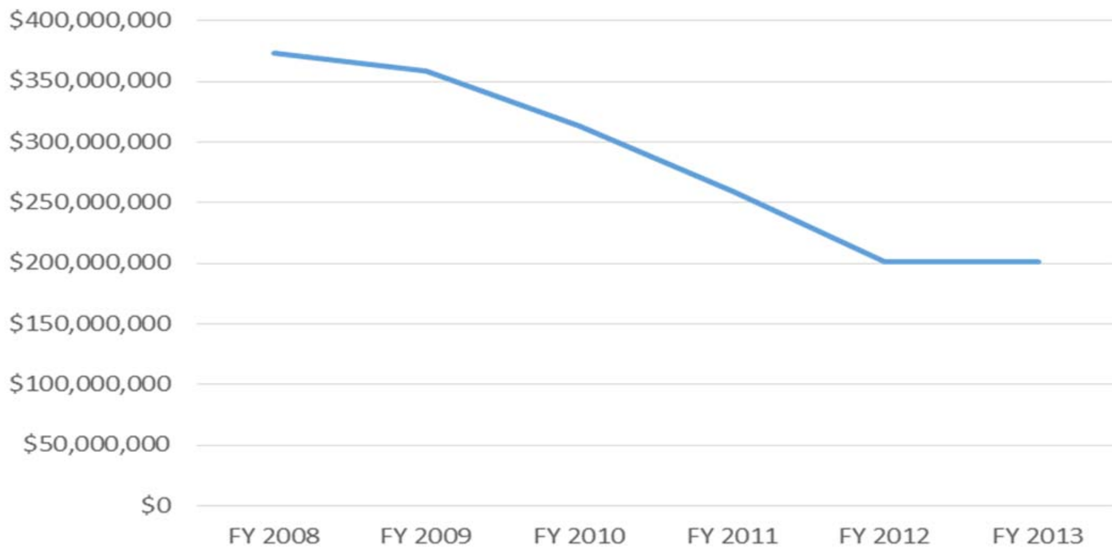


Exhibit 15. Undergraduate Enrollment Academic Years 2008 - 2013



Tuition rates have increased over the last several years to compensate for the reduction in State appropriation portion of GOF funding. Specifically, State appropriations have decreased 46 percent between Fiscal Years 2008 and 2013, as reflected in Exhibit 16.

Exhibit 16. AFRS Account 001 State Appropriation



According to the 2012 Financial Report, the increase in tuition rates has been partially offset by increases in scholarships and fellowships. Additionally, between Fiscal Years 2010 and 2013, nearly $28 million was made available for additional financial aid as a result of increased tuition. These amounts are above and beyond the legislatively mandated financial aid set-asides.

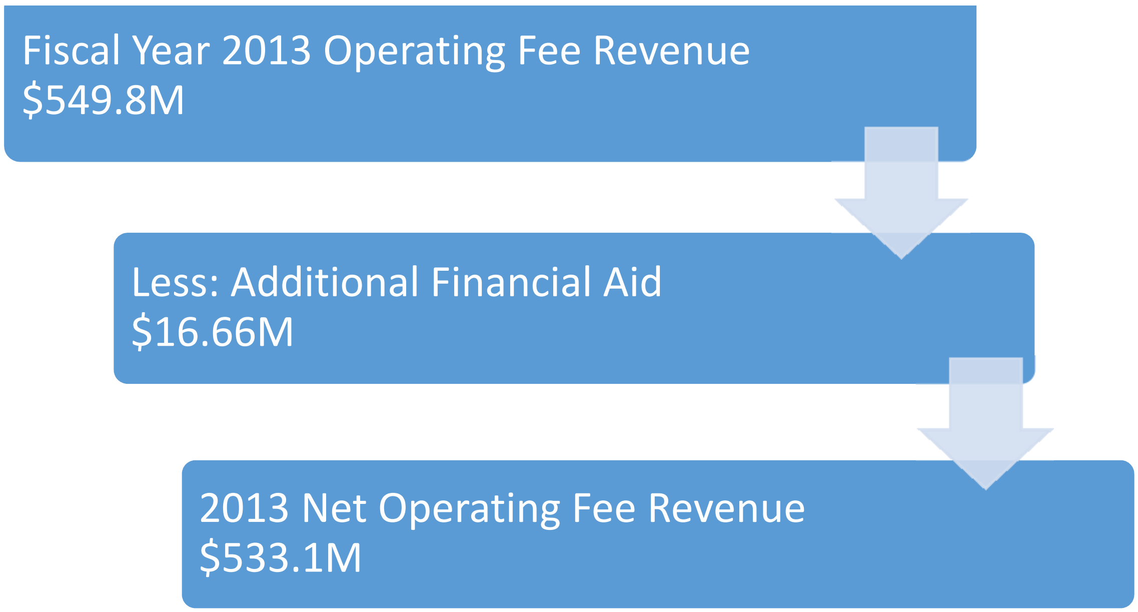
AFRS Account 149 Operating Fee Revenue Available to Fund Operating Expenses

Beginning in Fiscal Year 2010, operating fee revenue has been reduced by the transfer of certain revenues into FAS Fund 846 related to additional educational grants and financial aid associated with increased tuition, which the University describes as “net operating fee revenue”:

- FY 2010—$1.34 million
- FY 2011—$2.96 million
- FY 2012—$6.66 million
- FY 2013—$16.66 million

For example, Fiscal Year 2013 operating fee revenue of $549.8 million (as shown earlier in Exhibit 13) was reduced by $16.7 million to allow for additional education grants and financial aid, which resulted in net operating fee revenue of $533.1 million for Fiscal Year 2013. Exhibit 17 illustrates the Fiscal Year 2013 calculation of $533.1 million in "Net Operating Fee Revenue."

Exhibit 17. Fiscal Year 2013 "Net Operating Fee Revenue"



Further, Exhibit 18 provides a break-down of the $533.1 million in net operating fee revenue generated in Fiscal Year 2013 by tuition group and residency categories. The vast majority of net operating fee revenue is generated by the University's undergraduate students.

Exhibit 18. Fiscal Year 2013 Breakdown of Net Operating Fee Revenue by Tuition and Residency Categories

Campus	Tuition Group	Residency	Net Operating Fee Revenue	Percentage
Seattle	Undergraduate	Resident	$179,383,466	33.6%
	Undergraduate	Nonresident	$160,532,314	30.1%
	Graduate Tier I	Resident	$7,154,927	1.3%
	Graduate Tier I	Nonresident	$12,087,460	2.3%
	Graduate Tier II	Resident	$1,227,203	0.2%
	Graduate Tier II	Nonresident	$1,318,698	0.2%
	Graduate Tier III	Resident	$4,472,721	0.8%
	Graduate Tier III	Nonresident	$8,861,438	1.7%
	College of the Environment Graduate	Resident	$1,866,250	0.4%
	College of the Environment Graduate	Nonresident	$2,939,219	0.6%
	Education Graduate	Resident	$3,729,733	0.7%
	Education Graduate	Nonresident	$2,139,057	0.4%
	MLIS (Master of Library and Information Science)	Resident	$59,978	0.0%
	MSW (Master of Social Work)	Resident	$2,276,980	0.4%
	MSW (Master of Social Work)	Nonresident	$1,141,108	0.2%
	MPH (Master of Public Health)	Resident	$844,101	0.2%
	MPH (Master of Public Health)	Nonresident	$1,077,972	0.2%
	College of Built Environment Masters	Resident	$1,877,546	0.4%
	College of Built Environment Masters	Nonresident	$3,204,582	0.6%
	Engineering Masters	Resident	$14,527	0.0%
	Engineering Masters	Nonresident	$308,372	0.1%
	MPA (Master of Public Administration)	Resident	$2,745,065	0.5%
	MPA (Master of Public Administration)	Nonresident	$3,174,732	0.6%
	MBA (Master of Business Administration)	Resident	$2,197,146	0.4%
	MBA (Master of Business Administration)	Nonresident	$2,986,002	0.6%
	Law(Juris Doctorate)	Resident	$8,958,681	1.7%
	Law(Juris Doctorate)	Nonresident	$5,548,988	1.0%
	Law Graduate	Resident	$45,562	0.0%
	Law Graduate	Nonresident	$1,073,032	0.2%

Campus	Tuition Group	Residency	Net Operating Fee Revenue	Percentage
Seattle	Nursing Graduate	Resident	$1,257,117	0.2%
	Nursing Graduate	Nonresident	$261,272	0.0%
	PharmD (Pharmacy Doctor)	Resident	$4,662,407	0.9%
	PharmD (Pharmacy Doctor)	Nonresident	$3,010,646	0.6%
	Medicine (Medical Doctor)	Resident	$10,623,074	2.0%
	Medicine (Medical Doctor)	Nonresident	$6,888,213	1.3%
	Dentistry (Doctor of Dental Surgery)	Resident	$5,588,823	1.0%
	Dentistry (Doctor of Dental Surgery)	Nonresident	$733,122	0.1%
Bothell	Undergraduate	Resident	$27,762,482	5.2%
	Undergraduate	Nonresident	$7,093,941	1.3%
	Graduate Tier I	Resident	$305,737	0.1%
	Graduate Tier I	Nonresident	$30,628	0.0%
	Graduate Tier II	Resident	$1,489,192	0.3%
	Graduate Tier II	Nonresident	$28,450	0.0%
	Graduate Tier III	Resident	$14,029	0.0%
	Graduate Tier III	Nonresident	$17,715	0.0%
	MBA (Master of Business Administration)	Resident	$2,049,675	0.4%
	MBA (Master of Business Administration)	Nonresident	$194,601	0.0%
	Nursing Graduate	Resident	$755,052	0.1%
	Nursing Graduate	Nonresident	$23,460	0.0%
Tacoma	Undergraduate	Resident	$27,431,496	5.1%
	Undergraduate	Nonresident	$3,706,853	0.7%
	Graduate Tier I	Resident	$1,640,069	0.3%
	Graduate Tier I	Nonresident	$96,179	0.0%
	Graduate Tier II	Resident	$1,775,074	0.3%
	Graduate Tier II	Nonresident	$30,139	0.0%
	Graduate Tier III	Resident	$322,333	0.1%
	Graduate Tier III	Nonresident	$674,424	0.1%
	MBA (Master of Business Administration)	Resident	$791,984	0.1%
	Nursing Graduate	Resident	$492,729	0.1%
	Nursing Graduate	Nonresident	$98,232	0.0%
Total Fiscal Year 2013 Net Operating Fee Revenue			**$533,096,009**	**100.0%**

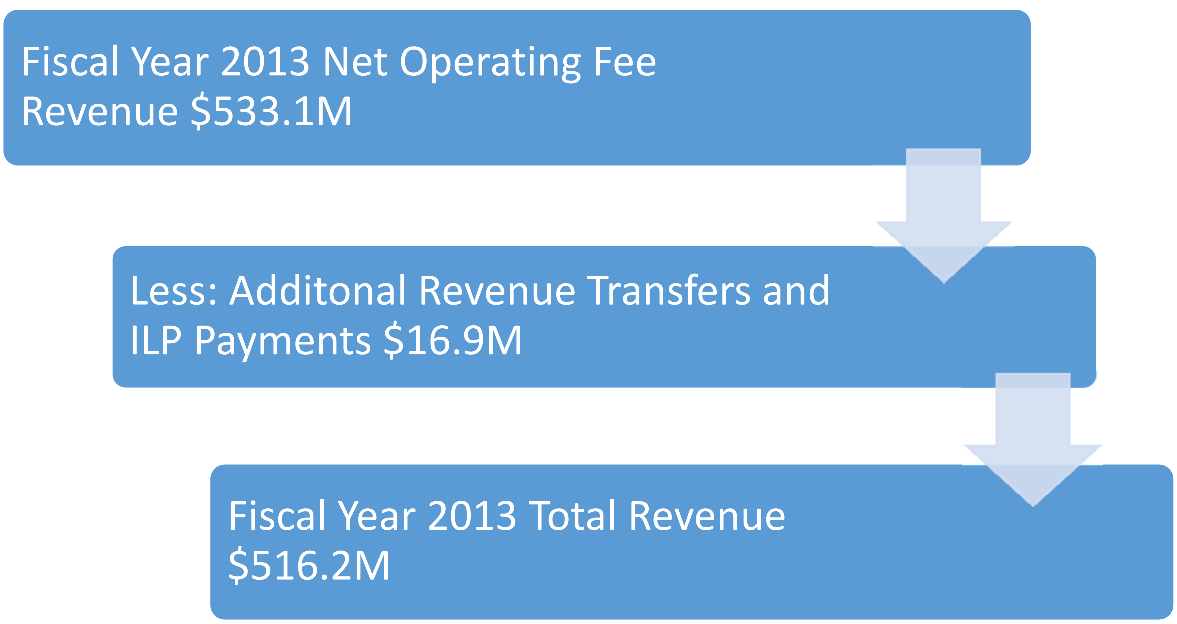
"Net Operating Fee" revenue is further reduced by the following to arrive at total revenue available to cover operational expenses:

- Revenue transfers largely related to the Husky promise commitment, UW Tower operations and facilities, UWTV Communications, and the Filer Property purchase. Revenue transfers are discussed in detail in the revenue transfer discussion in Section 5 of this report.
- Other operating transactions related primarily to principal and interest payments on Internal Lending Program (ILP) loans and State GO Bonds (Physics/Astronomy), as discussed in detailed in the ILP discussion in Section 7 of this report.

For example, Fiscal Year 2013 net operating fee revenue of $533.1 million (as shown earlier in Exhibit 18) was reduced by $16.9 million for the additional revenue transfers and other operating transactions (described above) to arrive at total revenue of $516.2 million for Fiscal Year 2013 available to fund operating expenses. Comparatively, operating expenses for Fiscal Year 2013 were $512.4 million.

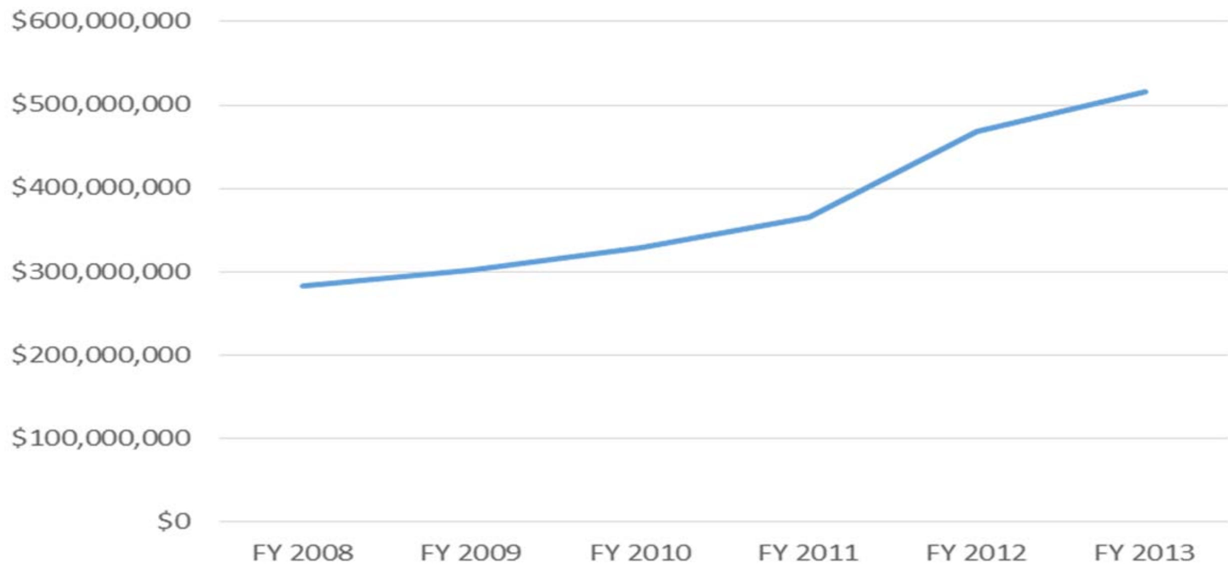
Exhibit 19 illustrates the Fiscal Year 2013 calculation of $516.2 million in total revenue available to cover operational expenses.

Exhibit 19. Fiscal Year 2013 "Total Revenue"



Similar to the trends shown for UW's operating fee revenue discussed earlier, UW's total revenue in FAS Fund 149 has also increased over the last three biennia—total revenue has increased almost 83 percent from $282.5 million in Fiscal Year 2008 to $516.2 million in Fiscal Year 2013, as shown in Exhibit 20.

Exhibit 20. Total Revenue as Reflected in FAS 149 for Reporting to AFRS Account 149[28]

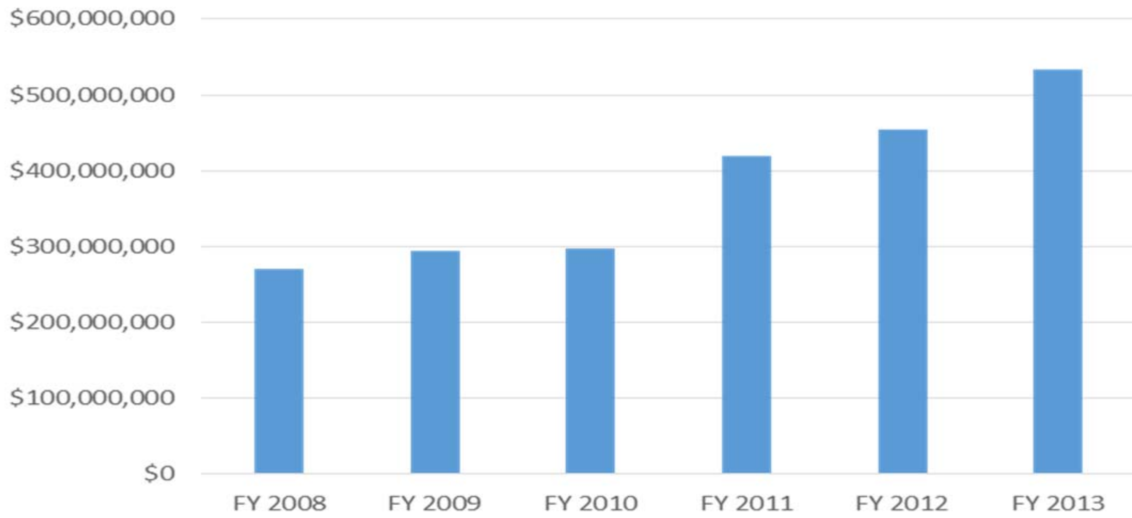


AFRS Account 149 Operational Expenses

AFRS Account 149 operational expenses generally fall into the following categories: compensation (salaries and benefits), equipment, library materials, services and supplies, utilities, debt service and other expenses. As shown in Exhibit 21, these operational expenses have increased from $271.9 million in Fiscal Year 2008 to $512.4 million in Fiscal Year 2013.

[28] FAS Revenue and Expenditures Reports for FY 2008 through FY 2013

Exhibit 21. Total Expenses as Reflected in FAS 149 for Reporting to AFRS Account 149[29]



GOF OPERATIONAL EXPENSES

To understand how UW utilizes AFRS Account 149 funding, one must understand how UW utilizes funding associated with its General Operating Fund (GOF). UW's GOF expenses are funded through both tuition (AFRS Account 149) and State appropriations (AFRS Account 001). As Exhibit 21 illustrates, AFRS Account 149 expenses have increased significantly from Fiscal Years 2008 to 2013; the following section will demonstrate, that State support has significantly decreased over the same time period. Changes in the level of either funding source impacts decisions for funding (i.e. tuition increases) with a goal to ensure sufficient GOF funding is maintained to support UW's instructional mission and administrative and operational functions. As such, the remainder of this section focuses on GOF expenses, tuition, and State support, as a whole.

While we found that total GOF expenditures have increased a reasonable 14 percent between Fiscal Years 2008 and 2013, the proportion of GOF expenses funded by State appropriations versus operating fee revenues has shifted significantly over the last three biennia with operating fee revenues being increasingly responsible for covering a greater portion of GOF expenses, as shown in Exhibit 22.

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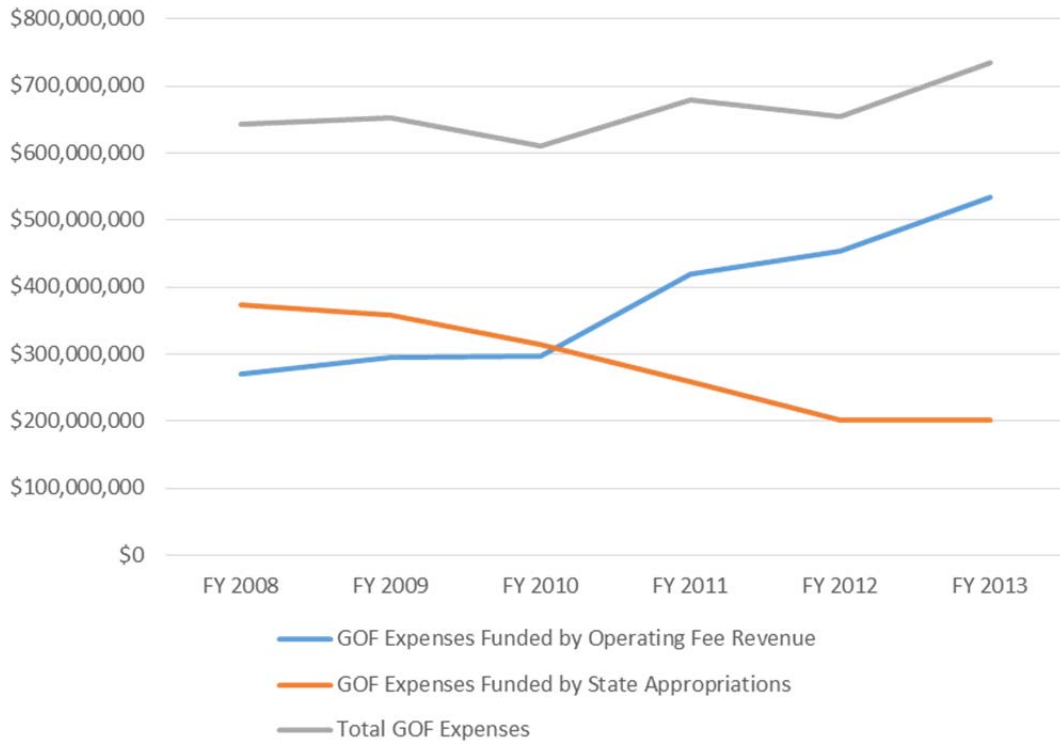
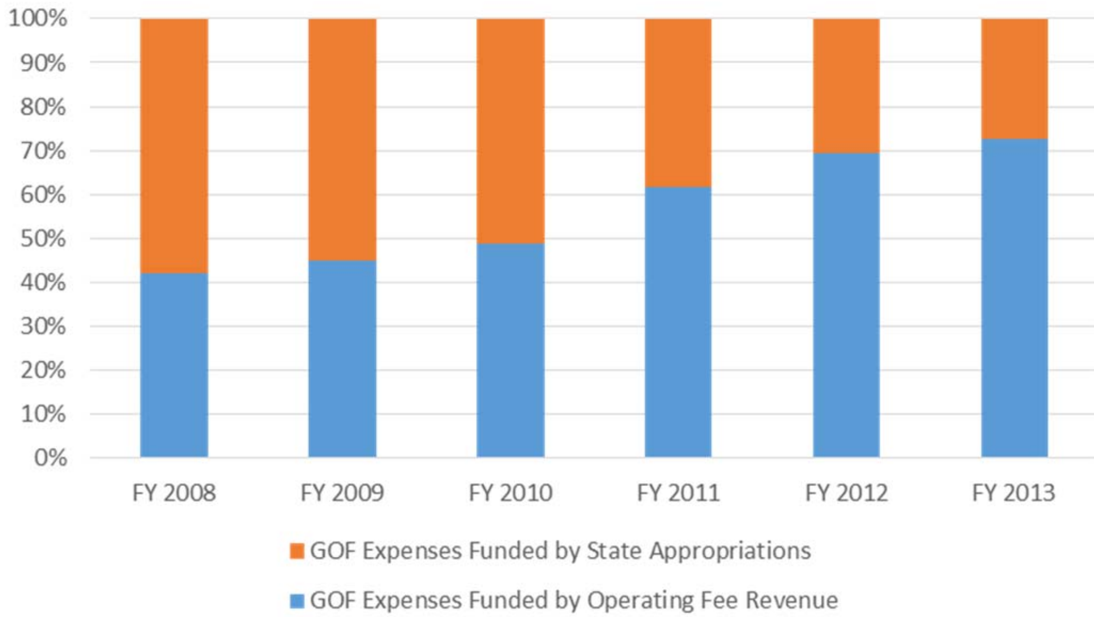
[29] FAS Revenue and Expenditures Reports for FY 2008 through FY 2013

Exhibit 22. GOF Expenses by Funding Source



In particular, in Fiscal Year 2008, 42 percent of GOF expenses were funded by operating fee revenues and 58 percent were funded by State appropriations; in Fiscal Year 2013, 73 percent of GOF expenses were funded by operating fee revenues and 27 percent were funded by State appropriations. The reason for this shift is simple—the percentage of GOF expenses supported by State appropriations greatly declined from Fiscal Year 2008 to 2013, shown in Exhibit 23.

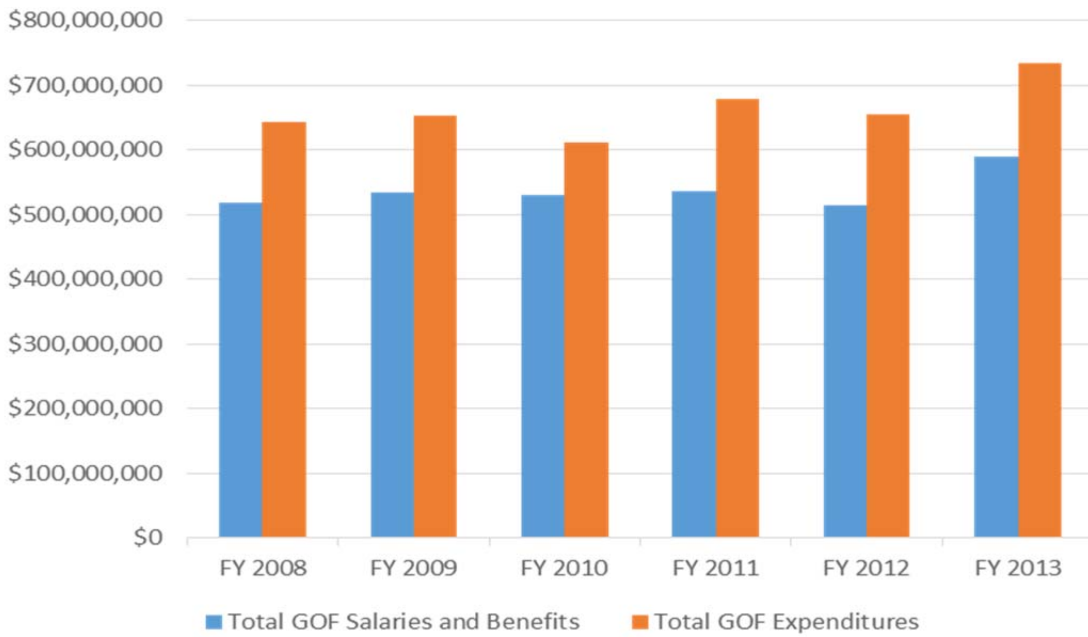
Exhibit 23. Percentage of GOF Expenditures By Funding Source[30]



Further, we found that both total GOF expenses and GOF compensation-related (salaries and benefits) expenses remained relatively stable over the last three biennia, as shown in Exhibit 24.

[30] FAS Revenue and Expenditures Reports for FY 2008 through FY 2013

Exhibit 24. GOF Compensation-related Expenses Compared to Total GOF Expenses[31]

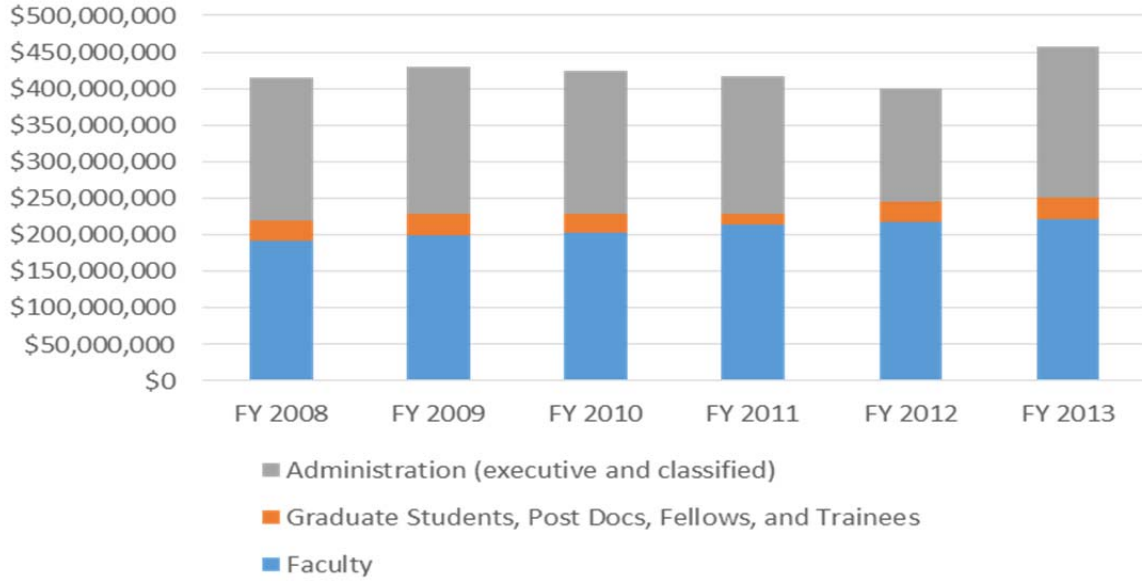


Our analysis reveals that the vast majority of GOF expenses have consistently been compensation-related: in Fiscal Year 2008, 81 percent of the University's total GOF funding was spent on compensation compared to 80 percent in Fiscal Year 2013. Additionally, we found that the *salary* portion of GOF compensation accounted for the vast majority of GOF total expenses—about 64 percent over the last three biennia.

In addition, as shown in Exhibit 25, faculty and administrative salaries comprise the largest components of GOF salary expenses, with faculty salaries averaging about 49 percent of these expenses across the three biennia and administrative salaries averaging about 45 percent.

[31] FAS Revenue and Expenditures Reports for FY 2008 through FY 2013

Exhibit 25. GOF Salary Expenses by Position Type[32]



Beyond compensation-related expenses that account for about 80 percent of all GOF expenses, the remaining 20 percent of GOF expenses typically fall within the following key categories:

- Services—Attorney General services, physical plant services, outside services (painting, printing, maintenance, etc.), miscellaneous contractual services, technology recharge fee, and interagency reimbursements
- Supplies—Non-capitalized equipment, computer supplies and software, and office supplies
- Utilities—Electricity, fuel, water, garbage, and sewer
- Debt Service—ILP and capital leases
- Other Expenses—Property rentals, insurance, licenses and permits, postage and other grants/subsidies
- Equipment—Computer equipment

All GOF expenses are tied to a budget number by activity type; all budget numbers have a funding source, such as GOF or DOF, attached. Specific to salary expenses, the funding source for a position is determined by examining the activities the individual will be responsible for as well as the position type—typically, faculty positions charged primarily with teaching are funded by GOF. Once the funding for a position is determined, an entry is made in UW's payroll system, Higher Education

[32] FAS Revenue and Expenditures Reports for FY 2008 through FY 2013

Payroll/Personnel System (HEPPS), to link the position to a budget number, which is attached to a funding source. All salary transactions are automatically generated by HEPPS and recorded in the FAS system.

MANAGEMENT AND CONTROL OVER SPENDING GOF FUNDS

Generally, it appears that UW's purchasing controls are established primarily through University-wide policies related to budget restrictions and reconciliations, and departmental/unit-level policies and processes related to segregation of duties, security, authorization, and documentation. The primary methods for purchasing goods and services involve using Pro Card, eProcurement Catalog Order, PAS purchase order, and Central Travel Account.

According to UW, there are no Revised Codes of Washington (RCW) that provide direction as to the type of expenses that can be paid with GOF funds; rather, UW is afforded significant discretion over the use of GOF funds to support its academic mission and operations. While there are no specific policies that describe what can be purchased on GOF funds, there are University and State Administrative and Accounting Manual (SAAM) expenditure rules that apply across most University programs and activities. These rules relate to areas such as:

- Travel
- Food
- Employee Recognition
- Procurement
- Equipment

Additionally, as described earlier in Section 3 related to UW's budgeting processes, the State requires the University to provide a spending plan for the State's support of UW. Over the years this process has varied, but generally UW must submit a spending plan to draw down funds on a reimbursement basis. Also, the Legislature may, at any time, specify restrictions on how GOF funds may be expended, the purposes for which the expenditures are made, and the expenditure amount.

To provide reasonable assurance that UW's purchasing activity was properly authorized, reasonable, allowable, and correct, UW's Internal Audit performs periodic audits of procurement systems, including Pro-Card activity and regular reviews of monthly budget reconciliations prepared by colleges, schools, departments, and units.

SECTION 4. Revenues and Expenditures Recorded in FAS Funds Included in AFRS Account 148

What is the Nature of Revenue and Expenses Associated with the Higher Education Dedicated Local Account (AFRS Account 148)?

AFRS Account 148 does not include State support or proviso funds. Instead, revenue is generated from self-sustaining/cost recovery activities, business-type activities, and indirect cost recoveries. As a result, most of the funds in AFRS Account 148 are "restricted" for specific purposes and are not spent on general University operations. In order to understand AFRS Account 148 revenues and expenses, one must first understand the funds and the related purposes for each fund that feeds into AFRS Account 148.

FAS Funds Feeding Into AFRS Account 148

During the period of our review, the State AFRS Account 148 – Dedicated Local Account included activity from six University of Washington FAS Funds (FAS Funds 143, 144, 147, 148, 150, and 372) that are "rolled-up" to the State AFRS Account 148, as shown in Exhibit 26.

Exhibit 26. Revenue and Expenses as Reflected in FAS Funds for Reporting to AFRS Account 148 (in thousands)[33]

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Revenue						
FAS Fund 143	$4,782	$4,895	$5,074	$5,159	$5,232	$5,343
FAS Fund 144	$248,703	$235,648	$263,480	$323,522	$298,550	$285,090
FAS Fund 147	$(1,904)	$(2,551)	$9,968	$211	$536	$(1,492)
FAS Fund 148	$162,658	$214,810	$235,414	$196,605	$215,681	$227,215
FAS Fund 150[A]	-	-	-	-	$68,223	$75,743
FAS Fund 372[B]	$751	-	-	-	-	-
Total Revenue	**$414,990**	**$452,803**	**$513,937**	**$525,496**	**$588,221**	**$591,899**
Expenses						
FAS Fund 143	$3,787	$4,059	$3,888	$4,591	$5,843	$4,704
FAS Fund 144	$213,380	$207,952	$229,683	$193,429	$223,824	$208,299
FAS Fund 147	$259	$202	$(295)	$109	$(172)	$331
FAS Fund 148	$195,097	$201,199	$226,421	$236,921	$199,707	$205,428
FAS Fund 150[A]	-	-	-	-	$56,507	$64,855
FAS Fund 372[B]	$(5,119)	-	-	-	-	-
Total Expenses	**$407,404**	**$413,413**	**$459,696**	**$435,050**	**$485,710**	**$483,617**

Notes: [A]FAS Fund 150 is only applicable in FY2012 & FY2013; [B]FAS Fund 372 is only applicable in FY2008

Descriptions of each of the six funds are as follows:

- **FAS Fund 143:** This fund records activity related to the Student Technology Fee (STF). Specifically, revenue in this fund is primarily derived from STF fees collected from students. Use of STF revenue is restricted by statute and may be used only for technology resources for general student use, such as access to the Internet, e-mail, computer and multimedia workstations and laboratories, computer software, and dial-up telephone services. Pursuant RCW 288.15.051, a student-led STF Committee at each campus approves an annual expenditure plan for the fee revenue. With the exception of Fiscal Year 2012, revenues generated from the Student Technology Fee have exceeded expenditures.

- **FAS Fund 144:** This fund acts as the University's Designated Operating Fund. The primary source of revenue for the fund is indirect cost recovery from federal, State, and other grants and contracts as well as other revenue sources including institutional overheads, Summer Quarter operating fees, investment income, miscellaneous fees, UW Bothell and UW Tacoma administrative overheads, administrative allowances, etc.

[33] FAS Revenue and Expenditures Reports for FY 2008 through FY 2013 – FAS Funds Included in AFRS Account 148

- **FAS Fund 147:** This fund is called the Dedicated Local Fund 2 and is used to record activity related to suspense accounts.

- **FAS Fund 148:** This fund is called the Dedicated Local Fund and acts as the University's central banking fund (common paymaster). Revenue in this fund is derived from a variety of sources including, course fees, academic fees, and other miscellaneous fees and charges. Expenditures in this fund include Summer Quarter expenses, and academic self-sustaining activities such as Washington, Wyoming, Alaska, Montana, and Idaho (WWAMI) Regional Medical Education program, medical residents, and dental clinics.

- **FAS Fund 150:** This fund is used to track activity related to the University of Washington Educational Outreach Operations. Educational Outreach programs are fee-based and self-sustaining. This fund was established in Fiscal Year 2012; activity related to Educational Outreach was previously recorded in FAS Fund 148. Revenue is primarily derived from tuition and fees charged to students and program participants.

- **FAS Fund 372:** This fund is no longer used by the University of Washington. In the past this fund was used to record activity related to debt services. Activity from this fund was only applicable to AFRS Account 148 in Fiscal Year 2008.

Revenue Reflected in FAS Funds Included in AFRS Account 148

Since Fiscal Year 2008, revenue reported in FAS Funds included in AFRS Account 148 has increased by 43 percent from nearly $415 million in Fiscal Year 2008 to $591.9 million in Fiscal Year 2013, as shown in Exhibit 27. As mentioned earlier, AFRS Account 148 revenue is primarily generated from self-sustaining/cost recovery activities, business-type activities, and indirect cost recoveries.

Exhibit 27. Total Revenue as Reflected in FAS Funds for Reporting to AFRS Account 148 (in thousands)[34]

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Federal Grants and Contracts	$181,002	$181,930	$209,891	$230,089	$230,698	$226,169
Sales and Services of Educational Depts.	$115,755	$123,313	$136,402	$126,171	$157,741	$163,111
Tuition & Fees	$121,764	$117,021	$159,389	$198,381	$159,505	$249,610
Investment Income	$46,341	$35,307	$32,217	$15,588	$36,419	$(2,545)
Grant & Contract Revenue or Contributions	$11,847	$13,866	$13,942	$14,826	$13,974	$15,922
State & Local Grants & Contracts	$6,531	$7,329	$7,592	$8,117	$7,734	$3,010
Revenue Transfers	$(73,741)	$(25,102)	$(23,741)	$(54,734)	$(20,404)	$(47,669)
Other Revenue	$5,491	$(861)	$(21,755)	$(12,942)	$2,556	$(15,710)
Total Revenue	**$414,990**	**$452,803**	**$513,937**	**$525,496**	**$588,221**	**$591,899**

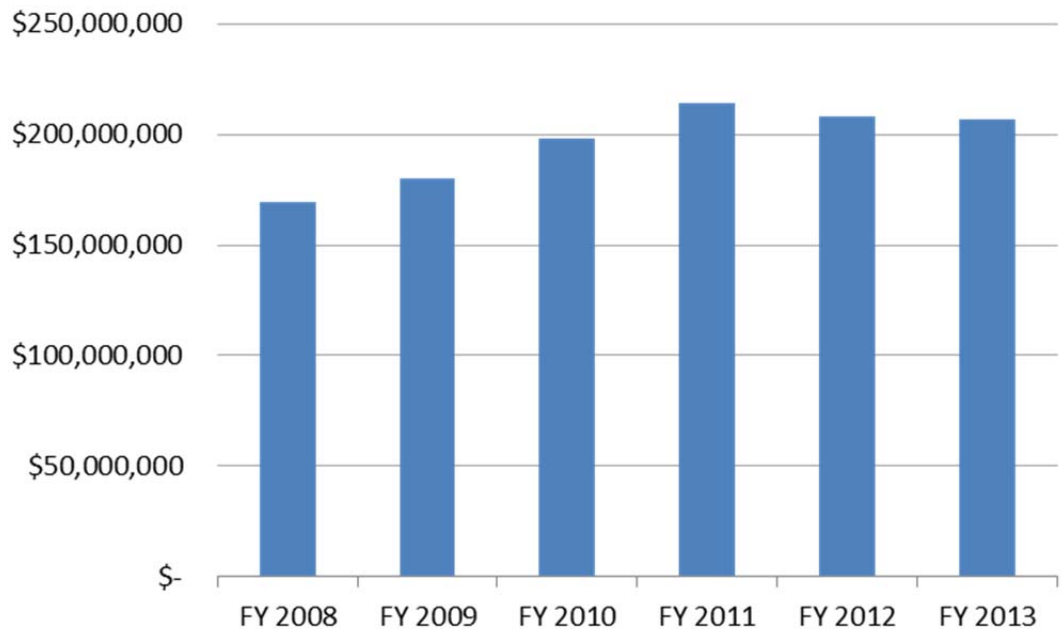
INDIRECT COST RECOVERY REVENUE

The largest source of revenue for AFRS Account 148 is indirect cost recovery (ICR) revenue generated from federal, state, and other grants and contracts. As discussed earlier in the report, 35 percent of the ICR revenue generated is first allocated to the "home" unit of the grant or contract. The remaining 65 percent is allocated by the Provost following Activity Based Budgeting to various units. As shown in Exhibit 28, ICR revenue grew from nearly $169.5 million in Fiscal Year 2008 to $206.5 million in Fiscal Year 2013, an increase of nearly $37.0 million or nearly 22 percent. Between Fiscal Year 2009 and Fiscal Year 2013 the University received a significant amount of new grant money related to the American Recovery and Reinvestment Act (ARRA); this increase in grant funding impacted the amount of indirect cost recovery revenue received by the University.

ICR funds are the primary source of infrastructure support for the University's more than $1 billion research portfolio and help ensure general State support and tuition revenue are not used to subsidize research infrastructure at the University.

[34] FAS Revenue and Expenditures Reports for FY 2008 through FY 2013 – FAS Funds Included in AFRS Account 148

Exhibit 28. Indirect Cost Recovery Revenue[35]



EDUCATIONAL OUTREACH PROGRAM FEES

In addition to offering classes and programs geared toward traditional students, UW offers other programs and services that are geared toward non-traditional students, including working adults, and are primarily offered in the evenings, weekends, and online. These programs are administered by UW Educational Outreach. All programs offered under Educational Outreach are fee based and self-sustaining programs. A wide variety of programs offered by UW fall within the Educational Outreach umbrella, including:

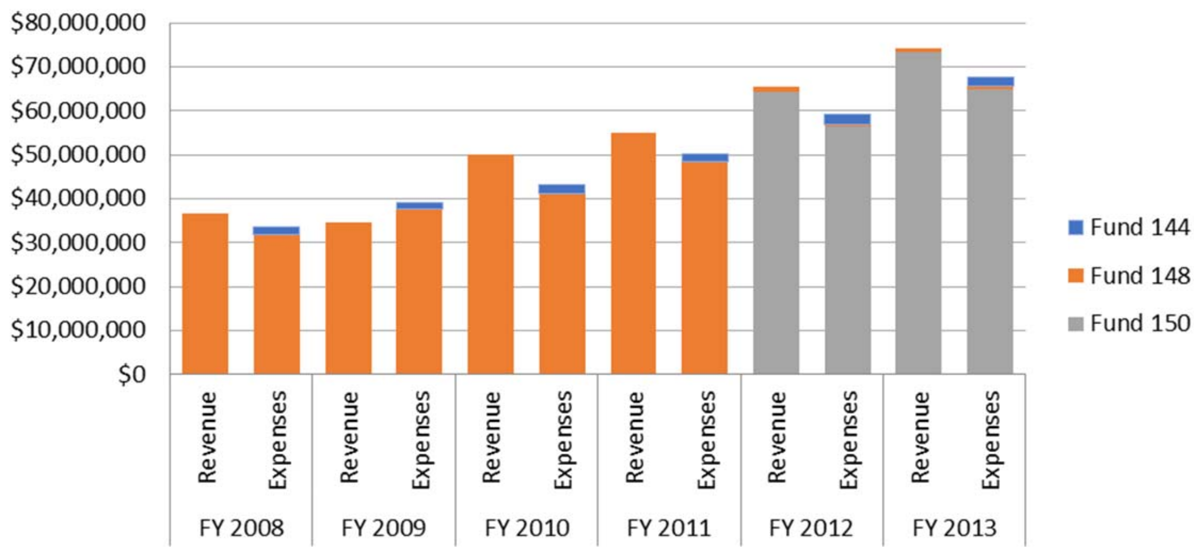
- Professional and Continuing Education Programs, including 75 master's degree programs and undergraduate degree completion (Online and Evening)
- Summer Youth Program
- UW in High School
- Early Fall Start
- Massive open online courses
- Community access – Non-degree enrollment
- Osher Lifelong Learning Institute
- Summer Quarter

[35] FAS Revenue and Expenditures Reports for FY 2008 through FY 2013 – FAS Funds Included in AFRS Account 148

- Study abroad programs for international students
- 130 certificate programs, including 41 online
- Conference services
- Partnerships with other universities, corporations, and international partners

In the University's financial accounting system, FAS, revenue and expenditures related to Educational Outreach are coded and tracked at the organization dean level designated as "255 Educational Outreach." Prior to Fiscal Year 2012, financial activity related to Educational Outreach, not including Summer Quarter, was primarily recorded in FAS Fund 148, with some activity in FAS Fund 144. From Fiscal Year 2012 forward, financial activity has primarily been recorded in FAS Fund 150, with some activity also in FAS Funds 144 and 148. Although Summer Quarter is administered by Educational Outreach, activity related to Summer Quarter is separately tracked.

Exhibit 29. Educational Outreach Revenue and Expenditure by FAS Fund[36]



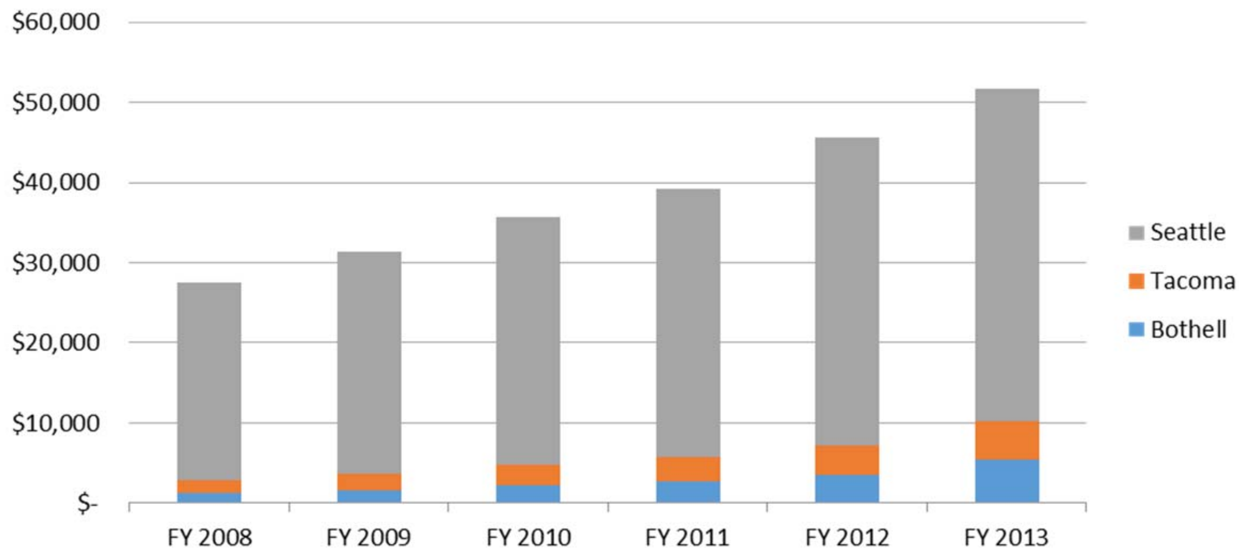
Educational Outreach revenues are derived mostly from "tuition and fees" charged for services and programs offered—programs offered through Educational Outreach do not receive state support. As illustrated in Exhibit 29 above, Educational Outreach revenue has increased from nearly $36.7 million in Fiscal Year 2008 to nearly $74.2 million in Fiscal Year 2013.

[36] FAS Revenue and Expenditures Reports for FY 2008 through FY 2013 - Organization Dean Level "255 Educational Outreach." Amounts reported do not include Summer Quarter.

SUMMER QUARTER

Summer quarter courses are administered by Educational Outreach. Similar to Educational Outreach, Summer Quarter is self-sustaining and does not receive State support. The Summer Quarter fees charged to students mirrors the tuition rates charged for the other State-supported terms (autumn, winter, and spring quarters). Summer Quarter operating fees are recorded in FAS Fund 144 and accounted for separately from other quarters, which are recorded in FAS Fund 149. In Fiscal Year 2013, the University collected nearly $51.7 million in Summer Quarter operating fees, of which nearly $41.5 million relates to the Seattle campus, as shown in Exhibit 30.

Exhibit 30. Summer Quarter Operating Fee Revenue[37]



STUDENT TECHNOLOGY FEE

The STF fee charged to students is intended to recover, in whole or in part, the costs of providing and maintaining particular services to students including, but not limited to: access to the Internet, e-mail, computer and multi-media workstations and laboratories, computer software, and dial-up telephone services (RCW 28B.15.051). Each campus maintains its own student-run STF Committee which is responsible for approving annual expenditure plans for the fee revenue. In Fiscal Year 2015, the STF fee charge ranged from $120 to $126 per academic year depending on the campus. Part-time students are charged a pro rata share of the fee charged to full-time students. From Fiscal Year 2008 to Fiscal Year 2013, UW collected nearly $30.5 million in STF revenue, with the largest proportion collected at the Seattle campus. Revenues and expenditures related to the STF are tracked in FAS Fund 143 separate from other DOF activity.

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[37] FAS Revenue and Expenditures Reports for FY 2008 through FY 2013 – FAS Funds Included in AFRS Account 148

Course Fees

Course Fees are additional charges to students that are intended to pay for specified course-related costs that range in purpose from field trip costs to specific supplies or resources, to private instruction. Course fees are assessed for a fraction of the courses offered at each of the three University campuses—Seattle, Tacoma, and Bothell.

As illustrated in Exhibit 31, in Fiscal Year 2013, UW collected a total of nearly $6.3 million in course fees for 1,568 courses, with a majority derived from course fees collected at the Seattle campus. The number of courses assessing course fees increased by 35 percent from 1,165 courses in Fiscal Year 2008 to 1,568 in Fiscal Year 2013 with the average course fee assessed more than doubling from $66 to $134 over the same period (refer to Exhibits 31 and 32). For Fiscal Year 2013 course fees ranged from $4 to $2,538, with an average course fee of $134 for all three campuses, as shown in Exhibit 31. For example, in Fiscal Year 2013, the School of Dentistry charged course fees ranging from $400 to $2,538; whereas, the Tacoma Computer and Software Systems charged course fees ranging from $4 to $50.

Exhibit 31. Course Fees Collected and Total Courses with Course Fees[38]

Fiscal Year		Seattle Campus	Tacoma Campus	Bothell Campus	University of Washington Total
2008	Fees Collected	$2,016,944	$75,460	$64,783	$2,157,187
	No. of Courses	1,051	61	53	1,165
2009	Fees Collected	$2,208,674	$95,673	$90,629	$2,394,976
	No. of Courses	1,111	69	72	1,252
2010	Fees Collected	$2,895,666	$112,795	$96,475	$3,104,936
	No. of Courses	1,141	73	70	1,284
2011	Fees Collected	$4,610,967	$157,909	$143,816	$4,912,692
	No. of Courses	1,285	99	87	1,471
2012	Fees Collected	$5,665,137	$202,681	$162,370	$6,030,188
	No. of Courses	1,296	138	106	1,540
2013	Fees Collected	$5,906,237	$203,030	$179,400	$6,288,667
	No. of Courses	1,323	135	110	1,568

[38] FAS Course Fee Reports for FY 2008 thru FY 2013

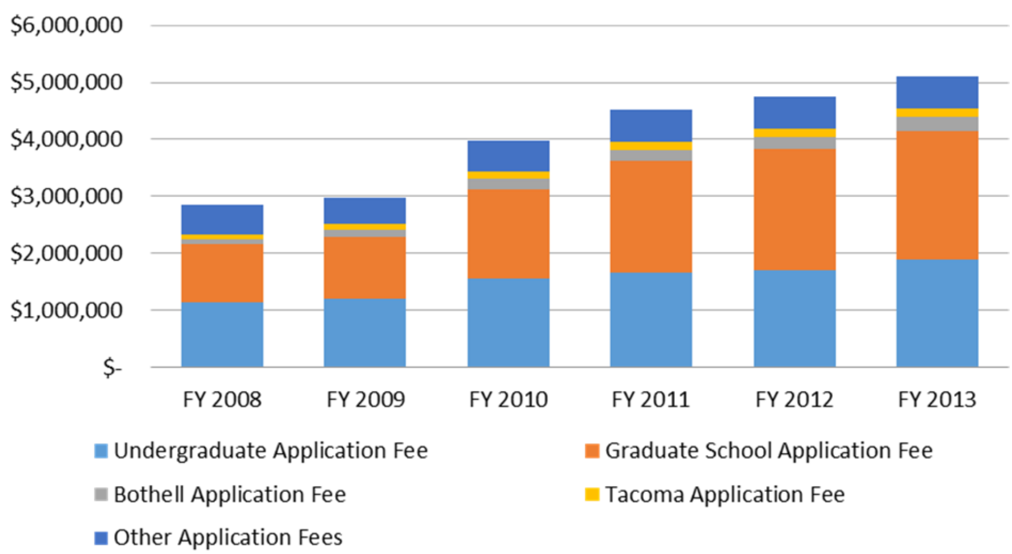
Exhibit 32. All Campuses Course Fees[39]

Fiscal Year	Minimum Fee Assessed	Maximum Fee Assessed	Average Fee Assessed
2008	$5	$665	$66
2009	$3	$701	$68
2010	$5	$701	$74
2011	$4	$2,173	$91
2012	$4	$2,538	$99
2013	$4	$2,538	$134

APPLICATION FEES

Application fees are charged to students applying to the University of Washington undergraduate and graduate programs, such as Undergraduate Application Fee, Graduate Application Fee, Dental School Application Fee, Law School Application Fee, and Pharmacy School Application Fee. As illustrated in Exhibit 33, in Fiscal Year 2013, UW collected nearly $5.1 million in application fees.

Exhibit 33. Application Fee Revenue[40]

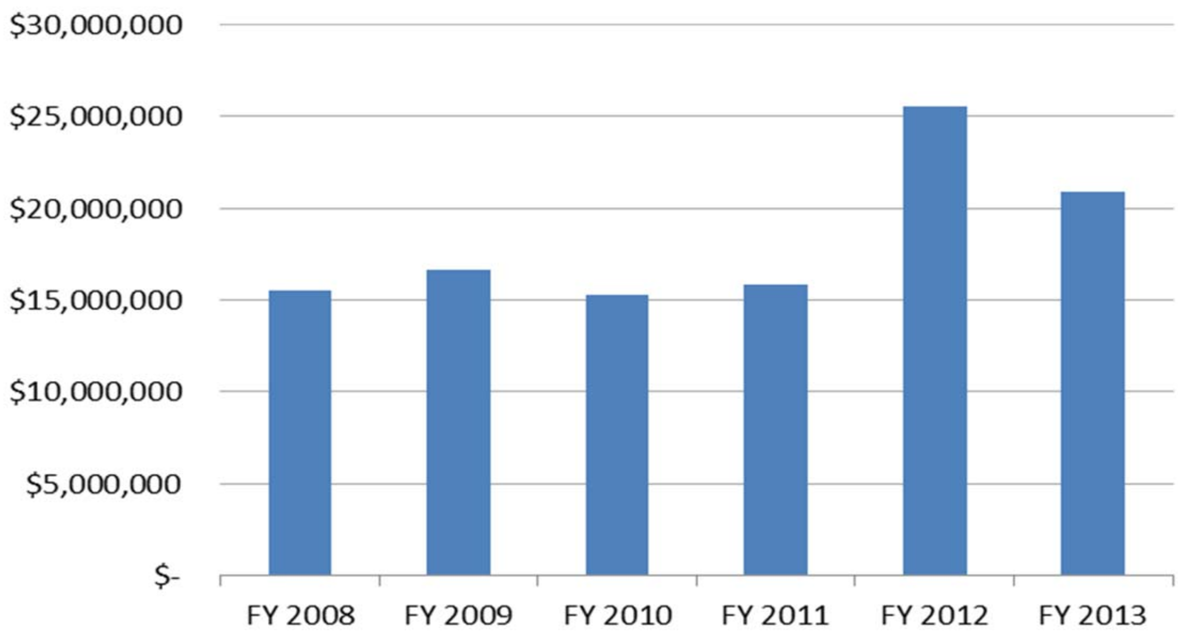


[39] FAS Course Fee Reports for FY 2008 through FY 2013
[40] FAS Revenue and Expenditures Reports for FY 2008 through FY 2013 – FAS Funds Included in AFRS Account 148

INSTITUTIONAL OVERHEAD

Revenue related to institutional overhead recorded in AFRS Account 148 increased from $15.5 million in Fiscal Year 2008 to nearly $20.9 million in Fiscal Year 2013, as shown in Exhibit 34. Institutional overhead is a Seattle-centric overhead rate that is applied to both on- and off-campus auxiliary activities to recover costs for centrally provided (or shared) administrative services.

Exhibit 34. Institutional Overhead[41]

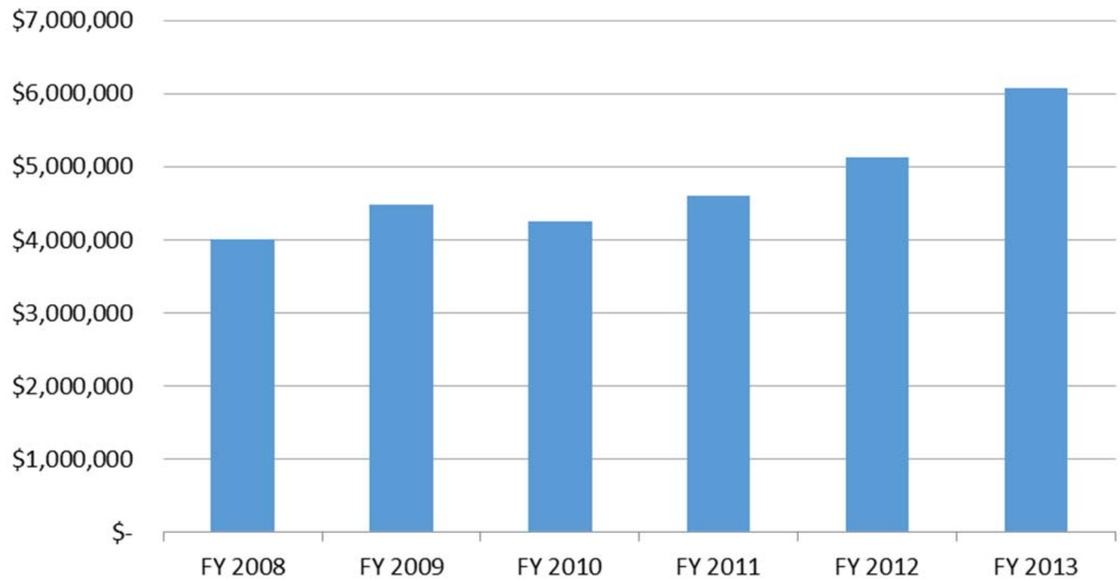


ADMINISTRATIVE OVERHEAD

Tacoma and Bothell campuses pay administrative overhead fees to the Seattle campus for shared administrative services. According to UW, Tacoma and Bothell use GOF budget authority to pay administrative overhead. Administrative overhead increased from nearly $4.0 million in Fiscal Year 2008 to nearly $6.1 million in Fiscal Year 2013, as show in Exhibit 35.

[41] FAS Revenue and Expenditures Reports for FY 2008 through FY 2013 – FAS Funds Included in AFRS Account 148

Exhibit 35. Administrative Overhead [42]

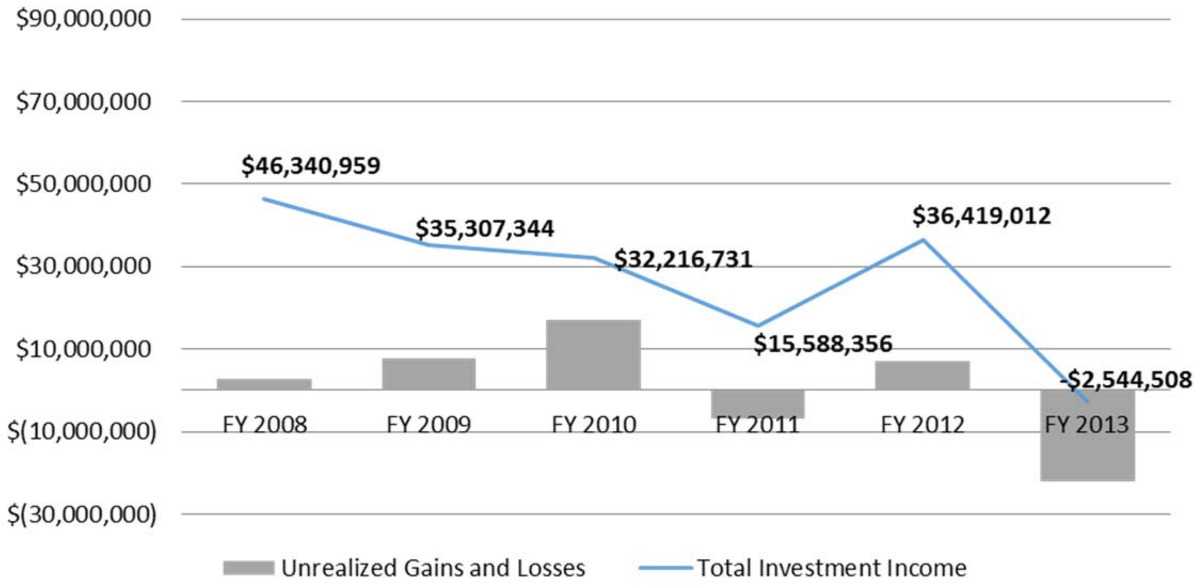


INVESTMENT INCOME

Investment income is revenue generated from invested funds—the operating funds of the University. At the end of each fiscal year, depending on fund performance and overall liquidity needs of the University, investment income is distributed to campus units. The amount of revenue generated from investment income has declined from $46.3 million in Fiscal Year 2008 to a loss of $2.5 million in Fiscal Year 2013. As illustrated in Exhibit 36, the loss in Fiscal Year 2013 is primarily due to unrealized losses. According to UW, the market decline in May and June of 2013 resulted in a loss of about $22 million. The University asserts that the loss experienced by the University was similar to the loss of other government bond indexes during the same period. We did not audit or verify this assertion.

[42] FAS Revenue and Expenditures Reports for FY 2008 through FY 2013 – FAS Funds Included in AFRS Account 148

Exhibit 36. Investment Income[43]



OTHER FEES

UW collects a number of other minor fees, such as parking fees, vending machine revenue, library fines, late fees, non-sufficient fund fees, and conference fees, and others charged by the University.

POLICIES, RULES, AND REGULATIONS FOR ASSESSING FEES INCLUDED IN AFRS ACCOUNT 148

The Revised Code of Washington provides requirements for the use and establishment of fees. Fees levied on all students, unless already approved (services and activities fees, and technology fees), must be approved by the State Legislature (RCW 28B.15.031). On an annual basis, UW submits an inventory of all new or increased fees to the Office of Financial Management for approval, per Citizens Initiative 960. This inventory identifies fees requiring a statutory change, such as an increase to tuition or requests for a new fee that would be charged to all students, as well as those not requiring a statutory change, such as increases to fees charged for fee-based programs and Summer Quarter.

Adjustments to the student assessment for the STF are restricted by RCW 288.15.051. Annually, a student-run STF Committee at each campus must approve annual expenditure plans for the fee revenue and must also approve any changes to the fee amount. Statute also restricts the amount charged to part-time students—to a pro rata share of the fee charged to full-time students.

[43] FAS Revenue and Expenditures Reports for FY 2008 through FY 2013 – FAS Funds Included in AFRS Account 148

In 1971, the RCW Section 28B.15.100, gave the Board of Regents the authority to establish course fees. Internally, UW established Administrative Policy Statement 33.1 that provides protocols for establishing and approving new academic fees that do not require legislative approval, as illustrated in Exhibit 37.

Exhibit 37. Fee Setting Authority and Delegations[44]

State Legislature	Board of Regents	University President	Provost	Deans & Vice Presidents
• Fees Impacting *All* Students[1]	• Tuition Fees • Summer Quarter Tuition & Fees • Service & Activity Fees • Fees to Cover Instructional Costs • Housing Rates & Parking Fees • Technology Fees • Other Fees as Determined by the Board of Regents	• University-wide Fees & Charges to Recover Costs or Ration Services, including: • Student Application & Registration Fees • Thesis & Dissertation Fees • Late Fees	• Degree Credit Program Fees • Course Fees greater than $50 per Quarter • Instructional Related Fees Charged to Students Entering a Program or Major	• Course Fees less than $50 per Quarter • Fees & Charges Intended to Ration Services Within Designated Area of Responsibility • Fees & Charges to Recover Costs of Continuing Education

Note: [1]Does not include fees already approved by Legislature, including service and activity fees, and technology fees.

Expenses Reflected in FAS Funds Included in AFRS Account 148

Expenses reflected in FAS Funds included in AFRS Account 148 generally fall into the following categories: compensation (salaries and benefits), personal service contracts, supplies, utilities, equipment, scholarships, and debt service, as shown in Exhibit 38.

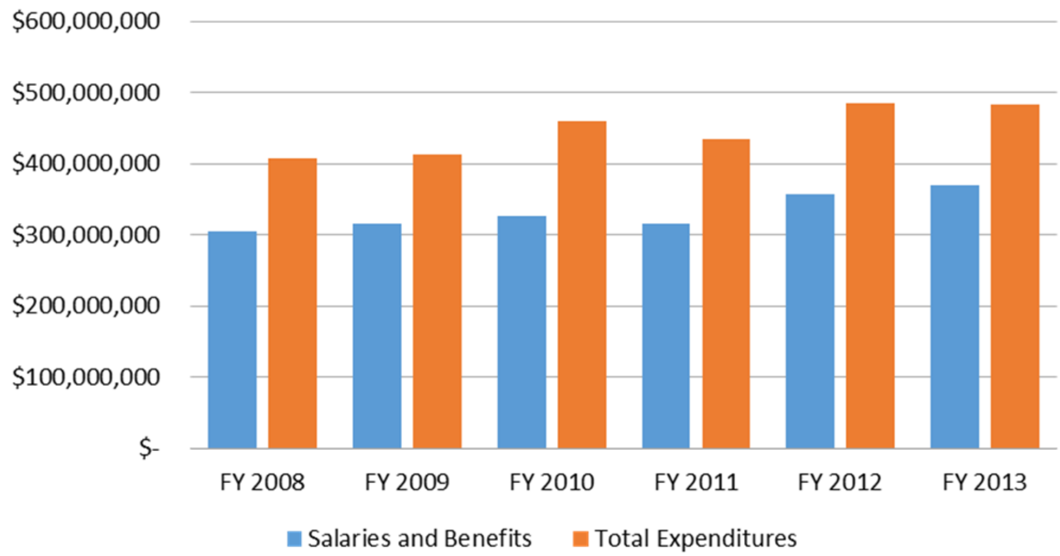
[44] RCW 28B.15.031 and University of Washington Administrative Policy Statement 33.1.

Exhibit 38. Expenses by Category (in thousands)[45]

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Salaries	$240,671	$254,108	$255,628	$247,226	$273,078	$280,908
Benefits	$63,762	$61,817	$70,671	$68,129	$83,325	$88,688
Services	$55,189	$56,594	$59,107	$70,854	$75,632	$85,242
Supplies	$33,536	$24,346	$41,578	$35,730	$37,854	$24,306
Utilities	$5,878	$6,156	$24,052	$3,653	$3,879	$3,933
Transfer of Costs to Other Funds	$(34,659)	$(39,118)	$(45,430)	$(47,641)	$(35,521)	$(57,499)
Equipment	$10,586	$8,598	$8,194	$9,924	$7,725	$9,669
Investment Expense	$2,143	$2,094	$2,221	$2,309	$3,859	$2,807
Scholarships	$1,012	$1,021	$1,499	$2,029	$2,679	$3,719
Other Expenses	$29,287	$37,796	$42,178	$42,837	$33,200	$41,843
Total Expenses	**$407,404**	**$413,413**	**$459,696**	**$435,050**	**$485,710**	**$483,617**

Overall, we found that total expenditures as well as compensation-related expenditures have increased at roughly the same rate, 19 percent and 21 percent respectively, over the last three biennia, as shown in Exhibit 39. Of note, in Fiscal Year 2008, nearly 75 percent of UW's total funding was spent on compensation as compared to 76 percent in Fiscal Year 2013.

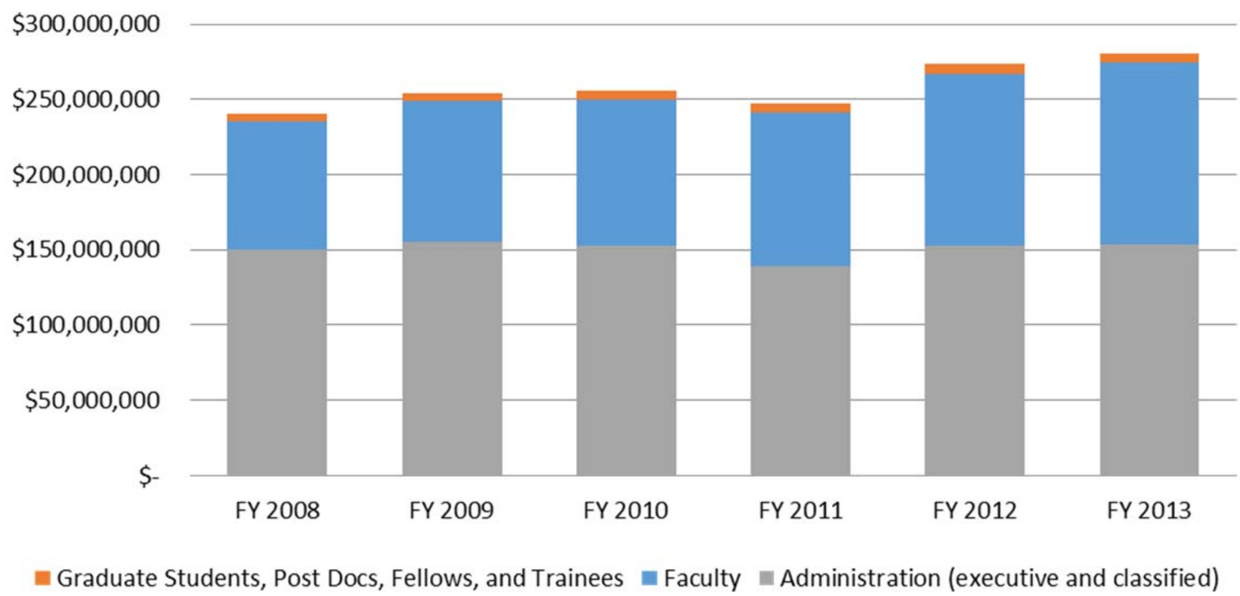
Exhibit 39. Compensation-related Expenses Compared to Total Expenses[46]



[45] FAS Revenue and Expenditures Reports for FY 2008 through FY 2013 – FAS Funds Included in AFRS Account 148
[46] FAS Revenue and Expenditures Reports for FY 2008 through FY 2013 – FAS Funds Included in AFRS Account 148

Salary costs related to administration have remained fairly consistent over the past six years. The proportion of salary costs related to faculty has increased over the same period. Specifically, as illustrated in Exhibit 40, in Fiscal Year 2008, faculty salaries represented 36 percent of all salaries; whereas, in Fiscal Year 2013 faculty salaries represented 43 percent of all salaries.

Exhibit 40. Salary Expenses by Position Type[47]



In addition to compensation-related expenditures that accounted for about 76 percent of all expenditures in Fiscal Year 2013, the remaining 24 percent of expenditures generally fall within the following key categories:

- Services—Attorney General services, audit and financial services, physical plant services, outside services (printing, maintenance, etc.), miscellaneous contractual services, Technology Recharge Fee, and travel
- Supplies—Non-capitalized equipment, computer supplies and software, and office supplies
- Utilities—Electricity, fuel, water, garbage, and sewer
- Debt Service—ILP and capital leases
- Other Expenses—Property rentals, insurance, licenses and permits, postage and other grants/subsidies
- Equipment—Computer equipment and other equipment

[47] FAS Revenue and Expenditures Reports for FY 2008 through FY 2013 – FAS Funds Included in AFRS Account 148

Similar to processes we identified for General Operating Fund (GOF), as discussed in Section 3 of this report, all expenditures are tied to a budget number by activity type and have a funding source. The same process described for GOF is employed for FAS Funds included in AFRS Account 148 to tie funding to a position. Salary transactions are automatically generated by UW's payroll system and recorded in the University's financial accounting system.

EDUCATIONAL OUTREACH

Educational Outreach related expenses have increased, from nearly $33.7 million to more than $67.7 million over the six-year audit period. Educational Outreach expenses are generally directly related to costs to provide the programs and include expenses related to institutional overhead support. A majority of Educational Outreach expenses are related to salaries and benefits of staff. In Fiscal Year 2013, salaries and benefits represented more than 81 percent of the total Educational Outreach expenditures. To cover Educational Outreach administrative and infrastructure costs, fees are assessed internally to departments offering programs through Educational Outreach. In Fiscal Year 2013, depending on the course or program offered, Educational Outreach charged programs and departments:

- Program Management Fees:
    - Ranging from $11,496 to $26,787 per program or
    - $195 for individual courses or
    - $3,341 per course
- Infrastructure Fees:
    - Ranging from $1,000 to $14,000 per course and/or
    - $2,600 per credit
    - Between $34 and $94 per hour for use of computer rooms

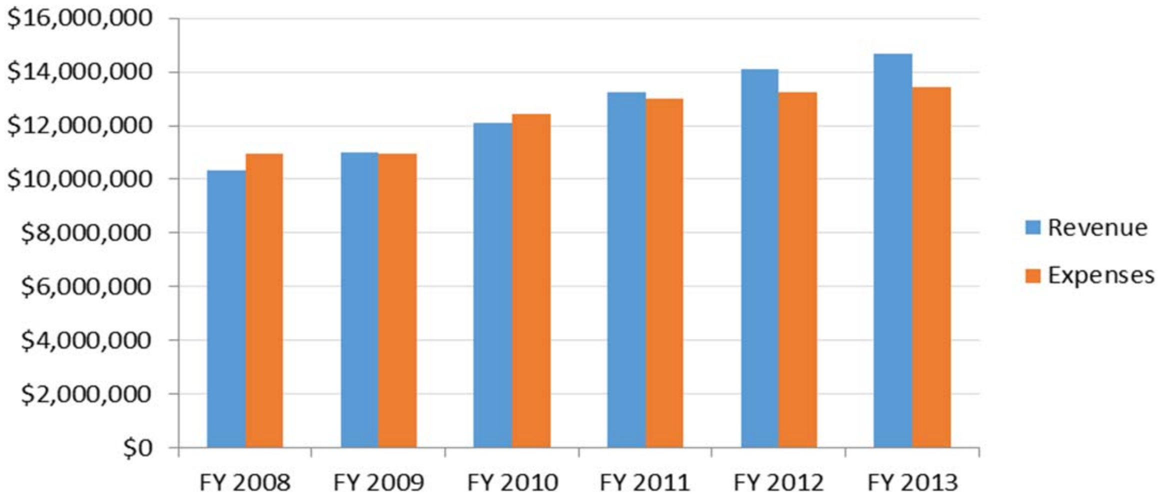
These fees are recorded as expenditure transfer credits in FAS.

SUMMER QUARTER

A separate budget for instructional costs is maintained by UW for Summer Quarter (designated as "280 Summer Quarter") and any remaining program fee revenue after Summer Quarter expenses are held centrally in the Provost budget. Revenue from Summer Quarter operating fees are held in FAS Fund 144 and transferred to individual unit budgets that actually pay for activities for Summer Quarter that are recorded in FAS Fund 148. Summer Quarter budgeted and actual expenses are tracked by Educational Outreach using a budget management system.

Summer Quarter revenue reflected in "280 Summer Quarter" in funds increased from more than $10.3 million in Fiscal Year 2008 to nearly $14.7 million in Fiscal Year 2013, and represents a little more than 28 percent of the actual revenue generated from the Summer Quarter Operating Fee. Expenses recorded to "280 Summer Quarter" increased from nearly $11.0 million to more than $13.4 million over the same period, as shown in Exhibit 41.

Exhibit 41. "280 Summer Quarter" Revenue and Expenses [48]



Management and Controls Over Spending of FAS Funds Included in AFRS Account 148

As noted earlier in the report, in Section 3, the University's purchasing controls are established primarily through University-wide policies. Given, most of the funds in FAS Funds included in AFRS Account 148 are generated from self-sustaining/cost-recovery activities, business-type activities, and indirect cost recoveries, UW has significant discretion over the use of most these funds. However, as previously discussed, the Revised Codes of Washington provides some direction as to what type of expenses can be paid by certain fees. Additionally, UW's Administrative Policy 33.1 established restrictions for the use of course fees. There are multiple restrictions related to the use of revenue generated from course fees:

- Course fees cannot be used to pay personnel costs related to faculty and teaching assistant time except where the student is receiving and paying for individualized instruction/tutoring.
- Revenue generated by course fees must be used to directly support a specific course offering.
- Income from course fees must be used as intended and recorded in departmental income accounts.
- Once a fee is established, future increases are limited by Initiative 601.

[48] FAS Revenue and Expenditures Reports for FY 2008 through FY 2013 – FAS Funds Included in AFRS Account 148

- Course fees must be deposited in self-sustaining budgets specifically designated for that purpose.
- Deans and vice presidents are responsible for reducing excessive surpluses and eliminating deficits in self-sustaining accounts.
- These fees may not recover more than the cost of goods or services provided, including applicable departmental and University-wide overhead costs.

In addition, as discussed earlier in Sections 2 and 3, the State Administrative and Accounting Manual (SAAM) provides additional spending restrictions and accountability controls over the use of funds.

SECTION 5. Revenue and Cost Transfers

What Types of Transfer Activity Occurs Within and Between AFRS Accounts 148 and 149?

The University regularly transfers revenue and costs within and between its numerous funds and budgets for a multitude of reasons, such as setting aside revenue surplus for financial aid, covering operating deficits, or transferring the actual costs of services or supplies from a central budget to another budget where the costs were incurred. Transfers are initiated by school or department staff, approved by a manager, generally via journal voucher or cost transfer invoice. Initiating schools and departments maintain accounting records to substantiate revenue and cost transfers.

REVENUE TRANSFERS

AFRS ACCOUNT 149 REVENUE TRANSFERS

Between Fiscal Years 2008 and 2013, UW transferred a total of $104.7 million out of AFRS Account 149 into other UW funds and transferred $11.3 million into AFRS Account 149 for a net transfer of $93.4 million out of AFRS Account 149, as reflected in Exhibit 42.

Exhibit 42. AFRS Account 149 Net Revenue Transfers (in thousands)[49]

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	Total Revenue Transfers
Transfers Out	($4,530)	($1,730)	($11,874)	($35,610)	($19,292)	($31,622)	($104,659)
Transfers In	$6	$1,084	$318	$216	$9,524	$108	$11,258
Net Revenue Transfers Out	**($4,524)**	**($646)**	**($11,556)**	**($35,394)**	**($9,768)**	**($31,514)**	**($93,401)**

We reviewed the largest revenue transfers in and out of AFRS Account 149—totaling $86.9 million or 93 percent of net revenue transfers.

As shown in Exhibit 43, of the transfers we reviewed, we found that the majority of revenue transferred out of AFRS Account 149 related to the following:

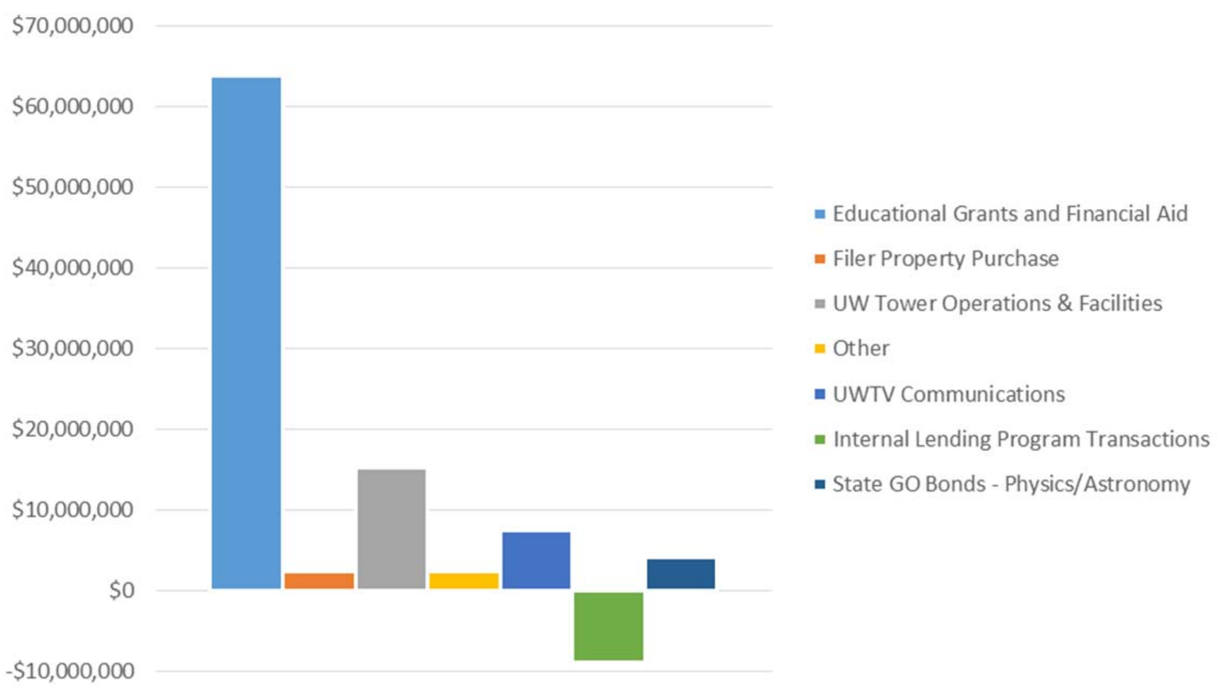
- Educational grants and financial aid (higher education grant financial aid and needs grant, Husky Promise)
- UW Tower operations and facilities

[49] FAS Revenue and Expenditures Reports for FY 2008 through FY 2013

- UWTV Communications
- State General Obligation (GO) Bonds (Physics/Astronomy)
- Filer Property purchase

We found that revenue transfers into AFRS Account 149 generally related to internal lending program transactions.

Exhibit 43. AFRS Account 149 Sampled Revenue Transfers FY2008–FY2013[50]



Of note, Fiscal Years 2011 and 2013 had higher revenue transfers because the Husky Promise commitment was implemented in Fiscal Year 2011 with $20 million transferred from AFRS Account 149 to AFRS Account 148 to fund the program. Also, Fiscal Year 2013 had additional surplus revenue transferred associated with financial aid as well as revenue transfers related to the purchase of the Filer property[51], and temporary use of savings on utilities budget to fund a capital budget established for satellite chiller/emergency power.

AFRS ACCOUNT 148 REVENUE TRANSFERS

Between Fiscal Years 2008 and 2013, UW transferred $523.6 million out of AFRS Account 148 into other UW funds and transferred $278.2 million into AFRS Account

[50] FAS Revenue and Expenditures Reports for FY 2008 through FY 2013
[51] The Filer property was purchased as a strategic acquisition due to its location and future redevelopment opportunity and uses could include office, clinics, research or residential.

148 for a net transfer of $245.4 million out of AFRS Account 148, as shown in Exhibit 44.

Exhibit 44. AFRS Account 148 Net Revenue Transfers (in thousands)[52]

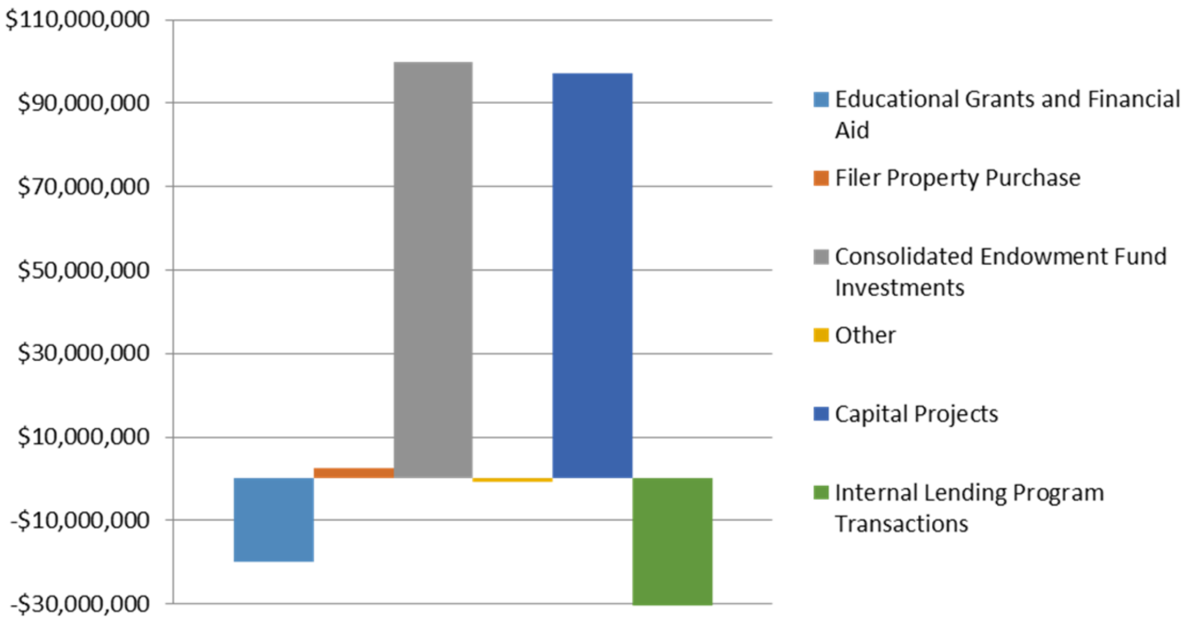
	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	Total Revenue Transfers
Transfers Out	($112,830)	($60,244)	($57,040)	($114,216)	($91,816)	($87,464)	($523,610)
Transfers In	$39,089	$35,142	$33,299	$59,482	$71,412	$39,795	$278,219
Net Revenue Transfers Out	**($73,741)**	**($25,102)**	**($23,741)**	**($54,734)**	**($20,404)**	**($47,669)**	**($245,391)**

We reviewed the largest revenue transfers in and out of AFRS Account 148 which represented $147.4 million or 60 percent of net revenue transfers.

As shown in Exhibit 45, of the transfers we reviewed, we found that the vast majority of revenue transferred out of AFRS Account 148 generally related to capital projects and Consolidated Endowment Fund investments. We found that revenue transferred into AFRS Account 148 generally related to educational grants and financial aid (Husky Promise) and internal lending program transactions.

[52] FAS Revenue and Expenditures Reports for FY 2008 through FY 2013

Exhibit 45. AFRS Account 148 Sampled Revenue Transfers FY2008 - FY2013



Of note, Fiscal Years 2008, 2011, and 2013 had higher revenue transfers because of revenue transfers related to capital projects and the Consolidated Endowment Fund. In Fiscal Year 2012, there were large capital project-related revenue transfers out of the account as well as revenues transferred into the accounting corrections related to the internal lending program.

Cost Transfers

Each year, UW transfers thousands of costs between budgets and funds for a variety of reasons. The intent of these transfers is to ensure costs are charged to the appropriate budget that incurred the expense. Due to the large volume of cost transfers occurring over the audit period, we focused on reviewing costs transferred during Fiscal Year 2013 associated with AFRS Accounts 149 and 148.

AFRS Account 149 Cost Transfers

In Fiscal Year 2013, UW transferred $77.5 million costs out of AFRS Account 149 into other UW funds and transferred $13.5 million costs into AFRS Account 149 for a net transfer of $64 million costs out of AFRS Account 149, as shown in Exhibit 46.

Exhibit 46. AFRS Account 149 Net Cost Transfers (in thousands)[53]

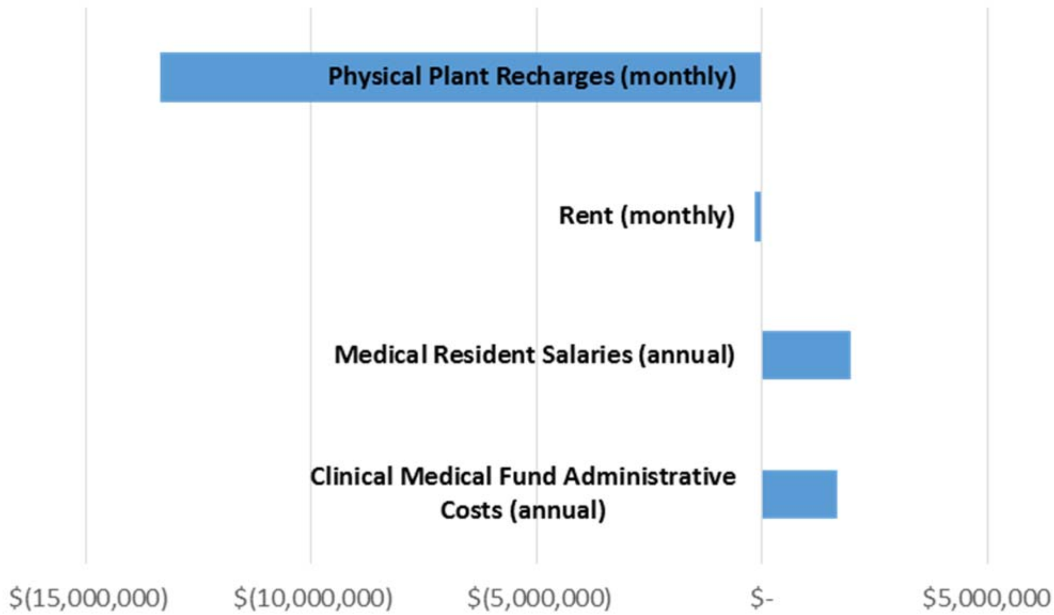
	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Transfers In	$7,256	$17,133	$10,529	$54,125	$39,317	$13,469
Transfers Out	($79,875)	($84,236)	($65,521)	($78,964)	($69,476)	($77,500)
Net Cost Transfers Out	**($72,619)**	**($67,103)**	**($54,992)**	**($24,839)**	**($30,159)**	**($64,031)**

We reviewed the largest cost transfers in and out of AFRS Account 149 which represented $9.9 million or 15 percent of Fiscal Year 2013 net transfers.

As shown in Exhibit 47, of the transfers we reviewed, we found that costs transferred out of AFRS Account 149 generally related to moving monthly costs for maintaining the buildings and infrastructure of UW's physical plant and rent expenses (physical plant recharges). We found that costs transferred into AFRS Account 149 generally related to medical resident salaries being paid with state appropriations as well as a one-time year-end administrative cost transfers between GOF and DOF budgets related to the Clinical Medicine Fund.

[53] FAS Revenue and Expenditures Reports for FY 2008 through FY 2013

Exhibit 47. AFRS Account 149 Sampled Cost Transfers FY2013[54]



AFRS Account 148 Cost Transfers

In AFRS Account 148, cost transfers occurred within four FAS Funds—143, 144, 148, and 150, with FAS Fund 148 responsible for the majority of cost transfer activity. In these four funds, salaries and contractual services categories accounted for the vast majority of the cost transfers.

In Fiscal Year 2013, UW transferred $65.6 million costs out of AFRS Account 148 into other UW funds and transferred $8.1 million costs into AFRS Account 148 for a net transfer of $57.5 million costs out of AFRS Account 148, as shown in Exhibit 48.

Exhibit 48. FAS Funds Included in AFRS Account 148 Net Cost Transfers (in thousands)[55]

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Transfers In	$7,327	$8,149	$13,370	$21,465	$18,575	$8,113
Transfers Out	($41,987)	($47,267)	($58,800)	($69,106)	($54,096)	($65,612)
Net Cost Transfers Out	**($34,660)**	**($39,118)**	**($45,430)**	**($47,641)**	**($35,521)**	**($57,499)**

[54] FAS Revenue and Expenditures Reports for FY 2008 through FY 2013
[55] FAS Revenue and Expenditures Reports for FY 2008 through FY 2013

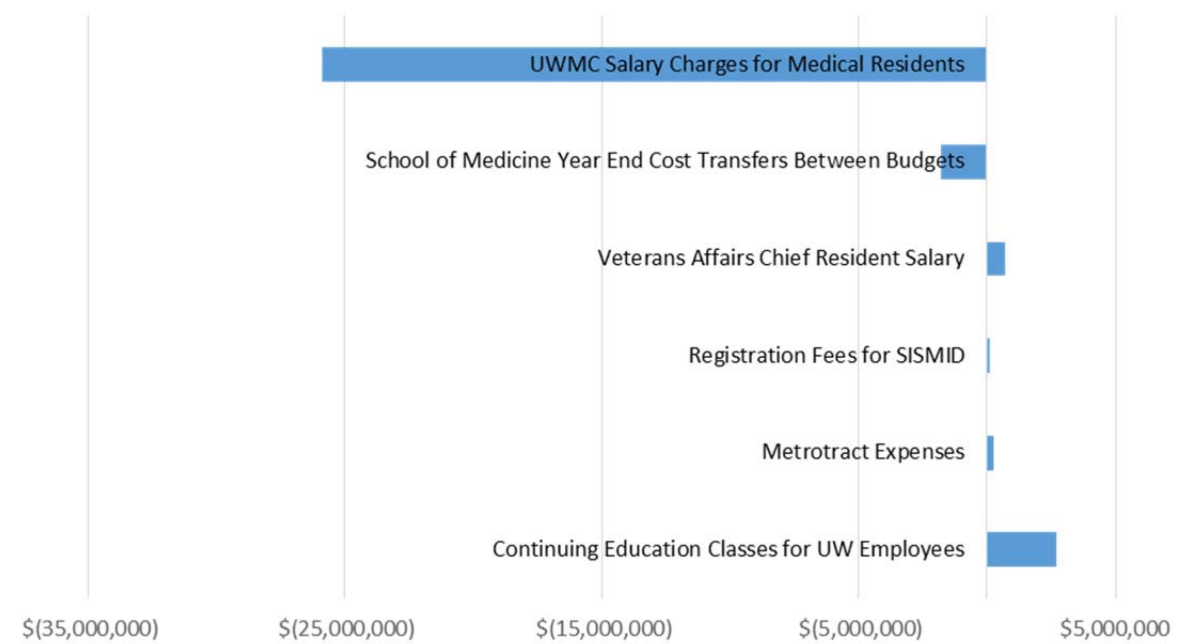
We reviewed the largest cost transfers in and out of AFRS Account 148 which represented $23.8 million or 41 percent of Fiscal Year 2013 net transfers. As shown in Exhibit 49, of the transfers we reviewed, we found that costs transferred out of AFRS Account 148 generally related to the following:

- Monthly UWMC salary charges for medical residents and
- Year-end entries by the School of Medicine to transfer costs between budgets

We also found that costs transferred into AFRS Account 148 generally related to the following:

- Quarterly Veterans Affairs Chief Resident salary reimbursements
- Monthly Metropolitan Tract expenses
- Annual scholarship payments of registration fees to the Summer Institute in Statistics and Modeling in Infectious Diseases (SISMID)
- Monthly costs associated with continuing education classes attended by UW employees

Exhibit 49. AFRS Account 148 Sampled Cost Transfers FY2013[56]



Overall, of the revenue and cost transfers we reviewed relating to AFRS Accounts 148 and 149, it appears that the transfers were reasonable and necessary to move revenue and expenses to the appropriate University funds and budgets in support of

[56] FAS Revenue and Expenditures Reports for FY 2008 through FY 2013

UW priorities, particularly educational grants and financial aid and maintenance the buildings and infrastructure of UW's physical plant.

SECTION 6. Use of FAS Fund 148 as the University Operating Cash Account

How Is FAS Fund 148 Used As The "University Clearing" Account And How Does The University Ensure Funds Are Not Commingled?

An important feature in understanding the flow of funds within AFRS Account 148 is the fact that University of Washington has designated one of the funds (FAS Fund 148) within that account as its "central paymaster/main operating banking system." In essence, the operating cash for much of the university is pooled, and managed and maintained in this fund like a central bank. As cash comes into UW, it is "deposited" to the "main operating account"; as cash is needed, it is "withdrawn" from the main operating account to pay the bill.

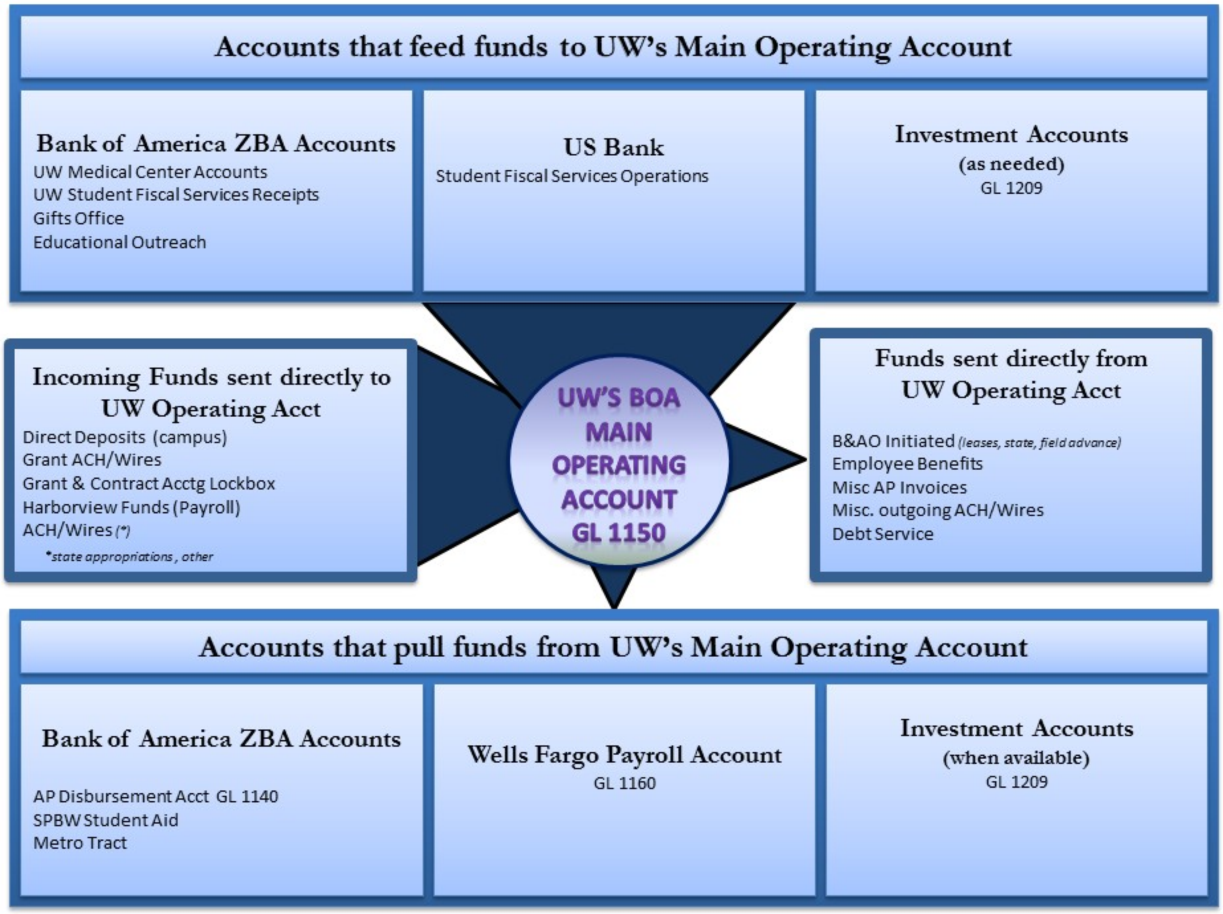
While UW may have a variety of reasons for this structure, our research suggests this is a common cash management approach that allows for centralized investing and entity-wide cash management and control. According to an article in the trade magazine of the National Association of College and University Business Officers[57], "pooling cash through a central bank allows institutions to optimize their operating assets and still provide sufficient liquidity for component units…Bank managers are able to look at upcoming expenses across the institution and forecast cash needs…" Although the use of a central bank concept often pertains to the investing aspect of cash management, the approach also provides for greater control over cash flow and financial management.

A central bank is in contrast to allowing physical cash to reside at units/department/colleges or isolating cash into individual funds. As UW's budgeting and financial management is not centered on the fund-basis, a central banking or pooled cash management approach uses accounting and transaction tracking to match revenues and expenditures to the appropriate fund and unit. This cash management approach is found in other university settings. For example, University of California follows the same model. "Most of the University's [of California] operating cash is recorded in the Current Funds account, called the Treasurer's General Cash, in the Office of the President's general ledger. Generally, this account contains cash belonging to the five major fund groups: Current Funds, Plant Funds, Endowment and Similar Funds, Loan Funds, and the Retirement System Funds. Cash is not identified by fund group except at fiscal year-end when balance sheets are prepared."[58]

UW receives funds in a variety of locations and forms. Funds may be received physically at colleges or units, through electronic means, via lock box, or other methods. As reflected in the Exhibit 50, generally, these funds flow into and through UW's Bank of America main operating account.

[57] NACUBO, Business Officer Magazine, 4/7/12, *What's a Central Bank?*
[58] University of California, Accounting Manual, Cash: Cash Controls C-173

Exhibit 50. UW Main Operating Account[59]



On a basic level of explanation, this cash "on deposit" in the main operating account is reflected in the asset and liability accounts of FAS Fund 148. Cash receipts (such as gifts, medical center receipts for patient care, tuition and fees, grants, wire transfers, etc.) obtained by various colleges and units of UW are physically deposited into trustee banking institutions that flow to the main operating account, which resides in FAS Fund 148. The FAS Fund 148 general ledger will show the cash as an asset along with a "due to" liability to the fund that "owns" the money. The monies in FAS Fund 148 are invested as part of UW Treasury's Invested Fund Pool where they will earn interest; largely, these interest earnings, or losses, are distributed back to the "owner" funds in proportion to the average balance deposited.

The operating funds in this pool are associated with FAS Fund 148 in terms of the central paymaster concept only; the financial activity related to these monies—revenue generation and spending of the cash for expenses, are posted directly to the owner fund and respective unit/department/college. UW uses a central disbursing

[59] Figure provided by UW Financial Management

function through which expenses are paid. For the most part, payments are initiated and approved at the local unit/department/college and the cash payment is executed through the main operating account. Activities like payroll are managed and controlled centrally by the University Controller, but disbursements also flow through the main operating account.

This flow of deposits and disbursement through FAS Fund 148 creates millions of transactions and constant activity within the fund. This significant activity related to central banking and disbursing along with the pooling of cash resources may create the appearance that funds are "comingled." In actuality, UW uses accounting entries involving "due to/due from," interfund balancing, and transactional accounting (revenue and expense) to create records that separate, identify, and track funds so not to lose "their identity."

A review of the FAS Fund 148 Balance Sheet at June 30, 2013 shows $1,573,262,168 in cash and liquidity investments; amounts due to other university funds in that report (interfunds) shows $1,119,241,081. Thus, of the cash held in FAS Fund 148 is significant; however, a very large portion belongs to other UW units and funds. Underlying the "due to" amounts are 89 specific general ledger codes specifically identifying the "other funds"— for example, GL Code "5169 Inter Rec/Pay Fund 149" or GL Code "5547 Inter Rec/Pay fund 15M." If balance sheets were prepared for other UW funds, they would reflect the "due from" balance. For example, FAS Fund 149 shows a "Due From Other Funds-Pooled Cash & Investments" of $83,071,070 at fiscal year-end 2013.

FAS Fund 148 not only hosts the central operating account, but also "owns" financial activities related to self-sustaining and other fee-based programs. The fund balance, as detailed in other sections of this report, relates to only those activities, as does some of the cash held in the fund. The revenue and expense transactions for these programs are appropriately posted to this fund—thus, a trial balance for FAS Fund 148 would reflect revenue and expense activity, but only that of the programs assigned to that fund.

While funds flow in and out of FAS Fund 148 as needed for UW operations, UW tracks the receipt and expenditure of these monies to retain the identity of the funding. Fund accounting ties UW funds to particular fund groups that control the "nature" of these funds – discretionary, state support and provisos, gifts, endowments, bond funds and Internal Lending Program (ILP), etc. As funds are budgeted, they are allocated based upon approved use. The external financial auditors of the University are responsible for ensuring the system of controls is sufficient. We did not audit the interfund "due to/due from" account or the use of funds.

SECTION 7. Internal Lending Program

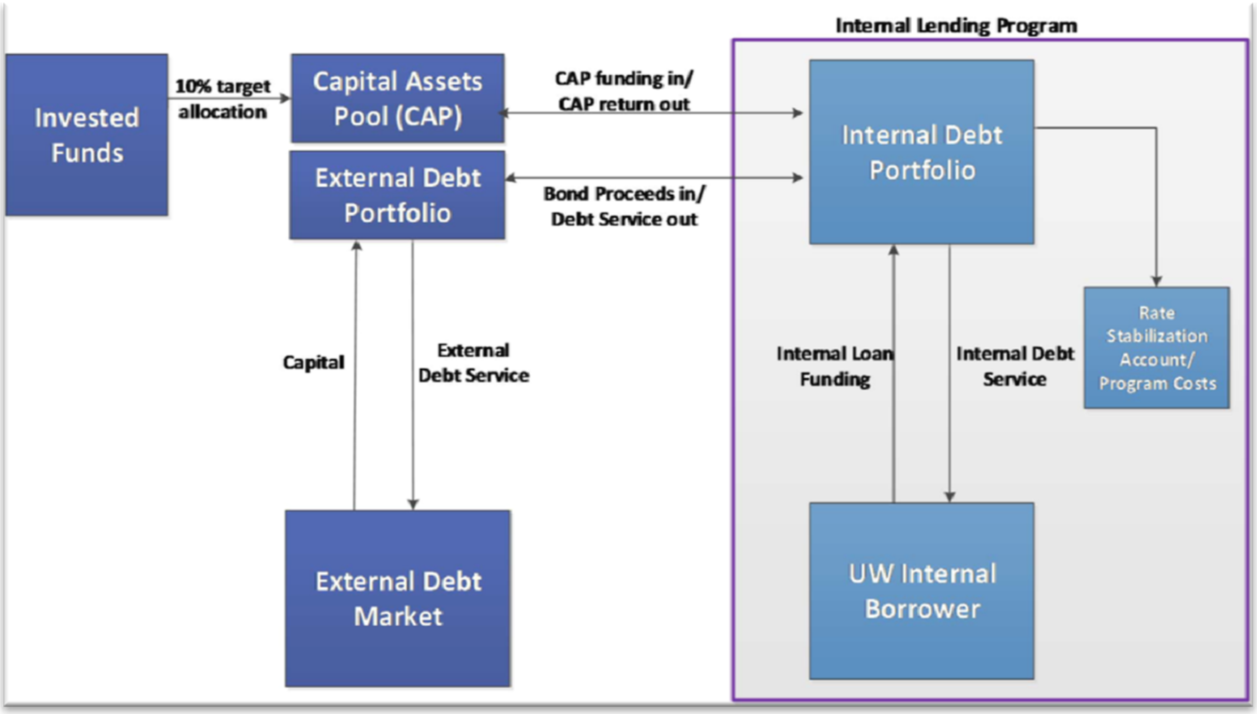
What Is The Internal Lending Program and Does It Impact The AFRS Accounts 148 and 149?

An area that has caused variances in AFRS account fund balances during the period of our audit relates to the University of Washington's (UW) Internal Lending Program (ILP). These variances, as discussed in other sections of this report, relate to the establishment of these program and the related transferring of ILP loan-related balances, as well as the treatment of these loans and related transactions between UW and the State. Going forward, ILP related transactions will continue to cause differences between UW's and the State's systems, FAS and AFRS, due to the prescribed accounting treatment between the two entities.

In May 2008, the Board of Regents approved the ILP, effective July 1, 2008. This program is intended to lower institutional borrowing costs, and create stable and predictable borrowing rates for internal borrowing to fund capital projects. These internal loans are funded through the issuance of debt obligations such as University General Revenue Bond or using ILP reserves. Under ILP, campus borrowers may secure loans for capital projects at a uniform interest rate.

The concept involves a "just in time" approach to external debt financing. According to UW, UW will issue debt on an on-going basis to generate the cash needed to fund approved capital projects for a short period, such as the upcoming year. Traditional approaches to debt financing require the issuance of bonds sufficient to cover all or a major portion of the costs for a specific project and then draw down/spend the funds from the loan proceeds as needed. This approach requires that the borrower pay debt service on a large proportion of the funding that will sit in a bank for long periods until needed. By pooling capital cash flow needs and issuing debt "when needed" the University expects to maintain rate stability and lower costs of capital overall. UW Treasury seeks to manage the fluctuation in interest rates through a rate stabilization fund and active management of UW's debt portfolio. UW Treasury depicts the program as in Exhibit 51.

Exhibit 51. UW Internal Lending Program[60]



The internal loan portfolio consists of loans to internal "campus" units for capital projects. Rather than issue bonds for a specific project that may entail spending on that project for a number of years, UW issues bonds just for the estimated amount of capital cash needed in the coming period and loans the amount of funds needed for the near-term to the internal unit as required to pay capital costs incurred.

The Board of Regents oversees the ILP program and approves its operating and external portfolio management policies. It approves the annual bond resolution for the issuance of external debt to be used for individual UW projects seeking debt financing from ILP.

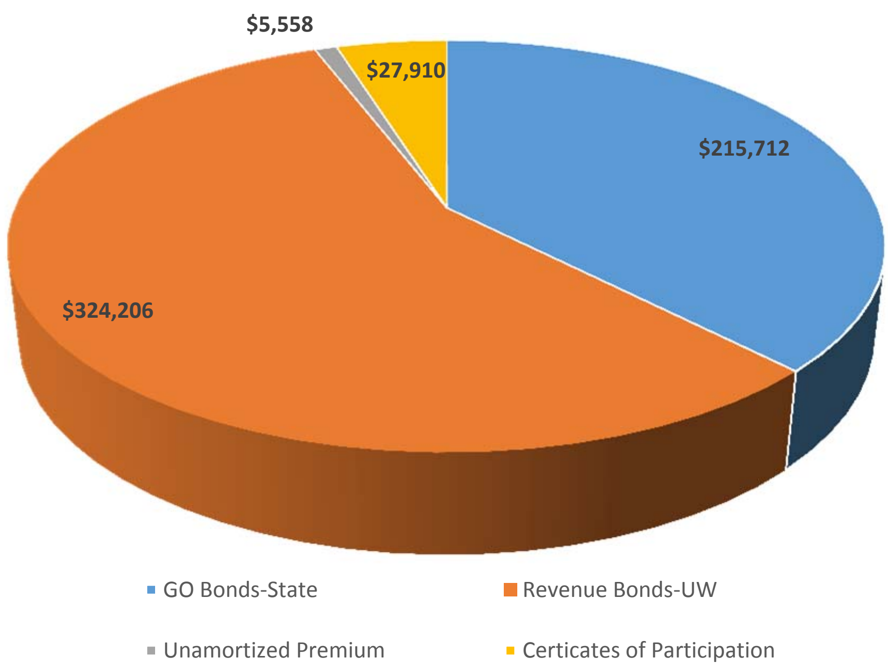
UW Treasury/ILP program manages the external debt portfolio as well as the "internal portfolio" – the principal and interest paid by the campus borrowers. These internal loan payments provide the funding for UW to pay the external debt service. Internal borrowers must apply for and be approved to borrow from the ILP. The Treasury conducts an appropriate due diligence process to evaluate the risks and ensure the borrower's ability to repay the internal loan. UW Treasury executes loan agreements with these internal borrowers following Board of Regent's approval. Management of the ILP and the external debt portfolio is performed in accordance with policies and guidelines approved by the Board of Regents. In addition, larger or more complex loans may require annual external audit of the borrowing unit's financial statements as part of their reporting process.

[60] Graphic – University of Washington "Debt Management Annual Report" 6/21/14

According to the ILP's financial statement audit, issued in January 2011, the "legacy" "debt of $576,386,287 incurred by the University or its units before July 1, 2008 and restricted investments of $4,937,799 were transferred to ILP at the remaining book value and related receivables from internal borrowers of $571,448,488 were established between the internal borrowers and ILP…" At that time, the internal borrowers were to pay the same interest rate at which the transferred debt was issued in the external market. New loans to internal borrowers would be made at a uniform internal lending rate.

The composition of this long-term "legacy" debt included State General Obligation Bonds, UW General Revenue Bonds, unamortized premium of these bonds, and Certificates of Participation. Exhibit 52, reflects a legacy debt totaling $573.4 million which does not include the approximately $3 million in commercial paper also transferred to the ILP.

Exhibit 52. "Legacy" Debt Transferred to the ILP Program as of July 1, 2008 (in thousands)



Although the scope of our review does not include accounts other than AFRS Accounts 148 and 149, several other funds were also impacted by this legacy transfer. Our review of the external audit of the ILP program, review of the University's financial statements, and the review of journal entries posted in relation to the transfer reflect consistency of data across the reports and entity.

ACCOUNTING COMPLEXITIES

Part of the setup of the ILP included moving the existing long-term liabilities from many of the other departments/funds to the ILP group of funds where these obligations would be centrally serviced and managed. The ILP would set up receivables for these loan agreements and the "owner" departments/funds would have related payable for the loans. Such internal transactions and the related accounting can be complex—tracking the assets, liabilities, and payment transactions (paying on and receipt of the principal and interest) without creating financial transactions within the University and also correctly transferring these transactions across to the State's financial reports.

Further, programs such as the ILP are not common within the government environment. Although such programs are found in other universities, such as University of Virginia, University of North Carolina at Chapel Hill, Harvard University, and The Ohio State University, accounting models for such programs are not readily available. As such, the accounting and reporting related to the ILP program both within UW and in translating to the State's AFRS system has proven challenging and is an evolving process. Our discussions with both UW and the Office of Financial Management convey that the processes for establishing and accounting for the program, particularly in terms of converting from UW's reporting method to the State's fund accounting framework, started with some difficulty but have evolved and changed since the ILP's inception. The original entry for the program required correction and subsequent decisions between UW and OFM prompting different treatment and thus, adjusting entries. Because UW and OFM decided that these transactions should be accounted for differently after the books were closed for the period, some of the adjustments were recorded as "prior period adjustments" that impacted the beginning fund balance for several AFRS accounts rather than these entries impacting the current year revenue or expense. Over the years, the parties have come to greater understanding of the program and the needed accounting and reporting treatments and have reached mutual agreement to the needed adjustments.

What also must be considered in understanding these issues is that AFRS Accounts 148 and 149 are only two of many funds that are impacted when booking ILP transactions. Both UW and OFM have indicated that loan transactions affect not only UW records, but also involve fund classification and statements on the State's government-type financial statements. As such, these transactions can appear misleading when viewed in isolation; to fully understand any of these transactions, particularly any subsequent adjusting entries, one must view the entirety of the transactions across all funds. Therefore, in respect to AFRS Accounts 148 and 149, although the ILP entries when viewed alone appear significant at the individual fund level, these entries when viewed in their entirety across the University appropriately "zeroed" out. Our review did not identify instances where revenue or funds were moved from one purpose to another—rather, the majority were year-end adjustments made with the OFM's agreement at the time.

We reviewed UW's financial statement audits and ILP program external financial audits prepared over the six-year audit period from Fiscal Years 2008 through 2013; we noted that neither set of auditors found any reportable issues or disclosures needed related to the ILP in these recordkeeping matters. As discussed in a separate bullet below, the State's external auditor disclosed that UW made appropriate "prior period adjustments" that reclassified ILP balances between State funds.

AFRS Account 148—Original entries

One of the original entries to reclassify the legacy bond liabilities was subsequently found to be incorrect. Bond liabilities totaling $573,356,720 (relating to nine FAS funds including FAS 148) were to be moved to AFRS Account FH2 (the AFRS account established for the ILP). However, the 2009 journal entries prepared to move the legacy bond debt incorrectly posted the entire amount of the ILP legacy balance to be moved—$573,356,720—to AFRS Account 148 and resulted in an incorrect reduction to fund balance in that account. This error was subsequently identified and corrected with the entire amount reversed; however, in order to not impact any revenues or expenses in the period when the adjustment is made, UW and OFM agreed that corrections would be done in 2011, and recorded to beginning fund balance for AFRS Account 148 as "Prior Period Adjustments." Other reclassification and year-end entries were also required to translate ILP activity in AFRS.

Handling of "Non-State Bonds" ILP Activity—AFRS Account 148

ILP loans recorded in AFRS Account 148 includes those related to Non-State Bonds (generally, UW General Revenue Bonds (GRB)), and "State Bonds" which are State General Obligation (GO) Bonds. To comply with State and GASB reporting requirements, Non-State Bonds are treated differently than GO Bonds.

For Non-State Bonds to comply with GASB requirements—as previously discussed, standards do not allow "governmental funds" to reflect long-term debt. Because UW, like other State universities, reports on a different basis, business-type activities (BTA), the treatment of long-term debt for UW's reporting is different than the State's requirements. As a result, at year-end, debt related to "non-state" ILP loans needs to be "removed" from AFRS Account 148 and posted to AFRS Account 999 to comply with GASB. The initial transaction, moving the 2009 ending balance of the ILP loans funded by GRB bonds in 148 of $84,565,086 resulted in what appears to be an increase in AFRS Account 148 fund balance, but when viewed across the State it is a shifting between funds and a zero sum adjustment resulted statewide.

Initially, principal payments made by borrower units/colleges/funds were charged as revenue transfers in FAS (and as such passed into AFRS). Although the accounting treatment of these transactions were agreed to in discussions between OFM and UW, as a better understanding by both parties of ILP activity and financial impacts was gained, preferred accounting treatments were changed. As a result, these charges to expenses/negative revenue were reversed and instead recorded as "interfund" transactions to appropriately impact the borrower fund balance sheets (reduce the liability/receivable). These were also considered prior period adjustments in the State financial statement made to fund balances.

Each year, principal payments (and any new lending funded by ILP GRB bonds) related to non-state bonds must also be moved from AFRS Account 148 to AFRS Account 999 so that the balances for the non-state ILP loans are stated in the appropriate amounts on the State's financial statements. Thus, each year there will be a difference between FAS Fund 148 fund balance and AFRS Account 148 fund balance related to these transactions.

As stated earlier, the majority of the adjustments for the accounting related to the ILP were booked in 2011 and related to AFRS accounting. Thus, they were reflected in the in the State of Washington's financial statements for the year ended June 30, 2011 within the Note 2 *Accounting, Reporting and Entity Changes,* a disclosure related to UW. "The University of Washington recorded a prior period adjustment to properly report balances related to their Internal Lending Program which is reported within the Higher Education Student Services Fund." This note described the impact of the adjustments to the State's Higher Education Special Revenue Fund, other non-major governmental funds, Higher Educational Student Services fund, internal service funds, and pooled cash agency fund.

Over the course of the ILP program, UW and OFM identified the need for changes to accounting treatments that resulted in subsequent adjustments. Such refining adjustments were made in Fiscal Year 2011, and again in Fiscal Year 2012 to adjust for timing differences between FAS and AFRS.

Our review of the accounting entries that were made related to AFRS Account 148 "non-state" bonds reveals that over the period, these entries result in an overall zero impact to fund balance. We also noted that the annual amounts of non-state bonds transferred from AFRS Account 148 to AFRS Account 999 agree with the ILP bond program worksheet (relating to all outstanding debt) provided by UW. At June 30, 2013, the adjustment to AFRS Account 148 fund balance relating to this transfer is $113,239,506 which agrees with UW's ILP worksheet.

Handling of "State Bonds" ILP Activity—Both AFRS Account 148 and AFRS Account 149

Similar to the circumstances with "non-state" bond ILP transactions, there were hitches with ILP accounting for both accounts regarding ILP loans associated with State General Obligation debt. Unlike UW General Revenue bonds that are backed by UW revenues and resources, State General Obligation bonds are backed by the full faith and credit of the State of Washington. Thus, these bonds are "owned" by the

State and managed by the State Treasurer. However, the University has agreed to pay the debt service and thus, carries ILP loans related to these bonds on its books. Because both the State and UW account for loans relating to these bonds, without making appropriate year-end adjustments, on an ongoing basis, these loans would result in “double counting” on the State’s financial records. Therefore, at year-end, the amounts relating to the State GO bond loans for both AFRS Account 148 and AFRS Account 149 are “removed” for AFRS reporting purposes.

Initially, when handling ending ILP loan balances funded by the State’s GO bonds, UW posted “write offs” of the State bond debt that subsequently were determined to have incorrectly impacted the fund balance of each of the two accounts. In AFRS Account 149 the result was increasing the Fund Balance by $33,012,917—the balance of the outstanding loans at June 30, 2009. A posting to AFRS Account 148 for its State Bond loans had a similar impact—increasing fund balance by $95,059,026. In 2011, it was determined that the fund balances in these accounts should not be affected and that the postings should have only impacted the balance sheets of the two accounts with the off-set to “interfund” accounts. In 2011, “prior period adjustment” journal entries reversed these transactions to remediate the impact on both fund balances.

Subsequently and going forward, the payment of principal on loans from the State GO Bonds are treated as interfund transactions for UW financial reporting and interest is posted to UW’s books when ILP “pays” the interest to the state. For State reporting, UW tracks all activities and removes these from each of UW AFRS accounts impacted by the State loans—in other words, these loans are not reported in UW’s transmissions to AFRS. Because of the need to meet reporting requirements on both sides, there will be an ongoing difference between FAS and AFRS that relates to loans from State GO Bonds. At June 30, 2013 the difference attributable to these ILP loans relating to AFRS Account 148 was $12,239,620 and for AFRS Account 149 $3,983,605.

Our discussions with UW and OFM indicates both parties believe that great strides have been made in addressing the challenges related to ILP accounting between the two entities. Both agencies indicated that FY 2014 will include additional adjustments to beginning fund balance for some AFRS accounts, but that changes in accounting treatment during the year should negate any need to make these type of correcting adjustments in the future.

Our testing involved tracing balances from the ILP account, into the University’s FAS system, and through to the State Auditor’s worksheets for the State’s financial audit, which found that the amounts materially tied and agreed as of June 30, 2013. We also found that the ILP liabilities reflected on the ILP debt service worksheet tracked to the ending balances reflected for AFRS Account 149 and for AFRS Account 148 and the treatment of the ILP program in both the FAS and AFRS systems appears to be in compliance with GASB and accounting standards.

SECTION 8. AFRS Accounts 149 and 148 Fund Balances

What Is The Nature Of Fund Balances Associated with AFRS Accounts 149 and 148?

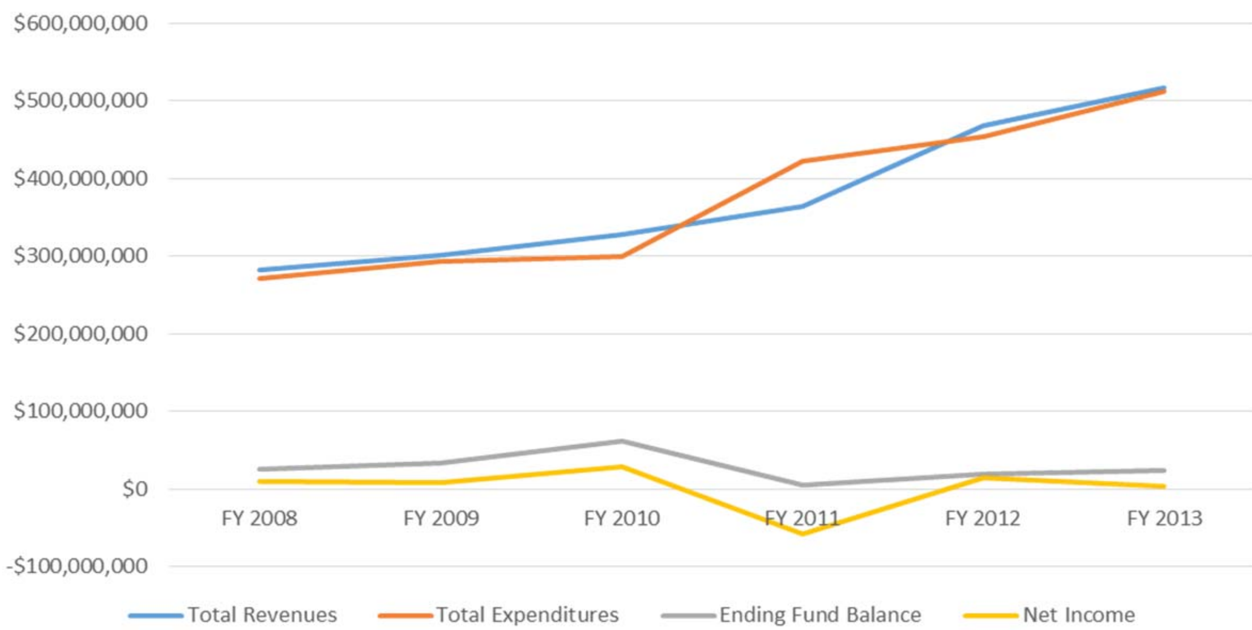
As previously discussed, accounting and reporting standards are applied somewhat differently for UW and the State. As a result, differences occur between fund balances in certain funds of the two entities, including those that are the subject to our audit. The term "fund balance" is defined as the difference between assets and liabilities in governmental and not-for-profit fund accounting. Governments do not operate for a profit and as such fund balance conveys whether resources are sufficient to cover liabilities. In relation to this audit, the fund balances for AFRS Accounts 149 and 148 reflect the difference between assets and liabilities for only a handful of UW's nearly 100 funds. Thus, the review of these two accounts reflects only a segment of UW's overall year-end position and does not provide a complete picture of its financial condition.

We examined the fund balance accounts for both AFRS Accounts 149 and 148 to assess the trends, components, reserves, and reasonability of the ending amounts. We also reconciled Fiscal Year 2013 FAS fund balances to AFRS for each of the two accounts. As previously discussed in Section 1 of this report, accounting and reporting standards require that UW and the State report using differing financial reporting models. As a result, these reporting requirements impact the fund balances reflected for the two accounts and show differences between FAS and AFRS. These reporting differences and the fluctuations year-to-year in these fund balances have created questions; UW and OFM have worked together over the past few years to improve year-end processes and to better understand these differences. Recently, UW has agreed to provide OFM with schedules identifying and detailing the differences between the two accounting systems.

IMPACTS TO AFRS ACCOUNT 149 FUND BALANCE

We found that FAS Fund 149 fund balance, which is included for reporting in AFRS Account 149, has remained relatively consistent over the six Fiscal Years 2008-2013—averaging $28.4 million annually across the time period, as reflected in Exhibit 53.

Exhibit 53. Changes in FAS Fund 149 Fund Balance[61]



FAS Fund 149 fund balance has averaged approximately eight percent of average annual revenues and expenditures. According to the University Office of Planning and Budgeting, in 2011, University administration and legislative staff collectively established an informal policy to maintain a fund balance of between $20-$30 million in AFRS Account 149, which they believe is required for three main reasons:

- Spending the account balance to zero would be fiscally irresponsible as some reserves are necessary to buffer against unknown or emergency expenses.
- Reserves are necessary to ensure all contractual and/or committed expenses are covered prior to the passage of the State budget since UW's academic year and the State fiscal year are not aligned.
- The University is increasingly enrollment-driven as the majority of the general operating budget is dependent on tuition, which increases volatility in the budget and requires reserves to account for unanticipated changes in enrollment.

While FAS Fund 149 fund balance has remained relatively consistent, on average, across the six-year time period, we noted that there was a $57 million net loss in 2011. This dip in net income related to the $20 million transferred out of 149 revenue to implement the Husky Promise commitment program as well as about $30

[61] FAS Revenue and Expenditures Reports for FY 2008 through FY 2013

million fewer cost transfers out of 149 in Fiscal Year 2011 compared to the previous year. According to UW, the amount of costs transferred each year may be influenced by the University's management of the account's fund balance. At the end of Fiscal Year 2013, fund balance had increased to $23.9 million or 4.6 percent of 2013 Total Revenue.

AFRS Account 149 Fund Balance Reconciliation: June 30, 2013 Year End

Over the three biennia included in this audit, in comparing beginning balance July 1, 2007 to the ending balance June 30, 2013 in between FAS and AFRS the variation is minor—a 5.2 percent drop for the FAS system and 3.4 percent increase in the AFRS system. Generally, over the period, the annual revenues and expenditures (operating activities) have reconciled between the two systems. However, the fund balance in AFRS has differed from FAS due primarily to the handling of and reporting for the Internal Lending Program. Specifically, when UW set up the ILP, the intent was to move the related loan obligations from the dozen or so "owner" departments/funds to the ILP group of funds where these bonds would be centrally serviced and managed. The ILP would have loan agreements with the "owner" departments who would pay the debt service (interest and principal) to ILP and ILP would then pay the external debt service.

AFRS Account 149 Reclassification

At the end of 2009, a transaction was posted for AFRS to "write off" or remove the ILP loans related to State debt totaling $33,012,917 attributable to AFRS Account 149 for the General Obligation bonds relating to the Physics-Astronomy capital project that was authorized by the Legislature. The intent of this entry was to not only move the liability to ILP, but also to remove the amounts related to the State's GO bonds from UW's financial records for AFRS reporting purposes; State GO bonds are ultimate liabilities of the State and were already included in AFRS. As mentioned previously, the initial recording of this transaction resulted in an increase to FAS Fund 149's fund balance; subsequently it was determined a better treatment was to post the move as an interfund transfer which would not impact fund balance. This was an accounting entry only and did not represent an actual economic transaction (no impact on actual cash or physical assets.)

To rectify this transaction, in Fiscal Year 2011 two separate but related entries were posted to FAS Fund 149 beginning fund balance (so to not impact either the prior year financial statements or be posted to the current period). The first "prior period adjustment" was to reverse the first transaction—zeroing the impact to FAS Fund 149 fund balance and posting it to interfund. But as $2,872,500 in debt service had also been posted and impacted fund balance, the adjustment to actually correct the balance at that point was less, $30,140,417—a reduction of fund balance. Another adjustment was needed to the prior period balances because of principal payments made for 2009 and 2010 that were charged as expenses (and effectively reduced fund balance). These payments were appropriately posted to increase fund balance by $5,457,126.

Our review of ILP set up and correcting transactions reflect a "zeroing out" – thus no overall impact to either FAS or AFRS account fund balances. On an ongoing basis, FAS to AFRS adjustments will need to be made to offset ILP principal that UW pays on loans related to State bond debt but not carried over to AFRS as these have already been accounted for by the State.

In addition to ILP-related fund balance adjustments, each year when UW closes its books and makes year-end adjustments to comply with GASB, there are required postings that cause FAS and AFRS fund balances to be different. With the exception of a minor difference of $4,820, over the entire six-year period (or three biennia) these accounting adjustments total to zero. Given the immateriality of the $4,820 adjustment made in 2010, we did not investigate that amount.

At the end of the 2011-2013 fiscal biennium, AFRS Account 149 fund balance reflected a difference of approximately $4 million between FAS and AFRS. The reconciling items are conveyed in Exhibit 54.

Exhibit 54. Reconciling Items Between FAS Fund 149 and AFRS Account 149 as of June 30, 2013

FAS Fund 149	**AFRS Account 149**
6/30/2013	**6/30/2013**
$23,890,187	**$27,980,362**

$4,090,175 difference

Difference Composed of:

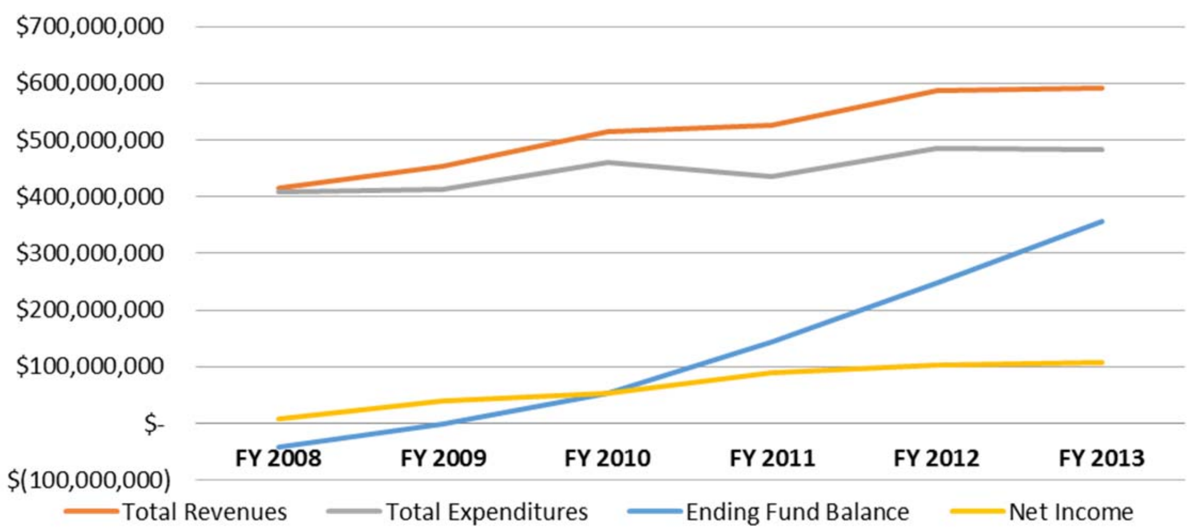
+$3,983,605	Adjustment to add back State bond interest for FY2011 to FY2013
+$20,111,389	GASB adjustment for non-state ILP debt
<$20,000,000>	Capital outlay "spend" moved for reporting purposes
<$4,820>	Other

In summary, all entries relating to ILP that impacted fund balance were traced—UW and OFM agreed to these reclassifications and these transactions were appropriately rectified and zeroed out. We noted adequate support for the entries and found they align with UW assertions. UW's external auditor did not recommend any adjustments to the University's financial statements relating to FAS Fund 149 adjustments—all relate to reporting differences between FAS and AFRS.

Impacts to AFRS Account 148 Fund Balance

The fund balance of the combined FAS Funds (Fund 143, 144, 147, 148, 150, and 372) that roll-up in to the State AFRS Account 148 – Dedicated Local Account has increased from Fiscal Year 2008 to Fiscal Year 2013—averaging $126.1 million per fiscal year over the six-year period under review, which is approximately 28 percent of the average annual expenditures.

Exhibit 55. Changes in FAS Fund Balances Included in AFRS Account 148[62]



Per FAS, the rolled-up fund balance has increased from a deficit in Fiscal Year 2008 to more than $356.5 million in Fiscal Year 2013, as shown in Exhibit 55. The increase in rolled-up fund balance is primarily due to increases in the FAS Fund 144 fund balance, as illustrated in Exhibit 56.

[62] FAS Revenue and Expenditures Reports for FY 2008 through FY 2013 – FAS Funds Included in AFRS Account 148

Exhibit 56. Ending FAS Fund Balances Included in AFRS Account 148 (in thousands)[63]

FAS Fund	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Fund 143	$5,783	$6,619	$7,806	$8,373	$7,761	$8,400
Fund 144	$224,433	$252,128	$285,926	$416,019	$490,745	$567,536
Fund 147	$(7,775)	$(10,528)	$(265)	$(163)	$545	$(1,278)
Fund 148	$(263,751)	$(250,140)	$(241,148)	$(281,464)	$(295,118)	$(273,331)
Fund 150[A]	-	-	-	-	$44,332	$55,220
Fund 372[B]	$0	$0	-	-	-	-
Combined Fund Balance	**$(41,311)**	**$(1,921)**	**$52,320**	**$142,766**	**$248,266**	**$356,547**

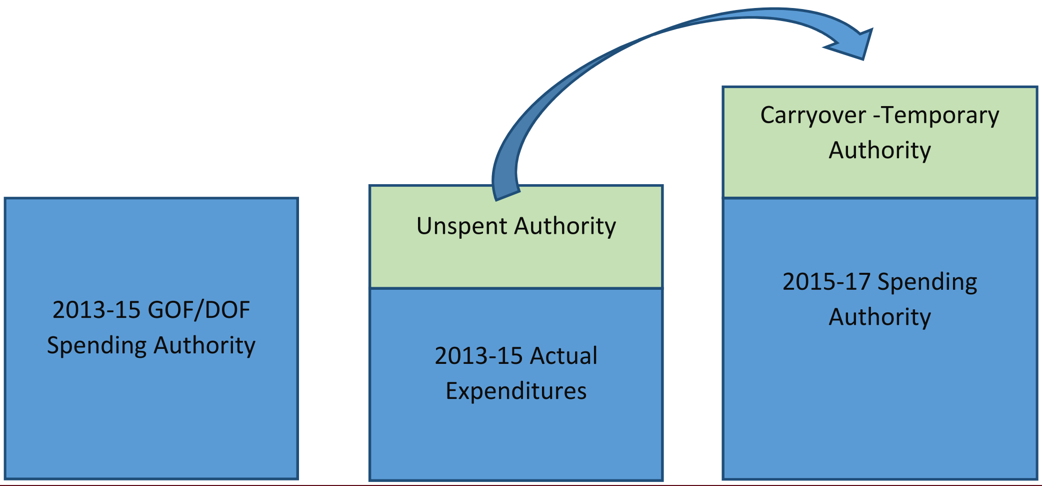
Notes: [A]FAS Fund 150 is only applicable in FY 2012 & FY 2013; [B]FAS Fund 372 is only applicable in FY 2008

Fund balance increases when revenue generated exceeds expenses and the surplus at the end of the period become available for carryover in the next biennium. UW defines carryover funds as “General Operating Fund and Designated Operating Fund budget authority allocated in a given biennium that remains unspent at the end of that biennium”. It is UW’s current policy that these funds are reallocated back to University units in the form of temporary funds in DOF budgets, as illustrated in Exhibit 57. It is important to note that the mechanism used to track individual unit budgets and budget carryover varies by fund and unit.

According to UW, there are more than 5,000 discrete budgets that may include carryover balances for a variety of reasons, such as emergency reserves, obligated start-up costs associated with faculty hires, capital investment, strategic initiatives, and providing funds to purchase new equipment. For FAS Funds 143 and 144, budget information is tracked in the University’s budget system. While some units track their budgets for self-sustaining activities in FAS Fund 148, others use their own budget applications. As such, without reviewing individual unit budgets, it is difficult to identify the individual components and purpose(s) for carryover of fund balances.

[63]FAS Revenue and Expenditures Reports for FY 2008 through FY 2013 – FAS Funds Included in AFRS Account 148

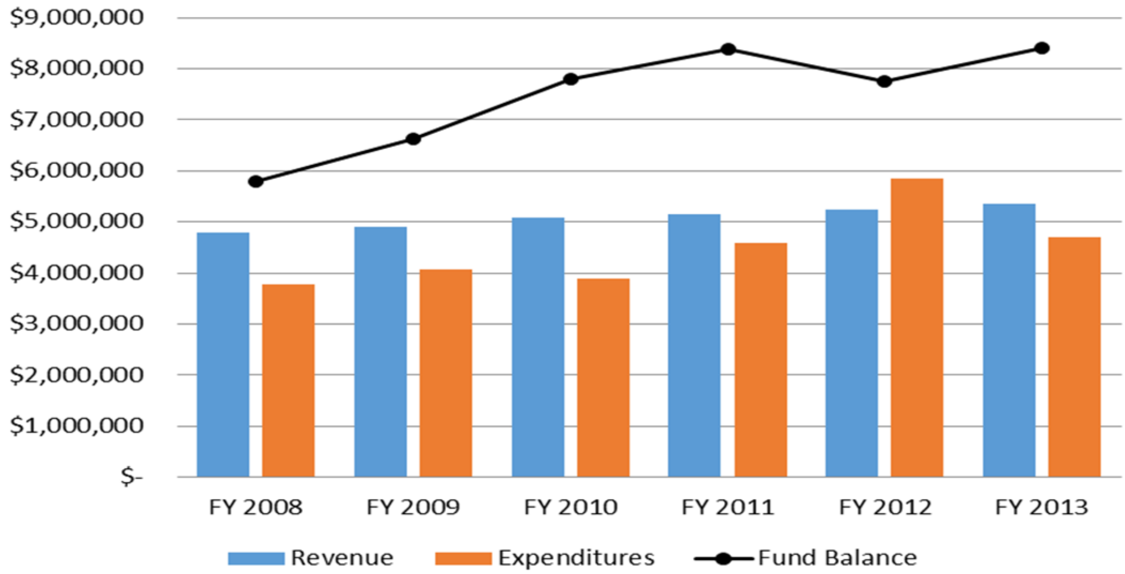
Exhibit 57. UW's Methodology Related to Carryover Funds



Further, unit budgets often involve several funding sources—thus, viewing a budget in terms of a single fund may mischaracterize the true condition of the fund and the budget. For example, a unit's budget may appear overspent when viewing one fund, but be underspent within another, with a net effect of little to no variance between budgeted and actual expenses in totality.

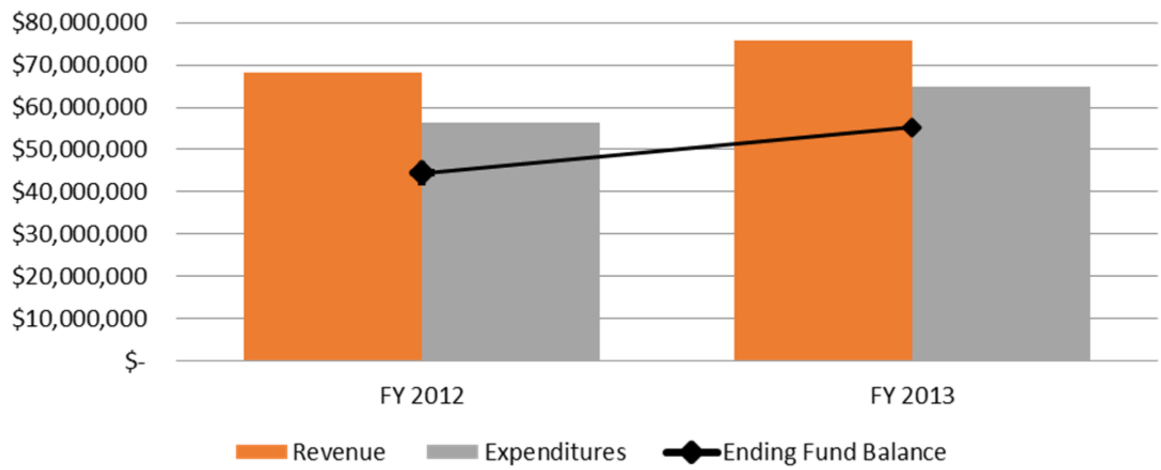
As discussed earlier, two of the funds, FAS Funds 143 and 150, that are rolled-up into the AFRS Account 148 fund balance are designated for a specific purpose. Specifically, FAS Fund 143 is designated to record activity related to the statutorily restricted (RCW 28B.15.051) Student Technology Fee. This fund is operated by and expenses approved by a University Student Advisory Committee. UW does not control the management of this fund or the fund balance. In Fiscal Year 2013, FAS Fund 143 had a fund balance of $8.4 million, representing a little more than two percent of the combined fund balance. The fund balance for Fund 143 has increased by more than $2.6 million, or 45 percent, from Fiscal Year 2008 to Fiscal Year 2013, from nearly $5.8 million to more than $8.4 million, as shown in Exhibit 58.

Exhibit 58. FAS Fund 143 Student Technology Fee Fund Balance[64]



FAS Fund 150 is used to track revenue and expenses related to Educational Outreach self-sustaining programs. Since the creation of this fund in Fiscal Year 2012, the fund balance has increased by nearly $10.9 million. In Fiscal Year 2013, FAS Fund 150 had a fund balance of more than $55.2 million, representing 15 percent of the combined fund balance, as shown in Exhibit 59.

Exhibit 59. FAS Fund 150 Educational Outreach Fund Balance[65]



[64] FAS Fund Balance Reports for FY 2008 through FY 2013
[65] FAS Fund Balance Reports for FY 2008 through FY 2013

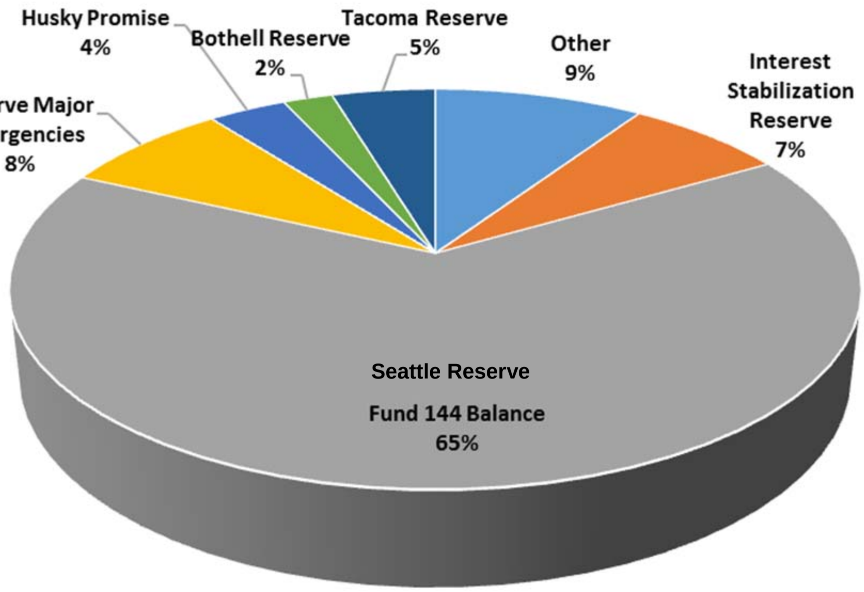
While there are no statutory restrictions on how surplus monies in FAS Fund 150 may be spent, it has been UW's practice to use these funds for the original purpose for which they were collected. Shortly after fiscal year-end, the revenue collected for each program is reconciled to the actual cost to operate the program; net income from fee-degree programs is sent to the program owner. For "fee degree-programs," with the exception of Summer Quarter, the department or school offering the program is considered the owner; as such, any surplus would be transferred to that department's or school's budget through a revenue transfer.

For programs offered directly by Educational Outreach, such as certificate programs, any surplus revenues remain in FAS Fund 150 and are either held in program reserve or are re-invested in start-up costs associated with new programs. For example, Educational Outreach recently started a low-cost Early Childhood online degree completion program. While this program will eventually be self-sustaining, fund balance from FAS Fund 150 will be used to cover the costs to launch the program and any additional related operating costs until the program becomes self-sustaining. Further, some of the fund balance has been set aside by Educational Outreach to implement a new financial management system that will be used to automate some of its internal manual accounting processes and improve its financial controls and reporting capabilities.

A portion of FAS Fund 150 fund balance is designated as Risk Opportunity Insurance. A percentage of fee revenue collected for each program is set aside as Risk Opportunity Insurance. These monies are set aside to ensure there are sufficient funds to cover the costs of Educational Outreach programs in the event a program does not generate enough revenue to cover the costs to provide the program.

Most of the AFRS Account 148 fund balance can be attributed to FAS Fund 144. The fund balance increased by more than $343.1 million from Fiscal Year 2008 to Fiscal Year 2013. A majority of the FAS Fund 144 fund balance can be attributed to the following categories, as shown in Exhibit 60.

Exhibit 60. FAS Fund 144 Fund Balance[66]



- <u>51-4000 "Fund 144 Balance" – Seattle Reserve</u> At the end of Fiscal Year 2013, $370.5 million, or 65 percent of fund balance, was designated as unspent allocated budget authority for the Seattle Campus of UW. As discussed earlier, at the close of each biennium, carryover from DOF and GOF are given back to units in the form of temporary funds in the DOF budgets.

  Reserves and carryover fund balance designations are tracked by each department or unit as part of the Provost's budget process. During this process, academic and university support units' fund balances are reviewed to ensure that the levels of reserves and carryover are justified and appropriate. Specifically, each unit is required to attribute carryover balances to the following seven categories: Start-up, Aid & Waiver Reserves, Temporary Salaries, Deferred Maintenance/Capital Investments, Reserves, Equipment, and Unit Strategic Initiatives. At the Provost's discretion, the Office of Planning and Budgeting provide GOF and DOF carryover balances back to units in the form of temporary DOF at the close of every biennium. According to UW, the Seattle Reserve is considered to be related to three separate functions: (1) Academic Unit Reserves and Carryover, (2) University Support Units Fixed Costs and Carryover and (3) Central Fund Balance. See descriptions of these below:

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[66] FAS Revenue and Expenditures Reports for FY 2008 through FY 2013

1. Academic Units Reserves & Carryover

The Academic Units of the University reserves total $185.5 million, half of the Seattle Reserve total. This total represents a summary of the 15 Colleges and Schools as well as Educational Outreach, with individual balances ranging from $919 to $70.9 million. Three Colleges and Schools make up nearly 74 percent of this balance and they are the School of Medicine ($71.0 million), the College of Engineering ($34.5 million) and the College of Arts & Sciences ($31.3 million). Information on each schools respective plans for these carryover funds are detailed below:

The School of Medicine had carryover funds of $71.5 million at June 30, 2013, which includes $0.5 million State funds, $12.6 DOF funds, and $51 million Indirect Cost Recovery revenue. The School of Medicine intends to use $45.5 million of the carryover funds as follows:

- 60 percent for Start-up Expenses
- 10 percent for Temporary Salaries
- 5 percent for Deferred Maintenance/Capital Investment
- 10 percent for Reserves
- 15 percent for Strategic Initiatives

The remaining $26 million of carryover funds are designated for the South Lake Union facility for short-term operating support over the next five years and long-term for facilities capital upgrade requirements.

The College of Engineering had carryover funds of $34.5 million at June 30, 2013. The College intends to use these carryover funds as follows:

- 51 percent for Start-up Expenses
- 34 percent for Reserves for Future Start-up Expenses
- 8 percent for Strategic initiatives
- 7 percent for Temporary Salaries, Deferred Maintenance/Capital Investment, Equipment, and Aid and Waiver Reserves

The College of Arts & Sciences had carryover funds of $31.3 million at June 30, 2013. The College intends to use these carryover funds as follows:

- 40 percent for Start-up Expenses
- 25 percent for Strategic initiatives
- 20 percent for Temporary Salaries, Equipment
- 10 percent for Reserves
- 5 percent for Deferred Maintenance/Capital Investment

2. University Support Units

The University Support Units reserves total $131.1 million or 35.4% of the Seattle Reserve total. This total represents a summary of 18 Support Units. The following three University Support Units make up nearly 81 percent of this balance:

- UW Finance & Facilities ($76.2 million),
- Dean of Libraries ($21.1 million), and
- Health Sciences Administration ($8.8 million).

According to UW, these units have fixed cost budgets used for variable costs, such as electricity, fuel, solid waste, and property rentals as well as carryover balances to support University wide Strategic Initiatives, Equipment Reserves and Temporary Salaries within these units.

3. Central University Funds

Central Administration University funds are generally designated operating fund revenues that are to be allocated to units in support of strategic initiatives, shared expenses and the UW mission. At the end of Fiscal Year 2013, Central Administration carryover totaled $53.9 million or 14.5% of the Seattle Reserve. According to UW, this carryover is mainly due to higher than expected ICR and Institutional Overhead revenue received.

- 51-4005 "Reserve for Major Emergencies" At the end of Fiscal Year 2013, $43.4 million was reserved for significant emergencies. For example, in the event of a significant interruption in service due to an earthquake, major fire, or other major event, these funds would be deployed with provost/president approval to provide funds to repair and/or replace critical teaching and research buildings and/or maintain service and operations for an extended period of time. As core operating budget increases, the amount of money set aside for emergency reserves also increases. According to UW, the major emergency reserve has increased over time primarily from revenue generated from investment income.

  In addition to these emergency reserves, auxiliaries (including hospitals, etc.) have their own cash (liquid) reserves to call upon in case of emergency. There are also self-insurance reserves to cover various liabilities and these programs are structured in various ways.

- 51-1422 "Interest Stabilization Reserve" This reserve was established in 1999 by UW's Treasury to stabilize the annual campus distributions from the Invested Funds pool. The intent is that in the event that the Invested Funds pool experienced a loss, UW would still be able to make a distribution to campuses by using funds from this reserve. At the end of Fiscal Year 2013, the balance was more than $40.9 million.

- 51-4009 "Husky Promise" As discussed earlier, in the biennium ending in 2011, $20,000,000 was transferred to DOF for the Husky Promise Fund.

- 51-4020 "UW Tacoma Fund Balance" At the end of Fiscal Year 2013, nearly $26.5 million was reserved in this account for the entire UW Tacoma campus. UW Tacoma campus plans to use these funds for enrollment growth and capital construction and renovations. According to UW, in Fiscal Year 2014 (outside the audit period), the campus spent a large percent of its reserve on capital projects.

- 51-4010 "UW Bothell Fund Balance" At the end of Fiscal Year 2013 nearly $12.8 million was reserved for UW Bothell campus. This balance includes $3 million in reserves to cover potential shortcomings on debt service, lease obligations, and other unforeseen events. According to UW, in the 2013-2015 fiscal biennium the campus used $4 million for the purchase of new lab equipment and supplies for Discovery Hall and $2 million to fund Science, Technology, Engineering, and Mathematics (STEM)faculty startup packages. The remainder of the balance is fully allocated across a variety of needs associated with campus growth and infrastructure needs, such as facility repurposing and space alternations ($500,000), advancement and external relations efforts ($175,000), a solar energy project through a grant matching program ($100,000), new housing consulting fees ($100,000), the Sally Ride Science Festival ($75,000), minimum wage adjustment ($50,000), and other growth-related expenses.

FAS Funds Included in AFRS Account 148 Fund Balance Deficits

In Fiscal Years 2008 and 2009, the combined FAS Fund Balance for all FAS Funds included in AFRS Account 148 had a negative fund balance. According to UW, the negative fund balance can be attributed to accounting corrections which were recorded in Fiscal Year 2014 (outside of the audit period) related to Consolidated Endowment Fund investments further described in Section 5. As a result, the fund balances reflected for Fiscal Years 2008 and 2009 were not accurate and should not be used to assess trends.

In addition, although FAS Funds 147 and 148 appear to have negative fund balances, as shown in Exhibit 56, the true condition of these budgets may not be overspent. Specifically, as previously discussed, activity related to a budget may span across multiple FAS funds; the activity of that budget when viewed in total likely conveys a different picture. As such, activity for a budget generally cannot be accurately assessed when viewed in the isolation of one fund. According to UW, these fund balances also do not reflect the accounting corrections which were recorded in Fiscal Year 2014 related to the Consolidated Endowment Fund investments.

Reserve and Fund Balance Policy

UW does not have a formal reserve policy for AFRS Account 148. Instead, DOF FAS Funds are included in UW accounts that are managed and monitored for "Days Cash On Hand" for bond rating purposes. According to UW, to maintain its "Aaa" bond rating its "Days Cash On Hand" must be sufficient and in-line with other Aaa rated UW peers—for 2013 the median number of days cash on hand for Public Universities was 261 days, which was more than UW's university-wide 157 days. Further, according to UW, many of the self-sustaining units are required to maintain reserves to comply with UW's ILP.

While UW has not historically established a reserve policy and there are no legislative policies governing AFRS Account 148 fund balance, in spring 2014, UW convened a Carryover Work Group "to consider and draft a policy guiding the provision of and expenditure plans for carryover funds in the future." In September 2014 this group proposed three policy changes that would go into effect for the Fiscal Year 2016 budget year. The new policy would limit DOF and GOF budget "emergency" reserves for administrative units to no greater than 10 percent of their permanent ABB base. The new policy could also potentially result in permanent and/or temporary reinvestment fund allocations being withheld. Specifically, if actual spending trends do not align with commitments provided by units during the budget process, surpluses or carryover balances could be withheld from the units in the next biennium.

AFRS Account 148 Fund Balance Reconciliation: June 30, 2013 Year End

In addition to analyzing the nature of the revenues and expenses included within AFRS Account 148, we also conducted a reconciliation of the fund balance between amounts shown on FAS and AFRS over the audit period. As previously discussed, AFRS Account 148 contains activities from a number of FAS funds. Over the six-year period of fiscal years 2008 through 2013, fund transactions totaled nearly $3.1 billion in revenue and nearly $2.7 billion of expense; in the 2011-2013 fiscal biennium, annual revenues were approximately $590 million and expenses averaged about $485 million. In terms of AFRS Account 148, the differences between FAS and AFRS over the six years of our review fall into the following categories:

- AFRS year-end adjustment entries to record financial activities not captured in FAS. The majority of these entries are reversed in subsequent periods. These include accruals, "true-up" postings, write-offs, transactions not posted to FAS, and others. Our review of these items found that throughout the six years, they all zero out.
- As discussed in the Section 7 of this report relating to ILP, certain adjusting entries to fund balance over the six years of our review can be attributed to ILP setup and corrections. Our review of the impact of these reclassifications reveal that they "zero out" over the period and leave no impact on the ending fund balance at June 30, 2013.

- As mentioned earlier in this report, the ILP program will continue to require FAS to AFRS adjustments:
  - Adjustments to offset ongoing ILP interest UW pays on ILP loans relating to State bond as these amounts cannot be carried over to AFRS. At June 30, 2013, this amount was $12,239,620.
  - On-going GASB adjustments at year-end will move ILP loan liabilities out of the governmental fund (which AFRS Account 148 is classified) to the State's AFRS Account 999. This amount is cumulative and will change yearly as ILP (relating to UW General Revenue Bonds) amounts attributable to AFRS Account 148 change (more loans are executed and debt service is paid). At June 30, 2013, this amount is $113,239,506. This amount agrees with UW's ILP worksheet and when added to the amounts related to State General Obligation Bond liability agrees with UW's June 30, 2013 financial statements.

At the end of the 2011-2013 fiscal biennium, a number of entries were required to appropriately post UW activities that impact AFRS Account 148 fund balance in order to assure its financial activities align with the State's needs for its GASB 34 reporting. While UW follows GASB 34 and 35, UW does not report on a fund basis, as is required for the State's GASB reporting. As a result, certain AFRS entries must be made by UW at the fund level for purposes of State reporting. These requirements cause the difference between FAS and AFRS fund balance.

Annually when UW closes its books certain adjustments must be posted at the program or fund level to capture financial activity for GASB reporting purposes. Two of these entries are posted each year and adjustments are made to the prior year account balance to appropriately reflect the expense or revenue.

- Benefits expense is booked in FAS as a predetermined percentage and is expensed all year following that ratio. At year-end, actual cash payments are compared against estimated expenses and then an adjustment is made to reflect the actual expense. This is an annual reconciling item. At June 30, 2013 the adjustment was additional expense of $13,545,509; this brings the GASB adjustment to equal a reduction of $59,447,980—a difference between FAS and AFRS.
- On the revenue side, the Children's University Medical Group (CUMG)—a joint venture between UW and Seattle Children's Hospital—employs UW School of Medicine physicians and bills and collects on UW's behalf. At year-end, an amount is posted to adjust the balance for amounts collected, but not yet remitted. At June 30, 2013, an increase to revenue of $2,170,301 was posted to bring the collections receivable balance to $17,937,230—this is the amount of difference between FAS and AFRS at year-end.
- Other adjustments, accruals, or corrections are also made to various expense and revenue accounts and impact AFRS Account 148 fund balance.

At the end of the 2011-2013 fiscal biennium, AFRS Account 148 reflected a difference of nearly $98 million between FAS and AFRS. The reconciling items are conveyed in Exhibit 61.

Exhibit 61. Reconciling Items Between FAS Funds Included in AFRS Account 148 and AFRS Account 148, as of June 30, 2013

FAS DOF Funds	AFRS Account 148
<u>6/30/2013</u>	<u>6/30/2013</u>
$356,547,348	**$454,389,373**

$97,842,025 difference

Difference composed of:

+$12,239,620	Adjustment to add back State bond interest for FY 2011 to FY 2013
+$113,239,506	GASB adjustment for non-state ILP debt
+$17,937,230	CUMG collections on UW’s behalf
<$59,447,980>	Cumulative difference between FAS estimates of benefits expense and cash payments
+$3,378,731	Wire transfers/ACH payments not booked in FAS
+$2,358,445	Correct transfers for interest allocation (reversed in FY 2014)
<$3,111,021>	Rent paid to Washington Biomedical in FY 2013 as a debit payable (reversed in FY 2014)
+$6,736,428	FY 2010 Accounts Receivable (reversed in FY 2014)
+$4,518,926	Accounts Payable Accrual
<$7,861>	Other

In summary, we found that all entries relating to ILP that impacted fund balance were traced and appropriately handled. Further, we noted that documents appropriately supported the ILP journal vouchers and other reclassifications, and reflect assertions made by UW. Additionally, the treatment of State and non-state ILP loans by UW at year-end is reasonable and GASB compliant. Finally, over all three biennia, with the exception of the detailed reconciling items noted above, all other adjustments made to fund balance were subsequently reversed or netted to zero.

It came to our attention during the audit that OFM and UW are currently working closely and collaboratively for more transparency and clarity in the FAS and AFRS accounting processes, particularly related to ILP and year-end fund balance matters. In addition to conducting joint meetings to better understand needs, deadlines, and improve year-end processes, UW recently began providing fund balance reconciliation worksheets to OFM that detail and explain the differences between FAS and AFRS account balances.

Net Position and Fund Balance Reporting

Provisions for GASB 35 provide that entities like UW that report on a BTA basis do not report "fund balances" but "net position". The financial reports issued by UW follow this methodology. Under this format, on UW's balance sheets net assets are classified in the following basic categories:

- *Invested in Capital Assets, Net of Related Debt*
- *Restricted:*
  - *Nonexpendable*
  - *Expendable*
- *Unrestricted*
      - ***Total Net Position***

These categories relate to the entire University and reflect all its assets less liabilities with the exception of its "discrete component units" which are shown in a second, separate column on the financial reports using the same classifications.

The State's financial reporting requirements are different; recently GASB 54 redefined the categories of "fund balance" relative to governmental fund types into five classifications:

- *Nonspendable fund balance*
- *Restricted fund balance*
- *Committed fund balance*
- *Assigned fund balance*
- *Unassigned fund balance*

The State follows provisions of GASB 54 for its governmental funds and has setup general ledger account codes to comply with these provisions. According to OFM, only the State makes the determinations of how all funds are reported in the financial statements and assigns the classifications related to fund balance. During the past few years OFM closely reviewed GASB 54 and the composition of the State's fund balances. According to OFM, they reviewed more than 600 accounts to assess these classifications considering the definitions set forth within the GASB 54 pronouncement, source of the funds, approval authority, order of spending and other factors. As such, OFM determinations are the following in terms of UW's ending fund balances:

- Fund balances in AFRS Accounts 148 and 149 are considered by the State to be "committed." GASB 54 generally defines committed as "constrained to specific purposes by a government itself." Thus, committed fund balance could be constrained by the State Legislature and the University's Board of Regents. Further, OFM "closes" AFRS Accounts 148 and 149 to "committed fund balance" at the end of each biennium.

  Alternatively, to be considered "restricted fund balances" amounts must be constrained by "their providers" such as grantors, bondholders, and higher levels of government." Thus, many federal and state grants or other such contracts are defined as restricted.

- Endowments have "non-spendable" and "spendable" portions but are restricted.
- According to OFM, only State working capital is deemed as "assigned."
- General funds, by definition and State classification, are included in "unassigned fund balance" as these are amounts that are and can be available for any purpose.

In summary, similar to its submission of other fund accounting data, UW provides OFM with its year-end financial data and OFM makes the determination of the fund balance classifications. The University's financial statements are reported in accordance with GASB 35 provisions and these determinations have no bearing on the State's classification methodology (OFM's classifications were not included in the scope of this audit.)

SECTION 9. Conclusions and Recommendations

During the course of our audit, it became clear that communications and transparency are key issues that the State and University of Washington (UW) wish to address and remediate. While the State Auditor's Office (SAO) engaged us to review and analyze UW in regards to two State funds, the issues of contention span far further than the revenues, expenditures, and management of AFRS Fund 148 and Fund 149. UW is a major enterprise, engaging in a variety of complex programs and services. As such, information related to UW must be conveyed in context and in a complete manner. Viewing its operations in terms of two funds offers a glimpse into its management and services—examining those funds with closest relationship to the State government; however, this is an incomplete view.

Both the State's Office of Financial Management (OFM) and UW are hampered with primary accounting and reporting systems that are 40 years old—lack functionality and flexibility to fully meet the needs of the governments. Moreover, UW's system is a completely different system than the State's; translating and transferring data is labor intensive, performed on an upload basis, one directional, and results in summarized information on the State's side. Both UW and OFM conveyed full cooperation in these processes and both agreed that creating programs or writing code to facilitate data retrieval on the AFRS side that would be similar to that of other State Agencies is prohibitively expensive and likely not a good investment for either of these out-of-date legacy systems. While both the OFM and UW desire current day fully integrated fiscal systems, such a recommendation is beyond the scope of this audit.

1. Ensuring the Timely Submission of Year-End Financial Data

Over the period of our review, UW did not comply with the timing requirements for year-end data submission. Since 2009, OFM and UW have worked together to improve communication and protocols for remitting year-end data. Gradually over the ensuing periods, UW has improved the timing of its reports and OFM indicates that incrementally UW came closer to meeting the State's reporting timelines. Both the OFM and UW stated that the greatest achievements have occurred in the past two years and improved communications and processes to streamline these efforts have resulted in the data being submitted significantly earlier in 2014, nearly meeting the deadline set forth by OFM for UW.

Recommendation:

1. In the absence of implementing a contemporary and fully functional financial system, UW should continue to work closely with OFM to develop reports, processes, and activities that will accomplish the necessary tasks to fulfill both UW's annual financial reporting requirements and meet the State's provisions for submission of financial information.

2. Alignment and Reconciliation of Budgetary Information between UW and the State

OFM sets forth protocols for its agencies and departments to provide budget data and submit allocation packages. However, UW's operations involve far more than the expending of State-provided appropriations; it is a complex organization operating multiple "businesses" that involve a variety of revenue generation programs and services that are outside of the State's direct budget activities. The State appropriates funding through the budget process and uses the "non-appropriated" funding controls to monitor "operating fees" generated from tuition payments. It appears, however, that OFM, legislative staff, and UW each follow independent processes to forecast and budget for those fees. As each use discrete predictive approaches and iterations, each come to differing amounts. This lack of consistency in operating fee amounts undermines the accuracy and credibility of the data, thus, making it less reliable and transparent.

Recommendation:

2. OFM, legislative staff, and UW staff should meet and discuss the tools used by each to project operating fees. This process should bring understanding to the key elements, definitions, assumptions, and drivers to predict and project tuition revenue. Key milestone dates to compare elements and factors and results should be negotiated. Models or assumptions should be realigned to conform to evolving data. At some point toward the end of the cycle, results among the three should be reviewed in concert and reconciled to come to a single figure for State budget and allotment plan purposes.

3. Providing the Legislature and State with Useful, Complete, and Reliable Data

Providing insightful, useful and complete information for legislative decision-makers is achievable. However, to ensure that information meets requirements and expectations it is essential that a collaborative relationship is in place. Because some information needs are "one-time" in nature while others could be periodic, annual, or biennial, what is critical is that communication and collaboration exists to make these data gathering and reporting efforts fruitful and fulfilling.

Information needs must be defined; understanding the goals and specifically identifying and determining the questions to be answered with the needed information to ensure satisfaction on both sides. Once the questions are known and how the information provided will be used, more useful reports can be designed and provided as agreed to by the parties.

Recommendation:

3.a Representatives of OFM, SAO, Legislature, and UW should meet to discuss information sharing matters. The discussions should determine the types of information that the Legislature and the State need to oversee UW and to provide appropriate detail and substance for decision making. All parties should be mindful to base reporting requirement decisions on how the reports are to be used, the objectives of these reporting exercises, and the timing or frequency of the needed information. Once these determinations are made, UW should develop templates and examples for these reports and obtain feedback from the potential users following a mutually agreeable timeframe. Once agreement is reached on the form, format, elements, and frequency of the report(s), UW should provide these reports following the schedule negotiated.

With the initial reports, UW should meet with the users to explain the data, its uses and limitations.

To ensure that the reports are beneficial, being used, provide the needed information, and that the related efforts are value added, the parties should reconvene periodically to discuss report utilization, any required reporting changes, and whether the process should continue or be modified.

3.b Annually, UW issues audited financial statements relative to its operations. A wealth of information can be gleaned from these statements and underlying data. Working in collaboration with the State and Legislature, a "user friendly" presentation of the results could provide valuable year-end information and results could add transparency and accountability. For example, in addition to explaining the financial results for the year, UW could include performance metrics such as breakdown of tuition dollar spent per resident undergraduate, percentage of students on state/university financial aid, annual cost of educating a resident undergrad, or breakdown of instructional costs by state support, tuition and other funding sources.

4. Complete and Centralized Policies and Procedures

Although UW has a rules coordination office, it does not appear that UW has established either a comprehensive body of institutional fiscal policies and procedures or a central resource for finding policies, procedures, and rules. Because UW has delegated and decentralized much of the responsibility for financial transactions, the need for a comprehensive set of guidance and protocols is even more important. In the absence of a fully-integrated enterprise-wide information management system, a central point for policies, procedures, and protocols would assist users in determining the source of and nature of data, tools and rules for accessing the data, and other useful information. Further, a centralized and comprehensive set of guidance tools would not only ensure that the full body of direction exists but is coordinated and in concert as well as facilitating the update and maintenance of these rules. Further such a University-wide "accounting manual" or complete set of fiscal policies, procedures, rules, and protocols would provide staff from around the large, complex entity a central resource for conducting critical activities and would ensure that these functions are completed in a uniform and deliberative manner.

4. UW should consider consolidating its various policies, procedures, guidance, tips, and tools into a central on-line resource. This effort could commence with an inventory of fiscal and student-related guidance, policies, and procedures, as well as existing system and off system data bases and repositories.

   Centralizing the availability of the information does not necessarily require the movement of this data from the current locations, rather the inclusion of and linking of the data from a central point. Further, this process will help identify gaps in the body of standards, data availability, and processes and procedures.

5. Decentralized Fiscal Information

Operating within a significantly outdated legacy system, even with the valuable tools UW has added, makes it difficult for UW management and staff to mine and analyze information for answering external requests as well as fulfilling management decision-making needs. While UW was very responsive to our requests, we noted that compiling such information was labor-intensive and required the expertise of a few individuals. In addition to a central catalogue of data sources, UW could consider a central repository of certain key fiscal records. For example, journal vouchers and supporting data are maintained at the source unit/department/college level and should financial management, OPM or others need to researching such transactions tracking down the records is time consuming and involves many individuals.

5. In the absence of an enterprise-wide knowledge management system, UW should consider opportunities to better utilize existing information. This could entail leveraging the cataloging of existing "cottage" or one-off databases and systems by convening a working group to discuss information sharing needs and ways to centralize access or provide for data repositories or warehousing.

Appendix A. List of Exhibits

Appendix B. Glossary of Terms

Account: An independent budget and accounting entity with a self-balancing set of accounts representing all related resources, obligations, and reserves. Similar to a "fund."

ABB -- Activity Based Budgeting: A method of budgeting in which the activities that incur costs in every functional area of an organization are recorded and their relationships are defined and analyzed. Activities are then tied to strategic goals, after which the costs of the activities needed are used to create the budget.

AFRS – Agency Financial Accounting System: State-owned accounting system used by all state agencies and higher-education institutions in the State of Washington. AFRS is a legacy mainframe financial system that has been in production for over 25 years.

Allotment: An agency's plan of estimated expenditures and revenues for each month of the biennium.

Appropriation: The legislative authorization to make expenditures and incur obligations from a particular account.

Auxiliary Enterprises: Activities in these areas are not "essential to the mission" of UW but are necessary to the efficient conduct of the mission.

BGT: University of Washington Budget System implemented in 1983 that is an online budget building and monitoring tool.

Biennium: Two year budgeting period. Begins July 1st in odd-numbered years and ends June 30th of odd-numbered years.

BTA -- Business-type Activity: A reporting model used by public entities (public universities, hospital, utilities, and others) to reflect how the operations are supported and how these entities spend their resources.

CUMG -- Children's University Medical Group: Seattle Children's Hospital and University of Washington School of Medicine practice plan

DOF -- Designated Operating Fund: Funds over which UW has unlimited discretion, though the university, as a matter of internal policy, may restrict their use. Composed of interest income, Summer Quarter revenue, clinical revenue, administrative overhead, and miscellaneous fees.

Educational Outreach – University of Washington Educational Outreach: A program of UW that offers programs and services geared toward nontraditional students, including working adults, and are primarily offered in the evening, weekends, and online. These programs are generally intended to be self-supporting.

FAS "Financial Accounting System": UW's legacy financial accounting system.

Fiscal Year: A 12-month period used for budget and accounting purposes. The state fiscal year runs from July 1 through June 30 of the following year, and is named for the calendar year in which it ends.

Fund: A self-balancing set of accounts, segregated for specific purposes in accordance with laws and regulations or special restrictions and limitations.

Fund Balance: The difference between assets and liabilities in a governmental fund.

General Obligation (GO) Bonds: Bonds whose repayment is guaranteed by the "full faith and credit" of the State.

GASB – Government Accounting Standards Board: is the source of generally accepted accounting principles (GAAP) used by state and local governments in the United States.

GOF -- General Operating Fund: Funds over which UW has significant discretion. Composed of State appropriations (tax support) and Operating fee revenue (portion of tuition).

GRB – General Revenue Bond: General Revenue Bonds, issued by UW, are special fund obligations of the University, payable from General Revenues.

Grants, Contracts, and Cooperative Agreements: monetary amounts awarded to UW by the state or federal agencies, philanthropic organizations, or private industry, to be used for specified purposes as defined by the terms and conditions.

ICR – Indirect Cost Recovery: Negotiated or specified rates of "overhead" charges on grants and contracts intended to reimburse UW for indirect or support costs of operations such as infrastructure, administration and other costs not directly charged.

ILP – Internal Lending Program: The Internal Lending Program (ILP) was adopted in July 2008 after receiving new legislative authority to issue local debt for any university purpose. The ILP makes internal loans to campus borrowers and manages repayment in accordance with financing agreements between the campus borrower and the institution. The University bundles those internal loans and borrows externally to secure the funds for those loans.

Indirect Costs: Cost incurred for common or joint objectives, and therefore cannot be identified readily and specifically with a particular sponsored project, and instructional activity, or any other institutional activity.

Institutions of Higher Education-Dedicated Local Account (AFRS Account 148)—Local fund used by universities, the Evergreen State College, and community colleges to account for dedicated revenue.

Institutions of Higher Education-Operating Fees Account (AFRS Account 149): Local fund used by institutions of education to account for all resources not required to be accounted for in other funds or accounts.

Internal Controls: A system of policies, procedures, and protocols to safeguard assets, ensure the reliability and integrity of financial information, ensure compliance with laws, rules, regulations, policies and procedures, promote efficiency and effectiveness, and accomplish UW operational goals and objectives.

Nonappropriated Funds: Monies that can be expended without legislative appropriation.

OFM – Washington Office of Financial Management: The Office of Financial Management provides vital information, fiscal services and policy support that the Governor, Legislature and state agencies need to serve the people of Washington State

OPB – University of Washington's Office of Planning and Budgeting: The University of Washington Office of Planning & Budgeting (OPB) supports UW community in accomplishing its goals through the planning and allocation of financial and physical resources, and providing analysis and information services to enhance university decision-making, planning and policy formation.

Operating Fees: Operating fees are that portion of "tuition and fees" charged to students that relates directly to instructional support and does not include building fees.

Proviso: Language in budget bills that places conditions and limitations on the use of appropriations.

RCW – Revised Code of Washington is a compilation of all permanent state laws now in effect. It is a collection of session laws (enacted by the Legislature and signed by the Governor, or enacted via the initiative process), arranged by topic, with amendments added and repealed laws removed. It does not include temporary laws such as appropriation acts.

Reconciliation: A process of comparing transactions and activity to supporting documentation. The process involves resolving any discrepancy that may be discovered.

SAO – Washington State Auditor's Office

Self-Sustaining Funds: Those typically generated by UW auxiliary activities. Expenditures are generally limited to the purpose for which the activity was established and the revenue collected.

STF – Student Technology Fee: Fee charged to students for the improvement of technology used by the students at UW campuses. Students lead the Student Technology Fee Committee, which allocates the expenditure of these fees.

WWAMI – Washington, Wyoming, Alaska, Montana, and Idaho Regional Medical Education program that aims to provide graduates that will deliver health care back to the region.

UNIVERSITY of WASHINGTON

Michael K. Young
President

December 29, 2014

The Honorable Troy Kelley
Washington State Auditor
Insurance Building, Capitol Campus
302 Sid Snyder Avenue SW
Olympia, WA 98504-0021

Dear Mr. Kelley:

The University of Washington (UW) appreciates the opportunity to respond to the audit conducted by Sjoberg Evashenk Consulting (SEC) on behalf of the Washington State Auditor's Office (SAO) in response to ESSB 6002, 2014 Supplemental Operating Budget. We support the general conclusion from the auditors; namely, that the UW has spent funds consistent with submitted plans with no exceptions or reportable issues. The UW takes its financial stewardship responsibility very seriously.

This was a complex audit, and responding to this audit over the past several months took significant effort by all parties, including the UW. UW staff spent over 2,500 hours in the past six months responding to requests from SEC for data and information. The degree to which SEC accurately captured and detailed the complexities of the audited activities was a monumental task over a short period of time. We appreciated their willingness to carefully listen to our explanations and review the hundreds of documents provided during the audit.

The UW substantively agrees with the five recommendations in the audit report. Our response will first include a general statement regarding the audit, followed by a response to each of the recommendations.

On the whole, we believe SEC accurately described the complexity of financial accounting at the UW, especially with regards to its efforts to translate financial accounting and fund balance information in state accounting systems. Fund balance in state AFRS Fund 148 and Fund 149 ensure adequate funding exists for critical risk areas, such as unanticipated contingencies, startup funds for faculty recruitment and retention, long-term strategic initiatives, and interest payments on debt. We appreciate that SEC cited the UW's increasingly collaborative efforts with the state to provide information about these funds that is clear, transparent and responsive.

As the audit describes, the UW is unique among state general government agencies, especially in terms of its diverse revenue streams and its ability to finance debt. Necessary, but different, government accounting guidelines can complicate comparisons of our activities to those of general government. The UW is required to comply with the Governmental Accounting Standards Board (GASB) reporting requirements as a Business Type Activity (BTA). According to the GASB standards, BTA financial statements are prepared on an institution-wide basis, using an economic resources measurement focus and the full accrual basis of accounting. BTA reporting organizations, including nearly all other institutions of higher education, are financed in whole or part by fees charged to external parties for goods and services. This is in contrast to general government (most Washington State agencies), which report under GASB requirements for state and local governments. These reporting standards aim to address the need for how

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public resources (e.g., tax revenue) were acquired and either used during the period or are expected to be used. Again, differences between the two reporting formats can make comparisons between general government and higher education, at times, difficult.

In addition, the UW has independent financing authority from the State. Thus, credit rating agencies, such as Moody's Investors Service, evaluate the UW like a commercial entity, requiring reserves levels to effectively manage risk and ensure sustained financial health. Note that the audit report places UW "days cash on hand" at the median when compared to higher education peers with a similar credit rating.

The audit report confirms that the UW has managed its finances responsibly and according to the expectations of its various funders. The result is that the UW has, for several years, maintained a Aaa credit rating from Moody's, the highest available, which was sustained during the Great Recession. Our Aaa rating ensures interest rates for capital borrowing remain as low as possible for capital acquisition, which supports the critical missions of teaching, research and public service, such as patient care.

Recommendation #1 – Ensuring the Timely Submission of Financial Data

We agree with this recommendation. Much effort has been directed in this area in recent years due in large part to the strong and collaborative relationship between the UW and Washington State's Office of Financial Management (OFM). Improvements have been significant in light of the aging nature of both the UW's and OFM's financial systems. We are committed to continuing to identify additional improvements to both meet the deadline and improve transparency and reconciliation, even in the absence of modern financial systems.

We will also revisit discussions with the OFM as to whether there is value, both from transparency and efficiency, to implement a discreet reporting format, rather than to distribute activities throughout the various funds across the State's Consolidated Annual Financial Report (CAFR). As noted in the audit report, the State of Washington is the only state amongst the 20 states listed that distributes higher education activities across state funds. Aligning Washington with other states and requiring discreet reporting from higher education institutions would greatly simplify the annual reporting process as well as show higher education separately, thus providing enhanced transparency to users of the financial statements.

Recommendation #2 – Alignment and Reconciliation of Budgetary Information between the UW and the State

The UW is committed to its ongoing work with the State to better align methodologies used for forecasting, budgeting and monitoring tuition and state appropriations; as such, we agree with this recommendation. This is no small task, given our aging systems and our requirements to responsibly manage resources at the institutional level, balancing the varied priorities and maintaining consistent approaches across the enterprise. We appreciate the willingness of our partners at OFM and legislative committee staff to better understand our budget and forecasting processes. In particular, we support current work with legislative staff to refine the state's tuition revenue model so that it is more predictive and accurate than it has been in the past.

Recommendation #3 – Providing the Legislature and State with Useful, Complete and Reliable Data

3a. We agree with the recommendation and support SEC's suggestion that we continue to build on existing relationships, increasing both understanding of information needs and related challenges. Such challenges include the range and complexity of activities across the University, limitations on the availability of certain types and levels of data, our aging systems and how these elements often inhibit our ability to provide timely information. We will continue to build on these relationships so that time-sensitive requests may require less translation and rework. We also support SEC's observation that requests include as much information as possible about how the information will be used to support greater responsiveness.

3b. We agree with the recommendation that a user-friendly presentation or "primer" could enhance understanding of the UW's year-end annual report results, including performance metrics and other ratios. While the UW provides numerous performance level data, ratios and other information to the State and the Legislature, we commit to a collaborative effort to enhance or improve what we provide.

Recommendation #4 – Complete and Centralized Policies and Procedures

The UW generally agrees with the recommendation for a comprehensive source of financial-related policies and procedures. As the audit stated, the UW has a decentralized structure. As such, having consistent policy and other guidance to ensure consistency across units is critical to ensuring responsible stewardship and transparency, but requires ongoing effort to achieve. The UW provides senior administrators and others with targeted training and tools for appropriate financial management responsibilities, both for budgeting and oversight and for specific functional activities, such as grants management, travel and procurement. Further, key websites that describe standard fiscal activities with relevant links to key policy guidance are provided, but could benefit from coordination and centralization.

Recommendation #5 – Decentralized Fiscal Information

We agree that having more centralized access to detailed financial data and backup documentation is a worthwhile objective. The UW already has a great deal of standard financial data available that is responsive to many information needs and requests, but we are continuing to expand these offerings. As stated by SEC, our aging systems and the need to maintain source data at the unit level in some cases, hampers our ability to centralize fiscal information to the extent we would prefer. The UW continues to work toward a centralized enterprise data warehouse to provide greater levels of detail and accessibility.

With regard to our aging systems, some progress is currently being made. The procurement and travel reimbursement system modernization effort is nearly complete and a new modern Human Resource and Payroll system will go-live January 2016. These modern systems have built-in business rules, along with robust reporting capabilities, to support this recommendation. In addition, these modernization efforts have required standardization of supporting business processes, thus simplifying training on policies, procedures and practices. We observe the powerful business improvement efforts that modern systems provide; as such, we look forward to replacing our financial and budget systems.

The UW appreciated the opportunity to respond to this very important effort.

Sincerely,

Michael K. Young

Cc: Richard Cordova, UW Internal Audit