MINNESOTA
Management
& Budget

June 3, 2010

Richard H. Pfutzenreuter
Vice President and Chief Financial Officer
University of Minnesota
334B Morrill Hall
100 Church Street SE
Minneapolis, MN 55455

Re: Approval of Proposal to Track and Report Direct Staffing Costs paid for with General Obligation Bond Proceeds

Dear Mr. Pfutzenreuter:

Thank you for your proposal to track program delivery costs for capital projects funded by general obligation bond proceeds as outlined in your letter dated May 17, 2010. We have reviewed your proposal and, by this letter, approve your plan.

As you proposed in your plan, quarterly statements documenting the direct internal employee costs for authorized capital projects charged to state bond accounts must be certified and submitted to your Executive Budget Officer, Kerstin Larson. Please contact her at (651) 201-8045 or Gay Cerney, Capital Project Coordinator, (651) 201-8049, with any additional questions you may have.

Sincerely,

Katherine C. Kardell

Katherine C. Kardell
Assistant Commissioner

Cc: Kerstin Larson, MMB
Gay Cerney, MMB
Angie Weidell-LaBathe, MMB
Mike Roelofs, MMB

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May 17, 2010

Katherine C. Kardell
Assistant Commissioner, Treasury Division
Minnesota Management and Budget
658 Cedar Street
St Paul, MN 55155

Dear Assistant Commissioner Kardell:

The purpose of this memorandum is to outline the rationale and methodology that the University of Minnesota proposes to implement in response to your October 20, 2009, policy regarding the use of general obligation bond proceeds for staff costs.

As you know, the University of Minnesota, acting on its own behalf, undertakes project planning, development, management and implementation activities for many of its capital projects. The type of costs charged to capital projects, excluding profit, are identical to those charged to capital projects by outside consulting, architectural, project management and construction firms. It is not and has not been our desire to charge non-project related costs to capital projects. We understand the concerns raised by the Legislative Auditor and we support your efforts to provide a new and more robust policy framework that clarifies what is an allowable expense that can be charged to state general obligation bond proceeds. We also support the need to more clearly track and report specific time spent on capital projects.

The University of Minnesota will fully comply with the policy issued October 20, 2009 by Minnesota Management and Budget. In developing our methodology we have relied heavily on ensuring conformance to a specific definition of a capitalizable cost contained in the October 20, 2009 policy issued by Minnesota Management and Budget. This policy states the following:

> Capitalizable costs of staff means the portion of the compensation of employees working directly on a capital project that is directly related to that capital project based on the compensation of each such employee (including employee benefits) and payroll taxes paid by the agency for such employee and the amount of time actually spent by such employee on the project that is properly capitalized as a cost of a project under generally accepted accounting principles and federal tax law.

The University of Minnesota has been heavily involved in deciphering the rules of capitalized costs ever since the Legislative auditors were on campus conducting an audit of the plant funds of the University in mid-2008. As you know, generally accepted accounting principles (GAAP) and federal tax law are subject to interpretation.

In order to ensure our full understanding of what is 'properly capitalized as a cost under generally accepted accounting principles and federal tax law', we sought the advice of outside bond counsel. As a result of our research and based upon the advice of bond counsel for the University we will include in our rate development only those costs that are capitalizable under GAAP and under section 263A of the Internal Revenue Code which are incurred as a result of the construction activity but only to the extent that those costs directly relate to the construction of the asset. The University will only include in its hourly staffing rates those capitalizable costs directly associated with the design, management or construction of capital projects and only to the extent those costs directly benefit the project or are incurred by reason of the construction activity.

The implementation of the October 20, 2009, MMB policy will be guided by the following principles:

- Comply with all Minnesota Department of Management and Budget policies related to the use of general obligation bond proceeds.

- Comply with all relevant Internal Revenue Code (IRC) and Treasury regulations related to capital expenditures and the use of general obligation bond proceeds.

- Comply with Generally Accepted Accounting Principles related to capital expenditures and the use of general obligation bond proceeds.

A capital project staffing rate will be calculated for each individual charged to a project. Labor costs for salaried individuals will be calculated by dividing the individual's total annual wage cost by the total annual hours to be spent working directly on projects and project support activities. Labor costs for hourly individuals will be charged directly to a specific project based upon actual time spent on the project.

The hourly rate for salaried and hourly individuals will also include a factor for the individual's share of other directly related costs (for example, a prorated share of fringe benefits, travel, vehicle usage, supplies, etc.) but only to the extent that those expenses directly relate to or are incurred as a result of the construction activity. The hourly rate will not include depreciation or amortization costs, overhead or other general administration expenses not directly related to or incurred as a result of the construction activity.

The University will implement the above practices for Higher Education Asset Preservation and Replacement (HEAPR) projects funded by the State of Minnesota in Laws 2010, Chapter 189, Section 2, Subdivision 2. The University estimates that it will charge approximately $2.8 million to HEAPR projects.

For those capital projects authorized by the State of Minnesota in Laws 2010, Chapter 189 Section 2, Subdivisions 3, 4, 5 and 6 involving the issuance of state general obligation bonds that require a one-third University share, the University will not charge state bond proceeds. The University will instead charge the above costs to its one-third share of the capital project.

The University will take the following internal steps to implement the new procedures:

- Formalize the process outlined in this memo in a University-wide administrative policy. This step will certify that all expenses charged to a project are capitalizable and uniformly applied.

- Conduct an initial review of staffing rates for compliance with the capitalization process outlined in this memo. Annual reviews will be conducted going forward as part of the annual budget process.

- Instruct and train staff to accurately records time on all capital projects started after July 1, 2010, including all projects funded in the 2010 capital appropriations bill. A sample time sheet is attached in Exhibit 1.

- Capital Planning and Project Management accounting will calculate and apply a monthly charge to projects based on the approved rates and actual time worked.

The University will begin providing summary quarterly reports to the Minnesota Department of Management and Budget starting in FY2011. A sample report is attached in Exhibit 2.

Brian Swanson, Office of Budget and Finance, will serve as the University's Capital Project Coordinator and the University designated contact with the Minnesota Department of Management and Budget.

Regards,

RHPfutzenreuter

Richard H. Pfutzenreuter
Vice President and Chief Financial Officer

cc: Kerstin Larson, Executive Budget Officer, Minnesota Management and Budget
Brian Swanson, Office of Budget & Finance, University of Minnesota