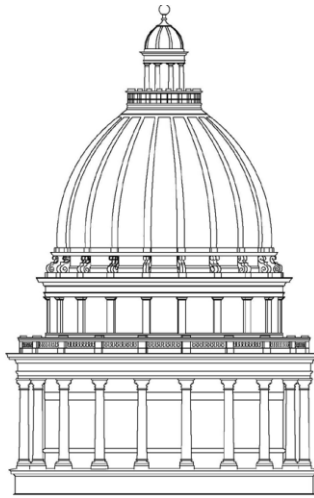


REPORT TO THE
UTAH LEGISLATURE

Number 2015-04



**A Follow-up Audit of
Higher Education's Management Practices for
Operation and Maintenance Funding**

June 2015

Office of the
LEGISLATIVE AUDITOR GENERAL
State of Utah



STATE OF UTAH

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AUDITOR GENERAL

June 23, 2015

TO: THE UTAH STATE LEGISLATURE

Transmitted herewith is our report, **A Follow-up Audit of Higher Education's Management Practices for Operation and Maintenance Funding** (Report #2015-04). A digest is found on the blue pages located at the front of the report. The objectives and scope of the audit are explained in the Introduction.

We will be happy to meet with appropriate legislative committees, individual legislators, and other state officials to discuss any item contained in the report in order to facilitate the implementation of the recommendations.

Sincerely,

John M. Schaff, CIA
Auditor General

JMS/lm

Digest of A Follow-up Audit of Higher Education's Management Practices for Operation and Maintenance Funding

Chapter I Introduction

In 2011, we reported that the Utah System of Higher Education's (USHE or Higher Education) operation and maintenance (O&M) funding was at a crossroads for its source of funding. Much has been accomplished since then, but some key policy decisions remain. For example, the Legislature may want to consider reviewing the Higher Education O&M funding model. Besides some COLA and utility adjustments, Higher Education institutions do not generally receive an increase in O&M when costs increase, but rather additional O&M is funded when a new building is constructed. We also found that the state's and institutions' building inventory records still do not match. Effective management of state buildings requires consistent, reliable data. We also found that some other states' higher education institutions have adopted specific formulas that direct the use of reimbursed research overhead funds¹. The Legislature may find such a system beneficial in Utah.

Chapter II O&M Policy Issues Continue

Concerns and Questions with O&M Accountability Persist. Concerns and questions continue with the Board of Regents' and some institutions' tracking and use of O&M funds. We reported in December 2014, that despite our 2011 recommendation to improve O&M records, the Board of Regents had not been consistently maintaining records on O&M funding source. The record keeping system we recommended was not available to us when we began the audit in 2014. Also, in response to our December 2014 report, the Commissioner of Higher Education cited an internal study that reported institutions are projected to fund an additional \$27 million in O&M beyond legislative appropriations for fiscal year 2015. However, the study also showed that for fiscal year 2014 actual O&M expenditures above legislative appropriations was \$22 million. We recognize institutions are making funding efforts toward O&M funding. However, the commissioner's study simplifies a complex issue. Further, detailed record keeping and accountability, as recommended in the 2011 audit report, are needed to review and analyze Higher Education O&M funding. The State Building Board is engaged in a review of O&M for both state agencies and Higher Education that, when completed, will provide additional insight into the care of state buildings.

¹ Reimbursed research overhead funds are provided in connection with many research grants to reimburse the institution for the facility and administrative costs associated with the research grant.

Board of Regents Should Review Policy in Key O&M Areas. A new area of concern identified during this review is the inconsistent application of the policy dealing with renovated/replaced buildings. The Board of Regent's should ensure this and any policy is consistently applied and enforced. This lack of oversight by the Board of Regent's potentially resulted in higher O&M appropriation requests. Also, we recommended in the 2011 audit that the Board of Regents establish a policy on revenue-generating activities at campus facilities. Though discussions have reportedly occurred, a policy has not been enacted.

O&M Policy Options Exist. Important policy questions are before the Legislature and the State Building Board on how O&M funding should be determined. Beyond periodic COLA and utility adjustments USHE institutions generally receive new O&M funds when new buildings are brought on-line. Accordingly, institutions may struggle to maintain older buildings. During the 2015 General Session, some legislators spoke of the need to reevaluate this model. Alternative funding models exist in Utah and other states that may better address maintenance needs. At the request of a legislative committee, and as statutorily directed in SB217, members of the State Building Board and others are in the process of reevaluating the state's O&M funding models.

Chapter III

Management of USHE's Auxiliary Buildings Is Inconsistent

State Agency and USHE Records Do Not Match, Contain Errors. Several State entities, along with USHE institutions, maintain building inventory information on Higher Education's buildings to meet each of their unique needs. However, because each entity collects only the specific building data they need (and may or may not keep their data current), inconsistencies exist among these records. In cases where records conflict and building classification issues occur, inappropriate funding can result. In 2011, we recommended the implementation of a new process that could uniquely and correctly identify every building in the state, so that building data could be tracked and accessed across state and Higher Education systems. Some progress has been made, but more needs to be done.

Auxiliary Building Classification Process and Oversight Can Improve. A consistent record of building classifications (auxiliary vs. educational) does not exist. State-funded capital improvements are authorized for educational buildings but not for auxiliary buildings. Accordingly, incorrect classification of building functions can result in capital improvement funds being used for ineligible buildings. As provided for in *Utah Code* 63A-5-104(7)(a), the Legislature now funds capital improvement monies for Higher Education's Education and General (E&G or education) and infrastructure needs at roughly the amount of 1.1 percent of current replacement value. Further, State Building Board (SBB) policy could be clarified to determine how to appropriately fund partial auxiliary buildings (those buildings that serve both auxiliary and academic functions).

Board of Regents and Building Board Have Recently Adopted New Auxiliary Policies. Auxiliary classification inconsistencies exist between the building inventory records of SBB, Risk Management, and USHE institutions. Much of this inconsistency may stem from both an outdated

Board of Regents auxiliary policy and a lack of an auxiliary building definition at the SBB. After making a request, the Board of Regents updated its auxiliary space policy to clarify to its institutions what will be considered auxiliary. Similarly, the SBB formerly adopted an auxiliary definition in December 2014 as recommended in the 2011 audit. The results of these changes are yet unknown.

Chapter IV

Policy Questions Remain Regarding Use of Reimbursed Overhead

Reimbursed Overhead Is An O&M Funding Source. Reimbursed research overhead funds are grants primarily awarded to the U of U and USU to reimburse them for indirect overhead costs incurred during research activities. O&M is one of the indirect costs categorized as research overhead. The U of U and USU receive significant reimbursements for O&M; however, the application of these funds varies.

Institutions Have Discretionary Use of Reimbursed Overhead Funds. Current statute and policy allow the institutions to retain and use overhead funds at their discretion. This policy was adopted in 1986 to help the institutions grow grant-funded research. Prior to 1986, the Legislature retained the majority of overhead funds as reimbursement for costs already paid with state funds.

Legislature Could Provide Additional Policy Guidance on Overhead Funds. The current situation raises policy questions about whether and how much reimbursed research overhead funding should be used to maintain important infrastructure and operating equipment that support buildings. We conducted a survey of U of U and USU peer institutions' use of overhead funds that was limited by peer institutions' reluctance to share sensitive information. Nevertheless, we found that some other institutions allocate overhead funds based on specific formulas. The Legislature may also find that requiring a certain percentage of reimbursed overhead funds be spent on O&M could provide a method of addressing the O&M needs created from research growth.

REPORT TO THE UTAH LEGISLATURE

Report No. 2015-04

A Follow-up Audit of Higher Education's Management Practices for Operation and Maintenance Funding

June 2015

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Chapter I

Introduction

In 2011, we reported that the Utah System of Higher Education's (USHE or Higher Education) operation and maintenance (O&M) funding was at a crossroads for its source of funding. Much has been accomplished since then, but some key policy decisions remain. For example, the Legislature may want to consider reviewing the Higher Education O&M funding model. Higher Education institutions do not generally receive an increase in O&M, (except for periodic COLA and utility adjustments), when costs increase, but rather additional O&M is funded when a new building is constructed. We also found that the state's and institutions' building inventory records still do not match. Effective management of state buildings requires consistent, reliable data.

We also found that some other states' higher education institutions have adopted specific formulas that direct the use of reimbursed research overhead funds². The Legislature may find such a system beneficial in Utah.

Most Recommendations from 2011 Audit Not Fully Implemented

In June of 2014, The Legislative Audit Subcommittee prioritized a follow-up audit on the implementation of 11 recommendations made in Audit Report 2011-08, *A Performance Audit of Higher Education Operation and Maintenance Funding*.³ To provide information prior to the 2015 Legislative Session, we released a report in December 2014 (ILR 2014-E) that addressed the three recommendations to the Legislature not yet acted upon. The Legislature did act on one of those recommendations in the 2015 General Session. This current report addresses the recommendations that have not yet been implemented. Figure 1.1 provides a summary of all 11

² Reimbursed research overhead funds are provided in connection with many research grants to reimburse the institution for the facility and administrative costs associated with the research grant.

³ Web link to *A Performance Audit of Higher Education Operation and Maintenance Funding* #2011-08 http://le.utah.gov/audit/11_08rpt.pdf

Much has been accomplished since our 2011 audit, but key policy decisions remain.

This report addresses recommendations from our 2011 report that have not yet been implemented.

recommendations with implementation status. Appendix A provides a complete account on all audit recommendations.

Figure 1.1: Summary of 2011 Audit Recommendations. See Appendix A for more detailed information.

Recommendation Summary and Status
<p>Legislature should consider funding O&M as an appropriation unit. Status: Implemented. Discussed in Report #2014-E. Implemented in 2015 General Session</p>
<p>The Legislature should review its policy and consider making state O&M funding decisions for non-state-funded construction at the time a building is authorized. Status: Implemented by SB 278 (2013 GS). Not discussed in this report</p>
<p>Board of Regents should review the A-1 and S-2 data reported by institutions and ensure that the data is comparable and meaningful. Status: Implemented. Not discussed in this report</p>
<p>Higher education institutions should review auxiliary facilities to ensure the facilities are paying the appropriate share of O&M costs. Status: In process. Discussed further in Chapter III</p>
<p>Legislature should consider directing the Board of Regents to maintain a record of all buildings built on campus that denotes the O&M funding source. Status: Not Implemented. Discussed in Report #2014-E</p>
<p>DFCM (State Building Board) should correct its building information by adopting a formal definition of auxiliary facilities and consistently applying it. Status: In process. Discussed further in Chapter III</p>
<p>DFCM (State Building Board) should work with higher education officials to include a unique identifier. . .that would ensure a building can be tracked consistently. Status: In process. Discussed further in Chapter III</p>
<p>Legislature should require all buildings to have an O&M funding plan in place before construction. Status: Partially Implemented. Discussed in Report #2014-E</p>
<p>Legislature should review <i>Utah Code</i> 53B-7-104 concerning reimbursed research overhead to determine if state policy should be modified. Status: In process. Discussed further in Chapter IV</p>
<p>Board of Regents should revise its policy on reimbursed overhead. Status: Not Implemented. Discussed further in Chapter IV</p>
<p>Board of Regents should establish a policy on revenue-generating activities in campus facilities. Status: Not Implemented. Discussed further in Chapter II</p>

Three of the 11 recommendations were implemented; four are in the process of being implemented.

Of the eleven recommendations:

- Three have been fully implemented
- One has been partially implemented
- Four are still in process
- Three have not been implemented

Adequate Care of Buildings Is Important

Higher Education facilities account for a little over one-third (39 percent) of the state’s building inventory. However, due to the size and cost of Higher Education facilities, about three-quarters (72 percent) of the state’s capital asset value is held within Higher Education. These buildings are often subject to heavy usage, so proper care and maintenance is extremely important to extend the life of the buildings. Figure 1.2 shows that, since our initial audit, 200 more USHE buildings have been reported⁴. The value of USHE buildings has reportedly increased by about \$1.4 billion.

Since 2011, nearly 200 additional USHE buildings have been reported to Utah’s capital asset inventory.

Figure 1.2 Utah Has a Major Investment in Academic Buildings. Buildings at USHE institutions number over 1,400 and are valued at \$6.8 billion.

	Number of Buildings	Current Value	Square Footage
2010	1,214	\$5.4 billion	30,500,000
2014	1,411	\$6.8 billion	38,300,000

Source: Risk Management and DFCM Building Inventory data

In all, about 12 percent of the Education and General Fund (E&G) is expended on O&M needs. The following figure shows O&M expenditures by institution for fiscal year 2014. Only amounts from the E&G line items are included.

⁴ As discussed in Chapter III, record keeping of state buildings needs improvement. Comparability of data from 2010 to 2014 might not be complete.

Figure 1.3 USHE Institutions Reported \$141 Million Worth of Expenditures for O&M in Fiscal Year 2014. The University of Utah (U of U) spent the most on O&M, but Snow College spent the most as a percent of its overall expenses.

Institution	O&M Expenses	E&G Expenses	% of Total
U of U	\$49,921,972	\$470,706,914	11%
USU	28,295,861	198,975,081	14%
WSU	12,024,725	134,737,383	9%
SUU	7,722,638	65,363,543	12%
UVU	15,939,304	162,715,945	10%
Snow	4,879,947	27,475,214	18%
DSC	5,893,718	49,682,845	12%
SLCC	16,571,734	124,496,794	13%
Total	\$141,249,899	\$1,234,153,719	12%

Source: Board of Regents A-1 Reports for FY 2014.

Legislative Changes Affect Which Entity Implements Audit Recommendations

Since 2011, the responsibilities and duties of both the Division of Facilities Construction and Management (DFCM) and the State Building Board (SBB or building board) have changed. Most recently, Senate Bill 217 (2015 General Session) added to the responsibilities of the building board. During our 2011 audit, we worked closely with DFCM and directed recommendations to the division. With the adjustment, many past and current recommendations must now be directed to the building board. A brief explanation of current duties for each entity illustrates why some recommendations are now made to the building board.

Building Board Has Been Granted Additional Oversight Responsibilities

In some cases, the building board is given authority to approve capital development projects without legislative approval. The board is also charged with determining and prioritizing capital improvement needs, including requesting funding needed to support such projects. Since 2011, the building board has also maintained various records, including master plans for current or future structures, a comprehensive five-year building plan submitted annually to the Governor and Legislature, and standards and rules that help to ensure

The responsibilities of DFCM and the building board have changed, altering the entity to which past and current recommendations are directed.

an effective, well-coordinated building program is in place for all state institutions. Additional job duties for the SBB can be found in *Utah Code* 63A-5-101 et seq.

Senate Bill 217 gave additional responsibilities to the building board, including the following:

1. Establishing standards and requirements for capital development project requests and for reporting O&M expenditures for state-owned facilities
2. Conducting ongoing facility maintenance audits for state-owned facilities
3. Working with the Board of Regents and other entities to collaboratively prepare a report to be submitted no later than September 1, 2015 that proposes
 - a. Establishing a process for tracking direct and indirect O&M costs on an individual building basis
 - b. Determining alternative funding mechanisms for O&M costs on facilities that incorporate the actual expenses, purpose, age, condition, and location of the facility. This proposal should also consider an internal service fund, individual appropriation line items, and a formula to determine funding.

We are encouraged by these modifications and specifically believe the collaborative study has potential to improve how the Legislature is funding Higher Education facilities. Because work in these areas is ongoing, this audit is reflective only of what has happened and does not report on any progress pertaining to the current building board study.

DFCM Focuses on Design, Construction, And Maintenance of Buildings

The recent legislative and other internal changes redirect DFCM's focus to constructing and maintaining buildings. DFCM oversees the design and construction of new facilities and capital improvements over \$100,000, but reportedly assists on smaller projects as well. The DFCM supervises and controls the allocation of space to state agencies and conducts studies to determine needs for those agencies. The

SB217 directs the SBB to collaboratively study O&M and capital improvement funding models in the state.

division leases and holds titles for all state-owned property and tracks compliance with maintenance and operation standards set by the building board. Among many other responsibilities, DFCM ensures that fair and competitive bidding occurs for construction of state facilities. Additional DFCM responsibilities can be found in *Utah Code* 63A-5-204 and 63A-5-701.

Audit Scope and Objectives

The scope of the original 2011 audit was to audit the Utah System of Higher Education to review whether state funding for O&M was being allocated and used by the institutions for its original purposes. The Legislative Audit Subcommittee directed that we follow up on that report's 11 recommendations and include any other issues identified during audit work. The scope of this audit includes the following:

- Determine the implementation status of each audit recommendation from Audit Report #2011-08
- Review current oversight structure over O&M and other building maintenance areas
- Review O&M funding models for higher education in other states
- Review the accuracy and completeness of the inventory of state buildings
- Review other states' accounting of reimbursed overhead funds

This audit follows up on past recommendations and reports on new issues.

Chapter II

O&M Policy Issues Continue

In the 2011 Audit Report 2011-08, *A Performance Audit of Higher Education Operation and Maintenance Funding*, we described Higher Education operation and maintenance (O&M) funding as being at a crossroads for their source of funding. Much has been accomplished since then to better direct and review O&M funding. The Legislature has statutorily addressed some O&M concerns and has tasked the State Building Board (in Senate Bill 217, 2015 General Session) to fully review and study O&M issues. As a result, the Utah System of Higher Education (USHE or Higher Education) and state agencies have made several encouraging improvements. However, some concerns remain. Several recommendations in the 2011 audit report called for increased accountability and oversight of O&M funds. Three of those recommendations were addressed in a previous follow-up report released in December 2014 (see Appendix A).

This chapter addresses both a past recommendation dealing with institutions' revenue-generating activities and new areas of concern identified during this follow-up audit. First, the chapter covers the need for increased tracking and accountability of O&M funds and addresses a concern with the upkeep of some Higher Education buildings. Second, the chapter identifies the need for enforcement of a policy dealing with renovated/replaced buildings, noting that the lack of policy enforcement could lead to over-appropriation of O&M funds. Lastly, the chapter indicates that the current O&M funding model for Higher Education institutions does not generally provide an increase in O&M when costs increase. Rather additional, significant O&M funding is associated with new building construction. This chapter also provides the Legislature information on higher education O&M funding models in other states.

Concerns and Questions with O&M Accountability Persist

Concerns and questions continue with the Board of Regents' and some institutions' tracking and use of O&M funds. We reported in December 2014, that despite our 2011 recommendation to improve O&M records, the Board of Regents had not been consistently

The Utah System of Higher Education and state agencies have made several encouraging improvements since 2011; however, some concerns remain.

maintaining records on O&M funding source. The record keeping system we recommended was not available to us when we began the audit in 2014.⁵ Also, in response to our December 2014 report, the Commissioner of Higher Education cited an internal study that reported institutions are projected to fund an additional \$27 million in O&M beyond legislative appropriations for fiscal year 2015.

We recognize institutions are making funding efforts toward O&M funding. However, the commissioner's study simplifies a complex issue. For example, the Legislature has not intended to fund all O&M needs at the campuses, because not all buildings qualify for state O&M funds. Further, some buildings that may have historically qualified for state O&M funding have not been appropriated O&M funds. Detailed record keeping and accountability, as recommended in the 2011 audit report, are needed to review and analyze Higher Education O&M funding. The State Building Board is engaged in a review of O&M for both state agencies and Higher Education that, when completed, will provide additional insight into the care of state buildings.

Commissioner's Study Shows Institutional O&M Support

An Office of the Commissioner of Higher Education (OCHE) study showed that institutions are budgeted to spend an additional \$27 million in O&M beyond legislative appropriations for fiscal year 2015. The study also shows that for fiscal year 2014 actual O&M expenditures above legislative appropriations was \$22 million.⁶ We believe that institutions are making some efforts to support O&M funding. We have also found that facility directors at each institution are qualified professionals with competent maintenance staff.

However, as one institution's finance vice president said of the commissioner's report, it does not compare "apples to apples." Differences should be expected between appropriations and expenditures. For example, the vice president noted that academic buildings that do not receive state funding should be supplemented from the institutions' funds, which would create a difference between appropriations and expenditures. Also, as noted in the 2011 audit

A recent study reports that institutions are greatly supplementing O&M needs. However, this study fails to account for buildings institutions should rightly be paying for.

⁵ For additional information on tracking and reporting of O&M, see Audit Report 2014-E at http://le.utah.gov/audit/14_cilr.pdf

⁶ See Appendix B for more detail on the commissioner's study

report, some auxiliary buildings were inappropriately receiving institution support, which would also skew the analysis.

The commissioner's study provides encouraging new information by demonstrating additional institutional support. However, inadequate record keeping still prevented a determination of exactly how much the institutions should be supplementing state O&M funds. In other words, was the additional \$22 million more or less than what was already required of the institutions to address significant maintenance issues? To bolster record keeping, the Legislature did increase O&M accountability during the 2015 General Session by requiring improved tracking of O&M appropriations. In addition, the Board of Regents has reportedly begun tracking O&M appropriations for each building constructed by USHE.

USHE Has High Capital Improvement Needs

The State Building Board conducts two different reviews of state buildings' condition. The first review, preventative maintenance audits, checks whether necessary preventative maintenance (for example, timely changing filters, ensuring proper lighting, and reviewing janitorial services) issues are being properly addressed. The building board employs two staff to conduct these reviews. The second review is known as facility condition assessments. These reviews are conducted by an outside consultant and review major systems (such as mechanical and electrical systems).

These studies are ongoing but preliminary data suggests that some institutions have significant deferred maintenance issues. We believe that a thorough analysis of this information should be performed once the data is complete. We are encouraged by 2015's Senate Bill 217 directing the State Building Board to review O&M issues. We believe the building board should specifically review whether there is a better O&M funding model for Higher Education. We provide information on other states' higher education O&M funding models later in the report.

The Legislature increased O&M accountability during the 2015 General Session.

Two separate studies on facility condition are ongoing and indicate a significant amount of deferred maintenance exists at Higher Education institutions.

Board of Regents Should Review Policy in Key O&M Areas

A new area of concern identified during this review is the inconsistent application of the policy dealing with renovated/replaced buildings. The Board of Regent's should ensure this and any policy is consistently applied and enforced. This lack of oversight by the Board of Regent's potentially resulted in higher O&M appropriation requests. Also, we recommended in the 2011 audit that the Board of Regents establish a policy on revenue-generating activities at campus facilities. Though discussions have reportedly occurred, a policy has not been enacted.

Policy on Renovated/Replaced Buildings Is Not Consistently Applied

The policy on renovated/replaced buildings has not been consistently enforced or applied. The 12-year-old policy states that when a building is renovated or replaced (demolished), the Office of the Commissioner of Higher Education (OCHE) has the responsibility to determine the campus average O&M cost per square foot to be deducted from renovated or replaced space. In the event an institution replaces or demolishes building space and then builds a new structure in its place, the institution is allowed to ask for an updated O&M formula amount,⁷ but must subtract the OCHE-determined average cost per square foot from the formula amount. However, there is some confusion about whether OCHE has ever made that determination. Figure 2.2 provides the language of the policy.

⁷ Higher Education institutions' O&M is funded by an established cost per square foot (in fiscal year 2015, classroom space was funded at \$8.32 per square foot). This cost per square foot is updated each year based on the consumer price index. A new building that is NOT replacing demolished space will receive O&M through the following formula (Gross Square Foot of New Building * O&M Formula Amount = O&M Appropriation.) Institutions that are demolishing space must subtract the "campus average cost per foot" from the new request. The formula should be structured something like this [(Gross Square Foot of New Building * Current Formula Amount) - (Gross Square Foot Demolished Space * Campus Average Cost per Square Foot)] = O&M request. However, as this chapter illustrates, OCHE staff have not been enforcing a consistent application of this policy that was adopted 12 years ago.

Figure 2.2 Operation and Maintenance Budget Request Model (Policy), Adopted June 4, 2003. This policy directs how an O&M funding request should be revised when renovated or replaced space is involved.

Requests for renovations or replacement O&M funding will be reduced by existing funding levels. This deduction will be determined by the Office of the Commissioner of Higher Education on a campus average cost per square foot.

Source: Utah State Building Board.

We asked some of the institutions if OCHE had determined a specific formula to determine the average cost per square foot. Three of the five institutions⁸ we asked responded that they had been directed to use the average cost per square foot found on the Regent's S-2 form. These institutions reported using the S-2 when making the calculation for remodeled/replaced space.

Dixie State University (DSU) reported not using a campus average cost per square foot at all but rather using an entirely different methodology. A DSU official said that their formula for calculating an O&M request that includes demolished buildings has always been to calculate the total square feet of the new building, then subtract the square feet of demolished space, then multiply the revised total square footage by the current year's formula amount [(demolished square feet – total new square feet) * current funding formula] = O&M request.

The University of Utah (U of U) has been using a campus average cost like Utah State University (USU), Southern Utah University (SUU), and Weber State University (WSU), but staff assert that the OCHE has never made a definitive determination, even 12 years after policy adoption. The U of U has calculated its own unique average cost per square foot that staff believe most accurately reflects the O&M cost of their campus. The commissioner's staff person assigned to facility maintenance initially stated that the average cost per square foot found in the S-2 form should be used when calculating demolished space. Later, however, the official agreed with the U of U and said that no such determination had been made. The official wrote the following in an email:

⁸ Institutions' surveyed included: University of Utah, Utah State University, Weber State University, Southern Utah University, Dixie State University.

OCHE has reportedly not been enforcing its policy on replaced buildings, which has led to three separate methods for funding among institutions.

The paragraph pertaining to how much should be deducted for renovation/replacement of existing facilities... is somewhat ambiguous and does not reference the cost per square foot calculated on the S-2 budget form, so it would not be accurate to portray it as the relevant cost pertaining to the procedure. OCHE and the Building Board have typically looked at the requests on the basis of “reasonableness” in compliance with the procedures rather than attempting to apply an arbitrarily calculated amount for an amount that is not clearly defined.

We reviewed two buildings that the U of U recently submitted for O&M funding for demolished or partially demolished space and found that the U of U’s calculation recommended a higher appropriation amount. Figure 2.3 shows the discrepancy in calculations.

Figure 2.3. Some U of U O&M Requests Might Be Inflated. The Commissioner’s Office is charged with determining how O&M for demolished space is calculated, but ambiguity still exists. The U of U uses a different average square foot cost than the one used by USU, SUU, and WSU, which use the Regent’s established average cost per square foot.

Building	Regent S-2 Form Amount	U of U Requested Amount	Difference
U of U OSH	\$916,010	\$1,049,456*	\$133,446
U of U Crocker Science	\$531,888	\$647,530*	\$115,642

*Source: Utah State Building Board Needs Statements
These amounts were funded by the Legislature in the 2015 General Session

Because the U of U uses its own estimated average cost per square foot, the institution requested (at least in these two examples) about \$250,000 more annually than would have resulted had they used the Regent’s average cost per square foot found in the S-2 report. Over the lives of the buildings, the additional costs are significant. The OCHE staff must do a better job enforcing this policy consistently for each institution.

Board of Regent’s/Commissioner’s Staff Need to Enforce Policy Consistently. Our survey of five schools found three different methods for calculating O&M requests for demolished or replaced building space. An additional concern is that while other schools reported using the S-2 number for replacement space, we were not always able to verify the accuracy of their statements. Most institutions

Two recent requests by the U of U resulted in more funding given for their demolished space than what would have been given for other institutions.

Institutions should provide more detail in O&M funding requests submitted to OCHE.

do not provide enough information on the needs request form to support the O&M request. We asked some of the institutions to provide the necessary details but they were not able to do so. The inability to provide calculation detail is concerning because if the information is not available, OCHE staff will not have the necessary data to verify the accuracy and reasonableness of the O&M request.

Policy Guidance Still Needed on Revenue-Generating Activities

We recommended in 2011 that the Board of Regents develop a well-defined policy to clarify how revenue-generating activities affect O&M costs. We found that the institutions sponsored many events and activities that generated revenue but also increased operation and maintenance costs. We provided several examples, including U of U's Kingsbury Hall, USU's Dee Glen Smith Spectrum, and SUU's Shakespeare's theaters.

Board of Regents staff reported that several discussions on this topic have occurred, but no policy has been adopted. However, some institutions, like SUU, have moved forward on their own. SUU reported to us that O&M funding for a new Shakespeare Festival facilities will be funded through a planned ticket surcharge, while other facilities' O&M funds will be generated through a new student fee. We are encouraged by some institutions' actions, but repeat our recommendation for the Board of Regents to formally visit this issue and provide policy guidance.

O&M Policy Options Exist

Important policy questions are before the Legislature and the SBB on how O&M funding should be determined. Beyond periodic COLA and utility adjustments USHE institutions generally receive new O&M funds when new buildings are brought on-line. Accordingly, institutions may struggle to maintain older buildings. During the 2015 General Session, some legislators spoke of the need to reevaluate this model. Alternative funding models exist in Utah and other states that may better address maintenance needs. At the request of a legislative committee, and as statutorily directed in SB217, members of the SBB and others are in the process of reevaluating the state's O&M funding models.

No observed progress has been made by the Board of Regents on a revenue-generating activities policy and how these activities contribute to O&M costs.

At the request of a legislative committee and as statutorily directed in SB217, members of the SBB are reevaluating the current O&M funding model.

Unlike State Agencies, USHE O&M Funding Is Generally Not Adjusted Over Time

The Legislature currently funds Higher Education facilities differently than it funds other state buildings. In the USHE model, the Legislature provides O&M funding for institutions on a building-by-building basis⁹, but this funding is then commingled with other funds in a larger account and loses its identity. That originally determined funding is generally not adjusted over time.¹⁰ Typically, USHE institutions receive an increase in their O&M budgets only when a new building is funded and constructed.

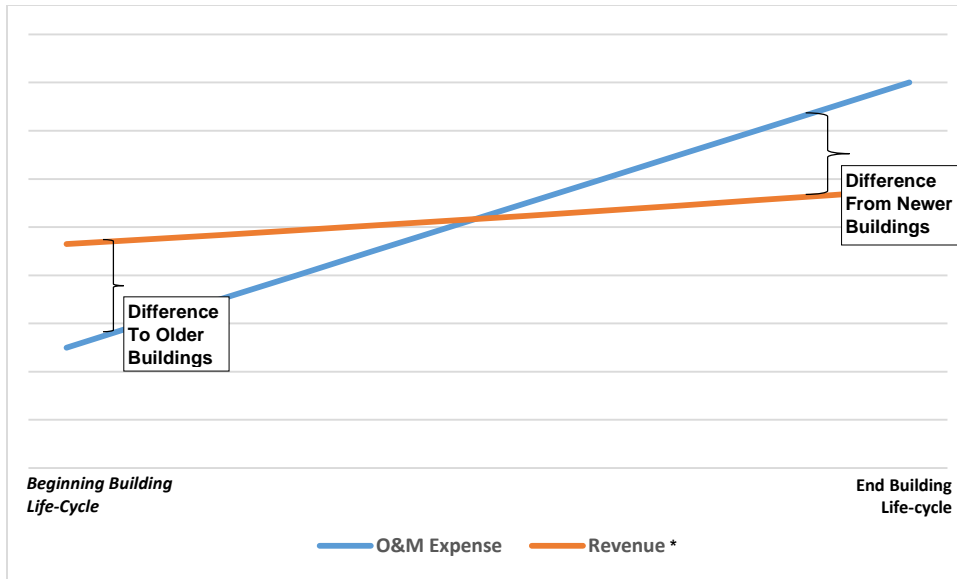
In contrast, state agency buildings are individually funded and are periodically adjusted, including for inflationary considerations, based on the O&M needs at the time. Figures 2.4 and 2.5 demonstrate the difference in funding models for state agency buildings and Higher Education buildings.

The Legislature funds Higher Education facilities differently than it does other state buildings.

⁹ O&M is funded at the time new USHE buildings are approved by the Legislature. However, O&M is offset with one-time reductions until the building is complete and occupied.

¹⁰ Periodic COLA salary adjustments are given to facilities personnel and some utility adjustments have been provided, but additional funding is not typically given to other O&M expenses.

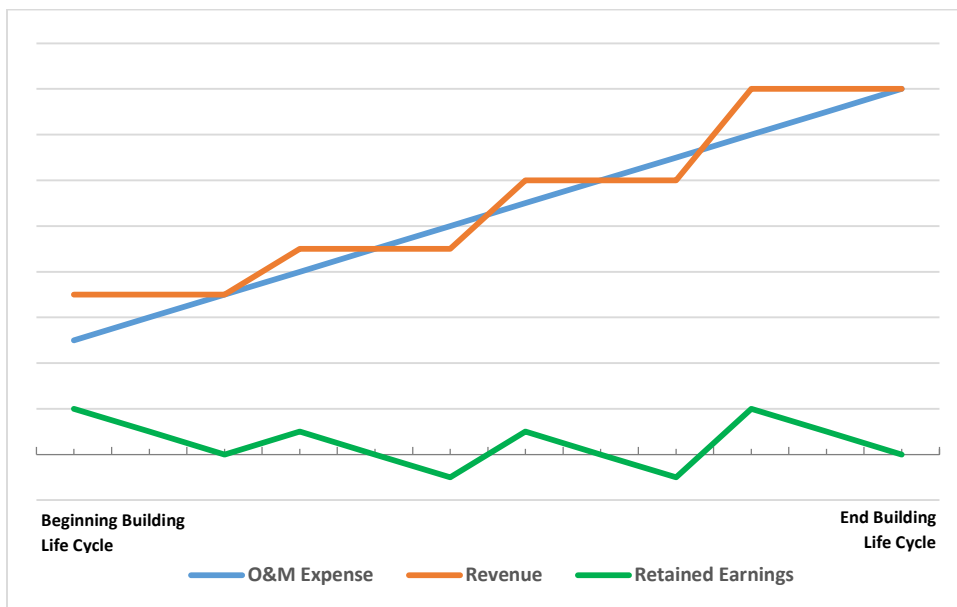
Figure 2.4 USHE Funding Model. USHE O&M generally does not increase, other than for some COLA adjustments for salaries and occasional utility increases. Over time, expenses outweigh funding, putting pressure on institutions to use funding generated by new building construction.



Source: Theoretical modeling developed with USHE
 * O&M Appropriations were estimated with a 2% COLA/Salary adjustment

Higher Education and DFCM funding models differ significantly.

Figure 2.5 DFCM Funding Model. DFCM manages buildings separately and uses retained earnings to offset peaks in costs. DFCM also receives revenue adjustments that are returned if retained earnings grow too high. There is no incentive to take O&M funding from new buildings.



Source: Theoretical modeling developed with the assistance of DFCM

Legislators have expressed concern over Higher Education's construction of new buildings to provide O&M for older facilities.

The two major funding models in the state are quite different, as shown in Figures 2.4 and 2.5. While DFCM's model tracks and adjusts funding on a building-by-building basis, the model used by USHE institutions does not adjust O&M funding, thus, new buildings must be constructed for an institution to receive more O&M funds. The DFCM model allows for the return or refund of O&M funds if O&M expenses are less than expected levels.

Legislators have recently expressed concern over the USHE model, including trying to determine whether current O&M levels are appropriately funding buildings. Minutes taken from a 2015 Higher Education Appropriations Subcommittee meeting state the following:

Rep. Gage Froerer discussed some of the common issues with IGG & Higher Education, particularly with O&M of existing facilities. The current formula for O&M funding is outdated. . . . [Institutions] find it more practical to build new buildings because of the higher O&M funding. These . . . [institutions] have to subsidize older buildings and are not receiving the funds necessary to maintain them. He cited the 50-year-old Browning Center at Weber State University, which only receives \$15,000 in O&M annually. He reported that, after 15-20 years, the actual initial [construction] cost of the building is less than the required O&M funding.

Further legislative action in the 2015 General Session occurred with the passage of Senate Bill 217, which requires the building board to conduct a detailed study on this topic. A task force is currently addressing many of these issues and exploring alternatives to funding O&M and capital improvements needs.

Another problem with the current USHE model, and perhaps a barrier to implementing a different method for funding O&M, is the lack of knowledge about how much funding each USHE building has already received. Historically, legislatively appropriated O&M has been funded along with instruction and most other areas in a single

line item,¹¹ therefore, O&M appropriations for each USHE building over the years are not known. This lack of information may make it difficult to move to a different model. However, models used in other states may be worthy of consideration.

Other States' Models for Funding O&M and Capital Improvements Are Varied

One way to determine if Utah Higher Education facilities are being appropriately funded is to perform a comparison with other states' institutions. The O&M and capital improvement funding models other states use provide a different perspective to funding capital facility needs. Interestingly, just as Utah has a model unique to Higher Education, some states also fund their institutions' buildings differently than they do other buildings. Information was obtained in phone conversations with a number of facility directors at peer institutions.¹²

Other States' O&M Funding Models Are Similar to Utah's or Are Embedded in Overall Funding. With regard to observed O&M funding models, the University of Washington and University of Iowa are similar to Utah in the way their states fund higher education O&M. New Mexico State University dropped a model similar to Utah's and instead O&M is funded as a percent of the institutional expenditures, or roughly 35 percent last year. The University of Arizona and the University of Wyoming receive lump sums of funding, rather than specific O&M appropriations.

Methods used by other states to fund O&M needs for their institutions could help Utah policymakers find a better model for our institutions.

¹¹ In the February 13, 2015, Higher Education Appropriates Subcommittee meeting, a motion was made and passed to instruct the Office of the Legislative Fiscal Analyst to track O&M funding as an appropriation unit within the E&G line item.

¹² Peer institutions are universities the Utah Board of Regents believes to have comparable facilities to Utah's university facilities, based on several factors. These comparisons are made in their annually published Databook. Comparisons in this report were made exclusively between U of U, USU, and their peers.

Some states fund their higher education facility needs in a lump sum. One state does not give an increase in O&M funding for newly constructed buildings.

One state reported constructing buildings without an associated increase in O&M funds, indicating that their university relies exclusively on a biennial lump sum block grant. The institution can appeal for additional funding in a separate request, however, these requests are usually not fully funded at the requested amount, nor are the funded amounts sufficient to cover the increased O&M costs. One of the facility directors in this state reported significant concerns with O&M funding. The director said that the institution has recently added about a million additional square feet of space, with very little new O&M funding.

Utah legislators recently discussed whether institutions' O&M should be funded in a lump sum, rather than using the current USHE model. The minutes of the February 9, 2015, Higher Education Appropriations Subcommittee meeting state the following:

Co-Chair Urquhart [explained that] currently the goal is to get the biggest, best building and put in the least amount of institutional funds possible. The Legislature could do a better job by requiring the institutions to stretch those dollars further. For example, institutions would get a set amount of money per FTE, and then they would have to use that money on capital facilities.

This proposed model mirrors how some other states fund O&M and is worthy of consideration.

Other States' Capital Improvement Funding Models Are Varied. Peer institutions receive capital improvement funds in a less straightforward approach than used for O&M, and a variety of models exist. Other states' institutions receive capital improvement funds in the following ways.

- The University of Arizona's capital improvements are funded through a separate capital appropriation when a request is approved.
- The University of Iowa receives some legislative money through an appropriation for capital improvement purposes. In addition, the university has an objective to fund existing buildings with institutional and other funds at 1 percent of current replacement value (CRV), and also pledges to

Capital improvement funding models in other states do not match closely with Utah's funding model.

designate 1.5 percent of CRV from institution funds to any new buildings if the Legislature approves construction.

- The University of Washington receives capital improvement funding through the capital budget request process at roughly 2.3 percent of CRV.
- The New Mexico State University, instead of receiving a percentage of CRV, is appropriated a fixed \$5.2 million annually for capital improvements. The state also votes on a general obligation bond every two years that, if passed, provides an additional \$20 million.
- The University of Wyoming is given 1.5 percent of CRV biennially if the Legislature approves the appropriation.

Our review of how other states fund higher education capital improvement needs indicates that the Utah Legislature’s current support for O&M is better than some states.

We also obtained data from APPA: Leadership in Educational Facilities, a nationally recognized organization that tracks higher education facility performance, to compare U of U facility data with other states’ data. See Figure 2.6.

Figure 2.6 APPA Data Compares USHE Institutions with Peer Institutions. The U of U operates at a lower expense per gross square foot (GSF) and appears to occupy less space per student.

University	Operating Expense/GSF	CRV/GSF*	GSF/Student FTE
<i>University of Utah</i>	\$3.68	\$248.59	224.02
University of California-Irvine	7.51	492.91	197.95
University of Iowa	3.65	474.76	288.13
University of New Mexico	4.16	413.41	251.56
University of North Carolina-Chapel Hill	4.19	381.43	404.27
University of Washington	3.83	493.61	270.12

Source: APPA: Leadership in Educational Facilities
 * Current Replacement Value (CRV) / Gross Square Foot (GSF)

Data from APPA shows that the U of U operates at a lower expense per gross square foot.

Further analysis in the APPA database shows that the U of U’s facilities expenditures are lower than several peer institutions and the U of U appears to occupy less space per student. Underlying

explanations for discrepancies in the data are not known, but we believe the data is a useful starting point for additional analysis that the building board is currently engaged in.

The State Building Board, Risk Management, and USHE institutions should collaboratively examine maintenance funding and upkeep data at other states' institutions. Also, as discussed in the next chapter, building records still differ between institutions and state agencies. Accurate, verified records on building utilization and auxiliary classification would help ensure that proper O&M and capital improvement funding is requested from the Legislature for eligible facilities.

How to best fund O&M and capital improvement needs in the future is a policy decision. Legislators have recently expressed interest in reevaluating this model and replacing it with something different. A study by members of the SBB may help to add perspective on this issue. While a variety of models exist, Utah's DFCM and peer institutions' models provide other ways of meeting the needs of aging buildings.

While other models exist, how to best fund O&M and capital improvement needs for Utah Higher Education institutions is a policy decision.

Recommendations

1. We recommend that, as required in policy, the Office of the Commissioner of Higher Education make a definitive determination of how costs should be revised for renovated or replaced building space when requesting O&M funding; the commissioner's office should then consistently enforce the policy.
2. We recommend that the Office of the Commissioner of Higher Education require USHE institutions to provide the commissioner's office and the Board of Regents with a detailed record showing how the institutions calculate O&M needs for renovated and replaced building space.
3. We recommend that the Board of Regents establish a policy on revenue-generating activities in campus facilities that addresses the extent to which paid admission charges should contribute to facility O&M costs.

4. We recommend that the Legislature consider the current Higher Education O&M funding model in light of the State Building Board's mandated study to determine if USHE buildings' O&M needs are being funded appropriately.

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Chapter III

Management of USHE's Auxiliary Buildings Is Inconsistent

The tracking of auxiliary buildings within the Utah System of Higher Education (USHE or Higher Education) continues to be a concern. Some problems identified in the 2011 audit are still present. We found that state entity and institutions' records still do not match. Inconsistent records hinder good information flow and the overall process of facility management. Further, inconsistent records have led to questionable funding of some capital improvement projects. This chapter addresses the following issues from the previous audit.

- State agency and USHE auxiliary building records do not match. Inconsistencies in records can cause confusion and potential funding errors.
- Auxiliary building classification process and oversight can improve.
- The Board of Regents' and State Building Board's (building board or SBB)¹³ adoption of a formal auxiliary facilities definition must now be consistently applied.

State Agency and USHE Records Do Not Match, Contain Errors

State entities, along with USHE institutions, maintain building inventory information on Higher Education's buildings to meet each of their unique needs. However, because each entity collects only the specific building data they need (and may or may not keep their data current), inconsistencies exist among these records. In cases where records conflict and building classification issues occur, inappropriate funding can result. In 2011, we recommended the implementation of a new process that could uniquely and correctly identify every building in the state, so that building data could be tracked and accessed across

¹³ In 2011, this recommendation was made to the Division of Facilities Construction and Management (DFCM). However, legislative changes have been made and the State Building Board now has this responsibility.

Problems identified in the 2011 audit still exist, including inconsistencies between agency and institution records.

State entities have been maintaining separate records on Higher Education facilities, leading to inconsistencies.

state and Higher Education systems. Some progress has been made, but more needs to be done.

Agencies’ Data Matching Has Improved but Errors Persist

In our 2011 report, *A Performance Audit of Higher Education Operation and Maintenance Funding*, we found that building records were inaccurate, incomplete, and inconsistent. Our recommendation was that a unique identifier be used for each building in the state’s inventory because multiple identification methods were creating confusion among stakeholders about the identity and function of some buildings. A significant amount of work has been accomplished in this area, but inconsistencies still exist.

To quantify inconsistencies, we obtained building inventory records from the director of the SBB, staff at Risk Management (which now shares data with SBB and DFCM) and facilities directors and staff from the University of Utah (U of U), Utah State University (USU), Weber State University (WSU), and Southern Utah University (SUU). The four institutions’ records for 269 buildings (25 percent of the sample reviewed) contained classifications that conflicted with the SBB’s records. Further, SBB records for 27 buildings (3 percent) differed from Risk Management’s building inventories. Because it was unclear whether either inventory was correct, we were unable to rely on either set of records for accurate information. Figure 3.1 indicates differences in records.

Record keeping has improved; however, differences between the records of the Building Board and those of Risk Management suggest more work is needed.

Figure 3.1 SBB and Risk Management’s Building Inventory Records Differ in Several Key Areas. Differences in building inventory counts, building classifications, and total nonmatching records suggest a need for greater collaboration between state entities.

Areas with Inconsistencies	Risk Mgt	SBB
Number of buildings on record for the four institutions we reviewed	1,038	1,065
Number of building classification differences (auxiliary, educational, etc.)	279	269
Number of buildings without a match	188	228

Source: Auditor Summary of Risk Management and SBB Data

The functions and responsibilities of Risk Management, the building board, and the institutions of Higher Education require each to have accurate, up-to-date building information. Each entity uses the

information in different ways, which may partially explain differences in their records. Timing of when the records were delivered to us could also explain some of the variance. However, we still found some concerning issues as we matched the records, particularly differing classifications of auxiliary space at the institutions. Other concerns include the following:

- Some SBB records appeared to be outdated.
- Multiple identifiers were assigned to some buildings.
- Multiple buildings had the same identifier.
- Some SBB records contained demolished or sold buildings.

To further illustrate these concerns, Figure 3.2 shows differences between the SBB’s records and one USHE institution’s records.

Figure 3.2 Differences Exist between Building Board Records and an Individual Institution’s Records. It appears the SBB records are out of date, still listing active buildings that the USHE institution has removed from its records.

USHE Institution Building	Institution’s Reported Status
Building 1	Building demolished in 2014
Building 2	Building demolished in 2012
Building 3	Building demolished in 2013
Building 4	Building sold in 2011
Building 5	Building assigned a new Risk ID
Building 6	Building split, now assigned two Risk IDs
Building 7	Building listed under two Risk IDs
Building 8	Not a building
Building 9	Not a building
Building 10	Building sold

Source: A USHE institution

Figure 3.2 demonstrates some of the concerns we found while comparing records between entities. Similar inconsistencies may exist in building records for other Higher Education institutions. It is important that accurate and consistent records be kept on Higher Education’s building inventory because these records are the basis of legislative funding for capital improvement needs.

A review of one USHE institution found additional problems.

Many records we are concerned with are used when determining legislative funding for capital improvement needs.

**Better Collaboration Needed
Between State Entities**

Better collaboration needs to occur between state entities and USHE institutions to develop an accessible building database, even though specific agency responsibilities differ. Various state entities are statutorily required to track, collect, and maintain data about buildings on campuses of Higher Education. While facility information has improved since the 2011 audit, more needs to be done, especially as it relates to tracking auxiliary buildings. Figure 3.3 cites *Utah Code* sections requiring the SBB and Risk Management to keep facility records.

Figure 3.3 State Agency Stakeholders SBB and Risk Management each have statutory requirements to interact with, and keep some records for, Higher Education facilities.

Stakeholder	Statutory Responsibility
SBB	63A-5-103(3)(a): The State Building Board shall ensure that the five-year building plan required by Subsection (1)(c) includes:...(ii) information, and space use data for all state-owned and leased facilities
Risk Management	63A-4-101(2) The risk manager shall... (d) coordinate and cooperate with any state agency having responsibility to manage and protect state properties including...institutions of higher education [and shall] maintain records necessary to fulfill the requirement of this section.

Source: *Utah Code*

In each of the above cases, SBB and Risk Management are required to maintain information specific to its individual need. There is, however, commonality in the basic information collected and the way the information is collected. Improving collaboration will help improve the integrity of the data maintained by the various stakeholders. For example, the SBB and Risk Management could collaborate in their work with institutions to update building records, coordinating with the Board of Regents in the process.

Several agencies are statutorily required to maintain records of Higher Education buildings, but little collaboration exists.

Developing accurate building records will require establishing an existing state entity to be in charge of collecting, storing, maintaining, and accessing the data. In a recent meeting between the Department of Administrative Services, DFCM, SBB, Board of Regents, and others, it was suggested that Risk Management could collect the necessary information for each agency. However, as some data are not of interest to Risk, such as auxiliary space and classifications, the SBB or others would have to work with institutions to assess the accuracy of the information.

We believe that it is possible and necessary for these shareholders to work together to maintain a unified records database of basic building information (e.g. building name, identifier, address, square footage, etc.) that ensures accuracy, integrity, and completeness. Accordingly, we recommend that Risk Management, DFCM, and the building board use one records database to query and update basic building information. This database should either be tied into institutions' records or reviewed on a regular basis to ensure consistency.

Auxiliary Building Classification Process and Oversight Can Improve

A consistent record of building classifications (auxiliary vs. educational) does not exist. State-funded capital improvements are authorized for educational buildings but not for auxiliary buildings. Accordingly, incorrect classification of building functions can result in capital improvement funds being used for ineligible buildings. As provided for in *Utah Code* 63A-5-104(7)(a), the Legislature now funds capital improvement monies for Higher Education's Education and General (E&G or education) and infrastructure needs at roughly the amount of 1.1 percent¹⁴ of current replacement value (CRV). Further, SBB policy could be clarified to determine how to appropriately fund partial auxiliary buildings (those buildings that serve both auxiliary and academic functions).

¹⁴*Utah Code* 63A-5-104(7) states that funding of 1.1 percent of the replacement cost of existing state facilities and infrastructure is to be given for capital improvements annually. However, in some fiscal years, this formula has not applied, with one year's funding being reduced to 0.9 percent.

Basic building record information could be centrally collected and stored by Risk Management, with other agencies reviewing records for accuracy.

Inconsistent Building Classification Can Result In Improper Capital Improvement Funding

The 2011 audit identified key USHE buildings that DFCM had categorized incorrectly. We duplicated that audit's study and found that some buildings' designation corrections had been made. Additionally, some buildings with essentially the same function are not classified similarly. Further, some buildings are classified differently among SBB, Risk Management, and institutional records. To illustrate, Figure 3.4 shows the classification of institutions' major sport and event arenas.

Figure 3.4 Buildings of Similar Function Have Different Designations in SBB, Risk Management, and Institution Records. Incorrect classifications can lead to improper funding for capital improvement needs.

Campus	Building	SBB Designation	Risk Designation	Institution Designation
U of U	Jon M. Huntsman Center	Part Auxiliary	Auxiliary	Auxiliary
USU	Spectrum Building	Auxiliary	Auxiliary	Educational
SUU	Centrum Arena	Part Auxiliary	Educational	Part Auxiliary
WSU	Dee Events Center	Educational	Educational	Part Auxiliary

Source: Institution, Risk Management and SBB building records

Partial auxiliary status in some cases may be understandable because the buildings may have some academic space (for example, the Centrum Arena at SUU). In one case, the institution believes that its building was originally assigned O&M funding but has no record of this (specifically, the Spectrum building at USU). The building board's classification of the Spectrum building as auxiliary renders the facility ineligible for capital improvement funds. However, in the 2015 *Five Year Building Program* the building board authorized \$175,000 for emergency lighting upgrades at the Spectrum arena, even though the board's own records classify the arena as ineligible for the funds.

Conversely, other institutions' buildings are classified as educational by the building board while the institutions classify them as ineligible or partially eligible for O&M funding. Such classification inconsistencies among records create the possibility for errors when awarding capital improvement funding. In fact, the SBB annually gives these records to the Legislative Fiscal Analyst (LFA) for use in

Some buildings serving similar purposes were found to have varying auxiliary classifications.

Greater collaboration is needed to ensure buildings are correctly classified and funded based on utilization of the space.

calculating the capital improvement funding requirement. Inaccuracies in these records can affect capital improvement funding.

Maintaining a single, inclusive state facility database (regularly audited by the building board) on a set interval will improve the process. Further, to ensure adequate accountability and an appropriate audit trail are established, and to prevent any inconsistencies created by the timing of when the building inventory was reviewed and the 1.1 percent calculated, the building board or Risk Management should submit a record detailing which buildings were used in calculating capital improvement funding needs to LFA, GOMB, and other interested parties at an established date.

Building Board Policy Should Be Strengthened on How to Manage Auxiliary Buildings

Building board policy is needed which requires a set interval for assessing classification of buildings, as well as for how to appropriately fund partial auxiliary buildings. We believe a collaborative approach is needed to ensure buildings are correctly classified and funded based on utilization and classification. Further, we believe a policy should be established by the SBB requiring a scheduled audit of building utilization and classification be conducted by their auditors on a set interval. Arizona addressed this issue by statutorily requiring a capital improvement model, Arizona Code 41-793E requires the following:

The agency responsible for a building system shall inspect the condition, maintenance, and utilization of each building within the building system not less than once every four fiscal years and shall report its findings....For purposes of complying with this requirement, the agency responsible for each building system shall inspect approximately fifty percent of its buildings within the first two years of the four-year cycle. The agency shall inspect the other fifty percent of the buildings in the remaining two years of the four-year cycle.

We recommend that the state entities administering the state's inventory of buildings accept classifications (as educational, auxiliary, or partial auxiliary) provided by the institutions; then the building board should audit the classifications on a set interval.

Maintaining a single database that is consistently audited by the building board will improve the process.

The SBB needs to develop a policy on how to appropriately maintain and fund partial auxiliary buildings.

Better Policy Needed for Partial Auxiliary Buildings. In the SBB's *Fiscal Year 2015 Five-Year Building Program* report, consideration was given to funding some capital improvement projects for partial auxiliary buildings. The building board did not fully fund some of these projects, including the auxiliary components. Confusion exists for partial auxiliary buildings because infrastructure needs were recently added to the capital improvement funding model. In March 2015, members of the building board discussed the difficulty in separating shared infrastructure costs for partial auxiliary buildings but did not adopt a definitive policy. We recommend the building board adopt a policy on how to maintain and fund partial auxiliary buildings on USHE campuses.

Board of Regents and Building Board Have Recently Adopted New Auxiliary Policies

Several auxiliary classification inconsistencies exist between the building inventory records of SBB, Risk Management, and USHE institutions. Much of this inconsistency may stem from both an outdated Board of Regents auxiliary policy and a lack of an auxiliary building definition at the SBB. After making a request, the Board of Regents updated its auxiliary space policy to clarify to its institutions what will be considered auxiliary. Similarly, the SBB formerly adopted an auxiliary definition in December 2014 as recommended in the 2011 audit. The results of these changes are yet unknown.

Board of Regents Auxiliary Building Policy Updates Are Slow to Be Applied

The Board of Regents' auxiliary policy has recently been updated. The policy was posted to the Board of Regents' website in January 2015, during the course of our audit. The prior policy included facilities that no longer exist (U of U Golf Course) and outdated institution names (UVU, formerly Utah Valley State College and DSU, formerly Dixie State College).

The new policy had been approved one year earlier but apparently had not been released until we requested policy information. We are encouraged with the new policy released by the Regents, but believe USHE's auxiliary building classifications will continue to include inconsistencies until a concerted effort is made by the Board of

The Board of Regents and Building Board have recently revised or adopted policies related to auxiliary facilities.

Regents and the SBB to correct and consistently apply the new auxiliary definitions.

Building Board Recently Adopted An Auxiliary Definition

As was the case with the Board of Regents, the SBB addressed the lack of a policy on auxiliary space during our follow-up audit. In 2011, we reported that the DFCM did not have a policy on auxiliary buildings and recommended they adopt one. Since that time, DFCM's and SBB's duties have changed and a new director of the SBB has been hired. The new director proposed an auxiliary space definition that was approved by the building board in December 2014. The definition, taken from National Association of College and University Business Officers (NACUBO), is shown in Figure 3.5.

Figure 3.5 The State Building Board Updated Its Auxiliary Policy. This NACUBO definition of auxiliary space was recently adopted by the board.

"An auxiliary enterprise exists to furnish goods or services to students, faculty, staff, or incidentally to the general public. An auxiliary enterprise also charges a fee directly related to, although not necessarily equal to, the cost of goods or services. The distinguishing characteristic of an auxiliary enterprise is that it is managed as an essentially self-supporting activity. Examples are residence halls, food services, intercollegiate athletics (only if essentially self-supporting), college stores, faculty clubs, faculty and staff parking, and faculty housing. Student health services, when operated as an auxiliary enterprise, also are included. Hospitals, although they may serve students, faculty, or staff, are classified separately because of their financial significance."

Source: National Association of College and University Business Officers definition was recently adopted by Utah State Building Board

The update to and adoption of auxiliary definitions by the State Board of Regents and the SBB is encouraging. However, it remains to be seen if these similar definitions will be consistently applied and reviewed by the two oversight entities. The State Board of Regents and the SBB should periodically review and update these definitions. As previously mentioned, errors in building inventory records still exist; the adoption of a definition is just the first step in changing the process.

The building board recently adopted an auxiliary space definition, now it must be consistently applied.

Recommendations

1. We recommend that all state agencies use one database to store, update, and manage the state's inventory of buildings.

2. We recommend that the State Building Board's annual submission to the LFA, GOMB, and others include a record detailing which buildings were used in calculating capital improvement funding needs. To prevent any inconsistencies the report should be generated and distributed at an established date.
3. We recommend the State Building Board create a policy that:
 - a. Requires a set interval review of all Higher Education buildings, including inspecting the condition, maintenance, and utilization of each building and to account for the apportionment of educational and auxiliary building functions.
 - b. Establishes guidelines on how capital improvements funds can be used on partial auxiliary buildings.
4. We recommend that the state entities administering the state's inventory of buildings accept the classifications (as educational, auxiliary, or partial auxiliary) provided by the institutions; then the building board should audit the classifications on a set interval.
5. We recommend that the Board of Regents and the State Building Board require all entities under their jurisdiction to comply with the updated or adopted auxiliary policy. The Board of Regents and State Building Board should ensure their policies and standards are kept up to date.

Chapter IV

Policy Questions Remain Regarding Use of Reimbursed Overhead

Reimbursed research overhead funds are an important funding source for Utah's two research institutions: the University of Utah (U of U) and Utah State University (USU). Current statute and Board of Regents policy allow the institutions to retain these funds and expend them at the institution's discretion. Peer institutions in other states are also allowed to internally retain and use discretion in spending reimbursed research overhead funds. The surveyed institutions have varying degrees of transparency with their use of overhead funds. OLAG's 2011 audit provided two recommendations dealing with reimbursed research overhead:

- The Legislature should review *Utah Code* 53B-7-104 concerning reimbursed research overhead to determine if state policy should be modified.
- The Board of Regents should revise its policy on reimbursed research overhead to use reimbursed overhead funds for operation and maintenance (O&M) if there is a significant need for additional funding.

Neither of these recommendations has been fully implemented (See Appendix A). The Legislature requested a review of overhead funds within this in-depth follow-up audit to gain further insight on the use of these funds. In turn, the Board of Regents has discussed the overhead policy, but has not revised the policy. Greater scrutiny is appropriate as use of research overhead funding is often less visible than that of other funding sources. The lack of oversight is compounded as space demands and use increase while (as stated in the last audit) "conditions of buildings and infrastructure have worsened." Some institutions in other states have adopted a specific funding formula that drives the expenditure of overhead funds. The Legislature could direct the institutions or Board of Regents to implement such a formula.

This chapter follows up on two past recommendations, neither of which has been fully implemented.

O&M is one of the overhead costs that grant-funded research reimburses.

Reimbursed Overhead Is An O&M Funding Source

Reimbursed research overhead funds are grants primarily awarded to the U of U and USU¹⁵ to reimburse them for indirect overhead costs incurred during research activities. O&M is one of the indirect costs categorized as research overhead. While the U of U and USU diligently provided us information about their overhead funds, the institutions do not track and report the information in the format we requested, creating some uncertainty about the accuracy and reliability of the data. The unique nature of the research foundation at USU further compounds this problem. Thus, the data provided in this chapter should be considered as estimates. If the Legislature desires further accountability of these funds, improved tracking and verification of the data is needed. Figure 4.1 shows an estimate of total overhead funds the two research institutions received in fiscal years 2010 and 2014, the estimated portion designated for O&M, and the estimated amount spent on O&M items from overhead funds (see Appendix C).

Figure 4.1 O&M Related Reimbursed Overhead. The two research institutions receive a significant amount of reimbursed overhead for their O&M costs.

University of Utah				
Fiscal Year	Total Reimbursed Overhead	Reimbursed Overhead for O&M Costs	Amount Spent of O&M	Percent of Total Overhead Spent on O&M
2010	\$76,200,000	\$18,600,000	\$7,700,000	10.1%
2014	\$78,600,000	\$19,700,000	\$9,000,000	11.5%
Utah State University**				
2010	\$10,000,000	\$ 2,500,000*	\$1,300,000†	13.0%
2014	\$12,600,000	\$ 3,000,000	\$2,700,000	21.4%

Source: The University of Utah and Utah State University

* This number was presented as \$6.1 million in the 2011 audit, but that number included the foundation and a less precise methodology to estimate O&M.

** USU's data does not include its foundation. See Appendix C.

† This is a revised number from USU. In 2011, USU reported \$350,000 (exclusive of the foundation) as overhead funds spent on O&M. USU revised the number to \$1.3 million.

¹⁵ The other state institutions can also receive these funds. However, because they do not have a research mission, these funds are relatively small. For example, Weber State University received about \$350,000, Southern Utah University received about \$1,000,000, and Utah Valley University received about \$900,000.

The U of U and USU receive significant reimbursements for O&M; however, as will be discussed later in this section, the application of these funds varies.

Institutions Have Discretionary Use of Reimbursed Overhead Funds

Current statute and policy allow the institutions to retain and use overhead funds at their discretion. This policy was adopted in 1986 to help the institutions grow grant-funded research. Prior to 1986, the Legislature retained the majority of overhead funds as reimbursement for costs already paid with state funds.

Legislature Used to Retain Reimbursed Overhead

Senator Hillyard provided insight on why the Legislature changed policy and allowed the institutions to retain reimbursed research overhead funds in testimony to the Infrastructure and General Government Appropriations Subcommittee on October 23, 2014. Senator Hillyard explained that, historically, the Legislature used to capture research overhead funds for deposit into the state's general fund. However, legislators noticed that the institutions were bidding on contracts without seeking much O&M reimbursement, because by bidding less, they were awarded more contracts. The state then had to come back in and fund the O&M anyway. Allowing the institutions to retain the overhead funds provided a greater incentive for the institutions to bid for more O&M reimbursement in the grant terms.

This policy rationale outlined by Senator Hillyard has worked. The U of U and USU receive significant overhead reimbursement, part of which they have used to grow their research mission. The amount of research funding going to the schools has significantly increased¹⁶, and notable and praiseworthy research projects have been completed. In addition, our 2011 audit found that both the U of U and USU research activities had indirect and ripple effects on state and local economies. Over the reviewed period, spending of approximately \$365 million at the U of U grew to \$525.3 million and \$187 million

¹⁶ Over the last 30 years total research grants at the U of U have gone from about \$64 million to about \$463 million.

The Legislature has allowed discretion with overhead funds to further encourage research growth.

at USU grew to about \$210 million. However, also during this period, O&M needs have been significant and sometimes not addressed because the reimbursed overhead funds have been used in other areas.

Reimbursed Overhead Statute and Policy Have Not Been Revisited in 25 Years

State statute dealing with reimbursed overhead was last updated in 1989 (originally passed in 1986) and the Board of Regents's rule was last updated in 1991. Figure 4.2 provides key language of state statute and Board of Regents policy.

Figure 4.2 Statute and Policy Governing Reimbursed Overhead. Current state law and policy give the institutions flexibility in the use of their net reimbursed overhead.

Utah Code 53B-7-104. Retention of Net Reimbursed Overhead Revenues.

. . . All budget documents for the system of higher education shall reflect retention by the institutions within the system of their net reimbursed overhead revenues for support of research and related programs under policies established by the State Board of Regents. These overhead revenues may not be considered a dedicated credit.

Utah Board of Regents Policy R535

All reimbursed overhead revenues shall be retained by the institution for the support of research and related programs. Related programs include expenditures for instruction, public service, **necessary physical plant**, and student, academic and institutional support. Institutions shall apply reimbursed overhead to direct and indirect support of research programs in approximately the proportion of such funds earned on research contracts to total reimbursed overhead revenues. . . .(emphasis added)

Source: Utah Code and Board of Regency Policy

As noted, since the first policy change in 1986, research at both research universities has grown significantly and been very beneficial to Utah's economy. However, while research has increased, some O&M was defrayed and condition of the buildings and supporting infrastructure has declined. Facility directors at some institutions are concerned that their buildings and infrastructure have not been adequately maintained.

For example, the U of U is currently completing \$100 million in state- and university-funded repair projects to its deteriorating infrastructure. In 2011, the former U of U president told the Legislature that the university had doubled its research funding in five years but led the nation in electrical outages. The president went on to say “our capacity to do that research depends on our capacity to keep the equipment running and the labs running. All of that is in serious jeopardy.”

We reiterate our conclusion from our 2011 audit that more of the reimbursed overhead could have been used over the past years to repair and maintain critical infrastructure and operational systems. However, we recognize this is a policy issue. Increased use of overhead funds for O&M needs would reduce the funding for other activities, such as research.

Legislature Could Provide Additional Policy Guidance on Overhead Funds

The current situation raises policy questions about whether and how much reimbursed research overhead funding should be used to maintain important infrastructure and operating equipment that support buildings. We conducted a survey of U of U and USU peer institutions’ use of overhead funds that was limited by peer institutions’ reluctance to share sensitive information. Nevertheless, we found that some other institutions allocate overhead funds based on specific formulas. The Legislature may also find that requiring a certain percentage of reimbursed overhead funds be spent on O&M could provide a method of addressing the O&M needs created from research growth.

Institutions Have Discretion in Using Overhead Funds Received for O&M

Current policy allows the institutions substantial flexibility in allocating and disbursing overhead funds. Appendix C provides a more detailed breakdown of the institutions’ expenditure of reimbursed research overhead funds. The U of U has stayed generally consistent over the last five years in the percent of O&M funding allocated to O&M-related expenses. USU reported using more of the reimbursed research overhead funds in 2014 than in 2010 for O&M-related expenses. However, due to accounting difficulties with U of

While the institutions have successfully grown their research activity, deferred maintenance and other O&M needs have also increased.

The Legislature may want to direct overhead spending through a formula, as is done in some other states.

U's and USU's information, data in Figure 4.3 and Appendix C should be viewed as estimates. A complete audit of cost accounting at the U of U and USU would be needed to determine whether current methodologies provide precise, reliable data. Figure 4.3 provides estimates of how overhead funds were used for O&M in 2010 and 2014.

Figure 4.3 Allocation of Reimbursed Overhead Funds to O&M. This chart shows an estimate of the two institutions' use of reimbursed research overhead funds specifically paid for O&M.

University of Utah			
Fiscal Year	Reimbursed Overhead for O&M Costs	Amount Spent on O&M*	Percent Spent on O&M*
2010	\$18,600,000	\$7,700,000	42%
2014	\$19,700,000	\$9,000,000	46%

Utah State University ¹			
Fiscal Year	Reimbursed Overhead for O&M Costs	Amount Spent on O&M	Percent Spent on O&M
2010	\$2,500,000 ²	\$1,300,000 ³	52%
2014	\$3,000,000	\$2,700,000	90%

Source: The University of Utah and Utah State University

1. These figures do not include USU's research foundation. See Appendix C for information on USU's foundation.

2. This number was presented as \$6.1 million in the 2011 audit, but that amount included the foundation and used a broader methodology to estimate O&M.

3. This is a revised number from USU. In 2011, USU reported \$350,000 (exclusive of the foundation) as overhead funds spent on O&M. USU revised the number to \$1.3 million. A full audit of the cost accounting of overhead funds would be needed to fully validate this figure.

*See Appendix C, Figure C.2, The U of U has categorized a bond payment as O&M, it may be more appropriately categorized as a capital improvement expense, which would reduce in FY 14 U of U's percent spent on O&M to 28%.

U of U allocates about half the funds received for O&M to O&M-related expenses (see Appendix C). USU reports using most of the funds they receive for O&M toward O&M. As a percent of total reimbursed overhead (see Figure 4.1), the U of U reports spending about 11.5 percent (\$9 million of \$78.6 million) of its reimbursed overhead for O&M, while USU reports spending about 21.4 percent (\$2.7 million of \$12.6 million).

The U of U allocates about half of its O&M funds to O&M needs. USU has recently increased its use of overhead funds for O&M.

Some States' Institutions Use a Funding Formula for Reimbursed Overhead Spending

Some peer research institutions of the U of U and USU in other states report using a specific formula that directs the spending of overhead funds. Because of the sensitivity of the data, only one peer institution would actually share the specifics of its formula.

Unfortunately, even in this case, there could be some disparity as to this institution's definition and classifications of O&M spending. That school reported that it will soon spend 10 percent (currently spending 9 percent) of total reimbursed overhead on O&M-related items. As shown in Figure 4.1, the U of U estimates spending 11.5 percent and USU estimates spending 21.4 percent of total overhead on O&M-related items.

With limited information from other states and some concern with data consistency at the U of U and USU, we caution against relying too much on comparisons with other states. We believe that each institution is unique when allocating grant-reimbursed overhead funds. The Legislature can feel comfortable steering reimbursed overhead funds to the specific needs and policy initiatives present in Utah.

Recommendations

1. We recommend that the Legislature review *Utah Code* 53B-7-104 to determine if statute or policy should be modified in relation to the use of grant-reimbursed research overhead funds. The Legislature could consider directing the Higher Education institutions and/or Board of Regents to develop a specific funding formula that would direct the spending of overhead funds.
2. We recommend that the Board of Regents revise its policy on reimbursed overhead funds to direct institutions to use those funds provided for infrastructure or O&M costs for those purposes if there is a significant need for additional funding in those areas. This could be accomplished through the adoption of a specific funding formula.

Several peer institutions in other states report using a specific funding formula that directs overhead spending.

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Appendices

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Appendix A

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Appendix A

Figure A.1 2011 Audit Recommendations and Implementation Status.

The follow-up audit was conducted in two separate reports, which are:

Report # 2014-E: Released December 2014.

Report # 2015-04 Released June 2015.

2011 Recommendation	1 Year Follow-up <u>Self-Reported</u>	Current Follow-up	Audit Report Placement and Discussion
We recommend that the Legislature consider funding O&M as an appropriation unit within the E&G line item.	Not Implemented	Implemented*	Report #2014-E, pages 8-10 Higher Education Appropriations Sub-Committee Implemented 2015 GS
We recommend that the Legislature review its policy and consider making state O&M funding decisions for non-state funded construction at the time a building is authorized or (if construction is delayed) before construction begins.	In Process	Implemented SB 278 (2013 GS)	Already implemented; not discussed in either report
We recommend that the Board of Regents review the A-1 and S-2 data reported by institutions and ensure that the data is comparable and meaningful.	Implemented	--	Already implemented; not discussed in either report
We recommend that the higher education institutions review auxiliary facilities to ensure the facilities are paying the appropriate share of O&M costs.	In-process	In-process	Report #2 Chapter III – pages 27-32 Auxiliary Classification Issues Persist
We recommend that the Legislature consider directing the Board of Regents to maintain a record of all buildings built on campus that denotes the O&M funding source as being either state-funded or other. If the funding source does not come from state funds, the record should specifically indicate the source of the O&M funding.	Implemented	Not Implemented**	Report #2014-E pages 6-8
We recommend that DFCM ¹ correct their building information by adopting a formal definition of auxiliary facilities and consistently applying it.	In Process	In Process	Report #2 Chapter III – pages 27-32 A formal definition was adopted by SBB in November 2014 but it is still not consistently applied
We recommend that DFCM ¹ work with higher education officials to include a unique identifier in their new database that would ensure a building can be tracked consistently across the state and higher education systems.	In Process	In Process	Report #2 Chapter III – pages 27-32 Information is better than last audit, but improvement is still needed

We recommend that the Legislature require all buildings to have an O&M funding plan in place before construction. The funding plan should show at least the amount of funds to be added to the institution's O&M budget and the source of the funds.	In Process	Partially Implemented	Report #2014-E, pages 4-6
We recommend that the Legislature review Utah Code 53B-7-104 concerning reimbursed research overhead to determine if state policy should be modified to direct institutions to use reimbursed overhead funds provided for infrastructure or O&M costs for those purposes if there is a significant need for additional funding in those areas.	Not Implemented	In Process	Report #2 Chapter IV – pages 33-39 Audit request to study this issue begins Legislature review of the topic.
We recommend that the Board of Regents revise their policy on reimbursed overhead to direct institutions to use reimbursed overhead funds provided for infrastructure or O&M costs for those purposes if there is a significant need for additional funding in those areas.	Not Implemented	Not Implemented	Report #2 Chapter IV – pages 33-39
We recommend that the Board of Regents establish a policy on revenue-generating activities in campus facilities that addresses the extent to which paid admission charges should contribute to facility O&M costs.	Not Implemented	Not Implemented	Report #2 Chapter II – page 13

* This recommendation was listed as not implemented in audit report 2014-E, however, the Legislature took action in the 2015 General Session that changed the status of this recommendation to implemented.

** The Board of Regents reported this recommendation as implemented in 2012. However, the Legislature has not yet directed the Board of Regents to implement the recommendation. The Regent's staff reported that they began working on this record but it was not available or up to date when we began our audit work. See pages 6 to 9 of Report #2104-E, http://le.utah.gov/audit/14_eilr.pdf

† Since the 2011 audit, the job objectives and duties of DFCM and the State Building Board (SBB) have changed, and what was formerly DFCM's responsibility to implement audit recommendations is now the SBB's responsibility. The SBB is now in charge of maintaining space use data for all state-owned facilities and for estimating capital improvement funding needs.

Appendix B

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Appendix B

Figure B.1 Board of Regents O&M Tracking. This information is part of the chart put together by the Office of the Commissioner of Higher Education to show that the institutions added additional tuition and other dollars to O&M beyond what the Legislature has appropriated.

Fiscal Year	2011	2012	2013	2014
Appropriations	\$120,770,616	\$122,848,316	\$125,554,816	\$127,913,334
Reported O&M Expenditures	\$145,378,956	\$147,643,086	\$146,477,565	\$150,267,007
Difference	\$24,608,340	\$24,794,770	\$20,922,749	\$22,353,673

Source: Officer of the Commissioner of Higher Education – Board of Regents

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Appendix C

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Appendix C

Figure C.1 Fiscal Year 2014 Breakdown of How Institutions Spent Overhead Funds. This figures breaks out how all reimbursed overhead funds were spent. The information is from the Board of Regent's S-5 report, however, some adjustments were made by USU (see footnotes below the figure).

Expense Type	U of U	USU Campus	USU Foundation
Develop New Research Funding	\$30,730,913	\$ 7,662,769	
Research Equipment	1,600,000	1,472,413	
Recruiting New Researchers/New Lab	4,417,016	2,406,779	
Retention of Key Researchers	1,050,000		0
Research Lab Remodeling	0	\$ 200,000	0
Capital Facilities ¹	6,677,729	1,143,287	1,182,056 ³
Programmatic Support	5,966,808	13,953,373	
Support for Research Facilities	2,049,661	1,403,203	0
General Support (other)	26,304,604 ²	1,453,560	
Total	\$78,796,731	\$30,877,440	

1. Some capital facilities charges are not considered O&M. Also, there are some O&M expenses contained in the general research support category. U of U reports total spent on O&M from reimbursed overhead as \$9 million. USU estimates \$3.9 million was spent on O&M.
 2. The largest expense in this category is graduate tuition support in the amount of almost \$11 million. High performance computing (\$2,908,100) and management information systems (\$2,232,000) are the next highest expenditures.
 3. This is a revised number for the foundation. \$534,285 was reallocated to O&M from programmatic support.
- Note: The total expenditures differ from the total revenue in Figure 4.1 due to the use of carryforward balances pushing expenditures over revenues.

Figure C.2 Fiscal Year 2014 Breakdown on How Institutions Spent Overhead Funds for O&M. This figure is an estimate that breaks out the category and amount of reimbursed overhead funds that were spent on O&M-related items.

University of Utah	
Expense Type	Amount
Bond Payment for Utility Infrastructure	\$3,416,000
Power for Komax Data Center	416,435
Environmental Health and Safety, Radiological Health	1,374,590
Share of Rent that Went to O&M (utilities, etc.)	3,860,086
Total	\$9,067,111

Source: University of Utah. This data was broken out by the University of Utah to show more detail. It will not match to a specific category in the Board of Regents S-5 report. Information was not fully audited to determine if it qualifies as a legitimate O&M expense.

Expense Type	Utah State University Amount	Utah State University Foundation Amount
Research Lab Remolding	\$ 200,000	\$ 0
Capital Facilities	1,143,287	1,182,056
O&M Research Facilities	1,403,203	0
Total	\$2,746,490	\$1,182,056

Source: Utah State University.

Figure C.3 Breakdown of USU and USU Foundation Overhead Funds Relating to O&M.

This figure shows the amount of overhead funds that were paid to USU and USU Foundation and how much of these funds were spent on overhead.

Fiscal Year	Utah State University			Utah State Foundation			Utah State Combined		
	Portion of Overhead for O&M*	Amount Spent on O&M	Spent on O&M	Portion of Overhead for O&M*	Amount Spent on O&M	Spent on O&M	Portion of Overhead for O&M*	Amount Spent on O&M	Spent on O&M
2010	2,500,000	1,300,000	52%	1,000,000	1,000,000	100%	3,500,000	2,300,000 ²	66%
2014	3,000,000	2,700,000	90%	1,200,000	1,200,000 ³	100%	4,200,000	3,900,000	95%

Source: Utah State University

* The information in this figure has been reviewed by the audit team but not fully audited. A full audit focused solely on reimbursed overhead would be necessary to verify accuracy of information. Please consider these figures as estimates.

2. USU revised its estimate of overhead spent on O&M from \$3.9 million that was reported on page 49 of the 2011 audit to \$2.3 million reported in this audit.

3. This is a revised number from USU Foundation. \$500,000 was reallocated from programmatic support to capital facilities in the report to the Board of Regents.

Please note while reviewing Figure C.3 that USU estimates that for fiscal year 2014, 23.35 percent of its reimbursed overhead was paid for O&M. USU Foundation estimates that for fiscal year 2014, 6.87 percent of its reimbursed overhead was paid for O&M. USU Foundation has different accounting rules from USU. Also, the foundation does not generally receive state support and therefore must use all of its overhead funds for the purposes they were provided for. USU receives state support and can use overhead funds in areas not related to facility or administrative expenses. Please note that the data in the 2011 audit combined USU and the foundation, the figures in Chapter IV of this report do not include USU’s foundation. Figure C.3 is provided for a comparison to the figures in the 2011 audit.

Also, as noted in Chapter 4, while the U of U and USU diligently provided us information about their overhead funds, the institutions do not track and report the information as we requested it. This created some uncertainty in the accuracy and reliability of the information. The data provided in the report should be considered as estimates. Reporting on overhead funds was especially challenging with USU’s research foundation.

Agency Responses

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June 5, 2015

Mr. John Schaff
Legislative Auditor General
W315 Utah State Capitol Complex
Salt Lake City, UT 84114 – 5315

Dear Mr. Schaff,

The Utah System of Higher Education (USHE) appreciates the opportunity to respond to the audit entitled **A Follow-up Audit of Higher Education's Management Practices for Operation and Maintenance Funding (Report No. 2015-04)**. The audit affirms the importance of proper care and maintenance of higher education facilities to extend their life for the benefit of our citizens; we wholeheartedly agree. A major study that focused on utilities infrastructure and related operation and maintenance (O&M) needs was completed in 2013 by the Office of the Commissioner of Higher Education and also confirmed the importance of preserving and even enhancing the existing levels of funding in order to avoid deterioration of these valuable physical plant assets.

USHE has demonstrated strong commitment to providing adequate support of O&M of state facilities. An O&M funding analysis completed by the Office of the Commissioner and referred to in this audit, reveals the priority placed on facilities upkeep by the USHE institutions. The study compiled a budgetary history of O&M allocations since FY1988 and demonstrated that, in the aggregate, the funds budgeted for O&M support by the institutions for facilities eligible for state O&M substantially exceeds the level of funds appropriated for that purpose.

We acknowledge and greatly appreciate the actions of the Legislature in supporting O&M funding for both state-funded facilities and for qualifying core-mission non-state funded facilities. Additionally, although not a part of this audit, the restoration of capital improvement (CI) funding to the statutory minimum of 1.1% of current replacement value (CRV) is an important and helpful commitment the Legislature is making on the facilities front.

Attached is the USHE response to each of the recommendations in the audit. We look forward to responding to questions and suggestions as this audit report is presented to various legislative committees.

Sincerely,


David L. Buhler, PhD
Commissioner of Higher Education

Response to the Follow-up Audit of Higher Education's Management Practices for Operation and Maintenance Funding

Chapter II

Recommendation 1: We recommend that, as required in policy, the Office of the Commissioner of Higher Education make a definitive determination of how costs should be revised for renovated or replaced building space when requesting O&M funding; the Commissioner's office should then consistently enforce the policy.

Response: We concur. For the upcoming funding request cycle, we will work to ensure consistency in the determination of O&M funding requests using the existing model as presently outlined in policy. We are currently participating with the State Building Board on a study of alternative funding mechanisms for O&M as was mandated by the passage of SB 217 during the 2015 Legislative Session. In compliance with the statute, a report from the study group will be presented to the Infrastructure and General Government (IGG) Appropriations Subcommittee on or before September 1, 2015. This report may well result in some changes to the way O&M funding needs will be calculated in the future.

Recommendation 2 – We recommend that the Office of the Commissioner of Higher Education require USHE institutions to provide the Commissioner's office and the Board of Regents with a detailed record showing how the institutions calculate O&M needs for renovated and replaced building space.

Response: We concur. We will work with the institutions to assure that the information is provided in sufficient detail to clearly display how the requested amounts were calculated.

Recommendation 3 – We recommend that the Board of Regents establish a policy on revenue-generating activities in campus facilities that addresses the extent to which paid admission charges should contribute to facility O&M costs.

Response: We agree that the revenue-generating entities designated as "auxiliaries" as defined by the National Association of College and Business Officers (NACUBO) should pay the applicable O&M costs for their facilities. The other revenue-generating entities referred to in the recommendation often are directly related to and benefit the academic programs of the institutions, in addition to fulfilling the public service role of the institutions. As such, they do not meet the "essentially self-supporting criteria" of auxiliaries.

Prior to consideration of a policy for adoption by the Board of Regents, the Office of the Commissioner will undertake a study of these non-auxiliary revenue generating activities to determine its magnitude and the potential for providing some level of O&M support.

Recommendation 4 – We recommend that the Legislature consider the current O&M funding model in light of the State Building Board's mandated study to determine if USHE buildings' O&M needs are being funded appropriately.

Response: *We concur. A review of the current funding models for existing and new facilities is appropriate. As is noted in Chapter II, Recommendation 1 above, we are currently participating in a Building Board study that includes consideration of this issue.*

USHE institutions have appreciated the ongoing funding increases provided for salaries and wages, and the occasional funding increases for utilities cost increases that have been provided as part of the existing O&M model. We recognize the current funding mechanism for existing facilities does not have a provision for price-level increases that occur over time for the required supplies and other non-personnel related costs of operating and maintaining the facilities and that where a disproportionate number of older buildings exist on a campus, this can pose a challenge. Notwithstanding the challenge, our institutions and their facilities operations teams are committed to keeping the buildings operational and fully functional.

Chapter III

Recommendation 1: We recommend that all state agencies use one database to store, update, and manage the state's inventory of buildings.

Response: *We concur and are collaborating with the relevant entities to accomplish this objective.*

Recommendation 2: We recommend that the State Building Board's annual submission to the LFA, GOMB, and others include a record detailing which buildings were used in calculating capital improvement funding needs. To prevent any inconsistencies the report should be generated and distributed at an established date.

Response: *We concur. This approach should result in a careful examination of the records and eliminate questions about what is included in the base calculation.*

Recommendation 3: We recommend that the State Building Board create a policy that:

- a. Requires a set interval review of all Higher Education buildings, including inspecting the condition, maintenance, and utilization of each building and to account for the apportionment of educational and auxiliary building functions.
- b. Establishes guidelines on how capital improvements funds can be used on partial-auxiliary buildings.

Response: *We concur. Since most, if not all, state buildings in this recommendation pertain to USHE, we agree to participate with the Building Board in developing such a policy.*

Recommendation 4: We recommend that the state entities administering the state's inventory of buildings accept the classifications (as educational, auxiliary, or part auxiliary) provided by the institutions; then the building board should audit the classifications on a set interval.

Response: *We concur. We support the recent decision to have the data base maintained by Risk Management separately record the portions of buildings that have dual purposes – both academic and auxiliary – in order to accurately portray the uses of the facilities.*

Recommendation 5: We recommend that the Board of Regents and the State Building Board require all entities under their jurisdiction to comply with the updated or adopted auxiliary policy. The Board of Regents and State Building Board should ensure their policies and standards are kept up to date.

Response: *We concur with this recommendation.*

Chapter IV

Recommendation 1: We recommend that the Legislature review Utah Code 53B-7-104 to determine if the statute or policy should be modified in relation to the use of grant-reimbursed overhead funds. The Legislature could consider directing the Board of Regents to develop a specific funding formula that would direct the spending of overhead funds.

Response: *If the Legislature wishes to revisit this issue, we will be happy to assist in providing information to facilitate its consideration. As you may know, the decision was made by the Legislature in the late 1980s to allow institutions to retain all of the reimbursed overhead as ongoing support to nurture and expand academic-based research programs that are an integral component of graduate degree instruction. Since that time, there has been a vast expansion in research activities, generating hundreds of millions of dollars for Utah's economy. In making this policy change, the State accepted the responsibility to pay the ongoing O&M costs of those buildings housing the academic research programs.*

With the passage of time, a review of the broad range of current funding needs for the academic research programs of USHE's research universities may be warranted. If so, such a review should include the assurance both that research facilities are provided with adequate O&M support and that USHE universities may continue to successfully compete for research funds. Not only are these funds critical for maintaining excellence in graduate degree programs, especially in the areas of STEM related-disciplines and medicine, they also have an enormous impact on the economy of the state by providing professional level jobs for Utah's citizens with the consequent contribution to the tax base of the state.

Recommendation 2: We recommend that the Board of Regents revise its policy on reimbursed funds to direct the institutions to use those funds provided for infrastructure or O&M costs for those purposes if there is a significant need for additional funding in those areas. This could be accomplished through a specific funding formula.

Response: *The existing Board of Regents policy (R535 Reimbursed Overhead) is currently written to reflect the legislative decision referred to in the response to Chapter IV, Recommendation 1 above i.e. "the 1980s legislative decision to allow institutions to retain all of the reimbursed overhead as ongoing support to nurture and expand..."*

In recent years, inadequate funds to cover some of the O&M the costs of research-related facilities have required institutions to allocate some of their research support funds to cover O&M and other physical plant-related costs, which is allowed by the existing policy. A continuation of such practices may be the appropriate course for the future, but because of the complexity of the issue, we believe it would be

advisable to defer a Regents' policy revision until the Legislature has had an opportunity to consider this matter, at which time a revision in policy can be updated in compliance with new legislative direction.

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Utah State Building Board

Gary R. Herbert
Governor

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June 10, 2015

Mr. John M. Schaff, CIA
Legislative Auditor General
W315 Utah State Capitol Complex
Salt Lake City, Utah 84114-5315

Dear Mr. Schaff:

On behalf of the Utah State Building Board, we wish to express thanks to you and your staff for their efforts on this follow up audit, and appreciate the opportunity to review and comment on: A Follow-up Audit of Higher Education Operation and Maintenance Funding Management Practices (Report No. 2015-04). It is the continued belief of the Utah State Building Board that Operation and Maintenance remains an invaluable and critically necessary process in the funding and longevity of state facilities. We also appreciate the Legislatures continued commitments to the area of capital needs and its complexities. We look forward to working with them and our stakeholders as the Building Board continues to research and address many of these ongoing important issues.

This response is to address the following key issues and recommendations:

Chapter I, page 2, Figure 1.1 Summary Item 6 - DFCM (State Building Board) should correct its building information by adopting a formal definition of auxiliary facilities and consistently applying it.

The State Building Board in December of 2014 formally adopted and put into place a definition for auxiliary buildings, and will consistently apply this to all future requests that have an auxiliary component. Adopted definition:

“An auxiliary enterprise exists to furnish goods or services to students, faculty, staff, or incidentally to the general public. An auxiliary enterprise also charges a fee directly related to, although not necessarily equal to, the cost of the goods or services. The distinguishing characteristic of an auxiliary enterprise is that it is managed as an essentially self-supporting activity. Examples are residence halls, food services, intercollegiate athletics (only if essentially self-supporting), college stores, faculty clubs, faculty and staff parking, and faculty housing. Student health services, when operated as an auxiliary enterprise, also are included. Hospitals, although they may serve students, faculty, or staff, are classified separately because of their financial significance.”

Chapter I, page 2, Figure 1.1 Summary Item 7 - DFCM (State Building Board) should work with Higher Education officials to include a unique identifier...that would ensure a building can be tracked consistently.

The State Building Board has been working with Risk Management, Higher Education and other stakeholders to review the unique identifiers used for state owned facilities. We have been encouraged by the development of the Risk Management's new Risk Connect data base. We have found this to be adequate for the Building Board, State of Utah and Higher Education's needs in having a unique identifier attached to their facilities for more consistent tracking of many building functions and information.

Chapter III, Recommendation 1 - We recommend that all state agencies use one database to store, update, and manage the state's inventory of buildings.

The State Building Board in conjunction with DAS agrees with this recommendation. We will continue to work closely with Risk Management, DFCM and Higher Education as this system continues to develop. We will also be initiating a regular interval of reviews of the building list as submitted to ensure a consistent and accurate collection of data.

Chapter III, Recommendation 2 - We recommend that the State Building Board's annual submission to the LFA, GOMB, and others include a record detailing which buildings were used in the calculating capital improvement funding needs. To prevent any inconsistencies the report should be generated and distributed at an established date.

The State Building Board will now submit to the LFA, GOMB and others the Master Building List used to calculate the state's capital improvement needs. This will be the list we receive from the Risk Connect database. We will work with the LFA, and GOMB to establish a cutoff date for this list to be generated and use this master list throughout the request year.

Chapter III, Recommendation 3 - We recommend the State Building Board create a policy that:

- a. *Requires a set interval review of all Higher Education buildings, including inspecting the condition, maintenance, and utilization of each building and to account for the apportionment of educational and auxiliary building functions.*
- b. *Establishes guidelines on how capital improvements funds can be used on partial-auxiliary buildings.*

The State building Board will address through policy and require:

- a.) set intervals of reviewing and auditing Higher Education buildings and list as it relates to apportionment of educational and auxiliary building functions. There is already a statute in place 63A-5-204 (3) requiring the inspecting of condition of state facilities in both

preventive maintenance functions and compliance to maintenance standards adopted by the State building Board. This will continue to be observed and adhered to.

- b.) The State building Board, in conjunction with Higher Education, will establish guidelines on how capital improvement funds can be used and appropriated on partial-auxiliary buildings.

Chapter III, Recommendation 5 - *We recommend the Board of Regents and the State Building Board require all entities under their jurisdiction to comply with the updated or adopted auxiliary policy. The Board of Regents and State Building Board should ensure their policies and standards are kept up to date.*

The State Building Board will work closely with the Board of Regents to assure compliance to the new rules and policies concerning auxiliary buildings. We will also work with the Board of Regents in updating auxiliary policies and standards, and setting a practical interval for reviewing these policies.

Thank you for allowing the State Building Board the opportunity to respond to this audit. If you have any additional questions, please do not hesitate to contact us.

Sincerely,

Ned Carnahan, Chair
Utah State Building Board

Jeff Reddoor, Director
Utah State Building Board

JLR: cn

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State of Utah

GARY R. HERBERT
Governor

SPENCER J. COX
Lieutenant Governor

Department of Administrative Services

KIMBERLY K. HOOD
Executive Director

KENNETH A. HANSEN
Deputy Executive Director

John M. Schaff, CIA
Auditor General
Office of the Legislative Auditor General
Salt Lake City, UT 84114

Dear Mr. Schaff,

The Department of Administrative Services (DAS) appreciates the opportunity to review and comment on A Follow-up Audit of Higher Education's Management Practices for Operation and Maintenance Funding. We believe that operation and maintenance is a critical component for extending the life of state facilities. We appreciate the Legislature's ongoing commitment to capital facilities in both state agencies and higher education. We believe the audit addresses important issues and recognize the objective manner in which the audit was performed.

As the majority of the recommendations in the audit are directed at the Board of Regents and the State Building Board, DAS will allow those entities to respond to those recommendations. DAS concurs with the recommendations in the audit and specifically responds to the two recommendations involving DAS as follows:

Chapter III, Recommendation 1 – We recommend that all state agencies use one database to store, update, and manage the state's inventory of buildings.

DAS agrees with this recommendation. The Division of Risk Management manages a database containing the insured buildings for the State. The Division is working with institutions, DFCM, and others to make sure this data is updated regularly and is consistent so that it may become the one source of information on buildings recommended by the auditor.

Chapter III, Recommendation 4 – We recommend that the state entities administering the state's inventory of buildings accept the classifications (as educational, auxiliary, or part-auxiliary) provided by the institutions; then the building board should audit the classifications on a set interval.

DAS agrees with this recommendation. The Division of Risk Management updated their database last year to be able to include information on auxiliary space and will work with the interested parties in collecting and maintaining that information. Thank you for the report and the professionalism of your staff.

Best Regards,
Kim Hood
Executive Director
Department of Administrative Services