

December 19, 2012  
Report No: ILR2012-E

Speaker Rebecca D. Lockhart, Co-Chair  
President Michael G. Waddoups, Co-Chair  
Senator Ross I. Romero  
Representative David Litvack

**Subject: A Survey of Revenue Bond Funding Sources**

Members of the Legislative Audit Subcommittee:

The Office of the Legislative Auditor General was asked to review funding sources of higher education institutions' revenue bonds. The Legislature has authorized the construction of many higher education facilities through revenue bonds. We were specifically asked to review whether revenue sources pledged to pay debt service obligations have been adequate and whether other sources of revenue have been substituted to meet bonding commitments.

For this audit, we met with the Board of Regents' staff to gather background information, review the revenue bonding process, and obtain an overview of the current projects institutions have financed through bond revenues. We also met with officials from four institutions to gain an understanding of the revenue bond process from their perspective.

The conclusion of our preliminary survey is that further audit work is not needed because strong controls exist. First, it appears that the revenue bond approval process has good controls to ensure sufficient funding is pledged to meet bonding commitments. Second, the Office of the State Auditor's annual financial audits of higher education institutions include a review of revenue bond projects. The auditor's examination provides a control to ensure pledged revenues are adequate and being used to pay obligations.

## **Revenue Bonding Approval Process Has Good Controls**

We found that revenue bond funding sources are scrutinized during the revenue bonding approval process. When an institution seeks to fund a facility project with revenue bonds, each project must go through an extensive approval process. After the institution has developed a plan for the project, including how it will be funded, the plan will be reviewed by six different boards, groups, or individuals. Part of this process's purpose is to ensure that pledged revenue sources are adequate to cover debt service obligations. The six reviews are listed in order of occurrence below:

1. The institution's board of trustees
2. The State Board of Regents
3. The Utah State Building Board
4. The Legislature
5. A bond counsel
6. A financial advisor

Each of the groups or individuals reviews the parameters of the project, including funding sources. The institution's board of trustees, the State Board of Regents, and the Legislature all have authority to approve or deny a project. The approval process takes at least a year to complete, but typically takes about 18 months.

## **Revenue Bond Projects Are Reviewed Annually**

After a project has been approved and funded, the State Auditor's Office reviews the financial viability of the revenue bond projects annually. This examination provides a good control to help ensure the state that pledged revenue sources are adequate to meet debt service obligations, and that institutions are in compliance with the bond covenants. The institutions' annual financial statements contain a note on all revenue bond projects summarizing the viability of the projects.

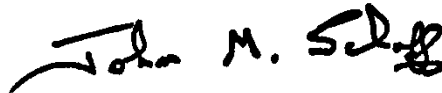
The state auditor's annual financial reviews include an examination of each project's bond covenants; which are official statements of what the institution promises to do with the bond revenue and how they will repay the debt (the pledged revenue sources). The state auditors make sure the institutions are in compliance with the bond covenants. In addition, auditors review debt service schedules and debt ratios to evaluate funding adequacy. The State Auditor's staff stated that they have not reviewed any institution that has pledged revenue sources for a project, then not used those pledged revenue sources as the primary source of funding the debt service obligations.

## **Institutions Concur that Strong Controls Exist**

We visited officials with four higher education institutions (University of Utah, Weber State University, Utah Valley University, and Salt Lake Community College) to obtain their perspective on the revenue bond process. Each of the four institutions that we visited has ongoing revenue bond projects. The officials believe that the revenue bond process has good controls, and that the state auditors complete an adequate review of the revenue bonds annually to ensure that only appropriate revenue is being used to pay debt service obligations.

In summary, we believe that no further action is needed at this time regarding revenue bond funding sources. We hope this information has addressed your concerns. Please let me know if you have any questions.

Sincerely,

A handwritten signature in black ink that reads "John M. Schaff". The signature is written in a cursive style with a large, sweeping initial "J".

John M. Schaff, CIA  
Auditor General

JMS/WDK