

Office of Audit and Advisory Services
401 Golden Shore, 4th Floor
Long Beach, CA 90802-4210

562-951-4430
562-951-4955 (Fax)
lmandel@calstate.edu

March 19, 2018

Ms. Sally F. Roush, Interim President
San Diego State University
5500 Campanile Drive
San Diego, CA 92182

Dear Ms. Roush:

Subject: Audit Report 17-76, Confucius Institute and Open Air Theatre, San Diego State University

We have completed an audit of *Confucius Institute and Open Air Theatre* 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

CSU Campuses

Bakersfield • Channel Islands • Chico • Dominguez Hills • East Bay • Fresno • Fullerton • Humboldt • Long Beach • Los Angeles • Maritime Academy • Monterey Bay
Northridge • Pomona • Sacramento • San Bernardino • San Diego • San Francisco • San José • San Luis Obispo • San Marcos • Sonoma • Stanislaus



CONSTRUCTION

San Diego State University

Confucius Institute and Open Air Theatre

Audit Report 17-76
February 1, 2018

EXECUTIVE SUMMARY

OBJECTIVE

The objectives of the audit were to ascertain the effectiveness of construction management policies and procedures related to the operational, administrative, and financial 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

We found the control environment for some of the areas reviewed to be in need of improvement.

Based upon the results of the work performed within the scope of the audit, except for the weaknesses described below, the operational, administrative, and financial controls for construction activities as of October 11, 2017, taken as a whole, provided reasonable assurance that risks were being managed and objectives were met. The review noted some issues with clarity in the request for proposal process and with the review of hourly labor rates for change order, allowance, and contingency work. The review also indicated that attention is required to ensure that fees are returned for unused allowance credits, conflict-of-interest forms are maintained, and change orders are properly approved. We also identified opportunities to improve controls over compliance with project close out certifications and campus accessibility standards.

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

OBSERVATIONS, RECOMMENDATIONS, AND RESPONSES

1. REQUEST FOR PROPOSAL PROCESS

OBSERVATION

The campus request for proposal (RFP) process for task order construction agreement (TOCA) procurements needed improvement.

We reviewed the campus RFP and found that the information provided was not specific and detailed enough for the responding contractors to reasonably bid their fees. Specifically, we found that although one of the contractors proposed a fee of 4 percent for overhead and profit (OHP) in its winning bid package, this fee percentage was determined to be inadequate for use with the projects actually performed. Instead, the contracts for the Confucius Institute and Open Air Theatre projects included OHP at 13 percent. It appeared that this may have been the result of the RFP not providing sufficient information on the projects, or types of projects, that the winning bidders would likely complete.

RECOMMENDATION

We recommend that the campus review and update its RFP process for TOCA procurements to provide additional detail on the specific projects, or specific types of projects, to be completed under the TOCA contract, so that contractors can provide a reasonable estimate of OHP during the bidding process.

MANAGEMENT RESPONSE

We concur. The campus has reviewed and updated its RFP process for TOCA procurements so that contractors can provide a reasonable estimate of OHP during the bidding process.

2. REVIEW OF HOURLY LABOR RATES

OBSERVATION

The campus review of hourly labor rates submitted for change order, contingency, and allowance costs needed improvement.

We reviewed change order, contingency, and allowance documentation for the Confucius Institute and Open Air Theatre projects and found that:

- The campus could not provide hourly labor rate worksheets for two of the subcontractors who performed change order work.
- For nine of the 12 change order costs we reviewed, four of the eight allowance costs we reviewed, and five of the nine contingency costs we reviewed, the labor rates claimed could not be verified with approved hourly labor rate worksheets. The campus stated that

a review had been performed to verify the reasonableness of the submitted labor rates, but this review had not been documented and maintained in the project files.

- For all four items we reviewed relating to general contractor change order work, supporting documentation was inadequate to verify the labor costs charged. Additionally, we noted that the hourly labor rates used were inflated, as they included mark-up such as fees and liability insurance.

Reviewing labor rates submitted for change order, allowance, and contingency costs decreases the risk that the contractor will charge the campus excess labor costs.

RECOMMENDATION

We recommend that the campus:

- a. Develop a process to ensure that hourly labor rate worksheets for subcontractors performing change order work are received, reviewed, and maintained.
- b. Verify labor rates for change order, allowance, and contingency costs with approved hourly labor rate worksheets, or, if another form of verification is used, document and maintain this review in the project files.
- c. Reiterate to staff that labor rates should not include mark-up.

MANAGEMENT RESPONSE

We concur. The CSU Project Performance Review checklist has been implemented into an automated template for the administration of all projects. The checklist will ensure that subcontractor labor rate worksheets are reviewed, do not include mark-up, and are maintained in the project files.

3. ALLOWANCE CREDITS

OBSERVATION

The campus did not request that the contractor return the general contractor's fee on unused allowance balances for the Confucius Institute or Open Air Theatre projects, as required by the Master Enabling Agreement, Rider A.

The campus also noted that there was a lack of clarity in the contract documents regarding what percentage or specific classification of contractor fee (OHP and/or site management fees) should be returned.

RECOMMENDATION

We recommend that:

- a. The campus communicate the requirement to return the fee on unused allowance balances to relevant construction management personnel.
- b. The chancellor’s office Capital Planning, Design and Construction department provide clarification in the contract documents as to what percent or specific classification of contractor fee should be returned.

MANAGEMENT RESPONSE

We concur.

- a. The campus has received repayment of the overcharged fees from the contractor. In addition, the CSU Project Performance Review checklist is now an automated template used for project administration, which ensures the return of fees on unused allowance balances.
- b. The chancellor’s office Capital Planning, Design and Construction department will provide clarification in the contract documents as to what percent or specific classification of contractor fee should be returned.

This recommendation will be implemented by June 2018.

4. CONFLICT OF INTEREST

OBSERVATION

The campus did not retain conflict-of-interest and confidentiality statements for committee members involved in the selection process of the general contractor for the Confucius Institute and Open Air Theatre projects, as required by Integrated California State University Administrative Manual (ICSUAM) §5402.00, *Formal Solicitation for Services*.

Maintaining conflict-of-interest and confidentiality statements for selection committee members reduces the risk of noncompliance with the formal solicitation process.

RECOMMENDATION

We recommend that the campus implement a process to retain conflict-of-interest and confidentiality statements for selection committee members in the future.

MANAGEMENT RESPONSE

We concur. The campus has implemented a process using digital signature and routing software tools to retain conflict-of-interest and confidentiality statements for selection committee members.

5. CHANGE ORDER APPROVAL

OBSERVATION

Change orders for the Confucius Institute project were not always approved in accordance with the capital outlay management plan.

We reviewed eight change orders and found that one change order totaling \$256,229 was not approved by the vice president of business and financial affairs.

The absence of proper approval of change orders increases the risk of errors, misunderstandings, and miscommunication regarding rights and responsibilities and may result in unwarranted changes and excess charges.

RECOMMENDATION

We recommend that the campus reiterate to staff that change orders must be approved in accordance with the capital outlay management plan.

MANAGEMENT RESPONSE

We concur. The campus has reiterated to staff that change orders must be approved in accordance with the capital outlay management plan.

6. PLAN REVIEW

OBSERVATION

The campus did not retain written certification stating that the campus organization representing people with disabilities was given the opportunity to review the plans for the Confucius Institute and Open Air Theatre projects, as required by ICSUAM §9233.01, *Responsibilities of Project Administrator Before and During Schematic Design Phase*.

Written certification from the campus organization representing people with disabilities documenting its review of plans for capital projects reduces the risk of noncompliance with campus accessibility standards.

RECOMMENDATION

We recommend that the campus determine who will be responsible for retaining future certification statements showing that the campus organization representing people with disabilities was given the opportunity to review capital project plans, and communicate that responsibility.

MANAGEMENT RESPONSE

We concur. In this instance, the campus did meet with and obtained approval from Student Disability Services for the Open Air Theater and Confucius Institute; however, written

documentation was not retained. The campus has since taken steps to implement an approval form to ensure documents are properly archived.

GENERAL INFORMATION

BACKGROUND

In November 2015, the Board of Trustees (BOT) approved schematic plans for the Confucius Institute Renovation project at a cost of \$4,000,000, with funding from donor funds and designated campus capital reserves. Additionally, that same month, schematic plans were approved by the BOT for the Open Air Theatre Concourse Improvements project, at a cost of \$3,890,000, with funding from Associated Students designated funds and sponsorship naming rights.

In April 2015, the campus executed a TOCA master enabling service agreement with the general contractor Reno Construction. The Confucius Institute and Open Air Theatre projects were performed under this TOCA agreement. The campus executed a construction services agreement for the Confucius Institute project with construction costs of \$2,794,516 on August 17, 2016. There were two phases for the Open Air Theatre project, with a construction services agreement for each phase. The agreement for phase one was executed on December 16, 2015, with construction costs of \$1,280,051; and the agreement for phase two was executed on July 15, 2016, with construction costs of \$1,531,847. The campus filed a notice of completion on May 2, 2017, for the Confucius Institute project, and on April 20, 2017, for both phases of the Open Air Theatre project.

The Confucius Institute project constituted a renovation of the Professional Studies and Fine Arts building's first floor, a 5,740-gross-square-foot facility. The building, located on the northwest quadrant of the campus, provides a dedicated space to facilitate a broad range of cross-cultural enrichment activities and accommodates multipurpose, exhibit, meeting display, and support space for the Institute. The Open Air Theatre project included the demolition of deteriorated and non-code compliant restroom and concessions stand facilities. The project consisted of the construction of a 1,450-square-foot men's and women's restroom facility and a 750-gross-square-foot concessions facility to provide code-compliant access and fixture capacity. The project also constructed steel platforms atop the new concessions stand and existing ticket booth to accommodate stage lighting brought in for performances. The improvements were designed to reference the Mission Revival architectural style of the campus and to replicate the design of the existing ticket booth structure, constructed in 2011.

The San Diego State University (SDSU) campus managed the Confucius Institute and Open Air Theatre projects, and it chose the TOCA delivery method. The campus additionally hired an outside construction management firm to assist with the project management duties of these two projects. In the TOCA method, the campus selects a service provider in a two-phase process and establishes a master enabling agreement to deliver multiple projects under a two-year contract. Each project's total cost must be less than \$7 million, and the total cost of all projects completed cannot be more than \$20 million. A separate task order and construction agreement are executed for each individual project. Fees for TOCA projects can be based on hourly rates or on a percentage of direct construction costs using a construction manager at risk or collaborative design-build delivery method. This delivery method provides additional efficiencies in bidding small major capital projects.

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 Capital Planning, Design and Construction (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 SDSU campus and the offices of the general contractor and selected subcontractors from August 22, 2017, through October 11, 2017. Our audit and evaluation included the audit tests we considered necessary in determining whether fiscal, operational, and administrative controls for the Confucius Institute and Open Air Theatre projects 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 general contractor 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 Design-Build 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

Senior Director: Michael Caldera
Senior Audit Manager: Wendee Shinsato
Senior Auditor: Jamarr Johnson