

Campus Research Corporation (Master Lease)

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Summary

Our audit of the Campus Research Corporation (“CRC”) Master Lease was included in our approved Fiscal Year (“FY”) 2015 Audit Plan. The Master Lease with CRC contributes to the University of Arizona’s (“UA”) strategic goals by connecting the University to industry in the development and commercialization of leading-edge technology. We have not previously conducted any audits of the CRC Master Leases.



Background: The University of Arizona Science and Technology Park (“UA Tech Park”) and The UA Tech Park - The Bridges are owned by the Arizona Board of Regents (“ABOR”) on behalf of the University of Arizona. Tech Parks Arizona (“TPA”) has responsibility for the performance of the two tech parks. TPA recruits technology companies that reflect the research strengths of the University. The UA Tech Park serves

as a research and development center where new technology can be prototyped, tested, evaluated, and demonstrated.

CRC, an Arizona non-profit corporation, assists TPA in the development, operation, marketing, and leasing of the parks. The CRC board of directors consists of 11 members; six elected at-large members, two appointed by ABOR, and three appointed by UA. The CRC board of directors meets quarterly to discuss finances and operations and approve budgets, financial statements, new leases, and other issues affecting the day-to-day operations of the UA Tech Park.

CRC is considered a discretely presented component unit of the UA, and as such, its financial statements are included with other component units in UA’s *Comprehensive Annual Financial Report*.

UA Tech Park’s nearly 6,500 employees work in areas that include aerospace and defense, homeland security, solar and renewable energy, mining innovation, advanced manufacturing, and other leading-edge technologies. In addition, UA Tech Park companies offer UA students a wide variety of internships and “real world” work experiences.

The UA Tech Park is located in Tucson at Rita Road and Interstate 10 and is comprised of 1,267 acres with 2 million square feet of improvements. The park is home to over 40 companies and business organizations that include offices and classrooms of UA South (see Appendix 1).

Support for innovation and education are central to UA Tech Park’s mission. For example, the Solar Zone is one of the largest multi-technology grid-level solar testing and

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demonstration facilities in the world. Similarly, the Arizona Center for Innovation is an innovation center that helps entrepreneurs, startups, and emerging companies transform their ideas into successful ventures.

When the UA Tech Park was acquired in 1994, ABOR entered into a lease dated August 5, 1994 with CRC (then known as Rita Road Campus Corporation). The lease grants CRC the right to sublease UA Tech Park land and buildings to third parties.

There are three Master Lease agreements with CRC. Master Lease 1 is for the developed portion of the UA Tech Park; Master Lease 2 is for the undeveloped portion of the UA Tech Park; and Master Lease 3 is for The Bridges. Our audit focused on Master Lease 1 only and will be referred to as “Master Lease” hereinafter.

Audit Objectives: To determine compliance with the Master Lease provisions, including whether:

- Rent payments were timely;
- Budget approval occurred in accordance with lease provisions;
- Required insurance was maintained;
- Assessed taxes were timely paid; and
- Required reporting complied with lease terms.

Scope: Our audit included the FY 2015 budget and FY 2014 assessed taxes, financial reports, and insurance.

Methodology: Our audit objectives were accomplished through:

- Meeting with TPA and CRC staff, including the Associate Vice President for TPA and the CRC Chief Financial Officer to become familiar with the UA Tech Park’s overall operations;
- Touring the UA Tech Park to obtain a general idea of the nature of the complex;
- Reviewing and summarizing the Master Lease and all amendments;
- Meeting with UA Office of General Counsel (“OGC”) personnel to discuss statutory requirements of the lease;
- Reviewing CRC’s audited annual financial statements;
- Reviewing ABOR Business and Finance Committee meeting minutes;
- Reviewing the FY 2015 budget and related CRC Board of Directors meeting minutes;
- Examining certificates of insurance and related documents;
- Meeting with the Assistant Vice President for UA Risk Management Services to discuss insurance documents; and
- Obtaining and reviewing tax receipts and tax reporting statements.

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Conclusions: Overall, CRC is complying with the Master Lease provisions. CRC maintained all insurance coverage required by the lease and timely paid all assessed taxes, such as Pima County property taxes and Arizona's Transaction Privilege and Use Tax. No actual rent payments were made to UA. Audit was advised that the UA Vice President for Tech Launch Arizona obtained the UA President's approval for CRC to retain net proceeds from the previous year for upcoming operations and expenses, as permitted by the lease provisions.

Although CRC recognized \$1,294,649 of additional rent expense for FY 2014, CRC received approval from the board of directors to credit an outstanding obligation to UA in the amount of \$400,000 for park start-up costs. Additionally, approval of a credit in the amount of \$894,649 was submitted to the UA CFO for land purchased by CRC on UA's behalf. Management is currently developing an affiliation/cooperation agreement to formalize unwritten agreements.

We found that budget approval and required reporting were not in compliance with the lease terms (see Audit Results, Recommendations, and Responses beginning on page 5). The University is working with CRC to execute an amendment to bring uniformity to all three Master Leases and to clarify ambiguous lease terms and provisions identified during the audit. This will help align the Master Lease provisions with CRC's current business practices.

According to the Institute of Internal Auditors International Professional Practices Framework, an organization is expected to establish and maintain effective risk management and control processes. These control processes are expected to ensure, among other things, that:

- The organization's strategic objectives are achieved;
- Financial and operational information is reliable and possesses integrity;
- Operations are performed efficiently and achieve established objectives;
- Assets are safeguarded; and
- Actions and decisions of the organization are in compliance with laws, regulations, and contracts.

Our assessment of these control objectives as they relate to this audit is presented on the next page.

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General Control Objectives	Control Environment	Audit Result	
		No.	Page
Achievement of the Organization's Strategic Objectives			
<ul style="list-style-type: none"> UA Tech Park contributed to the UA's strategic objectives by connecting the UA to the research and development industry. 	Reasonable to Strong Controls in Place		
Reliability and Integrity of Financial and Operational Information			
<ul style="list-style-type: none"> CRC financial statements, including the independent auditor's assertion that the financial statements are free from material misstatement, were presented to ABOR. 	Reasonable to Strong Controls in Place		
Effectiveness and Efficiency of Operations			
<ul style="list-style-type: none"> The annual budget was approved prior to expenditures, as required by the lease. 	Opportunity for Improvement	2	7
Safeguarding of Assets	Not Applicable		
Compliance with Laws and Regulations			
<ul style="list-style-type: none"> Lease requirements were clear and consistent. 	Opportunity for Improvement	3	8
<ul style="list-style-type: none"> Financial statements and the annual budget were presented within the time frames established in the lease. 	Opportunity for Improvement	1	5
<ul style="list-style-type: none"> Assessed taxes were paid in a timely manner. 	Reasonable to Strong Controls in Place		
<ul style="list-style-type: none"> Required insurance was maintained in accordance with lease provisions. 	Reasonable to Strong Controls in Place		

We appreciate the assistance of Tech Parks Arizona and Campus Research Corporation employees during the audit.

/s/

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Audit Results, Recommendations, and Responses

1. The annual financial statements and budget were not presented in the time frame established in the lease.

Condition:

- a) CRC did not provide financial statements to ABOR within the time frame established in the lease. The FY 2014 Tech Parks Annual Report that included CRC's financial statements for the years ended June 30, 2014 and 2013 were presented to the ABOR Business and Finance Committee at their November 2014 meeting.
- b) The CRC FY 2015 annual budget was not submitted by March 1st, as required by the lease. The budget was initially presented at the June 2014 CRC board of directors meeting and later approved by the board members at the September 2014 meeting.

Criteria:

- a) Paragraph 5(c) of the Master Lease states, "On or before February 15th of each year, the Lessee shall provide the Lessor with financial statements for the immediately preceding calendar year...." Amendment 1 to the Master Lease stipulated that "The Annual Report described in paragraph 5(c) of the Lease shall be filed with the Executive Director of the Board of Regents."¹
- b) Paragraph 5(c) states, "On or before March 1st of each year during the term of this Lease, the Lessee shall submit to the Lessor a proposed budget disclosing all anticipated expenditures and income of the Lessee for the Premises during the ensuing fiscal year commencing July 1 of that calendar year."

Cause:

- a) CRC's fiscal year ends on June 30th. The original lease terms were written presuming the Lessee's financial year would be based on the calendar year rather than a fiscal year ending June 30th.
- b) According to the CRC Chief Financial Officer, "The Tech Parks budget is very complex. In addition to ongoing operations and maintenance, CRC is responsible for any and all costs associated with the Parks – including but not limited to development activity, building renewals, tenant improvements, and periodic improvements to the buildings and grounds. Budgeting for these activities each year depends on numerous factors, including

¹ There is no longer an Executive Director of the Board of Regents. The position is now known as President of the Board of Regents. Also, it is not clear whether the amendment applies to the annual budget, as it is also included in Paragraph 5(c) of the original Master Lease.

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priorities that may be established by the UA and/or the CRC Board. CRC must then evaluate these priorities in light of the balance of funds available after maintenance and operations and necessary capital reserves are funded. This process takes time, and must then be reviewed by the CRC Board. It was not feasible to present a complete and accurate budget before June, and this would be a much more realistic deadline moving forward.”

Effect:

CRC could not comply with the terms of the lease, as written.

Recommendation:

Paragraph 5(c) of the Master Lease that pertains to presentation of the annual financial statements and annual budget should be revised. For example, the Master Lease should be revised to stipulate reporting dates that align with CRC’s fiscal year-end. Also, it should be clarified whether the requirement for annual reporting to ABOR applies to the financial statements and the annual budget, or just the financial statements.

Management Response: Target Implementation Date: February 2016.

We accept the recommendation of the Audit Report. Tech Parks Arizona (TPA) and Campus Research Corporation (CRC) will request that the Arizona Board of Regents (ABOR) revise the reporting provision of the Master Lease to align it with CRC’s fiscal year, July 1 – June 30. The proposed revision to the lease will require CRC to submit its financial statement to ABOR on or before December 1st. TPA and CRC are currently working with the UA Office of the General Counsel to draft the lease revisions.

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2. The annual budget was not approved in accordance with lease provisions.

Condition:

The CRC annual budget was not approved prior to the new fiscal year's expenditures. The budget was approved in September 2014, almost three months after the start of the new fiscal year that began July 1, 2014.

Criteria:

According to paragraph 5(b)(iii), "The annual budget shall be reviewed and approved by the Lessor prior to any expenditures therefrom."

Cause:

According to the UA Tech Parks Associate Vice President, it is not unusual for large corporations to continue to operate in a new fiscal year even though the budget is not yet approved, similar to the federal government operating under a continuing resolution.

Effect:

CRC could not comply with the terms of the lease, as written.

Recommendation:

Paragraph 5(b)(ii) of the Master Lease pertaining to budget approval should be revisited and revised to reflect more realistic procedures and requirements.

Management Response: Implemented.

We accept the Audit Report recommendation. The CRC Board of Directors has directed the management team to develop a new budgeting process and schedule. The proposed annual budget will be presented to the CRC Board of Directors in April of each year and will be approved and adopted prior to the beginning of the fiscal year on July 1 [beginning FY 2017]. This schedule will allow time for the President of the University to review the budget and provide her consent prior to its effective date.

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3. The Master Lease contained contradictory language regarding additional rent.

Condition:

The Master Lease is not clear as to when additional rent is due. The two paragraphs within section 5(b) of the Master Lease contain contradictory information. Specifically:

The first paragraph states: "Each year the Lessee shall pay as additional rent all of its net proceeds from the development and operation of the Premises received during the preceding year."

The second paragraph states: "Additional rent shall be payable quarterly on or before the fifteenth (15th) day following the close of each quarter during the Lease term...in an amount equal to the amount...total gross receipts for the quarter then ended exceed the total amount of authorized quarterly retentions for operations and improvements expenses for said quarter."

Criteria:

Best business practices dictate that lease requirements should be clear and consistent.

Cause:

The ambiguous lease requirements were not noticed because CRC has never made actual rent payments to UA.

Effect:

The lessee does not have clear guidance as to when rent is due, nor does UA have a specific time frame to legally enforce; i.e., annually or quarterly.

Recommendation:

Section 5b of the Master Lease should be amended to clarify whether rent is due annually based on the previous year's net proceeds or quarterly based on the previous quarter's net proceeds.

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Management Response: Target Implementation Date: February 2016.

We accept the Audit Report recommendation. CRC and the University have agreed to review and reconcile the University's past rent obligations to CRC and CRC's past rent obligations to the University. In addition, the parties will ask ABOR to approve a revision to the Master Lease clarifying rent obligations going forward.

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UA Tech Park Tenants ²	
Name	Description
Technology	
AgentSage	A tool that connects real estate agents with their clients utilizing preselected preferences.
Arizona Technology Council	Trade association for science and technology companies.
Arzon Solar	12 acre site with dual axis tracking concentrated photovoltaic ("PV") structures in the Solar Zone.
BASF	Chemical company creating chemistry for a sustainable future.
Citi	Financial company, providing consumers, corporations, governments and institutions with a broad range of financial services and products.
Cleveland Electric	Manufacturer of industrial thermocouples. A new fiber optic system is being tested in the Solar Zone to demonstrate its pedestrian detection capabilities.
Codelucida	Developing data processing technology that provides speed and reliability enhancements for solid state drives.
Darling Geomatics, Ltd.	Provides integrated 3D laser scanning, land surveying, and 3D modeling services, as well as environmental consulting.
DILAS Diode Laser, Inc.	Manufacturer of high-power diode laser components and systems.
Dmetrix	Digital microscopy instrument company developing ultra-rapid and fully automated digital microscope-slide scanning instruments.
DRS Technologies	US-based defense contractor and supplier of integrated products, services, and support to military forces, intelligence agencies, and contractors worldwide.
Duke Energy Renewables	Developer of the Gato Montes Solar Power Project, a 6.1 megawatt ("MW") solar PV facility at the Solar Zone, using thin-film, amorphous silicon modules.
Edible Optics	Science kit maker that develops products in the fields of engineering and science for school-aged children.
EOITech	Developing instruments for materials analysis, currently focusing on the detection of fake diamonds.
E.ON Climate & Renewables	Developer of the Tech Park Solar project, a 5 MW solar installation collaboration of Foresight Solar LLC and Solar Point Partners LLC that uses multicrystalline silicon modules and single axis trackers at the Solar Zone.
EpiSci	Cutting-edge research and development deeply rooted on the paradigm of "system science".
EPVSensors	Developing a novel through-the-eyelid tonometer for accurate eye pressure measurement at home.
Ferradigm	A biomedical company developing custom magnetic particle solutions to accelerate workflows and decrease cost in the biological sample processing market.
Grafted Growers	Specializes in the indoor production of grafted tomato and vegetable plants for the professional and hobby markets.
IBM	Focused on data storage systems development.

² Source: The University of Arizona Tech Parks Arizona web site, July 2015

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Name	Description
Technology (Continued)	
MSDx	Medical diagnostic company that provides biomarker tools for studying disease processes.
NP Photonics, Inc.	Optics company and manufacturer of fiber lasers, fiber amplifiers, and specialty fibers for the sensing, defense, metrology, and research markets.
OptumRx	Pharmacy benefit management organization that manages prescription drug benefits through a national network of community pharmacies and state-of-the-art mail service pharmacies.
Oracle Corporation	Information technology (“IT”) company that simplifies IT by engineering software and hardware to work together.
Raytheon	Design, development, and production of weapon systems for the U.S. military and the armed forces of more than 50 countries.
REhnu, Inc.	Renewable energy company that uses large glass mirrors to focus sunlight onto PV cells, producing utility-scale solar electricity.
Social Sitter	A web and mobile platform that filters social media messages for inappropriate content before the message goes public.
Thompson-Wimmer	Technical services provider and consulting firm for Unmanned Aircraft Systems.
Tucson Electric Power (TEP)	Electric utility company that has developed two PV projects at the Solar Zone.
Universal Bio Mining	Developing gold and copper extraction technology to produce gold from waste and deposits that are uneconomic with conventional technology.
Washington Gas Energy Systems	Renewable energy company.
University & Educational	
Arizona Center for Innovation	Business incubator and innovation center that promotes and accelerates technology commercialization, helping entrepreneurs transform their ideas into successful companies.
Tech Parks Arizona	Markets, develops, and manages the UA Tech Parks and the Arizona Center for Innovation on behalf of the University of Arizona.
University of Arizona South	A branch campus of the University of Arizona.
Vail Academy and High School	K–12 school in the Vail Unified School District.
Support Services for UA Tech Park	
AAA Landscape	Provides commercial landscaping.
CH2MHill	Provides full service facilities management assistance.
Cogenra Solar	Rooftop installation that provides solar electricity and heat generation in a single unit for building 9070.
Eurest Dining Services	Provides food service and onsite catering and also operates the Tech Park Café.
Facilities and Plant Services, IBM	Provides maintenance services through the managing operator, IBM.

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Name	Description
Support Services for UA Tech Park (Continued)	
Faulk Electric Corporation	Provides industrial and commercial electrical installations under contract to help the UA Tech Park.
Newark Grubb Knight Frank (NGKF)	Provides management services for the common areas.
Pacific Maintenance	Provides janitorial and cleaning services.
Securitas	Provides site security.
The Groundskeeper	Provides commercial landscaping.