

A Report on the

Financial Review of Agency Operations at the State Preservation Board



Office of the State Auditor
Lawrence F. Alwin, CPA

December 1995

Report No. 96-025

Key Points Of Report

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Overall Conclusion

The State Preservation Board (Board) has adequate controls over current projects, enterprise operations, and financial management information. Approximately \$4.3 million in unexpended appropriations will be available for use on the Historic Capitol Grounds Project. In addition, the Board's enterprise operations are self-supporting.

Key Facts And Findings

- The Board is successfully closing out the Capitol Interior Preservation Project. Through August 31, 1995, the Board has expended a total of \$181.2 million on the Capitol Restoration and Extension projects, with the final cost estimated at \$185.8 million.
- The Historic Capitol Grounds Project, which encompasses civil, site amenity, and landscape improvements to the Historic South Grounds of the Capitol, is set to be completed by the 75th Legislature. A total of \$6.23 million in funding is projected to be available for the project.
- According to a joint study by the State Preservation Board and the General Services Commission, the existing maintenance program, administered by the Commission, does not meet the needs of the renovated Historic Capitol Complex. The Board should take actions to ensure that all of the maintenance and management issues related to the Historic Capitol Complex have been adequately addressed.

Contact

Barnie Gilmore, CPA, Audit Manager (512) 479-4700



Office of the State Auditor

Lawrence F. Alwin, CPA

This financial review of agency operations was conducted in accordance with Government Code, §321.0133.

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Executive Summary

The State Preservation Board (Board) has adequate controls over current projects, enterprise operations, and financial management information and is successfully closing out the Interior Preservation Project. The written close-out procedures are being followed and the project, excluding minor warranty work, should be finalized by the end of January 1996. After final close out, the Board should have sufficient funds to complete the Historic Capitol Grounds Project. However, the following issues need to be addressed:

- According to a joint study by the Board and the General Services Commission, the existing maintenance program, administered by the Commission, does not meet the needs of the renovated Historic Capitol Complex. Resolution of this issue may require legislative action.
- Although management monitors revenues and cash balances from the cafeteria food services contract and press space leases, the profitability of these operations is not formally determined.
- A long-term plan has not been developed for meeting future costs relating to repairs, maintenance, and replacement of equipment and furnishings in the Capitol Dining Room and Capitol Press Space.
- Revenues from the Board's gift shop, bookstore, cafeteria food services contract, and press space leases were not deposited in a timely manner.

The quality control issues identified in our report *Follow-up on Management Controls at the State Preservation Board* (SAO Report No. 94-135, July 1994) have been resolved.

In addition, the Board has implemented recommendations from our *Review of Management Controls Over the Capitol Annex Cafeteria Operation*, (SAO Report No. 94-049, February 1994).

The Curatorial Division has adequate internal controls in place over Capitol Fund donations and fund-raising activities and to protect the historical artifacts of the Capitol. In addition, the Board's enterprise operations are self-supporting.

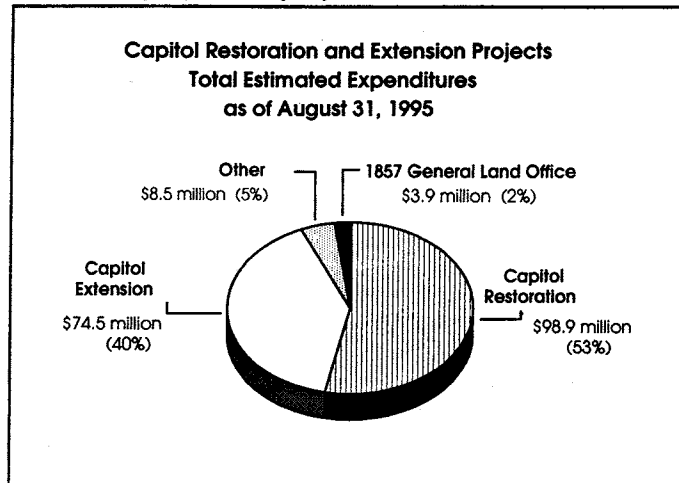
The Interior Preservation Project Is Nearing Final Completion

The State Preservation Board is successfully closing out the Interior Preservation Project, and the quality control issues identified in our report *Follow-up on Management Controls at the State Preservation Board* (SAO Report No. 94-135, July 1994) have been resolved. The "punch list" contains two items of an aesthetic nature and should be completed by January 1996.

Through August 31, 1995, the Board expended a total of \$181.2 million on the Capitol Restoration and Extension projects, with the final cost estimated at \$185.8 million. (See Figure 1.) This will leave approximately \$4.3 million in unexpended appropriations available for use on the Historic Capitol Grounds Project.

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Figure 1
The final cost of the Capitol Restoration and Extension projects is projected to be \$185.8 million



The alternative disputes resolution (ADR) process appears to have helped ensure that the Capitol Interior Preservation Project was completed on time. The use of the disputes review board (DRB) within the ADR process likely diminished the magnitude of potentially litigious claims which could have stalled construction work and could have compromised the scheduled deadline for completion.

The Historic Capitol Grounds Project Appears to Be Adequately Funded

The Historic Capitol Grounds Project which encompasses civil, site amenity, and landscape improvements to the Historic South Grounds of the Capitol, appears to be fully funded. In August 1995, the Board's governing body approved portions of the Master Plan along with a preliminary budget estimate of \$5.3 million. A total of \$6.23 million in funding is estimated to be available for the project which is planned for completion by the start of the

75th Legislature. Based upon these projections, it appears that sufficient money will be available to fund the entire scope of the Master Plan at an estimated cost of approximately \$6.22 million.

The Board's Enterprise Operations Are Self-Supporting

The Board's enterprise operations, consisting of the Capitol Complex Visitor's Center Gift Shop, Capitol Extension Bookstore, Capitol Dining Room food services contract, and Capitol Press Space leases, are self-supporting. The gift shop and bookstore generated total revenues of \$537,915 and net income after depreciation of \$115,860 during fiscal year 1995. The food services contract with Culinaire International generated rent revenues of \$113,540, and \$35,200 was collected from press space leases.

Although management monitors revenues and cash balances from the cafeteria food services contract and press space leases, the profitability of these operations is not formally determined. Profit and loss statements should be prepared at least quarterly to capture all revenues and expenses associated with the Capitol Dining Room and Capitol Press Space, including depreciation. This information can then be used to monitor the true profitability of these operations and to plan future operations.

A long-term plan has not been developed for meeting future costs relating to repairs, maintenance, and replacement of cafeteria and press space equipment and furnishings. The Board spent \$836,021 to equip and furnish the Capitol Dining Room and \$335,564 on the

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Capitol Press Space. A long-term plan is needed to ensure that future repair and replacement costs are predicted and adequate reserves are on hand to meet these needs.

Revenues from the Board's enterprise operations were not deposited in a timely manner. Of the 45 receipts tested during fiscal year 1995, 23 (51 percent) were deposited later than three business days after the date of receipt, resulting in lost interest revenue to the State of approximately \$57.00. Timely deposits of revenues are essential to protect against errors and misuse and to ensure that state funds are managed efficiently.

Issue for Further Study: Maintenance of the Historic Capitol Complex Should Be Evaluated

According to a joint study performed by the State Preservation Board and the General Services Commission, the existing maintenance program does not meet the special needs of the renovated Capitol Complex. Without an adequate maintenance program in place, there is a risk that the preventative and custodial needs of the Historic Capitol Complex will not be met, resulting in costly repairs in the future. The Board should take actions to ensure that all of

the maintenance and management issues related to the Historic Capitol Complex have been adequately addressed.

Summary of Management's Responses

Management generally concurs with the findings and recommendations contained in this report. They have included corrective action plans for implementing the recommendations.

Summary of Objectives and Scope

The objectives of this review were to determine the financial condition of the State Preservation Board as of August 31, 1995, and to evaluate the adequacy of control systems over policy management, information management, and resource management. We also followed up on prior audit issues.

The scope of this review included gaining an understanding of the Board's operations, performing substantive tests to determine its financial condition as of August 31, 1995, and evaluating the accuracy of financial projections used in planning future projects and operations.

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The Interior Preservation Project Is Nearing Final Completion

The State Preservation Board is successfully closing out the Interior Preservation Project. The quality control issues identified in our report *Follow-up on Management Controls at the State Preservation Board* (SAO Report No. 94-135, July 1994) have been resolved. In addition, the alternative disputes resolution (ADR) process appears to have aided the timely completion of the project.

Through August 31, 1995, the Board expended a total of \$181.2 million on the Capitol Restoration and Extension projects, with the final cost estimated at \$185.8 million. This will leave approximately \$4.3 million in unexpended appropriations available for use on the Historic Capitol Grounds Project. (See Appendix 3.1 for a detailed breakdown of the estimated funding sources and uses.)

Section 1-A:

The Interior Preservation Project Should Be Finalized by January 1996

Written close-out procedures are being followed, and the Interior Preservation Project, excluding minor warranty-related work, should be finalized by January 1996. The following is a summary of outstanding items as of the date of this report.

- In accordance with the terms of the contract, all operations and maintenance manuals (O&Ms) have been received from the contractor, approved by the architect, and submitted to the General Services Commission. O&Ms contain technical information on the operation and maintenance of mechanical and electrical/communication systems. They will be used in ongoing maintenance of the Capitol, Capitol Extension, and 1857 General Land Office Building.
- Record drawings are still in the process of being reviewed by the architect. (Record drawings are the construction plans as originally developed by the architect which have been updated during the construction process to reflect changes made to the original plans.) These documents are vital to successful maintenance of the buildings and planning future modifications. They contain information that shows the buildings "as built." Primary uses of these record drawings, or "as built," are to locate plumbing, mechanical, or electrical lines and equipment that are installed behind walls, in attics, in foundations, on-site underground, or overhead.
- The "punch list" contains two items of an aesthetic nature and should be completed by January 1996. As of May 25, 1995, the punch list was valued at \$1,354,392. By September 29, 1995, the value of the list had decreased to approximately \$235,000. [A punch list is a list of incomplete or unsatisfactory items that the contractor must finish in order for the contract to be closed out and final funds released. It is generally prepared toward the end of a project

by the architect with input from the owner (the Board).] Board management has assigned a value to the punch list and is holding funds from the contractor totaling approximately two times the amount of the estimated values of the items on the list. In this way, the Board is protected if the contractor leaves the job without completing the work. This situation does not appear likely.

- Four claims filed by the contractor totaling \$753,632 remain unsettled. The claims involve hardware, door jambs and casings, and a handicap lift for which the contractor is requesting payment. Board management's position is that these items were covered under the terms of the original contract. Two of the claims are being reviewed by the Governor's Office for final resolution. The remaining two claims are still being negotiated.

Management's Response:

The Board is proud to have completed the project on time and under budget. The Board remains committed to working with the General Contractor and the architects on the resolution of the few outstanding items in the best interests of the State. Completion of final close-out, claims, punch list, "as built" and future operations planning is the Board's current goal and focus. This project was completed in a large part because of the extraordinary effort and commitment of the Board's staff.

Section 1-B:

Quality Control Issues Have Been Resolved

It does not appear that there are any significant quality control issues relating to the Interior Preservation close out. Virtually all issues on the Non-Conformance Report (NCR) log have been resolved. In our previous report, *Follow-up on Management Controls at the State Preservation Board* (SAO Report No. 94-135, July 1994), we questioned the length of time it was taking to resolve quality control issues identified by the Board's inspectors. Our concern was that if quality control issues were not resolved in a timely manner, finishes, such as walls and ceilings, could not be closed up in time to meet the completion schedule. Since the schedule was met, this is no longer an issue.

Another quality control issue that appears to have been resolved relates to the Capitol Extension. It seems that a number of architectural finishes were damaged by movement from expansion joints in the Capitol Extension. Although this structure was engineered to accommodate anticipated movement of the foundation via the use of expansion joints, the Board's contract architect failed to adequately address the anticipated movement of the structure in all of the plans and details associated with architectural finishes in a number of locations. This omission resulted in damage to many architectural finishes (ceilings, walls, floors) in various areas as the foundation moved. A contract to repair these areas was recently let at a cost of approximately \$80,000. Since the design architect, 3D/International, has accepted responsibility for the remedial design work and is assuming the cost of the repairs, this is no longer an

issue. The work is currently being performed and is scheduled to be completed by the end of December.

Management's Response:

The Board adopted the State Auditor's Office recommendations and developed procedures for modifying systems, to best control the completion of the Capitol Interior Preservation Project. The implementation of these quality procedures was necessary to successfully complete the project, while adhering to the highest restoration quality standards. Through the use of these procedures the Board was able to validate quality workmanship and save money in the long-term by containing repair and replacement costs.

Section 1-C:

The Alternative Disputes Resolution Process Appears Beneficial

The use of a disputes review board (DRB) within the alternative disputes resolution process (ADR) likely diminished the magnitude of potentially litigious claims which could have stalled construction work on the Interior Preservation Project and could have compromised the scheduled deadline for completion. This process kept the project moving toward completion even while the contractor was filing claims.

The DRB was the principal means used on the project for resolving disputes that could not otherwise be negotiated. According to the American Society of Civil Engineers' report, *Avoiding and Resolving Disputes in Underground Construction*, a DRB is a forum that fosters cooperation between the owner (the Board) and the general contractor. It provides a means of resolving disputes equitably and economically. The result should be minimized disputes and reduced project delays.

A DRB consists of three members. One member is appointed by the owner, one by the general contractor, and a third is appointed by the other two members. This third person chairs the DRB. DRB members are supposed to be impartial and recognized experts in their fields. The members periodically visit the job site to keep up with current events. The DRB does not replace existing dispute settlement methods. Rather, it seeks to informally resolve disputes before they become involved in the judicial process. The DRB findings are non-binding, and either party can pursue legal remedies if they are not satisfied with the decision.

The contractor submitted 84 claims for additional compensation for various reasons during the project. Of these claims, 69 were negotiated to a mutually agreed settlement, leaving 15 to be heard by the DRB. To date, the DRB process has settled claims involving \$2,405,813 for \$1,089,309 (\$.45 on the dollar). Of the 15 claims heard by the DRB, six claim amounts were reduced, two claims were denied the contractor, two claims were withdrawn by the contractor, three claims were settled for the amounts claimed, and two remain open. The two open claims total \$689,233 and are being reviewed by the Governor's Office for final resolution. (Two additional

open claims, involving \$64,399, did not go through the DRB and are being negotiated separately.)

The potential for claims was very high on the Interior Preservation Project for the following reasons:

- This was an extremely complex renovation project with many unknown factors. Years of virtually uncontrolled building modifications created a situation where ceilings, walls, and floors concealed conditions of which the full impact could only be determined after they were opened.
- The scope of this project grew by more than 31 percent because of these unknown conditions, as well as other causes, including end-user requests for changes to the work and architect omissions and errors. The original base contract was for \$57,011,000. Change orders in the amount of \$17,761,006 were issued through August 1995.
- The scheduled completion date never changed despite the growth in project scope. In construction project administration, it is generally accepted that as the project scope grows, the schedule will likely have to be lengthened. Throughout the course of construction and changes to the scope, the schedule was continually being compressed, giving rise to contractor claims for accelerated performance.

These conditions made the climate ideal for claims that could result in litigation. Had this ADR method not been provided for in the construction contract, a deadlock could have occurred between the Board and the contractor which might have resulted in the schedule not being met. These are also ideal conditions for using a DRB.

Management's Response:

The Board agrees that without the ADR process, there was the likelihood that the construction work could have been stalled. There was the potential that the contractor may have stopped work without the recourse of the ADR process. The Board, general contractor and architect were committed to timely completion. The inability to move completion deadlines also played a major role in allowing the construction to remain ongoing. Both the unique pressures of this construction project and the ADR process played a role in avoiding delays. The Board is unable to say which in particular, or what combination of these, kept the project on schedule. The Board is grateful that deadlines were made.

Section 1-D:

Lessons Can Be Learned from the Disputes Review Board Process

Lessons can be learned from the disputes review board (DRB) process used on the Interior Preservation Project. According to criteria provided by the Construction

Industry Institute, the DRB process used on the Interior Preservation Project fell short of expectations in the following areas:

- **The owner and the contractor must be totally committed to the DRB process.** Board management was reluctant to use the DRB process in the beginning which may have influenced its perception of the process.
- **DRB members must have the total confidence and trust of the contractor and the owner. When the DRB members perceive this trust is lacking, it is incumbent upon them to remove themselves from the board.** Board management lost confidence in the members when they ventured into contract law by trying to circumvent the waiver of claims clause in the general conditions of the contract. It is not the DRB's charge to invalidate a contractual term. This was not an appropriate action by a DRB.
- **DRB members are to visit the job site on a regular basis and remain informed of the status of the work.** Although the DRB met on a quarterly basis at the project site, this may not have been enough to keep fully apprised of the events occurring during construction. As the scope of the project increased and the schedule was compressed, several issues arose between meetings. As a result, DRB members sometimes walked into a claim hearing "cold" on the conditions surrounding the claim.
- **A DRB is an informal forum to hear disputes and recommend action, which is not binding.** One DRB member and the contractor stated that the DRB's decisions should be binding. This indicates a lack of understanding of a fundamental DRB concept.

Despite problems that occurred with the DRB during the Interior Preservation Project, the DRB process was successful overall and helped ensure that a difficult schedule was met. The concept has a proven track record nationwide and should continue to be considered for large (in excess of \$10 million), complex state construction projects. Examples might include: underground utility or tunnel construction, heavy road and bridge construction, complex and extensive renovations, or large prison projects. Specific guidance relating to the construction process, including the use of disputes resolution boards, can be found in the following State Auditor's Office reports:

- *An Overview of Construction in Texas: Getting the Most for Our Dollars*, SAO Report No. 92-039, February 1992
- *Prison Construction in Texas*, SAO Report No. 93-033, January 1993
- *A Follow-up Report on Prison Construction*, SAO Report No. 94-142, August 1994
- *An Audit Report on Improving the Construction Process*, SAO Report No. 95-031, November 1994

Management's Response:

The Board, as the participant in the first true test of the DRB system within the State, agrees that the process had flaws. The Board recommends and encourages the State to develop a DRB implementation manual. Such a manual should include the general notice that a DRB should have a familiarity with the specific type of construction, an overview of the DRB's role, the DRB process, appeals information and guidelines. It is imperative that the owner, the general contractor, and the DRB members have a complete understanding of and consensus on the process, implementation procedures, available alternatives, and an end goal.

Section 2:

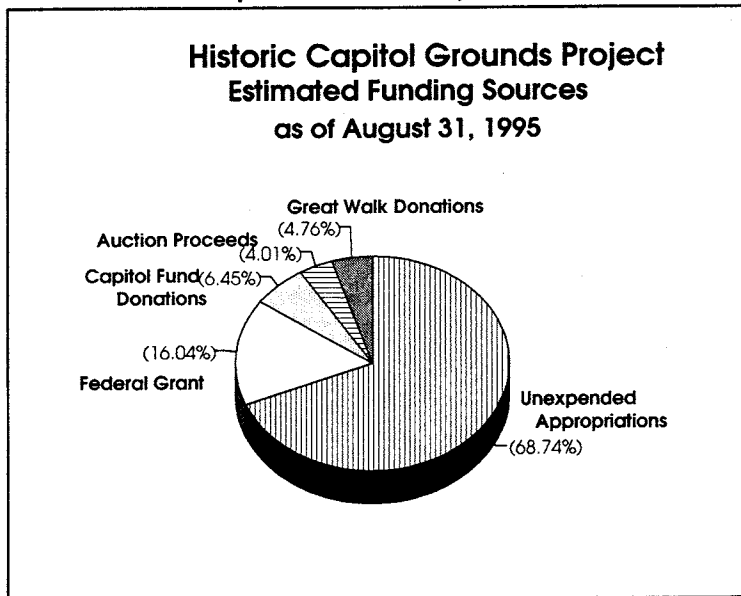
The Historic Capitol Grounds Project Appears to Be Adequately Funded

Based on estimates prepared by Board management as of August 31, 1995, the Historic Capitol Grounds Project is adequately funded and is planned to be completed before the 75th Legislature. Funding for the project, estimated at \$6.23 million, consists of unexpended appropriations from the Capitol Restoration and Extension projects, a federal grant under the Intermodal Surface Transportation Efficiency Act, auction proceeds, and private donations. (See Figure 2.)

The Master Plan for the Historic Capitol Grounds Project was prepared by EDAW/Broussard, a Landscape Architecture Joint Venture, and addresses the restoration and renovation of the grounds during the period 1888 to 1915. The Plan calls for a

comprehensive rehabilitation of the grounds and entails "civil, electrical, structural, and irrigation engineering; monument restoration; graphics and directional signage; and significant landscape architecture." The specific recommendations of the Master Plan are as follows:

Figure 2
Approximately \$6.23 million is projected to be available for the Historic Capitol Grounds Project



- Restore the Oval Walk and Great Walk Precinct to its appearance circa 1888-1915.
- Renovate the grounds to their character circa 1888-1915.
- Install a fire protection water supply system.
- Renovate the drives and curbs.
- Replace walks and create an accessible route through the grounds.
- Renovate and restore the monuments.

- Install comprehensive grounds lighting.
- Restore the perimeter fence and gates.
- Implement a comprehensive tree care and replacement plan.
- Install a site-wide interpretive and directional signage system.
- Install a water-conserving irrigation system.

On August 22, 1995, members of the State Preservation Board approved the Master Plan, excluding monuments, fences, and gates, which were to be addressed separately. The cost of the approved plan is estimated at \$5.3 million, including up to \$400,000 for monument restoration, which was approved as a separate line item. After the Interior Preservation Project is closed out, it appears that sufficient funds should be available to cover the additional \$921,365 estimated cost of the fences, gates, and park benches recommended in the Master Plan. It should be noted that the amounts contained in the Master Plan are rough cost estimates. A more accurate estimate is being prepared by a professional cost-estimating firm and was not available at the time of our review. Once the estimate study has been completed and the actual bids have been received, a more accurate funding analysis can be performed. (See Appendix 3.2 for a detailed statement of estimated funding sources and uses.)

Management's Response:

The Historic Capitol Grounds Project Master Plan is currently in the design development stage. Cost estimates in the Master Plan do not strictly reflect schematic or design development, these numbers are merely an overall estimate. The Board's scope may need alteration to the Master Plan in order to contain costs. Scope alterations will occur throughout the planning process, and will be approved by the Board prior to the letting of the construction. The Board intends to produce a final overall project budget within existing funding by bid time.

Section 3:

The Board's Enterprise Operations Are Self-Supporting

The Board's enterprise operations, consisting of the Capitol Complex Visitor's Center Gift Shop, Capitol Extension Bookstore, Capitol Dining Room food services contract, and Capitol Press Space leases, are self-supporting. The gift shop and bookstore generated total revenues of \$537,915 and net income before depreciation of \$143,789 during fiscal year 1995. Net income after depreciation amounted to \$115,860. The food services contract with Culinaire International generated \$113,540 in rent revenues, and \$35,200 was collected from press space leases.

Although management monitors revenues and cash balances from the food services contract and press space leases, the profitability of these operations is not formally determined. A long-term plan has not been developed for meeting future costs relating to repairs, maintenance, and replacement of cafeteria and press space equipment and

furnishings. In addition, revenues from the gift shop, bookstore, food services contract, and press space leases were not deposited in a timely manner.

Section 3-A:

Improve Monitoring of the Cafeteria and Press Space Operations

The Board has not developed a formal method for monitoring the profitability of its Capitol Dining Room food services contract and Capitol Press Space leases. Although the Board tracks revenues and cash balances from these operations, information relating to expenses is not summarized and analyzed.

According to the Board's enabling legislation, revenues from the cafeteria food services contract and press space leases are to be used solely to furnish and maintain the Capitol Dining Room and Capitol Press Space. Revenues and expenses should be analyzed at least quarterly to ensure these operations remain self-supporting and produce sufficient reserves to meet future expenses. In addition, it is essential that implicit costs, such as depreciation, be included when analyzing performance. The Board spent over \$836,000 to equip and furnish the Capitol Cafeteria. Approximately \$335,500 was spent on the Capitol Press Space, including \$268,000 on a state-of-the-art fiber optics system. Although depreciation is not reported in the financial statements of governmental fund types, it can be used by management to monitor performance of enterprise type operations. Because fixed assets have limited useful lives, depreciation is a method of allocating the cost of this usefulness to the periods that benefit from the assets' use.

According to the Board's records, the Capitol Dining Room and Capitol Press Space generated \$113,540 and \$35,200, respectively, in rent revenue during fiscal year 1995. Combined net income before depreciation amounted to \$142,142. Net income after depreciation was \$24,659. (See Appendix 3.4 for detailed profit and loss information.)

Recommendation:

Profit and loss statements should be prepared at least quarterly to capture all revenues and expenses related to the cafeteria and press space, including depreciation. This information can then be used to assess the true profitability of these operations and to make informed decisions regarding future operations.

Management's Response:

Because the cafeteria and press spaces are new and unique operations for the State, the Board requested the State Auditor's Office's aid in developing accounting procedures. In February 1994 the State Auditor's Office completed a review of the agency's management controls of the Capitol Dining Room. The Board implemented the appropriate procedures recommended in the report. The report did not recommend generating profit and loss statements with implicit cost calculations.

However, the Board assents that these statements would be a valuable planning instrument. The Board agrees that the agency will develop income statements on a quarterly basis for the cafeteria and press rooms. This information will assist in long-range planning of bidding specifications and fee structures, along with providing historical cost data.

Section 3-B:

Develop a Long-Term Plan for Equipment Maintenance and Replacement

A long-term plan has not been developed for meeting future costs relating to repairs, maintenance, and replacement of Capitol Dining Room and Capitol Press Space equipment and furnishings. According to the Board's enabling legislation, revenues from the cafeteria vending operations and press space leases are to be used solely for their maintenance and improvement. In addition, the food services contract between the Board and the cafeteria vendor, Culinaire International, specifies that the Board is to maintain all cafeteria equipment except for incidental repairs and maintenance (less than \$500).

Through August 31, 1995, the Board has expended over \$1.2 million on furniture and equipment in the Capitol Dining Room and Capitol Press Space. Without a long-term plan, the Board cannot reasonably estimate when equipment may need to be replaced and whether sufficient funds will be available to meet these future expenses.

Recommendation:

We recommend that the Board develop a long-term plan for meeting future costs relating to repairs, maintenance, and replacement of cafeteria and press space equipment and furnishings. Possible methods include establishing a fixed asset replacement plan using depreciation schedules and useful life estimates and estimating future repairs and maintenance costs based on past trends and periodic inspections.

Management's Response:

The Board agrees that it is necessary to develop a long-term equipment replacement schedule for the Capitol Dining Room and Capitol Press Space. Allowing proper use of earned funds, the Board may avoid encumbering state appropriations with the utility, custodial, maintenance and capital outlay costs necessary to provide these services.

Section 3-C:

Ensure Timely Deposits of Receipts

Revenues from the Board's gift shop, bookstore, cafeteria food services contract, and press space leases were not deposited in a timely manner. Of the 45 receipts tested during fiscal year 1995, 23 (51 percent) were deposited later than three business days after the date of receipt, resulting in approximately \$57.00 in lost interest.

According to Government Code, § 404.094, all state funds should be deposited into the State Treasury no later than three business days after the date of receipt. Timely deposits of revenues are essential to protect against potential errors and misuse and to ensure that state funds are managed efficiently.

Recommendation:

We recommend that the Board strengthen internal controls over its revenue collections by making deposits within three business days of the date of receipt.

Management's Response:

The Board acknowledges the loss of approximately \$57.00 in lost interest due to late deposits and agrees with SAO recommendations. The Board's internal accounting system was modified to correct the deficiency in making timely deposits. Currently all deposits are being made within 3 days. The reference to Chapter 404.094 does not apply in the case of these funds because the Board has specific authority to deposit these revenues into the "Capitol Fund" (Texas Government Code Chapter 443) which is held outside of the State Treasury. However, the Board concludes that compliance with the intent of Chapter 404.094 is a practical measure, and internal procedures have been adjusted as noted.

Issue for Further Study

Maintenance of the Historic Capitol Complex Should Be Evaluated

According to a joint study performed by the State Preservation Board (Board) and the General Services Commission (Commission), the existing maintenance program does not meet the special needs of the renovated Capitol Building, Capitol Extension, 1857 General Land Office Building, and the grounds common to these buildings. Although the Commission has assumed all maintenance duties, these facilities were not designed to align with its state building maintenance program. In addition, the costs of normal and preventative maintenance are higher on these buildings than on other state buildings the Commission manages.

The study makes several recommendations that will require legislative action. According to Board management, the maintenance study is being reviewed by legislative staff for consideration in the next biennium. Without an adequate maintenance program in place, there is a risk that the preventative and custodial needs of the Historic Capitol Complex will not be met, resulting in costly repairs in the future.

The Board should take actions to ensure that all of the maintenance and management issues related to the Historic Capitol Complex have been adequately addressed.

Objectives, Scope, and Methodology

Objectives

The objectives of this review were to determine the adequacy of control systems over policy management, information management, and resource management and to determine the financial condition of the State Preservation Board as of August 31, 1995. We also followed up on the status of recommendations made in *Follow-up Audit Report on Management Controls at the State Preservation Board* (SAO Report No. 94-135, July 1994) and the *Review of Management Controls Over the Capitol Annex Cafeteria Operation* (SAO Report No. 94-049, February 1994).

Scope

The scope of this review focused on assessing the methodologies and control systems used in preparing financial information for both reporting and planning purposes. We examined areas significant to the Board's operations relating to information management and resource management. We gained an understanding of areas relating to controls over policy management.

Methodology

The methodology used during this review consisted of collecting information, performing audit tests and procedures, analyzing the information, and evaluating the information against pre-established criteria.

Information collected to accomplish our objectives included the following:

- Interviews with personnel from the State Preservation Board, Culinaire International, General Services Commission, Office of the Comptroller, Spaw Glass (general contractor), Construction Industry Institute, and Disputes Review Board.
- Documentary evidence such as:
 - Other selected state statutes and regulations
 - Various management reports
 - Various legal and contractual agreements
 - State Preservation Board documents, memoranda, and publications
 - Sunset Advisory Commission Review documents
 - Accounting records
- Enabling legislation

Procedures and tests included:

- Detailed tests of transactions
- Observation and inspection
- Tests of controls over fixed assets
- Substantive tests of account balances

Analysis techniques used:

- Control review
- Budget vs. actual analysis
- Ratio analysis
- Trend analysis

Criteria used:

- Construction Industry Institute research publications
- Standard audit criteria established prior to the beginning of fieldwork

This review was conducted in accordance with generally accepted government auditing standards and in accordance with Texas Government Code, Annotated, Chapter 321.

The audit work was conducted by the following members of the State Auditor's staff:

- Randall M. Reid, CPA (Project Manager)
- Lucien Hughes
- Kevin Baker, CPA
- Bernie Gilmore, CPA (Audit Manager)
- Deborah L. Kerr, Ph.D. (Audit Director)

Background Information

The State Preservation Board (Board) was created by Texas Government Code Annotated, § 443 (Vernon 1987) to preserve, maintain, and restore the Capitol, the 1857 General Land Office Building, their contents, and their grounds. The policy-making body of the agency is a six-member board, including the Governor, Lieutenant Governor, and Speaker of the House of Representatives.

Since 1989, the main function of the Board has been to manage the \$186 million Capitol Restoration and Extension projects. Upon completion of the Historic Capitol Grounds Project in 1997, the Board will shift its focus from construction projects to the following:

- management of the furnishings collection
- oversight of change requests and ongoing preservation of the buildings according to the Master Plan
- preservation education and operation of the Visitor's Center
- coordination of activities in the buildings and their grounds

Curatorial Division

The Curatorial Division of the Board maintains the Capitol's collection of historical artifacts. The Historical Furnishings Project recreated the interior furnished appearance in the main public areas of the Capitol using original furnishings and artwork. The Division also coordinated the acquisition of new furnishings for the public areas in the Capitol Extension.

Capitol Complex Visitor's Center

In 1994, the Board opened the Capitol Complex Visitor's Center in the 1857 General Land Office Building, which includes a gift shop, a small theater, and an exhibition gallery. In January 1995, the Board expanded its gift shop operations by opening a bookstore in the Capitol Extension. Funding for the Center is a combination of state funds, income from the gift shop and bookstore, and special grants for semi-annual exhibits in the Changing Exhibits Gallery.

Other

The Board is also responsible for coordinating activities and events at the Capitol and its grounds. Approximately 500,000 individuals visit the Capitol each year and the Senate tour guide service gives, on the average, over 10,000 tours. Other activities of the Board include contract oversight (Capitol Dining Room), press space leasing, and private fund-raising for preservation and education programs.

Capitol Restoration and Extension Projects Statement of Estimated Funding Sources and Uses as of August 31, 1995

Estimated Funding Sources	
Appropriations	\$187,269,284
LoanSTAR Loan Reimbursements ¹	2,441,231
Other Sources	<u>337,096</u>
Total Projected Funding Sources	<u>\$190,047,611</u>
Final Projected Expenditures²	
Capitol Restoration Project	\$98,898,560
Capitol Extension Project	68,988,023
Capitol Excavation Project	5,533,193
1857 General Land Office Building	3,864,440
Furnishings	2,971,740
Project Contingency	5,278,651
Paver Project	<u>228,492</u>
Total Projected Expenditures	<u>\$185,763,099</u>
Estimated Funds Available for the Capitol Grounds Project	<u>\$ 4,284,512</u>

¹ During fiscal year 1994, the State Preservation Board participated in the LoanSTAR Loan Program which is funded through the Energy Management Center of the Governor's Office. Under this program, the Board was reimbursed for energy conservation modifications made during the Capitol Restoration and Extension projects. The reimbursements are treated as loans which are to be repaid through utility cost savings. The General Services Commission, which is responsible for paying the utility costs for the buildings in the Historic Capitol Complex, will realize the utility savings and repay the LoanSTAR loans.

² The final projected expenditure amounts include expenditures, encumbrances, and projected expenditures as of August 31, 1995. Total expenditures as of August 31, 1995, amounted to \$181,244,179; encumbrances totaled \$3,555,217; and projected expenditures were estimated at \$963,703. The projected expenditures are made up of the following items: unsettled claims with contractors (\$753,632); additional architectural and engineering fees (\$25,000); miscellaneous repair, move, and warehouse expenses (\$80,071); contingency estimates (\$100,000); and lead paint disposal (\$5,000).

Historic Capitol Grounds Project Statement of Estimated Funding Sources and Uses as of August 31, 1995

Estimated Funding Sources		
Unexpended Appropriations		4,284,512
Intermodal Surface Transportation Efficiency Act		1,000,000
Capitol Fund Donations		401,987
Auction Proceeds ³		250,000
Great Walk Donations		<u>296,662</u>
Total Estimated Funding Sources		<u>\$6,233,161</u>
Estimated Project Expenditures		
Fees		575,000
Construction		
Civil Improvements	\$ 719,060	
Site Amenity Improvements	1,045,556	
Landscape Improvements	979,300	
General Contractor Fee (12%)	329,270	
Contingencies (26%)	799,028	
Total Construction		3,872,214
Other Costs		
Goddess Structure	\$ 250,000	
Monument Restoration	400,000	
SPB Project Management	200,000	
Total Other Costs		<u>850,000</u>
Total Estimated Project Expenditures ⁴		<u>\$5,297,214</u>
Surplus/(Deficit) ⁵		<u>\$935,947</u>

³ As of August 31, 1995, the auction proceeds account in the Capitol Fund contained a total of \$324,712. Of this amount, Board management has allocated \$250,000 for the Historic Capitol Grounds Project.

⁴ These cost projections are preliminary estimates. More accurate estimates are being prepared by a professional cost-estimating firm and were not available at the time of our review. Once the estimate study has been completed and bids have been received, a more accurate funding analysis can be performed.

⁵ The Historic Capitol Grounds Master Plan, prepared by consulting architects EDAW/Broussard, included \$921,365 for work on the perimeter fence and furnishings. This work was excluded from the plan approved by members of the State Preservation Board on August 22, 1995. However, based on the above projections, it appears that sufficient funding for will be available for these additional items if approval is received.

**Capitol Complex Visitor's Center Gift Shop and Capitol Extension
Bookstore Statement of Revenues and Expenses for the Fiscal Year
Ended August 31, 1995**

	Capitol Complex Visitor's Center Gift Shop	Capitol Extension Bookstore	Total
Operating Revenues			
Sales	\$ 269,985	\$ 256,102	\$ 526,087
Penny Machines	4,914		4,914
Other Operating Revenues	<u>2,566</u>	<u>4,348</u>	<u>6,914</u>
Total Operating Revenues	<u>\$ 277,465</u>	<u>\$ 260,450</u>	<u>\$ 537,915</u>
Operating Expenses			
Cost of Goods Sold	\$ 150,091	\$ 131,924	\$ 282,015
Salaries and Benefits	52,206	30,423	82,629
Shipping and Handling	5,590	5,382	10,972
Supplies	5,216	948	6,164
Credit Card Fees	2,854	2,196	5,050
Telephone	1,637	432	2,069
Travel	1,625		1,625
Fees	966		966
Advertising	779	54	833
Postage	388	6	394
Miscellaneous Expenses	378	6	384
Repairs and Maintenance	435		435
Bad Debt	115		115
Copy Machine Rental	125		125
Memberships	39		39
Startup Costs		464	464
Cash Short/(Over)	<u>(82)</u>	<u>(71)</u>	<u>(153)</u>
Total Operating Expenses	<u>\$ 222,362</u>	<u>\$ 171,764</u>	<u>\$ 394,126</u>
Net Income Before Depreciation	\$ 55,103	\$ 88,686	\$ 143,789
Depreciation	(\$ 22,627)	(\$ 5,302)	(\$ 27,929)
NET INCOME	<u>\$ 32,476</u>	<u>\$ 83,384</u>	<u>\$ 115,860</u>

Capitol Dining Room and Capitol Press Space Statement of Revenues and Expenses for the Fiscal Year Ended August 31, 1995

	Capitol Cafeteria	Capitol Press Space	Total
Operating Revenues			
Rent	\$ <u>113,540</u>	\$ <u>35,200</u>	\$ <u>148,740</u>
Total Operating Revenues	\$ <u>113,540</u>	\$ <u>35,200</u>	\$ <u>148,740</u>
Operating Expenses			
Maintenance	\$ 2,842	\$ 99	\$ 2,941
Utilities	2,687		2,687
Supplies	18	411	429
Telephone		479	479
Other Services		<u>62</u>	<u>62</u>
Total Operating Expenses	\$ <u>5,547</u>	\$ <u>1,051</u>	\$ <u>6,598</u>
Net Income Before Depreciation	\$ 107,993	\$ 34,149	\$ 142,142
Depreciation (estimate) ⁶	(\$ 87,079)	(\$ 30,404)	(\$ 117,483)
NET INCOME	\$ <u>20,914</u>	\$ <u>3,745</u>	\$ <u>24,659</u>

⁶ Because depreciation schedules were not available, we estimated depreciation expense using the straight line method and the following criteria:

Salvage Value: 10 percent for equipment; 2 percent for furniture

Useful Life: 10 years for cafeteria equipment; 15 years for fiber optics system; 5 years for furniture

Appendix 4:

Comments from Ms. Dealey Herndon, Former Executive Director of the State Preservation Board

November 6, 1995

Lawrence F. Alwin
State Auditor
P.O. Box 12067
Austin, TX 78711-2067

Dear Mr. Alwin,

I appreciate the opportunity to comment on the audit of the agency during my tenure at the State Preservation Board. I know I speak for the Board members during that period and for the staff when I express our sense of pride that your findings were reaffirming. We were given the opportunity to preserve our magnificent Capitol, and we believed we had an obligation to do so in a business-like way. Your audit serves as confirmation that we were successful in that goal.

I want to comment on two areas not covered in the formal management report. First, the State Preservation Board was not the entity managing press leases until 1993. When we inherited that function, we saw it as an opportunity to recoup the costs of the project related to the press "delivery" system.

Second, I feel it is important to comment on the DRB process and your findings. Because of the impact of the DRB on our project and the potential impact of DRB's on future projects in the State, evaluation of the process as it relates to the state process continue. I agree with your finding that the existence of the DRB played a positive role in allowing us to keep the project on schedule. Beyond that, my comments follow:

Section 1D "The owner and the contractor must be totally committed to the DRB process. Board management was reluctant to use the DRB process in the beginning which may have influenced its perception of the process." This statement is incorrect. In 1990, the Board opposed the concept of a DRB. However, by 1992 when the new general conditions of the CIPP contract were being drafted, management was totally for it. SPB Project Manager Dave Stauch and I welcomed it as a means of resolving disputes. I personally directed changes in the contract general conditions to incorporate the DRB and then to develop the DRB contracts. Dave Stauch organized the process after the contract was signed, arranged the orientation, and worked hand-in-hand with Ken Cousins at Spaw-Glass to do quarterly site meetings.

Second, the DRB process was not successful beyond the acknowledged critically important benefit to schedule. Of the 15 issues taken to the DRB, the State lost all but three, with one split decision and one withdrawn. The three issues on which the state prevailed totaled \$55,962. The eleven issues on which the contractor prevailed amounted to \$2,384,901. Although we settled with the contractor for \$900,000 less, the state was the clear loser in the DRB process, with the DRB supporting the state for only 2% based upon dollars. In one case, the DRB actually recommended paying the contractor more than \$400,000 above what he had agreed in writing to settle for. In another case, all three DRB members agreed with the State on principle yet the majority decision was that we pay \$657,000 anyway.

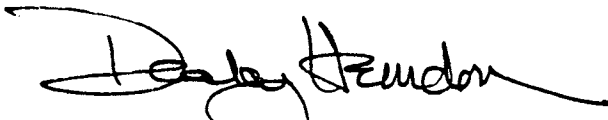
If the State had settled for the amounts recommended by the DRB on the disputed issues, we would have been required to pay in excess of \$2,400,000 as opposed to the \$56,000 the DRB agreed we did not owe. Since we lost on more than 75% of the issues and received support on only 2% of the dollars claimed, I am not convinced that having a DRB was a benefit overall to the State.

Before an issue reached the DRB, the State Preservation Board consistently paid on claims with merit. Only the small percentage that we believed had little or no merit went to the DRB. Yet we repeatedly lost, despite excellent documentation and the support of the architects and engineers.

The recommendations about future DRBs in the audit report and in management's response will be a benefit if the state chooses to use DRBs. Dave Stauch and I are available to assist in the development of a manual or firm guidelines. We will volunteer our time at the State's request.

In closing, I appreciate the fairness and professionalism of Randy Reid and Lucien Hughes. Mr. Hughes had great patience with my frustrations at the timing of some of the audits during the project. His quiet perseverance is to be admired; in the end, we all achieved our goals of a well-documented, successful project and a complete audit. I thank him for that and for understanding the primary goal of the project.

Sincerely,



Dealey Herndon

Copies of this report have been distributed to the following:

Legislative Audit Committee

Honorable James E. "Pete" Laney, Speaker of the House, Chair
Honorable Bob Bullock, Lieutenant Governor, Vice Chair
Senator John Montford, Chair, Senate Finance Committee
Senator Kenneth Armbrister, Chair, Senate State Affairs Committee
Representative Robert Junell, Chair, House Appropriations Committee
Representative Tom Craddick, Chair, House Ways and Means Committee

Governor of Texas

Honorable George W. Bush

Legislative Budget Board

Sunset Advisory Commission

State Preservation Board Members

Honorable George W. Bush, Chair
Honorable Bob Bullock, Co-Vice Chair
Honorable James E. "Pete" Laney, Co-Vice Chair
Honorable Layton Black
Honorable Chris Harris
Mr. Joseph Pinelli

State Preservation Board

Mr. Rick Crawford, Executive Director