

September 9, 2015

MEMORANDUM

TO: State Board of Regents

FROM: David L. Buhler

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

Issue

The Office of the Legislative Auditor General has issued a *Follow-up Audit of Higher Education's Management Practices for Operation and Maintenance Funding*. Their initial audit was concluded in September of 2011.

Introduction

The issue of the adequacy and proper use of Operation and Maintenance (O&M) and Capital Improvement (CI) funding in higher education has been a topic of discussion with the State Building Board and the Legislative Infrastructure and General Government Appropriations Subcommittee for several years. Interest has certainly been heightened by the growing challenge of funding all of the needs that occurred during the recent recessionary years.

The initial 2011 audit, *Performance Audit of Higher Education Operation and Maintenance Funding*, focused in part on a concern that "...adding buildings to campuses without an identified O&M funding source will dilute the resources intended for facilities with legislatively approved funding" and made a number of recommendations, some of which were directed towards the State Legislature, others towards the State Building Board, and still others towards the Utah System of Higher Education (USHE). Most of the concerns and recommendations directed towards the Building Board and USHE have been addressed. The current 2015 follow-up audit reviews those former issues and identifies a couple of new issues. New recommendations affecting the USHE are addressed in the "Salient Follow-up Audit Recommendations" section below.

Legislative Action

Context regarding the environment in which the two audit reports were released is provided by reviewing legislative actions taking place simultaneously over the past several years. Some of these actions are probably as a consequence of the 2011 audit; others are likely in part a cause for audit recommendations that occurred.

From the beginning of the recession in 2009, and through the 2014 legislative session, the legislature authorized construction of non-state funded USHE buildings without providing any state-funded O&M support for those projects that previously had qualified to receive state-appropriated O&M under the provisions of Regents' policy. Not until the 2015 session did the legislature again authorize the use of state-appropriated funds for O&M support for qualifying non-state funded building projects.

Additionally during the 2015 session, the co-chairs of the legislative IGG Committee proposed statutory language requiring consideration of alternative models for determination of O&M funding amounts and processes for all state facilities, including the USHE's. SB217 incorporated those changes and was adopted by the legislature. The Board of Regents is singled out as a primary collaborator to work with the Building Board in dealing with this issue. The study is currently in process of being completed, even as work continues on responses to the O&M audits.

Salient Follow-up Audit Recommendations

The salient findings and recommendations from the current audit and requiring attention are listed below:

1. Review of relevant O&M funding mechanisms for appropriateness
2. Determination of appropriate O&M funding support from "revenue-generating" activities
3. Adoption of a single data base for the inventory of state buildings
4. Appropriateness of the existing statute and Regents policy governing use of reimbursed overhead funding

(See table below for actual comments, audit responses and action being taken)

	Audit Comment	Audit Response	Action Being Taken
1	We recommend that the Legislature consider the current O&M funding model in light of the State Building Board's mandated study to determine if USHE buildings' O&M needs are being funded appropriately.	We concur. A review of the current funding models for existing and new facilities is appropriate. As is noted in Chapter II, Recommendation 1 above, we are currently participating in a Building Board study that includes consideration of this issue. USHE institutions have appreciated the ongoing funding increases provided for salaries and wages, and the occasional funding increases for utilities cost increases that have been provided as part of the existing O&M model. We recognize the current funding mechanism for existing facilities does not have a provision for price-level increases that occur over time for the required supplies and other non-personnel related costs of operating and maintaining the facilities and that where a disproportionate number of older buildings exist on a campus, this can pose a challenge. Notwithstanding the challenge, our institutions and their facilities operations teams are committed to keeping the buildings operational and fully functional.	We are currently working with the SBB on ways to resolve this issue. The State Building Board is scheduled to report the findings of this study by September 1, 2015.

	Audit Comment	Audit Response	Action Being Taken
2	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.	<p>We agree that the revenue-generating entities designated as "auxiliaries" as defined by the National Association of College and Business Officers (NACUBO) should pay the applicable O&M costs for their facilities. The other revenue-generating entities referred to in the recommendation often are directly related to and benefit the academic programs of the institutions, in addition to fulfilling the public service role of the institutions. As such, they do not meet the "essentially self-supporting criteria" of auxiliaries.</p> <p>Prior to consideration of a policy for adoption by the Board of Regents, the Office of the Commissioner will undertake a study of these non-auxiliary revenue generating activities to determine its magnitude and the potential for providing some level of O&M support.</p>	USHE is currently conducting a study on the activities occurring in campus facilities. After this study is complete USHE will evaluate appropriate policy requirements related to these activities.
3	We recommend that all state agencies use one database to store, update, and manage the state's inventory of buildings.	We concur and are collaborating with the relevant entities to accomplish this objective.	<p>The decision has been made to have State Risk Management be the custodian of the official data base and to establish the following procedures for keeping it up-to-date:</p> <ul style="list-style-type: none"> - In May of each year Risk Management will send a list of buildings to each state agency and institution - Agencies and institutions will update the lists by adding, subtracting, and modify the information as appropriate.
4	We recommend that the Board of Regents revise its policy on reimbursed funds to direct the institutions to use those funds provided for infrastructure or O&M costs for those purposes if there is a significant need for additional funding in those areas. This could be accomplished through a specific funding formula.	<p>The existing Board of Regents policy (R535 Reimbursed Overhead) is currently written to reflect the legislative decision referred to in the response to Chapter IV, Recommendation 1 above i.e. "the 1980s legislative decision to allow institutions to retain all of the reimbursed overhead as ongoing support to nurture and expand..."</p> <p>In recent years, inadequate funds to cover some of the O&M the costs of research-related facilities have required institutions to allocate some of their research support funds to cover O&M and other physical plant-related costs, which is allowed by the existing policy. A continuation of such practices may be the appropriate course for the future, but because of the complexity of the issue, we believe it would be advisable to defer a Regents' policy revision until the Legislature has had an opportunity to consider this matter, at which time a revision in policy can be updated in compliance with new legislative direction.</p>	We are currently in the data collection process. We are working with the institutions to obtain the required information so that we can provide our recommendation related to reimbursed overhead funds.

Commissioner's Recommendation

This is an information item; no action is required.

David L. Buhler
Commissioner of Higher Education

DLB/GLS/WRH