

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF INTEREST EARNED ON
ADVANCES OF FEDERAL FUNDS BY
THE UNIVERSITY OF HAWAII
JULY 1, 1997 THROUGH JUNE 30, 2000**



JANET REHNQUIST
Inspector General

DECEMBER 2001
A-09-01-04004

Office of Inspector General

<http://www.hhs.gov/oig/>

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OAS FINDINGS AND OPINIONS

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed as well as other conclusions and recommendations in this report represent the findings and opinions of the HHS/OIG/OAS. Final determination on these matters will be made by authorized officials of the HHS divisions.





DEPARTMENT OF HEALTH AND HUMAN SERVICES

Office of Inspector General
Office of Audit Services

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CIN: A-09-01-04004

February 26, 2002

Mr. Eugene S. Imai
Senior Vice President for Administration
University of Hawaii
Bachman Hall, Rm. 201
2444 Dole Street
Honolulu, Hawaii 96822

Dear Mr. Imai:

This report presents the results of our audit of the cash management procedures used by the University of Hawaii (UH) to determine the interest earned on advances of Federal funds. The objectives of our audit were to determine whether the UH's cash management policies and procedures were in accordance with Office of Management and Budget (OMB) Circular A-110, *Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations*, which required the UH to: (i) minimize the time between the receipt of Federal funds and their disbursement, (ii) maintain advances of Federal funds in interest bearing accounts, (iii) remit any interest earned on the advances, and (iv) meet certain other financial management standards. Our review included approximately \$122 million of advances of Federal funds requested by the UH during the period July 1, 1997 through June 30, 2000.

We found that the UH did not have the procedures required by OMB Circular A-110 to effectively determine its interest earned on advances of Federal funds. Our audit determined that UH's cash management procedures were deficient in the following areas: (i) UH did not have written procedures to ensure the timing and amount of advance requests met its disbursement cycle and immediate disbursement needs, (ii) UH College of Tropical Agriculture and Human Resources (CTAHR) did not perform timely and accurate reconciliation between the cash-on-hand balances shown on the Program Support Center (PSC) 272 Federal Cash Transaction report (272 report) to the general ledger for the United States Department of Agriculture (USDA) letter of credit programs, (iii) the UH CTAHR did not have proper segregation of duties within the cash management area, and (iv) UH did not calculate interest earnings on advances of Federal funds based on daily positive cash balances considering the lag time between check issuance and actual check clearance date.

Although we identified areas where the UH needs to improve its cash management, our analysis indicated that the UH did not have significant positive cash balances because the UH did not always draw all its estimated needs and did not include all expenditures when determining the draw amounts. Therefore, there was no material impact of the UH improperly calculating interest earned during our audit period.

We recommend that the UH: (i) establish written procedures on the timing and amount of advance requests to meet its disbursement cycle and immediate disbursement needs, (ii) ensure that CTAHR complete a full reconciliation between the cash-on-hand balances shown on the 272 reports and the general ledger for the USDA letter of credit programs from September 30, 1997 to the present, and submit revised 272 reports to USDA officials where appropriate, (iii) review CTAHR's internal control practices related to segregation of duties in the cash management area, and (iv) develop written procedures to calculate interest earnings on advances of Federal funds based on daily positive cash balances considering the lag time between check issuance and actual check clearance date.

In comments to our draft report, the UH concurred with the recommendations in our audit report. The UH's comments are summarized on page 8 and included in their entirety as an APPENDIX to this report.

We excluded two letters of credit from our review because the UH did not file 272 reports during the period July 1, 1997 through June 30, 2000. These letters of credit are discussed in detail under the "Other Matters" section of this report.

INTRODUCTION

BACKGROUND

Federal departments fund grants and contracts to educational institutions by either an advance of funds or on a cost reimbursement basis. When educational institutions receive funds through an advance, they must follow procedures to minimize the time elapsing between the transfer of funds from the U.S. Treasury and the actual disbursement. Cash advances should be limited to the minimum amounts needed and timed to the actual, immediate cash necessary to carry out the purpose of approved programs or projects. When Federal departments fund educational institutions on a reimbursement basis, the educational institution must use their own funds to pay for program costs before they request reimbursement from the Federal Government.

Federal agencies are required by OMB Circular A-110 to pay universities in advance for grant and contract costs. In return, the universities must:

- Apply cash management procedures that assure the timing and amount of cash advances are as close as is administratively feasible to actual disbursement for program purposes [*A-110, Subpart C, Section .22(b)*];
- Maintain the advance payments on deposits in interest bearing accounts until spent for program costs [*A-110, Subpart C, Section .22(k)*];
- Maintain financial management systems for their Federal awards that provide, among other requirements, accurate financial records pertaining to interest earnings [*A-110, Subpart C, Section .22(b)(2)*]; and

- Refund the interest earned (less a yearly allowance of \$250 for administrative costs) while the advanced funds are in university account(s) [*A-110, Subpart C, Section .22 (l)*].

Advances of Federal funds are provided to UH by the Department of Health and Human Services (HHS) PSC, Division of Payment Management (DPM) through an electronic fund transfer system known as Smartlink II. For each letter of credit, the UH estimated the amount of cash needed to pay the expenses for each Federal agency's grants and contracts and requested funds from DPM. The DPM disbursed the funds and generated the 272 report using the Payment Management System. The electronic funds transfer occurred generally one day after the request.

The UH Office of Research Services (ORS) performed the cash management procedures for all letters of credit with the HHS PSC except for letters of credit with the USDA. As part of its cash management procedures, ORS determined the timing and the request amount of Federal funds on letter of credit agreements and performed a reconciliation of cash-on-hand balances reported on the quarterly 272 report and the general ledger. The USDA's letters of credit were administered by CTAHR.

OBJECTIVES, SCOPE AND METHODOLOGY

Our overall objective was to determine whether the UH followed OMB Circular A-110 requirements regarding interest earned on advances of Federal funds for letters of credit disbursed by the HHS PSC. Specifically, we determined for the period July 1, 1997 through June 30, 2000 whether the UH:

- Had cash management procedures that minimized the time elapsing between the transfer of funds and its disbursement for program purposes;
- Reconciled the 272 reports to its accounting records; and
- Maintained advances of Federal funds in interest bearing accounts and remitted the interest to PSC.

To accomplish our objectives, we:

- Reviewed the UH's OMB Circular A-133 audit reports and audit working papers for the UH's Fiscal Years ending June 30, 1998 through June 30, 2000;
- Reviewed the UH's cash management policies;
- Obtained an understanding of the major expenses incurred on grants and contracts, including accounts payable, payroll, and indirect costs; and
- Held discussions with UH officials.

We did not review UH cash management procedures to test: (i) the treatment of refunds, returned checks, and other credits; (ii) the adequacy of bonding, insurance, and safeguards over

assets; (iii) that outlays were within budget amounts for each award; and (iv) other standards for financial management systems. We also did not evaluate the internal control structure of UH, because the objectives of this limited scope review did not require a complete understanding or assessment of the internal control structure.

We were unable to audit the cash-on-hand balances and the reported disbursements shown on the 272 report for the audit period July 1, 1997 through June 30, 2000. The CTAHR had made material errors on the reported cash-on-hand balances dating back to March 1996. We requested CTAHR to perform a review of the 272 report cash-on-hand balances, including reconciling the 272 report to the general ledger for the audit period. However, CTAHR was unable to complete its review for our audit comment.

The UH did not submit any 272 reports for Department of Labor (DOL) – Employment and Training Administration (ETA) and USDA – Cooperative Extension Services (USDA-CES) letter of credit grants for our audit period July 1, 1997 through June 30, 2000. Without the 272 reports, we were unable to audit cash-on-hand balances and the reported disbursements and, therefore, we are unable to render an opinion on these two programs. This is further discussed in the Other Matters section at the end of this report.

Our review was performed in accordance with generally accepted government auditing standards. We performed our fieldwork at the UH's offices in Honolulu, Hawaii during the period June 2001 through September 2001.

FINDINGS AND RECOMMENDATIONS

We found that the UH did not have the procedures required by OMB Circular A-110 to effectively determine its interest earned on advances of Federal funds. Our audit determined that UH's cash management procedures were deficient in the following areas: (i) UH did not have written procedures to ensure the timing and amount of advance requests met its disbursement cycle and immediate disbursement needs, (ii) UH CTAHR did not perform timely and accurate reconciliation between the cash-on-hand balances shown on the 272 report to the general ledger for the USDA letter of credit programs, (iii) UH CTAHR did not have proper segregation of duties within the cash management area, and (iv) UH did not calculate interest earnings on advances of Federal funds based on daily positive cash balances considering the lag time between check issuance and actual check clearance date.

Although we identified areas where the UH needs to improve its cash management, our analysis indicated that the UH did not have significant positive cash balances because the UH did not always draw all its estimated needs and did not include all expenditures when determining the draw amounts. Therefore, there was no material impact of the UH improperly calculating interest earned during our audit period.

We recommend that the UH: (i) establish written procedures on the timing and amount of advance requests to meet its disbursement cycle and immediate disbursement needs, (ii) ensure that CTAHR complete a full reconciliation between the cash-on-hand balances shown on the 272

reports and the general ledger for the USDA letter of credit programs from September 30, 1997 to the present, and submit revised 272 reports to USDA officials where appropriate, (iii) review CTAHR's internal control practices related to segregation of duties in the cash management area, and (iv) develop written procedures to calculate interest earnings on advances of Federal funds based on daily positive cash balances considering the lag time between check issuance and actual check clearance date.

Advance Payment Requests

We found that the UH ORS did not have written procedures to ensure the timing and amount of advance requests met the UH disbursement cycle and immediate program disbursements needs. OMB Circular A-110 stated that written procedures are needed to assure the timing and amount of cash advances are as close as is administratively feasible to actual disbursement for program purposes [*A-110, Subpart C, Section .21(b)(5) and Section .22(b)*].

The UH ORS requested funds on a cost reimbursement basis for letters of credit with National Aeronautics and Space Administration (NASA) - Headquarters, Agency for International Development (AID), and DOL-ETA. For HHS and NASA Goddard Space Flight Center (Goddard), UH ORS requested weekly draw amounts based on a combination of cost reimbursement and cost estimates for future program disbursements. The cost reimbursement draws considered the weekly letter of credit cash balances adjusted by the project unallowable costs and the deposits-in-transit. The cost estimates for future program disbursements were based on historical cost data using two cost components: (i) salaries, fringe, and related prorated indirect costs, and (ii) other direct cost and prorated indirect costs. The UH ORS normally would not request a weekly draw amount in instances where the adjusted weekly letters of credit net cash balances were positive.

We found that the UH's cash draw requests for HHS and NASA Goddard generally occurred on each Monday. However, the UH's payroll disbursement cycle occurred on the 5th, 15th, 20th, and 30th of each month which do not always fall on a Monday. Therefore, the weekly draw down requests are not timed to the payroll disbursement cycle.

The amount of the weekly draw requests for HHS and NASA Goddard was not always based on immediate disbursement needs. The UH's cost estimates were based on outdated cost information which, in some cases, were as much as 23 months old. We found UH's cost estimates for future program disbursements were conservative due to UH: (i) using only the estimated other direct costs and the prorated indirect costs component during a 1 year period without considering salaries and fringe benefits, (ii) electing not to request weekly draws during some periods, and (iii) not including some allowable expenditures when determining the draw amounts.

We recommend that the UH comply with OMB Circular A-110 by preparing written procedures on the timing and amount of advances of Federal funds which considers the UH's disbursement cycle and the use of reliable cost estimates for immediate program disbursements.

Because we found material errors and internal control weaknesses at CTAHR as discussed in the Scope section of this report, we did not review the advance payment request procedures for USDA letters of credit.

Reconciliation of the 272 Report to the UH Accounting Records

CTAHR did not perform any reconciliation of the 272 reports for the USDA Cooperative State Research Services (CSRS) and Agricultural Research Services (ARS) letters of credit during July 1, 1997 through June 30, 2000. A CTAHR official cited lack of training and limited resources as reasons for not preparing the reconciliation schedules.

Since no reconciliations were performed, we requested that CTAHR reconcile its September 30, 1997 quarterly 272 report for CSRS to its general ledger. This 272 report was selected because it showed a large positive beginning cash balance of approximately \$1.4 million. The CSRS reconciliation disclosed three significant errors totaling approximately \$3 million. First, the beginning balance of cash-on-hand was overstated by approximately \$2 million due to an error made by CTAHR on its March 31, 1996 report. Second, the expenditures for the quarter were understated by approximately \$1 million. Third, there was an irreconcilable difference of approximately \$88,000 between the 272 quarterly report and the general ledger. Because of these significant errors and the possibility of other undetected errors, we were unable to rely on the accuracy of the 272 report's cash-on-hand balances.

Our review of CTAHR also disclosed an internal control weakness due to the lack of proper segregation of duties in the cash management area. We found that the same CTAHR official (i) approved grant expenditures, (ii) prepared the cash draw requests, (iii) prepared the 272 reports, and (iv) was authorized to certify the 272 reports.

We recommend UH ensure that CTAHR complete a full reconciliation between the cash-on-hand balances shown on the 272 reports and the general ledger for the USDA letter of credit programs from September 30, 1997 to the present, and submit revised 272 reports to USDA officials where appropriate. Also, UH should review CTAHR's internal control practices related to segregation of duties in the cash management area.

For the remaining four agencies with letters of credit (HHS, NASA Headquarters, NASA Goddard and AID) administered by ORS, we found the UH performed timely and reliable reconciliations.

Interest Earned on Advances of Federal Funds

The UH improperly calculated the interest earned on advances of Federal funds, which understated the remitted interest earnings due to HHS DPM. According to OMB Circular A-110, advance payments on deposits should be maintained in interest bearing accounts until spent for program costs [*A-110, Subpart C, Section .22(k)*] and any interest earned while the advance of funds are in university accounts (less a yearly allowance of \$250 for administrative costs) shall be refunded [*A-110, Subpart C, Section .22(l)*].

The UH maintained one interest bearing checking account and various time certificate of deposit accounts for all of its university project accounts. Each month, the UH distributed the actual interest earned to the different projects based on the average weekly cash balances. The amount of interest earnings distributed to Federal projects are then credited into a general ledger account and remitted to HHS DPM on an annual basis.

The UH improperly calculated the interest earned on advances of Federal funds due to the following reasons:

- Federal cash balances were based on general ledger cash balances, which may be understated due to potential unallowable costs. These general ledger cash balances do not consider adjustments for certain unallowable costs, such as (i) project expenditures over the budget authorized amounts, and (ii) unauthorized pre-award expenditures. Adjustments for unallowable costs should be added back to the general ledger cash balance in calculating Federal cash balances.
- Federal cash balances were based on average weekly balances instead of daily positive cash balances. The UH ORS stated that, during our audit period, only weekly cash balances were available. However, effective July 1, 2000, the UH Financial Management Information System allowed for daily cash balances by project accounts. Interest should be calculated on daily positive cash balances with no offset for negative cash balances as indicated in HHS Departmental Appeals Board Appellate Division Decision No. DAB1754, dated November 29, 2000.
- Interest refunds payable to the Federal government were based on actual interest earnings. The use of actual monthly interest earnings does not reflect the true earnings available to Federal funds because the interest calculation is based on the cumulative total of all State, Federal, and other funds, which have both positive and negative cash balances. This methodology resulted in a smaller distribution of interest earnings to Federal letters of credit because it did not reflect the true earnings from positive cash balances.

Due to the fact that the UH did not have significant positive cash balances, there was no material impact of the UH improperly calculating interest earned during our audit period. However, for future corrective action, we recommend the UH establish written procedures to calculate interest earned on advances remitted to HHS DPM based on positive daily Federal cash balances considering the lag period between check issuance and actual check clearance date.

RECOMMENDATIONS

We recommend that the UH:

- Establish written procedures on the timing and amount of advance requests to meet its disbursement cycle and immediate disbursement needs;

- Ensure that CTAHR complete a full reconciliation between the cash-on-hand balances shown on the 272 reports and the general ledger for the USDA letter of credit programs from September 30, 1997 to the present, and submit revised 272 reports to USDA officials where appropriate;
- Review CTAHR's internal control practices related to segregation of duties in the cash management area; and
- Develop written procedures to calculate interest earnings on advances of Federal funds based on daily positive cash balances considering the lag time between check issuance and actual check clearance date.

UH Comments

The UH concurred with the recommendations in our audit report. The UH believes that upon implementation of its planned corrective action, it will improve its cash management and meet the Federal financial management standards in accordance with OMB Circular A-110. The full text of the UH response is included in APPENDIX A.

OTHER MATTERS

We excluded the DOL-ETA and USDA-CES letter of credit grants from our scope of review due to the non-filing of the 272 reports during the period July 1, 1997 through June 30, 2000. The UH did not have written waivers to support the non-filing of these 272 reports. According to OMB Circular A-110, when funds are advanced to recipients the Federal awarding agency shall require each recipient to submit the 272 report [*A-110, Subpart C, Section .52(a)(2)(i)*]. The Federal awarding agencies may waive the requirement for submission of the 272 report for any one of the following reasons: (i) when monthly advances do not exceed \$25,000 per recipient, provided that such advances are monitored through other forms contained in this section; (ii) if, in the Federal awarding agency's opinion, the recipient's accounting controls are adequate to minimize excessive Federal advances; or, (iii) when the electronic payment mechanisms provide adequate data [*A-110, Subpart C, Section .52(a)(2)(v)*].

Although there is no written waiver on file, DOL believes the submission of the 272 report is not needed because the electronic payment mechanisms provide adequate data. The USDA officials indicated that they have not required filing of the 272 report for the USDA-ETA letter of credit grants due to temporary software conversion issues. However, USDA will require the 272 report filing in the future. In the interim, USDA believes the submission of the 272 report was not needed for the same reason as indicated by DOL.

The UH should work with the DOL and USDA to either submit 272 reports or to obtain a waiver for submission of the 272 reports in accordance with OMB Circular A-110.

Final determination as to actions taken on all matters reported will be made by the HHS action official named below. We request that you respond to the HHS action official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

To facilitate identification, please refer to Common Identification Number A-09-01-04004 in all correspondence relating to this report.

Sincerely,

A handwritten signature in black ink, appearing to read "Lori A. Ahlstrand". The signature is fluid and cursive, with a horizontal line drawn through the middle of the letters.

Lori A. Ahlstrand
Regional Inspector General
for Audit Services

Enclosures - as stated

Direct Reply to HHS Action Official:

Mr. Stuart J. Feldsott
Chief, University and Non-Profit Payment Branch
Division of Payment Management
Financial Management Service
Program Support Center
P.O. Box 6021
Rockville, MD 20852



UNIVERSITY OF HAWAII

VICE PRESIDENT FOR ADMINISTRATION
AND CHIEF FINANCIAL OFFICER

November 29, 2001

Ms. Lori A. Ahlstrand
Regional Inspector General for Audit Services
Department of Health and Human Services
Office of Inspector General
Office of Audit Services
Region IX
50 United Nations Plaza, Rm. 171
San Francisco, CA 94102

SUBJECT: CIN: A-09-01-04004 University of Hawaii comment on draft report of the review of cash management procedures used by UH to determine the interest earned on advances of Federal Funds.

Dear Ms. Ahlstrand:

Thank you for your letter of October 26, 2001 regarding the University's cash management procedures to determine the interest earned on advances of Federal Funds. We appreciate the opportunity that you have given us to provide additional information and documentation regarding the matters presented in the draft report and the extension to December 6, 2001 to due so. Pursuant to your instructions, we offer the following:

Recommendations 1. Establish written procedures on the timing and amount of advance requests to meet its disbursement cycle and immediate disbursement needs.

The University concurs with this recommendation; the Office of Research Services will establish written procedures on the timing and amount of advance requests to meet UH disbursement cycle and immediate needs by January 2002.

Recommendation 2. Ensure that CTAHR complete a full reconciliation between the cash-on-hand balances shown on the 272 reports and the general ledger for the USDA letter of credit programs from September 30, 1997 to present, and submit revised 272 reports to USDA officials where appropriate.

The University concurs with this recommendation; CTAHR will complete a full reconciliation between the cash-on-hand balances shown on the 272 reports and the general ledger for the USDA letter of credit programs from September 30, 1997 to the present.

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Ms. Lori A. Ahlstand
November 29, 2001
Page 2

Recommendation 3. Review CTAHR's internal control practices related to segregation of duties in the cash management area.

The University concurs with this recommendation; CTAHR will review its internal control practices related to segregation of duties and make adjustments as necessary. *Additionally, an independent review will be conducted by our Internal Auditor ensure that proper internal controls are in place at CTAHR.*

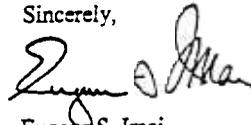
Recommendation 4. Develop written procedures to calculate interest earnings on advances of Federal funds based on daily positive cash balances considering the lag time between check issuance and actual check clearance date.

The University concurs with this recommendation; The General Accounting Office and Fiscal Services has completed its specifications to modify its interest allocation program. This modification will ensure that check issuance will not reduce the Federal cash balance until the actual check clearance date. Upon completion of the reprogramming and testing to ensure compliance with the applicable Federal regulations the University will implement this new procedure in July 2002.

The University believes that upon the implementation of its corrective action as stated above will improve its cash management and meet the Federal financial management standards in accordance with OMB Circular A-110.

If you may have further questions or require additional information please feel free to call me at (808) 956-8903 or Mr. Russell Miyake at (808) 956-7161.

Sincerely,



Eugene S. Imai
Vice President for Administration and
Chief Financial Officer