

REPORT HIGHLIGHTS

PERFORMANCE AUDIT

Subject

The Legislature created the School Facilities Board (SFB) in 1998 in legislation known as Students FIRST (Fair and Immediate Resources for Students Today). This law changed the way Arizona's schools are funded by establishing minimum adequacy guidelines for facilities and providing state funding to ensure the guidelines are met. SFB was created to develop the guidelines and administer the funding.

Our Conclusion

Rising school construction costs and rising student enrollment will have a growing impact on the State's General Fund. The Legislature may want to consider revising the building-renewal funding formula. SFB should continue efforts to improve oversight of building renewal expenditures and controls over the monies paid for school projects. In addition, SFB should improve internal controls over its IT system, which is used to manage payments.



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SFB responsibilities

SFB was created to ensure that school buildings and equipment meet appropriate guidelines for Arizona students to achieve academic success. The Board is charged with:

- Establishing **minimum adequacy guidelines** for school facilities.
- Administering a **deficiency corrections program** to bring facilities' deficiencies existing before 1998 up to the guidelines by June 30, 2006.
- Providing **new school construction monies** to districts to purchase land and build schools based on student enrollment projections and the required number of square feet per student.
- Providing **building renewal monies** to help maintain buildings' adequacy based on square footage, age, and student capacity.
- Managing the **Emergency Deficiencies Correction Fund**, which provides money to address protection of property, or public health, welfare, or safety.



Key facts

- 9,002—Deficiencies correction projects funded as of April 10, 2007.
- \$1.3 billion—Cost of deficiencies correction projects as of April 10, 2007.
- 328—New construction projects awarded as of June 7, 2007.
- \$1.96 billion—Monies distributed for new construction projects awarded between fiscal years 1999 and 2007.
- \$71.3 million—Building renewal funds distributed in fiscal year 2006.
- 14—Emergency corrections projects awarded between fiscal years 1999 and 2006.
- \$8.4 million—Cost of emergency corrections projects.

Future construction will place increasing demands on General Fund

Arizona is one of 13 states that use the General Fund as the primary source of state funding for new school construction funding.¹

However, several converging factors will significantly increase the impact of school construction on the General Fund.

Construction costs rising—Each year the Joint Legislative Budget Committee (JLBC) adopts an index that adjusts for construction market conditions. SFB then uses this index to determine whether

increased monies should be provided for school construction projects. Between fiscal years 2000 and 2005, the increases ranged from 0 to 5 percent. For fiscal years 2006 and 2007, the increases were above 12 percent, and SFB has since requested an additional 3 percent increase for fiscal year 2007.

Growth in student enrollment—SFB projects that Arizona's K-12 student population will grow 27 percent by 2015. This follows a 19 percent growth between fiscal years 1999 and 2006.

¹ Texas Legislative Council, *Facts at a Glance: State Roles in Financing Public School Facilities*, Austin, TX: Texas Legislative Council, December 2006.

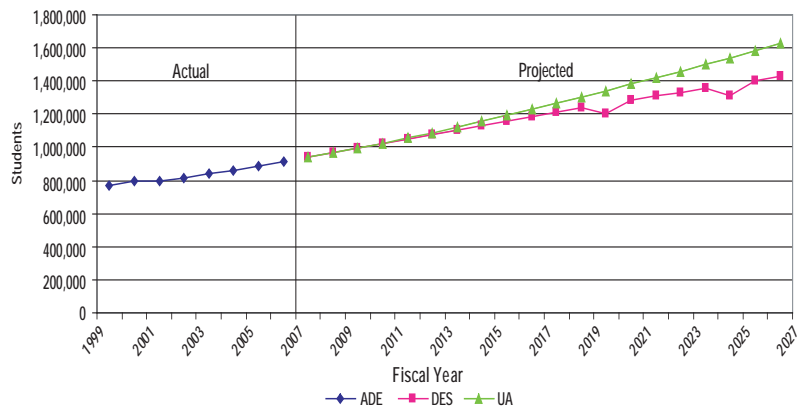
Increased funding demands—In fiscal year 2007, new school construction cost an estimated \$350 million. With rising construction costs and student populations, those costs are expected to increase significantly. JLBC projects that by 2012, the costs will be \$450 million, and SFB staff project costs of either \$487 million or \$544 million.¹ Between fiscal years 2008 and 2012, JLBC projects that the costs of school construction will total \$2.05 billion, and SFB staff project a total of either \$2.25 billion or \$2.35 billion.

Recent interpretations may result in greater General Fund impact—SFB has made awards in addition to awards calculated under a statutory funding formula, which totaled \$31.8 million in fiscal year 2007. To guide staff in determining what SFB will pay for, in February 2007, SFB interpreted some of the minimum adequacy guidelines. For example, the guidelines do not require playgrounds but SFB staff said that districts in the past paid for these with formula monies and now the Board has approved paying for playgrounds.

According to SFB, these interpretations will increase construction awards by 6 percent—from \$131.13 per square foot to \$138.25 for fiscal year 2007. This means an 80,000-square-foot elementary school award will increase by about \$569,000.

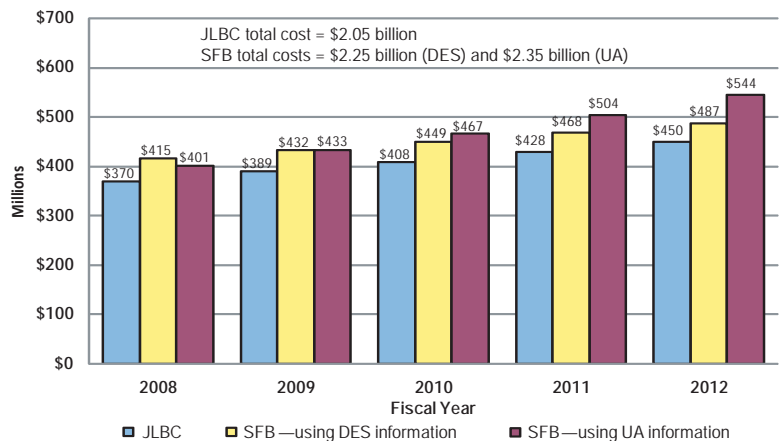
In making its awards of additional monies, SFB relies on a 2004 Attorney General opinion that says it can award inflationary increases for good cause. Although SFB management explained that the additional awards were necessary to compensate for inflation

Actual and Projected Student Growth¹
Fiscal Years 1999 through 2026



¹ Actual student growth is based on districts' 100th-day Average Daily Membership (ADM) that they report to the Arizona Department of Education (ADE). Student growth projections are prepared by SFB staff based on projected ADM calculated from Arizona Department of Economic Security (DES) and University of Arizona (UA) population projections.

Comparison of JLBC- and SFB-Projected Costs
for New School Construction
Fiscal Years 2008 through 2012



and allow districts to build schools comparable to those built in previous years using the statutory formula amount, the awards are not based on an inflationary adjustment allowed by statute. SFB should seek a formal Attorney General opinion regarding its authority to award these additional monies and then follow the Attorney General's advice.

Recommendations

SFB should:

- Seek a formal Attorney General opinion to determine if it has authority to award these additional monies.
- Comply with the opinion.

¹ JLBC and SFB staff used different methodologies when developing their projections, including different methods to calculate student enrollment growth and inflationary adjustments. SFB prepares two different projections using different population estimates.

Building renewal formula may need modification

SFB uses a statutorily prescribed funding formula to determine the amounts the districts need to renew and maintain their buildings. However, between fiscal years 1999 and 2007, the Legislature has only once completely funded building renewal according to the formula, using an alternative formula in fiscal years 2005 and 2006 that funded building renewal at a lower level.

The legislative branch has proposed modifying the formula. The Legislature attempted to change the funding formula in the 2002 through 2006 legislative sessions, but the Governor vetoed these bills because of pending litigation. However, in October 2006, the Superior Court granted a summary judgment

in favor of the State, opening the door for study and possible changes to the formula. The litigation awaits a final court order. In June 2007, the Legislature established a task force whose duties include reviewing and potentially making recommendations for changing the building renewal formula.

Past efforts to change the formula arose in part because some districts had accumulated large balances of building renewal money. However, districts indicated that they accumulate the money in order to address their major renovation projects and, even then, the amount accumulated does not meet the needs. In response, some districts said they have bonded for monies for renovations or delayed repairs.

Recommendation

The Legislature should consider modifying the building renewal funding formula to help districts better manage their building renewal monies.

SFB should improve building renewal oversight

Building renewal monies may only be used for goods or services that will help maintain or extend the useful life of school buildings as prescribed by statute. For example, the monies may be used for building renovations or major repairs, but may not be used for new construction or expansion.

Districts submit to SFB 3-year plans describing how they intend to use the building renewal monies. SFB staff then review the plans to determine compliance with the statute. If a plan includes inappropriate expenditures, the district must revise the plan and resubmit it.

By October 15 of each year, districts submit reports of their building renewal expenditures. Before fiscal year 2007, SFB staff only used these reports to compile an annual report showing each district's beginning and ending fund balances, revenues, and expenditures. SFB staff have now begun deter-

mining if the districts appropriately spent the monies.

Some district building renewal expenditures appear to have been for an unapproved or prohibited use. Auditors identified 193 fiscal year 2005 expenditures totaling about \$4 million that appeared to potentially be inappropriate. For example, stage equipment is not an allowable use of building renewal monies, and playground equipment is also a prohibited expenditure. However, SFB staff will need to further review and analyze the expenditures we identified to determine if they are allowable.

To help staff identify inappropriate expenditures, SFB should develop and implement a standard process for reviewing building renewal expenditures. Further, any inappropriate expenditure should be reported to the Superintendent of Public Instruction as required by law. SFB has not yet done so because it lacks a mechanism for districts to challenge its staff's determinations that certain expenditures are inappropriate.

Recommendations

SFB should:

- Improve oversight of building renewal expenditures.
- Provide districts an opportunity to challenge SFB staff's conclusions regarding building renewal expenditures.
- Report inappropriate expenditures to the Superintendent of Public Instruction.

Controls over payments should be improved

SFB pays out more than \$400 million annually for school districts' projects. SFB has some good practices for accounting for its money and how it is spent. However, the practices have not always been followed, and they are not written. A new staff member's unfamiliarity with the processes led to overpayments to two school districts. In addition,

until recently, SFB did not keep records of reconciling its payments data to the state-wide accounting system.

Further, SFB has a process for determining final payments that can also help identify overpayments and inaccurate information. However, SFB staff do not use this process for all projects. We found several errors that had not been discovered because the projects had not gone through this close-out process.

Recommendations

SFB should:

- Develop and implement written policies and procedures.
- Establish a training program for employees involved in payment processing.
- Use its close-out process for all projects.

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www.azauditor.gov

Contact person for this report:
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Database controls need improvement

SFB uses a project-tracking database to manage payments to districts and vendors. SFB uses the database to determine payment amounts for new construction, deficiency correction, and emergency deficiency correction expenditures.

Although the database is critical to SFB's functions, SFB lacks a strong overall control framework. For example, the following are key controls that the system lacks:

- **Documentation**—Written policies and procedures for users and explanation of how the database works.

SFB does not have in-house IT resources and instead relies solely on an IT consultant for day-to-day IT needs. In addition, the contract with the consultant does not establish that the State owns the database nor does it require the consultant to provide any system documentation. As a result, SFB must rely exclusively on the consultant to address day-to-day problems and future system development.

- **Access controls**—Ensure that only authorized users can view or change data in the system.

Recommendations

SFB should:

- Strengthen the control framework for its project-tracking database.
- Modify the consultant contract to establish state ownership of the database and require system documentation.
- Consider converting a vacant position to an IT position, using a consultant(s), or combining the two methods to meet its IT needs.