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October 11, 2018

Mr. Framroze M. Virjee, President
California State University, Fullerton
800 N. State College Blvd.
Fullerton, CA 92834

Dear Mr. Virjee:

Subject: Audit Report 18-63, One Banting, California State University, Fullerton

We have completed an audit of *One Banting* construction project as part of our 2018 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 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,
Fullerton**

One Banting

Audit Report 18-63
September 13, 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 and auxiliary procedures.

CONCLUSION

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

Based upon the results of the work performed within the scope of the audit, the operational, administrative, and financial controls for construction activities as of July 13, 2018, taken as a whole, were unlikely to provide reasonable assurance that risks were being managed and objectives were met.

We reviewed three construction projects at the One Banting property: the seismic retrofit, the Western State College of Law (WSCL) tenant improvement (TI), and the California State University, Fullerton (CSUF) TI. In general, the review found that the Auxiliary Services Corporation (ASC) did not administer the projects in compliance with California State University (CSU) requirements. For example, Board of Trustees (BOT) approval was not obtained before construction began on two of the projects, and key risk management issues, such as payment and performance bonds, appropriate insurance, and contract indemnification clauses, were not always addressed.

Additionally, the review found that the ASC did not require that the construction projects go through a formal bidding process, and standard CSU contract provisions for auxiliary organization construction projects were not used. The review also noted that evidence of plan checks and approvals from applicable regulatory agencies and appropriate close-out documentation could not always be located. Further, the ASC process to review change orders could be improved.

Campus management noted that the primary individuals involved in the One Banting construction projects are no longer with ASC, and the new management team is working with campus capital programs and facility management (CPFM) to improve processes. In compliance with the approved delegation plan, CPM will manage all future auxiliary projects.

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

OBSERVATIONS, RECOMMENDATIONS, AND RESPONSES

1. CONSTRUCTION MANAGEMENT

OBSERVATION

Management of the One Banting projects did not always adhere to CSU requirements.

For example, we found that:

- ASC did not obtain BOT approval for the seismic retrofit and WSCL TI projects before starting construction. For the seismic retrofit project, construction was completed before BOT approval was obtained.
- ASC did not obtain payment and performance bonds for the CSUF TI and WSCL TI projects as required by the *Auxiliary Organization Compliance Guide*.
- ASC did not obtain builder's risk insurance for any of the three projects. Additionally, evidence of general liability, worker's compensation, and business automotive insurance for the general contractor and subcontractors on the CSUF TI and WSCL TI projects, as well as for the subcontractors on the seismic retrofit project, could not be provided.

RECOMMENDATION

We recommend that campus, in conjunction with ASC:

- a. Consult with the Office of the Chancellor's Capital Planning, Design and Construction department to understand current requirements for obtaining BOT approval for auxiliary construction projects.
- b. Review the auxiliary organization compliance guide to determine the bonding and insurance requirements for auxiliary organization construction projects.

MANAGEMENT RESPONSE

We concur. The campus, in conjunction with ASC, will consult with the Office of the Chancellor's Capital Planning, Design and Construction department, review the auxiliary organization compliance guide, and establish a policy to insure proper bonding and insurance requirements to meet compliance guidelines for any future ASC construction projects. This will be completed by February 28, 2019.

2. BIDDING AND CONTRACTING PROCESSES

OBSERVATION

The bidding and contracting processes for the seismic retrofit and CSUF TI projects needed improvement.

We found that:

- Although the ASC *Purchasing Policy* required that a formal request for quotation (RFQ) and request for proposal (RFP) be solicited for projects greater than \$25,000, neither of the projects went through a formal bidding process.
- The ASC did not use standard CSU contract provisions for auxiliary organizations when structuring the construction agreements for the two projects.
- The construction agreement for the seismic retrofit project did not include key terms and conditions, such as a right-to-audit clause or liquidated damage provisions. In addition, although the agreement contained indemnification and insurance clauses, they did not fully comply with CSU requirements. Also, the agreement contained conflicting rates in contract clauses for mark-ups on overhead and profit rates, insurance, and bond costs.
- Although two cost proposals were obtained for the seismic retrofit project and the lowest proposal was accepted, the contract amount of \$830,672 differed from the proposed amount of \$798,394.
- There was no agreement in place specific to the CSUF TI project. Instead, ASC executed a master enabling agreement (MEA) with the general contractor to perform various construction projects up to a maximum dollar amount. Although the MEA stated that individual purchase orders would be issued for specific projects performed under the agreement, no such purchase order detailing the specific costs, terms and conditions for the CSUF TI could be located. Additionally, the MEA referenced general conditions for ASC Capital Projects; however, these general conditions did not exist. As a result, the contract did not include standard terms and conditions addressing areas such as the right to audit; indemnification; insurance; bonding; contractor fees and allowable costs; change orders; or liquidated damages.
- Although a cost proposal was obtained for the CSUF TI project from the general contractor, there was no evidence of review or verification of the costs for reasonableness. In addition, the proposal was dated one day prior to the first payment application, which billed ASC for 41 percent of the contract costs.

RECOMMENDATION

We recommend that the campus, in conjunction with ASC:

- a. Remind relevant procurement and construction administration staff that the ASC *Purchasing Policy* applies to construction projects and that projects greater than \$25,000 must go through a formal bidding process.
- b. Either use standard CSU contract provisions for auxiliary organizations when structuring future agreements for auxiliary-funded major capital outlay projects, or consult with campus capital planning staff, legal counsel, and/or CPDC to create ASC Capital Projects general conditions that address key terms and conditions related to construction projects.

MANAGEMENT RESPONSE

We concur. The ASC will submit a letter of instruction to program directors regarding purchasing policies and procedures for any future ASC construction projects. The anticipated date of completion is February 28, 2019.

In addition, ASC will develop a process to consult with the campus capital planning staff or legal counsel to evaluate and review the terms and conditions of any future ASC construction projects. The anticipated date of completion is February 28, 2019.

3. PLAN CHECK REVIEW

OBSERVATION

ASC could not provide evidence that the seismic retrofit, WSLC TI, and CSUF TI projects went through all plan checks and approvals from applicable regulatory agencies.

We found that:

- For the seismic retrofit project, although a campus building permit was obtained, evidence of a plan check approval from the state fire marshal and an access compliance review could not be located.
- For the WSLC TI project, although a campus building permit and plan check approval from the state fire marshal were obtained, they were issued after the start of construction.
- For the CSUF TI project, although a plan check approval from the state fire marshal was obtained, it was issued after the start of construction. Additionally, a campus building permit, access compliance review, and seismic peer review or waiver could not be located.

RECOMMENDATION

We recommend that the campus, in conjunction with ASC, develop a process to obtain and maintain appropriate plan check and regulatory agency approvals on future construction projects.

MANAGEMENT RESPONSE

We concur. ASC will adopt the campus' and CPDC's process to obtain and maintain appropriate plan check and regulatory agency approvals for any future ASC construction projects. This will be completed by February 28, 2019.

4. CLOSEOUT PROCESS

OBSERVATION

ASC could not provide evidence of appropriate closeout documentation for the seismic retrofit, CSUF TI, and WSCL TI projects.

We found that:

- State fire marshal final inspection reports for the seismic retrofit and WSCL TI projects could not be located.
- A certificate of occupancy was only available for the WSCL TI project. We also noted that it appeared that WSCL moved into its space before receiving the certificate of occupancy.
- Notices of completion were not available for any of the projects.

RECOMMENDATION

We recommend that the campus, in conjunction with ASC, develop a process to obtain and maintain appropriate closeout documentation for future projects.

MANAGEMENT RESPONSE

We concur. ASC will adopt the campus' process to obtain and maintain appropriate closeout documentation for any future ASC capital projects. This will be completed by February 28, 2019.

5. CHANGE ORDER ADMINISTRATION

OBSERVATION

The change order review process for the seismic retrofit and CSUF TI projects required improvement.

We reviewed seven change orders between the two projects and found that:

- Supporting documentation for general contractor self-performed work was not always provided.
- In three instances, the costs provided as part of the supporting documentation did not reconcile to the final amount paid.
- There was no process to validate rates used for labor costs. In one instance, a rate increased by approximately 45 percent between two change orders and was not questioned.

RECOMMENDATION

We recommend that the campus, in conjunction with ASC, develop a documented process to review and substantiate costs for construction change orders.

MANAGEMENT RESPONSE

We concur. ASC will adopt the campus' process to evaluate, review, and approve construction change orders for any future ASC construction projects. This will be completed by February 28, 2019.

GENERAL INFORMATION

BACKGROUND

In August 2013, the ASC purchased the One Banting building with the intention of expanding CSUF's presence in Irvine. The purchase was approved by the BOT during the July 23, 2013, board meeting. Following the purchase, ASC undertook three construction projects at the property. These projects included a seismic retrofit of the structure, a TI project for WSCL, and a TI project for the CSUF campus. In January 2016, the BOT approved the design and construction of the seismic retrofit and TI projects at a cost of \$5,250,000. Funding for these projects came from ASC reserves, WSCL, and designated capital reserves.

The first project to be initiated was the seismic retrofit. In October 2014, ASC executed an agreement with Saunders Construction Inc. for construction phase services at a construction cost of \$830,672. Construction on the project ended in July 2015. ASC managed the seismic retrofit project using the Design-Bid-Build delivery method.

In June 2015, ASC executed a five-year lease agreement with WSCL. As part of this agreement, ASC agreed to provide an allowance of \$1,906,825 to WSCL for tenant improvements to renovate the building from a commercial space to an educational environment. WSCL was responsible for managing the construction process for these improvements and invoiced ASC for reimbursement of construction costs. WSCL moved into the renovated space in March 2016. WSCL occupies the second floor and part of the first floor of the One Banting property, for a total of approximately 57,273 square feet.

In July 2016, ASC executed a master enabling agreement with David E. Glenn to provide up to \$10,000,000 of construction services for various ASC capital projects. The CSUF TI project was performed under this contract, for a total construction cost of \$1,078,893. Construction began in late 2016, and the campus took temporary occupancy in December 2017, receiving state fire marshal approval for final occupancy in April 2018. ASC managed the CSUF TI project using the Design-Bid-Build delivery method. The CSUF College of Business Center for Entrepreneurship currently occupies part of the first floor of the One Banting property, for a total of approximately 8,683 square feet.

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 Integrated California State University Administrative Manual (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. It also includes information on how the campus addresses project management for auxiliary projects. 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 CSUF campus from May 29, 2018, through July 13, 2018. Our audit and evaluation included the audit tests we considered necessary in determining whether operational, administrative, and financial controls for the One Banting 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.
- Contract and service agreement payment processing.
- Performance of required inspections and tests.
- Review, approval, pricing, and tracking of change orders.
- Administration of subcontractor labor rates.
- Construction management and overall project cost accounting and reporting.

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, administrative, and financial controls, which included detailed testing on a limited number of general contractor 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 and auxiliary 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:

- Education Code §66606
- Government Code §13402 and §13403
- Title 5, §42500 through §42502, *Functions of Auxiliary Organizations and Requirement for Written Agreements*
- Standing Orders of the Board of Trustees of the CSU
- Executive Order (EO) 666, *Delegation of Professional Appointments Related to Capital Outlay Projects and Campus Physical Development*
- EO 672, *Delegation of Capital Outlay Management Authority and Responsibility*
- 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 Auxiliary Organization Compliance Guide
- CSU Auxiliary Organization Sound Business Practice Guidelines
- Auxiliary Organizations Risk Management Alliance Policy and Procedure L-5, *Guidelines for Extending Liability Coverage to Non-Auxiliary Organizations*
- *Auxiliary Contract General Conditions for Design-Bid-Build Projects*
- *ASC Purchasing Policy*

AUDIT TEAM

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Senior Auditor: Jamarr Johnson