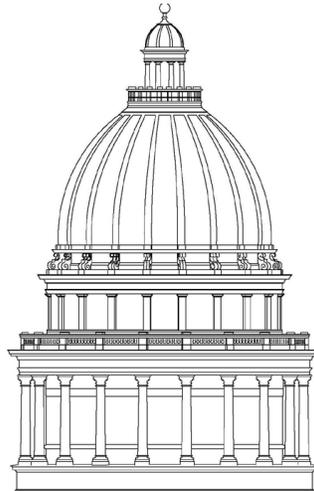


REPORT TO THE  
**UTAH LEGISLATURE**

Number 2011-08



**A Performance Audit of  
Higher Education Operation  
and Maintenance Funding**

September 2011

Office of the  
LEGISLATIVE AUDITOR GENERAL  
State of Utah





STATE OF UTAH

# Office of the Legislative Auditor General

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JOHN M. SCHAFF, CIA  
AUDITOR GENERAL

September, 2011

TO: THE UTAH STATE LEGISLATURE

Transmitted herewith is our report, **A Performance Audit of Higher Education Operation and Maintenance Funding** (Report #2011-08). A digest is found on the blue pages located at the front of the report. The objectives and scope of the audit are explained in the Introduction.

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

Sincerely,

A handwritten signature in black ink that reads "John M. Schaff" with a stylized flourish at the end.

John M. Schaff, CIA  
Auditor General

JMS:KRM/lm



# Digest of A Performance Audit of Higher Education Operation and Maintenance Funding

Higher education operation and maintenance (O&M) funding in the state is at a crossroads. In recent years, many new buildings have been constructed without an identified source of funds to operate and maintain the facility. In many instances, higher education officials feel the Legislature should (and perhaps eventually will) provide O&M funds for these new facilities. However, in the last two years the Legislature has approved institutional requests to build some facilities with the caveat that they may not request O&M or capital improvement funding in the future. We are concerned that adding buildings to campuses without an identified O&M funding source will dilute the resources intended for facilities with legislatively approved funding.

**O&M Appropriations Lose Their Identity After Funding, Thereby Reducing Transparency.** Tracking O&M funding to determine if it is being used for its originally allocated purpose is not possible. O&M funding is commingled at the institution level when appropriated by the Legislature and thereby loses its identity. Accordingly, it is not known how closely institutional O&M spending resembles actual legislative funding for O&M. This lack of information reduces the transparency of O&M funding and does not allow for complete accountability of funds.

**Legislature Could Consider Clarifications to State Policy.** If the Legislature feels greater transparency and accountability are needed for institutions' state O&M funds, policy clarifications should be considered. Options the Legislature could consider include: funding O&M as an appropriation unit and make state O&M funding decisions for non-state funding buildings before construction.

**Institutions Do Not Track O&M Funding Sources** Although institutions could not provide the data we initially sought, we were able to review the extensive facility data they do maintain. However, the records currently being maintained do not allow us to determine if O&M funds allocated by the Legislature in association with new buildings are being used for non-O&M expenditures, nor can we determine if funding originally intended for other academic or institutional purposes is currently being used for O&M.

**Some O&M Expenditures Raise Questions.** Because of the lack of criteria, we have no basis to assess the majority of expenditures from facilities budgets, though in our opinion, most appear reasonable. However, some expenditures raise questions. These include expenses for auxiliary facilities and for facilities not allowed to request state O&M funding.

## Chapter I: Introduction

## Chapter II: Inadequate Funding Information Limits Transparency and Accountability

## Chapter III: Institutions' O&M Budgets Are Not Tied to Legislative Appropriations

**Chapter IV:  
Improved  
Accountability of  
O&M Funds  
Requires Better  
Record Keeping**

**Institutional Records Do Not Adequately Track O&M Funding Eligibility** USHE institutions do not keep a detailed inventory of their buildings. These records track building space using several different categories. However, these records are not adequate to determine what building space is eligible to receive state-funded O&M. Although the facilities and management departments at the institutions we visited attempted to provide this data, ultimately we found inconsistencies that led us to question the data's reliability.

**DFCM Records Need To Be Updated.** Our review of DFCM's records revealed some errors. While DFCM's record is primarily used for capital improvement funding determination, eligibility for state-funded capital improvements and O&M are similar. Specifically, we found that DFCM has buildings listed as non-auxiliary when they appear to be auxiliary. These errors can overstate capital improvement funding. Our estimates, based on a limited sample, show that funding could be overstated by as much as \$2 million in a good budget year.

**Chapter V:  
Unfunded State  
O&M Recipients  
Increase Strain on  
Funding**

**Funding Plan Is Needed To Ensure O&M Stability.** We recommend that the Legislature require O&M funding plans to help ensure that institutions' O&M budgets are not taking on additional buildings without additional resources. The funding plans would also help provide more transparency to O&M funding. These plans could be required whenever the Legislature does not provide an appropriation for O&M. A concrete plan would help ensure that institutions' facilities budgets receive the needed infusion of funds by specifying the source of O&M funds.

**Chapter VI:  
Other Potential  
Funding Sources  
Should Be  
Considered**

**Reimbursed Overhead Funds Should Be Considered as an Additional Funding Source.** Over 20 years ago, the Legislature began allowing the institutions to keep their reimbursed overhead funds from federal and private sources and spend the funds at their discretion. Previously, the majority of funds had been returned to the General Fund as repayment for O&M costs already paid by the state. Partly by using the reimbursed overhead funds they have been allowed to retain, the two research universities have grown their research activities over the last two decades to the great benefit of the state.

**Revenue-Generating Activities Should Be Considered as an Additional O&M Funding Source.** With the acknowledged need for O&M funding at the institutions, all potential revenue sources should be considered. We believe the institutions should review revenue-generating activities on their campuses. Some campus facilities host public activities with admission charges and could be expected to contribute more to O&M costs. The Board of Regents should establish a policy that directs this behavior at the campuses.

# REPORT TO THE UTAH LEGISLATURE

Report No. 2011-08

## **A Performance Audit of Higher Education Operation and Maintenance Funding**

September 2011

Audit Performed By:

|                  |                 |
|------------------|-----------------|
| Audit Manager    | Richard Coleman |
| Audit Supervisor | Kade Minchey    |
| Audit Staff      | Ian Christensen |



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# Chapter I

## Introduction

Higher education operation and maintenance (O&M) funding in the state is at a crossroads. In recent years, many new buildings have been constructed without an identified source of funds to operate and maintain the facility. In many instances, higher education officials feel the Legislature should (and perhaps eventually will) provide O&M funds for these new facilities. However, in the last two years the Legislature has approved institutional requests to build some facilities with the caveat that they may not request O&M or capital improvement funding in the future. We are concerned that adding buildings to campuses without an identified O&M funding source will dilute the resources intended for facilities with legislatively approved funding.

Transparency and accountability of appropriated O&M funding is weak. In practice, the Legislature may fund a facility's ongoing O&M based on its size and function; other times, the Legislature does not fund O&M for a variety of reasons. However, our ability to review O&M issues was limited because there is neither a comprehensive record of how much funding is provided, nor a sufficient record of which buildings have been funded.

### **Adequate Care of Buildings Is Important**

Higher education facilities account for a little over one-third of the state's building inventory. However, due to the size and cost of higher education facilities about two-thirds of the state's capital asset value is held within higher education. Also, these buildings are often subject to heavy usage. USHE facilities include historic buildings, modern research laboratories, classrooms, offices, libraries, theaters, stadiums, and many others types of facilities. Proper maintenance of these structures helps to ensure that they fulfill their intended uses and their components do not have to be replaced sooner than would otherwise be necessary.

Many concerns have been expressed about the maintenance of physical facilities on campuses. For example, the following testimony

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**Transparency and accountability of appropriated O&M funding is weak.**

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**Proper care and maintenance of higher education facilities is critical in ensuring that their components last for their intended lifecycle.**

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was given by President Young of the University of Utah to a legislative committee in 2010:

We are at a crisis. . . .65 buildings on campus were without heat and hot water for days due to a line break. . . .in the past two years, 22 electrical outages have left parts of the university without power for more than 300 hours. . . .I cannot continue to do what we’ve been doing. (Capital Facilities and Government Operations Appropriations Subcommittee Feb 1, 2010)

As we spoke to individuals responsible for institutional facilities during our audit, they uniformly emphasized the importance of additional funding to adequately maintain facilities, including both campus-wide systems and individual buildings. However, some USHE officials did not generally accept the fact that the Legislature had chosen to not provide O&M for some buildings and other institutional resources were needed to fund these buildings. Institutions need to secure other funding sources to provide O&M on facilities that the Legislature has chosen not to fund.

Adequate O&M and capital improvement activities are important to preserve the state’s capital investment on USHE campuses and ensure that those facilities function optimally. O&M includes routine ongoing expenses while capital improvements include larger periodic expenses. *Utah Code* 63A-5-104 defines capital improvements as remodeling, alteration, replacement, or repair projects, and site and utility improvements with a total cost of less than \$2,500,000. Figure 1.1 provides basic statistics about all USHE facilities.

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**O&M includes routine expenses, while capital improvements involve larger periodic expenses.**

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**Figure 1.1 USHE Institutions Include More than 1,000 Buildings (FY2010).** USHE buildings represent over \$5 billion dollars of assets across the USHE campuses.

| Facilities Data for Utah System of Higher Education |               |                |
|---|---------------|----------------|
| Number of Buildings                                 | Current Value | Square Footage |
| 1,214   | \$5.4 billion | 30,500,000     |

Source: Division of Facilities Construction and Management (DFCM)

Figure 1.1 includes all USHE buildings listed on the state’s risk management database. Thus, besides education and training facilities, it includes hospitals and clinics as well as other auxiliary facilities such

as dormitories and bookstores. Hospitals and other auxiliary enterprises should fund their own O&M and capital improvement costs through internally generated revenues; these costs are not discussed in this report.

This report is focused on state O&M funding and costs. O&M expenses include the day-to-day costs of a facility such as fuel and power, routine maintenance, and custodial services. However, costs associated with programs housed in a facility (for example, academic or research staff) are not included in O&M and are not addressed in this report. As discussed below, state funding for O&M may or may not be provided for institutional facilities for a variety of reasons.

### **Not All USHE Buildings Qualify for State-Funded O&M**

The Legislature funds the operations and maintenance of many, but not all, buildings within USHE. Buildings constructed with state funds are generally provided with ongoing state O&M funds and access to state capital improvement funds. The process for approving these buildings and the associated O&M is typically straightforward. However, buildings built with non-state funds have typically been approved for construction first and then may receive O&M funding later.

The institutions may complete these non-state-funded buildings a number of years after initial construction approval was given, and then ask for the O&M. Not all of these non-state-funded buildings are provided O&M funding by the Legislature. As this report discusses, it is unclear what funding sources USHE institutions use to pay for O&M expenditures not funded by the Legislature. If the institutions do not secure alternative O&M funds for these buildings, then all buildings may suffer through the dilution of resources as state O&M funding is spread among buildings not intended for such funding by the Legislature.

When an institution receives O&M funding for a specific building, the funds are included in their Education and General (E&G) line item. Funds for many other activities are included in the same line item, including instruction, research, public service, and support

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**O&M expenses include routine maintenance, fuel and power costs, and custodial services.**

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**The Legislature funds O&M of many, but not all, buildings within higher education.**

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**Inadequate record keeping has made it unclear how many buildings the Legislature has not funded, and how the institutions are funding O&M for those buildings.**

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services. A specific record of how much the Legislature has appropriated for O&M is not maintained. The institutions have records for recent buildings constructed, 15 to 20 years back, but buildings have a life of 50 or more years. Consequently, there is no complete record that identifies all the buildings within higher education that were funded by the Legislature. The institutions do report each year on how they have expended E&G funds, including how much has been spent on O&M.

The following figure shows the budgeted O&M expenditures by institution for fiscal year 2011. Only amounts from E&G line items are included. In all, about 13 percent of E&G spending is for O&M.

**Figure 1.2 USHE Institutions Reported \$133 Million in O&M Expenditures Budgeted from E&G funds in Fiscal Year 2011.** The University of Utah is, by far, the institution with the largest O&M budget.

| Institution  | O&M Budget           | E&G Budget             | % of Total |
|--------------|----------------------|------------------------|------------|
| U of U       | \$46,474,431         | \$370,375,700          | 13%        |
| USU          | 25,277,900           | 176,110,400            | 14%        |
| WSU          | 11,649,376           | 116,558,400            | 10%        |
| SUU          | 8,172,674            | 57,784,100             | 14%        |
| UVU          | 13,104,401           | 140,983,300            | 9%         |
| Snow         | 5,336,865            | 25,551,300             | 21%        |
| DSC          | 5,053,178            | 33,173,000             | 15%        |
| CEU          | 1,521,178            | 14,614,500             | 10%        |
| SLCC         | 16,488,059           | 104,395,200            | 16%        |
| <b>Total</b> | <b>\$133,078,062</b> | <b>\$1,039,545,900</b> | <b>13%</b> |

Source: Board of Regents A-1 Reports for FY 2011 Budget for E&G line items.

The growing demands for O&M on older USHE buildings and the O&M needs of new and planned USHE buildings have elevated the topic of O&M. We believe that O&M funding is currently at a crossroads in that more transparency and accountability are needed to ensure state funds are used as intended.

### Audit Scope and Objectives

We were asked to audit the Utah System of Higher Education to review whether state funding for O&M is being used and allocated by

The institutions report \$133 million in O&M expenditures for fiscal year 2011.

We were asked to review whether state funding for O&M is being correctly used and allocated.

the institutions for its original purpose. The scope of our audit included the following areas:

- Review legislative appropriation of O&M funds to higher education institutions
- Compare institutions' facilities' O&M budgets with legislative appropriations
- Review institutions' O&M records
- Review use of state O&M funds
- Review other potential O&M revenue sources available to institutions

Most of our work was completed with the University of Utah (U of U) and Utah State University (USU). These institutions account for most of the O&M expenditures in higher education and probably have the most complex systems. We met repeatedly with both institutions' staff, trying to understand their processes and challenges. We also contacted facilities staff at other institutions and the Board of Regents to help address our objectives.

We also note that this audit had an extended time frame because of other audit needs. Although our audit began in 2010, work was suspended for a time when staff auditors were reassigned to complete other audit reports in time for the 2011 Legislative General Session.

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## Chapter II

# Inadequate Funding Information Limits Transparency and Accountability

Inadequate information limited our ability to address the initial scope of our audit: to determine if legislatively appropriated operations and maintenance (O&M) funding was being used according to its original purpose. We found that O&M funds are appropriated with other education and general (E&G) funds so the amount provided through appropriations is unknown. Further, records are not maintained on which buildings are entitled to receive state O&M funds. While information on some buildings can go back 75 years or more, we could not get reliable information on buildings even 15 or 20 years old. There simply is no readily accessible record of which facilities have been provided O&M funds by the Legislature.

Consequently, the amount of legislatively appropriated O&M funds that actually make up an institution's O&M budget is unknown. An institution could have transferred O&M funds to other priorities or supplemented their O&M budget with other funds. These record limitations make it an unworkable task to complete an inventory of the O&M funding sources of all buildings on the Utah System of Higher Education (USHE) campuses. It is important to note that we could not substantiate concerns relayed to us that O&M funding is inadequate for those buildings the Legislature has agreed to care for. The absence of data simply provides no basis for such an analysis.

### O&M Appropriations Lose Their Identity After Funding, Thereby Reducing Transparency

Tracking O&M funding to determine if it is being used for its originally allocated purpose is not possible. O&M funding is commingled at the institution level when appropriated by the Legislature and thereby loses its identity. Accordingly, it is not known how closely institutional O&M spending resembles actual legislative funding for O&M. This lack of information reduces the transparency of O&M funding and does not allow for complete accountability of funds. Although accountability of state O&M funding is lessened, the

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**Inadequate information limited our ability to determine if legislatively appropriated O&M was being correctly spent.**

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**We could not substantiate concerns that O&M funding is inadequate for Legislative funded buildings. The absence of data provided no basis for such an analysis.**

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existing system provides institutions flexibility to address their needs according to their judgment.

At the beginning of the audit, several individuals raised questions about the propriety of state O&M funding going to certain types of buildings (for example, athletic space, like the Spectrum Basketball Arena at USU, or fine art space, like Pioneer Memorial Theater at the U of U). We found that current policies, practices, and data are insufficient to answer the question. If policy makers desire more transparency and accountability of appropriated O&M funding, then better tracking and reporting of these funds is needed.

### **Legislative O&M Funding Decisions Are Not Tracked Over Time**

The amount of O&M funding provided to institutions by the Legislature is an accumulation of amounts provided over multiple years. However, the total funding is unknown because no one tracks it. O&M is not a separate line item, but is one part of the multi-component Education and General (E&G) line item. Thus, O&M funding for new buildings is added to the E&G appropriation, at which point the funds lose their identity as O&M funds and become, simply, E&G funds.

The Legislature decides whether to fund O&M on a building-by-building basis. As a rule, state-funded construction receives state O&M funds, but auxiliary enterprises (for example, hospitals, housing, or bookstores) do not. Less certain are campus facilities constructed with non-state funds; the Legislature may or may not provide O&M funding. Regardless, whenever state O&M funds are provided, those funds increase the institution's ongoing E&G funding.

Some additional O&M funding adjustments may occur over time. For example, the Legislature has sometimes provided additional funding for rising utility costs. In addition, salary increase funding, including Cost of Living Adjustments (COLAs) and merit increases for staff, increases the E&G appropriation; about 46 percent of O&M is personnel costs. However, budget cuts may also occur, reducing E&G funding and affecting all institutional programs, including O&M.

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**The total amount of state O&M funding provided to institutions is unknown.**

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**Appropriated O&M funds increase an institution's ongoing E&G funding.**

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## **Buildings Designated for State O&M Funding Are Not Tracked Over Time**

In addition to the lack of information about O&M funding totals, there is no inventory of those buildings appropriated state O&M. As discussed more fully in the next section, some buildings are appropriated a specific amount of state O&M funds, while other buildings are denied state O&M funds. However, a complete record of the funding decisions made over time is not available.

We began our audit work by asking the institutions which buildings had been provided state O&M funding. We worked extensively with the University of Utah and Utah State University staff as they tried to assist us. Eventually, however, it became clear that no one has maintained records of which buildings have been provided state O&M funding over the years. Generally, only auxiliary buildings (including hospitals) are acknowledged as ineligible for state-supported O&M, so other facilities are assumed to be eligible. The building records that the institutions have are discussed more in later chapters.

**O&M Funding Is Not Reserved for Specific Buildings.** It is important to point out that O&M funding provided for a specific building is not held in reserve for use on that building alone. A new building that has its O&M funded does not usually require the full amount of O&M in its first several years. Instead, O&M funding is effectively pooled to pay for the O&M expenditures of other buildings on a campus. Because increases in O&M are provided in amounts related to a specific building's square footage, we initially assumed that funds given to a building are dedicated to that building.

This inaccurate assumption often exists on campuses. One facilities director explained that he frequently has to remind building tenants that the O&M funding appropriated to "their" building is not dedicated to it. He said that he redirects funding away from new buildings to fund operations on the campus as a whole. While it seems reasonable that state O&M funds be shared with other buildings approved for such funding, we question whether these funds should be applied to buildings denied state O&M funds by the Legislature.

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**No historical inventory of buildings provided state O&M funds has been maintained.**

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**O&M funding provided for a specific building is not held in reserve for use on that building alone; instead the funding is pooled to pay for other buildings on campus.**

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## Legislature Decides O&M Funding On a Building-by-Building Basis

When a facility's construction is funded, the Legislature decides whether or not to fund its O&M. A key consideration is whether the facility is (1) state funded, (2) auxiliary, or (3) non-state funded. As a rule, state-funded construction receives state O&M funds, but auxiliary enterprises do not. Less certain are campus facilities constructed with non-state funds. Historically, non-state funded construction has had a delayed consideration of O&M funding, but recent legislative actions may signal a policy change.

### **New State-Funded Construction Is Routinely Provided State O&M**

When the Legislature funds a new building, it addresses ongoing O&M costs at the same time. The amount of O&M required is based on the size and type of space. An ongoing appropriation is provided at that time, even though construction has not yet commenced. Then, until the facility is ready for operation, the O&M amount is subtracted each budget year in one-time funds. Since the 2005 General Session, this practice has been followed to repair the previous disconnect between the Infrastructure and General Government Appropriations Subcommittee (approves new facilities' construction and funding) and the Higher Education Appropriation Subcommittee (funds operating budgets, including O&M).

For example, in 2011 the Legislature approved an increase of \$725,000 to Weber State University to pay for O&M of a new Professional Programs Classroom Building to be constructed with state funds on the institution's Davis Campus. Figure 2.1 shows how that amount was calculated.

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**A key consideration to a building receiving appropriated O&M funds is whether the facility is state funded, auxiliary, or non-state funded.**

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**State-funded buildings receive O&M based on the size and type of space.**

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**Figure 2.1 Calculation of O&M Funding Amount for the Professional Programs Classroom Building.** Funding amounts are based on the type and amount of space times a predetermined rate.

| Type of Space           | Square Feet   | Rate per Square Foot | O&M Funding Amount |
|-------------------------|---------------|----------------------|--------------------|
| Classroom or Office     | 89,007        | \$ 7.66              | \$ 681,794         |
| Central Utilities Plant | 5,500         | 7.88                 | 43,340             |
| <b>Total</b>            | <b>94,507</b> |                      | <b>\$ 725,134</b>  |

Note: Building spaces designed to be occupied by a charter school and by a student union are excluded from the O&M calculation since they will be charged for O&M.

By adding \$725,000 to WSU’s ongoing appropriation in fiscal year 2012, the Legislature provided the funds needed to care for the building once completed. While this process makes it seem as though the new O&M funds are dedicated to the new building, the funds will become commingled and may be spent at the discretion of the institution.

**Auxiliary Facilities Do Not Receive State O&M**

Auxiliary facilities should not receive state O&M because they are intended to be self supporting. Auxiliary enterprises include bookstores, dormitories, parking services, hospitals, and some other facilities that generate income. Since these business enterprises are intended to be self supporting, the charges to customers should cover all auxiliary expenses including O&M.

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**Auxiliary buildings are intended to be self-supporting and do not receive state O&M funds.**

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**Facilities Built with Non-State Funds May Be Considered for Possible State O&M Later**

Institutions frequently develop non-state sources of funds (for example, private donations or federal funds) to build facilities. When non-state funds are used to construct a new building, the Legislature does not provide ongoing O&M funds at the time of approval. Instead, the Legislature has often included statutory language allowing an institution to request O&M in the future if the building meets an academic or training purpose.

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**When non-state funds are used to construct a new building, the Legislature does not provide ongoing O&M funds at the same time.**

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For example, in 2009 the Legislature authorized the University of Utah to use \$30,737,000 in donations to plan, design, and construct a

Sorenson Arts and Education Complex with 85,400 new square feet. The legislation required that “no state funds be used for any portion of this project,” but it provided that:

The university may request state funds for operation and maintenance costs and capital improvements to the extent that the university is able to demonstrate to the Board of Regents that the facility meets approved academic and training purposes under Board of Regents policy R710.

At the time, the university estimated that the building would require \$573,566 annually for O&M (as well as \$1.5 million for added program costs). Although construction has begun, no provision has been made for future O&M costs. When the building nears completion, the university may request increased O&M funds. Thus, years after one Legislature authorized the university to construct a facility with donated funds, another Legislature will have to consider whether to fund the increased O&M that arises.

### **Recent Legislative Sessions May Signal a Change in State Policy**

For many years, the Legislature has allowed institutions to request O&M funds for non-state-funded buildings on a deferred basis as discussed in the prior section. According to a Legislative Fiscal Analyst’s Issue Brief, “Operation and maintenance costs are not funded at the time a non-state funded project is approved.” Instead, institutions have generally been allowed to request an additional appropriation for O&M from the Higher Education Appropriations Subcommittee when the facility is ready for occupancy. However, the past two years the practice has changed.

For example, in 2010 the University of Utah was allowed to “use \$17,878,000 in donations, federal funds, and institutional funds to plan, design, and construct an addition to the Henry Eyring Building, with 40,915 new square feet” with the provision that “no state funds be used for any portion of this project.” Although the project added space intended for academic and training purposes, statute provided that “the university may not request state funds for operation and maintenance costs or capital improvements.”

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**Institutions have generally been allowed to request an additional appropriation for non-state funded buildings once they were operational. However, over the past two years the practice has changed.**

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At the time, the university requested that they be allowed to ask for O&M when the building was completed in three years. However, in the appropriations subcommittee, the co-chair stated that: “Legislative policy is clear . . . at the time buildings are requested we appropriate ongoing O&M.” Further, the co-chair explained that as a taxpayer and a legislator, he did not want authorizing the institution’s request to build to be seen as obligating, or even creating an expectation for, ongoing O&M appropriations in the future. Thus, the U of U should not proceed with construction unless they have other funds available for O&M needs.

Because university officials felt the facility addition was critical to their Chemistry program, they agreed that O&M would be funded through existing budgets or with other institutional funds. To ensure the institutions are providing other funds for O&M on these buildings, Chapter V of this report recommends a funding plan that is designed to provide details on where these other institutional funds are being obtained.

### **Process May Lead to Inflated Funding Expectations**

As we met with USHE personnel, it was clear they felt additional O&M funding should be provided by the Legislature. Institutions feel if they were allowed to request funding by statutory language such as that shown earlier, then it should be provided. Further, institutions feel the Legislature should follow through with O&M funds when they develop private sources to construct buildings.

### **Institutions May Misinterpret Permission to Request O&M Funding**

Staff from the Office of the Legislative Fiscal Analyst has told institutions that permission to request funding does not guarantee it will be provided. However, institutional staff told us that traditionally the Legislature has funded such requests and so it is expected.

One indication that institutions have greater funding expectations than intended by the Legislature is that the Board of Regents’ policy is explicitly much broader than the “academic and training purposes”

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**The Legislature has added statutory language prohibiting institutions from requesting O&M for some non-state funded buildings.**

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**Institutions feel the Legislature should provide O&M funding for all non-auxiliary buildings.**

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**The Board of Regents policy on O&M funding eligibility is much broader than that in the statute.**

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included in the statutory language. Policy R710 takes what may be described as an “institutional mission” approach to O&M funding. After listing the types of space the Board of Regents considers eligible, the policy states:

The Board, on a case by case basis, may determine that an acquisition, construction or remodeling project to be used primarily for purposes other than approved academic and training purposes and associated support should be eligible for state appropriated O&M funds in whole or in part.

Under this definition, the Board of Regents has significant latitude when approving buildings eligible for state O&M funds. While higher education officials decide whether a building is eligible for state-funded O&M based on their policy, the Legislature will make a separate decision on whether to provide it.

### **Institutions Expect O&M Funds For Donated Buildings**

Higher education officials also feel that state O&M funds should be provided for privately funded (non-state funded) buildings. For example, according to Board of Regents minutes from August 2010,

The presidents also agreed that O&M funding was necessary to maintain their facilities. Many buildings are being erected with private donations, but state funding is needed to help pay the ongoing maintenance costs.

The likelihood of future state O&M funding for donated buildings is unclear. As mentioned above, in the last two general sessions, the Legislature included language prohibiting institutions from requesting O&M funds for some buildings.

Although donations for buildings are very valuable, the O&M is needed as well. Typically, constructing a building constitutes only about one-third of the total cost of ownership when O&M and capital improvements are considered. As discussed later in Chapter V, for a building with a 50 year life, O&M and capital improvement costs can be expected to be twice the cost of construction.

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**Higher education officials feel that state O&M funds should be provided for non-state funded buildings.**

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**While donations for buildings are very valuable, construction cost only accounts for about one-third of the total cost of ownership.**

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## Institutions' Sources of O&M Funds Are Unclear

Higher education officials feel the Legislature should provide more O&M funding. They report that for the past three years, the “amount of forgone O&M funding” now totals \$4.3 million. This figure represents the annual amount that USHE officials feel the Legislature should provide for new facilities’ O&M, but has not. However, the Legislature never promised funding for these facilities. Still, as discussed more fully in Chapter V, USHE officials identified 23 buildings that were “either not funded for qualifying O&M or were not authorized to seek O&M funding at the appropriate time.”

It is unclear how USHE plans on funding the O&M for these buildings. In a report to the Board of Regents, the Commissioner of Higher Education writes:

Some of these projects are already on-line, and since O&M expenses are essentially fixed costs, they have required institutions to reduce other budgets to compensate. When additional projects come on-line the ensuing costs will result in further reallocations. Ultimately, the ability of institutions to attract non-state funds to meet future capital facilities needs might be jeopardized should this lack of support for O&M funding continue.

In addition to \$4.3 million in forgone O&M funding identified by USHE, more buildings are in the pipeline. For example, as discussed earlier, the U of U is authorized to request O&M funds in the future for the Sorenson Arts and Education Complex.

Similarly, a facility is under construction at the College of Pharmacy. A pharmacy building expansion was authorized by the 2006 Legislature with an anticipated future O&M need of \$1.3 million per year. This example as well as other examples at the U of U and other institutions, were authorized to request O&M funds in the future. Whether the Legislature will provide new state funding to meet the O&M needs or whether institutions will need to develop other sources is unclear.

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**Several buildings are in the construction phase that will require O&M funds in the future. The source of funding for these needs is unclear.**

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## Legislature Could Consider Clarifications to State Policy

This chapter has described the difficulty we had trying to review state O&M funding for institutions. As we met with campus personnel, we found many were frustrated with their inability to properly maintain campus infrastructure and buildings. Although campus officials think the Legislature should provide more funding, they typically do not recognize that the Legislature has chosen to provide O&M for some buildings but not others. The Legislature apparently believes that higher education institutions have the responsibility to identify other sources of O&M funds for those facilities that are not appropriated state O&M funds.

If the Legislature feels greater transparency and accountability are needed for institutions' state O&M funds, policy clarifications should be considered. The main advantage of change would be to better ensure campus facilities are adequately maintained. However, a disadvantage to changing policy could be less institutional flexibility to meet needs they feel are important. Options the Legislature could consider include the following:

- **Funding O&M as an Appropriation Unit.** One result of choosing this option would be a better record of how much O&M funding the Legislature had provided each institution. In addition, it would still allow USHE autonomy to shift funds within the E&G line item appropriation.
- **Make State O&M Funding Decisions for Non-State Funded Buildings Before Construction.** This approach would reduce the expectations of institutions that O&M funds will be forthcoming at a later point in time.

While we list these options here, we recognize that they constitute significant changes that need discussion between legislators and USHE officials. In addition, there are other changes that should be considered with or without these options. For example, institutions could be required to keep records of O&M funding sources and inventories of state-funded buildings. Also, documentation of O&M funding plans for all non-state-funded buildings could be required. These additional changes are discussed more later in the report.

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**Policy clarifications are needed if the Legislature desires greater transparency and accountability.**

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## **Recommendations**

1. We recommend that the Legislature consider funding O&M as an appropriation unit within the E&G line item.
2. We recommend that the Legislature review its policy and consider making state O&M funding decisions for non-state-funded construction at the time a building is authorized or (if construction is delayed) before construction begins.

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## **Chapter III**

# **Institutions' O&M Budgets Are Not Tied to Legislative Appropriations**

Because funds are commingled as described in the prior chapter, O&M budgets established at USHE institutions could not be traced to O&M amounts appropriated by the Legislature. Instead, O&M budgets are simply the amount allocated by the institution. Of course, the institutions weigh many competing demands on available funds. While the focus of this report is on facilities, institutions have broader concerns.

We began our audit work by asking institutions for records of how much state O&M funding they received and which facilities were approved recipients. Since adequate records have not been kept, we have no way of knowing whether O&M funds allocated by the Legislature in association with new buildings are being used for non-O&M expenditures, nor can we determine if funding originally intended for other academic or institutional purposes is currently being used for O&M. However, we found that institutions' O&M expenditures from E&G funds include some questionable items, discussed later in the chapter.

### **Institutions Do Not Track O&M Funding Sources**

Although institutions could not provide the data we initially sought, we were able to review the extensive facility data they do maintain. Board of Regents' rule requires all institutions to report annually a space inventory based on national classifications. In addition, all institutions report summary E&G budgets, expenditures and square footage data each year. Neither report, however, includes information about O&M funding sources.

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**Because funds are commingled, O&M budgets are not traceable to O&M amounts appropriated by the Legislature.**

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**Institutions and the Board of Regents have extensive facility data, but information about O&M funding sources is not available.**

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## **USHE Space Inventory Does Not Address Building Funding Status**

The Board of Regents conducts a needs analysis of academic space at each of the institutions. The Regents also inventory non-academic space as auxiliary, hospital/clinic, or institutional unique. Several subcategories in the institutional unique category account for space such as farm, greenhouse, and public services. However, this space inventory system was not designed to capture the O&M funding information needed for this audit.

We note that the term “auxiliary” can mean a variety of things. The Board of Regents policy R550 defines auxiliary as the following:

Business enterprises or other support activities (as distinguished from primary programs of instruction, research, and public service, and from organized activities and intercollegiate athletics) the primary purpose of which is to provide specified services to students, faculty, staff or guests of the institution.

This definition limits the classification of buildings to auxiliary to just a few on the campuses. However, we found that facility staff would often refer to a building or portions of a building as auxiliary if they were not maintained by the facility department. In some cases, we were provided different lists of auxiliary buildings (or building space); therefore, this report deals with these buildings in the classifications as they were presented to us.

## **E&G Expenditure and Space Report Does Not Address O&M Funding Status**

Institutions annually submit data to the Board of Regents on O&M budgets and expenditures for E&G facilities along with the amount of space included. We reviewed summary data (from the A-1 and S-2 reports) but found the reports did not indicate whether or not the O&M was state-funded.

The Board of Regents state that the purpose of the S-2 form is to report “total gross square feet of E & G facilities operated by the

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**While the Board of Regents has a definition on “auxiliary” building space, we found this term was more broadly used at the institutions.**

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institution. Average cost per gross square feet is also calculated.”  
 Figure 3.1 shows budget data reported for fiscal year 2011.

**Figure 3.1 Square Footage Report Shows Variation.** The S-2 Report from the Board of Regents shows the amount of O&M budgeted from E&G funds per square foot by institution.

| Institution  | O&M Budget           | Square Feet       | O&M per Square Foot |
|--------------|----------------------|-------------------|---------------------|
| U of U       | \$46,474,431         | 6,639,231         | \$7.00              |
| USU          | 25,277,900           | 4,349,734         | 5.81                |
| WSU          | 11,649,376           | 2,079,921         | 5.60                |
| SUU          | 8,172,674            | 1,121,475         | 7.29                |
| UVU          | 12,956,455           | 1,946,958         | 6.65                |
| Snow         | 4,008,354            | 946,703           | 4.23                |
| DSC          | 5,747,928            | 1,011,711         | 5.68                |
| CEU          | 1,475,345            | 423,662           | 3.48                |
| SLCC         | 16,513,327           | 2,009,420         | 8.22                |
| <b>Total</b> | <b>\$132,275,790</b> | <b>20,528,815</b> | <b>\$6.44</b>       |

Source: Board of Regents S-2 Reports for FY 2011 Budget.

We did not rely on the above data and other USHE reports because it did not meet our needs and proved, in some instances, to be inaccurate. For example, the O&M budget numbers reported in the S-2 report, in some cases, do not match those in another Board of Regents’ report (shown in Figure 1.2). In the case of Snow College there is a \$1.3 million dollar discrepancy. When we asked about this discrepancy we were told that the amounts should match, and the O&M budget for Snow College shown in the above figure was simply wrong. We did not spend a great amount of time reviewing trends and anomalies in this data. We show it here to illustrate the type of O&M data collected.

Another concern with the S-2 report is that it includes building space that was not funded by the Legislature. For example, the North End Zone building at USU and the Sutton Geology building at the U of U have not been appropriated O&M funds. Yet, both are listed on the report. Thus, the report reflects space that institutions believe should receive state O&M funds whether or not the Legislature has provided funding.

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**Some information in Board of Regents reports was not reliable.**

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**The Board of Regents’ report includes space not funded by the Legislature. This raises some questions about the use of the report.**

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Although the S-2 report includes space not funded by the Legislature, it affects subsequent state O&M funding requests. The average O&M funding calculation is used to estimate new O&M funding adjustments for remodeled or demolished space. Thus, including space not legislatively funded raises a concern with the use of the report. The Board of Regents should review this report for accuracy and along with the Legislature determine if it is appropriate to include legislatively unfunded space in the report.

Because reported data did not meet our needs and was not entirely reliable, we reviewed some detailed records at the U of U and USU as discussed in the next section.

### **Some O&M Expenditures Raise Questions**

We worked with the facilities departments at both the U of U and USU to understand their operations. The departments have wide-ranging responsibilities for campus maintenance. Although we tried to determine which activities were state-funded O&M costs and which were not, that was not possible. The facilities departments' budgets are not directly linked to legislative O&M appropriations.

Nonetheless, in the course of daily operations, the facilities departments must decide which activities to charge to their budgeted funds and which to charge elsewhere. For example, facilities personnel report that they sometimes get requests to repaint an office for cosmetic rather than maintenance reasons. In such cases, they bill the department for the costs in order to preserve their facilities budget for necessary O&M costs. Thus, work outside normal O&M activities is classified as billable and the recipient is charged for the cost. Normal O&M costs on E&G space is non-billable and is paid for out of the facilities department budget.

Based on a limited review, it does appear that most expenditures from facilities budgets appear reasonable. However, some expenditures raise questions. These include expenses for auxiliary facilities and for facilities not allowed to request state O&M funding.

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**Most expenditures from facilities budgets appeared reasonable. However, O&M funds going to some auxiliary and facilities denied O&M funding are questionable.**

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## Auxiliary Facilities Should Pay for Their Own O&M

According to Board of Regents' policy, auxiliary enterprises include business or support activities that are intended to be essentially self-supporting. All housing, food service, and college store activities are classified and managed as auxiliary enterprises. Other activities which are expected to be self-supporting also should be classified and managed as auxiliary enterprises. As such, self-generated revenues should cover the direct and indirect operating costs.

Relatively few facilities are designated as auxiliary enterprises. However, both the U of U and USU included O&M costs in the facilities budgets that are a concern because it appears that auxiliary enterprises are being subsidized.

**U of U Rice-Eccles Stadium and Tower.** The U of U O&M budget has been paying all of the utilities for the Rice-Eccles Stadium and Tower. Utility costs were around \$480,000 for fiscal year 2009. The stadium and tower are not entirely separately metered, so there may be some other building costs in that figure.

Revenues from a single-use rental of the tower range from several hundred dollars to over \$2,500 for events such as wedding receptions or meetings by private entities. The field is also rented at a cost of \$86,000 to over \$150,000 for football games and concerts by prominent rock bands, such as U2. For the last ten years, this facility's average annual gross revenue is \$2.6 million. For the same time period expenses have averaged \$1.8 million, leaving a ten year average annual net revenue of approximately \$800,000.

Although the facility is not listed as auxiliary in the Board of Regents' policy R550, university staff told us it is managed as an auxiliary facility and it is included in financial statement of the Auxiliary and Campus Facilities Bond System Trust Funds. Accordingly, it seems appropriate that this building be charged for its utility consumption. At the end of the audit, the U of U reported to us that they agreed Rice-Eccles should pay for its own utility cost and reported charging the stadium about \$471,000 for utility costs in fiscal year 2011. The saved O&M funds could then be used to support other buildings' O&M costs on the campus.

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**Rice-Eccles Stadium  
has averaged about  
\$800,000 in net revenue  
over the last ten years.**

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**USU dorms have been receiving about \$138,000 annually in facility department funds.**

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**USU is paying for half of the utility cost at the University Inn even though most of the space is auxiliary.**

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**The Legislature prohibited USU from requesting O&M funds for its North End Zone Building, yet the facility receives about \$133,000 a year for fuel and power.**

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**USU Student Living (Dorms).** Until recently, USU has been giving six dormitories about \$138,000 annually in facility department funds. USU believes that these six dorms have always received some O&M funding, but they have no record that it was ever appropriated. USU reported to us that, since O&M funds are in such short supply on their campus, they decided in the last budget cycle to cut funding to these dorms and use the funds on other buildings. According to the Board of Regents' policy, housing should be self-supporting and so should cover all its own O&M.

**USU University Inn.** The University Inn is a five-story hotel. The first floor is student space, but floors two through five contain lodging space, with the exception of a few offices and conference rooms on the fifth floor. No traditional USU classes are offered at the Inn. Most or all of the facility appears appropriately managed as an auxiliary. However, half of the more than \$100,000 utilities budget is being paid by the facilities department. When asked about this expenditure, a USU official said that they are paying for utility costs in this building because there is some non-auxiliary space in the building. However, this official was not sure why it was half of the utilities and not another amount. The official said that the agreement predated his time in office.

Both auxiliary and other revenue-generating facilities should be reviewed at all higher education institutions to ensure they are appropriately contributing to facility O&M costs. Some non-auxiliary facilities also generate significant revenues and are discussed in Chapter VI.

### **Facility Not Allowed to Request State O&M Still Gets Some State Funding**

We found that at least one facility denied permission to request state O&M funds are nonetheless receiving them. Limited records did not allow us to compile a complete list. As described in Chapter II, some buildings are specifically prohibited from requesting state O&M funding when they are approved for construction.

For example, during the 2004 General Session, the Legislature prohibited USU from requesting O&M funding for the North End Zone building. However, the institution provides about \$133,000 a year for fuel and power from its facility department budget that could

otherwise be used to fund maintenance on other buildings on the campus. The North End Zone building primarily contains athletic space with some study room areas. Although USU believes at least some of the space qualifies for state O&M funding, statute prohibited them from requesting it. Six other facilities have been similarly barred from requesting state O&M funding the last two legislative sessions. The question arises whether state funds may be used for O&M costs on facilities that were denied permission to request O&M funds.

## **Recommendations**

1. We recommend that the Board of Regents review the A-1 and S-2 data reported by institutions and ensure that the data is comparable and meaningful.
2. We recommend that the higher education institutions review auxiliary facilities to ensure the facilities are paying the appropriate share of O&M costs.

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## Chapter IV

# Improved Accountability of O&M Funds Requires Better Record Keeping

Inconsistent building records have reduced the accountability and transparency of O&M funding. A master building record that indicates whether a building is eligible to receive state O&M funds does not exist. Instead, varying records exist within the institutions of the Utah System of Higher Education (USHE). None of these currently maintained records within USHE enabled us to make a determination on the appropriateness of using state O&M funds for certain buildings.

Further, the Division of Facility and Construction Management (DFCM) has been maintaining a record of buildings eligible for capital improvement funding. Eligibility for capital improvement funding is often similar to that for O&M funding; if the Legislature approves O&M funding for a building, then capital improvement funding typically is also approved. However, we found what errors in DFCM's records that are inflating capital improvement funding.

A limited sample of DFCM's records at three institutions shows what appears to be about \$185 million worth of auxiliary facilities that have been incorrectly categorized as non-auxiliary facilities. These records are the basis for calculating capital improvement funding; consequently, in a normal budget year where capital improvements are funded at 1.1 percent of current replacement cost, funding may be overstated by about \$2 million.

### Institutional Records Do Not Adequately Track O&M Funding Eligibility

USHE institutions do keep a detailed inventory of their buildings. These records track building space using several different categories. However, these records are not adequate to determine what building space is eligible to receive state-funded O&M. Although the facilities and management departments at the institutions we visited attempted to provide this data, ultimately we found inconsistencies that led us to question the data's reliability. In short, we were unable to obtain a

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**A master building record indicating whether a building is eligible to receive state O&M funds does not exist. Instead, varying records exist among the institutions.**

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**It appears that errors in DFCM records could be overstating funding by about \$2 million in a normal budget year.**

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reliable building list that denotes what buildings or parts of buildings are eligible for state O&M funds.

### **Inaccuracies and Incompleteness Exist in Institutions' Records**

At the beginning of the audit, we asked each facility management department for a list of campus buildings that included space designations so we could determine if it was being supported by state O&M funds. In response, we received inconsistent information that varied in degree of usefulness. Some of the institutions produced reports with very simple data that did not include the requested information. Some of the confusion in the building information likely stems from the fact that institutions have not tracked what buildings actually received state O&M funding; consequently, facility management staff do not know what buildings or building space (except for newly constructed buildings) have been granted or denied state O&M funding.

We are concerned that without reliable funding information, a process is created whereby unfunded buildings can dilute the funding pool used to support state-funded buildings. Below is a summary of some of the inconsistencies in data we received from the state's two research universities.

**Some Contradictory Records Exist at the U of U.** Facility staff worked carefully with us to provide the data we requested on building funding status. However, ultimately we found that since the data has not been tracked, the institution was unable to provide reliable information. The following bullet points show the different iterations of the data we received at the U of U.

- **Facility Management List:** This list was originally designed for a different purpose and did not provide us with complete information.
- **Dispatch Office List:** We requested a building list from the dispatch office which decides what special requests get state funding. This list had several differences from the first list and did not quantify all the unique attributes of buildings on campus.

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**Institutions provided us with inconsistent facility information.**

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**The U of U attempted to provide us with the requested data, but since the data had not been tracked, it was not available.**

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- **Fuel and Power List:** We requested another list of the buildings receiving state-paid utilities and buildings being billed for their utilities. This list had limitations due to metering issues, but again we found discrepancies in the data.
- **Clarification List:** After reviewing the above three lists, we put together several examples of information that conflicted with the above lists and/or the DFCM-supplied list. U of U facility management staff responded to our questions and provided updated information. This new information was useful but limited due to the lack of historical tracking.
- **Funding List:** We then asked the U of U for a list of the funding source of O&M projects by building. This report provided us additional useful information, but the data did not allow us to separate O&M expenses from special requests that may or may not be O&M related.

Again, staff at the U of U did work diligently to try to provide us with the necessary funding information, but it simply was not available to answer the questions in the scope of the audit.

**Some Discrepancies Exist in USU Records.** Similar to the U of U, officials at USU worked diligently to provide us with requested data. USU initially provided us with a record that showed what buildings were either maintained or not maintained by the facility department. The idea is that the facility department primarily maintains those building with state O&M funding. We later asked USU for a more detailed record of the O&M funding sources by building. This record was compiled specifically at our request.

This second record contained valuable information that was very detailed. This record showed some buildings being maintained by the facility department that were listed as not maintained on the first list. We asked the institution about this contradictory information and they told us that the funding record, compiled specifically for the audit, was correct. Staff also pointed out that a third record – the dispatch office record – agreed with the funding record. Without a consistent record, we have no way of determining how many buildings might be inappropriately receiving state O&M funds.

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**USU provided us with detailed information, but we could not determine the amount of state O&M funding.**

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**The Legislature should consider directing USHE to maintain records that identify O&M funding sources.**

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## **Improved Recordkeeping Can Bolster Transparency and Accountability**

To increase transparency and accountability of building use and funding, the Legislature should consider directing USHE to maintain records which identify O&M funding sources.

The Legislature could direct the Board of Regents or the institutions to maintain an inventory of their facilities that included details about the source of funds for its O&M. Since institutions already maintain an inventory of their facilities, they could add additional information about each facility's source of O&M funding.

This inventory would provide data about whether the Legislature has funded O&M. As described earlier, state-funded buildings receive O&M while auxiliary facilities do not. However, many other facilities, including non-state-funded construction, museums, and athletic space, may or may not be funded. A reliable inventory of space with state-funded O&M could provide a better understanding of the need for alternative funding sources. We believe that some institutional personnel feel that a shortage of O&M funding is the Legislature's fault, without recognizing that the institution has the responsibility to secure non-state O&M funds for some facilities.

## **DFCM Records Need to Be Updated**

Our review of DFCM's records revealed some errors. While DFCM's record is primarily used for capital improvement funding determination, eligibility for state-funded capital improvements and O&M are similar. Specifically, we found that DFCM has buildings listed as non-auxiliary when the institutions categorize them as auxiliary, and their function appears to be auxiliary in nature (e.g. hospitals, dorms, parking terraces). At least some of this inconsistency could be resolved if the State Building Board and DFCM establish a clear definition of an auxiliary facility as is required in *Utah Code 63A-5-104*, and consistently apply it.

DFCM did report to us that they are in the process of creating a new database that will assist in the tracking and management of capital

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**We found what appear to be substantial errors in DFCM's records.**

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improvement projects and could be designed to better review which buildings are auxiliary in nature.

**DFCM and Institutions Have Inconsistent Records**

Records kept by DFCM, the state's construction and facility agency, have substantial inconsistencies with records kept and maintained by the institutions. Specifically, DFCM is not listing some buildings as auxiliary that clearly appear to be auxiliary. Figure 4.1 shows examples where either Board of Regents policy or institutional records stipulate a building as auxiliary, yet DFCM has the building listed as non-auxiliary and eligible to receive capital improvement funds. The examples in Figure 4.1 are obvious inconsistencies; we believe that more exist.

**Figure 4.1 DFCM Records Are Inconsistent with USHE Records.**

This chart provides a few examples of inconsistencies between DFCM's records and USHE records. Specifically, either the Board of Regents or the institutions classify the buildings as auxiliary, but DFCM lists the buildings as non-auxiliary and thus eligible for capital improvement funding.

| Building                        | Replacement Value |
|---------------------------------|-------------------|
| <b>University of Utah</b>       |                   |
| Eccles Critical Care Pavilion   | \$54,500,000      |
| Huntsman Event Center           | 40,500,000        |
| Orthopedic Hospital             | 32,700,000        |
| Health Science NE Terrace       | 21,800,000        |
| Hospital Helipad/Parking        | 15,400,000        |
| <b>Southern Utah University</b> |                   |
| Eccles' Living Centers          | 12,300,000        |
| Ponderosa Terrace               | 1,000,000         |
| Housing Maintenance Shop        | 483,000           |
| Turnbaugh Home                  | 325,000           |
| <b>Utah State University</b>    |                   |
| Big Blue Parking Terrace        | 6,000,000         |

Source: DFCM and institutions' records. Replacement value is from DFCM data obtained from the Division of Risk Management

This figure shows just a sample of buildings at three campuses with potential inconsistencies of about \$185 million. The inaccuracies in DFCM's data can result in the appropriation of excess capital improvement funds, discussed more below. Note that some of these

**DFCM lists some buildings as non-auxiliary, when they appear to be auxiliary.**

**A sample of buildings at three campuses show potential inconsistencies of about \$185 million.**

buildings may contain space that is not considered auxiliary. For example, the Huntsman Event Center contains some office space for the institution's athletic department.

**DFCM/Risk Management Are In the Process of Creating A New Building Management Database.** DFCM reported to us that they are working with the Division of Risk Management to create a new database that could be used to address some of the concerns in this report. We believe that DFCM should include in their new database an identifier that would ensure a building can be tracked consistently across the state and higher education system. During the audit we found that a unique identifier does not exist to track a building system wide. Also, in many cases the institutions and DFCM have different building names in their respective building lists, consequently assigning a unique identifier is important.

**DFCM Needs to Consistently Apply A Clear Auxiliary Definition To Buildings.** It appears that the State Building Board and DFCM do not have a working definition as to what they consider an auxiliary facility. We attempted to obtain the State Building Board definition of an auxiliary facility, as required in *Utah Code* 63A-5-104, to assess whether the buildings DFCM has categorized as auxiliary or non-auxiliary were correct. However, the staff person we were directed to work with could not provide us with this definition. We recommend that the State Building Board and DFCM create an auxiliary definition and apply it to their building lists and data systems to ensure only properly authorized buildings obtain capital improvement funding.

### **Incorrect Categorization of Buildings Can Increase Capital Improvement Funding**

Whereas O&M funding is appropriated to support routine maintenance, capital improvement funding is provided for larger and more expensive maintenance issues. The *Utah Code* states that the Legislature will appropriate 1.1 percent of the replacement costs of non-auxiliary state facilities to capital improvement (*Utah Code* 63A-5-104). (In recent recession years, the statute has been amended to allow the Legislature to fund less than the full 1.1 percent.)

By statute, the replacement cost of existing state facilities excludes auxiliary facilities as defined by the State Building Board. As

mentioned above, we attempted to obtain DFCM's definition of auxiliary facilities to assess whether their categorizations were correct, but none was provided to us.

Using limited information, it appears that DFCM does have the building classification wrong for the buildings listed in Figure 4.1. The value of these buildings is about \$185 million. In a good budget year, multiplying that amount by 1.1 percent, the calculated legislative appropriation would, theoretically, have been overstated by about \$2 million (\$185 million x .011). That amount only takes into consideration the buildings that we identified in our limited sample.

DFCM should reconcile their data with that of the USHE institutions and update it annually to ensure that the Building Board and the Legislature are provided accurate information.

## Recommendations

1. We recommend that the Legislature consider directing the Board of Regents to maintain a record of all buildings built on campus that denotes the O&M funding source as being either state-funded or other. If the funding source does not come from state funds, the record should specifically indicate the source of the O&M funding.
2. We recommend that DFCM correct their building information by adopting a formal definition of auxiliary facilities and consistently applying it.
3. We recommend that DFCM work with higher education officials to include a unique identifier in their new database that would ensure a building can be tracked consistently across the state and higher education systems.

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**In a normal budget year, the errors in DFCM's records can lead to capital improvement funding being overstated by \$2 million.**

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## Chapter V

# Unfunded Facilities Increase Strain on State O&M Funding

The source of O&M funding for USHE buildings that receive no appropriation for O&M is unclear. Higher education officials have reported to the Legislature that the institutions use “other institutional funds.” However, the composition of those other institutional funds is not clear. Institutions could be drawing funds from a number of sources, including instructional funds.

It is concerning that institutions are able to pay the cost of an unfunded building’s O&M with state-funded buildings’ O&M monies. This practice reduces the resources available to maintain buildings the Legislature has made a commitment to fund. Thus, it reduces the level of preventative services to those buildings, which in turn increases the long-term cost of maintaining the funded buildings. Even with the data limitations previously outlined, we identified some instances where unfunded buildings are maintained with state O&M funds. We are concerned that this practice may be accelerated in the future, as O&M funding increasingly competes with other state priorities.

We recommend that institutions develop a funding plan for all buildings that do not receive a legislative appropriation for O&M. This funding plan could be approved by the Legislature before construction is authorized, or at least before construction begins. While O&M funding plans may be required in some cases by statute or Board of Regents policy, such plans are not prepared for all facilities that the Legislature has not funded. As discussed in Chapter II, the Legislature could change its current process and make O&M funding decisions on all buildings at the time of construction approval.

### Over the Life of a Building, O&M Costs Exceed Construction Costs

The construction cost is only one part of building ownership and maintenance. However, often it appears that buildings—especially

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**It is unclear what funding sources the institutions are using for O&M when it is not provided by the Legislature.**

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**We recommend the institutions develop a funding plan that stipulates where O&M funding will be obtained.**

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donated buildings—are presented to the Legislature as valuable gifts that the Legislature would be unwise to reject. While donations are very valuable and may often be essential to constructing some facilities, it is important that the total cost of ownership of these buildings be well understood.

As an example of the total cost of ownership for a building, Figure 5.1 shows this cost for two buildings at Salt Lake Community College. The calculation includes O&M appropriated by the Legislature and capital improvement funds at 1.1 percent of construction cost and multiplies it over the 50-year expected life of the building.

**Figure 5.1 O&M Costs Exceed Construction Costs.** Construction represents only about one-third of the total cost of ownership (excluding program costs). A building’s costs subsequent to construction present the greatest demands for funding.

|                            | SLCC<br>Jordan Health and<br>Science Bldg.<br>Built with State Funds<br>2007 |      | SLCC<br>Science and<br>Industry Bldg.<br>Built with Non-State<br>Funds, 1995 |      |
|----------------------------|--|------|--|------|
| Construction               | \$26,456,000   | 34%  | \$14,667,000   | 35%  |
| Operation and Maint.       | 38,097,000   | 48%  | 19,488,000   | 46%  |
| Capital Improvements       | 14,551,000   | 18%  | 8,067,000  | 19%  |
| Total Cost of<br>Ownership | \$79,104,000   | 100% | \$42,222,000   | 100% |

Source: SLCC and DFCM 5-year book  
Data is calculated using a 50-year expected building life

As this figure shows, the most substantial cost for constructing and maintaining a building is the O&M. Construction of the buildings accounts for about one-third of the total cost of ownership over the fifty-year life, while O&M and capital improvement costs comprise about two-thirds of the total cost of owning these buildings.

For legislatively funded buildings, the above costs are paid from legislatively appropriated O&M and capital improvement funding. Our primary concern is with those buildings that the Legislature does not fund. Without an increase to the O&M budget, it is not clear how the institutions are funding O&M.

**The most substantial cost of owning a building is the ongoing O&M, not the initial construction cost.**

## Funding Plan Is Needed To Ensure O&M Stability

We recommend that the Legislature require O&M funding plans to help ensure that institutions' O&M budgets are not taking on additional buildings without additional resources. The funding plans would also help provide more transparency to O&M funding. These plans could be required whenever the Legislature does not provide an appropriation for O&M. A concrete plan would help ensure that institutions' facilities budgets receive the needed infusion of funds by specifying the source of O&M funds

### Unfunded Buildings Can Strain O&M Budgets

A funding plan would help ensure that O&M budgets would be sufficient to properly maintain all the building and infrastructure resources on higher education campuses. Of primary concern is the practice of adding unfunded buildings to the established O&M budget without identifying a funding source. Limited records did not allow us to compile a full list of these occurrences, but we were able to identify some instances that are discussed throughout the report.

Adding the care of unfunded buildings to the facility budget puts a strain on all the other buildings being maintained within the facility budget. Some facility directors have reported that they do not currently have sufficient funds to maintain all their buildings. Consequently, they reduce the preventative maintenance on essential equipment in the buildings, which increases the costs of maintenance over the life of the buildings.

Figure 5.2 graphically illustrates the process of placing a building with unfunded O&M costs in the care of a facility department without additional resources.

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**O&M funding plans would help ensure that an institution's facilities budget receives needed funds when a new building is operational.**

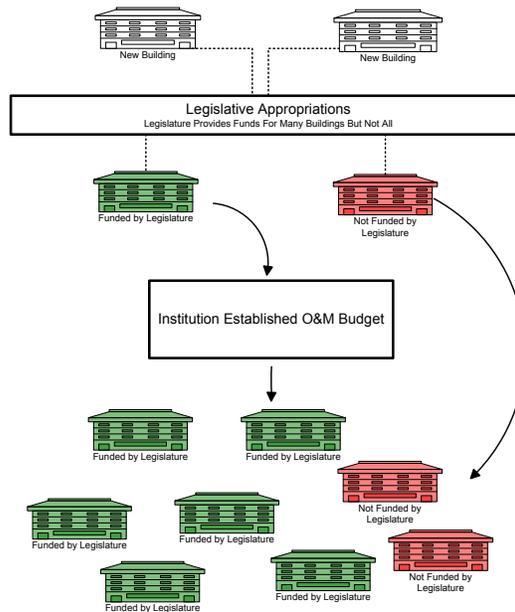
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**Adding unfunded buildings to an institution's facility budget adds strain to all buildings.**

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**Figure 5.2 Unfunded Buildings Can Bypass Institutions' Budget Process, Increasing the Strain on Facility Departments.** If institutions do not provide an alternate funding source for unfunded buildings, funding for items such as preventative maintenance is reduced for all buildings and long-term costs can increase.



This is only an illustration and does not represent an actual ratio of funded to unfunded buildings.

The buildings depicted in red in the above figure represent buildings that did not receive O&M funding from the Legislature. These unfunded buildings can find their way into the pool with other funded buildings because the current recordkeeping does not prevent such additions from occurring.

As previously stated, a lack of records prevents us from compiling a complete list of “red” buildings that fall in the category shown in Figure 5.2. However, as discussed in Chapter III, the North End Zone building at USU is an example. We believe other examples include the Adams Theater at SUU and many of the Fort Douglas buildings at the U of U.

### Recent Unfunded Building Examples Show the Need for a Funding Plan

Perhaps of a larger concern; however, is the potential for a future increase in the use of O&M budgets for unfunded buildings' O&M costs. In recent years, a number of buildings within the USHE system

**A lack of records prevented us from compiling a list of all unfunded buildings being subsidized by the facilities budget.**

have not received O&M funding, but were approved for construction. In most cases, the institutions we worked with could not specify the source of current or future funding to maintain these buildings. Figure 5.3 provides a list (compiled by the USHE) of buildings which we are concerned could create even more unfunded buildings and increase the strain on existing O&M budgets.

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**We are concerned that without a funding plan, future unfunded buildings may increase the strain on facility budget.**

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**Figure 5.3 Examples of Recent Buildings Where an O&M Funding Plan Is Needed.** This list was recently compiled by USHE and shows their examples of legislatively unfunded buildings. Note: this list was revised by the Board of Regents' staff after some errors were identified in the original list.

| Institution             | Project                                      | Estimated O&M      |
|-------------------------|--|--------------------|
| <b>Fiscal Year 2010</b> |  |                    |
| U of U                  | Sutton Geology                               | \$ 480,600         |
| U of U                  | Lassonde Entrepreneurial Center              | 58,600             |
| U of U                  | Red Butte Arboretum Visitors' Center         | 6,800              |
| U of U                  | Moran Eye Center                             | 235,000            |
| U of U                  | Meldrum Building                             | 76,400             |
| USU                     | Uintah Basin Entrepreneurship/Energy         | 551,000            |
| USU                     | Agriculture Equine Education Center          | 396,500            |
| USU                     | Tooele Regional Campus                       | 140,200            |
| USU                     | Early Childhood Development Building         | 496,200            |
| USU                     | Laub Athletic/Academic Bldg (North End Zone) | 266,700            |
| WSU                     | Hurst Lifelong Learning Center               | 210,500            |
| DSC                     | Training Facility                            | 40,600             |
| UVU                     | Murdock Property                             | 129,200            |
| UVU                     | Noorda Children's Theater Addition           | 56,200             |
| UVU                     | Intramural Fields                            | 51,900             |
| UVU                     | Economic Development Building                | 67,400             |
| UVU                     | Athletic Track                               | 50,000             |
| <b>Fiscal Year 2011</b> |  |                    |
| U of U                  | Eyring Chemistry Building Addition           | 344,900            |
| USU                     | Botanical Center Classroom Building          | 58,300             |
| SUU                     | Southern Utah Museum of Arts                 | 238,000            |
| <b>Fiscal Year 2012</b> |  |                    |
| USU                     | Regional Campus/Distance Education           | 291,000            |
| USU                     | Art Barn                                     | 35,000             |
| USU                     | Athletics Practice and Competition Center    | 61,000             |
| <b>Total</b>            |  | <b>\$4,342,000</b> |

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**These facilities have been deemed eligible for state O&M funding by the Board of Regents, but the Legislature has not provided funds and in some cases has prohibited future requests for state funds.**

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Source: Memorandum from the Commissioner of Higher Education to the State Board of Regents, March 16, 2011 as revised by USHE staff July 2011.

The examples in Figure 5.3 are a concern because there is no concrete plan to provide funding for the new O&M costs required by the buildings. For example, the institutions have now dropped six of the above buildings for consideration of funding (Lassonde, Moran,

Training Facility, Murdock Property, Noorda Theater, Intramural Fields). The O&M requested on these six buildings is almost \$600,000 a year. However, we are unaware of a concrete plan by the institutions to fund the O&M on these buildings. Instead these buildings could simply be added to the facility management pool of buildings they are required to maintain (“red” buildings in Figure 5.2). A better way of addressing O&M funding prior to construction could help ensure that buildings will be adequately maintained.

**Unfunded Buildings Are Difficult for the Institutions to Accept.** As discussed in Chapter III, in the 2004 Legislative General Session, the North End Zone building was prohibited from requesting appropriated O&M funding (HB 328). However, as shown in Figure 5.3 the institution continues to request funding for this building. It appears for some of these buildings that the only plan for O&M funding that the institutions have is through the Legislature. The institutions continue to ask for O&M even after the Legislature has forbidden it. This example shows why a funding plan that outlines where O&M funds will be obtained before construction starts would be useful.

**O&M Funding Expectations May Grow.** Another concern is that some of the amounts USHE identifies as unfunded O&M are higher than amounts discussed when the buildings were authorized. For example, when the Early Childhood Development Building was authorized in 2008, an anticipated O&M request of \$375,000 was identified; the amount approved by the Board of Regents is \$496,200. Board of Regents’ staff said that the amount was higher because the facility was enlarged to include more square feet than what was presented to and approved by the Legislature. Therefore, the facility built was different than the facility approved by the Legislature.

### **Statute and Board of Regents Policy Require O&M Funding Plan in Some Cases**

In some situations, O&M funding plans are already required. However, plans are not prepared for the buildings for which higher education officials feel the Legislature should fund O&M.

**Statute May Require an O&M Funding Plan.** If a higher education institution wants to construct a facility solely with non-state funds, including O&M and capital improvements, it may do so

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**In at least one instance, USHE continues to request O&M for a building even though this was prohibited by the Legislature.**

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**Funding plans are already required in some situations.**

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without legislative approval. However, State Building Board permission and recordkeeping are required. Figure 5.4 provides the relevant statutory language.

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**Figure 5.4 Utah Code Funding Plan Requirement.** Statute requires a funding plan in some cases.

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**Utah Code 63A-5-104. Capital Development and Capital Improvement Process**

(3)(b) Legislative approval is not required for a capital development project if the State Building Board determines that:

- (i) the requesting higher education institution has provided adequate assurance that:
  - (A) state funds will not be used for the design or construction of the facility; and
  - (B) the higher education institution has a plan for funding in place that will not require increased state funding to cover the cost of operations and maintenance to, or state funding for, immediate or future capital improvements to the resulting facility; ...

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**Utah Code has a provision for a funding plan, but it appears to have never been triggered.**

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As noted in the figure, the statute prohibits institutions from requesting state O&M or capital improvement funds for these facilities and then goes on to require that “the Division of Facilities Construction and Management shall maintain a record of facilities constructed under the exemption provided in Subsection (3)(b).” However, DFCM officials told us they did not have any such records, so it appears this provision has not been used. Instead, we believe that institutions typically bring requests to the Legislature in hopes of obtaining O&M funding.

**Board of Regents’ Policy May Require an O&M Funding Plan.** If a higher education institution intends to construct a facility that is not eligible for state O&M funding, Board of Regents policy requires a funding plan. However, it appears this policy is only triggered by facilities that officials recognize do not qualify for state-appropriated O&M, such as hospitals, auxiliaries, and some intercollegiate athletic facilities. Figure 5.5 shows the policy.

**Figure 5.5 Board of Regents Funding Plan.** Policy requires an O&M funding plan for buildings not eligible for state-appropriated O&M funds.

The Board of Regents has a provision for a funding plan, but it appears to be triggered only by buildings that institutions acknowledge do not qualify for state O&M.

**O&M Funding Sources for Projects Not Eligible for State-Appropriated O&M (Board of Regents Rule R710.4.5)**

In those cases where property acquisitions, construction, or remodeling projects are not eligible for state-appropriated O&M funding, the institutional proposal must include arrangements as to how O&M as defined by the State Building Board will be covered. Institutions are to pursue O&M funding in the following sequence for such ineligible non-state funded facilities: first, separate non-state funding assured through private contracts or an O&M endowment established by a private donor; and second, an institutional O&M funding plan with additional revenue to support the new space to be credited to its O&M accounts.

Our concern is with the type of facilities shown in Figure 5.3 that officials believe should be state-funded, but are not. We believe the O&M on those facilities is funded by using funds designated for state-funded buildings or possibly from other purposes, such as instruction. For example, the 2011 Legislature authorized USU to proceed with a Regional Campus and Distance Education (RCDE) building provided it could do so without requesting state O&M. In a memo to the Board of Regents, the Commissioner of Higher Education wrote

Without state-provided funds, tuition and fees from regional campus students will have to be used to pay the O&M expenses, thereby diminishing the resources available to RCDE to support the cost of instruction to these students.

When institutions build facilities without a new source of O&M funds, it appears that the maintenance of other buildings may suffer.

When institutions build facilities without a new source of O&M funds, it appears that the maintenance of other buildings and/or the instruction, library facilities, and other support of students may suffer. It is unclear whether the Legislature understands the negative impacts when they allow institutions to proceed without assured O&M funding.

In summary, the examples in Figure 5.3 represent a concern that will grow with the increasing number of buildings required to find O&M funding from sources other than state O&M appropriations. A funding plan required by the Legislature would help ensure that all new buildings are associated with an increase in the facilities

management budget, and that the source of these funds has been identified. If new O&M requirements will simply draw funds from existing buildings or from student instruction, the source should be clearly understood. Such information could help the Legislature decide whether it is wise to proceed with construction.

### **Recommendation**

1. We recommend that the Legislature require all buildings to have an O&M funding plan in place before construction. The funding plan should show at least the amount of funds to be added to the institution's O&M budget and the source of the funds.

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## Chapter VI

# Other Potential O&M Funding Sources Should Be Considered

The previous chapters in this report have discussed the need for policy changes and greater transparency and accountability with O&M funding. This chapter discusses two potential sources of additional O&M funding available to institutions.

- **Reimbursed Overhead:** The University of Utah (U of U) and Utah State University (USU) receive funding for O&M in conjunction with many of the research grants that they receive. Although the funds are reimbursed for O&M and other overhead costs, current policy allows the institutions to use them at their discretion. We recommend that the policy be reviewed to ensure it is up-to-date and properly serving the needs of the state and the institutions.
- **Revenue-Generating Activities:** Institutions sponsor many events and activities that generate revenue through admission charges. Since public attendance increases the need for O&M, it may be appropriate to recoup at least the marginal O&M costs through admission charges. We recommend the Board of Regents develop well-defined policy that clarifies how revenue-generating activities contribute to O&M costs.

It is important to consider potential O&M funding sources because of the concern expressed by many facilities personnel that buildings and campus infrastructure are not being adequately maintained.

### Reimbursed Overhead Funds Should Be Considered as an Additional Funding Source

Over 20 years ago, the Legislature began allowing the institutions to keep their reimbursed overhead funds and spend the funds at their discretion. Previously, the majority of the funds had been returned to the General Fund as repayment for O&M and other overhead costs already paid by the state. Partly by using the reimbursed overhead funds they have been allowed to retain, the two research universities

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**Two potential sources of additional O&M funding available to institutions are reimbursed overhead and revenue-generating activities.**

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have grown their research activities over the last two decades to the great benefit of the state. However, facility directors report that building maintenance on the campuses has suffered during this time period. Therefore the question arises whether the institutions should devote more of the reimbursed overhead funds provided for O&M or infrastructure maintenance for that purpose.

Research overhead funds are awarded to the U of U and USU to reimburse them for the indirect costs or overhead that are incurred in conjunction with the funded research. O&M is one of the indirect costs included in research overhead, along with things such as university and department support. About 25 percent of total reimbursed overhead received is related to O&M. Figure 6.1 shows that in fiscal year 2010, the U of U received about \$18.5 million and USU received about \$6 million in reimbursement for O&M costs.

**Research overhead funds are awarded to institutions to reimburse indirect costs incurred in conjunction with funded research.**

**Figure 6.1 O&M Related Reimbursed Overhead.** The two research institutions receive a significant amount of reimbursed research overhead for their O&M costs.

| Institution | Fiscal Year | Total Reimbursed Overhead (millions) | Portion Related to O&M Costs (millions) |
|-------------|-------------|--------------------------------------|---|
| U of U      | 2009        | \$ 66.6                              | \$ 16.2                                 |
|             | 2010        | 76.2                                 | 18.6                                    |
| USU         | 2009        | 21.1                                 | 5.9                                     |
|             | 2010        | 24.3                                 | 6.1                                     |

Source: U of U and USU

### **25 Years Ago, the Legislature Began to Allow the Retention of Reimbursed Overhead**

In the past, the Legislature retained the majority of overhead funds generated by research projects as reimbursement for costs already paid with state funds. Beginning in 1986, the Legislature began to change policy by allowing institutions to retain reimbursed overhead funds. The statutory section establishing state policy was last modified in 1989. Figure 6.2 details this statute and the Board of Regents' policy dealing with reimbursed research overhead.

**The Legislature used to retain reimbursed overhead funds, but changed the policy 25 years ago.**

**Figure 6.2 Retention of Reimbursed Overhead.** Current state policy gives the institutions flexibility in the use of their net reimbursed overhead.

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

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

**Utah Board of Regents Rule R535**

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

The policy rationale for allowing institutions to retain reimbursed overhead is to encourage growth in their research activities. Since the policy change, research at both universities has grown significantly and has been very beneficial to the state’s economy. According to a report released in 2009 by the Bureau of Economic and Business Research (BEBR) at the University of Utah, in fiscal year 2008, the U of U received and spent approximately \$365 million to fund its research activities. The BEBR estimates that the “indirect and ripple effects” of the sponsored research multiplied to about \$525.3 million. An economic report at USU in March 2011 reported that about \$187 million in grants were obtained, which multiplied to about \$210 million.

**While Research Has Increased, Condition of Buildings and Infrastructure Has Worsened**

Although university research has grown significantly, it seems that campus facilities have deteriorated. Facility directors at the institutions are concerned that buildings and infrastructure are not adequately maintained. For example, the U of U reported to us that their deferred maintenance has been growing because their O&M budget has not been adequate to make needed routine repairs and normal upkeep.

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**Research has grown significantly since the Legislature began allowing the institutions to retain reimbursed overhead.**

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**Facility directors report to us that the conditions of the facilities on campus have deteriorated during the last two decades.**

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The need for better infrastructure maintenance was highlighted by university officials at a legislative appropriations subcommittee in 2011. According to President Young of the U of U:

We have had 13 major power outages . . . and 5,000 hours of downtime. . . We lead the nation in electrical outages. We are number one. . . We have [more than] doubled our extramural research funds in the last five years . . . but our capacity to do that research depends on our capacity to keep the equipment running and the labs up and running. All of that is in serious jeopardy. (Joint Infrastructure and General Government Appropriations Subcommittee, February 1, 2011)

Obviously, adequate infrastructure upkeep is important to the research activities of the university. The U of U reported to us that based on certain rules, infrastructure maintenance can be calculated as part of the overhead reimbursement that the institutions receive. Therefore these funds could be used to correct some of the issues discussed by President Young. Of course, using more reimbursed overhead for O&M would leave less for other uses considered important by the university to promote research efforts.

According to facility management groups, a lack of adequate O&M funding has forced them to postpone repairs and normal facility upkeep. As a result, problems have grown over time. However, facilities personnel feel that investing in O&M can also have a multiplying effect in savings. The U of U facility group reports that if they received an extra \$8 million in funding, the total impact would be over \$21 million in savings from fuel and power, corrective maintenance, and the loss in downtime on campus. Thus, shifting some of the additional reimbursed overhead provided for O&M costs could have a significant benefit.

### **Universities Indicate They Are Devoting More Reimbursed Overhead to O&M**

University officials told us that, out of necessity, they are devoting an increasing amount of reimbursed overhead funds to O&M. It is beyond the scope of this audit to critique this change. But simply considering the importance of adequate O&M, it seems appropriate

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**Upkeep of institutions' facilities and infrastructure is important to the research mission at the U of U and USU.**

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that funds provided as O&M reimbursement be used for O&M as long as serious needs exist.

We did not attempt to audit how institutions spend their reimbursed overhead funds. In fact, because of the commingling of funds described throughout this report, we cannot tell where funds used for O&M originate. However, U of U officials told us that they spent about \$7.7 million on O&M related activities in 2010 and USU officials said they spent about \$3.9 million. Those amounts represent about 42 percent of O&M related reimbursed overhead at the U of U and about 65 percent at USU. Furthermore, institutions report additional reimbursed overhead funds will be used for the O&M on USTAR facilities when they are completed.

Given the concerns about the adequacy of O&M on campuses, the Legislature and the Board of Regents should review state policy on the use of reimbursed overhead. Since the relevant statutory section (*Utah Code* 53B-7-104) has not been amended since 1989, we think the current Legislature should review it to ensure it still meets the state's needs.

### **Revenue-Generating Activities Should Be Considered as an Additional O&M Funding Source**

With the acknowledged need for O&M funding at the institutions, all potential revenue sources should be considered. Along with reimbursed overhead funds, we believe the institutions should review revenue-generating activities as well. Facilities that are designated as auxiliary enterprises are currently expected to be essentially self-supporting, including O&M costs. However, other campus facilities not designated as auxiliaries host public activities with admission charges and could be expected to contribute more to O&M costs. The Board of Regents should establish a policy that directs this behavior at the campuses.

Currently, the institutions are paying for some O&M of facilities used for revenue-generating activities. The degree of this practice varies among the institutions. We understand that, in the past, some of these activities were occurring in buildings that appear to have received legislatively appropriated O&M funds. However, in some

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**U of U and USU officials reported that they are using more of their reimbursed overhead funds to pay for O&M activities.**

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**Institutions should review the contribution revenue-generating activities make towards O&M costs.**

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cases, the use of the buildings has changed while, in other cases, the appropriated funds may not be covering all the costs of the marginal O&M resulting from paid public attendance.

### **Institutions Should Review Policies On Revenue-Generating Activities**

Not all of the institutions were able to clearly articulate a written policy on revenue-generating activities. Further, in the case of some institutions, the practice of charging O&M costs to a revenue-generating activity was not consistently applied. We did find some examples where certain activities are receiving a subsidy for the O&M costs of their associated activities. Our review was not exhaustive, but we believe other examples exist.

In some cases, the subsidies we found may have occurred inadvertently more than by conscious decision by the Legislature or USHE. However, we recognize that the Legislature may have deliberately funded O&M for some revenue-generating activities. As previously stated, inadequate recordkeeping does not allow us to determine which buildings were specifically funded by the Legislature.

Further, the usage or role of some older buildings has likely changed through time. The functions of a building funded by a past Legislature may not be the current purpose being funded today by legislative appropriations. Again, weaknesses in the records do not allow us to positively identify these occurrences. The next section provides a few examples of where possible subsidization may be occurring.

### **Arts and Athletics Are Examples Where Subsidies Can Occur**

O&M subsidization appears to be occurring in some areas on campus. Our limited review of revenue-generating activities revealed that this phenomenon is commonly occurring in arts and athletics, though we note it is also occurring in other types of activities and buildings. We reviewed selected buildings and activities for illustrative purposes and did not conduct a comprehensive review of activities on the campuses. We do note that some agreements are in place with various facilities to repay a portion of O&M costs. However, the consistency and accounting for these agreements is unclear.

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**Some institutions could not clearly articulate their policies on revenue-generating activities.**

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**Our review was limited, but we did find some O&M subsidization occurring.**

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**U of U Pioneer Memorial Theater.** The U of U reported to us that 99 percent (about \$300,000) of Pioneer Memorial Theater’s fiscal year 2010 maintenance and repair expenses were paid from the U of U’s facility budget. That amount does not include utility expenses also paid from the facility budget (about \$69,000 in fiscal year 2009). The University of Utah’s Pioneer Memorial Theater contains two theaters: 1) the Lee Theater, the main theater on the main level of the facility, and 2) the Babcock Theater, which is in the building’s basement. The university’s theater department uses the basement and does not use the main theater. Pioneer Theatre Company (PTC) is the *only* group that uses the main theater.

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**99 percent of Pioneer Memorial Theater’s maintenance and repair budget was paid by the U of U facility department.**

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PTC describes itself as “a fully professional theatre-in-residence at the University of Utah.” Pioneer Memorial Theater serves as the performing venue and administrative headquarters for PTC. We could find no evidence of PTC making regular contributions or payments to the University of Utah for use of the facility or the O&M costs associated with PTC’s use of the building. We believe that the practice of subsidizing entities like Pioneer Memorial Theater should be carefully scrutinized.

**U of U Kingsbury Hall.** The U of U reported to us that, in fiscal year 2010, 93 percent (about \$250,000) of Kingsbury Hall’s maintenance and repair expenses were paid from the U of U’s facility budget. That amount does not include utility expenses also paid from the facility budget (about \$230,000 in fiscal year 2009). The Kingsbury Hall facility on the University of Utah campus maintains a very full schedule. However, only a handful of university-based activities occur there each year; the venue almost exclusively hosts public performances by non-university entertainers and other groups.

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**93 percent of Kingsbury Hall’s maintenance and repair budget was paid by the U of U facility department.**

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According to its director, Kingsbury Hall is operated by the University of Utah under the auspices of the University of Utah Associate Vice-President for the Arts. Yet, as already mentioned, few events held at the facility are university-related. Again, we recommend that policy makers review this practice to ensure it is still a desirable use of state O&M funds.

**USU Dee Glen Smith Spectrum Athletics Center.** Total O&M costs of this facility were about \$640,000 in fiscal year 2010, of which

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**90 percent of the Spectrum's maintenance and repair budget was paid by the USU facility department.**

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**88 percent of the maintenance and repair for the Shakespeare Theaters at SUU is paid for by the facility department.**

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the facility budget paid about \$573,000 (90 percent). The Spectrum is home to USU men's and women's basketball, as well as women's volleyball and gymnastics. Some institution events, such as graduation, also occur in this building. USU believes that the Spectrum did receive O&M funds when it was built in 1970. Nevertheless, even if the institution did receive funding 40 years ago, it is likely insufficient today. Currently, the athletic department only contributes about 5 percent toward O&M or similar activities. The facility budget pays about 90 percent of the O&M on the Spectrum with the remaining 5 percent coming from other sources. We believe USU should review funding for this facility and look for ways to offset O&M costs with revenue generated from the activities held there.

**SUU Shakespeare Theaters.** The Randall Jones Theater and Adams Outdoor Memorial Theater at SUU are venues that are primarily professional theater. SUU believes that the Randall Jones Theater was funded for O&M by the Legislature in 1989, but they have no records substantiating this. O&M costs for this building were over \$255,000 in fiscal year 2010. SUU does not believe the Adams Theater, built in 1971, received any legislatively appropriated O&M funds. Nevertheless, the facility budget paid for about \$46,000 in O&M costs in fiscal year 2010. SUU reported that the Shakespeare festival does pay about \$30,000 for O&M support or about 10 percent of the O&M cost for the Randall Jones and Adams Theaters. We recommend that SUU carefully review its policy with these facilities.

We recommend that the Board of Regents develop a policy on revenue-generating activities that occur at the institutions. The policy should address to what extent paid admission charges should contribute to facility O&M costs.

## **Recommendations**

1. We recommend that the Legislature review *Utah Code* 53B-7-104 concerning reimbursed research overhead to determine if state policy should be modified to direct institutions to use reimbursed overhead funds provided for infrastructure or O&M costs for those purposes if there is a significant need for additional funding in those areas.

2. We recommend that the Board of Regents revise their policy on reimbursed overhead to direct institutions to use reimbursed overhead funds provided for infrastructure or O&M costs for those purposes if there is a significant need for additional funding in those areas.
3. We recommend that the Board of Regents establish a policy on revenue-generating activities in campus facilities that addresses the extent to which paid admission charges should contribute to facility O&M costs.

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## **Agencies' Responses**

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September 1, 2011

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

Dear Mr. Schaff:

On behalf of the Utah System of Higher Education (USHE), we wish to thank you for the efforts of the audit staff as they reviewed higher education operation and maintenance (O&M) funding. We comprehend the difficulty of the audit objectives, in particular looking at the adequacy of O&M funding over the years. Making this task even more difficult are the changes over time in how the Legislature appropriates funding for O&M.

Current levels of state O&M funding are the byproduct of countless individual funding decisions, both increases and decreases, over the life of each institution (which is as long as 161 years). During this time, there have been numerous changes in state laws, policies, and practices regarding funding and budgets. While a complete historical record documenting each of those many decisions is not available nor achievable it is also not possible to identify or document the exact amounts of the current education and general (E&G) line item appropriations that were specifically authorized by the Legislature as O&M funding. Nevertheless, for many years, aggregate O&M funding has generally been one of many elements identified and included in the E&G line item.

Further, we recognize that revenue challenges over the last few years have necessitated the deferral of O&M funding for some new facilities and reduction in annual capital improvement funding to amounts significantly less than the level that has previously been determined by the Legislature as necessary to provide for the ongoing care of facilities. Appropriate funding for O&M and capital improvements will be essential to the long-term care and operation of our facilities.

This response addresses some of the key issues listed as follows:

- O&M funding is a necessary component in sustaining the efficient operation of facilities needed to instruct Utah's students.
- The growth in the number of students is known and the demand for buildings to instruct these students— while also providing the latest technological and programmatic capabilities— is ever increasing.
- USHE is committed to improved tracking of O&M funding.

### **Future O&M Funding is Needed**

The auditors were unable to review historical O&M funding across the life of the institutions. Much of the reason for this is due to the changing nature of exactly how O&M has been appropriated or historically tracked. Over the last 20 years or more, information is more readily available, but the older historical information has been lost or was not recorded. Despite the lack of longer-term historical information, it is well known that O&M funding has not been provided on new, non-state-funded buildings for the last three years due to the economic recession. The budget cuts which have accompanied a period of record USHE institutional enrollments and no new funding for O&M, has created a dearth of needed funds to maintain the buildings.

We appreciate the efforts of the Legislature over the years to provide funding for both O&M and capital Improvement funding which are critically important to higher education due to the substantial investment in physical facilities and associated infrastructure. O&M funding addresses the daily operating requirements and routine repairs required to keep our buildings and infrastructure in operating condition. Capital improvement funding addresses major repairs and upgrades that become necessary at various points due to the normal wear and aging of facilities and infrastructure. The need for funding will continue for USHE institutions as we support the demands on facilities and infrastructure from the current and future student populace.

### **Demand for Buildings Will Continue with Growing Student Populace**

The State of Utah has seen growth in and demand for new building construction for elementary and high school facilities due to growth in the number of students. As these students matriculate into higher education, the demand on institutional facilities to support these students will also increase. In addition, the growing demand to teach the latest technology and prepare students for the workforce is also a reality. As the demand on the institutions' facilities increase, so will the importance of providing O&M funding to allow for maximum life of the buildings.

### **Improved Tracking of O&M Funding**

The USHE is committed to improved recordkeeping on facilities and O&M funding. We look forward to continue to work closely with the Division of Facilities Construction and Management (DFCM) and also the Legislative Fiscal Analysts' Office to provide greater accuracy in records.

Since the creation of the Board of Regents in 1969 there has been a conscious effort to regularize the process and establish appropriate policies to guide the Regents in discharging their responsibility to provide the facilities and related support to enable institutions under its jurisdiction to fulfill their assigned roles and missions. Over the ensuing years, the policies have been reexamined and amended from time to time, culminating in the adoption of the current policy in December of 1998. In that

revision, specific conditions were implemented that needed to be met to qualify non-state funded facilities for state-appropriated support of O&M costs. The Regents affirmed that facilities to be used for “approved academic and training purposes and associated support” were eligible for state-appropriated support. They also acknowledged that other non-state funded projects could be eligible for state appropriated O&M funding on a case by case basis to the extent that they “relate to important institutional activities such as instruction, research generating student credits, and service within the institution's role statement.”

The amended policy also described projects that generally would not qualify for state appropriated O&M funding, including space dedicated to athletics events and self-support auxiliary activities (i.e., college bookstores, food service, student housing, etc.). In those cases where the requested projects do not qualify for state-appropriated O&M support, the amended policy requires institutions to disclose arrangements as to how O&M costs will be covered.

### **Summary**

The institutions value the O&M funding for their facilities and take great care to use it appropriately. In some cases, institutions have reallocated funds from other parts of their budget or from other funding sources in order to provide additional funding for O&M when the state-appropriated funds were not adequate to meet needs.

We appreciate the recognition that the auditors pointed out regarding the importance of fully functioning infrastructure as demonstrated by the quotes of President Michael Young. We wish to emphasize, however, that the infrastructure needs at the University of Utah are due to the age and obsolescence of the existing system and not due to any lack of care in O&M or capital improvements.

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

Sincerely,



William A. Sederburg  
Commissioner of Higher Education

Attachment

## **Response to the Legislative Audit of Higher Education Operation and Maintenance Funding**

The Utah System of Higher Education (USHE) appreciates the opportunity to respond to the audit of higher education operation and maintenance (O&M) funding. The USHE and the audit do point out the need to secure O&M funding, because without it, the possible dilution of funds will cause a decrease in the ability to best operate and maintain existing and future facilities. We recognize that the recent economic recession has made it more difficult for the Legislature in supporting institutions financially and also for the institutions to be able to function and provide education to their students.

Here are a list of the recommendations to the audit and the respective USHE response:

### **Chapter 2**

**Recommendation 1:** *We recommend that the Legislature consider funding O&M as an appropriation unit within the E & G Line Item.*

Response: The USHE agrees with providing better information that would allow for improved historical tracking of O & M funding. To the extent possible, the USHE prefers to provide a reconciliation report to the Office of the Legislative Fiscal Analyst (LFA) that may be easier to comprehend and would accomplish a similar result as this recommendation instead of creating a separate O&M “appropriation unit.” It is important to note that the total amounts budgeted and expended each year within the E&G line item for O&M support are already annually reported to the Office of the Commissioner of Higher Education (and thereby to the Regents) and to the LFA as a part of the annual operating budget process.

**Recommendation 2:** *We recommend that the Legislature review its policy and consider making state O&M funding decisions for non-state funded construction at the time a building is authorized or (if construction is delayed) before construction begins.*

Response: We recognize the value of funding commitments being in place at the time a building is authorized. We also recognize – as did the Legislature when affecting this change – the value of a bifurcated approach to O&M funding decisions, depending on whether the building was State Funded or Non-State Funded. We pledge our support to policy review efforts on this front, should they occur. We would also note, as does the audit report, that the buildings constructed with donations or gifts to the universities are a huge benefit to the state. We ask that the Legislature continue to support higher education with state-supported, O&M funding for those buildings serving the core missions of the institutions for the benefit of the state’s citizens.

### Chapter 3

**Recommendation 1:** *We recommend that the Board of Regents review the A-1 and S-2 data reported by the institutions and ensure that the data is comparable and meaningful.*

Response: We concur. Assignments have been made prior to release of this audit to assure that those data are properly reviewed and verified in the future.

**Recommendation 2:** *We recommend that the higher education institutions review auxiliary facilities to ensure the facilities are paying the appropriate share of O&M costs.*

Response: We concur. When possible, and in accordance to Regents' policy, auxiliary facilities should be essentially self-supporting. There will be exceptions at times, such as for those buildings that serve a public service component where it may be justified; however, this should be the *exception* to the rule. It should be noted that, most, if not all, of the uses of O&M funds that were specifically questioned by the auditors, have been corrected, some of which were identified and corrected by the institutions before they were identified by the auditors.

### Chapter 4

**Recommendation 1:** *We recommend that the Legislature consider directing the Board of Regents to maintain a record of all buildings built on campus that denotes the O&M funding source as being either state-funded or other. If the funding source does not come from state funds, the record should specifically indicate the source of the O&M funding.*

Response: We concur. Prior to the initiation of this audit, the Office of the Commissioner began an effort to improve the recordkeeping on facilities and O&M funding. Within staffing constraints, this effort is ongoing and will use the audit recommendations for future improvements in this process. It is important to note that this effort is rather complex because some buildings have a mix of state and other sources of O&M funding, and the functional use of buildings changes from time to time to meet evolving needs, thereby possibly changing the appropriate source of O&M funding.

**Recommendation 2:** *We recommend that DFCM correct their building information by adopting a formal definition of auxiliary facilities and consistently applying it.*

Response: We concur. We are committed to assisting DFCM in their efforts.

**Recommendation 3:** *We recommend that DFCM work with higher education officials to include a unique identifier in their new database that would ensure a building can be tracked consistently across the state and higher education systems.*

Response: We concur. We agree to work with DFCM to assist in this effort.

## Chapter 5

**Recommendation 1:** *We recommend that the Legislature require all buildings to have an O&M funding plan in place before construction. The funding plan should show at least the amount of funds to be added to the institution's O&M budget and the source of the funds.*

Response: The USHE will work with the Legislature to provide the required information. The USHE urges the Legislature to continue to provide O&M funding support as has been done. As this is applied, we believe that the use of a building, not the source of capital funding for the construction project, should be the primary driver in determining the funding source for O&M support.

## Chapter 6

**Recommendation 1:** *We recommend that the Legislature review **Utah Code 53B-7-104** concerning reimbursed research overhead to determine if state policy should be modified to direct institutions to use reimbursed overhead funds provided for infrastructure or O&M costs for those purposes if there is a significant need for additional funding in those areas.*

Response: The USHE agrees with the general nature of this recommendation: that it is important to encourage the institutions to use reimbursed overhead when possible for O&M expenditures, but would also point out that there are growing oversight and grant management demands that also need to be funded with this money. We also note that a significant portion of reimbursed overhead is already being used for infrastructure and O&M funding.

**Recommendation 2:** *We recommend that the Board of Regents revise their policy on reimbursed overhead to direct institutions to use reimbursed overhead funds provided for infrastructure or O&M costs for those purposes if there is a significant need for additional funding in those areas.*

Response: We concur. We agree to look at our policy and revise areas that may be in need of clarification and direction. As explained earlier, there is a growing demand on oversight responsibilities on research grants which are also paid from reimbursed overhead funds. We would urge decision makers to understand the competing demands and other necessary uses of these funds. Flexibility in the use of reimbursed overhead within statutory provisions is a key element in the success we have had in growing our research activity and the economic engine this has become for the State.

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

Response: We concur. We would note that there are some revenue-generating activities that also may serve a greater public service purpose that USHE institutions do provide to their communities.

Understandably, as budgets are increasingly tight, these revenue generating activities should be looked at to help capture some of the costs to host these events or activities.





State of Utah

GARY R. HERBERT  
*Governor*

GREG S. BELL  
*Lieutenant Governor*

Department of Administrative Services

KIMBERLY K. HOOD  
*Executive Director*

Division of Facilities Construction and Management

DAVID G. BUXTON  
*Director*

September 7, 2011

Mr. John M. Schaff, CIA  
Auditor General  
Office of the Legislative Auditor General  
W315 Utah State Capitol Complex  
PO Box 145315  
Salt Lake City, UT 84114-5315

Dear Mr. Schaff:

Thank you for your letter and the "Exposure Draft" of **A Performance Audit of Higher Education Operation and Maintenance Funding** (Report No. 2011-08) which was included for our review. I have found much of your audit to be accurate and helpful; however I would like to respond to the following items:

The opening argument in Chapter IV "Improved Accountability of O&M Funds Requires Better Record Keeping" makes the statement that "...in a normal budget year where capital improvements are funded at 1.1 percent of current replacement cost, funding may be overstated by about \$2 million." The real "normal" funding is between .6 and .7%, so the amount stated is *overstated*, and should be more like \$1.1 million. This amount is still 3.5 percent below the national average for building maintenance.

The audit appears to recognize that the auxiliary status of newly approved buildings appears to be well understood. I agree that this is the case, because the Capital Budget Estimate that is prepared for each building request documents the increase in O&M funding that is required as a result of the building approval, if any. What the audit does not point out is that after a particular facility is approved and constructed; agencies may request O&M for that building in their budget request that is not reviewed by the Building Board, DFCM, or the Legislative Committee that reviews building requests. So, if the building is subsequently approved for O&M funding through Higher Ed's Appropriation Committee, the agency begins to act as if that facility is now eligible for improvement funding, and includes those requests to the DFCM and Building Board for approval in the future. There seems to be a gap in communication between these two committees which allows specific projects to be funded inappropriately.

Let me know if you have any questions to my response or would like to discuss this matter further.

Sincerely,

David G. Buxton  
Director

DGB:LH/cn  
cc: Kade Minchey