

UNIVERSITY OF NEW ORLEANS
LOUISIANA STATE UNIVERSITY SYSTEM
STATE OF LOUISIANA



MANAGEMENT LETTER
ISSUED FEBRUARY 16, 2011

**LEGISLATIVE AUDITOR
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BATON ROUGE, LOUISIANA 70804-9397**

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Under the provisions of state law, this report is a public document. A copy of this report has been submitted to the Governor, to the Attorney General, and to other public officials as required by state law. A copy of this report has been made available for public inspection at the Baton Rouge and New Orleans offices of the Legislative Auditor.

This document is produced by the Legislative Auditor, State of Louisiana, Post Office Box 94397, Baton Rouge, Louisiana 70804-9397 in accordance with Louisiana Revised Statute 24:513. Five copies of this public document were produced at an approximate cost of \$14.35. This material was produced in accordance with the standards for state agencies established pursuant to R.S. 43:31. This report is available on the Legislative Auditor's Web site at www.la.la.gov. When contacting the office, you may refer to Agency ID No. 3610 or Report ID No. 80100069 for additional information.

In compliance with the Americans With Disabilities Act, if you need special assistance relative to this document, or any documents of the Legislative Auditor, please contact Wayne "Skip" Irwin, Administration Manager, at 225-339-3800.

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Our procedures at the University of New Orleans (UNO) for the period July 1, 2009, through June 30, 2010, disclosed the following:

- UNO entered into a performance-based energy efficiency contract with Johnson Controls, Inc., on October 30, 1998, that includes stipulated (unmeasured) savings and, therefore, does not comply with state law. This is the third consecutive year for this finding.
- The findings identified in the prior year management letter on UNO, dated January 15, 2010, relating to unlocated movable property and noncompliance with state movable property regulations have been resolved by management.
- No significant control deficiencies, noncompliance, or errors relating to UNO's capital assets, capital lease obligations, and educational and general expenses were identified.
- No significant control deficiencies or noncompliance that would require reporting under Office of Management and Budget (OMB) Circular A-133 were identified for the Research and Development Cluster and the State Fiscal Stabilization Fund - Education State Grants, Recovery Act (CFDA 84.394) for the year ended June 30, 2010.

This report is a public report and has been distributed to state officials. We appreciate UNO's assistance in the successful completion of our work.

Background

UNO, the urban research university of the State of Louisiana, provides essential support for the educational, economic, cultural, and social well being of the culturally rich and diverse New Orleans metropolitan area. Located in an international city, the university serves as an important link between Louisiana and both the nation and the world. The university strategically serves the needs of the region through its undergraduate and graduate programs and through mutually beneficial collaborations with public and private bodies whose missions and goals are consistent with and supportive of UNO's teaching, scholarly, and community service objectives.

- The university's technological and cultural alliances connect the institution, its faculty, and its students to the community.
- Joint projects with public schools, governments, foundations, businesses, and civic groups enrich opportunities for learning and community growth.
- Research and graduate programs focus on fields of study in which UNO is nationally competitive or responding to specific state or regional needs.



LOUISIANA LEGISLATIVE AUDITOR
DARYL G. PURPERA, CPA, CFE

January 20, 2011

**UNIVERSITY OF NEW ORLEANS
LOUISIANA STATE UNIVERSITY SYSTEM
STATE OF LOUISIANA**
New Orleans, Louisiana

As required by Louisiana Revised Statute 24:513 and as a part of our audit of the Louisiana State University System's (LSU System) financial statements for the fiscal year ended June 30, 2010, we conducted certain procedures at the University of New Orleans (UNO) for the period from July 1, 2009, through June 30, 2010.

- Our auditors obtained and documented an understanding of the UNO operations and system of internal controls through inquiry, observation, and review of UNO's policies and procedures documentation including a review of the related laws and regulations applicable to UNO.
- Our auditors performed analytical procedures consisting of a comparison of the most current and prior year financial activity using UNO's annual fiscal reports and/or system-generated reports and obtained explanations from UNO management of any significant variances.
- Our auditors reviewed the status of the findings identified in the prior year engagement. In our prior management letter on UNO, dated January 15, 2010, we reported findings relating to unlocated movable property, energy efficiency contract contrary to law, and noncompliance with state movable property regulations. The findings relating to unlocated movable property and noncompliance with state movable property regulations have been resolved by management. The finding relating to energy efficiency contract contrary to law has not been resolved and is addressed again in this report.
- Our auditors considered internal control over financial reporting and examined evidence supporting UNO's account balances and classes of transactions material to the LSU System's financial statements as follows: capital assets, capital lease obligations, and educational and general expenses.
- We also tested UNO's compliance with laws and regulations that could have a direct and material effect on the LSU System's financial statements.

- Our auditors performed internal control and compliance testing in accordance with Office of Management and Budget Circular A-133 on the following federal programs for the fiscal year ended June 30, 2010, as a part of the Single Audit for the State of Louisiana:
 - Research and Development Cluster
 - State Fiscal Stabilization Fund - Education State Grants, Recovery Act (CFDA 84.394)

These procedures were performed in accordance with *Government Auditing Standards* as part of our audit of the LSU System's financial statements for the fiscal year ended June 30, 2010. The annual financial information provided to the LSU System by UNO is not audited or reviewed by us, and, accordingly, we do not express an opinion on that financial information. UNO's accounts are an integral part of the LSU System's financial statements, upon which the Louisiana Legislative Auditor expresses opinions.

Based on the application of the procedures referred to previously, we have reported a finding relating to energy efficiency contract contrary to state law. We found no significant control deficiencies, noncompliance, or errors relating to our analytical procedures or our other procedures including our procedures on federal programs that should be communicated to management.

The following significant finding is included in the report for management's consideration.

Energy Efficiency Contract Contrary to State Law

UNO entered into a performance-based energy efficiency contract with Johnson Controls, Inc. (JCI) on October 30, 1998, that includes stipulated (unmeasured) savings and, therefore, does not comply with state laws. This is the third consecutive year for this finding. Louisiana Revised Statute (R.S.) 39:1496.1(A) provides that a state agency may enter into a performance-based energy efficiency contract for services and equipment. R.S. 39:1484(A)(14) requires the payment obligation to be either a percentage of the annual energy cost savings attributable to the services or equipment under the contract or guaranteed under contract to be less than the annual energy cost savings attributable to the services or equipment under the contract. R.S. 39:1496.1(D) requires the contract to contain a guarantee of energy savings to the entity. The statute further provides that the annual calculation of the energy savings must include maintenance savings that result from operational expenses eliminated and future capital replacement expenses avoided as a result of equipment installed or services performed by the contractor.

Attorney General Opinion 07-0002 provides "...for the stipulated operational savings to be included in the total guaranteed savings, those savings must actually be guaranteed. In order for the operational savings to be guaranteed, the Contract would have to provide for some type of measurement and/or verification of the operational savings..." Although the attorney general opinion was directed to local government, the same guarantee is required in state law.

The energy efficiency contract, as amended, which is for 19 years and approximately \$30.7 million between UNO and JCI, stipulates the value of the operational savings in the contract. Under Schedule E of the original contract, JCI guaranteed a total of \$29,572,695 in savings during the term of the contract. The savings consist of measurable savings of \$18,742,695 and operational savings of \$10,830,000. A contract amendment effective July 1, 2004, increased the guaranteed saving by \$146,160. According to the contract, "Operational Savings" are agreed by the parties to be achieved and "will not be additionally measured or monitored during the term of the Agreement." Exhibit 2 of Schedule E defines operational savings to include avoided repair, maintenance, service contract, and other costs and also states that the operational costs will not be additionally measured or monitored during the contract term. The operational savings are not guaranteed because the contract does not provide for measurement and/or verification of the operational savings. The total rental and service payments due to JCI over the life of the contract are approximately \$30.7 million. Therefore, the payment obligation exceeds the adjusted guaranteed annual energy cost savings.

At the signing date, management felt that the contract complied with state law. However, because the operational savings are stipulated and are not measurable and verifiable, the contract is contrary to law. In addition, there is a risk of making payments specified in the contract that are greater than the energy cost savings attributable to the services or equipment under the contract.

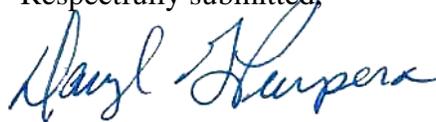
LSU System management has represented to us that its legal counsel has conducted detailed investigations and evaluations of each of the agreements, has retained an industry expert to assist in a comprehensive review of the technical materials and calculations associated with these contracts, and is currently actively engaged in extensive settlement discussions with JCI's legal counsel regarding resolution of the issues associated with each of these contracts.

Management should revise its energy efficiency contracts to ensure that savings components are verifiable and that the guaranteed savings have been realized. In addition, management should ensure that the payments required by the contract are not greater than the energy cost savings attributable to the services or equipment under the contract. LSU System management concurred with the finding and is addressing the issue as described previously (see Appendix A).

The recommendation in this letter represents, in our judgment, one which is most likely to bring about beneficial improvements to the operations of UNO. The nature of the recommendation, its implementation costs, and its potential impact on the operations of UNO should be considered in reaching decisions on courses of action. This finding relating to UNO's compliance with applicable laws and regulations should be addressed immediately by management.

This letter is intended for the information and use of UNO and its management, others within UNO, the LSU System and its Board of Supervisors, and the Louisiana Legislature and is not intended to be, and should not be, used by anyone other than these specified parties. Under Louisiana Revised Statute 24:513, this letter is a public document and it has been distributed to appropriate public officials.

Respectfully submitted,



Daryl G. Purpera, CPA, CFE
Legislative Auditor

JMJ:JR:EFS:THC:dl

UNO 2010

Management's Corrective Action
Plan and Response to the
Finding and Recommendation



Louisiana State University System

3810 West Lakeshore Drive
Baton Rouge, Louisiana 70808

Chief Financial Officer

October 19, 2010

225 / 578-6935
225 / 578-5524 fax

Mr. Daryl G. Purpera, CPA
Legislative Auditor
P. O. Box 94397
Baton Rouge, LA 70804-9397

Re: Audit Finding - Energy Efficiency Contract Contrary to State Law

Dear Mr. Purpera:

I am writing in response to your letter dated October 6, 2010 to Chancellor Martin regarding fiscal year 2010 Audit findings associated with a performance-based energy efficiency contract between Johnson Controls, Inc. (JCI) and LSU and also in response to your letter dated October 12, 2010 to President Lombardi with virtually identical audit findings for each of the other four LSU System institutions that are also currently party to a performance-based energy efficiency contract with JCI, specifically, the University of New Orleans, Louisiana State University Health Science Center in Shreveport, University Medical Center, and Lallie Kemp Hospital. This letter is meant to serve as the LSU System's response to any similar findings regarding each of these contracts for the 2010 fiscal year.

As noted in your findings, and in previous correspondence to your office from the LSU System (see attached), LSU System's counsel has conducted detailed investigations of each of these agreements and has retained an industry expert to assist in the review of the complex technical materials and calculations. After working with the expert and the five facilities to determine the status and history of these contracts and after attempts to obtain relevant information from JCI's out-of-state counsel, notice of default was sent to JCI on February 3, 2010. The LSU System's counsel indicated the LSU System's position with regard to each of these contracts and informed JCI that these issues must be resolved. On February 5, 2010, LSU's counsel was contacted by new, local counsel for JCI who indicated that JCI was willing to actively work to resolve the issues related to each of these contracts. Since this time, numerous meetings and correspondence have taken place between LSU System counsel, JCI local counsel and the five LSU System institutions regarding the status of each of the five contracts, the unique issues associated with performance under each contract, issues associated with savings under each contract, termination options for each contract and the most appropriate method of addressing any other issues under each contract. During the past month, JCI and the LSU System have exchanged terms associated with a proposed termination of the Louisiana State University Health Sciences Center, Shreveport contract. Currently LSU is awaiting a response from JCI on its proposed terms and hopes to move forward with similar negotiations related to

Louisiana State University & Agricultural and Mechanical College

*LSU at Alexandria • LSU at Eunice • University of New Orleans • LSU in Shreveport • Hebert Law Center • LSU Agricultural Center
Pennington Biomedical Research Center • LSU Health Sciences Center - New Orleans • LSU Health Sciences Center - Shreveport • LSU Health Care Services Division*

Mr. Daryl G. Purpera, CPA
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each of the four other contracts in an effort to avoid costly litigation. Should negotiations be unsuccessful, LSU is prepared to institute litigation to resolve the issues associated with these contracts by nullifying the agreements, forcing amendments to the agreements or recovering for breach of the agreements.

Sincerely,

A handwritten signature in black ink, reading "Wendy C. Simoneaux". The signature is written in a cursive style with a large, stylized initial "W".

Wendy C. Simoneaux
Chief Financial Officer

Enclosure

Cc: General Counsel P. Raymond Lamonica