REPORT TO THE

UTAH LEGISLATURE

Report No. 2000-04

A Follow-up Review
of the
Division of Facilities Construction
and Management

September 2000

Audit Performed by:

Audit Manager	Rick Coleman
Audit Supervisor	Leslie Marks
Audit Staff	John Darrow
	Wayne Kidd
	Ivan Djambov

Table of Contents

Digest of
A Follow-up Review of the Division of Facilities Construction and Management

This report follows up on issues raised in a 1992 audit report on DFCM and adds discussion on facility maintenance.

This report indicates that while the Division of Facilities Construction and Management (DFCM) is taking steps to improve facility maintenance, Utah needs to address issues to further improve the maintenance of public facilities. We also found that DFCM can improve its management of construction contingency funds and increase accountability within project budgets. In addition, improvements are possible in services to agencies leasing space.

Our audit was requested by the Audit Subcommittee of the Legislative Management Committee, primarily to review issues presented in a 1992 report released by this office. (See **A Performance Audit of the Division of Facilities Construction and Management**, #92-07, for further information.)

The main chapters in the report present the following information:

Chapter II presents several options to consider for funding facility maintenance in the state.

Legislature Should Consider Options to Improve Facility Maintenance: Utah is facing the likelihood of significant investment being needed in the area of facility maintenance. DFCM recently estimated the cost for projects needed immediately or within five years to be $670 million. Several states have developed significant initiatives to address their facility needs; some of these approaches may be useful in Utah. This chapter addresses the following points:

- Aging state assets and recently identified needs indicate that facility maintenance needs to improve

- The Legislature has options for addressing unmet maintenance needs in state facilities, one of which is increasing the percent of current replacement value in the formula used to calculate funding for capital improvement projects

- The Legislature should consider increasing the accountability of facility maintenance to ensure that funds intended for maintenance are spent effectively

- The Legislature may want to expand or restructure the rent charged to state agencies in order to provide more funding for facility maintenance

These options can be considered separately or in combination; we identified options for solutions that are long range or systemic rather than temporary.

Chapter II Recommendations

1. We recommend that the Legislature review the options available to improve facility maintenance in the state, to include the following issues:
   a. consider increasing the percent of replacement value currently allocated to capital improvement projects
   b. consider separating facility cost categories from program cost categories in the state's budget and accounting systems
   c. consider convening a task force to study or direct the Building Board to submit a proposal on the viability of a rent structure for agencies that includes all components of operations and maintenance costs as well as a component for future replacement costs.

2. We recommend that the Building Board develop a policy on whether and how much capital improvement funds may be used for program-oriented projects.

3. We recommend that DFCM monitor the use of facility audit and condition assessment results in agencies' capital improvement requests, reporting to the Building Board and the Legislature on the incorporation of this data in the request process.

4. We recommend that the Building Board develop a policy that provides for the revocation of agency maintenance delegation agreements in the event an agency fails to meet established maintenance standards.

Chapter III shows that management of the contingency fund needs better controls and that policies should be developed for project budget transfers.

Management of Contingency Fund Can Improve: In following up on the 1992 audit, we re-examined the construction contingency reserve fund and found that the management of the fund can be improved in the following areas:

- Better controls over transfers within project budgets are needed; the Building Board should adopt budgeting policies to provide guidance on acceptable practices

- Better controls over change orders are needed; change order policies need to be clarified and updated

- If additional controls are deemed necessary, a project-specific contingency fund or review by the Building Board prior to exceeding project contribution to contingency can be considered to limit draws from the contingency fund

Control issues should be dealt with to ensure that funds are spent as approved through the appropriation process. Current policies and practices do not always minimize discretionary spending of funds in construction projects or provide adequate accountability.

Chapter III Recommendations

1. We recommend that the Building Board adopt policy language that clarifies acceptable project budget transfers.

2. We recommend that project close-out reports to the Legislature provide full cost information, including all agency-paid costs.

3. We recommend that DFCM limit the use of contingency reserve funds to unforeseen expenses. Additionally, we recommend that expenses that can be planned for should be budgeted in the project.

4. We recommend that the Building Board update and clarify the policy on payment and classification of change orders so that clear direction is provided to program directors as well as agencies and contractors.

5. We recommend that the Legislature consider whether additional controls over contingency fund expenses are needed; if so, we

recommend they consider implementing a project-specific contingency reserve fund or requiring Building Board approval for contingency fund draws exceeding project contribution level.

Chapter IV recommends that leasing can benefit from the use of negotiation when arranging leases.

Leasing Services Can Improve: A review of lease procurement time frames, state lease rates, and lease management indicates that improvements can be made in the following areas:

- The procurement process should be modified to include a market search option for some leases in addition to the existing Request For Proposal (RFP) process; the added option should provide faster service and more favorable lease rates
- Agencies needing space should be more involved in locating a site, which could reduce DFCM workload and increase agency satisfaction
- The leasing unit needs formal policies and procedures to standardize leasing activities and promote more efficient and effective service

This area followed up on issues raised in the prior report on leasing services provided by DFCM.

Chapter IV Recommendations

1. We recommend that the Legislature amend the **Utah Code** to clarify that DFCM can use a market search option in addition to the RFP process in the procurement of leases.

2. We recommend that DFCM should involve state agencies when locating space to lease.

3. We recommend that DFCM management should review staffing needs in the leasing unit.

4. We recommend that DFCM develop formal policies and procedures for leasing activities.

5. We recommend that the Real Estate Section comply with **Utah Code** 63A-5-302(c) et seq. by performing the various responsibilities listed therein and that DFCM develop performance measures for leasing based on those responsibilities.

Chapter I
Introduction

At the request of the Audit Subcommittee of the Legislative Management Committee, this audit of the Division of Facilities Construction and Management (DFCM) was conducted primarily to review issues presented in a 1992 report released by this office. (See **A Performance Audit of the Division of Facilities Construction and Management**, #92-07, for further information.) In addition, we conducted research on other states' efforts to address maintenance backlog or deferred maintenance issues, comparing them to steps taken in Utah.

Facility maintenance in Utah can improve. We present some options in Chapter II for the Legislature to consider.

In the maintenance area, we found that while DFCM is making progress, Utah can improve maintenance of public facilities. Facility assessments being conducted for DFCM show significant levels of unmet maintenance needs in state facilities. We found other states that have taken some initiatives to identify and/or fund maintenance projects to address the deterioration of their public facilities. The Legislature needs to consider whether the steps taken elsewhere might aid Utah to better maintain its facilities.

We believe that the construction contingency fund needs more controls; leasing services can also improve.

This report also follows up on two of the issues raised in the prior report: construction contingency funds and lease management. We found that DFCM can improve its management of construction contingency funds and increase the accountability of public funds spent on construction. In addition, improvements in service to state agencies are possible in the leasing services provided by DFCM.

DFCM Provides Facilities Services to the State

DFCM's mission is to assure that the citizens of Utah receive full value in the design, construction, and management of state facilities. The division, as part of the Department of Administrative Services, serves as staff to the State Building Board, which is charged with responsibility to plan, direct, and report on the state's building program, make rules to perform its duties, and recommend any needed changes in the law to ensure an effective state building program.

DFCM Has Multiple Responsibilities to Fulfill

DFCM performs both a service role and a control role for state agencies. The division is responsible to help agencies get needed facilities built, remodeled, and maintained, but it is also responsible for ensuring that building codes, space standards, and Building Board maintenance standards are met. DFCM staff present agencies' facility needs to the Building Board, the governor, and the Legislature, but they must also evaluate and prioritize those needs and inevitably choose among them. These dual roles mean the division is sometimes viewed as an ally and sometimes as an adversary by other state agencies.

DFCM has multiple responsibilities in building, improving, maintaining, leasing, and managing state facilities.

DFCM manages and coordinates new capital development, improvements to capital facilities, leasing activities and debt service management for capital bonds, and a variety of facilities management activities. There are about 31 million square feet in state-owned facilities (excluding auxiliary space), and according to law, the division holds title to all real property and buildings owned by the state (with specific exceptions). Thus, the division has responsibility to direct or delegate maintenance management of facilities for all state agencies except higher education and the Capitol Preservation Board. Agencies doing their own facilities management must still report compliance with Building Board maintenance standards to DFCM annually.

Important definitions provided in the **Utah Code** (63A-5-104) include capital development projects which are remodeling, site or utility projects with a cost over $1 million; a new facility with a construction cost over $250,000; or a purchase of real property where an appropriation is requested. Capital improvement projects mean any remodeling, alteration, replacement or repair project costing less than $1 million; a site or utility improvement costing less than $1 million; or a new facility with a construction cost of less than $250,000. In addition to costs, state facilities use agency appropriations for operations and maintenance. Some agencies, notably Higher Education, receive various outside sources of funding that may be used for facilities.

To carry out the above listed responsibilities, the division is organized into two major programs:

- the administrative program, which includes the management of the construction of facilities and any real property transactions for most state agencies, and
- the facilities management program, which includes facilities management, preventive maintenance, paving, roofing, computer-assisted design (CAD) services, and hazardous materials sections.

DFCM operates on both appropriated and internal service funding, and handles over $130 million in construction funds.

DFCM employs 166.5 full-time equivalent (FTE) employees: 39 full-time employees on the administrative side and 127.5 in facilities management. The administrative budget totaled $3.0 million in fiscal year 2000; the appropriated facilities management budget was $2.5 million. The majority of the facilities management budget is provided by an internal service fund (ISF), recovering its costs by charging agencies for its services to manage 140 buildings. The fiscal year 2000 ISF income was $17.2 million. The capital construction budget handled by DFCM totaled over $131 million in fiscal year 2000.

DFCM Has Reorganized Since the Last Audit

DFCM has undergone a reorganization since the 1992 audit report was released. The present division director restructured the division in May 1998. Most changes occurred on the administrative side and focused on the area handling new construction. Fifteen project manager positions were replaced with seven program directors; their responsibilities and decision-making authority were reassessed and increased.

DFCM's 7 program directors handle the work previously done by 15 staff.

Among the changes emphasized by the division director is that the current program directors include staff with a variety of backgrounds in addition to architect experience. More responsibility for projects now resides with staff; for example, the program directors have authority to approve project change orders without getting management approval. The director also pointed out that the 7 program directors handle the work load formerly handled by 15 project managers.

The director created a capital budget manager position in the division to coordinate agencies' requests for projects and provide liaison services between DFCM and agencies. Other changes include the elimination of all but one staff building inspector; inspections are now contracted out as needed. During the time of the reorganization, the division's base budget was reduced by about $300,000.

A process change that the division director considers to be integral to the reorganization is the introduction of a different procurement process, known as PBPS, or Performance-Based Procurement System. In 1999, DFCM began to use PBPS to choose contractors for some capital development and capital improvement projects. Low bid procurement provides that the qualified bidder submitting the lowest monetary bid wins the contract, while PBPS is designed to emphasize the quality of performance of the contractors and subcontractors, with price still being a factor under consideration. DFCM hopes to improve the construction process as well as the quality of facilities through the use of PBPS as one of the procurement processes it uses.

Facilities Maintenance Is Currently of Local and National Interest

Facility maintenance issues are being raised and addressed across the nation.

We found that insufficient maintenance of public assets is a widespread concern. Information from other states and some institutions as well as the federal government and associated research entities indicates that public assets are not being maintained adequately. For example, a study by the National Research Council states that numerous studies of federal facilities "indicate that the physical condition of this portfolio of public assets is deteriorating. Many necessary repairs were not made when they would have been most cost effective and have become part of a backlog of deferred maintenance." In some states, task forces have reviewed the condition of state facilities and recommended that significant, sometimes drastic, action is needed to remedy the problem of unmet maintenance needs.

This Report Provides Follow-up And New Information

Chapter II provides a discussion of ways to improve facility maintenance in Utah.

While some of the issues presented in the report are revisiting prior issues from the 1992 report, other issues were not raised in that report. For example, Chapter II of this report indicates that similar concerns are being expressed in Utah by the Building Board, the Legislative Capital Facilities Appropriations Subcommittee, and DFCM. DFCM has taken steps that will be described along with actions taken by other states that may be helpful here in Utah. Although maintenance issues were not included in the 1992 report on DFCM, they have been included in this report because of the level of interest and concern expressed recently in Utah.

Contingency Fund and Leasing Management Issues Have Been Revisited

Chapter III reports on the contingency fund, and Chapter IV discusses leasing activities.

Two areas from the 1992 report were revisited in the current review. We believe improvements are possible in the management of the construction contingency fund and the leasing services provided by DFCM's real estate program.

As a result of a recommendation from the 1992 report, the contingency fund was split into a statewide contingency fund and a project reserve fund. The first serves as a contingency fund for construction projects funded with state appropriations, providing funds for unforeseen expenses that arise. The second fund collects any savings from bids that came in under budget and any residual funds remaining at the end of a project, using these funds, if needed, for bids that come in over the projection. Further discussion on the contingency reserve fund can be found in Chapter III.

Chapter IV presents information following up on the leasing services provided by DFCM to state agencies. By modifying the current requirement that all leases must be bid competitively, savings are possible through negotiations on some leases.

Some Prior Audit Areas Are Not Included

Our initial survey work showed that the areas listed above were areas where we could have some positive impact. Several areas in the 1992 audit were not reviewed in depth this time due to the chosen focus and time frame for completing our work. These previously audited areas are listed below, however, with a brief summary of their present condition.

- **Space Justification Will Improve Planning:** DFCM developed space standards for state buildings in response to the recommendation of the 1992 report. The standards are provided to architects developing building plans and are also used by the leasing staff when ascertaining the needs of an agency seeking to lease space.

- **Potential Bias Should Be Avoided in Selecting Consultants:** The 1992 audit found some instances of possible bias on the part of selection committee members. DFCM has taken several steps in response to this concern. For instance, proposals are reviewed and finalists interviewed by different committees. In addition, DFCM recently introduced a Performance-Based Procurement System (PBPS). The division feels PBPS is a more objective method to select contractors. The PBPS is in early stages of use, so we did not attempt to evaluate its effectiveness.

- **Delays Need to Be Monitored and Controlled:** This area of the 1992 report found that DFCM needed an information system to monitor construction delays and identify their causes. The current information system (Prostat) includes contract dates and change order time extensions to contracts, but monitoring of delays in construction occurs primarily through staff's regular project management activities. DFCM is in the process of implementing a new computer management system for all division activities and should investigate how to use the abilities of that system to monitor and improve timely completion of construction projects.

Audit Scope and Objectives

This audit was requested by the Audit Subcommittee of the Legislative Management Committee as a follow-up study to a prior report on DFCM. In identifying areas to include in the follow-up, we reviewed the past audit report, interviewed DFCM staff and staff at agencies served by DFCM, and reviewed national and scholastic literature on construction, maintenance, and leasing. We contacted other states and professionals in facilities management, reviewed DFCM accounting and management reports and documents, observed Building Board meetings and Legislative Capital Facilities Appropriations subcommittee meetings, and reviewed appropriate meeting minutes and documents.

Our objectives in this audit were specifically to do the following:

- conduct research on maintenance practices and approaches to funding maintenance backlogs or deferred maintenance elsewhere and compare those identified steps to actions taken by DFCM and the Building Board

- review the management of the contingency fund and reserve fund to determine if these funds are managed according to legislated mandates and policy direction
- review the real estate (leasing) program within DFCM to determine if the leasing services are efficiently providing cost-effective space to state agencies

This Page Left Blank Intentionally

Chapter II
Legislature Should Consider Options to Improve Facility Maintenance

Since unmet maintenance needs in the next 5 years may cost $670 million, the Legislature should consider some financing options.

Utah is facing the likelihood of significant investment being needed in the area of facility maintenance. The Division of Facilities Construction and Management (DFCM) is currently taking steps to determine the level of unmet maintenance needs in state facilities; a recent estimate of the cost for projects needed immediately or within five years is $670 million. Once the level of need is more precisely identified, the next step is to consider how to address that need. We found several states that have developed significant initiatives to address their facility needs. Some of these approaches may be useful in Utah. This chapter addresses the following points:

- Aging state assets and recently identified needs indicate that facility maintenance needs to improve

- The Legislature has options for addressing unmet maintenance needs in state facilities, one of which is increasing the percent of current replacement value in the formula used to calculate funding for capital improvement projects

- The Legislature should consider increasing the accountability of facility maintenance to ensure that funds intended for maintenance are spent effectively

- The Legislature may want to expand or restructure the rent charged to state agencies in order to provide more funding for facility maintenance

These options can be considered separately or in some combination. Our scope did not include a full review of facility management issues; rather, our intent was to seek information on some issues facing Utah, primarily in facility maintenance, then present some approaches being used in other states, along with steps Utah has taken to address these issues. We identified options that address maintenance needs with solutions that are long range or systemic rather than temporary.

Facility Issues Are Being Raised Nationally as Well as Locally

In addition to planning for growth, there appears to be an increasing awareness of the need to better maintain existing public facilities, not only in Utah but elsewhere as well. For example, we found several audit and research reports at the national level that focused on better stewardship of federal facilities. In addition, numerous states are involved in policy discussions and legislative action addressing similar facility issues to those being raised in Utah.

Some states are taking steps to address maintenance needs; they provided ideas to consider.

Many states have not yet taken steps to determine the level of unmet facility needs existing in their states, though some are now moving in that direction. We contacted the following states and entities who were referred to us as leaders in their approaches to a variety of maintenance issues: Alaska, Florida, Minnesota, Nebraska, South Carolina, and Brigham Young University. In addition, we reviewed reports and literature from the National Research Council, the General Accounting Office (GAO), and the National Association of College and University Business Officers (NACUBO).

Facility Maintenance Is Funded in Several Ways

Funding for maintenance in Utah comes from a variety of sources, including appropriations for capital improvement or capital development projects. The **Utah Code** 63A-5-104 defines capital improvement as follows: “any remodeling, alteration, replacement or repair project with a total cost of less than $1,000,000; site and utility improvement with a total cost of less than $1,000,000; or new facility with a total construction cost of less than $250,000.” A capital development project is defined as follows: “any remodeling, site, or utility project with a total cost of $1,000,000 or more; new facility with a construction cost of $250,000 or more; or purchase of real property where an appropriation is requested to fund the purchase.”

Regular maintenance expenses are included within agencies’ operating budgets although they are not clearly identified specifically as facility expenses. Some agencies, Higher Education, for example, may receive funds for maintenance in a donation of funding for a facility. DFCM operates its facility management program as an internal service fund, charging a per square foot fee to agencies in facilities DFCM manages.

Facility Maintenance in Utah Can Be Improved

Utah faces some challenges in facility maintenance.

Before presenting some options for consideration by the Legislature, the Building Board, and DFCM, it is important to understand the nature of the challenge Utah faces in adequately maintaining its facilities. The state has undergone a lot of growth in the last 30 years and is still growing. Not only have many facilities been added to the state's inventory, but more will be added in future as growth continues. There is also increased demand for state-provided services resulting from the growth.

Utah has over $4 billion in facilities; 39% of these are over 25 years old.

According to DFCM staff, most of the state's facilities have been built since 1960 to meet growth in the state. Many facilities are now reaching the point of needing significant renewal or replacement of major components. Thirty-nine percent of state buildings are more than 25 years old. How to maintain and improve the existing facilities, which have a replacement value of over $4 billion, while also planning for the demands of the continued growth expected in Utah, is now the question.

Figure 1. Utah Has a Large Proportion of Aging Buildings. Since major building systems are typically considered to have a 20 to 25-year life, many of these facilities are approaching the time for significant capital repairs and replacements.

Building systems are reaching the end of useful life; repair and replacement issues will arise.

Building Age	Square Feet	Percent of Total
1 to 25 years	23,524,000	61%
25 to 50 years	11,191,000	29
50+ years	3,971,000	10
Total	**38,686,000**	**100%**

Utah has about 38.7 million square feet of facilities, not counting developed land such as park acreage and trails. About two-thirds of the total square footage is in Higher Education facilities. With 39 percent of state buildings over 25 years old, DFCM and agency facility managers are facing the need to renovate and/or replace major components in these facilities, such as HVAC (heating, ventilation, and air conditioning), mechanical and electrical systems.

Awareness of the need to preserve and maintain existing facilities is growing in many states; the increased interest is due in part to the belief that continuing to put off needed maintenance will result in higher costs in the future. Numerous approaches to identifying and then meeting maintenance needs have been developed. In Utah, the Building Board and Legislature have already taken a number of steps in response to facility maintenance concerns.

Assessments Show Significant Level of Facility Needs

DFCM estimates that Utah faces $670 million in maintenance needs within five years.

DFCM is contracting for formal condition assessments of state facilities. The reports list needed projects and estimate the cost of the projects for various facility components. Based on extrapolation from the unmet maintenance needs identified in the assessments completed as of late May 2000, DFCM estimates that the state will need about $670 million to address immediate to five-year needs (exclusive of the State Capitol) for all facilities.

The condition assessments are being conducted by architectural and engineering firms to provide on-site determinations of the current condition of a variety of systems and components. These include the following categories of assessments:

- architectural
- structural
- mechanical
- electrical
- hazardous materials
- infrastructure

The $670 million includes immediate and 2 to 5 year needs categorized as critical or potentially critical.

Reports provide information on the estimated costs of projects in each listed category by immediacy of need: immediate (currently critical), one year (potentially critical), two to five years (necessary, not yet critical), and six to ten years (recommended). These categories have recently been revised from the immediate, five year, and ten year needs (used in the figure below) used in assessments until early 2000. The assessments are required by law and intended to be performed on a repeating cycle.

Figure 2. Condition Assessments Stratify Facility Needs and Have Been Used to Predict Total Need. The needs by category identified as of May 2000 (without the cost for the State Capitol project) and the estimated cost to take care of the needs for the total square feet in state facilities. The immediate and five-year needs total over $670 million.

Category of Need	Expected Cost Determined by Assessments (in millions)	Projected Cost Total (in millions)
Immediate	$ 72.3	$ 425.3
Five Years	41.7	245.3
Ten Years	56.8	334.1
Desirable	1.9	11.2
Total	**$172.7**	**$1.02 billion**

The State Capitol project would add an estimated $180,000,000 to the immediate need category.

The expected cost column provides the estimated cost of projects for the facilities reviewed through May 2000, while the projected total cost column applies the cost identified to date to the rest of the state's facilities. To date, the condition assessments have reviewed over 5 million square feet (about 17 percent) of the total square footage in state facilities. Most of higher education's facilities have not been assessed by DFCM contractors; contracts have recently been signed for those reviews.

We did not verify the data provided in the condition assessments. However, taken together with other information presented below, it appears that the condition assessment results are indicative of significant need in Utah's facilities.

Other Information Also Shows Need To Improve Maintenance

The Legislative Fiscal Analyst issued a mid-1999 report estimating $350 million in maintenance backlog.

Some additional sources of information on the State of Utah public facilities reflect concern about unmet maintenance needs. For example, the following items emphasize different aspects of the need to improve facility maintenance:

- The Legislative Fiscal Analyst issued a report on "Deferred Maintenance in State Owned Buildings" in mid-1999 that conservatively estimated $350 million in maintenance backlog and recommended a number of actions to the Legislature to address maintenance issues.

- DFCM facility maintenance audit results show that the majority of facilities audited to date do not meet Building Board maintenance standards.

- The Building Board established policy during the May 2000 meeting that made capital improvement projects its top priority, sending a message of their commitment to address maintenance needs in the state ahead of even new growth issues.

Building Board and Capital Facilities Appropriation Subcommittee members have repeatedly stressed the need for facilities funding.

- The chair of the Legislative Capital Facilities and Administrative Services Appropriations Subcommittee has repeatedly stated his concern with the amount of deferred maintenance in state facilities.

The amount of unmet maintenance needs determined to date from the condition assessments as well as the projected total represents a significant investment in facility upkeep. Since much of our research indicated that other states and the federal government are in similar situations, we looked for approaches being used elsewhere to address these needs once they have been identified. The rest of this chapter presents several concepts for Utah policymakers to consider, either singly or in combination, to improve facility maintenance in state facilities.

Legislature Should Consider Increasing Funding for Capital Improvements

The Legislature could increase funding for capital improvements beyond the current 0.9% of asset replacement value.

The Legislature should consider increasing the funding currently provided for capital improvement projects. The Legislature could increase the funding to the level recommended in national research and literature (2 to 4 percent of the replacement value of a state's assets), thereby providing a larger stream of funding to address currently unmet needs.

Capital improvement projects are projects requested for funding beyond regular ongoing facilities maintenance. Several sources state that a set percentage of capital asset replacement value should be spent annually on facilities maintenance. While Utah's Legislature has taken the significant step of mandating 0.9 percent of the state's current replacement value be spent on capital improvement projects, the Legislature needs to consider whether the amount so designated should be increased in response to the amount of need identified through the ongoing condition assessments.

Legislature Has Funded Capital Improvements

FY01's allocation for capital improvements was $36.7 million.

In recognition of the growing need for capital improvements in state facilities, the Legislature mandated two years ago that 0.9 percent of the current replacement value of state facilities must be allocated to capital improvement projects before funds are appropriated to capital development. The allocation for capital improvement projects totaled $36.7 million for fiscal year 2001 to be used for projects with total costs less than $1 million.

As previously defined, capital improvement means any remodeling, alteration, or repair project with a total cost of less than $1,000,000, or a site and utility improvement with a total cost of less than $1,000,000.

A proposal to increase the mandated funding was defeated in the 2000 Legislative Session.

A proposed amendment to the **Utah Code** would have increased the percentage from 0.9 to 1.1 percent. This amendment was unsuccessful in the 2000 Legislative Session, but it would have provided an additional $8.2 million for capital improvement projects for fiscal year 2001 beyond the $36.7 million allocated.

Sources Say Spend 2-4% Of Asset Value Annually

The NRC recommends spending 2 to 4% of replacement value annually for repairs and maintenance.

The National Research Council published a study on the management of federal facilities that recommended that while "there is no single, agreed-upon guideline to determine how much money is adequate to maintain public buildings effectively...an appropriate budget allocation for routine maintenance and repair for a substantial inventory of facilities will typically be in the range of 2 to 4 percent of the aggregate current replacement value of those facilities." Included in the funds provided by this allocation are the following costs:

- annual maintenance and repairs of structures and utility systems
- roofing, chiller/boiler replacement, electrical/lighting, etc.
- preventive maintenance
- preservation/cyclical maintenance
- deferred maintenance backlog
- service calls

APPA recommends 2.5% of replacement value as an allowance for annual depreciation.

Though the study indicated that there is not complete agreement on the percentage to be dedicated to such costs, we found other studies that came to similar conclusions. For example, in an article on Arkansas' Department of Higher Education in the journal **Facilities Manager**, the Association of Physical Plant Administrators (APPA) recommended an allowance of 2.5 percent of replacement value for the cost of annual life cycle deterioration of facilities. Arkansas was proposing that 1.5 percent of facilities replacement value be devoted to facilities needs, with additional funds provided for university research facilities and for deferred maintenance costs.

Arkansas and South Carolina recommend a percentage of replacement value along with other funds for maintenance.

In addition, in a study of South Carolina's facilities, the consultant calculated that approximately 1.1 percent of total replacement value should be spent annually to maintain facilities *after* all deferred maintenance problems were taken care of. South Carolina's deferred maintenance backlog is estimated at $426 million.

These studies do not necessarily identify the percentage needed for precisely the same maintenance activities. In Utah, regular maintenance activities are not funded in the 0.9 percent allocation but are included within agencies' operating budgets. As will be discussed, the lack of separate accounting codes and budget lines for facility maintenance expenses obscures how much Utah agencies spend on maintenance. Providing greater accountability may put total maintenance spending within the recommended ranges. If not, the Legislature should consider whether an increase in the allocation for capital improvement projects is needed to address capital needs.

BYU's CNA program provides a steady annual stream of funds for maintenance that is non-lapsing.

BYU Uses Non-lapsing Funds to Provide a Funding Stream for Maintenance Activities. BYU provides an illustration of a different method to provide funding for facility maintenance. A national study on facility maintenance approaches cited Brigham Young University as a leader in an approach that uses non-lapsing funding as a way to plan for years in which greater expenditures occur because of life cycle needs. This institution provides that unspent funds in one year can be kept for future costs expected because of the wear and tear (life cycle costs) associated with facilities.

BYU uses a program called Capital Needs Assessment (CNA) which provides a steady stream of funding for capital needs. Based on actual condition assessments, facility management staff have identified the costs and analyzed the life cycle needs of their facilities and determined when they expect costs to be incurred for ongoing and preventive maintenance as well as replacement. A set amount is then designated for facilities each year. Facilities management staff have the ability to retain unspent funds in low needs years for the years when higher costs are incurred. Over a cycle of years, the funding is adequate to meet the school's facility maintenance needs.

Beyond the consideration of increasing the allocation to capital improvement projects, attention should be given to the process of allotting funds among requested projects. The prioritization of projects submitted for funding from the 0.9 percent allocation has recently changed, as will be discussed in the next section.

Prioritizing Requests for Funding Is Beginning to Focus on Facility Needs

Data from condition-based assessments should be the main determinant of project prioritization.

Though most capital improvement funds are used for facility needs, program issues frequently compete with facility needs in the capital improvement project process. We believe that data from the condition assessments and other condition-based input should be the primary determinant of project prioritization. DFCM should continue to make objective maintenance needs data a critical factor in the capital improvement prioritization process. Policy direction may be needed from the Building Board or the Legislature as to whether program issues should be considered in this process.

DFCM staff are responsible for collecting and prioritizing agencies' capital improvement project requests for review by the Building Board. In a recent change to the request process, DFCM asked agencies to include condition assessment and facility audit results when developing their requests. DFCM receives other input on needed capital improvement projects, including the observations of program directors who manage capital projects for agencies and recommendations from DFCM's roofing, paving, and asbestos abatement staff as well as from agencies' facility coordinators.

Agencies submitted requests for almost three times as much funding as was available for FY01.

Once improvement project requests have been received, DFCM staff review the requests, visit most of the proposed sites, and develop a list of recommended projects for review and approval by the Building Board. For fiscal year 2001 funds, agencies submitted about 550 projects for consideration, of which over 200 were recommended to the Board for partial to full funding approval. While nearly $100 million in projects were requested, about $36.7 million was available through the capital improvement allocation.

DFCM is often asked to assess the merits of a project based on a program need.

Programmatic Needs Provide a Challenge to the Prioritization Process. Because of the large number and dollar amount of projects requested and the limited amount of funds available, it appears important to emphasize the facility maintenance needs submitted. However, DFCM sometimes faces the challenge of assessing the merits of an improvement project that is based on program need. At present, DFCM staff are put in a position of deciding among projects needed to maintain or improve the actual facility versus projects that are needed because of a change in program delivery.

Program delivery issues should not take precedence over facility needs in choosing projects.

While a remodeling project may be needed to better serve the agency's clients, the question arises how DFCM staff should make decisions on the best use of limited capital improvement funds when program needs compete with facility needs. DFCM staff raised this issue when discussing the project prioritization process. They are concerned that they do not have the expertise needed to make determinations about the level of need for programmatically-based project requests.

An illustration of a programmatic request that involves construction or remodeling is the conversion of a dormitory at the Utah State Developmental Center into apartment-like units. This request is based on a change in the approach to housing patients, which is a programmatic or service delivery need.

The Building Board should consider enacting a policy that limits the use of capital improvement funds for programmatic requests.

We feel that DFCM staff are in the best position when basing their recommendations on prioritization of projects on need as established by the condition assessments, facility audits, and other input from professional facility management staff. To this end, the Building Board should consider enacting a policy that limits the use of capital improvement funds to facility needs and maintenance projects.

Use of Assessment Data in the Project Request Process Should Continue. In an effort to increase the use of facility needs data in improvement project requests, DFCM asked agencies last year whether a condition assessment or a facility audit had been done and, if so, how the results of those reviews were incorporated into their project request list. As more facilities undergo assessments and audits, DFCM should continue to ask agencies to develop and prioritize their project requests based on data generated by these reviews.

DFCM staff feel that the majority of projects requested last year were need-based, an improvement over the past. To test this assumption, we compared a sample of capital improvement requests to the condition assessment reports for the facilities and found that there was good correlation between agency requests and assessment data. About 82 percent of the requested projects were listed as immediate needs in the assessment reports for facilities in the sample. Agencies are starting to use the assessment data in the capital improvement request process.

DFCM should continue to encourage agencies to use assessment data to develop their project requests.

DFCM should continue to encourage agencies to use the assessment reports. In addition, DFCM should track the use of the assessment data by agencies in project requests and report on the level of use to the Building Board and the Legislature to ensure compliance with the policy recommended in the discussion above.

Facility Maintenance Needs More Accountability

The Legislature should consider separating facility cost areas and expenses from program costs.

The Legislature could increase accountability by mandating the separation of facility budgets and expenditures from agencies' programmatic budgets. Some accountability is presently provided through DFCM's facility audits, but separating facility costs from program costs should greatly increase the level of accountability for these funds.

- Separating facility costs from program costs would provide the ability to track maintenance costs, thus making it harder to divert funds intended for maintenance into programs

- DFCM's facility audit program checks for adherence to Building Board maintenance standards, thereby assessing how well facilities are maintained

We found that some states are taking steps to create distinct budgeting and expenditure categories for facilities maintenance. The facility audit program allows for the possibility of revoking maintenance delegation agreements with agencies that do not maintain state facilities adequately. DFCM's audit results, to date, show a need for improvement in the majority of facilities audited.

Separate Budgeting Would Improve Maintenance Accountability

Utah lacks separate budget and expense categories for facility costs.

Among the challenges facing DFCM, the Building Board, and the Legislature in dealing with the state's maintenance needs is the lack of accountability for facility operations and maintenance funds. This problem is by no means unique to Utah; most of the states and the federal government are also struggling with the lack of separately identified budgeting and expenditure categories for facility costs.

It was next to impossible to determine just how much is spent on facility operations and maintenance.

We could not determine how much is spent in Utah on facility operations and maintenance. The state's budget and accounting system does not separate facility maintenance categories from the agency's program budgets. For example, salary costs for maintenance personnel are combined with administrative, program, and support staff salaries. Equipment for maintenance activities is grouped with office equipment.

The Legislative Fiscal Analyst relies on estimates for much of the spending on facilities because of this lack of separate budget categories. Recently, the Governor's Office of Planning and Budget sent out a survey to agencies in an effort to determine how much is spent on facilities maintenance. Staff in several agencies indicated they provided their best estimates to answer the survey but did not have hard data available because of the combined budget categories.

The current budgeting method greatly reduces accountability for facilities maintenance expenses. It also raises the question of how managers determine how much funding should go to programs versus how much is needed to properly maintain facilities. One large agency's facilities coordinator commented to us that the attitude is that any funding he requests for maintenance takes money away from program provision.

The NRC recommends clear budgeting and cost accounting to increase accountability for facilities costs.

National Study Recommends Clear Budget Structure. In a study on the stewardship of federal facilities, the National Research Council (NRC) stated that the federal government practices are not structured to provide for effective accountability for the stewardship of facilities and that budgetary pressures on agency managers encourage them to divert potential maintenance and repair funds to support current operations. The report indicated that it is difficult, if not impossible, to determine how much money is appropriated and spent for maintenance and repair of facilities because budget and expenditure tracking mechanisms vary so much.

The NRC made a recommendation on clear budgeting in its study, stating that the government should adopt more standardized budgeting and cost accounting techniques to facilitate tracking of maintenance and repair funding and reflect the total costs of facility ownership. Some states have already taken such steps.

Alaska recently passed a law to separate facility costs from operating programs in order to identify the level of spending on facilities. This step was taken in response to a task force report identifying a huge maintenance backlog in Alaska public facilities. Legislative staff there indicated that achieving the separation of accounts was less trouble than agencies feared and has resulted in less diversion of funds to other areas of the budgets.

Staff in Arizona indicated that their maintenance cost areas are separately identified. They stated they wanted to keep costs for ongoing and regular maintenance separate from the funding intended for capital renewal projects.

Facilities may suffer if funds in common budget areas are used for program needs.

Facility Staff Say Maintenance Funding Is a Problem. Facility coordinators in various Utah agencies indicated that a lack of funding contributes to their inability to maintain facilities properly. In our opinion, this feedback from facility staff is a further indication that facilities sometimes suffer when both program and facility needs are budgeted in the same categories.

We called a sample of agency facility coordinators to discuss some of the capital improvement projects they submitted for funding in fiscal year 2001. The majority of the projects (58 percent) were requested because of end of life cycle needs or equipment obsolescence. Other reasons they provided included design or material problems, deferred maintenance, and lack of in-house maintenance personnel to do the work.

Sometimes facility staff turn to the capital improvement process to pay for regular and ongoing maintenance needs.

While over half of the requested projects belong in the capital improvement request process, it appears to us that many of the projects should be taken care of in regular, ongoing, and preventive maintenance activities.

In other words, we would expect that the regular budget should cover these needs. Since these needs have not been covered and agency facility coordinators indicated they have a funding shortage, these requests provide another argument in favor of more clearly separating facility costs within agency budgets to provide greater visibility to these expenditures.

Maintenance Audits Are an Important Accountability Activity

In addition to the testimony of facility coordinators, facility audits occurring under DFCM's direction indicate that the maintenance of Utah state facilities can improve. DFCM staff in the Facilities Management section conduct audits of state-owned facilities to determine whether the facility maintenance programs meet state Building Board standards for maintenance. Of the 260 facilities audited to date, we found that about 26 percent received passing scores. In light of these results so far, we believe the Building Board should develop some policy language related to actions to be taken by DFCM when agencies fail to address substandard maintenance program performance.

Of the 260 facilities audited to date, about 26% received passing scores.

The primary components of a good maintenance management program include the following:

- a computerized maintenance management system that generates work orders,

- an inventory of equipment and performance of condition assessments, and
- record keeping and tracking of work done.

Once work is done, the computer system should have the capability to adjust the maintenance schedules to reflect the next cycle of needed activity. As part of the audits, DFCM is encouraging agencies to implement computerized maintenance management systems. The audits check not only for adequate record keeping and whether a system is in place, but they also check the actual condition of the facility being reviewed.

We asked several agencies' facility coordinators for evidence (maintenance logs) of the maintenance activity being done on facility components and systems. Most were unable to provide such logs; some were in the process of developing the capability, often as a result of having been audited by DFCM.

The facility audits review whether a facility has a maintenance management program in place and whether the facility is adequately maintained. The results, to date, indicate there is a need for improvement in maintenance programs in state-owned facilities. Figure 3 below shows the results of audits and follow-up audits conducted to date.

Figure 3. Facility Audit Scores Show Need for Improvement in Facility Maintenance Programs. The passing score of 90+ was earned by 26% of facilities audited; another 31% are within 10 points of meeting Building Board maintenance standards.

Audit Scores	Number of Audits	Percent of Audits in Range
50-59	1	0.4%
60-69	11	4.2
70-79	100	38.2
80-89	81	30.9
90+	69	26.3
	262	100.0%

Low scores may indicate that agencies don't get the funds they need.

One implication from the low scores is that facility maintenance staff may not get the funds they need to run an adequate program; this is, in fact, a frequent assertion. Increasing the visibility of facility maintenance funding in agency budgets would promote greater accountability for those funds.

Low scores reinforce the need for better maintenance.

DFCM staff indicated that many facilities have only been audited once and that repeat audits are needed before drawing any conclusions on statewide maintenance programs. The standards have been required since 1997 and staff felt that agencies are still working toward compliance. Still, we feel that the prevalence of low scores reinforces the preliminary findings of the contracted condition assessments that there are unmet maintenance needs in state facilities.

Because of the prevalence of low scores, we believe that the Building Board should develop a policy that addresses the eventuality of having to take action in case an agency that performs its own maintenance repeatedly fails to meet the required standards. At present, agencies apply to DFCM for the delegation authority to perform their own maintenance. This application includes details on what the agency intends to do and what resources are to be used to do the work; the application functions as the evidence of delegation.

One possibility is for the Building Board to require a more formal delegation agreement be put in place between DFCM and an agency. Beyond that, policy language should address what steps DFCM could take if an agreement needed to be revoked. Having such a policy in place might provide additional incentive for agencies to improve maintenance activities to the required levels.

Legislature Should Consider Facility Rent Based on Full Costs

The Legislature should consider increasing the DFCM rent charged to agencies to reflect the actual costs of managing facilities.

The Legislature should consider directing DFCM to increase the rent agencies pay to cover the full cost of services provided to agencies in buildings maintained by DFCM. The five states that were referred to us as leaders in dealing with maintenance issues charge rent to their state agencies. Most of these charge at a level that reflects the actual costs of managing facilities, and several include a component that provides funds for major projects or future repair/replacement needs. A benefit of this option is that better tracking of costs must occur in order to set the rental rate.

DFCM charges the tenant agencies for services provided to operate and maintain these facilities, including custodial and grounds services, utilities, and some maintenance. DFCM manages about 140 state facilities; the average rate was $3.90 per square foot in fiscal year 2000. These rates, however, do not include the full costs of facility management, as can be seen by comparing them to the average lease rate paid by state agencies that rent office space at about $14.00 per square foot.

One model for the total costs of facility ownership is provided by the National Research Council in its study of federal facilities. This study includes the following as components of total ownership costs:

- routine maintenance, repairs, and replacements
- facility-related operations
- alterations and capital improvements
- legislatively mandated activities
- new construction and total renovation
- demolition of facility

Of these categories, the first two are included in the rates charged to agencies by DFCM. The other categories are funded on a case by case request basis from the funds appropriated for capital improvement projects through the 0.9 percent of current replacement value formula, through the capital development appropriation process, or via another funding source such as federal or private funds.

Some States Recover More Costs of Services

Some states charge for future repair and replacement costs as well as for ongoing maintenance needs.

In addition to custodial and grounds services and utilities, we found that some states include all ongoing and preventive maintenance as well as a charge for future repair and replacement of building components, often calling this capital depreciation. Some charge for cyclic painting and carpet replacement. Thus, rent usually covers more than minimal maintenance and provides funds for facility *management*.

For example, Florida charges rent ($14.74 in 1998) to the facilities in a pool managed by their facilities management agency. Rent covers the costs of operating, maintaining, repairing and improving the facilities, and paying debt service since Florida uses bonding to build many facilities. Slightly more than nine percent of the rent ($1.38 in 1998) goes into a capital depreciation fund that accrues for maintenance projects.

Similarly, Nebraska charges a rent ($12.36 average) that is sufficient to cover operating, maintaining, renovation, and repair costs and to fund building renewal. Rents go into a revolving fund along with some other sources of funding. A recently passed bill provides that two percent of agencies' rent will be put into a building renewal fund as well. South Carolina also charges rent to state agencies ($11.30 per square foot for office space) with about $0.90 per square foot of the total rent put into a depreciation reserve account for future maintenance costs.

An Alaska task force, set up to identify the level of unmet facility maintenance needs, issued a report that included a recommendation to develop a rent structure for state agencies. Legislative staff there provided statutory language indicating that when implemented, the rent will cover facility use, management, operation and maintenance costs, and depreciation of facilities.

Other task force recommendations included setting up separate budgeting for routine and preventive maintenance and providing funding for the elimination of Alaska's accrued maintenance backlog in a six-year time frame; partly by developing a grant program to agencies that would be funded from the state's reserves.

Full Cost Rent Would Require Advance Planning

Numerous issues should be dealt with if cost-recovery rent is implemented.

Policymakers would need to address various issues if a move to full facility cost recovery is pursued. To this end, the Legislature may wish to appoint a task force to study the various issues involved in moving to full cost recovery from agencies in state-owned space. In fact, legislative interest in this issue during the past legislative session is evidenced in a directive to the Legislative Fiscal Analyst to conduct a feasibility study of the use of a facility pool in Utah, addressing funding questions. Alternatively, the Legislature could direct the Building Board to submit a proposal for consideration.

Among the issues that can be considered are the following:

- What costs should be included?
- Should the increase be made incrementally or in one adjustment?
- Which agencies and what facilities should be included in the rent structure?
- Should there be a special fund created to receive some portion of the rent for future replacement needs of the facilities?
- What would be the effect on capital improvement funding in the state should full rent be instituted for at least some agencies?
- Would a goal be to bring more agencies under DFCM's management in a full cost rental agreement?

Other issues will most certainly surface as well. We offer these as starting points for discussion should this option be considered as a way to improve facility maintenance in the state.

Full Cost Rental Charges Would Improve Cost Tracking

Charging rent would require facility staff to accumulate cost-based data for their facilities.

Charging rent at the full cost of facility management would promote better tracking of facility costs. In order to set the rental rate, all costs of owning or occupying a facility would need to be identified and factored into the per square foot charge. Facility coordinators and other agency managers would need to develop ways to accumulate cost-based data on their facilities, facilitating the tracking of those costs and providing better data to enable more informed decisions on asset management.

Full-cost rent charges would provide policy makers more accurate information about true program costs.

Full-Cost Rent Could Aid Policy Makers. Full-cost rent would also benefit policymakers by allowing a better understanding of real program costs. Governments are increasingly moving towards more accurate cost accounting to permit activity-based costing. Activity-based costing techniques try to measure how much it costs to conduct specific government activities, regardless of how the activity is financed. Policy-makers benefit by being able to weigh program accomplishments against program costs and use that information to help decide how to allocate resources.

Currently, facility costs are not consistently matched to the programs for which they are incurred. For example, facility funds obtained by revenue bonds are repaid through charges to agency budgets, but funds obtained by general obligation (GO) bonds are not since they are repaid through a separate General Fund line item appropriation. Therefore, agencies in facilities funded with revenue bonds may appear much more costly than those in facilities funded by GO bonds when the actual cost difference is slight.

Currently, facility costs may or may not be paid through agency budgets.

Similarly, facility maintenance costs may or may not be paid through agency budgets. Routine maintenance expenditures come through agency budgets, but deferred maintenance expenditures that come through the capital improvement process are not charged to agency budgets. DFCM's director expressed concern that agencies may neglect routine maintenance to save resources. He indicated agencies could then ask for capital improvement funding to correct problems caused by inadequate maintenance.

Full-cost rent would facilitate more activity-based costing. Managers would be better able to gauge maintenance efficiency, and policymakers would be better able to weigh program costs and benefits. However, implementing full-cost rent would be a major change and involve some challenges, as summarized above.

Recommendations:

1. We recommend that the Legislature review the options available to improve facility maintenance in the state, to include the following issues:
   a. consider increasing the percent of replacement value currently allocated to capital improvement projects
   b. consider separating facility cost categories from program cost categories in the state's budget and accounting systems
   c. consider convening a task force to study or direct the Building Board to submit a proposal on the viability of a rent structure for agencies that includes all components of operations and maintenance costs as well as a component for future replacement costs.

2. We recommend that the Building Board develop a policy on whether and how much capital improvement funds may be used for program-oriented projects.

3. We recommend that DFCM monitor the use of facility audit and condition assessment results in agencies' capital improvement

requests, reporting to the Building Board and the Legislature on the incorporation of this data in the request process.

4. We recommend that the Building Board develop a policy that provides for the revocation of agency maintenance delegation agreements in the event an agency fails to meet established maintenance standards.

Chapter III
Management of Contingency Fund Can Improve

In following up on the 1992 audit, we re-examined the construction contingency reserve fund and found that the management of the fund can be improved in the following areas:

- Better controls over transfers within project budgets are needed; the Building Board should adopt budgeting policies to provide guidance on acceptable practices
- Better controls over change orders are needed; change order policies need to be clarified and updated
- Better controls over project draws from the contingency fund are needed; options include a project-specific contingency fund or a review process before exceeding contingency budget

Control issues should be dealt with to ensure that funds are spent as approved through the appropriation process. The intent of the 1992 report recommendations was to reduce discretionary spending of funds in construction projects and increase accountability. Current policies and practices do not always meet this intent. Finally, the present structure of the contingency fund allows over-expenditures since there is no limit on a project's draw from the statewide fund.

1992 Report Recommended Improving Controls over Contingency Funds

The intent of the 1992 report recommendations has been circumvented.

The 1992 audit report stressed the need for better controls over the statewide contingency reserve fund. Splitting the fund into a statewide contingency reserve fund and a project reserve fund was recommended as a way to control the supplementing of construction expenditures from sources other than project funds. Although the fund was subsequently split into two funds, some DFCM practices with contingency funds and project budgets do not meet the intent of the 1992 recommendations.

Following our 1992 audit, the Legislature split the old contingency reserve into two funds in 1993:

- **Project Reserve Fund:** This fund receives monies from construction bid savings and from funds remaining in a project budget at completion. This fund is approved for use in paying for construction contract bids that exceed approved budgets.

- **Statewide Contingency Reserve Fund:** This fund receives monies budgeted for contingencies from all project budgets funded with state appropriations or general obligation bonds.

Contingency funds are provided to cover change orders and other unforeseen, necessary costs in construction projects.

According to the **Utah Code** 63A-5-209, "statewide contingency funds shall be held by the director to cover costs such as change orders and other unforeseen, necessary costs beyond those specifically budgeted for the project." A change order is a modification of the original cost or plans of a project. Change orders represent the largest component of contingency fund activity, totaling about 73 percent in fiscal year 1999. In fiscal year 1999, $3,942,000 was deposited into the fund from projects and $3,337,000 was spent from the fund.

Current Guidelines Are Vague and Need Updating

Contingency fund rules and policy need improving.

The formal guidelines for activity in the contingency fund in general and with change orders specifically are in need of improvement. DFCM policies and procedures on change orders date from 1994 and are in need of revision:

- Building Board rules on the contingency fund do not sufficiently address current practices with change orders, which are the main expense from the fund

- The rules provide for uses of the fund that conflict with **Utah Code** language

Although some DFCM policy guidelines do exist, they are not consistently followed.

Though limited, these guidelines are the present basis for activity with change orders and contingency funds. Our review of practices in the division shows that these guidelines are not consistently followed.

As the rest of the chapter will show, transfers within project budgets circumvent the purpose of the contingency fund to pay for construction cost increases. In addition, DFCM uses the contingency reserve fund to pay for items which are known and should be budgeted for in projects. Recommended changes include improving policies and changing the contingency fund from statewide to project-specific in structure.

Better Controls Are Needed Over Project Budgets

Budget shifts should be controlled to curb cost overruns and preserve the intent of project funding.

Construction project budgets are frequently adjusted to cover over-expenditures in a category such as construction costs or architect/engineer services. As a result, other categories such as moving costs or furniture and equipment lose their funding. Since these changes occur within the budgeted total of a project, significant increases in construction costs can occur without using the statewide contingency fund. Better controls over budget shifts are needed to preserve the intent of project funding and help control cost overruns in specific areas.

Project reports provided to the Legislature do not show all costs.

Budget shifts may undermine the Legislature's intent behind the reserve funds and the project approval process. The two reserve funds provide mechanisms to fund unexpectedly high construction bids and to fund unforeseen costs incurred during construction. Budget shifts provide another way to pay for over-budget costs without tapping the reserve funds. At the same time, routine budget shifts create the impression that some budget categories are knowingly padded so amounts may later be shifted to pay for other costs. We also found that project close-out reports provided to the Legislature do not include all costs; change orders and other costs paid from agency funds are excluded. We feel the Building Board should develop clear policies for project budget transfers and ensure that full project costs are reported to the Legislature.

Review of Recently Closed Projects Raised Many Questions

To compare project budgeting, spending, and contingency fund activity, we reviewed recently closed projects. We started with all project close-out reports provided by DFCM to the legislative fiscal analyst for projects closed between January 1999 and May 2000. Some projects did not include statewide contingency fund activity because they were not funded by state appropriations or general obligation bonds. We initially reviewed all 15 closed projects with contingency fund activity, then limited our analysis to four projects that used only appropriated funds and drew from the contingency fund. Although we reviewed only recently closed projects, some of them were quite old. For example, two projects were initiated in 1991 and one each in 1992 and 1993 under a previous division director. However, these projects included recent activity, some of which concerned us. DFCM's executive director reports that some of the issues discussed below were problems that DFCM has now corrected.

Sometimes DFCM transfers budget residuals to construction projects rather than to the project reserve fund.

In the 15 project reports we reviewed, numerous items raised questions in our minds. Frequently, but not always, DFCM transferred budget residuals not to the project reserve fund as we expected but to construction budgets instead. As a result, many construction change orders were not paid for by the contingency fund but were covered by budget transfers. On one project, discussed later, construction bid savings were retained in the project budget and used for change orders; also, residual funds were later transferred to the contingency reserve rather than the project reserve. The following list summarizes some additional information about the 15 projects we reviewed:

- Construction expenditures exceeded budget by $8.6 million or 11 percent. All 15 projects overspent construction budgets.
- Architect/engineer expenditures exceeded budget by $0.5 million or 10 percent. Overall, 12 of 15 projects exceeded budget.
- Change orders totaled $8.8 million.
- The statewide contingency fund contributed $3.4 million to the projects, leaving about $5.4 million in change orders to be paid from other sources.
- Agencies for which the projects were being built paid $2.1 million of the change orders.
- On nine projects, the furnishings and equipment category was underspent by an aggregate amount of $1.9 million. On one project, the $54,500 budget residual was transferred to the project reserve fund, but on the other eight projects, the funds were available to pay for change orders.
- On six projects, the moving budget was underspent by an aggregate amount of $186,000. On one project, the $50,000 moving budget

residual was transferred to the project reserve fund, but on the other five projects, the funds were available to pay for change orders.

- On six projects, the life cycle costing/value engineering budget was underspent; while on two projects it was overspent. The amount underspent on the six projects ($95,000) was available to pay for change orders.
- On one project, $45,900 budgeted as Percent For the Arts funding was used instead to pay for a construction change order in 1997 to purchase a "muffin monster," a waste management component.

While our review of the 15 projects raised many issues, a number of complexities made a full analysis difficult. Many of the projects had additional funding sources besides appropriated funds or general obligation bonds; change orders and cost overruns were shared in a variety of ways. To help obtain a clear picture, we concentrated our review on four of the projects that were funded from appropriated funds and/or capital bond proceeds (not lease revenue bonds or private sources) and had access to the contingency fund.

Budget Items Are Often Shifted to Cover Overruns in Other Areas

Budget shifting creates discretionary spending for project cost overruns.

Our analysis of four projects' close-out reports and other DFCM project documents shows that funds are being transferred from one budget area to another to cover shortages, thereby covering increases that do not show up in a review of contingency expenses. The Building Board should develop a policy as to how or when these budget transfers may take place. The current practice of shifting funds from one budget category to another apparently occurs with little oversight and in essence allows discretionary spending for project cost overruns.

Significant budget transfers in the four projects provided funds for cost overruns in construction and architect contracts.

On all four projects we found that cost overruns in budget areas such as construction or architect/engineer costs have been paid with funds from other budget areas. The frequency of such transfers differed from project to project. One project in particular had several questionable transfers, while the other projects had fewer of them. Overall, we found enough inconsistency in the transactions that we are concerned that funds may not have been spent as intended by the Legislature through the appropriation process.

Projects Had Questionable Transfers. One project had over $1 million in construction change orders and other budget overruns. The statewide contingency fund exists to pay these types of costs unless they result from agency-requested scope changes or errors made by a contractor. In these latter cases, the agency or contractor should pay the extra costs. However, Figure 4 shows that the majority of the additional funding for this project came from budget residual funds that were not transferred to the project reserve fund.

Figure 4. This Project Illustrates How Additional Costs Are Paid Mainly From Other Budgeted Areas. This construction project had over $1 million in added costs, $900,000 of which were for construction change orders. Note that only about 35% of the added costs were paid from the contingency fund.

Items Requiring Additional Funding	Cost
Construction change orders	$ 908,192
Excess contingency fund contribution	30,582
Architect/engineer contract over budget	37,111
Unbudgeted administrative costs	33,206
Total	**$1,009,091**
Sources of Additional Funding	**Cost**
Statewide contingency fund contribution	$ 353,466
Agency funding	67,617
Furnishing budget residual	299,404
Construction budget residual*	267,162
Testing budget residual	21,442
Total	**$1,009,091**

** Construction contract bids came in under budget but the residual was not transferred to the project reserve fund.*

The furnishings and value engineering budgets, among others, provided funds to construction cost increases.

Two of the items requiring additional funding in Figure 4 should be explained. First, the excess contingency fund contribution was made in error, according to DFCM staff. Staff explained they mistakenly transferred more to the contingency fund (based on a preliminary budget) than was later appropriated by the Legislature. Second, the unbudgeted administrative costs include some items that should be budgeted; we will discuss this concern later in this chapter.

Of greater concern are some sources of funding for the additional costs. As noted earlier, the contingency fund should "cover costs such as change orders and other unforeseen, necessary costs beyond those specifically budgeted for in the project." However, on this project, DFCM used budget residuals to pay for such costs. The project reserve fund should receive budget residuals and the contingency fund should pay for unforeseen costs. Thus, funds not needed for their appropriated purpose would be put into the project reserve fund while necessary cost increases would be paid by the statewide contingency fund. Together, the two funds provide accountability and oversight while allowing DFCM flexibility to pay for needed costs.

On this project, construction bid savings and budget residuals were not transferred to the project reserve fund as expected. DFCM staff explained that bid savings were not transferred because there were three construction contracts and, by the time the last one was let, change orders had already accumulated on the first contract. In our opinion, using the construction bid residuals to pay for change orders defeats the purpose of the two reserve funds. As for the furnishings and testing budgets' residuals, DFCM transferred them to the contingency fund at the end of the project in 1999 although the **Utah Administrative Code** requires residual amounts to be transferred to the project reserve fund. DFCM staff explained that change orders had caused such a large draw on the contingency fund that they wanted to offset some of that amount.

The other three projects we reviewed did not have as many questionable transfers as the project discussed above, though there were some. For example, we observed the following items:

- the second project included budget transfers of $236,635 from the furnishings and equipment budget and $18,000 from value engineering to the construction budget to provide funds for awarding construction contracts

- the third project included a transfer of the $30,000 value engineering budget to construction
- the fourth project used mainly contingency funds for additional costs, but also supplemented those with $30,000 which had been budgeted for value engineering

It is our opinion that change orders should not be paid by funds within project budgets, but they should be paid by the contingency fund as outlined in **Utah Code**. Shifting other budget funds within the project decreases accountability. Contingency fund expenditures are summarized for inclusion in materials given to the Building Board at meetings, but budget transfers are not. If change orders are paid by other project funds, the Building Board would be unaware of those changes to the project and the accompanying expenditures.

Budget shifts are handled inconsistently, indicating a need for policy.

Budget Transfers Are Done in Different Ways. For example, some project budget funds were used to pay change orders during the course of a project. However, as previously discussed, on one project furnishings funds were transferred to the contingency fund at the end of the project to reimburse the fund for previously paid change orders. In some cases, but not always, bid residuals were kept with the project and used to pay change orders instead of accessing the contingency fund. These differing practices illustrate that a policy is needed to guide how funds should be shifted, or whether they should be shifted at all.

Administrative rules provide that the project reserve fund shall receive remaining balances from project construction budgets. **Utah Administrative Code** R23-5-8(2) states that "upon completion of the project, any residual balance of Appropriated Funds in any budget category shall be transferred to the Project Reserve..." This language indicates that unused balances in *any* budgeted category should be transferred to the reserve fund. We are concerned that the rule fails to restrict the budget transfers outlined above. If legislative intent is to keep project budgets intact and to pay change orders from contingency funds, the rule should provide limits on balance transfers.

Change orders should not be paid from funds budgeted for other costs in a project.

In our opinion, based on **Utah Code** provisions, contract bid savings, project residuals, and project reserve funds are not intended for paying change orders, nor should change orders be paid by project funds already budgeted for specific costs. It is the purpose of the contingency fund, as outlined in the **Utah Code**, to pay for these unforeseen costs. Further, developing a project budget creates the presumption that the funds in each category are needed to pay costs to be incurred for the purpose for which they were reviewed and approved. The practice of shifting funds from some areas to pay cost overruns in other areas of the budget raises a question whether the funds were needed in the original category or were placed there simply as a cushion for discretionary use elsewhere in a project.

The Building Board should review DFCM's practice of moving funds from areas such as furnishings and equipment or moving costs to determine whether this practice needs more controls. It is our opinion that any allowed transfer of budgeted funds should be outlined in policy to provide for accountability and reasonable controls over this activity. At present, these budget transfers are made with little accountability; project directors consult with the project accountant, but the transfers are not required to have any other review.

Full Project Costs Are Often Not Reported to the Legislature

DFCM project reports to the Legislature do not include some costs paid by agencies.

The full costs of many construction projects are not reported to the Legislature. This is because the project close-out reports given to the Legislature do not include the amount of agency-funded items such as change orders. Project cost reports to the Legislature should provide total costs including agency-paid items.

Our review of project close-out reports for fiscal year 1999 revealed that the total construction cost for a project is a net figure. To illustrate, in one of the projects discussed above, the agency paid over $319,000 for landscaping costs but these costs do not show on the project close-out report provided to the Legislative Fiscal Analyst. Thus, project close-out reports frequently understate the total construction costs.

Agency-funded change orders also do not appear on the close-out reports. One project's close-out report showed final construction costs to be $6,819,798. However, DFCM project data showed that the total adjusted construction contract (with all change orders) was $6,889,537, a difference of $69,740. The project files showed that the agency paid for a change order of $69,740. This figure was not included in the total construction expenditures on the project close-out report provided to the Legislature. Construction expenses on other close-out reports we studied also did not include agency-funded change orders.

Building Board Should Develop Policies

Project budget practices need clear policy guidelines.

Because significant shifts in budgeted funds have occurred within projects to pay change orders and other added costs, we believe the Building Board should address project budgeting and expenditures with some policy language.

The Building Board is required by **Utah Administrative Code** R23-5-10 to include in its five-year building plan a report in the contingency and project reserve funds; further, DFCM "shall report regularly to the Board on the status of the Statewide Contingency Reserve and the Project Reserve." Requiring this reporting emphasizes the importance of these expenditures. At present, the same reporting is not required on the use of budgeted funds to pay for change orders or added costs in other categories.

Shifting budgeted funds within construction or remodeling projects provides a means of paying for cost increases or change orders in the projects. In fact, one project director told us he prefers to look for funds within the project budget to pay for a change order before going to the contingency fund. Therefore, if this option is to continue, we believe the Building Board should provide policy direction in this area so that at least the same level of accountability is provided for these expenditures as for expenditures from the contingency fund. Alternatively, the shifting should not be permitted without prior justification and DFCM management approval ahead of the shift.

Better Controls Are Needed Over Change Orders

Contingency fund use should be limited to Utah Code -approved purposes.

Contingency fund uses should be limited to approved purposes, and controls over change orders on construction projects can improve. The primary use of the contingency reserve fund is to pay for construction change orders; at present, about 73 percent of fund expenditures pay for change orders, while the rest pays administrative costs, insurance, and some testing and advertising. We recommend improving controls over contingency fund uses in the following areas:

- DFCM uses the contingency fund for some expenses that are inconsistent with **Utah Code** provisions; the contingency fund should only be used to pay for unforeseen costs, not costs that should be included in a project's initial budget

- Policies need clarification to provide better direction to program directors and agencies on determining payment responsibility for change orders

- The lack of clear policy direction has allowed the contingency fund to be used for costs that should be paid by other parties in projects

- Accountability for change order decisions and especially payment responsibilities needs to improve

Reserving the contingency fund for unforeseen costs and budgeting up front for known costs should promote better planning, allow for better analysis, and provide more accountability as projects go through the construction process. Clarifying contingency fund rules and policies provides better direction from the Building Board to staff and will better align contingency fund uses with **Utah Code** language.

Some change order definitions can be improved to match actual uses.

In addition, as will be discussed, the current definitions of change orders sometimes conflict with actual practice by DFCM. Scope changes may include contract adjustments that were planned from the beginning, changes to the scope of work, or mandates from the state fire marshal. As part of policy improvements, definitions of change orders should be clarified.

Some Contingency Fund Uses Do Not Comply with Utah Code

Known project costs should not be paid from contingencies but be budgeted at project inception.

DFCM has paid for typical project costs such as legal services, insurance, surveys, testing, and inspection from the contingency reserve fund. The contingency reserve fund is intended as a reserve for unforeseen, though necessary, project costs. Paying known costs from the contingency reserve fund is inappropriate; these items should be covered at a project's inception within the budget. The Building Board needs to implement clearer policy on the acceptable uses of the contingency fund, aligning policy with the language in the **Utah Code**.

The Contingency Fund Should Only Be Used for Unforeseen Costs. **Utah Code** 63A-5-209 states that "contingency funds shall be held by the director to cover costs such as change orders and other unforeseen, necessary costs beyond those specifically budgeted for the project." Key words are "unforeseen" and "necessary." In our opinion, some payments from the fund in recent years have not qualified as unforeseen, even though they were necessary. DFCM staff report that they used authority provided in legislative intent language from 1990 to use the contingency funds as they did.

For example, according to DFCM records, over $688,000 has been paid out of the contingency reserve fund for Attorney General Services from fiscal year 1995 to fiscal year 1999. Since Attorney General services are a known and ongoing cost to the division, legal services should be budgeted as an administrative expense. DFCM reports that they are gradually phasing out the payment of legal costs from the contingency reserve fund, and provided several fiscal year 2000 project budgets showing legal services as a budgeted item.

Rules should be more in line with Utah Code.

We are also concerned that **Utah Administrative Code** R23-5-7 states that legal services, insurance, surveys, testing, inspection, and bidding costs may be paid out of contingency reserve fund. Since these costs are normal and expected costs in construction, they are not unforeseen and should not be paid from the contingency reserve. The rules governing uses of the contingency fund should be revised to bring it in line with "unforeseen" costs specified in the **Utah Code**.

Other states save their contingency funds for unknowns and budget for known expenses.

Other States Limit Contingency Uses to Unknowns. Other states do not pay for routine costs from their contingency funds. We contacted construction management officials in Arizona, Colorado, Idaho, Nevada, and Washington to determine how they pay for legal expenses, inspections, and other similar costs for their construction and remodeling projects. All reported that these costs are paid from budgets within the projects. Some legal expenses might have been paid from contingency funds if they involved unforeseen litigation associated with a specific project. In similar instances here, paying for unforeseen legal expenses from DFCM's contingency reserve fund would also be appropriate.

Other states show that certain repeating expenditures such as legal services and inspections can be included in the projects' budgets. While this practice may not necessarily result in cost savings, it creates more accountability by associating specific costs to specific projects and allows for easier analysis of project costs versus unforeseen costs rightfully coming from contingency funds.

Payment Policies Need to Be Clarified

Policy clarification on payment responsibility for change orders is needed.

Clearer delineation of responsibility for payment of change orders is among the improvements needed in the DFCM policies on the contingency reserve fund. Project files show that the contingency fund pays for change orders that should be paid by others. Clear policy direction is needed as to whether the agency, the contractor, the contingency fund, or some other source is responsible for paying increased project costs. Project directors indicated that they have difficulty enforcing the currently available guidelines.

There is presently leeway in determining change order payment responsibility.

At present, the **Utah Code** does not specify responsibility for payment of change orders. Building Board rules provide some general guidance; current DFCM policy guidelines allow leeway regarding payment responsibility. As a result, the contingency fund has paid change order costs we feel should have been paid from other sources.

The current DFCM policy lists four types of change orders, defined as follows:

- **Scope change:** change in the scope of contract documents

- **Unknown condition:** unknown, hidden, or reasonably unforeseeable conditions which differ materially from those indicated in the contract documents and are within the scope of the work

- **Omission:** an omitted but necessary item required to accomplish the programmatic intent of the project which adds value and is within the intended scope of the contract documents

- **Error:** a change necessary to correct the failure of any portion of the contract documents, i.e., the originally intended work in the contract documents not performing the intended function

The policy indicates that the source of funds to pay the change order is to be determined by the program director and goes on to indicate that omissions or errors are to be paid by the project architect/engineer to the extent that the omitted work is not adding value to the project. Regarding scope changes, the policy states that they are usually to be paid for by the user agency/institution. Additional language in Building Board rules (R23-5-7) state that the contingency reserve fund "may be used to fund changes in scope only if the scope change is necessary for the proper functioning of the program that was provided for in the approved project scope."

Responsibility for payment of change orders differs according to change order category.

According to discussions with DFCM staff, change orders should be paid by different players in the construction process. Generally, scope changes should be paid by the agency. However, staff indicated that those scope changes initiated by DFCM program directors or other officials, such as the state fire marshal, would be paid by the contingency reserve fund (although this is not specified in the policy). Errors should be paid by the architect/engineer firm. Staff indicated that omissions and unknown conditions would be paid from the contingency fund, which does not agree with the policy statement that omissions are to be paid by the architect to the extent that the work does not add value to the project.

The Building Board needs to clarify a variety of issues on payment of change orders in policy.

The following issues, among others, should be addressed by the Building Board.

- The policy does not specify who pays for the added value of errors or omissions (the user agency or the contingency fund?).

- The policy states that scope changes are *usually* paid for by the user agency/institution and that a commitment in writing for payment is needed before the change is made. We found numerous examples of scope changes not being paid by agencies.

- Payment for unknown conditions are not addressed in the policy, although we assume that they are the "unforeseen" costs referred to in **Utah Code**.

In addition, we found that several kinds of scope change orders exist, but policy does not address the differences. For example, a scope change may be an agency-requested change or addition, a required change ordered by the fire marshal, or a change in the scope of an existing contract (e.g., for additional services or longer time of services). The policy, however, defines a scope change simply as a change in the scope of contract documents and does not address possible differences in payment responsibility.

Lack of Policy Direction Makes for Difficulties in Change Order Payment

Some view the contingency fund as a source of funds for all sorts of changes in projects.

Program directors indicate there is often difficulty regarding payment of change orders. Apparently the statewide contingency fund is sometimes viewed as a readily available pot of funds for project increases. Several DFCM program directors indicated they have difficulties getting some parties to pay for changes. Our review of project files verifies this assertion. We found cases where architects have not paid for errors, and agencies have not paid for requested changes or additions.

Program directors told us they have difficulty getting architect firms to pay for errors. The program directors sometimes classify a change order as an omission rather than an error because the architect/engineer won't pay for the change. Program directors also told us that they will sometimes give the architect/engineer the opportunity to correct an error without processing an official error change order. These statements are supported by the fact that less than one percent of change orders in fiscal years 1996 and 1997 were classified as errors.

Many errors are not paid by architects/ engineers.

We examined several projects and their associated change orders. We found several instances where errors were not paid by the architect as called for in policy, but rather they were paid by the contingency fund. The figure below summarizes a sample of projects with error change orders and the source of payment of those errors.

Figure 5. A Sample of Projects Shows That Errors Are Often Paid by the Contingency Fund, Not the Architect. The contingency fund is intended to pay for the unknown and unforeseen costs that arise, not the errors made by contract architects.

Project	# of Error Change Orders	Amount	Funding Source
1	1	$ 2,058	Contingency Fund
2	2	12,493	Contingency Fund
3	4	41,675	Contingency Fund
4	1	18,167	Architect
5	2	8,989	Contingency Fund
6	2	1,707	Contingency Fund
7	2	6,386	Contingency (51%), Architect (49%)

Of the 14 change orders classified as errors in these projects, 11 were paid totally from the contingency fund. Only one was paid in full by the architect, and another was split between the contingency fund and the architect. Figure 5 shows that architect/engineer firms are not always held accountable for their errors. Paying for these change orders from the contingency fund increases costs of projects to the public.

Scope changes should generally be paid by the agency, but this is not always the case.

Agencies Do Not Always Pay for Changes They Request. Program directors also indicated that the contingency reserve fund has been viewed as a ready source of funds for agency changes and additions. These changes requested by agencies have sometimes been paid from the contingency fund although scope changes are generally to be paid by the requesting agency.

To illustrate, the contingency fund paid for an agency's change of locks in a facility. The company changed the internal components of locks that had already been selected. Although the agency had accepted the bid, they wanted to change to a different company. The program director agreed with the change although he initially told us this was an agency request. We do not agree that this change meets the intent of the rule that scope changes will be paid if they are needed to ensure the proper functioning of the building. The change should not have been paid from the contingency fund.

The contingency fund is used to pay for costs it should not pay.

While agency-requested expenses may be justified, we question whether the contingency reserve should be used. In our opinion, the Building Board needs to provide more specific, clearer policy to give the program directors, agencies, and others better guidance on change order payment responsibilities. If it becomes clear that the contingency fund is the payment source of last resort for changes other than unknown conditions, it is our belief that fewer cost increases in state projects will occur.

Accountability for Change Order Decisions Should Increase

In addition to the challenges described above that require better policy direction for the program directors as they administer the contingency fund, we are also concerned that millions of dollars flow each year into and out of the contingency fund with little accountability. Rather, the program directors are given a great deal of discretion in using these funds and approving change orders.

Program directors have a great deal of autonomy in handling change orders.

DFCM staff use a recently developed procedure regarding construction projects that includes a few change order guidelines. This document states that program directors "are authorized to approve change orders and change directives" and that they "are authorized to access the Contingency Reserve to cover unforeseen costs that are eligible for this funding source." There is no stated dollar limit on the authority. In some situations, consultation with another program director is called for; consultation with the division accountant is also indicated. Management approval is not needed for the majority of change orders.

Since there is no limit set on the cost of the change orders, program staff are given a lot of responsibility and leeway in this area. It is our feeling that greater accountability is needed when the cost of state construction projects increases. We are concerned that large change orders can be approved without accountability being provided through outside review.

Added Controls on Contingency Fund Draws May Be Needed

Options are available to limit the draws on funds in the statewide contingency fund.

If additional controls are desired, the Legislature may want to consider ways to limit draws on the statewide contingency fund. If deemed necessary, options are available to promote better accountability in the construction process and to deter unnecessary project expenditures. Other states have been able to minimize this risk through a project-specific contingency fund structure. Another option would be to require a review and approval process before a project can exceed its contribution to the contingency fund.

Contingency Reserve Fund Is At Risk For Overuse

There is currently no limit on a project's ability to draw from contingency funds.

The contingency reserve fund is a statewide fund, available to all new construction and remodeling projects (with the exception of projects funded through lease-revenue bonds or non-appropriated funds). There are no set limits on the amount of funds a project can draw from contingency. Because of pressures from agencies and/or contractors, the contingency reserve fund has sometimes been used to fund expenditures beyond what had been budgeted for contingencies.

The reasoning for a statewide structure is that some projects will need extra funds while others will come in under budget. Thus, funds from projects that do not use all their contingency funds would be available for cost overruns on other projects. Projects are not limited in their draw on contingency reserve funds, except through the program directors' approval authority.

Project contribution to contingency is based on a percentage of the total budget.

DFCM sets budgets for contingencies based on a percentage of construction costs. For new construction, the scale ranges from 4.5 to 6.5 percent, and for remodeling projects it ranges from 6 to 9.5 percent. According to DFCM officials, the contributions to the contingency fund were determined based on historical need for such extra monies.

We reviewed contingency fund expenses for 117 closed or completed projects DFCM managed from fiscal year 1994 through fiscal year 1998. We observed that fewer projects have overdrawn their contingency contribution in more recent years, which supports DFCM's assertion that staff have tried to control construction costs. However, we also learned from program directors that agency personnel as well as architects or construction contractors frequently request access to contingency funds for extra costs in projects.

DFCM staff say agencies and architects encourage ready access to contingency funds.

Some Parties Believe the Contingency Reserve Fund Should Be Freely Available. DFCM staff indicated that the contingency reserve is sometimes viewed by architects, contractors, and agencies as readily available to fund a variety of expenditures. Architects are often opposed to paying for mistakes because they believe "that's what the contingency fund is for." Owner agencies often ask for contingency reserve funds to cover extra items they want to add after a project has started.

Providing more controls over contingency fund draws would still allow needed expenses to be paid.

Providing an additional control over additional expenses would encourage distinctions to be made between essential additional costs and those that are more wanted than needed. Projects sometimes incur unforeseen costs that are necessary. However, most of the program directors told us they have been asked to approve changes or additions to a project that were not essential for the approved scope and function of the facility; the feeling is that the funds are available so they should be used.

Other States Have Project-Specific Contingency Funds

Facility construction and management staff in Arizona, Colorado, Idaho, Nevada, and Washington all budget similar percentages for contingencies in much the same way as DFCM. However, these contingency funds are not put into a single account to be used by all projects. The budget for contingency stays with a project and is only used to fund added expenditures for that project.

Other states have had success with project-specific contingency funds.

The other states' officials said that their project-specific contingency structure creates more accountability and puts pressure on construction management to complete projects within budget. In these other states, when project budgets are exhausted, the owner agency has few options other than to go back to its legislature and ask for additional funds for the project. The officials reported that their legislatures are not eager to approve additional funding. As a result, agencies do all they can to finish projects within the budget.

Some Utah Projects Already Have Project-Specific Contingency Funds. DFCM's projects that are funded with lease-revenue bonds essentially have a project-specific contingency reserve fund. These projects do not have access to the statewide contingency reserve. The set-aside for contingency is budgeted within a project at its beginning, and expenditures for change orders and other expenses are limited to the amount budgeted for the project. Limiting access to contingency funds in lease-revenue bond projects provides some precedent for other projects to operate similarly.

A legitimate concern involves how to access funds for essential cost increases when a project has used all of its contingency budget. The following discussion offers another option to address this concern.

Another Option Requires Building Board Approval

An approval process for expenses exceeding contribution to contingency is another option.

In lieu of setting project-specific contingency budgets, the Legislature or Building Board may want to consider requiring Building Board approval before a project can expend more from the statewide contingency fund than it has contributed. This option would provide a mechanism to allow a project to move forward if it is determined that costs exceeding contribution are essential to complete the project.

In discussions of these two options, DFCM's director raised concerns about the efficacy of a project-specific contingency fund. Among his concerns is the feeling that a project-specific contingency would be completely exhausted as a matter of course. In his opinion, a better cost control would be a review process. The director mentioned a method used in California, where a review board is authorized to approve needed cost increases, accessing a pool of emergency funds.

Should this option be implemented, the Building Board could review requests for additional project costs that exceed a project's contribution to the statewide contingency fund to determine if the request meets **Utah Code** criteria for a draw from the fund. This would increase accountability and help ensure that only needed expenses are approved. The statewide contingency fund would then be accessed for the approved expenses.

Recommendations:

1. We recommend that the Building Board adopt policy language that clarifies acceptable project budget transfers.

2. We recommend that project close-out reports to the Legislature provide full cost information, including all agency-paid costs.

3. We recommend that DFCM limit the use of contingency reserve funds to unforeseen expenses. Additionally, we recommend that expenses that can be planned for should be budgeted in the project.

4. We recommend that the Building Board update and clarify the policy on payment and classification of change orders so that clear direction is provided to program directors as well as agencies and contractors.

5. We recommend that the Legislature consider whether additional controls over contingency fund expenses are needed; if so, we recommend they consider implementing a project-specific contingency reserve fund or requiring Building Board approval for contingency fund draws exceeding project contribution level.

This Page Left Blank Intentionally

Chapter IV
Leasing Services Can Improve

Leasing services can improve by using a second procurement method and by putting policies and procedures in place.

As noted in the introductory chapter, the leasing services provided by DFCM's Real Estate Program can improve. First, the procurement process should be modified to exempt leases that have a smaller square footage from the Request For Proposal (RFP) process to provide faster service and more favorable lease rates. Second, lease management can become more effective through the development of formal policies and procedures to standardize leasing activities and promote more efficient and effective service.

The Real Estate Program is responsible for obtaining and managing leases for all state agencies, except the Utah System of Higher Education, Utah Applied Technology Education Services, and the Administrative Office of the Courts. The real property and facilities under DFCM's jurisdiction are leased for the State of Utah by DFCM for and in behalf of the various state agencies. DFCM is responsible for managing 342 leases; the different types of space are shown below.

Figure 6. DFCM Provides Leasing Services for a Variety of Types of Space With the Most Common Being Office Space. Office leases consist of 58 percent of the total number of leases managed by DFCM.

Type of Space	Number of Leases	Total Square Feet
Office Space	200	996,136
Other Building	87	618,871
Rent Free Space	27	18,696
Land	28	13,694,655
Total*	**342**	**15,328,358**

**An additional 51 leases with 363,000 square feet are managed by the Administrative Office of the Courts.*

While the total square feet in land leases is by far the largest segment of area leased, the number of leases for office space represents the bulk of leasing activity for DFCM.

Another Procurement Option Is Needed

A market search needs to be used in addition to the Request For Proposal process.

The Real Estate Program should modify the leasing procurement process in order to offer a market search option designed to provide more timely service. The current RFP process managed by DFCM is very time consuming and should usually be reserved for use when leasing large spaces containing a set square footage. In many cases, using an option called a "market search" would enable state agencies and DFCM to look for appropriate space, obtain quotes, and choose a site that best meets the agencies' needs. DFCM should retain oversight, coordination, and approval authority to ensure compliance with the **Utah Code**. For those space needs that would be met with a market search,

- The procurement time frame should improve
- Better lease rates and locations could be obtained
- DFCM could rely on agencies to help locate suitable space

Generally, the leasing procurement process is initiated when an agency needing space submits a request to DFCM. The agency completes a space standards form and sends it to DFCM to assess space needs. DFCM reviews the space standards, develops an RFP, and places an advertisement in the newspaper. Property owners submit bids to DFCM, which reviews the bids with the agency and selects a site.

Exceptions to the RFP process include sole sourcing. DFCM can do a single source search to find needed space because of a limited time frame or when the RFP process costs more than the needed space. So far this year, DFCM has done one sole source lease. DFCM also has a category of 31 leases that occupy county or city space. These leases fit a separate category because they do not go through the RFP process, and most of the space is rent-free. This year DFCM has set up ten new leases that occupy county or city space.

The Legislature may want to address the issue of allowing DFCM to use the market search when leasing small space.

The DFCM statute (63A-5-302) states that DFCM should follow procurement rules when providing leasing services. DFCM staff believe this requires them to use the RFP process when arranging leases. However, the director of state purchasing indicates that the procurement of real property (including leasing) is exempt from state procurement provisions (see 63-56-2(4)). With clarification in the **Utah Code**, or at least in DFCM's administrative rules, DFCM would be able to use the market search option to improve leasing services. The Legislature or Building Board may wish to set a limit on the size or cost of lease for which this option may be used, as will be discussed.

Limiting the use of the RFP process should reduce lease procurement time.

Reducing the need for the RFP process could have a significant impact on lease procurement, depending on the point at which DFCM and the Building Board determine when the RFP is required. To consider possible benchmarks, if Utah used the market search method for space below 3,000 square feet, then 54 percent of the current leases wouldn't need the RFP process. If 5,000 square feet were the benchmark, then 71 percent of the leases wouldn't go through the RFP process. Advantages to this change include shortening lease procurement time and obtaining savings through lower negotiated lease rates.

Procurement Time Frame Can Be Shortened

Limiting the RFP process should significantly reduce total procurement time for leases. We reviewed a sample of 22 office leases and found that it took an average of 139 days, about five months, to procure those leases.

Most nearby states procurement time is less than Utah's average time.

Most nearby states' average procurement time is less than Utah's average time. Figure 7 shows the average procurement time in other states, whether the RFP process is used, and the total number of leases.

Figure 7. Utah Has the Second Highest Procurement Time of the Western States Sampled. Two other states limit the use of the RFP process, and two do not use it for leases.

State	Procurement Time (Days)	RFP Used?	Total Number of Leases
Washington	270	Over 5000 s.f.	1,300
Arizona	90	No	375
Wyoming	90	Yes	171
Idaho	75	Over 3000 s.f.	405
Nevada	75	No	278
Utah	**139**	**Yes**	**342**

With the exception of Washington, which has a large number of leases, the other states have a shorter procurement time. We believe that quicker leasing occurs largely because other states either don't use or limit the use of the RFP process and because agencies help in the procurement process.

Within the DFCM lease sample, five leases did not use the RFP process. For those five leases, procurement time took an average of 57 days, while leases using the RFP process took 154 days to procure. Eliminating the RFP process would help DFCM provide more timely service to state agencies and, in turn, provide faster services to the public.

The advertisement time extends the procurement process by a month.

Eliminating the advertisement time alone would reduce the procurement process by a month for those leases not going through the RFP process. An advertisement for space is usually run three weeks in a newspaper, with additional time needed to prepare and submit the advertisement to the newspaper. Sometimes the ad is run for four weeks.

If no bids are received, then the RFP has to be re-advertised. Even then, a re-advertised RFP may not produce bids. For example, one agency needed space, but DFCM didn't get a response after sending out an RFP. Notices of the RFP were then sent directly to realtors in the area, without response. DFCM then used a direct search to find the needed space.

Additionally, some savings (about $11,350) would accrue from the reduced advertisement cost. The savings is based on the 3,000 square foot benchmark, an average advertising cost of $3,000, and an estimate of the number of new leases per year that go through the RFP process.

Better Lease Rates and Location Can Be Obtained

Better lease rates should be obtained with market search and negotiation.

The current RFP process reduces the negotiating power of the DFCM real estate specialists. We believe this leads to higher than necessary lease rates for state agencies. The specialists have stated that they could get better rates if they didn't have to use the RFP process. In addition, better locations may be able to be obtained using the market search option.

Use of Negotiation May Lower Lease Rates. We asked DFCM staff for their data comparing state leases to market. Staff indicated they do not conduct a formal analysis of state lease rates compared to market. Therefore, we took a sample of state leases around the state and compared lease rate information for the state agency to that of nearby tenants in office space using the same type of lease (full service, partial, or net). The sample results showed that the state agencies were paying an average of six percent higher rates than nearby tenants.

The ability to negotiate may enable agencies to obtain better locations.

Increased Use of Negotiation May Improve Locations. The sites selected via DFCM's current process may not be the best location for a state agency. For example, in one case an agency did a demographic study to determine where in Salt Lake City it should locate. The RFP process did not result in any bids submitted for space in the desired area. One landlord informed a DFCM real estate specialist he submitted a late bid in the desired area. Had the market search option been available in this situation, DFCM could have negotiated for a better location. Under the RFP process, DFCM did not give consideration to this late bid. By implementing a market search option, DFCM and agencies could negotiate in certain situations for better sites rather than being limited to bids received.

Agencies Should Be More Involved with Leasing

The present procurement process does not use state agency staff effectively. After an agency requests space and submits a space standards form, its main role is to evaluate and select a site with DFCM after bids have been received. Agencies review the lease agreement and any space improvement plans. But the DFCM real estate specialists handle most of the workload in between these points. DFCM should involve agency staff to use their expertise in the procurement process.

State agencies can help DFCM locate suitable lease space.

For leases not using the RFP process, the state agencies needing leased space could locate appropriate space. Having the agencies locate space should decrease procurement time and workload for the real estate specialists. In Arizona, Idaho, and Nevada, the state agencies locate needed space, then submit the information to an oversight agency for review and approval. As noted above, these states take less time to complete lease arrangements.

If the recommended market search option is implemented, the space standard form would still need to be completed by the agency and approved by the DFCM real estate specialist. The selected site would be approved by DFCM to make sure it met state requirements. However, having a market search option to locate space would eliminate some steps from the current DFCM procurement process.

Other States' Processes Provide Some Ideas for Revising DFCM's Leasing Process. For example, to help prevent conflicts of interest, agencies could locate space using a team which would include DFCM staff. The agency and DFCM would obtain at least three quotes, and if they selected a quote that was not the lowest rate, that site would need to be justified. Florida requires a conflict of interest statement and a disclosure statement. Florida's requires disclosure by individuals with four or more percent interest in the property or in the entity holding title to the property being leased to the state. Similar statements could be required in Utah to help avoid conflicts of interest.

DFCM management will need to review staffing needs.

If the recommended changes to the procurement process are implemented and the leasing process shortened for most leases, DFCM management will need to review staff workload to determine an appropriate level of staffing. The proposed revisions suggest that the real estate specialist workload will be reduced. DFCM management will need to determine whether the decrease in workload reduces staffing need or provides a more manageable workload for the current specialists.

Lease Management Can Be More Effective

Some lease management practices which reduce consistency in the Real Estate Program need to be addressed. Each real estate specialist has unique duties, but the leasing process should have the same basic format. The two following areas need to be addressed:

- Leasing policies and procedures need to be clarified
- Performance measures should be developed to promote efficient service

Policy and procedures are needed to provide consistent leasing guidelines.

The Real Estate Program needs to formalize its polices and procedures to provide guidelines that are known to all stakeholders. Formal policies should reduce conflicts between the real estate staff and state agencies while increasing the effectiveness of the leasing function. Performance measures should be incorporated into policy, so the specialists in the Real Estate Program can track their own work, and management can evaluate the specialists' performance.

Policies and Procedures Need to Be Formalized

The Real Estate Program lacks formal policies and procedures. We found that there is inconsistency among the leasing specialists, particularly in lease management activities. Policy and procedures provide consistent guidelines for staff in their areas of responsibility and let other parties know the required parameters of a program's activity. They also can promote strategic thinking and the implementation of program goals.

To illustrate, some agencies' facility planners are not always clear on their responsibilities and their relationship with the DFCM leasing specialists regarding lease maintenance. For example, one facility planner said that a gray area for him is when he is allowed to contact landlords concerning problems. Sometimes DFCM has allowed him to contact landlords, and other times the specialists said they would handle the problem.

One cause of this confusion is that each real estate specialist's procedure for managing ongoing maintenance issues is different. One specialist requires an email from the tenant agency stating the maintenance problem, but the tenant agency works with the landlord to resolve minor maintenance issues. Another specialist wants to know only about major problems. The third specialist receives and personally handles a wide spectrum of maintenance issues.

State agencies should be managing the routine maintenance issues.

In our opinion, state agencies, such as Workforce Services and Human Services, should be managing the day-to-day maintenance issues with the landlord. As tenants, they are the first to recognize problems, are the ones most affected by problems, and are the ones paying the rent. These issues include problems with janitorial services and minor maintenance issues such as light bulb replacements. If there are major or re-occurring issues, then the tenant agency should notify the real estate specialist of the problem. The procedures should be the same for all specialists.

Freeing the DFCM leasing specialists from handling minor maintenance problems would enable them to spend more time on setting up leases and handling major issues. In several nearby states—Colorado, Idaho, Nevada, and Wyoming—the tenant agencies work directly with the landlord to resolve maintenance issues.

Performance Measures Should Be Developed

The program should measure timeliness, lease rates, and customer satisfaction.

Performance measures can help improve the Real Estate Program; these measures should include procurement time evaluation, lease rate analysis, and customer satisfaction surveys. By evaluating the current conditions, the Real Estate Program staff can determine whether changes are needed to better assist the state agencies in timely and efficient procurement.

Procurement Time Needs to Be Evaluated. Reviewing a sample of lease files showed a lack of uniform information throughout the files. A copy of the lease and the RFP were in every file, but, as mentioned earlier, it was difficult to determine from some of the files when the agency made the initial request for space. Some of the files contained a letter, memo, or email from the state agency requesting space, but other files lacked that information. Without the request information, it was difficult to determine how long the actual leasing process takes.

The request information needs to be in the lease file so the real estate specialists can monitor and analyze the leasing process themselves. The specialists should be reviewing current conditions to help internalize strategic thinking and results-orientation within the Real Estate Program. One specialist recently began to include a lease time line in each leasing file to track the procurement process. This performance tracking approach has merit.

The requirement to compare state rates to market is not being met by DFCM.

Lease Rates Should Be Compared to Market. As outlined in the **Utah Code** 63A-5-302, the Real Estate Program has the duty to compare lease rates to current market rates and evaluate whether the lease rates are reasonable under current market conditions. We were unable to document that the required rate comparisons are being done. The Real Estate section should regularly compare state agency lease rates to the relevant market rate as required.

Other states do compare state rates to market rates.

To illustrate some analytical options, Washington averages the state rates by city, contacts commercial realtors to obtain an average market rate by type of space for the respective cities, and then makes a comparison. Arizona reviews the current market rate for the statewide real estate market and the Phoenix area specifically. Besides performing market rate comparisons, Arizona also projects state rate trends and tracks the percent increase in lease costs per year. Nevada divides its market rate comparisons into four areas: the average state rate paid in Reno, Las

Vegas, Carson City, and all other areas combined. Nevada compares state rates in these four areas to the average market rate for the areas and tracks the price difference (average market rate minus the average state rate) for each fiscal year.

Customer Satisfaction Surveys Are Also Needed. Finally, we believe that feedback from state agencies is beneficial and needed on a regular basis. The last time that DFCM sent out a leasing customer satisfaction survey was in 1995. A survey is a valuable tool to provide feedback to the program. Data that are collected regularly from a well-designed survey can show the benefits of the program, current conditions, attitudes, and unforeseen problems.

Recommendations:

1. We recommend that the Legislature amend the **Utah Code** to clarify that DFCM can use a market search option in addition to the RFP process in the procurement of leases.

2. We recommend that DFCM involve state agencies when locating space to lease.

3. We recommend that DFCM management review staffing needs in the leasing unit.

4. We recommend that DFCM develop formal policies and procedures for leasing activities.

5. We recommend that the Real Estate Section comply with **Utah Code** 63A-5-302(c) et seq. by performing the various responsibilities listed therein and that DFCM develop performance measures for leasing based on those responsibilities.

This Page Left Blank Intentionally

Agency Response

State of Utah

Division of Facilities Construction & Management

Michael O. Leavitt
Governor
Raylene G. Ireland
Executive Director
Richard E. Byfield, AIA
Director

Department Of Administrative Services
4110 State Office Building
Salt Lake City, Utah 84114
Phone: (801) 538-3018
Fax: (801) 538-3267

September 20, 2000

Wayne L. Welsh, Auditor General
Office of the Legislative Auditor General
130 State Capitol, P.0 Box 140151
Salt Lake City, Utah 84114-0151

SUBJECT: Response to Legislative Audit Report No. 2000-04

Dear Mr. Welsh:

The Division of Facilities Construction and Management (DFCM) appreciates the substantial effort expended by members of your staff in reviewing some of the functions within DFCM. We appreciate the information provided and are working to implement the recommendations.

In particular, we appreciate the Auditor's findings in Chapter II regarding the need for increased funding to take care of the State's buildings and infrastructure. Both the Building Board and DFCM have been raising substantial concern regarding this issue for several years. We will work with the Governor and the Legislature to further develop methods to address this issue.

We wish to point out that DFCM has taken a number of steps over the last few years that we believe will assist us in addressing the recommendations raised in the audit. In 1998, DFCM underwent a substantial reorganization, primarily in the areas involving the oversight of construction projects. This resulted in a substantially smaller, yet more focussed, staff to oversee construction projects and ensure that the State receives full value for its expenditures. We have also taken a number of steps to improve processes and make better information available for those who make decisions. Unfortunately, the need to audit projects that had been completely closed out resulted in a review of our construction management that occurred almost entirely before this reorganization took place. The activity on the audited construction projects that occurred after the reorganization was primarily that of cleaning up issues that arose before the reorganization.

Another major change that DFCM has initiated was originally referred to as the Performance Based Procurement System (PBPS). This process replaces the traditional methods for selecting architects and contractors with one that relies on actual past performance and management plans for minimizing the risks involved with projects. Due to issues raised by some involved in this industry, the Building Board has expended substantial effort in evaluating the PEPS. This has resulted in what is now referred to as a Value Based Procurement process that the Board is now implementing. The PBPS showed great promise in its ability to control project costs and similar results are expected from the Value Based Procurement process, which is an improved version of the PBPS. This should continue to substantially reduce the volume of change orders and resulting demands on the Statewide Contingency Reserve.

Our specific responses to the Auditor's recommendations follow. The Auditor's recommendations are repeated and then followed by our response in order to aid the reader in understanding the issues we are responding to.

Chapter II Recommendations

1) We recommend that the Legislature review the options available to improve facility maintenance in the state, to include the following issues:

a) Consider increasing the percent of replacement value currently allocated to capital improvement projects

b) Consider separating facility cost categories from program cost categories in the state's budget and accounting systems

c) Consider convening a task force to study or direct the Building Board to submit a proposal on the viability of a rent structure for agencies that includes all components of operations and maintenance costs as well as a component for future replacement costs.

Response:
DFCM will provide information and offers its assistance in evaluating the audit suggestions and developing funding mechanisms to address the concerns raised in the audit.

2) We recommend that the Building Board develop a policy on whether and how much capital improvement funds may be used for program-oriented projects.

Response:
DFCM will assist the Building Board in developing a policy pertaining to the use of capital improvement funds for program-oriented projects.

3) We recommend that DFCM monitor the use of facility audit and condition assessment results in agencies' capital improvement requests, reporting to the Building Board and the Legislature on the incorporation of this data in the request process.

Response:
DFCM agrees with the recommendation. Our new information management system has been specifically designed to track all information documented by facility audits and condition assessments. We plan to use this database as the basis for future capital improvement requests. We also plan to include a report on how this data is being used in the 5-Year Building Program that we produce annually for the Governor and Legislature.

4) *We recommend that the Building Board develop a policy that provides for the revocation of agency maintenance delegation agreements in the event an agency fails to meet established maintenance standards.*

Response:
DFCM has initiated dialogue with the Building Board to develop a policy for the process of revoking agency maintenance delegation when maintenance standards are not met. However, there are some challenges that would need to be overcome in revoking an agency's maintenance delegation. The biggest challenge is that the funding and associated staff for maintenance is located within the agency's budget while the authority to expend that budget would be shifting to DFCM. This is aggravated by the condition noted in the audit that past budget and accounting procedures have not clearly identified how much was intended to be spent on maintenance and how much has actually been spent on maintenance.

This situation would greatly complicate the transition of maintenance responsibility as there would likely be disputes regarding the amount of funding that should be provided to DFCM to pay for the maintenance. In response to similar concerns raised by others prior to this audit, the Governor's Office of Planning and Budget created a new form for reporting maintenance budgets and expenditures starting with the current budget cycle. It is still too early to assess the effectiveness of this new reporting requirement.

Chapter III Recommendations

1) *We recommend that the Building Board adopt policy language that clarifies acceptable project budget transfers.*

Response:
DFCM will work with the Building Board to develop a formal policy that clarifies when transfers between lines within a project budget are allowable and that provides for appropriate justification, approval and reporting.

2) *We recommend that project close-out reports to the Legislature provide full cost information, including all agency paid costs.*

Response:
DFCM will ensure that all project close-out reports include all costs. The exceptions noted by the Auditor are the result of necessary accounting adjustments not being made on some of the reports that were provided.

3) *We recommend that DFCM limit the use of contingency reserve funds to unforeseen expenses. Additionally, we recommend that expenses that can be planned for should be budgeted in the project.*

Response:
DFCM concurs with the Auditor's recommendation and has been working to this end for many years. Prior to 1990, DFCM covered the cost of inspection, surveys, insurance, legal services and similar project costs from an account known as the Project Administration Fund. This account was funded through a line item in each project budget. The 1990 Legislature chose to discontinue this account and directed DFCM through intent language to cover these costs from the Contingency Fund.

DFCM has been working with the Legislative Fiscal Analyst and the Capital Facilities Appropriations Subcommittee for a number of years to provide categories within project budgets for these items. As of the last legislative session, most of the items noted by the Auditor have been provided for within the project budget. DFCM will submit project budgets to the next legislative session that fund all of the items noted by the Auditor. It should be noted, however, that the Contingency Reserve will continue to be accessed appropriately when the actual cost of these items exceeds the amount that was anticipated in the budget due to unforeseen circumstances.

4) *We recommend that the Building Board update and clarify the policy on payment and classification of change orders so that clear direction is provided to program directors as well as agencies and contractors.*

Response:
DFCM concurs with the recommendation that it work with the Building Board to clarify policies regarding the classification and funding of change orders. We are working with our staff to obtain a consistent understanding and application of this policy. Over the past two years, DFCM has initiated a new procurement method that has resulted in a substantial reduction in change orders. DFCM recently received approval from the Building Board to expand its use of the Value Based procurement method. This is expected to dramatically reduce the demands on the Contingency Reserve from change orders.

5) *We recommend that the Legislature consider whether additional controls over contingency fund expenses are needed; if so, we recommend they consider implementing a project-specific contingency reserve fund or requiring Building Board approval for contingency fund draws exceeding project contribution level.*

Response:
DFCM will work with the Building Board to address the suggestion that approval be obtained from the Building Board before a project may draw more from the Contingency Reserve than it contributed. This could be implemented without legislation. It should be noted that current policy and practice provide for a regular reporting of Contingency Fund activity. Written explanations are provided for substantial draws.

DFCM strongly disagrees with the Auditor's alternative proposal that the structure of the Contingency Reserve be changed from a statewide fund to a project-specific fund. We believe that such an action would return the State to the same challenges it faced prior to the creation of the statewide fund and that it would promote the very abuses that the Auditor is seeking to eliminate.

While it is true that a project-specific fund would prevent projects from going significantly over budget; it would reinforce the perception that many agencies currently have that the amount budgeted for contingency should be accessible to them to pay for the things that they want to have in the project. Another drawback with this approach is that if a project encountered substantial budget difficulties, it would either have to be stopped pending additional funding from the next legislative session or completed without essential elements that would have to be added later. Either action would result in a substantially higher final cost.

Chapter IV Recommendations

1) We recommend that the Legislature amend the Utah Code to clarify that DFCM can use a market search option in addition to the RFP process in the procurement of leases.

Response:
DFCM concurs with the recommendation to use a market search for smaller procurements of lease space. We will work with the Building Board to adopt procurement rules that provide guidelines for how this process will work and the size of procurement that can utilize it.

It should be noted that when the Legislature adopted the statutes that currently govern leasing by DFCM, a conscious action was taken to require that this leasing activity follow the requirements of the State Procurement Code. As a result, DFCM has been utilizing the Request For Proposal method provided for by the Procurement Code. The Procurement Code does contain a provision for alternative procedures to be used for small procurements. We believe that this would allow the Building Board to adopt rules defining a "small lease procurement" and authorizing the use of the market search for those procurements. This would not require legislative action to implement.

2) *We recommend that DFCM should involve state agencies when locating space to lease.*

Response:
DFCM currently involves state agencies throughout the leasing process. It appears that the concern being raised by agencies has more to do with their role in the process. DFCM will review this issue and discuss it with our major customers to look at what roles are appropriate.

3) *We recommend that DFCM management should review staging needs in the leasing unit.*

Response:
As changes are resolved in the leasing process and the relative roles of DFCM and the agencies, DFCM management will review its staffing needs in this area.

4) *We recommend that DFCM develop formal policies and procedures for leasing activities.*

Response:
DFCM concurs with the need to enhance its policies and procedures for leasing.

5) *We recommend that the Real Estate Section comply with Utah Code 63A-5-302(c) et seq. by performing the various responsibilities listed therein and that DFCM develop performance measures for leasing based on those responsibilities.*

Response:
DFCM will evaluate leases as required by the referenced statute. DFCM will also develop performance measures for the leasing area that include the responsibilities listed in the statute.

We appreciate your consideration of our response to this audit and look forward to resolving the issues raised therein.

Sincerely,

Richard E. Byfield,
Director

cc:
Raylene Ireland
David Adams