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July 25, 2017

Dr. Gayle E. Hutchinson, President
California State University, Chico
400 West First Street
Chico, CA 95929

Dear Dr. Hutchinson:

Subject: Audit Report 17-74, Taylor II Replacement Building, California State University, Chico

We have completed an audit of the *Taylor II Replacement Building* construction project as part of our 2017 Audit Plan, and the final report is attached for your reference. The audit was conducted in accordance with the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*.

I have reviewed the management response and have concluded that it appropriately addresses our recommendations. The management response has been incorporated into the final audit report, which has been posted to the Office of Audit and Advisory Services' website. We will follow-up on the implementation of corrective actions outlined in the response and determine whether additional action is required.

Any observations not included in this report were discussed with your staff at the informal exit conference and may be subject to follow-up.

I wish to express my appreciation for the cooperation extended by the campus personnel over the course of this review.

Sincerely,



Larry Mandel
Vice Chancellor and Chief Audit Officer

c: Timothy P. White, Chancellor

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CONSTRUCTION

**California State University,
Chico**

Taylor II Replacement Building

Audit Report 17-74
June 20, 2017

EXECUTIVE SUMMARY

OBJECTIVE

The objectives of the audit were to ascertain the effectiveness of construction management policies and procedures related to the fiscal, operational, and administrative controls over construction activities, determine the adequacy of internal controls and processes, identify cost recovery opportunities, and ensure compliance with relevant governmental regulations, Trustee policy, Office of the Chancellor directives, and campus procedures.

CONCLUSION

Based upon the results of the work performed within the scope of the audit, a few specific control weaknesses were noted; generally, however, controls were adequate, appropriate, and effective to provide reasonable assurance that risks were being managed and objectives were met.

In general, the audit did not reveal any significant internal control problems or weaknesses that would be considered pervasive in their effects on construction management. However, the review did indicate that attention is required to ensure that project final reconciliations are completed and reviewed and extra service agreements are appropriately authorized. We also identified opportunities to improve controls over compliance with change order administration and campus accessibility standards.

Specific observations, recommendations, and management responses are detailed in the remainder of this report.

OBSERVATIONS, RECOMMENDATIONS, AND RESPONSES

1. FINAL ACCOUNTING

OBSERVATION

The campus did not require the construction manager to submit a final accounting of the guaranteed maximum price (GMP) construction agreement.

Specifically, we found that the construction manager did not provide sufficient documentation demonstrating that the total cost of the project equaled or exceeded the final GMP construction agreement amount of \$44,381,763. The documentation should include, but not be limited to, all actual subcontractor costs, direct material and labor provided by the construction manager, and a reconciliation of contractual fees paid by the campus.

Submittal of a final accounting of actual project costs by the construction manager decreases the risk that the campus' payments will exceed the total GMP construction amount and that any errors and irregularities would not be detected.

RECOMMENDATION

We recommend that the campus, in conjunction with the Capital Planning, Design and Construction department (CPDC) at the chancellor's office, require the construction manager to submit a final accounting of the GMP construction agreement and perform a verification of the costs. In the event the total actual cost is less than \$44,381,763, the campus should notify CPDC and request that the difference be returned to the campus.

MANAGEMENT RESPONSE

We concur. The campus will require the construction manager to submit a final accounting of the GMP construction agreement and perform a verification of the cost. In the event the total actual cost is less than \$44,381,763, the campus will notify CPDC and request that the difference be returned to the campus.

Completion date: November 30, 2017

2. EXTRA SERVICE AUTHORIZATIONS

OBSERVATION

Extra services authorization (ESA) letters for the Taylor II Replacement Building project were not always approved in accordance with the campus capital outlay management plan.

We reviewed 27 ESA letters and found that 15 were not approved by an individual at the appropriate level.

Proper approval of ESA letters decreases the risk of errors, misunderstandings, and miscommunication regarding rights and responsibilities, as well as unwarranted changes and excess charges.

RECOMMENDATION

We recommend that the campus institute a procedure to ensure that ESA letters are approved in accordance with the campus capital outlay management plan.

MANAGEMENT RESPONSE

We concur. The campus will institute a procedure to ensure that ESA letters are approved in accordance with the campus capital outlay management plan.

Completion date: November 30, 2017

3. CHANGE ORDER ADMINISTRATION

OBSERVATION

Administration of trade subcontractor labor rates and associated labor burden needed improvement.

We reviewed hourly labor rates and the associated labor burden charged by two trade subcontractors for a sample of change orders, and we found that one trade subcontractor charged inflated labor rates on nine separate change order requests. This increased labor costs by \$1,513.

Appropriate review of hourly labor rates and the associated labor burden charged to the project reduces the risk of inappropriate or unsupported project costs.

RECOMMENDATION

We recommend that the campus provide refresher training relating to the change order review process, including verification of labor rates to approved hourly labor rate worksheets, to appropriate campus personnel.

MANAGEMENT RESPONSE

We concur. The campus will provide refresher training to the appropriate campus personnel relating to the change order review process and verification of labor rate charges to the approved hourly labor rate worksheets.

Completion date: November 30, 2017

4. PLAN REVIEW

OBSERVATION

The campus did not maintain written certification stating that the campus organization representing people with disabilities was given the opportunity to review the plans for the Taylor II Replacement Building, as required by Integrated California State University Administrative Manual (ICSUAM) §9233.01, *Responsibilities of Project Administrator Before and During Schematic Design Phase*.

Obtaining written certification from the campus organization representing people with disabilities reduces the risk of noncompliance with campus accessibility standards.

RECOMMENDATION

We recommend that the campus develop a process to record and maintain written certification statements showing that the campus organization representing people with disabilities was given the opportunity to review capital project plans.

MANAGEMENT RESPONSE

We concur. The campus will develop a process to record and maintain written certification statements showing that the campus organization representing people with disabilities was given the opportunity to review capital project plans.

Completion date: November 30, 2017

GENERAL INFORMATION

BACKGROUND

In May 2012, the Board of Trustees (BOT) approved schematic plans for the California State University, Chico (CSU Chico) Taylor II Replacement Building project at a cost of \$58,281,000, with funding from lease revenue bonds approved in fiscal year 2011/12.

In September 2011, the campus executed an agreement with the architectural firm WRNS Studio for services related and incidental to the design and construction of the Taylor II Replacement Building project. It also executed an agreement with the construction manager (CM), Otto Construction, for preconstruction services that included design and bid phase services. In November 2013, the campus executed a GMP agreement with the CM for construction phase services at a construction cost of \$44,381,763 and issued a Notice to Proceed on November 19, 2013, with a completion date of November 13, 2015. The campus filed a Notice of Completion on May 13, 2016.

The Taylor II Replacement Building project is a 91,000-square-foot facility located at the southeast corner of the CSU Chico campus, adjacent to Kendal Hall and Laxson Auditorium. The facility consolidates the College of Humanities and Fine Arts into one building and supports the art, English, and foreign languages academic programs. The facility also includes a recital/dance hall, a recording studio, art galleries, lecture stations, various laboratory spaces, faculty offices, and administrative and support areas. An internal courtyard is surrounded by a diverse mix of academic, performance, and creative spaces, allowing students to engage and showcase intellectual and artistic talents. The project achieved a Leadership in Energy and Environmental Design (LEED) silver rating. LEED is a third-party certification program begun in 1999 by the United States Green Building Council and is a nationally accepted benchmark for the sustainable “green” design, construction, and operation of buildings.

The CSU Chico campus managed the Taylor II Replacement Building project, and it chose the CM at Risk with GMP delivery method. In this method, a construction management firm chosen by a competitive bidding process provides all or significant portions of design and construction administrative services and takes part in establishing the GMP. The CM at Risk acts as the general contractor during construction, assumes the risk of subcontracting the work, and guarantees completion of the project. The liability for the success in completing the project on time and in budget lies with the construction manager, and not with the university. Further, there is a potential for cost savings should the project be completed below the GMP.

Campus presidents have been delegated the authority to directly manage state and non-state funded capital outlay projects. The chancellor’s office issues this delegated authority to the campus subject to its compliance with the capital outlay certification procedure. To comply, the campus submits a request for Delegation of Capital Outlay Management Authority to the Certification Review Board (CRB) for review. Then the executive vice chancellor and chief financial officer in the chancellor’s office must approve the request. The campus president is responsible for ensuring that he or she exercises delegated authority in compliance with applicable statutes, regulations, and BOT policies; the campus manages capital projects via a process consistent with the provisions of the ICSUAM; and the campus has in place appropriate internal controls and processes to ensure that responsibilities are carried out in a

manner consistent with the campus capital outlay management plan submitted with the request for delegated authority.

The campus capital outlay management plan defines the campus organizational and operational structure and expenditure authority and serves as the campus policies and procedures for the administration of construction activities. Updated plans are to be submitted when campus operational structure changes are made that impact the plan. Certification is continuous unless a CPDC post-project performance review determines that problems were caused by campus negligence, in which case the CRB may recommend that the campus be placed on probation. The CRB may ultimately recommend that certification be withdrawn if identified operational/management deficiencies are not remedied.

Each campus president (or designee) also has been delegated authority to make all professional appointments relative to capital outlay projects and campus physical development in accordance with applicable statutes, regulations, BOT policies, and ICSUAM provisions; and must ensure the use of systemwide standardized architectural, engineering, and other professional appointment contract forms. Further, each construction administrator, project manager, inspector of record, campus representative, and design professional is required to use the CSU *Construction Management Project Administration Reference Manual*, which contains the CSU construction management policies and procedures that apply to a project.

SCOPE

We visited the CSU Chico campus and the offices of the CM and selected subcontractors from March 20, 2017, through April 20, 2017. Our audit and evaluation included the audit tests we considered necessary in determining whether fiscal, operational, and administrative controls for the Taylor II Replacement Building project were in place and operative.

Specifically, we reviewed and tested:

- Delegation of construction management authority.
- Review and approval of project design, budget, and funding.
- Professional services agreements and any extra services changes.
- Administration of the bid and award process.
- Contract execution and required contract bonds and insurance.
- Subcontractors and subcontractor substitutions.
- Contract and service agreement payment processing.
- Procurement of major equipment and materials.
- Performance of required inspections and tests.
- Review, approval, pricing, and tracking of change orders.
- Administration of subcontractor labor rates and associated burden.
- Construction management and overall project cost accounting and reporting.
- Construction allowances and contingency balances.

As a result of changing conditions and the degree of compliance with procedures, the effectiveness of controls changes over time. Specific limitations that may hinder the effectiveness of an otherwise adequate system of controls include, but are not limited to, resource constraints, faulty judgments, unintentional errors, circumvention by collusion, and management overrides. Establishing controls that would prevent all these limitations would not be cost-effective; moreover, an audit may not always detect these limitations.

Our testing and methodology was designed to provide a review of key operational and administrative controls, which included detailed testing on a limited number of CM and selected subcontractor transactions. Our review did not examine all aspects of financial controls or encompass all financial transactions for every contractor and subcontractor.

CRITERIA

Our audit was based upon standards as set forth in CSU Board of Trustee policies; Office of the Chancellor policies, letters, and directives; campus procedures; and other sound administrative practices. This audit was conducted in conformance with the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*.

This review emphasized, but was not limited to, compliance with:

- Executive Order (EO) 672, *Delegation of Capital Outlay Management Authority and Responsibility*
- EO 666, *Delegation of Professional Appointments Related to Capital Outlay Projects and Campus Physical Development*
- ICSUAM §9000 through §9005, *Capital Outlay and Public Works Contracts*
- ICSUAM §9200 through §9212, *Professional Services for Campus Development*
- ICSUAM §9230 through §9237, *Project Plan Development for Major Capital Construction Projects*
- ICSUAM §9700 through §9843, *Construction Management for Public Works Contracts*
- CSU *Construction Management Project Administration Reference Manual*
- CSU *Administration of University Property - Equipment Procedures*
- *Contract General Conditions for CM at Risk with GMP Projects*
- Public Contract Code Chapter 2.5, *CSU Contract Law*
- Public Contract Code §4100 *et seq.*, *Subletting and Subcontracting Fair Practices Act*
- Government Code §13402 and §13403

AUDIT TEAM

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Senior Auditor: Jamarr Johnson