

MEMORANDUM

To: Board of Regents
From: Board Office
Subject: Report on Organizational Review Project
Date: October 7, 2002

Recommended Action:

Receive the MGT of America, Inc., report on the "State Regulatory Statutes" project, Phase II, Project II-10.

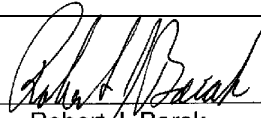
Executive Summary:

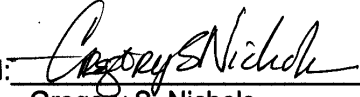
Final MGT Report – Phase II Last month the Board received the report on all of the Organizational Review, Phase II and Phase III projects except for the report on "State Regulatory Statutes" Phase II, Project II-10, which had not yet been completed. This month the final "Threshold" project report is being presented to the Board. A representative of MGT of America, Inc., will make a presentation on the report at the October Board of Regents meeting.

Recommends "Independent Agency" Status The report describes the procedures used by MGT of America, Inc., in this project and concludes that, rather than focus on only selected topics such as "limitations on investments" and "approval of leases," a more comprehensive strategy was needed. In particular, MGT addresses the benefits that would come from no longer regarding a Regent institution as a "state agency" but rather as an "independent agency." Such an agency designation would still mean that the institutions would operate for the benefit of the state while being reliant on the state funding.

"Need for Flexibility" MGT argues that the multiple missions of the Regent institutions and declines in state funding over the years suggests a new status that will allow the institutions to better leverage resources. Like business enterprises, the institutions must compete to generate large amounts of revenues, must manage costs and must be highly flexible to respond quickly to market forces. The goal of "independent" status is to provide the Regent institutions with the additional flexibility they need to operate in the most efficient and effective way possible in a highly competitive market.

Next month the Board Office will make recommendations concerning the MGT recommendations contained in this report. A full copy of the MGT Report is attached.


Robert J. Barak

Approved: 
Gregory S. Nichols

***ANALYSIS OF OPPORTUNITES
FOR REGULATORY RELIEF
FOR THE OPERATIONS
OF REGENT INSTITUTIONS***

SUBMITTED TO:

**Board of Regents, State of Iowa
11260 Aurora Avenue
Urbandale, Iowa 50322**

SUBMITTED BY:

**MGT of America, Inc.
2123 Centre Pointe Boulevard
Tallahassee, Florida 32308-4930**

OCTOBER 7, 2002

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1.0 INTRODUCTION

1.0 INTRODUCTION

1.1 Background

In July 2001, MGT of America was selected by the Board of Regents to undertake Phase I of a three-phase Organizational Review of the Board, the Board Office and the five institutions. Phase I focused on the identification of potential opportunities to improve the efficiency, effectiveness, and accountability of the Regent enterprise that would be evaluated in depth during Phases II and III.

During Phase I, MGT identified several instances where state laws and regulations appeared to be contributing to inefficiencies in the administrative operations of the Regent institutions. To this end, MGT developed Recommendation II-10 that provided:

The Board of Regents should, after further study, propose modifications to state statutes and other policies to achieve efficiencies through the following authorizations:

- *Authorize institutions to bid auditing services currently being provided by the state auditor. This provision would be consistent with authority granted to community colleges and municipalities.*
- *Authorize institutions to carry forward unspent and unencumbered balances at the end of the fiscal year thereby eliminating purchases made for lower priority items simply to use up all available funds.*
- *Authorize institutions to contract for minor construction projects up to \$250,000 without utilizing formal competitive bids. The current threshold of \$25,000 provides only for the smallest of projects and needs to be increased to provide for more effective project delivery.*
- *Authorize institutions to construct facilities utilizing design-build techniques. This will provide for improved delivery timetables with the best available contractor in a cost effective manner.*
- *Authorize the institutions to establish equipment capitalization levels up to \$5,000, which is the federal level. The current level of \$2,000 represents a threshold that is outdated. The capitalization of equipment requires that it be carried as inventory and considered permanent for indirect cost calculations.*

- *Amend existing statutes and rules relating to settlement claims on property losses and small liability claims to provide for a more definitive settlement process. Institutions should be delegated authority to manage the claims process. In many cases, it is unclear where agency responsibility falls in settling claims, especially those related to fire damage.*

As part of its Phase II efforts, MGT visited with administrative staff members at each of the Regent universities who have responsibilities in the areas identified during Phase I. In addition to gaining more detailed information about the impact of the regulatory practices in question, several additional areas where inefficiencies are caused by state regulations were discussed and added to the list of topics for consideration as part of the effort under Recommendation II-10. These additional topics were:

- Limitations on investment practices
- Approval of leases
- Administration of workers' compensation

While these additional topics were being developed, still other instances of regulatory-related inefficiencies were brought to MGT's attention. State regulatory practices that were once considered just minor annoyances had become much greater concerns as the Regent institutions struggled to find opportunities to reallocate scarce resources from support of administrative operations to protect their core academic missions.

1.2 Concept of the "Independent Agency"

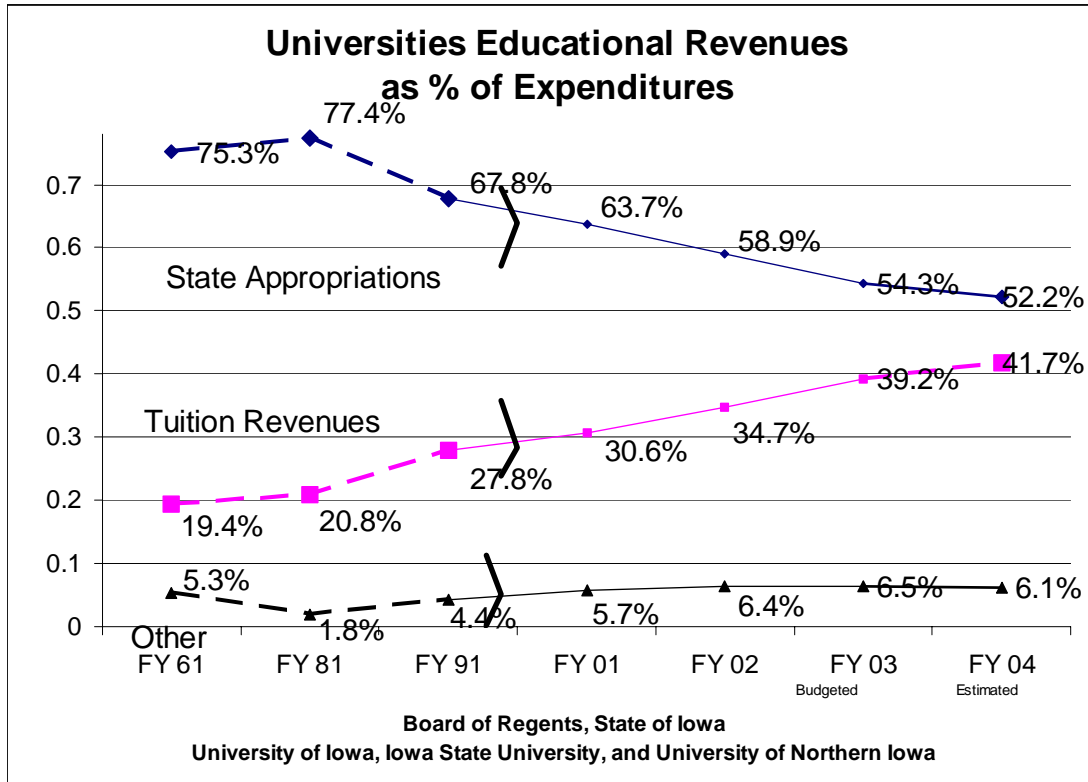
As the list of overly burdensome state regulations continued to grow, MGT determined that its earlier approach of focusing on individual instances of inefficiencies related to state regulations was no longer sufficient. Instead of focusing only on selected topics, a more comprehensive strategy became necessary. In particular, MGT began to address the benefits that would come from no longer regarding a Regent institution as a

state agency, but rather as an “independent agency” that would still operate for the benefit of the state while being reliant on the state as well as others for its funding.

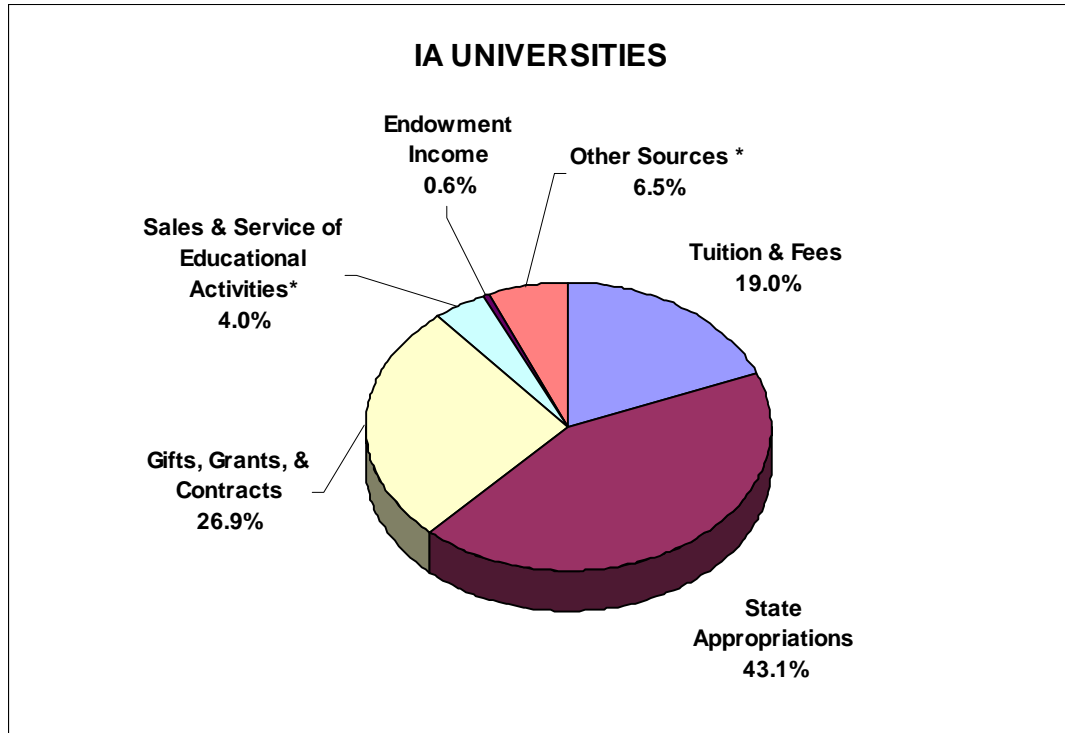
For this purpose, a key distinction between a state agency and an independent agency is the extent to which the organization relies on state appropriations to carry out its state-mandated mission. As seen in Exhibit 1-1, the multiple missions of the Regent universities in instruction, research and public service are supported by significant funds by many different parties, including the state, students and others. Exhibit 1-1, which only portrays trends in the general university funds, reveals that the role of the state in providing funds for operations of the universities has declined significantly over the past several decades. That is, the evolution of Regent institutions into independent agencies is not a recent phenomenon, but in fact has already been occurring over time.

When all fund groups of the universities are taken into account, such as those for sponsored research, auxiliary enterprises and similar entities, the proportion of the overall budget borne by state appropriations is further lessened. According to the national IPEDS data for FY 2000, for example, state appropriations accounted for only 43 percent of total funding for the three Regent universities, as seen in Exhibit 1-2.

**EXHIBIT 1-1
 TRENDS IN GENERAL FUND REVENUE BY SOURCE
 REGENT UNIVERSITIES, STATE OF IOWA**



**EXHIBIT 1-2
DISTRIBUTION OF REVENUE BY SOURCE
ALL SOURCES OF FUNDS, REGENT UNIVERSITIES
FY 2000**



Unlike the typical state agency, the Regent universities are able to leverage the state investment into a much larger pool of resources that benefit Iowa citizens. As seen in Exhibit 1-3, the Regent universities now generate \$1.26 from out-of-state sources for instruction and research programs for every \$1 of state appropriations. Although the Regent universities have been effective in attracting outside funding, their primary purpose remains to meet the needs of Iowans for instructional programs, research outcomes and public service.

EXHIBIT 1-3

**RETURN ON STATE GENERAL EDUCATION OPERATING INVESTMENT OF \$1
 TO THE REGENT UNIVERSITIES**

	General Fund State Appropriations	External Gifts, Grants, and Contracts	Non- Resident Tuition	Total Return
FY 1998	\$1.00	\$0.69	\$0.18	\$0.87
FY 1999	\$1.00	\$0.82	\$0.18	\$1.00
FY 2000	\$1.00	\$0.80	\$0.18	\$0.98
FY 2001	\$1.00	\$0.83	\$0.19	\$1.02
FY 2002	\$1.00	\$1.03	\$0.23	\$1.26

Notes

Excludes UIHC appropriations.

The Regent universities generate significant revenues from resources outside the state.

The state utilizes the same investment to provide education for thousands of lowans pursuing undergraduate degrees, diverse graduate/professional programs, and a wide array of service/extension activities throughout the state.

1.3 Rationale for Independent Agency Status

The Regent institutions are currently classified, in many instances, as state agencies of Iowa. As such, their operations are subject to the same statutory requirements as all other agencies of the state, except as specifically exempted. Unlike more typical state agencies, however, universities are required by their missions of teaching, research, and service to carry out extremely broad and varied areas of operations seldom found to the same scale within the operating mission of any other state agency. To describe their operations simply, Iowa’s Regent institutions must operate more like communities or businesses than as state agencies, thereby making “independent agency” status more appropriate.

Regent institutions not only deliver academic programs, but also must feed, house, and protect students and provide the infrastructure to accomplish this in the most

efficient and effective manner. In this regard, they function more like communities than the typical state agency. Although some other state agencies also have such “feed, house, and protect” responsibilities, none come close to operating at the magnitude of the three universities.

Like a business enterprise, the universities must compete to generate large amounts of revenues, must manage their costs to remain highly competitive in the market place, and must be highly flexible so that they can respond quickly to market opportunities. The typical state agency does not have to generate the magnitude of annual revenues from non-state sources in a highly competitive market that the universities must attract in order to survive.

The goal now is to provide the Regent institutions with the additional flexibility they need to operate in the most efficient and effective way possible in a highly competitive market. This comes with a commitment to maintaining accountability for the use of state resources and to continuing to provide the quality higher education services Iowa’s citizens have come to expect and enjoy.

1.4 *Precedents for Distinct Status for Regent Institutions*

While the Regent institutions have typically been regarded as state agencies for most purposes, the notion that they are different from the typical state agency has already been recognized in some regards. Exhibit 1-4 is a partial list of situations where the differences between the universities and state agencies have already been recognized in state law.

EXHIBIT 1-4

**EXAMPLES OF SEPARATE STATUTORY TREATMENT
 FOR BOARD OF REGENT INSTITUTIONS**

Code Section	Separate Treatment of Regent Institutions
§§ 262, 262A, and 263A	Bonding Authority and Related Activity
§262.34	Construction
§8.52	Accountable Government Act
§19A.1g	Collective Bargaining
§262.9(16)	Admission standards for students
§23A.2	Competition with Private Enterprise
§19A.3	Affirmative Action

Not only have the unique operating requirements of the Regent institutions been recognized through special statutory provisions, similar arrangements have also been made for other state-sanctioned organizations that can not function effectively and efficiently as a state agency.

The Board of Regents has repeatedly demonstrated its capacity to provide effective state oversight for the Regent institutions. Over the years, the Regents have been noted for their:

- strong governance
- leadership among state agencies in strategic planning and performance measurement
- process for open decision-making
- extensive policies and procedures that were developed in public work sessions
- commitment to public reporting.

In short, the Regents have earned the confidence of other state officials for their ability to function as a successful business while part of state government.

1.5 Overview of Report

The remainder of this report focuses on specific instances where the operation of the Regent institutions appears to be unduly restricted by the need to operate under the state agency model rather than a business or independent agency model. While specific statutory changes would be valuable in each instance, the remaining chapters are best considered only as examples of a broader regulatory environment that contributes to inefficient operations of the Regent institutions. Broad topics of the following chapters are:

- Closed System of State Services
- Budget Policies and Practices
- Investment Management
- Insurance Issues
- Construction Issues

In each category, specific examples are offered to demonstrate where the Regent institutions could function more efficiently and effectively if granted status as an independent agency.

2.0 CLOSED SYSTEM OF STATE SERVICES

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2.1 Introduction

The Regent institutions, along with other state agencies, are required by law to utilize other state agencies for certain professional and support services. In many instances, similar services are available through the private sector but the Regent institutions and other state agencies are restricted in their ability to consider alternative providers.

The practice of providing professional and support services through central government agencies is relatively common throughout the United States. This practice is increasingly coming into question, however, as most states are evaluating opportunities to privatize, or outsource, some of these functions. For certain types of services, state governments frequently find that the private sector can provide the same or higher level of service at a lower cost.

A distinct feature of central support services in Iowa state government is that some of the provider agencies must generate their own operating revenue through inter-agency billings rather than receiving a direct appropriation to carry out their functions. Examples of such agencies that depend on agency billings include:

- Attorney General
- Auditor of State
- Workers Compensation Insurance
- Iowa Communications Network

While some may argue that this self-generated funding arrangement serves to make the provider agency more business-like and responsive to customers, these benefits do not appear to accrue because the provider agency enjoys a monopoly and does not have to compete with others in setting the price of services. From a user-

agency perspective, the current arrangement may lead to higher than necessary costs to carry out essential administrative and professional functions.

To illustrate the issues with the current situation, the remainder of this chapter focuses on one such closed system for essential services that faces the Regent institutions – audit services from the Auditor of State.

2.2 Current Situation for Audit Services

Due to their complex organizational arrangements and multitude of revenue sources, the universities require a variety of audit services each year. A fundamental, traditional and important audit of a university is the independent audit of its annual financial statements. Under Chapter 11, section 11.2 of the Iowa Code, the Auditor of State is directed to conduct a periodic, but not less than quarterly, preliminary audit of educational institutions to check the monthly reports submitted to the director of revenue and finance, and to conduct a final annual audit at the close of each fiscal year. Section 11.5B provides for reimbursement by the audited agency of the Auditor of State for expenses incurred for performing the required audits. The Regent institutions are covered under this section for their general financial audit and compliance audit, but can engage private CPA firms for audits of bonded enterprise activities.

Section 11.6 of the Code provides separately for audits for counties, cities, school districts, and community colleges, and specifically provides that:

examinations shall be made as determined by the governmental subdivision either by the auditor of state or by certified public accountants, certified in the state of Iowa, and they shall be paid from the proper public funds of the governmental subdivision.

In terms of efficiency, this language permits school districts and community colleges in Iowa to solicit bids from the Auditor of State and/or private CPAs to determine the most competitive price. Universities, on the other hand, must simply pay whatever the state

auditor charges because of their “state agency” status, not their “educational institution” status. The proposed independent agency designation and related code changes would permit the Regent institutions to secure auditing services with similar flexibility to that already enjoyed by other state-supported educational entities in Iowa.

2.3 Assessment of Current Auditing Arrangement

Universities must constantly seek ways to reduce costs – not only to be good stewards of entrusted public funds, but also to be responsive to the needs of students as well as to be competitive in the market for contracts and grants. This means that they must constantly search for more efficient ways of operating. The search must be ongoing, leaving no area uninvestigated – even when those areas involve other state entities. One such opportunity for cost reduction involves the financial audits of the universities.

Currently, the Auditor of State conducts all independent financial audits of the universities, and the universities must pay whatever charges the Auditor of State sends to them. As shown in Exhibit 2-1, the Regent institutions pay approximately \$1 million per year to the Auditor of State.

EXHIBIT 2-1
EXPENDITURES FOR AUDIT SERVICES
REGENT INSTITUTIONS

Annual State Audit - Actual Reimbursements to the State Auditor / Hours								
Institution	FY 1995	FY 1996	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002¹
SUI²								
Reimbursements	352,285	345,707	389,655	404,337	383,574	380,260	354,715	448,864
Hours	8,808	9,267	9,785	9,171	8,807	8,451	8,794	
ISU²								
Reimbursements	387,600	370,608	384,852	325,191	410,682	262,646	395,214	393,686
Hours	10,455	10,248	10,736	10,099	8,651	8,167	7,834	
UNI²								
Reimbursements	106,881	112,715	113,753	108,035	103,092	112,687	129,441	148,759
Hours	2,474	2,688	2,801	2,436	2,274	2,414	2,422	
ISD³								
Reimbursements	55,484	64,250	47,964	44,699	55,000	50,629	56,847	46,029
Hours	1,382	1,183	1,104	1,140	1,200			
IBSSS³								
Reimbursements	25,816	24,954	24,271	25,693	26,163	22,978	21,652	31,244
Hours	658	638	593	605	600			
TOTAL REIMBURSEMENTS	928,066	918,234	960,495	907,955	978,511	829,200	957,869	1,068,582
TOTAL HOURS	23,777	24,024	25,019	23,451	21,532	19,032	19,050	n/a

1 FY 2002 numbers were taken from the June 30, 2002 Department of Management Reports (all budget units), which are presented on an accrual basis.
2 Numbers are submitted by the institutions and are presented on an accrual basis.
3 ISD and IBSSS numbers taken from the June 30 Department of Management Reports (cash basis.)

To determine the reasonableness of the audit expense now facing the Regent universities, we compiled information from those state universities that are members of either the Big Ten or Big 12 athletic conferences (whose memberships include the University of Iowa and Iowa State University, respectively). The audit costs paid by the comparison state universities with private CPA firms are often much lower, as shown in Exhibit 2-2.

**EXHIBIT 2-2
AUDIT EXPENDITURES AT OTHER STATE UNIVERSITIES**

University	Type of Auditor	State Auditor Compensation Method	Cost	Notes	
Big Ten Conference					
University of Illinois	Private CPA	n/a	\$ 858,526		
Purdue University	Not Provided				
Indiana University	State Auditor	Appropriation	\$30/day/auditor	See Note	
University of Iowa	State Auditor	Auditor Billings	\$ 448,864		
Michigan State University	Private CPA	n/a	\$ 198,000		
University of Michigan	Private CPA	n/a	\$ 813,000		
University of Minnesota	Not Provided				
Ohio State University	Not Provided				
Pennsylvania State University	Private CPA	n/a	\$ 341,700		
University of Wisconsin	Not Provided				
Big 12 Conference					
University of Colorado	Private CPA	n/a	\$ 200,000		Part of statewide audit Part of statewide audit Amount for entire system
Iowa State University	State Auditor	Auditor Billings	\$ 393,686		
Kansas State University	Private CPA				
University of Kansas	Private CPA				
University of Missouri	Private CPA	n/a	\$ 222,000		
University of Nebraska	Private CPA	n/a	\$ 98,130		
Oklahoma State University	Private CPA	n/a	\$ 111,000		
University of Oklahoma	Not Provided				
Texas A&M University	State Auditor	Auditor Billings	\$ 53,000		
Texas Tech University	State Auditor	Auditor Billings	\$ 40,000		
University of Texas	Not Provided				

Source: MGT survey of Big Ten and Big 12 Universities.

Note: For Indiana University, the total cost of the audit is the sum of the appropriation and the daily rate.

The process for choosing the auditors for public universities differs significantly among the states. In some states, the state legislature totally funds the state auditor's office and the auditor then performs the university audits without charge to the institution. In other states, the model is similar to that adopted in Iowa in the early 1980s, where the state auditor performs the audit and then bills the university. In a third group of states, the institutions choose their independent auditors. Most comparison universities, however, rely on external CPA firms for their annual financial and A-133 audits.

The structural problem with the model used in Iowa is that the state auditors have no incentive to control costs since they operate as a monopoly. In fact, the incentive is *not* to control costs since revenue needed to operate the audit agency is based on the number of work hours that can be billed to client agencies. This is not to say that the

Closed System of State Services

Auditor of State in Iowa is operating inefficiently or is overcharging the universities, but rather to identify a deficiency in the current incentive structure. Both of the other models (i.e., direct legislative funding of the state auditor and the institutional choice of a private auditor) provide some incentives to control costs. This is especially the case when auditors are chosen through competitive bids.

2.4 Implications for Regulatory Relief

MGT recommends that statutory changes be pursued to allow the universities to be free from the current closed system of state services. In particular, MGT believes that the Regent institutions should be permitted to procure various professional and support services, including their auditing services, under a competitive bid process.

3.0 BUDGET POLICIES AND PRACTICES

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3.1 Introduction

As a state agency, the budgeting process for the Regent institutions is dictated by a myriad of state laws and regulations. Additionally, the budgeting process for Regent universities is subject to institutional traditions (e.g., extensive review by a faculty senate budget committee) and Board of Regents procedures. Probably no other state agencies undergo such an elaborate, open and participative process for requesting, allocating and managing their budgets as the Regent institutions.

The typical budget cycle for the Regent institutions begins many months prior to the start of the fiscal year. At the July and September meetings of the Board of Regents, requests for state appropriations for the next fiscal year. The legislature determines state appropriations during its session normally from in January through April. . Once the state appropriations are finalized, the Regents review preliminary operating budgets in June and approve detailed operating budgets for each institution in July. Further, any major deviation from the adopted spending plan must be considered and approved by the Regents throughout the year.

In addition to the Regent and institutional budget planning and review processes, budgets for the Regent institutions are submitted to state officials in considerable line-item detail. This practice is expensive to carry out and appears to have little impact on the resulting level of lump-sum state appropriations. As compared to other state-supported educational entities, such as school districts and community colleges that request a single lump sum for educational assistance, the Regent institutions are faced with a much more costly budget development and administration process.

After State funds have been appropriated for the institutions, the Board of Regents exercises fiscal oversight over the institutions at a “macro” level, through general

guidelines and a series of governance reports. The institutions have the primary responsibility for day-to-day financial management at the “micro” level. This system of governance is intended to ensure oversight for the sound financial management of the Regent institutions while affording the institutions relatively wide latitude in the administration of their internal fiscal affairs.

The Board, as a governing body, imposes requirements to ensure that financial management is performed competently and in accordance with established policies and procedures. Some of the significant requirements include:

- Each institution, as part of its budgeting process, identifies reallocations in accordance with the Board’s five-year program of reallocations averaging two percent per year. This is in line with the Board’s strategic planning goals to increase effectiveness and efficiency.
- Budget totals are ceilings that may not be exceeded unless approved by the Board.
- The institutions must prepare periodic governance reports to ensure that financial operations are in general conformance with established Board fiscal policy, prudent financial management, and generally accepted accounting and auditing requirements of the State. Examples of required fiscal reports include:
 - the comprehensive fiscal report
 - calculations of the cost of instruction per student
 - annual reports on deferred maintenance
 - quarterly investment and cash management reports
 - internal and external audits, and
 - semi-annual reports on major leases and lease-purchase agreements.
- The institutions are delegated authority to develop and implement internal policies, procedures, and mechanisms that enable them to carry out their ongoing financial management. These policies must align with Board policy.

Beyond the regulations affecting budget requests and approvals, the Regent institutions are also subject to statutes dealing with end-of-year budget reversions. The

need for deregulation from this process is developed below as just one example of the need for greater budget flexibility for Regent institutions.

3.2 Current Situation for Budget Reversions

Section 8.33, Iowa Code, provides for the reversion of unexpended funds that have not been otherwise encumbered or obligated. Specifically, section 8.33 provides, in part, that:

No obligation of any kind shall be incurred or created subsequent to the last day of the fiscal year for which an appropriation is made, except when specific provision otherwise is made in the Act making the appropriation. On August 31, or as otherwise provided in an appropriation Act, following the close of each fiscal year, all unencumbered or unobligated balances of appropriations made for that fiscal term revert to the state treasury and to the credit of the funds from which the appropriations were made, except that capital expenditures for the purchase of land or the erection of buildings or new construction continue in force until the attainment of the object or the completion of the work for which the appropriations were made unless the Act making an appropriation for the capital expenditure contains a specific provision relating to a time limit for incurring an obligation or reversion of funds.

Further:

No payment of an obligation for goods and services shall be charged to an appropriation subsequent to the last day of the fiscal year for which the appropriation is made unless the goods or services are received on or before the last day of the fiscal year, except that repair projects, purchase of specialized equipment and furnishings, and other contracts for services and capital expenditures for the purchase of land or the erection of buildings or new construction or remodeling, which were committed and in progress prior to the end of the fiscal year are excluded from this provision.

While not articulated in the Iowa statutes, the presumed intent of such legislation elsewhere is to help replenish the state treasury at the end of the year. Interestingly, the budget reversion requirements in Iowa statutes do not apply to public schools and community colleges.

3.3 Assessment Of Budget Reversions

Budgetary flexibility provides universities with opportunities to ensure effective budget management, to maintain accountability, and to provide for the best possible delivery of instruction, research, and service. Universities' budget flexibility is especially necessary during periods when unplanned statewide budget reductions occur.

Across the states, it is common practice for state universities to have “carry-forward” authority for unspent and unencumbered funds remaining at year end, even when other agencies in the same state do not have the same authority. For example, state universities in North Carolina and Florida have a special status that excludes them from requirements for budget reversions that apply to other state agencies. Our survey of Big Ten and Big 12 business officers, as shown in Exhibit 3-1, found that most major state universities in the region also are exempt from budget reversions.

Even without current carry-forward flexibility that is consistent with national higher education budget practice, the Regent universities have been able to modify their operating policies to take advantage of permissive provisions in the current law in order to mitigate the otherwise negative effects of their statutes on their ability to manage. For example, a list of needed repair and renovation projects and a list of needed scientific equipment is developed and maintained by the universities for encumbering of funds at year end. While timing issues may mean that these items are not always the number one funding priority, they are certainly important to, and consistent with, overall university program requirements.

**EXHIBIT 3-1
BUDGET REVERSION REQUIREMENTS FOR
BIG TEN AND BIG 12 UNIVERSITIES**

University	Carry Forward Authority		Restrictions
	Encumbered	Unencumbered	
Big Ten Conference			
University of Illinois	Yes	No	Spend by August 31st
Purdue University	Not Provided		
Indiana University	Yes	Yes	None
University of Iowa	Yes, Restricted	No	Non-recurring items
Michigan State University	Yes	Yes	None
University of Michigan	Yes	Yes	None
University of Minnesota	Not Provided		
Ohio State University	Not Provided		
Pennsylvania State University	No	No	N/A
University of Wisconsin	Not Provided		
Big 12 Conference			
University of Colorado	Yes	Yes	None
Iowa State University	Yes, Restricted	No	Non-recurring items
Kansas State University	Yes	Yes	None
University of Kansas	Yes	Yes	None
University of Missouri	Not Provided		
University of Nebraska	Yes	No	None
Oklahoma State University	Yes	Yes	None
University of Oklahoma	Not Provided		
Texas A&M University	Yes	No	None
Texas Tech University	Yes	No	Encumbered Purpose
University of Texas	Not Provided		

The ability that has been developed to encumber funds quickly just before year- end enables the university to maximize the use of its operating budget under current statutory restrictions. Exhibit 3-2 shows that only a minimal amount has been reverted to the state treasury in recent years, both from new, very special-focused appropriations. That is, relief from the current reversion policy would have virtually no impact on the state treasury while permitting the Regent institutions to deploy resources for potentially higher priorities.

**EXHIBIT 3-2
 RECENT HISTORY OF OPERATING BUDGET REVERSIONS
 REGENT UNIVERSITIES**

Year	SUI	ISU	UNI	Total
FY 1993	\$0	\$0	\$0	\$0
FY 1994	\$0	\$0	\$0	\$0
FY 1995	\$0	\$0	\$0	\$0
FY 1996	\$38,330	\$0	\$0	\$38,330
FY 1997	\$0	\$23,965	\$0	\$23,965
FY 1998	\$0	\$0	\$0	\$0
FY 1999	\$0	\$0	\$0	\$0
FY 2000	\$0	\$0	\$0	\$0
FY 2001	\$0	\$0	\$0	\$0
FY 2002	\$0	\$0	\$0	\$0

3.4 Implications for Regulatory Relief

The overall budget reductions which have occurred in Iowa have left the universities in a difficult and challenging financial position. In order to meet these challenges, MGT recommends that the Regent institutions be freed from most of the detailed budget requirements that were intended for other agencies with less oversight already in place. In particular, MGT recommends that a more permissive budget carry-forward policy be implemented that would provide much needed flexibility to the universities and would be consistent with higher education budget management practices across the country.

4.0 INVESTMENT MANAGEMENT

4.0 INVESTMENT MANAGEMENT

4.1 Introduction

The Board of Regents oversees the investment programs of the Regent institutions through the efforts of its Banking Committee. The committee meets regularly to review various banking matters, including the performance of the investment portfolios.

The Regent institutions maintain two investment portfolios – operating and endowment/quasi-endowment. Both portfolios include restricted and unrestricted funds. As shown in Exhibit 4-1, the value of the combined portfolios as of June 30, 2002 was approximately \$1.2 billion.

**EXHIBIT 4-1
INSTITUTIONAL INVESTMENT PORTFOLIOS
MARKET VALUE (THOUSANDS OF DOLLARS)
AS OF JUNE 30, 2002**

Institution	Operating	Endowment/ Quasi-Endowment
University of Iowa ¹	\$554,069	\$220,253 ²
Iowa State University	267,159	82,444 ³
University of Northern Iowa	61,677	-
Iowa School for the Deaf	2,559	-
Iowa Braille & Sight Saving School	526	-
Total	\$885,990	\$302,697

¹ Includes UIHC

² Includes UNI

³ Includes ISD and IBSSS

In the late 1980s, a scandal in investments rocked state government in Iowa. Based on its desire to avoid future problems of this nature, the Legislature enacted an extensive set of laws in 1992 known as the Uniform Prudent Investor Act. Even though the Regent institutions had not been involved in the scandal and were known for sound

financial management, they fell under the jurisdiction of the new investor act along with other state agencies.

While the investor act was well intentioned, it has proven over time to place unreasonable limits on how effectively the Regent institutions can manage their funds.

For instance, the Regent institutions are restricted in:

- Composition of investment portfolio -- §12B.10 and 12B.10A identify restrictive investment standards but exclude the various public employee retirement systems, the Iowa Finance authority, the state's deferred compensation plan, the tobacco settlement authority, and the Board of Regents. However, the investments by the Regents are limited to the following:
 - investments set out in subsection 4
 - common fund for nonprofit organizations
 - common stocks

For short term operating funds, the funds shall not be invested in investments having maturities exceeding sixty-three months.

The public investment maturity and procedural limitations also do not apply to joint investment trusts organized under chapter 28E of the code whose primary function is to invest public funds.

- Custodial agreements -- §12B.10C limits the use of custodians but legislation excludes most of the same public employee retirement systems, the Iowa Finance authority, the state's deferred compensation plan, the tobacco settlement authority, but not the Regents.

In the remainder of this chapter, we analyze the impact of one of these limitations – composition of portfolio -- on the effectiveness of the Regents' investment program. It is offered as just one example of the need for the Board of Regents to have greater flexibility in the area of investment management.

4.2 Current Situation for Portfolio Management

Section 262.14 of the Code provides for investment of Regent institutions funds and provides restrictions on these investments through Section 633, division XX, part 4,

subpart c, the Uniform Prudent Investor Act. Section 262.14 requires the Board to establish a written investment policy, “the goal of which is to provide for the financial health of the institutions governed by the board.” The current Regent investment policy outlined in Section 7.34C, subparagraph 1a, limits the maturity of invested securities to 63 months, based upon the requirements contained in Iowa Code Section 12B.10 subparagraph d(4).

4.3 Assessment of Portfolio Restrictions

Current restrictions governing the investment guidelines for operating funds have had a negative impact on returns. Current policy limits the maturity of invested securities to 63 months. Analyses by the universities, however, indicate that a more diversified portfolio with greater earning potential could be realized if investments could be made in securities with longer maturity periods.

In comparison to investment practices in the broader environment, the 63-month limitation seems surprisingly short. For instance, the Regent institutions can not even investment in the 10-year Treasury bond, which is considered the benchmark for measuring yields on fixed income instruments. As seen in Exhibit 4-2, bond yields on October 7, 2002 increased as the maturity periods grew longer. The state’s 63-month limitation, in effect, forces the Regent institutions to invest in the most volatile end of the fixed income market.

4.4 Implications for Regulatory Relief

MGT believes that the Board of Regents, through its Banking Committee, is capable of managing the investments of the Regent institutions without being subject to excessive regulations by the state. As illustrated in Exhibit 4-2 depicting differences in

yields by maturity, current state regulations are resulting in lower than desired financial performance for the investments of the Regent institutions.

**EXHIBIT 4-2
COMPARISON OF YIELDS ON BONDS
BY LENGTH OF MATURITY PERIOD**

Regent Eligibility	Type of Bond	Yield as of October 7, 2002
Yes	US Treasury	
	3 month	1.46%
	6 month	1.46%
	2 year	1.73%
No	5 year	2.63%
	10 year	3.63%
Yes	Municipal	
	2 year AA rated	1.37%
	2 year insured	1.36%
	2 year A rated	1.47%
	5 year insured	2.21%
	5 year AA rated	2.21%
No	5 year A rated	2.53%
	10 year insured	3.27%
	10 year AA rated	3.26%
	10 year A rated	3.96%
	20+ year insured	4.33%
	20+ year AA rated	4.32%
Yes	Corporate	
	2 year AA rated	2.28%
	2 year A rated	4.42%
	5 year AAA rated	3.05%
	5 year AA rated	3.38%
No	5 year A rated	4.97%
	10 year AAA rated	4.15%
	10 year AA rated	5.25%
	10 year A rated	6.22%
	20+ year AAA rated	5.36%
	20+ year AA rated	6.26%
	20+ year A rated	7.59%

5.0 INSURANCE ISSUES

5.0 INSURANCE ISSUES

5.1 Introduction

Insurance is another broad area where the efficient operations of the Regent institutions are hampered by state regulations. Two insurance-related issues were identified during Phase I of this review — property loss and liability. A third issue— related to the cost of workers compensation coverage – emerged during Phase II activities. Property loss and workers compensation are discussed, individually below, as examples of how excessive state oversight impedes effective risk management practices.

5.2 Property Loss

5.2.1 Current Situation

The current process relating to property insurance, which is established by guidelines of the Executive Council (Governor, Secretary of State, Treasurer of State, Secretary of Agriculture, and Auditor of State), requires that the Universities report casualty losses to the Board Office and the State Auditor within twenty-four hours of occurrence. The State Auditor is then responsible for making a recommendation to the State Executive Council which has payment approval authorization.

In addition, Section 29.C.20 of the Code provides for a contingent fund for disaster aid. It provides in part that:

A contingent fund is created in the state treasury for the use of the executive council which may be expended for the purpose of paying the expenses of suppressing an insurrection or riot, actual or threatened, when state aid has been rendered by order of the governor, and for repairing, rebuilding, or restoring state property injured, destroyed, or lost by fire, storm, theft, or unavoidable cause, and for repairing, rebuilding, or restoring state property which is fiberoptic cable and which is injured or destroyed by a wild animal, and for aid to any governmental

subdivision in an area declared by the governor to be a disaster area due to natural disasters or to expenditures necessitated by the governmental subdivision toward averting or lessening the impact of the potential disaster, where the effect of the disaster or action on the governmental subdivision is the immediate financial inability to meet the continuing requirements of local government.

5.2.2 Assessment

Under the current process, the State Auditor performs two roles – that of claims investigator and also claims adjuster. Often, the State Auditor’s detailed findings about the incident and/or the full extent of loss are not always provided to the universities until considerable time has elapsed. Claims may be denied by the state due to late notification or if the claims resolution process crosses fiscal years. Further, the Department of Management is required to make claim payments, but there is no established time frame in which these payments must be made.

5.3 Workers' Compensation

5.3.1 Current Situation

Chapter 85 of the Code describes Workers' Compensation provisions that affect Regent institutions and other state agencies. In FY 2002, the Department of Personnel contracted with a private company to manage the state Workers' Compensation program. This decision was made in order to comply with new state requirements providing for electronic transfer of claims by July 1, 2001.

5.3.2 Assessment

The institutions are concerned with the premium increase that has occurred as a result of:

- updated claims projections,
- reserve deficiencies applicable to prior claims, as well as
- administrative assessments.

In addition, claims reserves have been depleted and payments to medical providers have been suspended.

The absence of data relating to claims is a further concern. With little or no claims data, it is impossible for the universities to establish loss prevention programs that could help to reduce the costs of future claims.

The Board of Regents and the universities have initiated discussions with the Department of Personnel in an effort to resolve these issues. To date, minimal progress has been made.

5.4 Implications for Regulatory Relief

The two examples described above help to identify the merits of a major delegation of responsibility for insurance issues to the Board of Regents and Regent institutions. For instance,

- Allowance for the recovery of losses based on repair or replacement value, and provision of definitive descriptions of covered property and exclusions would strengthen the management process. In addition, more timely payment and reporting of all notices of differences during the adjustment process would benefit the Regent institutions.
- Establishment of a Regent system-wide Workers' Compensation Program might permit more effective risk management and lower costs for the Regent institutions.

The Regent universities are of sufficient size and have staffing expertise available to manage their insurance programs in ways that will settle claims more promptly, reduce current administrative costs, and implement prevention programs that should ultimately lower claims expense.

6.0 CONSTRUCTION ISSUES

6.0 CONSTRUCTION ISSUES

6.1 Introduction

In discussions with university representatives, issues relating to bid limits for new construction, renovation, and repair are high priority areas for obtaining additional flexibility from the state. Current regulations lead to costly procurement practices and/or delays in completing relatively minor projects. During our Phase II analyses, we focused on two issues that serve to illustrate the range of opportunities for more efficient practice if construction issues were deregulated and the Regent institutions had more options in managing their construction programs. The two examples are:

- Bid threshold for construction and repair projects, and
- Alternative contracting methods.

Each issue is examined below.

6.2 Bid Threshold

6.2.1 Current Situation

The Regent institutions are required to utilize a competitive bid process for construction in excess of \$25,000, subject to the provisions set forth in Section 263.34 of the Code. Specifically, this Section provides that:

When the estimated cost of construction, repairs, or improvement of buildings or grounds under charge of the state board of regents exceeds twenty-five thousand dollars, the board shall advertise for bids for the contemplated improvement or construction and shall let the work to the lowest responsible bidder. However, if in the judgment of the board bids received are not acceptable, the board may reject all bids and proceed with the construction, repair, or improvement by a method as the board may determine. All plans and specifications for repairs or construction, together with bids on the plans or specifications, shall be filed by the board and be open for public inspection. All bids submitted under this section shall be accompanied by a deposit of money, a certified check or a credit union certified share draft in an amount as the board may prescribe.

A bidder awarded a contract shall disclose the names of all subcontractors, who will work on the project being bid, within forty-eight hours after the award of the contract. If a subcontractor named by a

bidder awarded a contract is replaced, or if the cost of work to be done by a subcontractor is reduced, the bidder shall disclose the name of the new subcontractor or the amount of the reduced cost.

6.2.2 Assessment

The current bid limit threshold was increased from \$10,000 to \$25,000 in 1981, more than 20 years ago. Records indicate that the previous \$10,000 threshold was established in 1924. If the \$10,000 value in 1924 were converted to the value of current 2002 dollars using *Engineering News Record* indices, the conversion would yield a bid threshold of approximately \$303,791 before requiring a formalized competitive bid process (Exhibit 6-1). Or, more conservatively, converting the value of \$25,000 in 1981 to the value of current 2002 dollars using the *Engineering News Record* indices yields an adjusted threshold amount of \$46,193 (Exhibit 6-2).

**EXHIBIT 6-1
 BOARD OF REGENTS, STATE OF IOWA
 CONSTRUCTION-BID THRESHOLD, 1927 BASE**

Year	STATUTORY THRESHOLD	PRICE INDEX*	ADJUSTED THRESHOLD**
1924 ^A	\$ 10,000	100.0	\$ 10,000
1981 ^B	\$ 25,000	1,644.1	\$ 164,415
2002 ^C	\$ 25,000	3,037.9	\$ 303,791

*Index is based on the Engineering News-Record *Construction Cost Index History (1908-2002)*.

**Adjusted dollar value according to base year value of \$10,000 in 1924.

^ARepresents the first verifiable year where the \$10,000 statutory threshold was in place.

^BStatutory threshold raised from \$10,000 to \$25,000 in 1981.

^CFor 2002, the value for "Price Index" represents the average of monthly values for January through October, 2002.

**EXHIBIT 6-2
BOARD OF REGENTS, STATE OF IOWA
CONSTRUCTION-BID THRESHOLD, 1983 BASE**

YEAR	STATUTORY THRESHOLD	PRICE INDEX*	ADJUSTED THRESHOLD**
1981	\$ 25,000	100.0	\$ 25,000
2002 ^A	\$ 25,000	184.8	\$ 46,193

*Index is based on the Engineering News-Record *Construction Cost Index History (1908-2002)*.

**Adjusted dollar value according to base year value of \$25,000 in 1981.

^AFor 2002, the value for "Price Index" represents the average of monthly values for January through October, 2002.

6.3 Alternative Contracting Methods

6.3.1 Current Situation

Currently, the Regent institutions have few alternatives to the low bid award contracting process described in the narrative above.

6.3.2 Assessment

Job Order Contracting (JOC) is an approach that has been effective in providing a timely response to an institution's construction needs and has been particularly effective on single item and small projects. This approach allows the institutions to enter in blanket agreements with vendors for a specified series of construction tasks, with unit costs and other terms being detailed in a Unit Price Book. This book is established through bid documents including plans and specifications. The only item not provided for in the bid documents is the exact location and quantity of the tasks to be performed. When the need for services arises, the project can be expedited through issuance of a task order rather than a full invitation to bid.

Other widely used construction delivery methods by universities across the nation that are alternatives to the low bid award process include:

- Design-Build -- Contracts where an institution's request for proposal combines both the design and construction of the facility into a single contract. Universities in other states and other building owners have found this approach can lead to better coordination between the architect and builder and greatly reduces the amount of time required to complete the project.
- Construction Manager at Risk -- A construction delivery method in which a general contractor is brought on during the design phase to be included in the design team and to propose a guaranteed maximum price at or towards the end of the design development phase. If the owner accepts the guaranteed maximum price, this contractor will construct the facility.

Certain projects can be accomplished with overall increased efficiency utilizing these construction methods. However, projects need to be evaluated on an individual basis for factors relating to size, scope, complexity, and required timeframe for completion before a delivery system is selected.

6.4 Implications for Regulatory Relief

As noted in the above examples, state regulations in the area of construction serve to create many impediments to the effective and efficient construction, repair and improvement of facilities at Regent institutions. Specific recommendations for addressing each individual example described above include:

- The construction bid limit should be increased to at least \$100,000 and perhaps up to \$250,000. This level would be more reflective of relevant market value and would provide the universities the latitude to determine if the project scope warranted formal plans and specifications on a project by project basis. In many instances, less formal plans and price quotes would provide adequate safeguards for project control under the increased threshold bid limit. Significant time and cost savings could be realized.

- Legal authority for alternatives to the current construction low-bid process, such as job-order contracting, design-build and construction manager at risk, should be pursued. These alternatives have the potential to provide the universities with the necessary flexibility to provide for increased efficiency in the overall management of their construction program. The primary objective should be to provide quality construction at the best possible price in the timeframe that meets the criteria of the universities.

Beyond such particular recommendations, however, MGT believes that even greater benefit would derive from granting the Board of Regents greater options in its construction programs free from state regulations.

7.0 SUMMARY

7.0 SUMMARY

The Board of Regents has a proud tradition of providing strong and effective state-level oversight of the Regent institutions. The Board's oversight is apparent in a number of important ways:

- An ongoing focus on strategic planning
- A rigorous reallocation process
- A comprehensive set of operating policies
- Accountability through written governance reports covering all aspects of operations
- Periodic organizational reviews, and
- First-hand knowledge of programs and operations through a series of meetings held on campuses throughout the year.

Indeed, the Board of Regents can be regarded as a model for efforts to deliver services to the people of Iowa in an effective and efficient manner.

This approach to state-level oversight has proven to work well. The Regent institutions and their programs are highly regarded among national peers. Further, the Regent universities are extremely effective in attracting funds from outside the state that help to provide educational services to Iowa residents.

On top of the Board's own oversight efforts, however, the Regent institutions face a myriad of other regulatory pressures at the state level that sometimes serve to impede efficient operations. These other regulations are problematic because they were intended to apply to state agencies that have neither the type of oversight provided by the Board of Regents nor the requirement to compete nationally for funding. In effect, the Regent institutions must operate as large businesses while being regulated like a typical state agency.

Growing out of Phase I recommendations from the organizational review of the Board of Regents and Regent institutions, MGT has now examined various state regulations that were identified as being especially cumbersome for institutions with the

broad-based missions that have been assigned to the Regent universities and special schools. During Phase II, MGT has examined such issues as:

- Closed System of State Services
- Budget Policies and Practices
- Investment Management
- Insurance
- Construction

While MGT offered specific suggestions for regulatory relief in each category, the overall finding was that state leaders need to regard the Board of Regents and its institutions as “independent agencies.” The concept of an independent agency recognizes that the Regent institutions, while continuing to fulfill their primary purpose of meeting the educational needs of Iowans, must compete in a national market for resources. To compete effectively, the Regent institutions must have greater administrative flexibility than is typically granted to state agencies. Instead of being subject to state laws intended for other situations, state oversight for the Regent institutions should be delegated to an independent Board of Regents that has full authority to operate efficiently while continuing to hold institutional officials accountable to the people of Iowa.