



REPORT OF
THE
STATE AUDITOR

**Capital Construction
Contingency Funds**

**Performance Audit
May 2000**

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Members of the Legislative Audit Committee:

This report contains the results of a performance audit of the uses of capital construction contingency funds. The audit was conducted pursuant to Section 2-3-103, C.R.S., which authorizes the State Auditor to conduct audits of all departments, institutions, and agencies of state government. The report presents our findings, conclusions, and recommendations, and the responses of the State Buildings Program, the Office of State Planning and Budgeting, and the State Controller's Office.

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**Capital Construction Contingency Funds
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Authority, Purpose, and Scope

This performance audit was conducted under the authority of Section 2-3-103, C.R.S., which authorizes the State Auditor to conduct audits of all departments, institutions, and agencies of state government. The audit was conducted in accordance with generally accepted governmental auditing standards. Our audit procedures included reviewing documentation; analyzing data; and interviewing staff at the State Buildings Program, the Office of State Planning and Budgeting (OSPB), the State Controller's Office, and various state agencies and higher education institutions. Audit work was conducted between November 1999 and March 2000.

This audit was conducted at the request of the Capital Development Committee (CDC). The purpose of the audit was to address issues related to the expenditure of contingency funds appropriated for capital construction projects.

We gratefully acknowledge the assistance and cooperation of staff at the State Buildings Program, OSPB, the State Controller's Office, and the state agencies and higher education institutions we contacted during the course of the audit. The following summary provides highlights of the comments, recommendations, and agency responses contained in the report.

Overview

Capital construction is statutorily defined to include the purchase of land, buildings, site improvements, fixed and movable equipment, design services, and instructional or scientific equipment when costs exceed \$50,000. Controlled maintenance is defined as corrective repairs or replacement of existing state-owned, general-funded buildings or equipment. The State Buildings Program within the Department of Personnel/General Support Services is responsible for overseeing state capital construction projects and the controlled maintenance of state facilities. Our audit focused solely on capital construction and, therefore, did not review issues related to controlled maintenance.

The capital construction appropriation process begins with the submission of a project request form to OSPB or the Colorado Commission on Higher Education (CCHE). Funding requests contain a variety of information including a project justification and detailed cost data. Once OSPB and/or CCHE have reviewed the funding requests, they submit a list of recommended projects to the CDC. The CDC reviews the list of recommendations and prioritizes individual projects according to urgency and funding availability. The CDC's recommendations are then forwarded to the Joint Budget Committee (JBC) for review, approval, and inclusion in the annual Long Bill.

As stated previously, our audit focused on one specific component of the funding appropriated for capital construction projects (i.e., contingency funding). State guidelines allow agencies to establish contingency budgets for their construction projects that equal between 5 and 10 percent of a total project budget (i.e., 5 percent of the total budget for new construction projects and 10 percent of the total budget for renovations and controlled maintenance projects). The specific information requested by the CDC, as well as findings and recommendations we developed as a result of our review, are summarized below.

What Was the Total Amount of Funding Appropriated for Capital Construction During Fiscal Years 1995 - 2000 and What Portion Was Earmarked for Contingency?

Over the past six fiscal years approximately \$2.4 billion has been appropriated for capital construction projects. Project appropriations came from general, cash, and federal funding sources. On the basis of our review of a sample of actual project budgets, we estimate that approximately \$115.5 million of the \$2.4 billion was earmarked for contingencies (4.8 percent).

How Much of the Contingency Funding That Was Appropriated During This Period Actually Reverted?

Any unused funding that remains when a project is completed must revert to the source from which it was originally appropriated. COFRS data provided by the State Controller's Office show that for the period Fiscal Year 1995 through the third quarter of Fiscal Year 2000, \$52,438,992 in capital construction funding was reverted by state agencies and higher education institutions. Of this amount, however, \$34,799,535 was related to five projects that were never pursued, and thus, funding reverted in full. Consequently, we excluded these dollars for the purposes of our review, which left a reversion total of \$17,639,457 for the period. These dollars came from projects that received their initial appropriations as far back as 1985 to as recently as 1999.

We also compared the amount of funding earmarked for contingencies for projects receiving their initial appropriations in Fiscal Years 1995, 1996, and 1997 with the actual reversions that were recorded from these projects. We found that about \$8.5 million of the \$48.8 million in estimated funding set aside for contingencies on these projects actually reverted (17 percent).

How Is the Expenditure of Contingency Funds Determined by Agencies and What Mechanisms Are in Place to Approve Appropriate Uses of Contingency Funds?

We surveyed staff in 35 state agencies and higher education institutions to obtain information about the processes they use to determine and approve the expenditure of project contingency funds.

Generally, we found that the decision to use contingency funds is made on a case-by-case basis by one or more individual(s) familiar with the construction project. Overall, it appears that the approval mechanisms used by state agencies and higher education institutions are generally sufficient to ensure prudent use of funds.

For What Purposes Are Contingency Funds Expended?

State Buildings Program guidelines state that contingency budgets are established to compensate for “unknowns” that arise during the course of construction. Our review showed that contingency funding is actually used for a variety of purposes other than “unknowns,” including items that were mistakenly omitted from the budget due to a planning oversight and “add alternates.” “Add alternates” are items that are components of a project that do not affect its functionality or scope, but can be reduced or omitted to meet budget. We performed a detailed review of project spending (including contingency expenditures) for a sample of ten projects that were completed or substantially completed during the period Fiscal Year 1995 to 1999. We found that the contingency budgets on these projects were spent on unknowns as allowed by policy as well as “add alternates” (e.g., an acoustical tile ceiling, carpeting). Contingency funds were also used for items that were mistakenly omitted from the original project budget (e.g., advertising, inspections). Overall, it appeared that the contingency funding expended on these projects was used for reasonable purposes that added some value to the project. As noted previously, however, contingency funds were used for purposes that clearly deviated from the current definition of “appropriate uses” as established by the State Buildings Program. We recommend that the Office of State Planning and Budgeting and State Buildings Program, working with the Capital Development and Joint Budget Committees, review the current guidance regarding what constitutes an appropriate use of contingency funds and, if desired, make modifications.

What Suggestions Are There for Monitoring Appropriate Uses of Contingency Funds?

Our review showed that improvements can be made in not only how the uses of contingency funds are monitored, but also in other areas. Our findings include the following:

- State agencies and higher education institutions are not currently required to report how they spent capital construction appropriations (including contingency funding) on a project-specific, project-end basis. Requiring this type of reporting would improve accountability for capital construction spending and could help ensure appropriate use of contingency funds. In addition, we believe that state agencies and higher education institutions should be required to delineate key objectives for each project at the time they request funding. Identifying a few key objectives and then reporting on the attainment of them would help ensure that the legislative intent for a project was met.

- It is impossible in many cases to determine whether agencies even broadly adhered to the budgets established by the CDC and JBC for individual capital construction projects. For example, we could not easily identify actual spending by major budget categories, including how much was spent on contingency items, on most of the projects we reviewed in depth. This is because state agencies and higher education institutions do not always use COFRS coding in a manner that supports a reconciliation between expenditure data and project budget information. Reconciling this information will be important if a project-end reporting model is adopted. Additional training is also needed to ensure that project-end reconciliations are possible.
- Current statutes exempt the Department of Transportation, the Division of Wildlife, and the Division of Parks and Outdoor Recreation from complying with certain project planning and reporting requirements established by the State Buildings Program. After reviewing these statutes, we were unable to determine why these exemptions exist or the benefit derived from them. Further, recent audits of all three of these agencies have uncovered problems related to their use of capital construction monies. We believe the General Assembly should reassess the necessity and benefits of excluding these agencies from capital construction planning and reporting requirements.
- Inaccurate project cost estimates are contributing to the use of contingency funds. For example, we found that agencies do not always include routine items such as advertising in their project budgets, which may result in the use of contingency funds. Providing more detailed guidance on the items that are normally included in most capital construction project budgets should help improve the accuracy of cost estimates and help avoid the use of contingency funds to cover routine items.
- The Construction Project Application Form (i.e., SC 4.1 Form) incorrectly states that a 3 percent contingency rate should be used for new construction projects instead of the 5 percent actually allowed by OSPB. We found that the 5 percent rate is more consistent with the capital construction contingency rates allowed by the other states we contacted. As such, to ensure agencies are establishing adequate contingency budgets, we believe that the SC 4.1 Form should be revised to reflect the higher 5 percent rate.
- The current format of the SC 4.1 Form makes it difficult to calculate the contingency budget correctly. As a result, in some cases agencies apply a contingency rate to their project budgets that exceeds the rate allowed by OSPB guidelines. Conversely, state agencies and higher education institutions do not always base their contingency budget calculations on the entire cost of a project as required by the State Buildings Program and OSPB. By excluding some project costs from their contingency budget calculations, agencies may not be setting aside sufficient funding for problems that may arise during a project. Revising the form to make it easier to calculate the contingency rate should help eliminate these errors.

Summary of Agency Responses to the Recommendations:

The Office of State Planning and Budgeting, the State Buildings Program, and the State Controller's Office agree or partially agree with all of our recommendations. A summary of their responses to the recommendations, along with estimated implementation dates, can be found in the Recommendation Locator on Page 7.

RECOMMENDATION LOCATOR

Rec. No.	Page No.	Recommendation Summary	Agency Addressed	Agency Response	Implementation Date
1	24	Revise the Construction Project Application Form (SC4.1 Form), clarify capital construction budget instructions and guidelines, and improve oversight.	Office of State Planning and Budgeting	Agree	June 2001
			State Buildings Program	Agree	June 2001
2	27	Review current definition of what constitutes an appropriate use of contingency funds, which may include clarifying and/or expanding the current definition.	Office of State Planning and Budgeting	Agree	June 2001
			State Buildings Program	Agree	June 2001
3	28	Revise the capital construction budget instructions to provide more detail on the items routinely included in most project cost estimates and then provide training and/or technical assistance on these changes.	Office of State Planning and Budgeting	Agree	June 2001
			State Buildings Program	Agree	June 2001
4	30	Review the methodology for projecting inflation factors and the current procedures for applying these factors to cost estimates, and consider estimating separate factors for higher-cost areas of the State.	Office of State Planning and Budgeting	Partially Agree	June 2001
5	32	Review Construction Project Application Forms (SC4.1 Forms) to ensure project funds are initially allocated among major budget categories in the same amounts approved by the CDC.	Office of State Planning and Budgeting	Partially Agree	June 2001

RECOMMENDATION LOCATOR

Rec. No.	Page No.	Recommendation Summary	Agency Addressed	Agency Response	Implementation Date
6	36	Require state agencies and higher education institutions to prepare a report at the end of each project that compares budgeted and actual expenditures and specifically describes how contingency funds were spent.	Office of State Planning and Budgeting	Partially Agree	June 2001
			State Buildings Program	Agree	June 2001
7	37	Require state agencies and higher education institutions to delineate key objectives for a project at the time funds are requested and then report on the attainment of these objectives at project-end.	Office of State Planning and Budgeting	Agree	June 2001
8	38	Require higher education institutions to implement a more extensive coding system for project expenditure reporting and provide training and guidance to all agencies regarding the proper uses of COFRS codes.	State Controller's Office	Agree	November 2000
9	41	Reassess the necessity and benefit of excluding the Department of Transportation, Division of Wildlife, and Division of Parks and Outdoor Recreation from capital construction requirements and guidelines, and propose statutory changes if necessary.	Office of State Planning and Budgeting	Partially Agree	June 2001

Description of Capital Construction Appropriation Process

Overview

Capital construction is defined by state law (Section 24-30-1301, C.R.S.) to include the purchase of:

- Land, buildings, or other physical properties.
- Site improvements or development.
- Fixed and movable equipment, including installation.
- Design services.
- Instructional or scientific equipment when the cost exceeds \$50,000.

Controlled maintenance is defined as corrective repairs or replacement of existing state-owned, general-funded buildings and other physical facilities, including the replacement and repair of fixed equipment necessary for the operation of the facilities.

The Department of Personnel/General Support Services (the Department) is responsible for the general oversight of the State's capital construction and controlled maintenance expenditures, procedures, and standards. Within the Department, the State Buildings Program (State Buildings) is specifically responsible for overseeing state capital construction projects and the controlled maintenance of state facilities. State Buildings also develops and enforces construction standards.

Appropriation Process

The capital construction appropriation process begins with the submission of a project request form (i.e., Form CC-C) to the Office of State Planning and Budgeting (OSPB) or the Colorado Commission on Higher Education (CCHE) (higher education institutions only). This form provides various information, such as a project description, justification, timetable, and detailed cost and financing information. In addition, statutes require that capital construction requests exceeding \$250,000 be

accompanied by an approved Facility Program Plan. These plans provide basic information on the need, purpose, and intended use of a facility, as well as cost and construction schedule data.

Once OSPB and/or CCHE have reviewed the project funding requests, both organizations submit a list of recommended projects to the Capital Development Committee (CDC) for consideration. The CDC reviews these lists, as well as the accompanying project plans from the agencies and higher education institutions, holds meetings with the agencies and institutions to discuss their requests, and conducts site visits. At the end of this review process, the CDC prioritizes approved projects according to urgency and funding availability. The CDC's recommendations for funding priorities are then forwarded to the Joint Budget Committee (JBC) for review, approval, and eventual inclusion in the annual Long Bill. It should be noted that some capital construction projects may be introduced and funded through a special bill process and, thus, will not go through these same review and approval processes.

Once funding is approved, in most cases an agency must submit a Construction Project Application Form (i.e., SC 4.1 Form) to the State Controller's Office and the State Buildings Program. Exceptions to this rule include projects dealing with equipment only and higher education projects funded entirely from cash sources. The SC 4.1 Form is used to set up the agency's spending authority for a project. The form details the amounts budgeted for professional services, construction, equipment, and contingency for the project, as well as funding sources and other information.

During the past six fiscal years, appropriations for capital construction projects exceeded \$2.4 billion. Further detail on the total amount appropriated for projects is provided in the next section of the report.

Scope of Audit

This audit was conducted at the request of the CDC. The CDC submitted a letter requesting that the audit address the issue of contingency funds appropriated for capital construction projects because of concerns about the use of these funds. According to OSPB guidelines, state agencies and higher education institutions are allowed to include a contingency amount when estimating the total costs of their construction projects. The current contingency rates allowed by OSPB are 5 percent of the total budget for new construction projects and 10 percent of the total budget for renovations and controlled maintenance projects. According to State Buildings Program guidelines, contingency budgets are established "to compensate for unknowns."

Specifically, the CDC requested that the audit:

- Determine the total funding appropriated for capital construction for Fiscal Years 1995 through 2000 and the corresponding amounts earmarked for contingency within those appropriations.
- Identify the amount appropriated for contingency that reverted.
- Review how the expenditure of contingency funds is determined by state agencies and higher education institutions and for what purposes the funds are expended.
- Explain the mechanisms that are in place to approve appropriate uses of contingency funds.
- Make suggestions for monitoring appropriate uses of contingency funds.

To address the issues identified by the CDC, we focused solely on capital construction appropriations and did not review issues associated with controlled maintenance appropriations. This decision was made because of the relatively small amount of funds that has been appropriated for controlled maintenance in recent years (i.e., controlled maintenance funding made up only about 10 percent of all funding appropriated for construction during Fiscal Years 1995 through 2000).

Contingency Funds

Overview

During the course of this audit we reviewed information related to capital construction appropriations made during Fiscal Years 1995 through 2000, as well as the reversions that occurred during these years. Our audit procedures also included the following:

- We surveyed 35 state agencies and higher education institutions that received capital construction appropriations during the past six fiscal years. Our survey provided general information on 107 construction projects that received funding during this period. The survey also addressed issues such as how the contingency rate is applied to projects, how contingency funds are typically spent, who makes decisions related to the expenditure of contingency funds, and how the expenditure of contingency funds is monitored.
- We performed in-depth analyses of documentation associated with ten capital construction projects that were completed or substantially completed during Fiscal Years 1995 through 2000. Our review of these projects encompassed issues like those mentioned above, but in much greater detail.
- We reviewed 189 Construction Project Application Forms (i.e., SC 4.1 Forms) for projects receiving capital construction appropriations during the period Fiscal Year 1995 to Fiscal Year 2000. The purpose of this review was to estimate average contingency rates that were applied to projects receiving appropriations during this time frame. This information was then used to estimate the total dollar amount earmarked for contingencies for projects funded during these years.

Throughout this chapter we will provide the information requested by the CDC, as well as the findings and recommendations that resulted from our review.

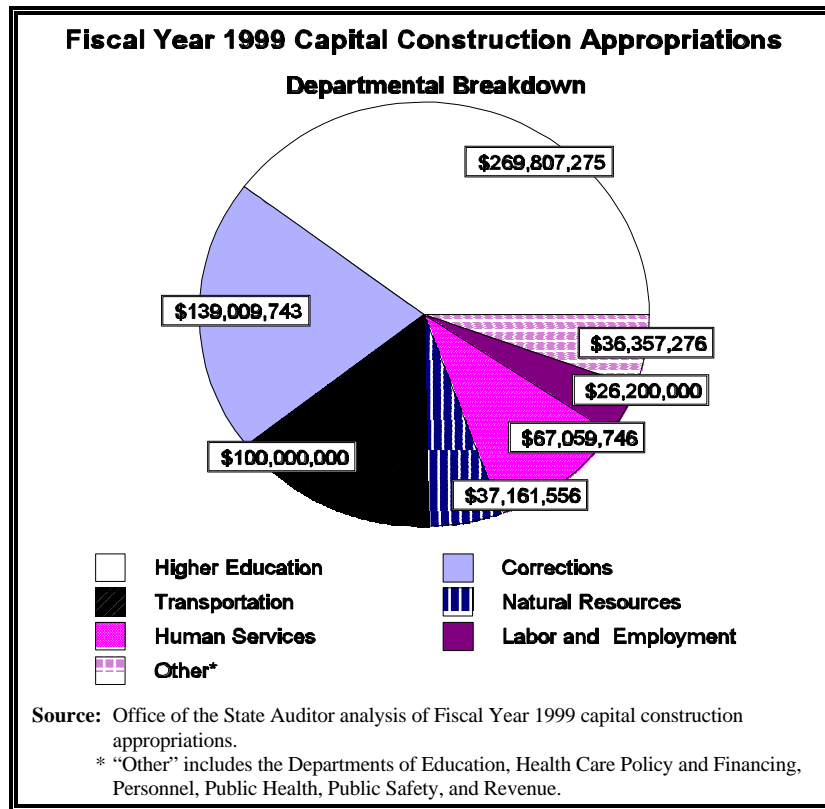
What Was the Total Amount of Funding Appropriated for Capital Construction During Fiscal Years 1995 - 2000?

The total amount of funding appropriated for capital construction during Fiscal Years 1995 through 2000 was approximately \$2.4 billion. This total includes funding from all sources (i.e., general, cash, and federal funding sources). In order to determine this amount, we reviewed Long Bills, special bills, and supplemental appropriation bills. As the following table indicates, the largest total capital construction appropriation that was made in our review time frame occurred in Fiscal Year 1999.

Capital Construction Appropriations Fiscal Years 1995 - 2000				
Fiscal Year	Long Bill	Special Bills	Supplementals	TOTAL
1995	\$107,725,693	\$262,852,223	(\$5,797,359)	\$364,780,557
1996	\$171,012,667	\$57,879,692	\$39,313,285	\$268,205,644
1997	\$238,647,454	\$154,950,613	(\$2,444,474)	\$391,153,593
1998	\$212,605,176	\$81,521,925	\$1,387,706	\$295,514,807
1999	\$546,707,608	\$117,006,770	\$11,881,218	\$675,595,596
2000	\$431,232,857	\$2,676,000	\$3,691,822	\$437,600,679
Total	\$1,707,931,455	\$676,887,223	\$48,032,198	\$2,432,850,876
Source: Office of the State Auditor analysis of the various legislation.				

Upon reviewing this information, we did not identify any major trends. The total amount appropriated for capital construction varied from year to year. Further, appropriation amounts for specific projects ranged widely from about \$15,000 to about \$115 million. When reviewing the information at the agency level, however, we did note some trends. For instance, the Department of Higher Education received the largest amount of capital construction funding in each of the years reviewed, while the Department of Corrections was generally the second largest funding recipient. Other departments appropriated a substantial amount of capital construction funding during the period included Transportation, Natural Resources, Human Services, and Military Affairs. The following chart illustrates the breakdown of capital construction

funding appropriated for Fiscal Year 1999, which is typical for the period. A complete breakdown by department for each of the six fiscal years reviewed can be found in Appendix A.



What Portion of the Total Capital Construction Funding Appropriated for Fiscal Years 1995 - 2000 Was Earmarked for Contingency?

Of the approximately \$2.4 billion appropriated for capital construction during Fiscal Years 1995 through 2000, we estimate that about \$115.5 million was earmarked for contingency. Our estimation process for determining this figure is explained below. As stated previously, state guidelines allow agencies to budget 5 to 10 percent of the total cost of a capital construction project for contingencies (i.e., 5 percent for new construction and 10 percent for renovations and controlled maintenance projects). We found that agencies do not consistently apply these contingency rates to their project budgets. (This issue is discussed in more depth later in the report.) Because of the inconsistencies we observed, it was impossible to easily

identify the funding earmarked for contingencies in any one year without conducting additional procedures. As such, we reviewed the actual initial budgets (including amounts identified for contingencies) that were established for a random sample of 189 projects that received funding in Fiscal Years 1995-2000. This information was found on the SC 4.1 Forms filed for each project at the State Controller's Office. We then used these data to estimate average contingency rates for each of the years in our review time frame. Average contingency rates were subsequently multiplied by total capital construction appropriation amounts to derive a figure that represented the estimated dollars earmarked for contingencies in each budget year. Our estimation process excluded projects under the authority of the Department of Transportation, the Division of Wildlife, and the Division of Parks and Outdoor Recreation because these agencies do not routinely identify contingency funding amounts on their SC 4.1 Forms. The following table shows the results of our review and estimation processes:

Estimated Contingency Funding Capital Construction Projects Receiving Appropriations in Fiscal Years 1995 to 2000			
Fiscal Year	Total Appropriations¹	Estimated Average Contingency Rate²	Estimated Contingency Funding
1995	\$364,780,557	4.81%	\$17,545,945
1996 ¹	\$244,601,170	4.61%	\$11,276,114
1997	\$391,153,593	5.12%	\$20,027,064
1998	\$295,514,807	4.76%	\$14,066,505
1999	\$675,595,596	4.70%	\$31,752,993
2000	\$437,600,679	4.76%	\$20,829,792
TOTALS	\$2,409,246,402		\$115,498,413
<p>Source: Office of the State Auditor analysis of Long Bills, supplemental appropriation bills, special legislation, and data obtained from the State Controller's Office.</p> <p>¹ Fiscal Year 1996 total appropriations were adjusted to remove all funding (i.e., \$23,604,474) associated with three Department of Military Affairs projects that were never pursued. The sizable nature of these appropriations and the fact that all funds associated with the projects eventually reverted led us to treat these cases as outliers.</p> <p>² Calculated on the basis of our review of a sample of initial budgets as shown on SC 4.1 Forms for 189 capital construction projects that received funding in the years shown. Projects under the authority of the Department of Transportation, Division of Wildlife, and Division of Parks and Outdoor Recreation were excluded because these agencies do not routinely identify contingency amounts on their SC 4.1 Forms.</p>			

As the table shows, we estimate that about \$115.5 million, or about 4.8 percent of the total funding appropriated for capital construction projects during Fiscal Years 1995 through 2000, was earmarked for contingencies. No distinct trends were apparent from our analysis; the estimated amount earmarked for contingencies varied from year to year.

How Much of the Contingency Funding That Was Appropriated During This Period Actually Reverted?

Agencies are required to revert any funds (including contingency monies) that remain after a construction project is completed. Residual funds revert to the funding source from which they originated. We estimate that approximately \$8.5 million of the \$48.8 million (17 percent) in capital construction funding allocated to contingency on projects that received initial appropriations during Fiscal Years 1995 through 1997 reverted. Our calculation was limited to this time period because these were the only years for which we had fairly complete appropriations and reversions data. The following sections provide additional information about how these figures were derived, as well as more detailed information on the total capital construction reversions recorded in Fiscal Years 1995 through 2000.

COFRS data provided by the State Controller's Office show that during the period Fiscal Year 1995 through the third quarter of Fiscal Year 2000, state agencies and higher education institutions reverted \$52,438,992 in capital construction funding and \$1,527,665 in controlled maintenance funding, for a grand total of \$53,966,657 in reverted funds. We observed, however, that funding for five capital construction projects that were never pursued skewed these results. Appropriations totaling \$34,799,535 for these projects reverted in their entirety. If these amounts are excluded as outliers, a total of \$17,639,457 in capital construction funding reverted, as shown in the following table:

Capital Construction and Controlled Maintenance Appropriations Reversions Recorded in Fiscal Years 1995-2000¹	
Total Reversions	\$ 53,966,657
Controlled Maintenance Reversions	(1,527,665)
Reversions Associated With Five "Outlier" Projects [i.e., \$5 million for a Lower Arkansas River Commission project (Division of Wildlife); \$6,195,061 for a juvenile detention center (Division of Youth Corrections); and \$23,604,474 for three Department of Military Affairs' projects].	(34,799,535)
Adjusted Total Reversions	\$17,639,457
Source: Office of the State Auditor analysis of COFRS data.	
¹ Fiscal Year 2000 data are complete through 3-31-00.	

Most of the \$17.6 million in reverted funds came from cash sources (\$11.6 million or about 66 percent). Federal funds accounted for another \$3.6 million of the total (20 percent), with about \$2.4 million in general funds making up the balance (14 percent). Six departments accounted for 94 percent of all the reversions that were recorded during our review period (i.e., the Departments of Natural Resources, Higher Education, Military Affairs, Revenue, Personnel/General Support Services, and Corrections). This result appears reasonable given the information provided previously in the report with regard to the departments that received the most appropriations during the period.

We also compared the appropriations and reversions by funding source for Fiscal Year 1997 only to determine if capital construction funds are being reverted in the same percentages they are being appropriated. As the following table shows, a majority of the funds appropriated were general funds, while the majority of funds reverted were cash funds. We did not investigate the reasons for this disparity, but at least one explanation may be apparent. Specifically, general-funded projects normally receive the most scrutiny during the budgeting process, therefore, the cost estimates associated with these projects may be more exact at the outset, resulting in fewer leftover dollars at project-end.

Comparison of Capital Construction Appropriations and Reversions Fiscal Year 1997				
Funding Source	Amount Appropriated	Percent	Amount Reverted	Percent
General Funds	\$283,102,044	72.4%	\$8,076	.5%
Cash Funds	\$101,846,006	26.0%	\$1,299,125	90.0%
Federal Funds	\$6,205,543	1.6%	\$136,953	9.5%
Total	\$391,153,593	100%	\$1,444,154	100%
Source: Office of the State Auditor analysis of appropriation and reversion data.				

Capital Construction Appropriations May Not Revert for Several Years

We observed that the reversions recorded during our review time frame came from projects that received initial appropriations as far back as 1985 and as recently as 1999. Authority to spend capital construction monies may extend past the usual three-year time frame for various reasons. For example, some projects receive their funding in phases. In these cases, when new funding is received, any funding that is left over from previous phases is added to the new funding, and the three-year spending period begins anew. Further extensions of spending authority may also be approved if a project is substantially complete but has outstanding encumbrances. The State Controller's Office conducts an annual process that provides reasonable assurance that all capital construction projects are either closed out at fiscal year-end (with any unused funds being reverted accordingly) or, in the case of ongoing projects, that continued spending authority is granted only if appropriate (e.g., the three-year time period has not expired or outstanding encumbrances exist).

The following table shows reversions recorded in Fiscal Years 1995 through 2000 (through the third quarter) by the year the project associated with the reversion received its initial funding. The previously mentioned outliers are removed from these data. As the table shows, no distinct trends were apparent.

Capital Construction Reversions Recorded in Fiscal Years 1995-2000¹ Shown by Year of Initial Project Appropriation	
Year of Initial Project Appropriation	Total Adjusted Reversions
Fiscal Year 1992 & Prior	\$ 1,494,120
Fiscal Year 1993	3,274,378
Fiscal Year 1994	3,775,636
Fiscal Year 1995	3,238,456
Fiscal Year 1996	3,853,021
Fiscal Year 1997	1,444,154
Fiscal Year 1998 & After	559,692
TOTAL	\$17,639,457
Source: Office of the State Auditor analysis of COFRS data. ¹ Fiscal Year 2000 data are complete through 3-31-00.	

Our review of reversion data also included comparing the estimated capital construction funding that was earmarked for contingencies in certain years against the actual reversions recorded from projects receiving their initial funding in those same years. As mentioned previously, our comparison was limited to Fiscal Years 1995 through 1997 because those were the only years for which we had fairly complete appropriations and reversions data. Our comparison is shown in the following table:

Comparison of Estimated Capital Construction Funding Earmarked for Contingencies Versus Actual Reversions					
Fiscal Year	Total Appropriations	Actual Reversions	Average Contingency Rate¹	Estimated Contingency Funding¹	Difference-Actual vs. Estimated
1995	\$364,780,557	\$3,238,456	4.81%	\$17,545,945	\$14,307,489
1996 ²	\$244,601,170	\$3,853,021	4.61%	\$11,276,114	\$7,423,093
1997	\$391,153,593	\$1,444,154	5.12%	\$20,027,064	\$18,582,910
TOTALS	\$1,000,535,320	\$8,535,631		\$48,849,123	\$40,313,492
<p>Source: Office of the State Auditor analysis of COFRS data.</p> <p>¹ See methodology statement in notes in table on page 16.</p> <p>² Fiscal Year 1996 total appropriations and actual reversions were adjusted to remove \$23,604,474 in funding related to three Department of Military Affairs projects that were never pursued and reverted in full.</p>					

As the table shows, only about \$8.5 million of the \$48.8 million in funding estimated to have been set aside for contingencies actually reverted (17 percent). The remaining dollars (i.e., \$40.3 million, or 83 percent of the estimated contingency funding) were spent. The probable uses for expended funds are discussed later in the report.

Colorado’s Contingency Rate Is Consistent With Other States

In order to determine the appropriateness of the contingency rates allowed by OSPB, we reviewed the rates applied to capital construction projects in other western states. We found that Colorado’s 5 percent contingency rate for new construction projects and 10 percent contingency rate for renovations/controlled maintenance projects are consistent with the rates applied in the other states. Most of the states we reviewed applied contingency rates in the same manner as Colorado—that is, they applied a set rate depending on the type of project (e.g., new project, renovation, controlled maintenance project). We also found that other options exist. Although we do not necessarily advocate the use of either of these systems, we wanted to provide these examples for informational purposes:

- In Wisconsin the percentage allowed for contingency decreases over the life of a project. For example, contingency funding is generally set at 7 percent of a project’s total estimated cost at project outset. This amount is reduced to 5 percent at the design stage and then 3 percent following bidding

procedures. This alternative would work in Colorado on those projects that receive funding in phases. Applying this alternative to projects receiving one lump sum appropriation, however, would be more difficult. The advantage to a system like this is that it provides proportionally more contingency funding and, consequently, more spending latitude in the earlier phases of a project when costs are less well-defined. In turn, as a project progresses and costs become more clearly known, contingency funding is proportionally decreased.

- In Utah the contingency rate is based on a sliding scale approach (i.e., the lower the cost of a project, the higher the percentage allowed for contingencies). For new construction projects, for example, the allowed contingency rate ranges from 4.5 percent (for higher-cost projects) to 6.5 percent (for lower-cost projects). The contingency rate for renovations ranges from 6 percent (for higher-cost projects) to 9.5 percent (for lower-cost projects). This alternative could be applied easily in Colorado, regardless of whether funding is phased or appropriated in a lump sum. The advantage of this system is that it provides more control over the actual dollar amount allocated for contingency on each project.

Current SC 4.1 Form Results in Incorrect Contingency Calculations

During our review we identified several issues affecting how the contingency calculation is actually made on a project-by-project basis. First, OSPB's capital construction budget instructions state that a 5 percent contingency rate should be applied to new capital construction projects. On the other hand, the SC 4.1 Form (i.e., the form agencies submit upon receiving a capital construction appropriation) states that a 3 percent contingency rate should be applied to new projects. From our general survey we found that many state agencies and higher education institutions actually apply the 3 percent contingency rate to new construction projects, instead of the 5 percent that is allowed. This may be one reason why the estimated average contingency rates for projects receiving appropriations in Fiscal Years 1995 through 2000 ranged between 4.61 and 5.12 percent. As stated previously, we found the 5 percent contingency rate allowed by OSPB is appropriate and consistent with other states. Therefore, if they apply the 3 percent contingency rate, agencies may not be allocating enough of their project budgets to contingency.

Another problem we found is that the current format of the SC 4.1 Form makes it difficult to calculate the contingency amount correctly. As we discuss in the following section, the contingency budget amount should be based on total project cost, including professional services, construction, and equipment. Under the form's

current structure, however, the line for the contingency calculation is located after the lines for professional services and construction, but before the lines for equipment and other miscellaneous costs. During our review of SC 4.1 Forms, we found that the contingency amount was sometimes calculated incorrectly. We believe the design of the form contributed to these miscalculations and in some cases caused agencies to apply an 11.11 percent contingency rate to their projects. This contingency rate is actually higher than the rate allowed by OSPB guidelines. Further, although SC 4.1 Forms are reviewed by the State Buildings Program and the State Controller's Office, the calculation errors we found were not identified and corrected by these reviews. To ensure that state agencies and higher education institutions apply the appropriate contingency rate to new construction projects and calculate the contingency amount correctly, the SC 4.1 Form needs to be restructured and review procedures improved.

Contingency Rates Are Calculated Inconsistently

As we alluded to earlier, according to OSPB's capital construction budget instructions, the project contingency should be calculated on the cost of the *entire* project, including professional services, construction, and equipment and furnishings. The State Buildings Program's project cost management guidelines further state that "it is essential that the project contingency is based on the overall project budget including all associated costs and not solely on the construction cost." Staff at the CDC also stressed the importance of calculating contingency budgets on the basis of total project costs.

We found that agencies and higher education institutions do not always base their contingency calculation on the entire cost of a project. For many projects, we found that the contingency budget was based solely upon estimated construction costs, which excludes the cost of professional services (i.e., architectural and/or engineering services) and equipment. Further, many of the agency staff we surveyed appeared to be unaware that the contingency calculation should be based on the entire project cost. In fact, one individual specifically stated in his general survey response that "capital construction contingency rates do not apply to capital equipment."

Although construction costs are probably the "least known" of the three budget components that typically make up a capital project budget, the cost of professional services and equipment are also somewhat speculative. By not basing the contingency budget on the entire cost of the project, agencies may not be setting aside enough funds to cover unexpected costs that may arise. For example, one of the projects we reviewed overspent the amount budgeted for professional services by 25 percent, or \$64,363. This reduced the funding available for construction and equipment costs by about 3 percent, leaving little money available for problems that arose during the construction phase. Clarifying the existing budget instructions and guidelines

concerning how a project contingency should be calculated should help remedy this situation.

Recommendation No. 1:

To improve the accuracy of contingency calculations, the Office of State Planning and Budgeting and the State Buildings Program should:

- Revise the Construction Project Application Form (i.e., SC 4.1 Form) to state the correct contingency rate of 5 percent for new construction projects.
- Rearrange the lines on the Construction Project Application Form (i.e., SC 4.1 Form) so that all project costs can be subtotaled before the contingency and total project cost figures are calculated.
- Clarify capital construction budget instructions and construction guidelines concerning how contingency amounts should be calculated.
- Improve oversight of contingency calculations on the Construction Project Application Form (i.e., SC 4.1 Form).

Office of State Planning and Budgeting Response:

Agree. The OSPB will work with the State Buildings Program to revise the SC 4.1 Form, clarify the budget instructions, and improve the oversight of contingency calculations. Implementation is scheduled to be complete by June 1, 2001.

State Buildings Program Response:

Agree.

How Is the Expenditure of Contingency Funds Determined by Agencies, and for What Purposes Are the Funds Expended?

Generally, we found that contingency funds are being used to cover the cost of items that were not anticipated during the initial stages of a project, items that were removed and then added back to a project to meet budget, and items that were mistakenly omitted from a project's original budget altogether. We found that the decision to expend contingency funds is typically made on a case-by-case basis, as needs arise during construction.

As mentioned previously, State Buildings Program guidelines state that contingencies are established for a project to compensate for “unknowns” that arise during the course of design and construction. The guidelines further allow the movement of contingency dollars from one budget category to another, as long as they are not used to increase a project's scope outside the legislative intent of the appropriated funds. Like all other project funds, contingency dollars that remain after a project is completed must be reverted to the fund from which they were originally appropriated.

During our review we found that state agencies and higher education institutions are using contingency funds for items other than “unknowns.” In addition to unforeseen or unknown conditions that arise, we found that contingency funds are also frequently used for “add alternates.” “Add alternates” are items that are components of a project that do not affect its functionality or scope, but that can be reduced or omitted to meet budget. Once a project progresses and it is determined that funds are available, however, these items are sometimes added back into the project. We found that some “add alternates” are items that may result in future energy savings for the State or may postpone replacement costs due to higher quality and/or a longer life (e.g., better-quality windows or a more efficient furnace), while others may be aesthetic in nature. Of the 35 agencies and higher education institutions surveyed, 37 percent specifically stated that they use contingency funds for “add alternates,” including items like the following:

- A state college spent approximately \$10,000 to add a suspended acoustical tile ceiling to a building in lieu of a ceiling consisting of exposed concrete/steel/duct work.
- A state college added electric hand/hair dryers to a locker room at a cost of approximately \$7,000 in lieu of paper towel dispensers and waste receptacles. Project managers reported this change would produce long-term savings by reducing costs for paper towels and maintenance.

- During a renovation project, a state agency replaced existing carpet in an office so that it would match other newly installed carpet at a cost of approximately \$1,000.
- A state college painted existing facility walls at a cost of approximately \$5,000. Without this “add alternate,” these walls would have gone unpainted.
- A state college facility approved colored concrete patterning for the floors of a facility lobby at a cost of approximately \$1,000. Without this “add alternate,” the floor would have been left plain.

Contingency Funds Are Sometimes Used on Items Omitted From Budget

We also found that contingency funds are sometimes used on items that were excluded from the original budget due to an oversight by an agency at the planning stage. Specifically, we found that contingency funds were used in the following situations:

- Installation of motorized shades in university classrooms at a cost of about \$26,000. The project manager stated that the shades were mistakenly left off of the original plans for the classrooms, which are used for multimedia presentations and distance learning classes.
- Installation of a kitchen lavatory in a locked adolescent facility for about \$2,700. This lavatory was added upon the direction of a Health Department inspector.
- Required inspection of a fire alarm system at a youth detention center for approximately \$1,800.
- Code review and advertising costs of about \$1,200 that were associated with the completion of a greenhouse project.

Overall, for the construction projects we reviewed in depth, we found that contingency funds were used for reasonable expenses that added some value to the project. From the examples provided above, however, it is also clear that contingency funds are being used for many purposes other than “unknowns” that arise during construction. In a strict sense, therefore, state agencies and institutions are deviating from current policy with regard to how they actually use contingency funding on their construction projects.

The State Buildings Program staff and private industry experts we interviewed stated that it is common practice to spend contingency funds not only on unforeseen items, but also on “add alternates” and items mistakenly omitted from the budget. These types of expenditures are routine and may be necessary components of a particular project, or they may add value for other reasons (e.g., energy savings). Consequently, even though state agencies and institutions may not be following existing policy when they use contingency funds for these types of items, they are adhering to industry standards. As such, we believe that it may be time for the agencies involved with the State's capital construction process to review existing guidance regarding what constitutes an appropriate use of contingency funds and determine whether modifications are needed.

Recommendation No. 2:

The Office of State Planning and Budgeting and the State Buildings Program, working in conjunction with the Joint Budget Committee and the Capital Development Committee, should review the current definition of what constitutes an appropriate use of contingency funds. This may include clarifying and/or expanding the current definition.

Office of State Planning and Budgeting Response:

Agree. The OSPB will work with the State Buildings Program in conjunction with the CDC and JBC to review and rewrite, as warranted, the definition of what constitutes an appropriate use of contingency funds. Implementation is scheduled to be complete by June 1, 2001.

State Buildings Program Response:

Agree.

Improvements Are Needed in Quality of Cost Estimates

As described in the previous section, we found that standard construction expenses are often mistakenly omitted from the cost estimate for a project due to an oversight by an agency during the planning process. The examples provided above included the costs for items such as code review and advertising. The cost of these items is often

not negotiable, nor can these costs be easily eliminated. As such, failure to include the cost of these standard construction items in a project budget will require the use of contingency funds.

The OSPB capital construction budget instructions provide guidance for agency staff who prepare project cost estimates. The instructions also include examples of the costs typically associated with most capital construction projects. Some agency staff who are less familiar with the construction process, however, might find the preparation of a cost estimate easier if the budget instructions provided more detail. For example, the current OSPB budget instructions do not state that advertising costs should be included in a project budget proposal. From our review, however, we found that most construction projects incurred some type of advertising expenses, including some as high as \$7,500.

In addition, although the budget instructions do state that the cost of code review should be considered in a project cost estimate, the instructions do not specify the different types of code review that may apply. Therefore, to help state agencies and higher education institutions more accurately estimate project costs, OSPB, working with the State Buildings Program, should revise the capital construction budget instructions to provide more detail on the items that are routinely included in most construction estimates. Additional training and technical assistance may also be necessary to ensure agency staff have a good understanding of the components of a comprehensive project cost estimate.

Recommendation No. 3:

The Office of State Planning and Budgeting should work with the State Buildings Program to revise the capital construction budget instructions to provide more detail on the items that are routinely included in most construction project cost estimates. The State Buildings Program and the Office of State Planning and Budgeting should then provide training and/or technical assistance to all state agencies and higher education institutions on these revisions.

Office of State Planning and Budgeting Response:

Agree. The Fiscal Year 2001 OSPB Budget Instructions have been revised to clarify project cost estimates. Budget instruction training will occur in June 2000. Additional training and technical assistance through the State Buildings training program will be implemented by June 1, 2001.

State Buildings Program Response:

Agree.

Inflation Can Affect the Quality of Cost Estimates

During our review we found that inflation can affect the quality of cost estimates for construction projects, which may, in turn, result in the use of contingency funds. Annually OSPB sets an inflation factor that state agencies and higher education institutions can apply to their project cost calculations in certain situations. Currently the inflation factor set by OSPB is applied uniformly across the State (i.e., there is no geographic differential) and is based upon projections made in a national construction publication, *The Engineering News Record* (adjusted for Denver-Boulder conditions). The following table compares the inflation factors estimated by OSPB for the last six fiscal years with the actual construction inflation factors for those years.

Comparison of OSPB Projected Construction Industry Inflation Factors With Actual Construction Industry Inflation Rates Fiscal Years 1995 Through 2001		
Fiscal Year	OSPB Projected Inflation Factor	Construction Industry Actual Inflation Rate ¹
1995	4.0%	5.5%
1996	6.6%	1.4%
1997	2.1%	2.0%
1998	2.3%	8.3%
1999	2.6%+1.8% ²	1.2%
2000	4.8%	2.3% YTD
2001 Request	3.0%	NA
<p>Source: OSPB memorandum to the Capital Development Committee dated December 9, 1999.</p> <p>¹ Actual inflation rates were obtained from <i>The Engineering News Record's</i> "Building Cost Index" for Denver-Boulder area. Figures represent inflation for the construction industry only.</p> <p>² The extra 1.8 percentage points were allowed for Archuleta, Delta, Gunnison, La Plata, Las Animas, Logan, Mesa, and Montrose Counties.</p>		

As the table indicates, over the past six fiscal years, the OSPB projected inflation factor has differed, sometimes substantially, from the actual inflation rate for Colorado's construction industry (i.e., Denver-Boulder area). The process used to estimate inflation is not an exact one. Even so, it is important that this process be as accurate as possible because of the negative effects that inflation can have on a construction budget. Therefore, OSPB should review its methodology for projecting construction industry inflation rates to determine if the accuracy of its projections can be improved.

Two additional problems became apparent from our review of inflation-related issues. First, we found that the inflation factor allowed by OSPB does not accurately account for the inflation that may occur between the time when a project cost estimate is prepared and when bids are finally let on the project (typically a year or more). The inflation that occurs during this time period may result in the use of contingency funds on some projects. Currently OSPB does not allow an inflation factor to be applied to construction funding requests unless the project is scheduled to be funded in phases. Allowing agencies to apply an inflation factor that helps cover any cost increases that occur during this interim period could help reduce contingency spending on some projects.

Second, we found that the inflation factors allowed by OSPB may not accurately reflect market conditions in all areas of the State. This problem was noted on some of the responses we received on our survey of state agencies and higher education institutions. In Fiscal Year 1999, OSPB allowed an additional inflation percentage to be applied to cost estimates for projects in certain counties (i.e., Archuleta, Delta, Gunnison, La Plata, Las Animas, Logan, Mesa, and Montrose Counties) because of concerns about higher construction costs in these areas. According to OSPB staff, there are no plans to allow a differential inflation factor anytime again in the future. We believe that this issue should be revisited, however, since ensuring that the inflation factors allowed by OSPB reflect conditions statewide—not just in the Denver-Boulder area—may help agencies avoid the use of contingency funds in some instances.

Although the information we received on this issue is generally anecdotal, we believe that enough concern has been expressed on this subject to warrant OSPB's consideration of the problems we found.

Recommendation No. 4:

To improve the quality of capital construction project cost estimates and reduce the use of contingency funds, the Office of State Planning and Budgeting should consider:

- Reviewing its methodology for projecting inflation factors to obtain the most accurate estimates.
- Reviewing the current procedures for applying inflation factors to project cost estimates to determine if improvements are needed.
- Estimating separate inflation factors for higher-cost areas of the State that reflect the differences in construction costs (if cost differences are enough to warrant such a change).

Office of State Planning and Budgeting Response:

Partially agree. The OSPB will review methodology and current procedures regarding inflation factors. Implementation of the first two items listed above is scheduled by June 1, 2001. Separate inflation factors for higher cost areas of the state cannot be established due to a lack of sufficient data to justify varied statewide inflation rates, as well as the significant costs of such an undertaking.

Agencies Are Changing Project Budget Allocations Immediately After Funding Is Approved

We also found that agencies are sometimes changing the amounts allocated to specific project budget categories immediately after they have been approved by the CDC. For the ten projects that we reviewed in depth during the audit, we compared CDC-approved budgets to original SC 4.1 Forms completed by the agencies at project initiation to determine if the amount allocated to the specific budget categories had changed. Two of the ten projects did not have a CDC-approved budget because these projects received funding through a special bill. Initial CDC budget information was no longer available for two other projects. Of the six projects that did receive CDC approval and where initial budget information was still available, we found that changes had been made in the amounts allocated to specific budget categories (e.g., professional services, construction, equipment, contingency) for three of the six projects (50 percent).

According to CDC staff, it is important that the allocation of budgeted funds remains consistent with the specific amounts approved, at least in the initial stages of a project. There are several reasons for this. For example, current law requires allocation of 1 percent of a project's construction budget for "art in public buildings." When the amount of funds budgeted for construction costs changes, the dollar amount allocated

for public art also changes. In addition, when reviewing project funding requests, CDC staff consider how the agency intends to distribute the funds among the costs for professional services, construction, and equipment. Specifically, staff review a budget to determine what percentage of the total project budget has been allocated for professional services. Staff stated that their “rule of thumb” is that professional services should be no more than 10 percent of the total budget for the project. The CDC staff, as well as members of the Committee, also look at a project’s construction cost per square foot and/or cost per bed. (The construction cost per square foot and/or cost per bed is based on only the construction portion of the total budget and does not include costs for professional services and equipment.) If the allocation of funds to individual budget categories is significantly altered after a project has been approved, the cost per square foot and cost per bed can change dramatically. Although a reallocation of funds is often necessary as a project progresses, in order to address the CDC’s concerns, we believe that the allocation of funds among major budget categories should remain “as approved” at least through the design and planning stage of a project.

Recommendation No. 5:

The Office of State Planning and Budgeting should review Construction Project Application Forms (i.e., SC 4.1 Forms) to ensure that state agencies and higher education institutions allocate project funds among major budget categories in the same amounts approved by the Capital Development Committee, at least through the design and planning stage of a project.

Office of State Planning and Budgeting Response:

Partially agree. The OSPB will review all non-higher education agencies’ SC 4.1 Forms to ensure compliance with the budget submittal. SC 4.1 Forms for all higher education projects should be reviewed by CCHE as they are the reviewing agency for the original budget submittal. Implementation is scheduled by June 1, 2001.

What Mechanisms Are in Place to Approve Appropriate Uses of Contingency Funds?

Currently the mechanisms in place to approve the appropriate uses of contingency funds vary from agency to agency. We surveyed 35 state agencies and higher education institutions and found the following examples of approval mechanisms:

- A project committee oversees the design and construction processes and the need for changes. An authorized representative of the institution, the State Buildings delegate, and the Controller's delegate sign all change orders including those that necessitate the use of contingency funds.
- The facilities director, architect/engineer, and State Buildings Program representatives evaluate unforeseen problems and solutions with input from the contractor. The final decision to use contingency funds is made by the facilities director and college administrators.
- A project manager oversees the construction process and makes day-to-day decisions regarding how to spend contingency funds. Consultation between the project manager and the Vice President of Administrative Services is required for major contingency expenditures.
- Each request to spend contingency funding is brought to a group that includes the Vice President of Finance, other administrative staff, building users, the architect, the contractor, and the project manager. The group makes the final decision.
- A project manager is responsible for day-to-day coordination of expenditures, along with the architect/engineer and contractor. The project manager makes all final decisions regarding expenditures, including contingency expenditures.
- An accountant in charge of capital construction funds makes decisions related to the expenditure of contingency funds.

From the information we obtained, it appears that the approval mechanisms used by these agencies are generally sufficient. Although the specific mechanisms in place varied from agency to agency, representatives from 27 of the 35 state agencies and higher education institutions responding to our survey (77 percent) reported that they require the expenditure of contingency funds be approved by more than one individual. In most cases the project manager, or another person close to the project, is involved in the approval process. Having more than one person involved in the

approval process is a good internal control and helps provide a reasonable level of assurance that the expenditure of construction funds, including contingency dollars, is appropriate.

In four of the remaining eight agencies, only one person approves project expenditures, but the agencies reported that this individual is typically someone very familiar with their construction projects. In the four other agencies, contingency spending decisions are not separated from other types of project spending decisions. This is because these agencies do not usually identify a specific contingency budget for their projects, either because it is not required or because their projects are atypical and, therefore, do not require a contingency budget.

What Suggestions Are There for Monitoring Appropriate Uses of Contingency Funds?

After reviewing the contingency funds allocated for construction projects over the past six fiscal years and how those funds have been spent, we found that several improvements can be made in monitoring the use of contingency funds. Specifically, we found that accountability for the use of contingency funds can be enhanced by requiring agencies and higher education institutions to:

- *Submit project-end reports that compare budgeted with actual expenditures and provide detailed information about the use of contingency funds.*
- *Establish key objectives for each project so that legislators and other interested parties can more easily determine whether the legislative intent for a project has been met.*
- *Improve accounting for the expenditures associated with capital construction projects.*

These issues are discussed in more detail in the following sections of the report. Before any changes are made, however, the following matter needs to be resolved. As the table on page 21 illustrates, in recent years agencies have spent most of their contingency funds. We have also determined that contingency funds are being used for purposes that go beyond the established definition of “appropriate” uses. If the presumption is that contingency funds are just another part of the budget for a project and reversions are not expected, then enhanced monitoring and improved accountability are probably not needed. On the other hand, if the decision is made that contingency funds are a special, added budget component and they are to be used for only certain purposes (e.g., for “unknowns” and not for “add alternates”), then

state agencies and higher education institutions need to improve their methods for overseeing the use of these funds. The following discussion outlines the accountability enhancements that we suggest if tighter controls are desired.

Centralized Oversight of the Use of Contingency Funds Could Cause Delays and Increase Costs

In discussions leading up to this audit, one idea that was offered was to have all contingency funds be appropriated to one agency, such as the State Buildings Program, which would then approve all contingency expenditures. We do not believe this alternative would be prudent due to time and cost issues. Specifically, according to industry experts, under this alternative the approval of expenditures would take more time, which would result in construction delays and increased costs. On the basis of information obtained from our review, we believe the current process of appropriating contingency funds to each individual agency or higher education institution is the most cost-effective method for allocating these funds and should be continued.

End-of-Project Reporting Would Improve Monitoring of Contingency Funds

If the decision is made that improved oversight of contingency budgets is needed, then in addition to other recommendations in the report, we recommend adoption of project-end reporting enhancements. During our review we found there is currently no requirement for agencies to report budget-to-actual comparisons at project-end. A project-end report could be beneficial for several reasons. First, it could provide an easy way to determine whether specific budget categories within a total project (i.e., funding allocated for professional services, construction, equipment, and contingency) were overspent or underspent. This could help agencies improve their budgeting for future projects. A project-end report would also provide an avenue for agencies to provide specific information about how they used their contingency funds.

The State Buildings Program already has a Project Status Report Summary Form that it makes available to all state agencies and higher education institutions. This form compares budgeted with actual expenditures and agencies are encouraged to complete it at the end of a project. Agencies are not required to complete the form, however, and do not have to submit it to State Buildings or any other authority. Requiring use of this form is one way to facilitate project-end reporting using existing infrastructure. Information provided in this report should also be supported by COFRS documentation, to the extent possible.

Recommendation No. 6:

The Office of State Planning and Budgeting and the State Buildings Program should require that all state agencies and higher education institutions prepare a final report at the end of every capital construction project. The report should compare budgeted with actual expenditures based on the project categories contained in the Construction Project Application Form (i.e., SC 4.1 Form) and describe how contingency funds were spent.

Office of State Planning and Budgeting Response:

Partially agree. The OSPB will require a final report to be prepared at the end of every capital construction project; however, the OSPB has concerns about the costs to the agencies to provide such a report and the current staffing ability of the State Buildings Program to assimilate these data. Therefore, the OSPB will make every effort to streamline this reporting requirement in order to minimize the reporting burden imposed on agencies. We will work with the State Auditor's staff, as well as the Capital Development Committee staff, to determine the appropriate standards for such a report. Implementation is scheduled to be complete by June 1, 2001.

State Buildings Program Response:

Agree.

Determining Whether Legislative Intent Has Been Met Is Difficult

We also found there is no easy way to determine whether the legislative intent for a particular construction project was met. Under the current process most state agencies and higher education institutions are required to submit a Facility Program Plan when capital construction funds are requested. This plan typically includes a description of the project and a cost estimate, among other information. Even when a Facility Program Plan is prepared, once funding for a project has been appropriated, the only description of an "approved" project is found in one line item in the Long Bill. For projects funded through a special bill process, even less information about the intent of the project may exist.

According to representatives from the State Buildings Program, it is very difficult to determine if the changes made to a project during construction are consistent with legislative intent given that intent is often expressed solely by a one-line description. We agree. For example, one of the projects we reviewed was a general-funded college campus lighting project. The project, as approved by the CDC, involved hiring a private contractor to install ten light poles. When the project was ready to begin, however, representatives from the college decided to have campus staff install 25 light poles. Although the changes resulted in more lighting on the campus (and probably enhanced campus safety), we were unable to determine if these changes were within the original legislative intent for the project. Obviously, the scope of the project was expanded by a significant amount. Also, the college's plant incurred some expenses that were not charged to the project's account, which technically drove the project over budget by about \$1,400, or 5 percent of the total project cost. None of these changes were discussed with CDC or State Buildings Program staff.

Establishing Key Objectives Would Improve Monitoring of Contingency Funds

Requiring state agencies and higher education institutions to delineate a few key objectives (e.g., approximately three to five objectives) for a project at the time funding is requested could help establish a baseline upon which to gauge whether legislative intent is being met as construction on a project progresses. With the assistance of OSPB, these objectives should be developed by the agency and should include goals that the agency intends to fulfill with the project (e.g., 500 beds, level of security, number of rooms, square footage). The objectives should be reviewed, modified if needed, and approved by the CDC and the JBC during the appropriation process. The approved objectives should then be submitted to the State Buildings Program, along with the Construction Project Application Form (i.e., SC 4.1 Form). Objectives should also be included in the project-end report described above, with a documented description of how they were met.

Recommendation No. 7:

The Office of State Planning and Budgeting should implement a requirement that all state agencies and higher education institutions delineate key objectives for a project at the time capital construction funds are requested and then report on the attainment of these objectives at project-end.

Office of State Planning and Budgeting Response:

Agree. The OSPB will require that all agencies and institutions delineate key objectives to be accomplished by a capital construction appropriation. Implementation is scheduled to be complete by June 1, 2001.

Improvements Are Needed in Accounting for Project Expenditures

We found that several improvements in the accounting associated with capital construction projects are needed. Overall, we found that it was difficult to reconcile the expenditures entered in COFRS with the budgets recorded on the SC 4.1 Form for each project. That is, we could not easily use COFRS records to determine how much money was spent on professional services, construction, and equipment for a particular project. This is because state agencies and higher education institutions do not consistently charge capital construction expenditures to the appropriate COFRS object codes. We also found that many higher education institutions use a limited coding system, thereby charging all building expenditures on a particular project to one or two COFRS object codes. For example, on a college building project, no expenditures were coded to equipment, even though about \$450,000 was budgeted for it. On another college heating and ventilation project, all expenditures were charged to one object code (i.e., direct purchase of capital equipment), even though \$5,330 was budgeted for professional services. Although use of the limited coding system has been approved by the State Controller's Office in the past, it makes reconciling actual project expenditures by budget line more difficult.

Being able to accurately classify expenditures into the major budget categories will be important if the decision is made to require project-end reporting. If this occurs, agencies and higher education institutions will need to be able to provide accounting records that back up their comparisons of budgeted with actual expenditures. Requiring a more extensive coding system and providing training on the proper use of COFRS object codes would improve monitoring of contingency funds and accountability for how these funds are spent.

Recommendation No. 8:

To improve monitoring of contingency funds and to improve accountability for how these funds are spent, the State Controller's Office should:

- Require that higher education institutions use a more extensive expenditure coding system.
- Provide training to state agencies and higher education institutions on the proper use of COFRS object codes to ensure that coding is accurate and that project expenditures can be more easily tracked back for final project reporting purposes.

State Controller's Office Response:

Agree. We will be working with the State Buildings Program and the Office of State Planning and Budgeting on the form of the final project report. We will review the current use of object of expenditure codes for capital construction projects to determine how the account coding might better align with the project expenditure categories. State agencies, including higher education institutions, will be advised of the proper use of these codes. Use of object codes for construction projects will continue to be monitored through exception reports.

Should Transportation, Wildlife, and Parks Be Exempt From Planning and Reporting Requirements?

In addition to the accountability issues described above, we identified other accountability issues related to capital construction expenditures made by the Department of Transportation, the Division of Wildlife, and the Division of Parks and Outdoor Recreation. For at least 20 years, statutes have exempted these agencies from complying with some of the capital construction planning and budgeting requirements that other agencies must follow. Specifically, Section 24-30-1303 (3), C.R.S., states:

All buildings and facilities, **except public roads and highways and projects under the supervision of the Division of Wildlife and the Division of Parks and Outdoor Recreation**, erected for state purposes shall be constructed in conformity with a construction procedures manual for state facilities and state-assisted facilities prepared by the Department [of Personnel] and approved by the Governor. Such construction shall be made only upon plans, designs, and construction documents which comply with approved state standards and rules and regulations promulgated pursuant to this section.

After reviewing these statutes, we were unable to determine why these exemptions exist. One explanation could be that the Division of Wildlife and Division of Parks and Outdoor Recreation receive a majority of their capital construction funding from non-general fund sources, as does the Department of Transportation. Indeed, CDC staff stated that even though funding requests from the Divisions of Wildlife and Parks and Outdoor Recreation are reviewed, because these requests are generally cash funded, they do not receive the same level of scrutiny that other funding requests receive. With the passage of TABOR, however, increased scrutiny and greater accountability over the use of cash funds is now necessary. Further, other agencies, such as the Department of Military Affairs, receive a majority of their construction funding from federal or other non-general fund sources (like the exempted agencies), but must adhere to state requirements and guidelines related to capital construction.

Audits Have Revealed Capital Construction-Related Problems at These Agencies

Recent audits of the exempted agencies have revealed project and fiscal management problems specifically related to the use of capital construction funds. For example:

- In our most recent performance audit of the Department of Transportation (February 2000), we found that improvements were needed in the Department's fiscal management practices, including its management of capital construction funds. Specifically, we found that increased monitoring and oversight of construction projects could improve overall fiscal management at the Department.
- In a recent performance audit of the Division of Wildlife (October 1999), we found that the Division needed to improve its management of capital construction projects, specifically in the areas of planning and budgeting. The audit found excessive movement of funds among projects, cancellation of projects, and routine use of funds for projects not specifically approved by the CDC.
- In a performance audit currently under way at the Division of Parks and Outdoor Recreation, we are also looking at capital construction issues. Although this review was not complete at the time our audit was finished, preliminary conclusions showed that problems with Parks' management of capital construction funds are also apparent.

During our audit of capital construction contingency funds, our review of SC 4.1 Forms showed that the exempted agencies do not normally allocate project funds among the specific budget categories found on the form (i.e., professional services,

construction, equipment, and contingency). Accountability for the use of construction funds is lessened if a specific budget is not formally identified for each of these major budget categories. Further, although neither the Division of Wildlife nor the Division of Parks and Outdoor Recreation formally allocates a contingency budget on the SC 4.1 Form, both agencies routinely revert leftover funds from their construction projects. During Fiscal Years 1995 through 2000 (through 3-31-00), for example, the Division of Wildlife accounted for over \$6 million of the \$17.6 million in total reversions recorded (34 percent). The Division of Parks and Outdoor Recreation accounted for another \$535,000 of the total reversions (3 percent). This indicates to us that these agencies do allocate a contingency budget on their projects but that this information is not necessarily provided to the oversight agencies that would normally receive the information (e.g., State Buildings Program, State Controller's Office). This may also lessen accountability for the use of capital construction funds.

In light of the fiscal and project management issues discussed previously, we believe the General Assembly should reassess the necessity and benefit of excluding these agencies from complying with capital construction requirements and guidelines. Less accountability and oversight does not appear to have enhanced management of capital construction projects when it comes to the Department of Transportation, the Division of Wildlife, and the Division of Parks and Outdoor Recreation. The uniqueness of the Department of Transportation's construction projects, however, may justify its continued exemption from the requirements and guidelines. On the other hand, requiring that the Divisions of Wildlife and Parks and Outdoor Recreation comply with the capital construction requirements and guidelines that other agencies must follow could improve their accountability. More specifically, accountability could be enhanced if these agencies were required to break out their project budgets according to the categories used by other agencies and submit a project-end report on the use of project funds, along with all of the other agencies. If the decision is made that any or all of these agencies should comply with capital construction requirements and guidelines, statutory changes may be necessary.

Recommendation No. 9:

The Office of State Planning and Budgeting, in consultation with the State Buildings Program, should reassess the necessity and benefits of excluding the Department of Transportation, Division of Wildlife, and Division of Parks and Outdoor Recreation from capital construction requirements and guidelines, and propose statutory changes if necessary.

Office of State Planning and Budgeting Response:

Partially agree. Reassessment of the Division of Wildlife and the Division of Parks and Outdoor Recreation capital construction processes is scheduled for implementation by June 1, 2001. The OSPB does not believe that the Department of Transportation should be subject to capital construction requirements and guidelines because of the role of the Colorado Transportation Commission and the magnitude of transportation projects.

Appendix A

Appendix A

Comparison of Capital Construction Funding by Department Fiscal Years 1995-2000

Agency	1995	1996	1997	1998	1999	2000	TOTAL
AGRICULTURE	\$0	\$80,000	\$378,000	\$160,500	\$0	\$0	\$618,500
CORRECTIONS	\$100,238,088	\$66,804,991	\$27,170,000	\$78,835,675	\$139,009,743	\$4,308,880	\$416,367,377
EDUCATION	\$0	\$0	\$0	\$439,000	\$3,568,000	\$5,457,454	\$9,464,454
HEALTH CARE POLICY & FINANCING	\$0	\$0	\$664,357	\$463,036	\$3,850,879	\$13,798,394	\$18,776,666
HIGHER EDUCATION	\$132,212,717	\$99,652,377	\$167,861,674	\$134,247,940	\$269,807,275	\$256,536,241	\$1,060,318,224
HUMAN SERVICES	\$26,227,656	\$7,325,634	\$6,254,367	\$6,530,803	\$67,059,746	\$45,746,886	\$159,145,092
JUDICIAL BRANCH	\$0	\$0	\$0	\$0	\$0	\$0	\$0
LABOR AND EMPLOYMENT	\$0	\$0	\$6,560,000	\$26,200,000	\$26,200,000	\$22,400,000	\$81,360,000
LEGISLATIVE BRANCH	\$0	\$0	\$0	\$0	\$0	\$345,700	\$345,700
LOCAL AFFAIRS	\$0	\$0	\$0	\$0	\$0	\$6,352,000	\$6,352,000
MILITARY AFFAIRS	\$4,834,800	\$40,703,809	\$0	\$6,285,177	\$0	\$5,456,625	\$57,280,411
NATURAL RESOURCES	\$15,972,657	\$15,390,566	\$17,929,323	\$27,971,590	\$37,161,556	\$34,039,609	\$148,465,301
PERSONNEL/GSS	\$3,007,668	\$4,740,857	\$20,380,549	\$1,745,403	\$4,846,904	\$17,950,000	\$52,671,381
PUBLIC HEALTH & ENVIRONMENT	\$7,286,971	\$2,000,000	\$9,274,026	\$3,806,724	\$11,519,425	\$6,225,440	\$40,112,586
PUBLIC SAFETY	\$0	\$1,188,252	\$1,953,433	\$5,466,200	\$6,339,289	\$7,535,315	\$22,482,489
REGULATORY AGENCIES	\$0	\$0	\$0	\$1,575,000	\$0	\$31,645	\$1,606,645
REVENUE	\$0	\$283,375	\$1,289,660	\$1,787,759	\$6,232,779	\$1,916,490	\$11,510,063
TRANSPORTATION	\$75,000,000	\$30,035,783	\$131,438,204	\$0	\$100,000,000	\$9,500,000	\$345,973,987
TOTAL	\$364,780,557	\$268,205,644	\$391,153,593	\$295,514,807	\$675,595,596	\$437,600,679	\$2,432,850,876
Source: Office of the State Auditor analysis of capital construction legislation.							

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