Metro

Renewal and Replacement:

Finalize asset management strategy to inform financial policies

May 2024
A Report by the Office of the Auditor

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MEMORANDUM

May 30, 2024

To: Lynn Peterson, Council President
Ashton Simpson, Councilor, District 1
Christine Lewis, Councilor, District 2
Gerritt Rosenthal, Councilor, District 3
Juan Carlos Gonzalez, Councilor, District 4
Mary Nolan, Councilor, District 5
Duncan Hwang, Councilor, District 6

From: Brian Evans. Metro Auditor

Re: Audit of Renewal and Replacement

This report covers the audit of financial policies related to asset renewal and replacement. Financial policies create a shared vision for how an organization will use its resources. The purpose was to evaluate Metro's revenues and expenditures for renewal and replacement and determine how projects were prioritized and managed.

The audit found several best practices were in place across the four components used to manage renewal and replacement. However, an agencywide asset management strategy was not finalized. An agencywide asset management strategy is the most important because it sets the overall vision for aligning the other three components: financial policies, information systems, and processes. Ongoing evaluations and refinements are crucial to improve each component and ensure alignment.

The audit found variations in the information systems used for making renewal and replacement decisions. This reduced Metro's ability to ensure projects addressed the most urgent needs. Processes for identifying and prioritizing projects lacked guidance and documentation, which reduced transparency.

We have discussed our findings and recommendations with Marissa Madrigal, COO; Andrew Scott, Deputy COO; Brian Kennedy, CFO; and Ryan Kinsella, Capital Asset Management Director. I would like to acknowledge and thank all the people who assisted us in completing this audit.

Summary

Renewal and replacement is the process of replacing capital assets to extend their life or increase their efficiency while retaining original use. Metro maintains renewal and replacement reserves to pay for capital maintenance and replacement. As of June 30, 2023, renewal and replacement policies applied to about $310 million, or 41%, of the total value of Metro's assets.

The purpose of this audit was to evaluate Metro's revenues and expenditures for renewal and replacement and determine how projects are prioritized and managed. Several best practices were in place but an agencywide asset management strategy was not finalized. This reduced Metro's ability to increase the sophistication of renewal and replacement information systems and processes. It also made it difficult to establish appropriate financial policies for renewal and replacement needs.

Additional efforts were needed to ensure consistency across financial policies and align them with an agencywide asset strategy. Financial policies create a shared vision for how an organization will use its resources. Without clear and well-aligned financial guidance, decision makers will not know if they are budgeting too much or not enough for renewal and replacement.

There were variations in the information systems used for making renewal and replacement decisions. These systems included asset data, facility condition assessments, and project reporting. Asset data were reportedly incomplete and some reporting requirements were not met. This reduced Metro's ability to ensure projects addressed the most urgent needs.

Processes for identifying and prioritizing projects lacked guidance and documentation, which reduced transparency. Information to identify projects was inconsistent. Additional guidance and standardized practices will be needed as new approaches are developed to identify projects. A project prioritization process was in place but may not be specific enough to provide objective scoring. Additionally, prioritization scores did not appear effective in guiding decision-making.

The Capital Asset Management Department was leading the effort to finalize an agencywide asset management strategy. Work included improving the detail and consistency of data collected and using Facility Condition Assessments as a tool to identify renewal and replacement projects.

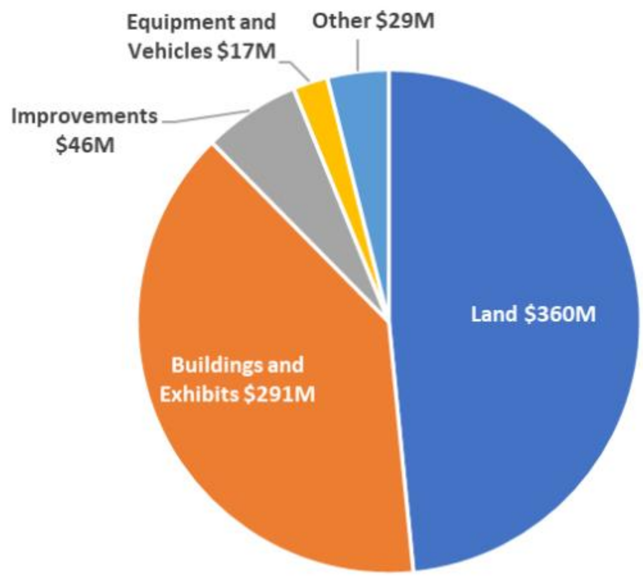
This audit includes ten recommendations to assist Metro as this work is completed. Five are intended to finalize the agencywide asset management strategy and improve reporting. The other five are designed to identify long-term asset requirements and strengthen the quality of information used in decision-making.

Background

Renewal and replacement is the process of replacing capital assets to extend life or increase the efficiency of an existing asset, while retaining its original use. Metro defines renewal and replacement as the construction, reconstruction, or major renovation of capital assets. Metro maintains renewal and replacement reserves to pay for capital maintenance and replacement so capital assets meet or exceed their estimated useful life.

As of June 30, 2023, Metro owned or leased nearly $743 million in assets. Renewal and replacement policies and practices apply to buildings and exhibits, and equipment and vehicles, which amount to about $310 million, or 41% the total value of Metro's assets.

Exhibit 1 Land, buildings, and exhibits made up most of Metro's assets

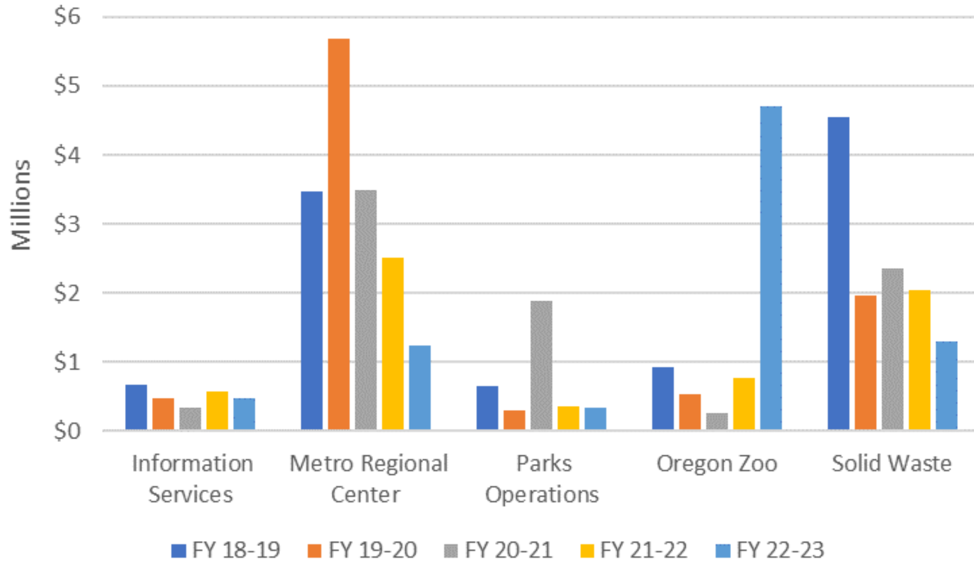


Source: Auditor's Office analysis of Metro Annual Consolidated Financial Report.

Dedicated renewal and replacement funds are maintained for Information Services, Metro Regional Center (MRC), Parks operations, Oregon Zoo, and Solid Waste services. For Portland'5, Oregon Convention Center (OCC), and Portland Expo Center (Expo), renewal and replacement funds are combined with funding for new capital assets. Between fiscal year (FY) 2018-19 and FY 2022-23, Metro budgeted a total of $95.2 million in the dedicated renewal and replacement funds, and $102.1 million in the combined capital funds, adjusted for inflation.

Expenditures from renewal and replacement funds over the last five fiscal years were $41.8 million. Year-to-year expenditures varied across these funds. Combined capital expenditures for Portland'5, OCC, and Expo totaled $85 million over the last five years. Since the combined capital funds also include new capital investments, we were not able to show detailed year -to-year renewal and replacement expenditures from these funds.

Exhibit 2 Year-to-year renewal and replacement expenditures varied across funds



Source: Auditor's Office analysis of Metro financial system data, adjusted for inflation.

Metro Council annually adopts financial policies during the budget process. The financial policies are intended to provide the framework for overall fiscal management, promote effective and efficient operations, support the achievement of strategic goals, and safeguard assets.

The financial policies include a detailed section that outlines Capital Asset Management Policies (CAMP). CAMP provides the basic framework for managing capital assets. It defines renewal and replacement, sets requirements for capital and renewal and replacement processes, and establishes the financing principles for funding capital projects.

CAMP requires the establishment of renewal and replacement funds or accounts for each operating fund with major capital assets. The intent is to ensure sufficient resources for capital maintenance and replacement so capital assets meet or exceed their estimated useful lives. They are not intended for funding major capital assets.

In addition to the financial policies annually adopted by Council, there are more detailed policies and procedures to guide internal operations. Those related to renewal and replacement include Capital Improvement Plan (CIP) instructions and renewal and replacement reserve policies. The CIP instructions provide the guidelines to develop the agency's five-year CIP. The reserve policies set reserve targets, establish annual contributions, and identify appropriate uses of the renewal and replacement funds. The reserve policies were reported as not officially approved but used by finance managers to guide their work.

The CIP applies to projects with estimated costs of $100,000 or larger and at least five years of useful life, including renewal and replacement projects. Capital Asset Management (CAM) facilitates the CIP process each year, while departments identify, prioritize, and propose projects for the CIP.

Exhibit 3 Metro's capital improvement planning process applies to renewal and replacement projects

	Identification and Prioritization	Project Concept and Scheduling	Proposed CIP and Risk Mitigation	Review and Approval
Description	• Identify all potential projects • Score and rank projects using the CIP prioritization tool	• Develop project scope, schedule, budget, and staffing • Estimate the project timeline	• Develop CIP based on project prioritization and funding available • Identify risks and plan for risk mitigation	• Leadership reviews CIP and submits to Council for approval.
Entity in charge	Departments, Capital Planning Oversight Committees (CPOC)	Departments, CPOC	Departments, CPOC	CAM, CIP Executive Committee, Chief Executive Officer, Council

Source: Auditor's Office summary of FY 2024-25 CIP instructions.

The governance of capital assets has evolved over the past decade. In 2013, Metro updated the CAMP to require a Capital Asset Advisory Committee to advise on the ongoing management of renewal and replacement reserves. This committee was later disbanded. In FY 2020-21, CAM became a stand-alone department which oversees the CIP process. The Asset Management Division within CAM was charged with implementing Metro's overall asset strategy.

Besides CAM, several parties across the agency are responsible for managing asset renewal and replacement. Finance managers work with departments and Finance and Regulatory Services (FRS) to develop renewal and replacement reserve policies. Facility managers help ensure assets are cared for, functioning as intended, and are replaced when needed. The CIP instructions indicate each department engages their Capital Planning Oversight Committees (CPOC) to plan for and manage capital projects. In two reviewed departments, CPOC memberships included finance staff, facility staff, and department directors.

In 2016, two audits issued by the Metro Auditor's Office identified weaknesses in asset management. Since then, Metro has taken several steps to strengthen its asset management practices, which included the management of renewal and replacement. Metro hired a consultant in 2018 to review asset management processes and develop recommendations for Metro's Strategic Asset Management Plan (SAMP), asset management standards, and capital planning standards. In FY 2023-24, Metro piloted the use of facility condition assessments in two departments to guide the development of the CIP, as well as to standardize and provide asset data for Metro's information system.

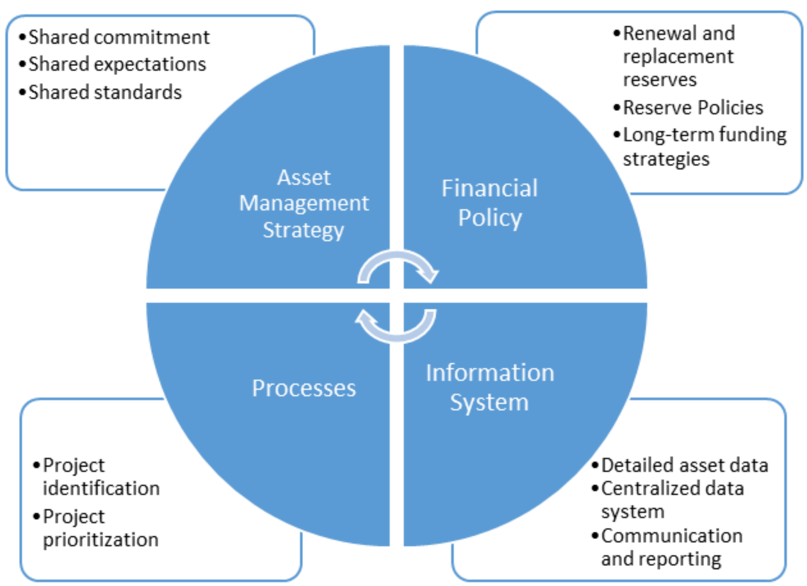
Results

Several best practices were in place for managing renewal and replacement. However, an agencywide strategy was not finalized. This reduced Metro's ability to increase the sophistication of renewal and replacement information systems and processes. It also made it difficult to establish appropriate financial policies for renewal and replacement needs. Additional attention in the following areas will help improve asset management practices:

- Agencywide asset management strategy
- Financial policies for funding renewal and replacement
- Information systems used for decision-making
- Guidance to ensure consistent and transparent processes

Best practices in the management of renewal and replacement discuss four components. An agencywide asset management strategy is the most important because it sets the overall vision for aligning the other three components: financial policies, information systems, and processes. Ongoing evaluations and refinements are crucial to improve each component and ensure alignment. For instance, a complete and accurate asset database requires resources to develop and maintain. Those resources could be wasted if the database is not used to inform renewal and replacement decisions.

Exhibit 4 Effective renewal and replacement involves four components



Source: Auditor's Office summary of SAMP recommendations and best practices outlined by the Government Finance Officers Association.

Metro implemented several best practices in each of these components. For example, it set aside funds for renewal and replacement projects. Agencywide reserve guidelines were outlined in CAMP and finance staff developed facility-specific policies for reserves.

A centralized data system capable of storing specific asset data was in place. CAM was in the process of finalizing standards for rating assets and guidance for collecting asset data during Facility Condition Assessments (FCA). Budget changes for renewal and replacement projects were communicated to Metro Council through the budget amendment process. The Metropolitan Exposition Recreation Commission received updates about project spending in comparison to project budgets for OCC, Portland'5, and Expo.

Metro was in the process of exploring the use of FCAs to identify immediate and long-term renewal and replacement needs. These reports included an objective evaluation of the condition of an organization's assets and forecasted costs to maintain and replace them.

A formal process was also in place to prioritize renewal and replacement projects. This process included a template to score potential projects based on established criteria. The three facilities we reviewed had oversight committees to evaluate projects and monitor their progress.

At the time of our review, CAM was leading the effort to finalize an agencywide asset management strategy. Work included improving the detail and consistency of asset data collected and using FCAs as a tool to identify renewal and replacement projects. We found additional opportunities to improve renewal and replacement practices.

Exhibit 5 Opportunities to improve Metro's management of renewal and replacement existed across four areas

Component	Currently in place	Potential for improvement
Strategy	• Commitment to take care of assets	• Finalized agencywide asset management strategy
Information System	• Centralized database • Development of data standards	• Finalized data standards and requirements • Regular project reporting, as required in CAMP • Agencywide asset condition reports
Processes	• Defined process to prioritize projects	• Defined processes to identify projects • Improved documentation to increase transparency in prioritization
Financial Policies	• Renewal and replacement reserves • Reserve policies	• Reserve policies based on asset needs • Consistency across policies, guidelines, and agencywide asset management strategy

Source: Auditor's Office summary of audit findings.

Financial Policies

Additional efforts were needed to ensure consistency across financial policies and align them with an agencywide strategy. Financial policies create a shared vision for how an organization will use its resources. Renewal and replacement reserves provide financial flexibility and are a tool to proactively care for assets. Without clear and well-aligned financial guidance, decision makers will not know if they are budgeting too much or not enough funding for renewal and replacement.

Guidance for developing renewal and replacement reserves was inconsistent

Lack of an agencywide asset management strategy created barriers to developing appropriate renewal and replacement reserve policies. Inconsistencies across Metro's policies also reduced clarity about the intent for renewal and replacement reserves.

Guidance in CAMP was different from the guidance finance staff used to establish renewal and replacement reserves. CAMP required some reserves to be sufficient to cover ten years of needed projects. However, a ten-year project list had not been identified and we were informed reserves were insufficient to cover five years of planned projects. In the absence of this information, finance staff set targets for annual contributions and how much should be in the account at the end of the year (fund balance). These targets were based, in part, on what had been funded through prior year CIPs and available funding, rather than a forward-looking estimate of future needs.

CAMP suggested the purpose of renewal and replacement funding was to protect public investments by extending the useful life or increasing the efficiency of an asset. We heard additional perspectives about these funds. Some thought the purpose was to set aside funds in the event of an emergency. Another idea was the funds could be used as long-term savings accounts. Others believed setting aside too much money over a long period of time would be inefficient because those funds could be used for other projects or operating expenses.

There were also opportunities for interpretation in how renewal and replacement was defined. For instance, CAMP noted that renewal and replacement funding was not intended for routine maintenance. One of the reserve policies we reviewed included painting as an allowable activity, which could be interpreted as routine maintenance depending on the size of the project. CAMP defined renewal and replacement as construction, reconstruction, replacement, or major renovation. It also noted that funds should not be used on building replacements or significant structural upgrades. One of the reserve policies we reviewed included infrastructure replacement as an allowable activity.

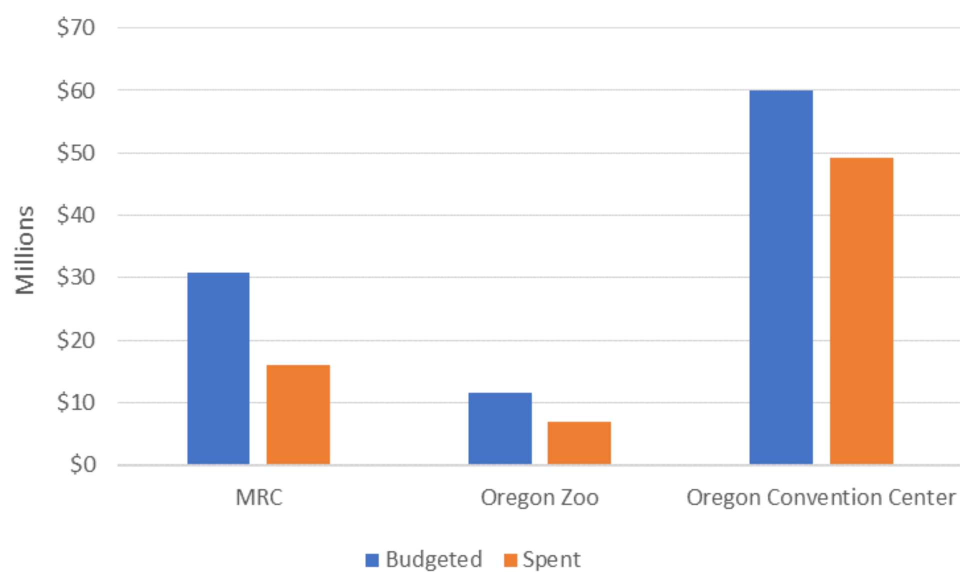
It was also difficult to determine which reserve policies were in effect. A draft 2024 agencywide reserve policy referred to a 2022 capital reserve policy as guidance for renewal and replacement reserves. However, the draft policy also included guidance for some renewal and replacement reserves that was not aligned with the 2022 policy.

Year one of the CIP did not consistently predict renewal and replacement spending

The CIP includes capital projects for the next five years. The first year of the CIP also serves as a budget. We found the first year of the CIP was inconsistent in predicting total annual spending. Differences between planned and actual spending could have several possible causes. Some of them were within Metro's control and some were not. Examples included contractor availability, the accuracy of cost estimates as projects are developed, and staff capacity to manage projects. This emphasized the importance of learning from previous efforts to increase the accuracy of project planning and budgeting.

We compared budgeted amounts in the CIP to actual spending in those years from FY 2018-19 to FY 2022-23 for MRC, Oregon Zoo, and OCC. MRC spent about half of its renewal and replacement budget in the five years we reviewed, Oregon Zoo spent about 60%, and OCC spent about 82%.

Exhibit 6 Year one of the Capital Improvement Plan inconsistently predicted annual renewal and replacement spending



Source: Auditor's Office analysis of budget documents and data from Metro's financial system.

Overall, the accuracy of the CIP as a planning tool varied across facilities and fiscal years. Over the last five fiscal years, the amount of the initial budget spent ranged from 2% to 98%. While COVID likely created challenges in carrying out planned projects, learning more about the causes of these fluctuations could improve the accuracy of project planning and budgeting.

Tracking data to determine why some planned projects were not started when expected can help improve efficiency. Project delays can potentially result in reduced public benefit and increased costs over the long-term. Examples include additional maintenance and staff time needed to care for aging assets. Increases can also happen because of inflation and construction cost escalations, which may be out of Metro's control, but remain important for increasing the accuracy of planning.

For instance, across the three facilities we reviewed, there was a $6.05 million difference between what was initially budgeted and what was spent in FY 2021-22. If that work carried over to FY 2022-23, then Metro could have expected an additional cost of about $380,000 based on inflation alone. In a more extreme example, there was about a $13.8 million difference between what was initially budgeted and spent in FY 2018-19. If work planned for FY 2018-19 were to be carried out in FY 2022-23, Metro may need to pay about $2.6 million more than originally planned, based on inflation. This is a simplification, but it highlights potential costs of delaying projects.

We also compared the amount of money spent in each fiscal year to the projects that were budgeted for those years. Most of the spending that took place was for projects initially budgeted in the CIP.

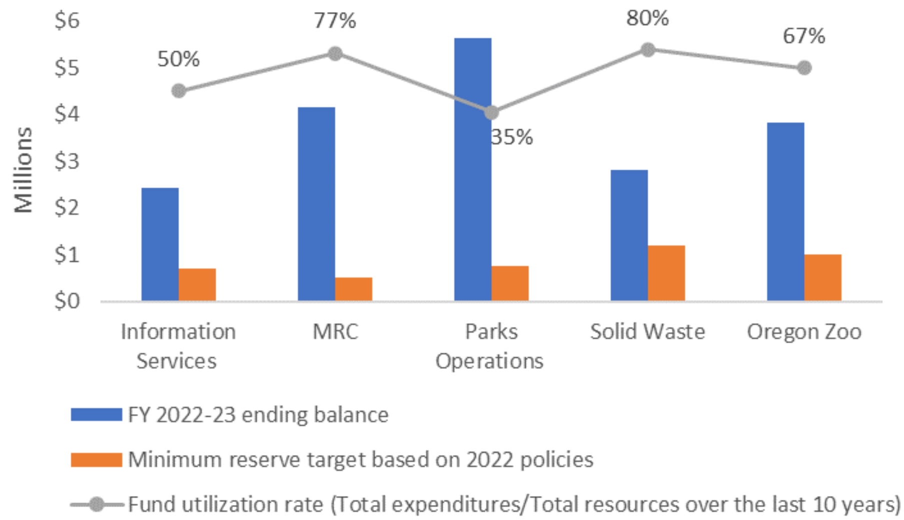
Metro's current financial planning maintains required reserves but does not ensure funding for all CIP projects

Metro had enough resources to cover renewal and replacement expenditures and maintain balances above the reserve targets required in its reserve policies. However, estimates of renewal and replacement trends suggest the current reserve policies may not guarantee coverage of all projects in the five-year CIP. As a result, additional funding for some parts of the organization may be needed.

We evaluated revenues, expenditures, and fund balances of five renewal and replacement funds based on available data in the past 10 fiscal years. By the end of FY 2022-23, all five funds had remaining balances above their reserve targets in the 2022 Renewal and Replacement Reserve Policies.

We also evaluated how well resources were used in each fund. MRC, Solid Waste, and Oregon Zoo used between 67% to 80% of their total available funding, which included revenue transfers and fund balances. Parks Operations and Information Services tended to maintain relatively high balances compared to their yearly expenditures, which resulted in lower percentages of funds used.

Exhibit 7 Metro successfully covered expenditures and met reserve targets in all renewal and replacement funds



Source: Auditor's Office analysis data from Metro's financial system, adjusted for inflation.

Being able to cover actual spending trends is a success, but it could incent slow project delivery. Metro has consistently spent less than it had planned in renewal and replacement funds. This indicated the CIP was not fully implemented for these funds. Had all projects been implemented as planned, Metro might have required additional revenue transfers to cover spending.

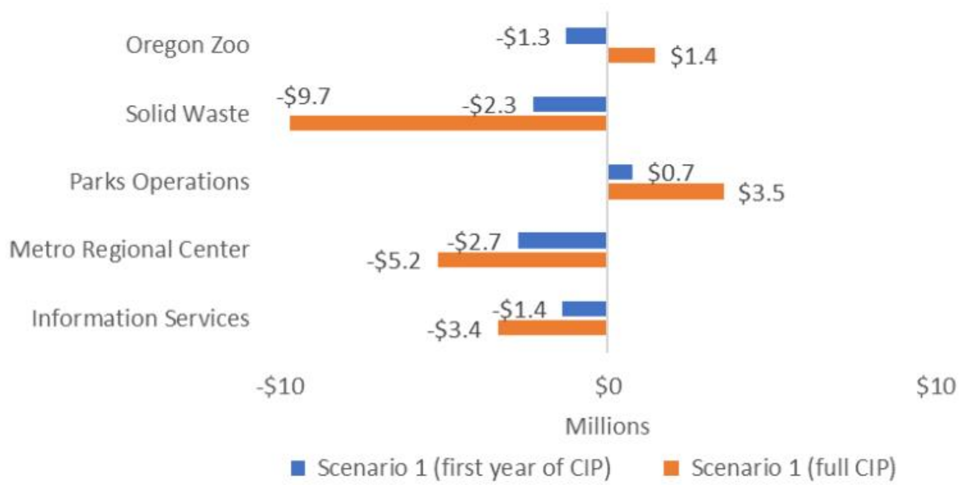
Best practices suggest a government's financial plans and CIP should address the continuing investment necessary to properly maintain its capital assets. Aligning financial plans with the CIP is important to manage different risks. Saving too much each year could result in a surplus that could be better used for other purposes. Alternatively, not having enough funds could result in delays in project delivery and damage to assets.

Our analysis indicated planning practices may not be as well-aligned as they could be. The CIP outlined projects for five years, but only the first year was budgeted through the annual budget process. This could lead to a situation where too much is budgeted for the first year of the five-year plan, but not enough is set aside to fund all the planned projects for future years. Aligning financial policies with the CIP can help avoid this situation and guide short-term and long-term decision-making.

The only formally documented financial planning we found was the reserve policies. However, it is unclear if the reserves can be used to fund any CIP project or if they are intended only for emergencies. Aligning capital planning and financial planning may require more than the reserve policies. For example, a financial plan could include considerations of alternative fundings sources such as fee revenues and outside debts, besides ongoing allocations.

To estimate the adequacy of funding for renewal and replacement, we set up three financial scenarios. In Scenario 1, we used the reserve policies to estimate revenues, and the FY 2023-24 CIP to estimate expenditures for the renewal and replacement funds in the next five years. We found revenue transfers would only cover the next year's planned projects in one fund and would cover the next five years' projects in two funds. This means Metro will need to draw down the fund balance to complete planned projects. Of the five renewal and replacement funds, Parks Operations had no planned projects for the next five years. .

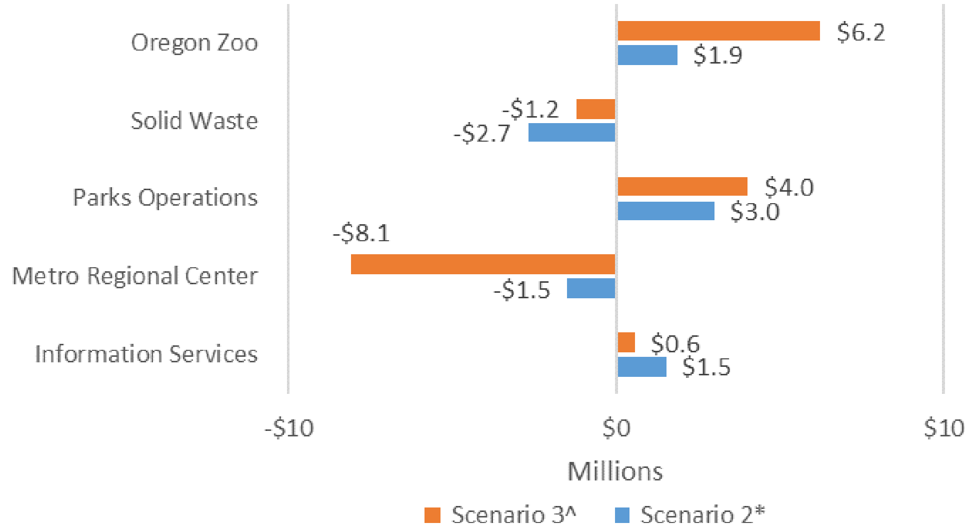
Exhibit 8 Metro's current practice does not ensure adequate revenue transfers to cover CIP projects in all but one renewal and replacement funds



Source: Auditor's Office analysis of CIP and Renewal and Replacement Reserve Policies by Department and Fund.

We also estimated future revenues and expenditures based on the assumption that trends from previous years continue. Scenario 2 uses a rolling five-year average of all revenues and expenditures while Scenario 3 excludes outlier projects and one-time revenue sources. These estimates show that the Parks Operations, Information Services, and Oregon Zoo funds may have more revenues than needed while MRC and Solid Waste may have to draw on their balances to fund renewal and replacement projects.

Exhibit 9 Based on past trends, MRC and Solid Waste may have to draw on their existing balances to fund renewal and replacement



Source: Auditor's Office analysis of data in Metro's financial system.
*Rolling five-year average of all actual revenues and expenditures
^Rolling five-year average of all actual revenues and expenditures excluding outliers

It is important to note that none of the above scenarios are meant to provide predictions of future financial resources and spending. Rather, they are meant to provide data points to evaluate the adequacy of renewal and replacement reserves and provide insights into financial planning practices. It will be important to consider and finalize the purpose of renewal and replacement reserves. If the reserves policies aim at covering the five-year CIP or ten years of needed projects, it would require more annual set asides. Alternatively, if the policies are intended to cover actual project costs based on 5-year past trends, less annual set asides may be needed for some funds.

Information Systems

There were variations in the information systems used for making renewal and replacement decisions. These systems included asset data, facility condition assessments, and project reporting. Data standards and requirements were not fully implemented, and some project reporting was not carried out as required. This reduced Metro's ability to ensure projects addressed the most urgent needs.

Asset data were reportedly incomplete

We were told that information in Metro's asset database was incomplete. CAM was restructuring Asset Essentials to be an asset inventory, that was formerly used to track maintenance and work orders. This meant assets that had no maintenance or work orders in the past may not currently be reflected in the system. Further, the level of detail in the system may vary, which could make agencywide analysis challenging.

According to best practices, detailed asset information should be collected, monitored, and communicated to prioritize limited resources. Details include asset condition, expected condition, estimated useful life, maintenance, and asset criticality. This information can be used to manage assets.

Exhibit 10 Detailed information can inform funding decisions

Information	What it is	Why it matters
Condition	Rating of asset condition (i.e. like new or needs replacement)	Easy-to-understand summary of asset health
Expected condition	Acceptable level for asset performance	Shows needed or unneeded investment when compared to current asset condition
Expected useful life	Estimated percentage of useful life remaining	Informs long-term financial planning
Criticality	Importance rating, i.e. • how often used/not used • impact and likelihood of failure • health and safety requirements	Prioritizes asset needs when there is limited funding
Maintenance levels	Rating based on frequency of scheduled and unscheduled maintenance	Informs ongoing financial planning; Identifies assets that may need to be replaced sooner than expected
Budgeted vs. actual project spending	Comparison of planned spending to actual spending	Identifies trends and challenges that can be used to make course-corrections in financial and project planning processes

Source: Auditor's Office analysis of practices outlined by the Government Finance Officers Association, Metro's Strategic Asset Management Plan, and information included in MRC facility condition assessment.

CAM was in the process of implementing data standards for the asset database. The intent was to ensure consistency and eventually use the data to identify renewal and replacement needs. CAM provided an example of how this information could also be used to evaluate the impact of the CIP on the current condition of assets. For instance, if projects in the 5-year CIP were completed for Asset 1, its condition would improve from marginal (0%-25% of useful life remaining and high maintenance needs that impact operations) to excellent (75%-100% of useful life remaining and routine maintenance only).

Exhibit 11 Data can show the impact of completing projects

Transfer Station Asset	Current Condition*	Condition after implementing CIP projects*
Asset 1	Marginal	Excellent
Asset 2	Adequate	Good

Source: Auditor summary of CAM department draft analysis
** Condition ratings: Failed →Poor → Marginal → Adequate →Good →Excellent*

CAM expected to implement data standards by the end of 2024. We were informed it may take a minimum of five years to ensure the asset database contains detailed data for all assets. It was beyond the scope of this audit to evaluate the accuracy and completeness of information in Metro's asset database. It will be important to have controls in place to ensure information is complete and accurate.

Some reporting requirements in Metro's financial policies were not met

We were unable to find evidence that reporting was taking place as required by the annually adopted financial policies. CAMP required CIP status reports that included a comparison of budgeted to actual spending. CAMP also required that reports be presented to the COO and the Metropolitan Exposition and Recreation Commission quarterly, and to Metro Council twice annually.

Historically, Metro Council received this information through Metro's Quarterly Financial Reports. However, these reports were discontinued in 2018. We were unable to find alternative reports that contained the required information. The financial policies adopted by Metro Council on June 22, 2023 reduced clarity about the roles and responsibilities for providing these reports. The old policy directed a specific position in FRS to report to Council. We were told another department is now responsible, but the policy does not identify which one.

Best practices also recommend easy-to-understand reports at least every three years that summarize agencywide asset condition. This information should describe how actual condition and performance compares to expected condition and performance. It should also include renewal and replacement lifecycles, funding sources and restrictions, and long-term trends.

Processes

Metro uses the five-year CIP to identify renewal and replacement projects and prioritize resources. Several improvements were in process to align Metro's processes with best practices. These included using a Facility Condition Assessment (FCA) to inform project identification and establishing criteria to prioritize projects. However, guidance and documentation did not exist or were not adequate in some places, which reduced the transparency of the process. As CAM continues to strengthen asset management practices, it will be important to develop clear guidance.

Information to identify renewal and replacement projects was inconsistent

Information expected to identify renewal and replacement projects was inconsistent across the facilities we reviewed. This was partly because guidance was not in place. CIP instructions did not specify how projects should be identified. Using an FCA and improving the quality of asset data appear to be promising practices to identify projects. To be effective, additional guidance and standardized practices across the agency are needed.

The three facilities we reviewed had FCA reports available to help identify projects. One FCA was completed in 2023 and two were completed in 2016. To best ensure timely identification of needs and assist in long-term financial planning, Metro standards recommend updating the FCA every five to ten years.

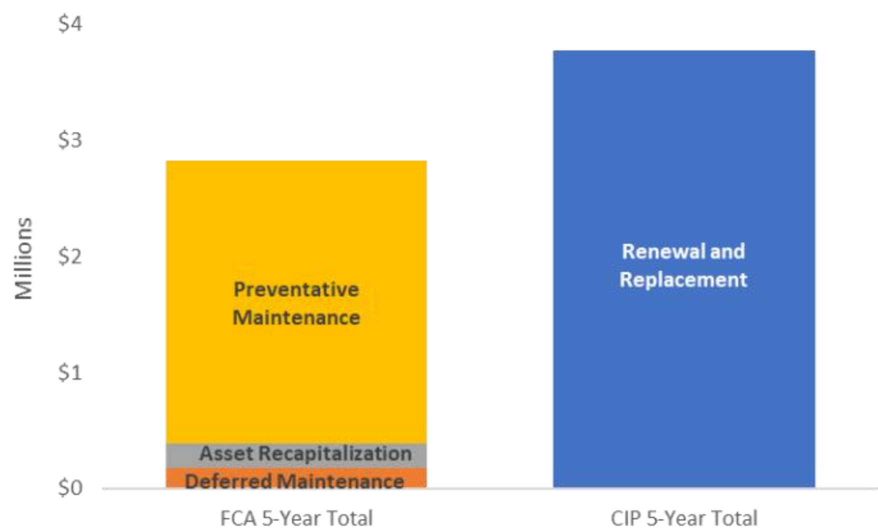
Two FCAs we reviewed presented information differently. One used a color-coded rating scale with nine categories to describe asset condition. The other used a five-point rating scale ranging from poor to excellent. Both reports used a point system to estimate the overall health of an asset, but the point ranges differed. This meant that an asset identified in "good" condition in one report may not be identified as "good" in another.

Both FCAs met the purpose of providing Metro information about the condition of its assets. However, differences in data could impact Metro's ability to compare asset information across facilities. A consistent asset rating system would improve Metro's ability to identify similar needs across the agency and potentially reduce costs by grouping similar projects together.

During our review, CAM was piloting FCAs as a tool to identify renewal and replacement needs. The pilot presented an opportunity to develop clear guidance for using FCAs to identify renewal and replacement projects. Because FCAs could be conducted every five to ten years and doing so requires staff time and financial resources, they may not be needed in all situations. This is important because they could become costly if each facility is expected to conduct one every five years.

To understand how FCAs can be used to develop the CIP, we compared the MRC's FCA to the most recently proposed five-year CIP. The largest estimate from the FCA was for preventative maintenance. Under Metro's financial policies, routine maintenance should not be paid for with renewal and replacement funding. We did not reconcile specific investments in the CIP and FCA, but inconsistent definitions could lead to misalignments between the investments listed in each document.

Exhibit 12 Inconsistent definitions made alignment between CIP and FCA investments unclear



Source: Auditor's Office analysis of Metro Regional Center Facility Condition Assessment and Metro 2024-25 proposed budget.

The potential for misalignment underscores the importance for CAM to develop standards for how FCAs should be used to identify renewal and replacement projects. This information will help decision-makers understand the resources needed to align FCAs and CIP projects.

Lack of documentation in the prioritization process reduced transparency and might impact priorities

Best practices suggest that governments identify priority factors and develop a process to prioritize potential capital projects. Metro has a prioritization mechanism and process in place.

The CIP instructions provided a prioritization template and guidelines. Projects are prioritized in five categories:

- legal mandate
- health and safety
- end of useful life
- improved services/efficiency/return on investment
- leadership goals

Departments are asked to score all projects in each of these categories to achieve an overall prioritization score and provide a subjective rank from one to three. Departments can provide further project descriptions and rationale for rankings, if any. Departments then make the decision on which projects to move forward. Records of this prioritization phase were properly maintained across the three facilities we reviewed. The prioritization template was used as intended, but sometimes not fully filled out. This phase marks the first round of prioritization.

Though the prioritization process was in place, it may not be specific enough to provide objective scoring for each proposed project. We heard the template was an implementation of the SAMP recommendations. SAMP recommended eight categories with specific, quantifiable factors. In contrast, Metro's template used five broad categories with no specific factors to help interpret what was being evaluated.

Exhibit 13 Metro's prioritization matrix appeared to be a simplified version of a consultant's recommendations

Metro prioritization	SAMP recommended prioritization
Health and safety	Health & safety risk • Asset failure impact • Likelihood of asset failure
Legal mandate	Code/Regulation Compliance
End of useful life	Business Operations Risk • Asset criticality • Current asset condition • Likelihood of asset failure • Impact of asset failure to operation
Improved services/ efficiency/ returns on investment	Operational impact
	Unique operation criteria
	Financial impact • Outside funding opportunity • Return on investment
Leadership goals	Sustainability goals • Goal alignment • Progress towards goal
	Council priority

Source: Auditor's Office analysis of Metro's prioritization template (FY 2024-25) and Strategic Asset Management Plan report – Capital Planning Standard appendix, Plan B Consultancy.

Metro's scoring scale for each prioritization category was not well-defined. For example, if an asset is not likely to fail but would seriously affect employee safety or be costly to fix, it could be considered either a moderate or significant risk using Metro's guidance. However, the SAMP's recommendation was to evaluate health and safety risk based on two factors: how likely the asset is to fail and the potential damage if the asset fails.

SAMP also included a scoring scale based on discrete timeframes and quantifiable measurements for each risk factor. These included the number of employees, clients, or patrons impacted, the seriousness of the health or safety issue, and the estimated dollar amount of damage incurred. While Metro's current approach helped simplify the prioritization process, the simplification had the potential to introduce subjectivity, especially when comparing across departments.

More critically, the prioritization score did not appear effective in guiding decision-making. An analysis of the prioritization worksheets of the reviewed facilities from FY 2019-20 to FY 2023-24 showed that only 1% of potential projects received high scores (34-38 points), while 79% received low scores (0-16 points). Among the low score projects, 22% were ranked as a top priority by departments, and 59% were moved forward to the next phase. Among the low score projects that received a top priority ranking and/or were moved forward, less than half were accompanied with explanations.

The lack of documentation reduced the utility and transparency of department ranks, which were meant to account for prioritization factors not captured by the template.

Once projects were prioritized and moved forward, they were matched with available funding to develop the CIP. It is likely that in this phase, departments made the decision to fund certain projects while delaying others, depending on available funding and capacity. Alternatively, departments could request additional funding to cover all proposed projects. This could be called the second round of prioritization.

We found a lack of guidance and documentation for this phase. Some projects were not included in the prioritization template but appeared in the department's proposed CIP. The CIP instructions did not provide guidance for matching funding. It appeared that departments' CPOC could decide how funding would be matched to projects. Within a CPOC, the finance manager assisted with determining available funding, and the department director made the final decision about which projects to propose for the CIP.

In absence of clear guidance, the lack of documentation reduced the transparency of the prioritization process, increased the chance of inconsistent prioritization across departments, and could lead to misalignment between project priority and use of resources.

Recommendations

To finalize Metro's asset management strategy and meet reporting requirements, the Chief Financial Officer and Capital Asset Management Director should:

1. Identify which recommendations from the 2018 consultant report to implement
2. Formally approve the finalized strategy
3. Document milestones and roles and responsibilities to implement the strategy
4. Update the Capital Asset Management Policies and Renewal and Replacement Reserve Policies to align with expectations set forth in the agencywide asset management strategy
5. Provide regular reports to Metro Council and the Chief Operating Officer about:
   a. The status of capital improvement projects including budget to actual spending, and the status of project completion
   b. Agencywide asset conditions

To identify long-term asset requirements and strengthen the quality of information used in decision-making, the Capital Asset Management Director should:

6. Finalize asset data standards to set expectations for:
   a. Which assets are required to be in the asset database
   b. Level of asset detail
   c. Asset rating criteria
   d. Roles and responsibilities for maintaining and updating asset data to make sure it is as complete and accurate as possible
7. Create consistent requirements for all Facility Condition Assessments and ensure they are reflected in the scopes of work of contractors
8. Develop guidance on how to align Facility Condition Assessments with the Capital Improvement Plan
9. Periodically evaluate the accuracy of Facility Condition Assessment estimated costs to actual project costs
10. Revise the project prioritization template by:
    a. Refining the risk categories and scoring scales
    b. Requiring explanation for department rankings when moving low-priority projects forward or delaying high-priority projects

Scope and methodology

The purpose of this audit was to evaluate Metro's revenues and expenditures for renewal and replacement and determine how projects are prioritized and managed. To do this, we had two audit objectives:

1. Determine trends in renewal and replacement revenue and expenditures over the last ten years and develop scenarios to evaluate the adequacy of renewal and replacement resources in the future.
2. Determine how renewal and replacement projects are prioritized and managed.

To develop our audit objectives, we reviewed relevant Metro policies and procedures. Reviewed policies included the annually adopted financial policies, particularly the Capital Asset Management policy, the draft Strategic Asset Management Plan, and reserve policies drafted by Finance and Regulatory Services staff. Reviewed procedures include the Capital Improvement Plan instructions.

We conducted interviews with Metro leadership and staff to learn more about processes, strengths, and opportunities for improvement. We gained a general understanding of the information systems used to store asset data and used Metro's financial system to extract data and conduct preliminary analyses of expenditures and budget. To identify audit criteria, we reviewed practices outlined by the Government Finance Officers Association. We also reviewed relevant audits within Metro and in other local governments through the Association of Local Government Auditors database.

To determine trends in revenue and expenditures in renewal and replacement funds, we used data from Metro's financial system. We were able to obtain ten years of data for some, but not all, funds.

We created three scenarios to evaluate the adequacy of resources in the future, through FY 2027-28

1. Revenues based on Metro's renewal and replacement reserve policies as of FY 2021-22, and expenditures based on the FY 2023-24 Capital Improvement five-year plan.
2. Revenues and expenditures based on historic data with an assumed 3% inflation.
3. Revenues and expenditures based on historic data that excluded what appeared to be one-time revenue sources and excluded projects with real expenditures greater than 2 standard deviations from the average real expenditure of all projects in the same fund. Assumed 3% inflation.

To determine how renewal and replacement projects are prioritized and managed, we judgmentally selected three of Metro's facilities for additional review: The Metro Regional Center, Oregon Zoo, and Oregon Convention Center. As a result, audit conclusions cannot be generalized across all Metro facilities. We obtained and reviewed documents from the FY 2024-25 Capital Improvement Planning process and compared Metro's practices across facilities and against Government Finance Officers Association best practices. We also evaluated practices against requirements outlined in Metro's annually adopted financial policies.

This audit was included in the FY 2023-24 audit schedule. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Management response

Metro
600 NE Grand Ave.
Portland, OR 97232-2736

Memo

Date: May 28, 2024
To: Brian Evans, Metro Auditor
From: Marissa Madrigal, Chief Operating Officer
Ryan Kinsella, Capital Asset Management Director
Subject: Management Response to Financial Policies for Renewal and Replacement Audit

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Auditor Evans:

Thank you for the opportunity to respond to the 2024 Financial Policies for Renewal and Replacement Audit. We generally agree with the findings and recommendations and appreciate your collaborative approach in identifying opportunities for improvement throughout the audit.

Your audit summarizes the challenges of a maturing asset management program for Metro. While Metro has made progress in implementing parts of the 2018 Strategic Asset Management Plan, budget reductions during the pandemic eliminated the Asset Manager position and much of the work that was occurring.

In the past 18 months, however, the Capital Asset Department (CAM) has made inroads: the Asset Manager position was restored and filled, a new Asset Management Team was reconstituted, and significant and concrete steps have been taken in areas noted in the audit, including:

- CAM Asset Management reviewed best practices asset management data standards and condition ratings and worked with a consultant to reestablish these critical data standards to conform with our Asset Management system-of-record, Asset Essentials.
- Asset Management conducted a facility condition assessment of the Metro Regional under the new standards and uploaded data into Asset Essentials as a “proof of concept.” Following the facility condition assessment, CAM Asset Management collaborated with MRC Campus Operations to translate FCA findings into preventative maintenance schedules and projects for future CIPs. The Asset Management Team also established a 10-year forecast of the Metro Regional Center’s needs that will inform investment, maintenance and repair decisions.
- The Asset Management Stakeholder Advisory Group was reestablished as a representative group of stakeholders who will inform the updated AM policy
- Asset Management developed an agencywide solicitation for facility condition assessments; approach ensures efficiency in pricing, ready access for FCA for departments, ensures findings are uniform and conform to Metro’s condition and criticality standards

In the coming year, the Capital Asset Management Department plans to update Metro’s Asset Management Policy, work with departments to plan and conduct facility condition assessments within available capacity and resources, and update the prioritization process of capital improvement plan development. Our primary goal is to inform investment decisions and maintenance practices through an asset management framework to efficiently extend asset life and services. As detailed below, CAM is implementing process improvements that align with the recommendations.

Management's response to the audit's recommendations follow.

To finalize Metro's asset management strategy and meet reporting requirements, the Chief Financial Officer and Capital Asset Management Director should:

1. Identify which recommendations from the 2018 consultant report to implement

Response
Management agrees. This assessment was completed in July 2023. During this evaluation, Asset Management (AM) staff performed a point-by-point review of the Strategic Asset Management Plan (SAMP) recommendations, identifying completed items, outstanding items, and areas where Metro would benefit from alternative approaches, based on the experiences of staff since the SAMP was completed. The current Asset Management workplan is informed by this assessment.

Timeline
Already completed.

2. Formally approve the finalized strategy

Response
Management agrees. In summer 2023, Asset Management began developing a new, agency-wide Asset Management Policy. The Asset Management Policy will codify the goals of the Asset Management Program, the roles and responsibilities of CAM, FRS and facility operators in implementing the goals of the policy and provide a framework for achieving implementation.

Policy development efforts to date have included extensive stakeholder input sessions, with one-on-one reviews held with each operating department and central services provider with a vested interest in asset management, as well as interviews with peer jurisdictions and additional peer research. This effort was temporarily paused to allow for a Facility Condition Assessment (FCA) pilot to be performed on the Metro Regional Center, providing valuable feedback on asset management approaches and standards which will be integrated into the Policy.

Timeline
The Asset Management work plan calls for policy development to resume in the second half of 2024, with the policy completed and adopted by the end of the calendar year.

3. Document milestones and roles and responsibilities to implement the strategy

Response
Management agrees. Roles and responsibilities will be codified in the Asset Management Policy as described above. Milestones will be documented in the Asset Management Program's workplan.

Timeline
The Asset Management Policy will be updated by end of 2024. It is important to note that implementation is dependent upon data collection, primarily through Facility Condition Assessments, which we anticipate will be phased over several years across Metro's facilities.

4. Update financial policies related to the Capital Asset Management Plan and reserves to align with expectations set forth in the agencywide asset management strategy.

Response

Management agrees. Metro will update the financial policies as needed. The asset management strategy's goals will be best achieved through the integration of asset management practices into the capital planning process. This means the capital improvement plan should be developed by identifying 5-10 year capital needs, informed by service needs and risk tolerance and then developing a financing plan for meeting those needs, which could include annual cash contributions, grants, forecasted rate/fee increases, debt financing, and draws on reserves. Which financing tool works best will depend upon the cost efficiency, service demands, revenue constraints and risk tolerance. Setting-aside sufficient reserves to cover our capital needs is not realistic, but reserves represent one potential resource for planned periodic investment or unexpected capital emergency funds.

Timeline

Any necessary changes to financial policies will be made by July 2025.

5. Provide regular reports to Metro Council and the Chief Operating Officer about:

a. The status of capital improvement projects including budget to actual spending, and the status of project completion

b. Agencywide asset conditions.

Response

Management agrees. The audit identifies the need to provide reports to Metro Council and the COO on the status of the Capital Improvement Plan; however, multiple reporting channels are in place which inform key stakeholders and provide avenues for updating executive leadership and Council. These reporting processes include the following:

- FRS tracks monthly actuals and projections, including capital expenditures; updates are provided to the COO's office on a quarterly basis;
- The Construction Project Management Office (CPMO) provides monthly status updates to sponsors and executive sponsors; CPMO sends quarterly updates to department leadership;
- The CAM director and CIP analyst briefs department leadership and Capital Project Oversight Committees (CPOCs) on any key findings of current projects and proposed CIP projects as part of an annual review;
- The CAM Director briefs the CIP Executive Committee annually; key findings are communicated through the budget process. The CIP Executive Committee consists of the COO, DCOOs, CFO, General Manager of Visitor Venues, and the CAM Director.
- The Metropolitan Exposition Recreation Commission is briefed by departments as part of the capital budget process;
- The Adopted Budget provides a status of CIP.

CAM is currently evaluating the reporting needs of the capital improvement plan and project status. Our plan is to identify key audiences, their primary interests/objectives, key decision points, the frequency of when the information needs to be shared, and the data sources for the information/report. Metro Council and the COO were identified as key stakeholders in this evaluation; updated reporting will include budget to actual information, asset condition (as data permits), and any other additional information as identified in our evaluation process.

Timeline

CAM will begin annual reporting by July 2025. This depth of asset condition will be dependent upon the completion of facility condition assessments and availability of data.

To identify long-term asset requirements and strengthen the quality of information used in decision-making, the Capital Asset Management Director should:

6. Finalize asset data standards to set expectations for:
- **a. Which assets are required to be in the asset database**
- **b. Level of asset detail**
- **c. Asset rating criteria**
- **d. Roles and responsibilities for maintaining and updating asset data to make sure it is as complete and accurate as possible**

Response

Management agrees. We began aligning asset data standards across Metro through reviewing completed and outstanding recommendations in the Strategic Asset Management Plan and the initial policy drafting process. The Asset Management team has further refined these draft standards through the pilot FCA at the Metro Regional Center, which allowed the AM team to evaluate each point noted above in a real-world setting.

To complete establishing these standards, we will be convening an Asset Management Stakeholder Advisory Group (AMSAG). The AMSAG will provide valuable feedback and approval from stakeholders in each operating department and central services providers who manage asset data.

Timeline

Changes to data standards will be presented to stakeholders and adopted by the end of 2024.

7. Create consistent requirements for all Facility Condition Assessments and ensure they are reflected in the scopes of work of contractors

Response

Management agrees. The Asset Management team is in the process of creating a Request for Qualifications for agency-wide facility condition assessment services, aiming to ensure competitive pricing for assessment services and to make these serves readily available to departments. The RFQ also stipulates that any vendor performing condition assessments for Metro facilities will utilize data standards provided by Metro, including asset categorization, condition and criticality criteria, and data format for integration with Metro's asset management software.

Timeline

Requirements have been established in the current RFQ for FCA services. Contract award is anticipated by September 2024.

8. Develop guidance on how to align Facility Condition Assessments with the capital improvement plan

Response
Management agrees. Incorporating an asset management framework, informed by data developed through FCAs, is a key opportunity for how Metro can improve its CIP development process. Over time, using facility condition data will allow for a more planful approach in identifying capital needs and ensuring resources are available so that are facilities efficiently and effectively serve our region.

To this end, there are multiple approaches to integrating FCA data into the CIP process, all of which are constrained by the availability of facility condition data. For example, a five-year list of recapitalization and major maintenance work might be identified from FCA data, which would be used as the basis (or a basis) for CIP development. The Asset Management team is currently evaluating options and guidance for the FY 2025-26 CIP development process.

Notably, CAM has already piloted this process for the Waste Prevention and Environmental Services (WPES) Department and the Metro Regional Center. During the recent FY 2024-25 CIP development, the Asset Management team translated WPES previously available facility data into new standards, and then analyzed and drew conclusions on upcoming asset needs intended to inform CIP development. The AM team conducted a similar analysis for the Metro Regional Center.

Timeline
Guidance will be shared with departments in August 2024 for the FY 2025-26 CIP development process.

9. Periodically evaluate the accuracy of Facility Condition Assessment estimated costs to actual project costs.

Response
Management mostly agrees. Updated facility condition assessments will be useful in estimating the amount of funding needed to bring assets back to good repair. Moreover, validating these cost estimates is an important consideration and helps ensure FCAs are providing value to Metro.

However, comparing the accuracy of FCA estimates to project costs is a more complex task for a couple of reasons: first, FCAs provide rough order of magnitude estimates for facility component replacement based upon industry standards. Not reflected in these estimates are inflationary increases and market changes to labor and materials. These two factors have significantly impacted project costs over the past four years.

Second, nearly all capital projects address multiple goals, including the renewal and replacement of an asset and components. Capital projects also address changing service levels and advance Metro's other policy goals, such as sustainability, resiliency, and access – all of which can impact project costs. While an FCA can provide a rough estimate of renewal and replacement costs, an FCA will not factor in the costs of other goals. For example, an FCA may be able to identify the need and estimated costs for replacing an office building based upon current design. In contrast, the estimated capital project costs would also reflect the additional costs of building within Metro's Sustainable Building and Sites policy, updating any ADA needs and access issues not included in the original building design, any needs to expand or contract the footprint based upon forecasted space need, and costs associated with the Percent for Art policy.

Depending on the project's scope and how other needs are addressed, it is likely that the estimates included in an FCA will be incomplete. Moreover, parsing asset renewal and replacement costs from the costs associated with policy goals and other service needs would be challenging.

Timeline
CAM will annually report on assets and asset systems for each department and facility as part of the annual CIP review, presented annually to the CIP executive committee in January. Reports will include a summary of asset condition and estimated replacement cost as data becomes available from FCAs. Reporting will address annualized level of capital investment relative to the annualized FCA estimated costs, recognizing that there are significant shortcomings with this methodology but that this estimate provides a “rough order of magnitude” assessment.

10. Revise the project prioritization template by:
  a. Refining the risk categories and scoring scales
  b. Requiring explanation for department rankings when moving low-priority projects forward or
  delaying high-priority projects.

Response
Management agrees. The Asset Management team is currently reviewing the prioritization process and template, aiming to develop a tool that is useful for departments and better incorporates an asset management framework. An updated prioritization framework will retain consideration for current criteria, including how the project addresses healthy and safety concerns and aligns with Metro policy goals. In addition, the updated prioritization framework will better incorporate asset management principles. The current prioritization template is not explicitly tied to asset data or what has been collected in FCAs. There is a significant opportunity for us to better align these data sets with the CIP evaluation process.

Timeline
An updated prioritization process and template will be shared with departments in August 2024 for the FY 2025-26 CIP development process.

Thank you again to Auditor Evans and his team for their thougtful work in examining Metro’s financial policies and asset management strategy.

Metro

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