REVIEW OF CAPITAL OUTLAY FUNDING AND CASH FLOW PROCESSES

JANUARY 2014

www.apa.virginia.gov | (804) 225-3350 | reports@apa.virginia.gov

EXECUTIVE SUMMARY

The focus of this report is capital outlay planning and execution in the Commonwealth, which has evolved significantly over the past 25 years. This report reviews the implementation of the pooled project approach, introduced during the 2008 Special Session of the General Assembly. The pooled Capital Outlay process is a phased review, approval, and appropriation method. The new process assigns each project into one of the three phases: pre-planning, detailed planning, or construction. Subsequent to these assignments, projects are grouped together to create a pre-planning, detailed planning, and/or construction pool. Agencies and institutions can only complete the pre-planning, detailed planning, or construction phase of the project dependent on the assignment to a given pool.

The pooled project approach has not been functioning as intended for all projects. Projects are not advancing through the three phases as outlined in the Code of Virginia in a consistent manner. This report highlights several examples of projects bypassing either a detailed planning or pre-planning pool. Other examples include projects skipping all phases and being placed directly into the construction pool without any pre-planning or detailed planning work completed. Due to their nature, some projects may need to deviate from the three-phase approach, entering the process at the detailed planning or construction phase, rather than the pre-planning phase.

Very few projects have completed construction using the new pooled approach since its introduction during the 2008 Special Session. However, the Commonwealth has realized significant benefits from the new approach and can realize further benefits if it functions as intended. For example, the new process ensures the completion of comprehensive planning before the authorization of construction, along with obtaining more accurate and competitive construction bids. Although economic factors have caused the Commonwealth to fund capital projects with debt rather than general fund cash, the Commonwealth continues to use the pooled capital approach to ensure adequate capital outlay planning and execution.

– T A B L E   O F   C O N T E N T S –

	Pages
AUDIT SUMMARY	
INTRODUCTION	1
EVOLUTION OF THE CAPITAL OUTLAY PLAN	2 - 4
CAPITAL OUTLAY OVERVIEW	4 - 16
STATE COUNCIL OF HIGHER EDUCATION FOR VIRGINIA	16 - 17
STATEWIDE IT SYSTEMS FOR CAPITAL OUTLAY	18 - 19
EVALUATING THE IMPLEMENTATION OF THE POOLED APPROACH	19 - 21
AGENCY AND INSTITUTION FEEDBACK	21 - 23
TRANSMITTAL LETTER	24 - 25
APPENDIX A: CAPITAL OUTLAY PROCESS DIAGRAM	26
APPENDIX B: RECOMMENDATIONS	27 - 28
RESPONSIBLE OFFICIALS' RESPONSES	29-31
RESPONSIBLE OFFICIALS	32

INTRODUCTION

This report reviews capital outlay planning and execution in the Commonwealth. The main objective of this report is to obtain a thorough understanding of the capital funding process, including each of the three stages of the pooled funding process. Additional objectives include determining the effectiveness of the process used to prioritize capital outlay projects on a statewide level, determining the feasibility of a statewide capital outlay prioritization system, and evaluating the effectiveness of the process to determine the timing of bond issuances. The final objective surrounds the status of the Department of General Services' implementation of a capital project information technology solution, as required in the 2008 Chapter 879 Acts of the Assembly. The Auditor of Public Accounts has issued several reports related to Capital Outlay in the past. These include a June 2008 report titled, *Statewide Review of Capital Outlay*, and a November 2004 report titled, *Review of the Commonwealth's Capital Outlay Process*. Both of these reports included recommendations for improvement over capital outlay planning and execution in the Commonwealth.

Capital Outlay encompasses large non-recurring expenses, which can include acquisition, construction, improvements to infrastructure, and equipment. Acquisition is the process of obtaining interest in real property through a purchase or gift. New construction is a single undertaking involving the creation of one or more facilities which can include site work, expansion or extension of exterior dimensions, or the complete replacement of a facility. Improvements generally encompass a complete change to an existing facility exceeding $1,000,000. Equipment is a tangible resource of a permanent or long term nature generally associated with the construction or improvement of a facility. Maintenance reserve is also a significant function in the capital outlay process; however, this report does not cover maintenance reserve.

Capital Outlay can also include improvements to real property leased for use by a state agency or public educational institution. Financing by public funding and the title transfer to state property upon the expiration of the lease are requirements to be considered a capital lease. However, leases are not included in the scope of this report. Also for the purposes of this report, capital outlay projects do not include road projects included in the Commonwealth Transportation Board's Six-Year Improvement Program.

EVOLUTION OF THE CAPITAL OUTLAY PLAN

The capital outlay planning process in the Commonwealth has evolved significantly over the past 25 years. In 1990, the General Assembly enacted legislation directing the Secretary of Finance to review the use of debt in the Commonwealth and recommend a Six-Year Capital Outlay Plan to maintain a high credit rating for future debt issuance. The General Assembly formalized the capital planning process further in 2002 by requiring the Governor to submit to the General Assembly, by November 1 of each odd-numbered year, a Six-Year Capital Improvement Plan. Therefore, updates to the Six-Year Capital Outlay Plan occurred every two years, with minor changes in the middle year. In the 2008 Special Session of the General Assembly, legislation further modified the capital outlay planning process by requiring the Governor to annually submit a tentative bill establishing a capital outlay plan that includes new capital outlay projects and previously planned or authorized capital outlay projects to be funded entirely or partially from general fund-supported resources for the next six year period. The plan lists each project by agency and title, includes price tiers, along with the agency's overall priority assigned to the project.

The 2008 Special Session of the General Assembly also established the Six-Year Capital Outlay Plan Advisory Committee (Advisory Committee) to assist the Governor in the creation of the Six-Year Capital Outlay Plan. The Advisory Committee consists of the following members: Secretary of Finance, Director of Department of Planning and Budget, Director of the Department of General Services, Executive Director of the State Council of Higher Education for Virginia (SCHEV), and the Staff Directors of the House Appropriations and Senate Finance Committees. Responsibilities of the Advisory Committee include providing recommendations to the Governor on the creation of the Commonwealth's Six-Year Capital Outlay Plan as well as the creation of new project pools annually.

The General Assembly also introduced the pool funded approach to capital outlay in the 2008 Special Session. The pool funded capital outlay process is a phased review, approval, and appropriation method requiring the review and approval of a project up to three times before obtaining final funding approval for construction. The new process assigns each project into one of the three phases: pre-planning, detailed planning, or construction. Subsequent to these assignments, projects are grouped together to create a pre-planning, detailed planning, and/or construction pool. Thus, a project may remain on the capital outlay plan for two or three years until it reaches the full funding phase. The intention of the new process was to create an efficient method to ensure the completion of adequate planning prior to the construction stage, which assists in minimizing cost overruns. The table below illustrates the various pre-planning, detailed planning, and construction pools created from the start of the 2008 Special Session through the latest session. Due to their nature, some projects may need to deviate from the three-phase approach, entering the process at the detailed planning or construction phase, rather than the pre-planning phase.

Table 1
Capital Outlay Project Pools

Chapter 1 2008	Chapter 874/890 2010/2011	Chapter 3 2012	Chapter 806 2013
Pre-Planning Pool 7 Projects			**Pre-Planning Pool** 10 Projects
Detailed Planning Pool 26 Projects		**Detailed Planning Pool** 33 Projects	**Detailed Planning Pool** 17 Projects
VCBA Construction Pool 48 Projects **VPBA Construction Pool** 12 Projects	**VCBA/VPBA Construction Pool** 31 Projects	**VCBA/VPBA Construction Pool** 37 Projects	**VCBA/VPBA Construction Pool** 48 Projects

The Commonwealth's Six-Year Capital Outlay Plan and new project requests are the basis for the development of the pre-planning, detailed planning, and construction project pools. The Advisory committee selects projects from the Six-Year Capital Outlay Plan and makes recommendations to the Governor for projects to include in a pre-planning, detailed planning, or construction pool. The project pools are included in the Budget Bill, Central Capital Appropriations section and reviewed by members of the General Assembly. After approval by both the House and Senate and signature by the Governor, project pools are finalized in the Central Capital Appropriations section of the Appropriations Act.

Although significant changes occurred during the 2008 Special Session, the capital outlay process is still evolving today. Due to factors such as the economic environment and the political climate, combined with limited resources, the new process experienced many challenges. Capital outlay planning during the 2008 Special Session took an aggressive pace when the economy was strong and relatively stable. A short time later, the economy significantly declined along with the Commonwealth's revenue estimates, reducing the availability of general fund cash. As a result, the Commonwealth began funding capital projects with debt rather than cash. The Commonwealth used debt to continue moving projects through the pooled process.

Additional changes to the capital outlay process occurred during the 2013 session of the General Assembly. These changes included establishing an annual limit of $250 million of debt issuance in any fiscal year for the new capital projects approved for construction during the 2013 session of the General Assembly. Carryover of the unused portion to subsequent year's debt issuances can occur if the total debt issuance is less than $250 million in a given fiscal year. For example, if the capital cash flow projections indicated only $150 million of debt would be required to cover the capital outlay expenses during one fiscal year, the remaining $100 million of unused debt issuance could be carried forward to subsequent years, allowing for the potential of $350 million of debt being issued during the next fiscal year. Although the total dollar value of the debt authorized in the Chapter 806 construction pool exceeds $877.5 million, capital outlay expenses generally occur over several years. Therefore, the debt issuances can occur in annual $250 million increments to cover project expenses as needed. This requirement should help further control the accountability of the use of bond proceeds.

During the most recent 2013 session, the General Assembly passed Acts of Assembly Chapter 806, which requires agencies and institutions to submit quarterly cash flow requirements to the members of the Advisory Committee for all new projects authorized in the 2013 Comprehensive Capital Outlay Program. This does not apply to any previously approved pool funded projects. The cash flows shall indicate quarterly cash needs to complete planning, working drawings, and construction funding to the project completion. A new responsibility of the Advisory Committee will include reviewing the cash flow requirements and forwarding the projected cash flows to the Department of the Treasury (Treasury). Treasury will use the cash flows as guidance for the issuance needs for the capital projects by both the Virginia College Building Authority and the Virginia Public Building Authority. In addition, the Advisory Committee will be required, at a minimum, to meet at the end of each quarter to evaluate the progress of Chapter 806 capital outlay projects. Chapter 806 also requires the Auditor of Public Accounts to review all cash flow projections annually to determine adherence to the cash flow requirements and whether any deviation in appropriations or allotments causes project delays.

***OBSERVATION**: Only requiring projects included in Chapter 806 to submit cash flow requirements, significantly diminishes the value of the quarterly cash flow projections.*

***RECOMMENDATION #1**: The General Assembly may wish to consider requiring all projects using the pool funded approach to submit quarterly cash flow requirements to the Advisory Committee.*

CAPITAL OUTLAY OVERVIEW

The 2008 Special Session of the General Assembly instituted significant changes to the capital outlay process. This section describes the life cycle of the capital outlay process and highlights the significant changes that have occurred over time. For the purposes of this report, the capital outlay process will be broken into the following sections: Capital Outlay Plan Development, Capital Outlay

Plan Review, Bill Development, and Project Phases and Execution. See Appendix A for a process diagram of the capital outlay process.

Capital Outlay Plan Development

Agencies and institutions are continuously developing or updating an inventory of capital outlay project requests that are necessary to fulfill their basic needs. Agencies and institutions develop individual capital outlay requests based on the entity's strategic plan, master site plan, and the Commonwealth's latest Six-Year Capital Outlay Plan.

Subsequent to the 2008 Special Session, the Advisory Committee established the method by which agencies and institutions submit capital requests in the capital outlay development phase. Code of Virginia, Section 2.2-1517, requires the Director of the Department of General Services (General Services), on behalf of the Advisory Committee, to initiate the capital request submission process by issuing capital outlay instructions to agencies. These instructions request that agencies and institutions develop a list of potential capital outlay projects to include in their six-year plans, which emphasize long term planning for capital outlay expenses. The instructions are the basis for the type of projects, the information required for each project, and the method of submission. In practice, the Department of Planning and Budget (Planning and Budget) has been issuing these instructions.

OBSERVATION*: Historically, Planning and Budget, rather than the Director of General Services, has issued capital outlay instructions to agencies and institutions.*

RECOMMENDATION #2*: The General Assembly may wish to consider modifying Code of Virginia, Section 2.2-1517, to reflect the actual entity or party responsible for the issuance of capital outlay instructions to agencies and institutions.*

Beginning in 2011, agencies and institutions started using the Capital Module within the statewide Performance Budgeting System to submit capital outlay proposals. Agencies and institutions are required to rank the capital project requests in priority order as well as justify the need for each request in terms of the agency's goals, objectives, programs, and services. The capital outlay proposal submissions include the origin of the request, a project title, project type, project location, building name and function, and infrastructure element, along with the scope of any energy or technology costs. Also included is a detailed description of the project, project justification, alternative considerations, and funding methodology. Detailed instructions for capital outlay submissions to the Performance Budgeting Capital Module are publically available on the Planning and Budget website.

***OBSERVATION**: The number of projects submitted annually by agencies and institutions can vary significantly. Some agencies and institutions submit only one project where others submit in excess of 150 projects to be included in the Six-Year Capital Outlay Plan. Currently, there is not a maximum threshold for the number of projects agencies and institutions can submit. Limiting the amount of capital submission could lead to savings by agencies and institutions along with General Services and Planning and Budget due to the resources required to submit and review capital outlay projects.*

***RECOMMENDATION #3**: General Services and Planning and Budget should consider limiting the number of capital request submissions by agencies and institutions. This limit should consider the number of projects an agency or institution can realistically construct within the next six years based on current programmatic needs and resources available.*

Capital Outlay Plan Review

Agencies and institutions submit all project proposals to the Performance Budgeting Capital Module, and an analyst at Planning and Budget individually reviews each project. Analysts review the programmatic needs of the agency or institution in relation to the capital requests. Professional judgment, combined with extensive knowledge of agency operations, enables analysts to suggest which projects to be included in the Six-Year Capital Outlay Plan. Based on this analysis, Planning and Budget compiles a list of critical potential projects for consideration in the capital plan. Planning and Budget then provides General Services the list of potential projects for further review.

Next, General Services develops an estimated project construction cost for each project using the original information submitted by agencies and institutions, detailed data gathered by General Services and Planning and Budget, as well as General Services' specialized construction pricing software. The computation of these inputs results in the "budget development number" for each project. The time period between the capital outlay requests and submission to the Advisory Committee is generally very limited. Therefore, Planning and Budget, with assistance from General Services, reviews the complete list of projects submitted and only assigns a budget development number for those projects that have the greatest potential to advance through the entire capital outlay process.

General Services, specifically, the Bureau of Capital Outlay Management (BCOM) is the party responsible for providing building code, cost, and procurement reviews for applicable state agency and institution construction and capital outlay projects. BCOM uses a variety of tools including the Virginia Building Construction Cost Database to calculate a budget development number for each project advanced by Planning and Budget. Construction related to capital outlay projects has historically spanned several years; therefore the calculation of the budget development numbers include an annual inflation assumption based on the Engineering News Record inflation forecasting.

General Services documents the final budget development number in the Capital Module within the Performance Budgeting system.

Six-Year Capital Outlay Advisory Committee (Advisory Committee)

The 2008 Special Session created the Six-Year Capital Outlay Plan Advisory Committee. A responsibility of the Advisory Committee is to provide recommendations to the Governor on the creation of the Six-Year Capital Outlay Plan as well as the creation of new project pools on an annual basis. The Advisory Committee members must meet quarterly to review the cash flow projections for all projects included in Chapter 806 of the 2013 General Assembly session.

In 2011, Code of Virginia, Section 2.2-1517, was amended to clarify that the Secretary of Finance is responsible for determining a time and place for the Advisory Committee meetings. Historically, the Advisory Committee has only met annually to discuss the status of the Six-Year Capital Outlay Plan.

The Advisory Committee categorizes capital requests based on the following criteria: supplemental funding needs for equipment, emergencies and code compliance, broken infrastructure, renovations, improvements, acquisitions, and new construction. Code of Virginia, Section 2.2-1516, provides the following specific criteria for determining capital outlay priorities:

- Projects that address safety, health, regulatory, security, environmental requirements, or accreditation;
- Projects to upgrade or replace major mechanical systems and utility infrastructure;
- Projects to renovate or maintain existing facilities;
- Projects to construct, expand, or acquire facilities in order to meet programmatic needs;
- For public institutions of higher education, projects that meet State Council of Higher Education for Virginia recommendations or guideline parameters;
- Projects that improve energy efficiency;
- Projects that are listed on, or eligible to be listed on, the Virginia Landmarks Register;
- Renovation projects for which a facility condition assessment has been completed; and
- Projects previously planned.

The Advisory Committee reviews all projects and uses the criteria above in determining recommendations to the Governor of projects to be included in the Six-Year Capital Outlay Plan. The Advisory Committee submits a complete list of capital projects to the Governor and the Chairmen of the House Appropriations and the Senate Finance Committees on or before October 1 of each year. The Advisory Committee also includes any recommended changes to the Six-Year Capital Outlay Plan or project funding.

As part of this review, the audit team met with several members of the Advisory Committee to gain an understanding of the entire process used by the committee in formulating recommendations to the Governor. The Advisory Committee does not have a formalized methodology to determine which projects are appropriate to move to the next project stage. No one is assigned responsibility for coordinating this process. Currently, the informal process includes the Director of General Services providing Advisory Committee members a list of projects based on previous analysis completed by both General Services and Planning and Budget and SCHEV providing members its analysis of higher education projects. The Advisory Committee reviews the list and members have the opportunity to comment and obtain clarification on project justification, status, or purpose. However, the informal process does not require committee members to formally vote whether a project should advance through the capital outlay process. Due to the large number of projects initiated in 2008, most Advisory Committee members conveyed the main focus of the meetings has generally surrounded projects that have already entered either the pre-planning, detailed planning, or construction stage rather than focusing on the long term planning that is contained within the six-year capital plan.

***OBSERVATION**: Members of the Advisory Committee do not consistently receive detailed project information prior to the committee meetings. No one is assigned responsibility for coordinating this process. Without detailed project information, Advisory Committee members are unable to ensure Code of Virginia, Section 2.2-1516, is consistently applied. The Directors of General Services and Planning and Budget have detailed knowledge of projects due to their significant involvement in the agency capital outlay submission process that is not consistently conveyed to all committee members.*

***RECOMMENDATION #4**: The General Assembly may wish to consider designating a responsible party who can ensure all Advisory Committee members are provided all available information on a continuing basis regarding all potential and ongoing projects to enable each member to make informed decisions.*

Six-Year Capital Outlay Plan

The Governor introduces the Six-Year Capital Outlay Plan as a standalone bill. Beginning in 2011, and each year thereafter, Code of Virginia, Section 2.2-1518, requires introduction of the tentative bill on or before December 20th. The bill contains proposed amendments to the current Six-Year Capital Outlay Plan enacted into law, including adjusting the fiscal years covered by the plan, allowing the plan to cover the six years beginning on the immediately following July. When submitting the bills for the capital outlay plan, the Governor considers the capital outlay project list and any amendments or modifications to the six-year plan submitted by the Advisory Committee. The Capital Outlay Bill is independent of the Budget Bill and does not contain funding or guarantee a project will advance.

The Six-Year Capital Outlay Plan has morphed significantly since the 2008 Special Session. The Governor approved Chapter 46 during the 2009 Session, and created a Six-Year Capital Outlay Plan for the period beginning July 1, 2009. The format of this Six-Year Capital Outlay Plan organized projects by cost tiers and no longer included a detailed cost estimate for each project. Projects were assigned to different categories or tiers based on estimated project cost. The tiers provided an estimated minimum and a maximum project cost. For example, the tiers included categories of $0 to $10 million, $10 million to $25 million, $25 million to $50 million, all the way up to a category of above $100 million. Therefore, the first section included projects with a dollar range of $0 to $10 million then $10 million to $25 million and so on. The plan included the agency or institution, project title, agency priority, and project description. The project description included a brief justification for the project. This format made it very difficult for a reader to determine how many projects each agency submitted and the associated ranking in relation to the agency's other projects. Projects are not ranked statewide, only by agency.

Introduction of legislation related to the Six-Year Capital Outlay Plan did not occur during the 2010 Session. Both the House and Senate made adjustments to the Six-Year Capital Outlay Plan submitted by the Governor during the 2011 and 2012 Sessions; however, both bills failed due to lack of agreement between the House and Senate. As a result, the Commonwealth proceeded with the capital project phases as outlined in Chapter 46 during fiscal years 2011, 2012, and 2013.

Approval of Chapter 404 during the 2013 Session, repealed Chapter 46 of the Acts of the Assembly of 2009. Chapter 404 created a Six-Year Capital Outlay Plan for the period beginning July 1, 2013. The format of this six-year plan changed significantly between the 2011 and 2012 Sessions in the Governor's submitted plans that never passed. Starting in 2012, the format of the Six-Year Capital Outlay Plan organized projects by agency, rather than by cost tier. The six-year plan continued to provide the agency or institution, project name, agency priority, and a cost range. This format made it possible for a reader to easily review the total number of projects associated with each agency or institutions and the associated project ranking. However, the six-year plan no longer contained the project description field starting in 2012, which had previously provided details on justification and need of each project.

OBSERVATION*: The current Six-Year Capital Outlay Plan does not provide sufficient information for a reader to determine the status of all projects included. Generally, a project remains in the six-year plan until construction is complete.*

RECOMMENDATION #5*: The Governor and the General Assembly may wish to consider providing greater transparency of the Commonwealth's capital outlay projects by identifying the status of each project in the Six-Year Capital Outlay Plan. The plan could also indicate whether a project advanced to pre-planning, detailed planning, or the construction phase. An additional improvement to the Six-Year Capital Outlay Plan would be to include a project description.*

As mentioned above, the projects within the Six-Year Capital Outlay Plan are not ranked or prioritized statewide, only by agency. Although the Advisory Committee uses the criteria in Code of Virginia, Section 2.2-1516, to determine capital outlay priorities, they do not create a distinct structured ranking. Because there are so many political, economic, and environmental factors affecting the timing and progress of capital projects, having a numerical ranking would place unnecessary restrictions on the process. Therefore, it is not feasible to rank projects statewide.

Bill Development

The Governor reviews the capital outlay projects recommended by the Advisory Committee and creates the Central Capital Appropriation section of the Budget Bill independent of the Six-Year Capital Outlay Plan. Introduction of the Budget Bill occurs on an annual basis into both houses of the General Assembly. Per Code of Virginia, Section 2.2-1516, this bill shall be consistent, as far as practicable, to the corresponding fiscal years of the Six-Year Capital Outlay Plan.

The Central Capital Appropriation section includes "project pools" funded entirely or partially from general fund supported resources. Projects included in the Central Appropriation section are in addition to any projects that are part of the Central Maintenance Reserve or General Appropriation Act. The Central Capital Appropriation section indicates the proposed funding source along with the placement of a project in either the pre-planning, detailed planning, or construction project pool.

Both the House and Senate review the Budget Bill submitted by the Governor and have the ability to make modifications or adjustments. Once the House and Senate make all required modifications or adjustments, review of the Budget Bill occurs during the crossover session. Development of a final Budget Bill occurs during crossover after both chambers agree on content and funding. Presentation of the final Budget Bill for the Governor's signature occurs once the General Assembly has reached agreement. As with any piece of legislation, the Governor can do one of three things: (1) sign the bill into law; (2) veto the bill completely, or (3) send the bill back to the General Assembly with proposed changes. Once the Governor signs the Budget Bill, project pools are authorized for funding.

Project Phases and Execution

The three basic steps, or phases, to a Capital Project include: Pre-planning, Detailed Planning, and Construction.

> ***Pre-planning phase*** is the process meant to define the scope of the project and provide detailed definition and cost estimates. Pre-planning generally includes a statement of program definition, space requirements, estimates of gross and net square footage, functional adequacy requirements, analysis of program execution options, site analysis, site plans, conceptual floor plans, elevations, exteriors, and unique permit requirements. General Services develops a cost estimate during pre-planning to include total cost of the project, construction costs, cost per square foot, costing methodology, and any factors that are unique that may impact the total project cost.

Detailed planning phase includes the preparation of architectural and engineering documents up to the preliminary design stage.

Construction phase includes the preparation of final working drawings and specifications, advertising for a sealed bid or proposal, awarding a contract pursuant to law, and construction of a project until completion.

Code of Virginia, Section 2.2-1520, established three "accounts" which include the Central Capital Planning Fund, the State Agency Capital Account, and the Public Educational Institution Capital Account to fund capital projects.

The sole use of the Central Capital Planning Fund is to pay pre-planning or detailed planning costs of a capital outlay project the General Assembly has previously approved. A $50 million appropriation from the General Fund occurred during the 2008 Special Session, which created a non-reverting Central Capital Planning Fund. Once a project advances to the construction stage, it is required that the Central Capital Planning Fund be reimbursed for payments made for pre-planning or detailed planning through the use of bond proceeds or other funds appropriated by the General Assembly. Therefore, the intention of the Central Capital Planning Fund was for it to be a revolving fund and replenished by construction funds unless a project fails to advance to the construction stage.

OBSERVATION*: Planning and Budget does not maintain a detailed accounting of the $50 million Central Capital Planning Pool appropriation established by 2008 Special Session. We determined that over $34.2 million of the available funds in the Central Capital Planning Pool were reverted to the General Fund by the end of fiscal year 2012. The remaining funds were advanced to various agencies to perform pre-planning and detailed planning activities. The Central Capital Planning Pool received reimbursement of $14.8 million in fiscal year 2013 for various projects advancing to the construction pool. These reimbursements were immediately used to advance $14.7 million to new projects for planning purposes.*

RECOMMENDATION #6*: Planning and Budget should develop a method to track the Central Capital Planning Pool expenses to ensure appropriate use, as well as determine if the reimbursement from bond proceeds is occurring as required.*

In addition to using the Central Capital Planning Fund, agencies and institutions may request authority and appropriation to conduct pre-planning for projects using non-general fund sources. Reimbursement of costs can occur up to the lesser of $250,000 or one percent of the project construction costs once the project advances to the construction stage. The current Capital Outlay process allocates up to $250,000 for pre-planning expenses if a project is included in the pre-planning project pool approved by the General Assembly. However, exceptions have occurred where projects received greater than $250,000.

The Advisory Committee reviews each project at the completion of pre-planning to determine whether it is appropriate to advance the project to a detailed planning project pool. If the Advisory Committee approves the project to advance, it is included in a detailed planning pool and recommended to the Governor to be included in the Capital Outlay Bill. The Governor reviews the project once again and submits the Capital Outlay Bill to the General Assembly for approval. Once approved, a more comprehensive planning phase can begin, referred to as the detailed planning phase.

At the conclusion of detailed planning, the Advisory Committee reviews all projects to determine whether it is appropriate to advance the project to a construction project pool. It was the intent of the General Assembly to have the ability to stop a project after detailed planning if the project's costs, scope, or justification significantly changed at the completion of detailed planning. Advancement of a project to the construction stage follows the same legislative approval process that occurred during pre-planning and detailed planning.

After approval for construction, a project receives funding through general funds or bond issuances administered by Treasury. Chapter 874, 2010 Acts of the Assembly, required the Secretary of Finance to submit a plan before the 2011 session to the Governor and Chairmen of the money committees delineating the schedule for issuance of debt associated with projects approved during this session, given the constraints of the Commonwealth's debt capacity. After Planning and Budget approves the funding through the issuance of the CO-2, BCOM will issue a CO-8, which allows the capital project to move into the construction phase. The construction phase includes the preparation of final working drawings and specifications, advertising for a sealed bid or proposal, awarding a contract pursuant to law, and actual construction of a project.

Subsequent to construction approval, a project receives appropriation through one of two capital accounts, the State Agency Capital Account or the Public Educational Institution Capital Account. These two accounts form the basis of the constructions pools and are replenished by additional bond appropriations as more projects receive approval for construction. All pool funded projects should flow through one of these two construction accounts. A project authorized for Virginia Public Building Authority (VPBA) Bonds uses the State Agency Capital Account. Alternatively, a project authorized for Virginia College Building Authority (VCBA) Bonds uses the Public Educational Institution Capital Account.

After General Services approves a project for construction, the agency creates a bid package and places the project out to bid. In order for the project to proceed, the agency must receive bids that are within 105 percent of the budget. If the agency receives construction bids that are over 105 percent of the project budget, then the agency must enter the cost-over run process. Code of Virginia, Section 2.2-1519, requires that the budget amount determined during the detailed planning phase should be used to determine if the construction bid exceeds the established 105 percent threshold of the general fund-supported resources.

The Directors of Planning and Budget and General Services have the authority to approve the awarding of construction contracts if construction bids do not exceed 105 percent of the general fund-supported resources for the project as determined during the detailed planning phase. If the lowest construction bid is above 105 percent of the general-fund supported resources, the agency or institution must enter the cost overrun process, and select one of the following options:

- supplement the general fund resources with non-general fund resources to cover the amount exceeding 105 percent;
- reduce the size or scope of the project; or
- request supplemental allocation of general fund resources, if supplemental non-general funding is not available or reducing the size or scope is not feasible.

To date, only two projects in Chapter 1 have experienced the cost overrun process. These projects obtained additional funding from the project pool of approximately $700,000. These agencies submitted an appeal for additional pooled funds only after they demonstrated reducing the size or scope or obtaining other supplemental support for the projects was not feasible. However, these projects are rare examples considering the number of projects that have gone through the new process. This most likely is attributed to the current economic environment, which has created increased competition between contractors. An additional contributing factor is individual estimated project cost information is no longer made publically available prior to the bidding process.

Bond Issuance

Subsequent to authorization for construction, Planning and Budget notifies Treasury of the maximum amount of bond proceeds authorized for each individual project. Based on draw schedules compiled from agencies by Planning and Budget, Treasury determines the appropriate dollar amount of bonds to issue to ensure sufficient funds are available to fulfill agency requisitions for approximately a one year timeframe. Treasury does not currently maintain authorized project amounts by the authorizing legislation or associate specific projects with individual bond issuances. Generally, Treasury fulfills requisitions submitted by agencies and institutions using bond proceeds from the oldest eligible series of the applicable VCBA or VPBA issuances with remaining funds. The applicable VCBA or VPBA Board reviews and approves the proposed bond issuances. In addition, the Treasury Board approves the term and structure of VCBA and VPBA bond issuances. Both VCBA and VPBA bond issuances occur incrementally as needed to fund the pool of projects. As previously discussed, bond proceeds reimburse the Central Capital Planning Funds for all approved pre-planning or detailed planning expended from the fund.

Treasury is responsible for tracking requisitions submitted by agencies and institutions. That process, coupled with the control provided through the appropriations process, ensures the total amount of requisitions does not exceed the amount authorized for each individual project. Based on our review, none of the pool funded projects have exceeded their authorized bond funded amounts. Once an agency or institution submits a requisition, Treasury is responsible for transferring the funds in the Commonwealth Accounting and Reporting System (CARS) or wiring the funds to the appropriate account.

***OBSERVATION**: Chapter 806 of the 2013 General Assembly establishes a maximum limit of $250 million in bond proceeds issued during any given fiscal year for projects approved in this Chapter. Chapter 806 also requires agencies and institutions to submit quarterly cash flow projections to assist Treasury in determining the appropriate amount of bonds to issue. These requirements only apply to projects included in Chapter 806.*

***RECOMMENDATION #7**: Treasury should develop a mechanism to track issuance amounts associated with projects approved for construction in Chapter 806. The methodology developed by Treasury must be able to track projects approved by Chapter 806 and other pool funded projects separately, due to the requirements of the enabling legislation.*

Comparison Information

The creation of a new pre-planning, detailed planning, or construction project pool can occur during each General Assembly session; however, the creation of a new project pool in each phase historically has not occurred each year. The table below illustrates the various pre-planning, detailed planning, and construction pools created from the start of the 2008 Special Session through the latest session, including the total dollar amount authorized for each construction pool.

Table 2
Capital Outlay Project Pools with Authorized Amounts

Chapter 1 2008	Chapter 874/890 2010/2011	Chapter 3 2012	Chapter 806 2013
Pre-Planning Pool 7 Projects			**Pre-Planning Pool** 10 Projects
Detailed Planning Pool $44,791,850 26 Projects		**Detailed Planning Pool** (SR/HEO)* $26,067,818 $15,425,911 33 Projects	**Detailed Planning Pool** $29,000,000** 17 Projects
VCBA Construction Pool (Bonds) $595,760,000 48 Projects **VPBA Construction Pool (Bonds)** $274,746,000 12 Projects	**VCBA/VPBA Construction Pool** (Bonds) $1,087,588,000 31 Projects	**VCBA/VPBA Construction Pool** (Bonds/GF/SR)* $89,868,856 $19,500,000 $10,285,200 37 Projects	**VCBA/VPBA Construction Pool** (Bonds/HEO)* $877,500,000 $56,000,000 48 Projects

*GF – general fund; SR – special revenue; HEO – higher education operating
**This amount also includes the appropriation for the 10 projects included in Chapter 806 pre-planning pool.

Since the creation of the initial project pools during the 2008 Special Session, there have been several separate pre-planning, detailed planning, and construction pools created as illustrated in Table 2 above. One interpretation of the Code of Virginia is to have three set pools and each year projects and funding are added or removed based on the current status of the projects within the pools. The original intent of the process was to move a project through planning before consideration to place a project within the construction pool. However, there have been several projects placed directly in a construction pool in subsequent General Assembly sessions that have not completed either pre-planning or detailed planning. This is discussed in additional detail in the following section, "Evaluating the Implementation of the Pooled Approach."

The current capital outlay process allows the Commonwealth to obtain more accurate and competitive construction bids. Prior to the 2008 Special Session, before a project went out for bids, the projected cost of all projects were publically available and listed individually in the Appropriation Act. Alternatively, with the new pooled funded approach, only the total dollar value of the entire construction pool is publically available. Therefore, the Commonwealth has been able to benefit from significant saving by receiving more accurate and competitive bids for construction contracts.

Prior to the creation of the current capital outlay process, the Appropriation Act, under the capital outlay section, listed all projects individually that received approval. This entry illustrated the appropriation amount and the source of funding for individual projects. Unless there was a significant change, the project did not appear in the Appropriation Act again even though the expenses and funding for the project actually occurred over several years. Up until the last few years of the old process, even when projects received an additional appropriation, the Appropriation Act only showed the new appropriation amount. The Appropriation Act did not identify the fact that it was a supplemental appropriation, include the total appropriation to date, or show the expenditure status of the project. It was difficult to determine the amount of appropriations that was previously approved for each project, the number of times projects were appropriated additional funding, or the current status of the project. In the old process, additional wording was included in the Appropriation Act related to the timing of original appropriations and total funding to date. However, the General Assembly did not consistently apply this documentation to the capital projects in the Appropriation Act. In some instances, there is just wording noting that the appropriation is supplemental to a previously approved project. In other instances, the Appropriation Act includes the details of all past appropriations and the total to date. The design of the new current capital outlay process eliminates this issue by including each project in a project pool.

An additional advantage of the pooled approach includes more efficient use of bond proceeds. Prior to the 2008 Special Session, appropriation of bond proceeds for each project used project estimates created prior to the completion of detailed planning. Therefore, a firm project cost was unavailable to determine the appropriate amount of bond funding necessary. In the new process, agencies can use the Central Capital Planning Fund for pre-planning and detailed planning, and authorization to draw funds from bond proceeds does not occur until the construction phase when the total project costs are more definitive.

STATE COUNCIL OF HIGHER EDUCATION FOR VIRGINIA

The Director of the State Council of Higher Education for Virginia (SCHEV) is a member of the Advisory Committee. One of SCHEV's responsibilities includes reviewing capital outlay project information for public institutions of higher education.

In addition to higher education institutions submitting capital outlay information to Planning and Budget and General Services, higher education institutions submit similar information to SCHEV. Code of Virginia, Section 2.2-1517, requires SCHEV to review the information submitted by institutions and submit the results of their review to the Advisory Committee on or before June 30 of each year.

SCHEV evaluates the need among the Commonwealth's higher education institutions for new academic and administrative space under its Fixed Asset Guidelines. SCHEV has developed a process that addresses prioritization of requests for major renovations and capital improvements through the use of a comprehensive data collection system, which captures essential information related to the level and discipline of instructional activity, the size and condition of existing facilities, and the productivity with which these facilities are used.

SCHEV uses empirical information to place proposed capital outlay projects into the following priority groups:

Priority Group 1: projects that are fully justified under SCHEV's Fixed Asset Guidelines or considered critical to supporting the capital outlay needs of Virginia's system of higher education.

Priority Group 1.B: projects that address critical state wide capital outlay needs and which meet some but not all of the space and productivity criteria in SCHEV's Fixed Asset Guidelines.

Priority Group 2: projects that meet one but not both of the space and productivity criteria in SCHEV's Fixed Asset Guidelines.

Priority Group 3: projects that do not meet either the space or productivity criteria in SCHEV's Fixed Asset Guidelines but which have a compelling programmatic justification.

Priority Group 4: projects that are not justified under SCHEV's Fixed Asset Guidelines.

SCHEV's evaluation of the space, productivity, and programmatic justifications for the higher education projects should be a factor in the Advisory Committee's prioritization of projects in making recommendations to the Governor for inclusion in the Six-Year Capital Outlay Plan.

OBSERVATION*: There is not adequate coordination between Planning and Budget, General Services, and SCHEV regarding the capital outlay submission review process. SCHEV completes the reviews independent of Planning and Budget and General Services creating the potential for duplication of effort.*

RECOMMENDATION #8*: As recommended in Recommendation #4, the General Assembly may wish to consider designating a responsible party to gather and disseminate project information for the Advisory Committee's consideration. This responsible party should coordinate efforts between Planning and Budget, General Services, and SCHEV to review the information submitted by agencies and institutions during the capital outlay review process to avoid duplication of effort.*

STATEWIDE IT SYSTEMS FOR CAPITAL OUTLAY

The Commonwealth uses several statewide information technology (IT) systems during the planning and execution of capital outlay projects. This section includes information on GC Pay, Building Information Tracking System, and the Performance Budgeting System Capital Module. The capital project IT solution, as required in the 2008 Chapter 879 Acts of the Assembly, did not receive funding from the General Assembly; therefore, General Services did not move forward with this initiative.

GC Pay

GCPay is a web-based service to process pay applications and track expenses for construction projects. The contractor is responsible for a monthly service fee, up to $150 per project, for use of the system. All pool-funded bond projects must use GCPay for payment processing. Uses of the system include submitting, reviewing, and approving construction contractors' applications for payment and architectural and engineering (A/E) invoices. The system also contains the functionality to provide Small, Women-owned, and Minority-owned business (SWaM) reporting. GCPay created an electronic method for submission of the Schedule of Values, or CO-12 form. GCPay also has the capability for agencies and institutions to enter all other costs associated with a construction project, outside of the construction and A/E services. This enables the agency or institution to capture all expenditure and budget data associated with projects in one location in real time. Agencies and institutions are required to report all expenses related to pooled projects in GCPay.

OBSERVATION*: GCPay does not interface with any agency or higher education institution's accounting system. Therefore, approval of the contractor's application for payment does not automatically initiate payment. In addition, entities must enter expense data into GCPay separate from their accounting system. Without reconciling GCPay to their accounting system, agencies and institutions cannot ensure the data in GCPay is accurate and reliable.*

RECOMMENDATION #9*: General Services should require all agencies and institutions to timely reconcile project expenditure data in GCPay to the applicable accounting system used by the entity. This reconciliation will ensure the accurate and timely recordation of all project expenses in GCPay. This will ensure users will be able to make informed decisions regarding the timing of bond issuances and track overall project status.*

GCPay has the ability to generate reports for Treasury, Planning and Budget, and the General Assembly to track project cost and budget information. If all parties properly use GCPay, it will contain the required information to track the overall status of the project and also assist in determining the timing of bond issuances. However, our review determined that not all agencies and institutions are using GCPay to accurately record all project costs.

Building Information Tracking System

The Building Information Tracking System (BITS) is a web-based General Services computer application used for processing Capital Outlay (CO) forms and Building Official (BO) forms. Specifically, the following CO and BO forms are processed or viewed within BITS:

- CO-2 Authority to Initiate Capital Outlay Project
- CO-4 Application for Approval of Schematic Design
- CO-5 Application for Approval of Preliminary Design
- CO-6 Application for Approval of Working Drawings
- CO-8 Approval to Award Construction Contract
- CO-14 Project Completion Report
- CO-17 Building Permit
- CO-13 Certificate of Use and Occupancy
- CO-3 A/E Contract (view only logs)
- CO-11 Construction Change Order (view only logs)

This system allows for data centralization and efficient processing of relevant forms across multiple agencies including the initiating agency, General Services, SCHEV, and Planning and Budget. BITS has eliminated the need for many hardcopy CO forms, which greatly increased the efficiency and streamlined the capital outlay approval process. Higher education Tier-Three schools are exempt from some aspects of BITs form processing.

Performance Budgeting System Capital Module

State agencies and institutions use the Commonwealth's Performance Budgeting System (PB System) to submit budget information to Planning and Budget for review. This system replaces several older applications including CapSix. Within the PB System, there is a Capital Module that agencies and institutions use to enter capital outlay submissions, in agency priority order, for possible inclusion in the Six-Year Capital Outlay Plan. The Capital Budget Module also allows agencies to bulk submit their entire package of capital budget requests to Planning and Budget at one time. This information carries over from year to year. Therefore, agencies and institutions only enter new capital outlay submissions or updates to previously submitted projects.

EVALUATING THE IMPLEMENTATION OF THE POOLED APPROACH

As illustrated in Table 2, the 2008 Special Session, Chapter 1, created a pre-planning pool of projects. This pool contained a total of seven projects funded from the Central Capital Planning Fund. Each of these projects was appropriated $250,000 for pre-planning purposes, with the exception of one project which only required $233,000 to complete the pre-planning stage of the project. Five of the seven projects moved directly to the construction pool created in Chapter 890 of the Acts of the Assembly, and appeared to bypass the detailed planning stage. The remaining two projects in the pre-planning pool did not advance to either the Chapter 890 or Chapter 3 construction pool; however, they are still considered active projects.

The detailed planning pool created during the 2008 Special Session, Chapter 1, included a total of 26 capital outlay projects. Out of the 26 projects, 22 of the projects advanced to the construction pool in Chapter 890. One of the projects transitioned to a Central Maintenance Reserve item in Chapter 3, and the remaining three projects were evaluated as not feasible, funding was reverted, and the projects did not advance to a construction pool. The design of the multi stage process was intended to prevent a project from advancing further early on in planning, without costing the Commonwealth a significant amount of money, if planning or detailed planning determined a project was not feasible. Therefore, for this year, this aspect of the pool funded approach appears to be working as intended.

As illustrated in Table 2, Chapter 890 contained 31 projects in the construction pool. Out of these 31 projects, one project was never included in a pre-planning or detailed planning pool. Five of these projects completed pre-planning, but no detailed planning, and 22 projects received funding for detailed planning in Chapter 1. Approval for detailed planning funding for the remaining three projects occurred in Chapter 781 under the agency line items. However, Chapter 781 did not create any additional project pools using the pool funded approach.

Also illustrated in Table 2, Chapter 3 created a detailed planning pool and a VCBA/VPBA construction pool. There are 33 projects in the detailed planning pool and 36 projects in the construction pool. One additional project was added to the Chapter 3 construction pool, through Chapter 806, creating a total of 37 projects. Out of the 33 projects in the detailed planning pool, we could not find evidence these projects had been through a pre-planning pool. Further, it appears that 35 out of the 37 projects in the construction pool had been through neither a pre-planning nor a detailed planning pool. Instead, these 35 projects used funds from the construction pool to complete detailed planning and had no pre-planning completed. One project out of the 37 was in the Chapter 3 detailed planning pool, meaning it was a member of two different pools at the same time within the same Appropriation Act. General Services identified this error and adjusted accordingly. In Chapter 3, use of the construction pool funding occurred to advance funds for detailed planning for projects put in the construction pool, which did not have any prior planning.

Chapter 806 created a pre-planning pool, detailed planning pool, and construction pool, as illustrated in Table 2. There is a total of 47 projects included in the construction pool. Out of these projects, 15 projects have not had pre-planning or detailed planning. Planning and Budget intends to have the construction pool advance funds for detailed planning similar to the handling of Chapter 3 projects. There is a total of 17 projects in the detailed planning pool, none of which have been previously included in a pre-planning pool.

***OBSERVATION**: The multi-stage pool funded capital outlay process does not fit every project. Projects do not always advance through the three phases in a consistent manner, as outlined in the Code of Virginia. As stated above, there are numerous examples of projects bypassing either a detailed planning pool or pre-planning pool. There are also examples of projects skipping all phases and being placed directly into the construction pool without any pre-planning or detailed planning work completed. Due to the nature of some projects, this may be reasonable.*

***RECOMMENDATION #10**: The General Assembly, along with the Advisory Committee, may wish to consider developing criteria to define the type of projects that do not need to progress through all three phases. They should also ensure all projects that do not meet those criteria advance through each required project phase in a consistent manner.*

AGENCY AND INSTITUTION FEEDBACK

In order to obtain feedback from actual participants in the capital outlay process, the Auditor of Public Accounts surveyed agencies and institutions throughout the Commonwealth. Over 30 agencies and institutions provided feedback, which accounts for approximately 50 percent of the respondents surveyed. The majority of respondents represented those entities that are the biggest users of the capital outlay process, which included 12 of the 15 public institutions of higher education in the Commonwealth. In general, respondents stated the process has the potential to save the Commonwealth money if implemented as intended. However, as with any new process, there are concerns and opportunities for improvement.

Generally, agencies and institutions believe the process is not working as designed. Several respondents noted that the extra time it takes to get through planning increases costs associated with the project. Project delays add costs by breaking the continuity of planning and design changes that require consideration due to building code changes and other factors. The timing of the release of planning money in the process creates time gaps between pre-planning and detailed planning. These delays can cause issues related to pricing of materials, labor, and potential design changes. After detailed planning, agencies and institutions have experienced additional delays while the agency waits for the approval of construction funding. These delays further impact the overall cost of a capital project.

***OBSERVATION**: Institutions may be using non-general fund sources as a means to advance projects more quickly through pre-planning and detailed planning prior to receiving authorization from the General Assembly. If an institution uses agency non-general funds to conduct pre-planning and detailed planning prior to receiving proper approval, there is a risk the Advisory Committee or the General Assembly may not approve the project at a later date. Therefore, those funds used to advance the project before proper approval would have no value.*

***RECOMMENDATION #11**: The General Assembly may wish to give consideration to the inherent timing issues associated with the segmented project approval for the various stages of the pooled process. Agencies and institutions should also ensure they receive proper approval prior to using non-general funds for pre-planning and/or detailed planning.*

Agencies have also highlighted being at a significant disadvantage to institutions of higher education. Agencies typically do not have operating funds available to fund pre-planning or detailed planning on their own. This allows higher education institutions to get projects ready for consideration in a construction pool sooner than agencies can. Going forward, it could also provide institutions an advantage by allowing them to complete planning earlier and gain access to limited capital funding for construction as a result of the Commonwealth's debt capacity limit.

Agencies and institutions have also noted that Design-Build and CM at Risk contracts are more difficult to fit into the new process, and even lose their potential value, especially if funding does not occur timely. With Design-Build, in order to realize the benefits, the agency initially hires an A/E to prepare design documents through the schematic design. Then the agency hires a general contractor to complete the remainder of the design, using its own A/E, and to perform the actual construction. Similarly, with CM at Risk projects, the agency holds two contracts. The first contract is with a professional A/E for design services. The second contract is a two-phase contract (pre-construction and construction) with a CM at Risk Contractor. Therefore, the timing of the funding request and release are critical to the processes working effectively.

***OBSERVATION**: The pool process can hinder the use of Design-Build and CM at Risk construction contracts from working effectively if project approval and funding does not occur timely.*

***RECOMMENDATION #12**: The General Assembly may wish to consider modifying the pool funded process to better accommodate the use of Design-Build and CM at Risk construction contracts.*

Furnishings, Fixtures, and Equipment (FF&E) funds have also presented challenges for agencies and institutions. Requests for FF&E funds can typically occur six to nine months from project completion. After the request for funds occurs, approval and release of funds to the agency can take a significant amount of time. In today's environment, production of many FF&E solutions are highly specialized and can take six to nine months, along with additional time for the equipment to be installed properly on-site. This leaves buildings that have the potential to be complete and ready for occupancy, but not adequately prepared for their intended purpose.

OBSERVATION: *Consideration of FF&E funds have not consistently occurred during the creation of the various construction pools since 2008.*

RECOMMENDATION #13: *FF&E funds should consistently be included in the capital planning process. Not applying FF&E funding consistently through the legislative process decreases the transparency of capital spending from a tax payer's viewpoint and creates the potential that newly constructed facilities will not be available for use if there is no funding available for FF&E.*

Commonwealth of Virginia

Auditor of Public Accounts

Martha S. Mavredes, CPA
Auditor of Public Accounts

P.O. Box 1295
Richmond, Virginia 23218

January 15, 2014

The Honorable Terence R. McAuliffe
Governor of Virginia

The Honorable John M. O'Bannon, III
Chairman, Joint Legislative Audit
and Review Commission

We have audited the Commonwealth's Capital Outlay Process and are pleased to submit our report entitled **Review of Capital Outlay Funding and Cash Flow Processes**. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

<u>Audit Objectives</u>

Our audit objectives were to

- Obtain a thorough understanding of the capital project funding process, including the three-stage process and use of pooled funding;

- Evaluate the effectiveness of the process to determine the timing of bond issuances to meet construction cash needs;

- Determine the effectiveness of the current process used to prioritize capital outlay projects on a statewide level;

- Determine the feasibility of a statewide capital outlay prioritization system; and

- Determine the status of General Services' implementation of a capital project IT solution required in the 2008 Chapter 879 Acts of the Assembly.

We conducted surveys and interviews with personnel at the Departments of General Services, Treasury, and Planning and Budget, the State Council of Higher Education for Virginia, and the members of the Six-Year Capital Outlay Plan Advisory Committee. We performed analysis of capital outlay budgets and expenses and reviewed capital outlay policies in order to draw our conclusions and develop our observations. We reviewed legislative changes that occurred during the 2008 through 2013 legislative sessions. We reviewed processes and procedures put in place through June 2013.

Conclusions

Generally, we found that the multi-phase capital outlay process outlined in the 2008 Special Session of the General Assembly has not been functioning as intended for all projects. Due to their nature, some projects are not advancing through the three phases in a consistent manner, as outlined in the Code of Virginia. However, the Commonwealth has realized significant benefits from the new approach and can realize further benefits if it functions as intended. For example, the new process ensures the completion of comprehensive planning before the authorization of construction, along with obtaining more accurate and competitive construction bids.

Exit Conference and Report Distribution

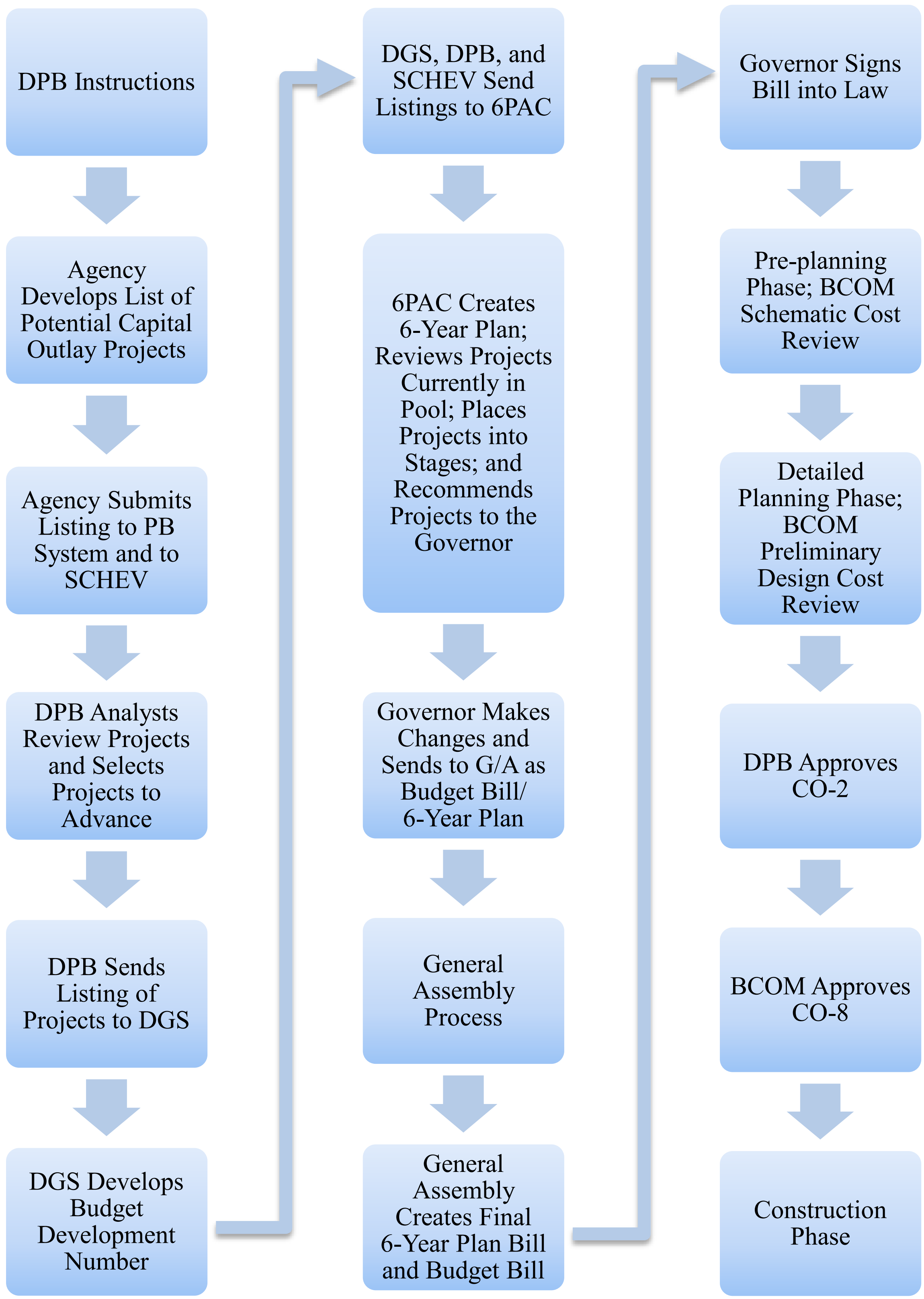
We discussed this report with General Services, Planning and Budget, Treasury, and SCHEV management. General Services' and SCHEV's response to the findings identified in our audit are included in the section titled "Responsible Officials' Responses." We did not audit these responses and, accordingly, we express no opinion on them. Treasury and Planning and Budget chose not to provide a written response for inclusion in the report.

This report is intended for the information and use of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

AUDITOR OF PUBLIC ACCOUNTS

DBC/alh

Appendix A: Capital Outlay Process Diagram



Appendix B: Recommendations

RECOMMENDATION #1*: The General Assembly may wish to consider requiring all projects using the pool funded approach to submit quarterly cash flow requirements to the Advisory Committee.*

RECOMMENDATION #2*: The General Assembly may wish to consider modifying* Code of Virginia*, Section 2.2-1517, to reflect the actual entity or party responsible for the issuance of capital outlay instructions to agencies and institutions.*

RECOMMENDATION #3*: General Services and Planning and Budget should consider limiting the number of capital request submissions by agencies and institutions. This limit should consider the number of projects an agency or institution can realistically construct within the next six years based on current programmatic needs and resources available.*

RECOMMENDATION #4*: The General Assembly may wish to consider designating a responsible party who can ensure all Advisory Committee members are provided all available information on a continuous basis regarding all potential and ongoing projects to enable each member to make informed decisions.*

RECOMMENDATION #5*: The Governor and the General Assembly may wish to consider providing greater transparency of the Commonwealth's capital outlay projects by identifying the status of each project in the Six-Year Capital Outlay Plan. The plan could also indicate whether a project advanced to pre-planning, detailed planning, or the construction phase. An additional improvement to the Six-Year Capital Outlay Plan would be to include a project description.*

RECOMMENDATION #6*: Planning and Budget should develop a method to track the Central Capital Planning Pool expenses to ensure appropriate use, as well as determine if the reimbursement from bond proceeds is occurring as required.*

RECOMMENDATION #7*: Treasury should develop a mechanism to track issuance amounts associated with projects approved for construction in Chapter 806. The methodology developed by Treasury must be able to track projects approved by Chapter 806 and other pool funded projects separately, due to the requirements of the enabling legislation.*

RECOMMENDATION #8*: As recommended in Recommendation #4, the General Assembly may wish to consider designating a responsible party to gather and disseminate project information for the Advisory Committee's consideration. This responsible party should coordinate efforts between Planning and Budget, General Services, and SCHEV to review the information submitted by agencies and institutions during the capital outlay review process to avoid duplication of effort.*

RECOMMENDATION #9*: General Services should require all agencies and institutions to timely reconcile project expenditure data in GCPay to the applicable accounting system used by the entity. This reconciliation will ensure the accurate and timely recordation of all project expenses in GCPay. This will ensure users will be able to make informed decisions regarding the timing of bond issuances and track overall project status.*

RECOMMENDATION #10*: The General Assembly, along with the Advisory Committee, may wish to consider developing criteria to define the type of projects that do not need to progress through all three phases. They should also ensure all projects that do not meet those criteria advance through each required project phase in a consistent manner.*

RECOMMENDATION #11*: The General Assembly may wish to give consideration to the inherent timing issues associated with the segmented project approval for the various stages of the pooled process. Agencies and institutions should also ensure they receive proper approval prior to using non-general funds for pre-planning and/or detailed planning.*

RECOMMENDATION #12*: The General Assembly may wish to consider modifying the pool funded process to better accommodate the use of Design-Build and CM at Risk construction contracts.*

RECOMMENDATION #13*: FF&E funds should consistently be included in the capital planning process. Not applying FF&E funding consistently through the legislative process decreases the transparency of capital spending from a tax payer's viewpoint and creates the potential that newly constructed facilities will not be available for use if there is no funding available for FF&E.*

COMMONWEALTH *of* VIRGINIA

Department of General Services

Richard F. Sliwoski, P.E.
Director

Joseph F. Damico
Deputy Director

1100 Bank Street
Suite 420
Richmond, Virginia 23219
Voice (804) 786-3311
FAX (804) 371-8305

January 31, 2014

Martha Mavredes
Auditor of Public Accounts
P. O. Box 1295
Richmond, VA 23219

Dear Ms. Mavredes:

Thank you for the opportunity to review the Auditor of Public Accounts' audit report on statewide Capital Outlay Funding and Cash Flow.

Overall, the Department of General Services (DGS) is in general concurrence with the findings and recommendations identified in your report. However, we feel that additional information is necessary to most accurately portray the current application of the Capital Outlay Pool Process. We communicated such information on January 8, 2014, in response to your request for our feedback, dated December 17, 2013. We appreciate your consideration of the majority of our feedback and respectfully resubmit some of our comments that were not adopted into your final report. Accordingly, listed below are six items that augment your report by clarifying important points on how the Capital Outlay Pool Process is currently applied:

(1) The Executive Summary characterization that the "the pooled project approach has not been functioning as intended for all projects" does not recognize the underlying success of the process.

> DGS Clarification: The intent for pooled project budgets to be "right sized" has been successful; it has resulted in project budgets being funded that match the appropriate project scope rather than projects expanding to match the available funds.

(2) Recommendation #3 (page 6 of the draft report) suggests that it is appropriate to "limit the number of capital request submissions by agencies and institutions."

> DGS Clarification: An arbitrary limit, as suggested in Recommendation #3, to capital budget requests runs the risk of not identifying important state capital requirements for agencies and institutions of larger size or with more complex program requirements.

(3) The Capital Outlay Plan Review section (pages 6-10 of the draft report) identifies those Higher Education agencies with the authority to exercise independent capital outlay program authority (UVA, VT, CWM, VCU and VCCS).

DGS Clarification: The report accurately states that several of these agencies act outside of central government oversight for Building Official and Capital Outlay Forms processing (UVA, VT, CWM). However, the report does not clarify that the effect of the different source of capital outlay program authority leads to significant differences that make the application and management of the pool process less consistent and effective.

(4) Within the Project Phases and Execution section (page 11 of the draft report), the report identifies the three basic steps of the Capital Pool Process as Pre-planning, Detailed Planning and Construction.

DGS Clarification: However, the report failed to identify an intermediate Schematic step between the Preplanning and Detailed Planning stages. At the Schematic step, the scope of work is verified and a Cost Target is provided to the agency for use in project design and development.

(5) Within the Comparison Information section (pages 15-17 of the draft report), the sentence: "Public disclosure of detailed projections of project costs do not occur prior to the construction bidding process" has been deleted.

DGS Clarification: It should be noted that this is a key point that emphasizes the value of the pool process; this sentence should be retained.

(6) Recommendation #10 (page 22 of the draft report) suggests that the General Assembly and the Six-Year Capital Outlay Plan Advisory Committee ("Advisory Committee") develop "criteria to define the type of projects that do not need to progress through all three phases (Preplanning, Schematic and Preliminary)."

DGS Clarification: DGS asserts that stand alone building construction projects benefit by progressing through the pool process and should continue to be funded through the pool process. However, indeterminate multi-part projects (maintenance reserve, blanket projects, and umbrella projects) do not benefit by progressing through the three step process and thus should not be included in a pool.

Thank you for the opportunity to comment and for your consideration of our feedback.

Sincerely,

Richard F. Sliwoski

Richard F. Sliwoski, P. E.

Peter Blake
Director

COMMONWEALTH *of* VIRGINIA

STATE COUNCIL OF HIGHER EDUCATION FOR VIRGINIA
James Monroe Building, 101 North Fourteenth Street, Richmond, VA 23219

(804) 225-2600
FAX (804) 225-2604
www.schev.edu

January 29, 2013

Ms. Martha Mavredes
Auditor of Public Accounts
James Monroe Building
101 North 14th Street 8th Floor
Richmond, VA 23219

Dear Ms. Mavredes:

Thank you for the opportunity to review the final draft of the *Review of Capital Outlay Funding and Cash Flow Processes Report.* It accurately portrays the current capital outlay process and areas for improvement. If followed, the recommendations will make the process more efficient and effective. As noted in recommendation numbers 5 through 8, transparency is critical to the success of the process. Additionally, we are encouraged that the report identifies an initial point of contact (Department of Planning and Budget) for the process.

While we agree with all recommendations presented by the APA, we continue to underline the need to limit the number of projects that can be submitted for consideration (recommendation 3) to those that realistically can be completed within the six-year timeframe. We also understand the rationale behind omitting recommendation number 4 regarding the FICAS database, but continue to support the goal of a single database for maintaining facility condition reporting.

We commend the APA staff on this report and concur with your recommendations. We believe that the areas of concern outlined in the report, if addressed as you have recommended, will improve the capital outlay process and lead to better results for the Commonwealth. Thanks again for the opportunity to review and comment on the draft.

Sincerely,

Peter A. Blake

RESPONSIBLE OFFICIALS

DEPARTMENT OF GENERAL SERVICES
Richard F. Sliwoski, Director

DEPARTMENT OF PLANNING AND BUDGET
Daniel S. Timberlake, Director

DEPARTMENT OF THE TREASURY
Manju Ganeriwala

SIX-YEAR CAPITAL OUTLAY PLAN ADVISORY COMMITTEE

Richard D. Brown
Secretary of Finance

Daniel S. Timberlake
Director, Department of Planning and Budget

Richard F. Sliwoski
Director, Department of General Services

Peter A. Blake
Executive Director, State Council of Higher Education for Virginia

Robert P. Vaughan
Staff Director, House Appropriations Committee

Betsey Daley
Staff Director, Senate Finance Committees