April 5, 2019

Dr. Robert S. Nelsen, President
California State University, Sacramento
6000 J Street
Sacramento, CA 95819

Dear Dr. Nelsen:

Subject: Audit Report 18-65, Student Housing Phase II, California State University, Sacramento

We have completed an audit of the Student Housing Phase II 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
CONSTRUCTION

California State University,
Sacramento

Student Housing Phase II

Audit Report 18-65
March 7, 2019
EXECUTIVE SUMMARY

OBJECTIVE

The objectives of the audit were to ascertain the effectiveness of operational, administrative, and financial controls over construction activities; identify cost recovery opportunities; and ensure compliance with relevant governmental regulations, Trustee policy, Office of the Chancellor directives, construction contract general conditions, and campus procedures.

CONCLUSION

We found the control environment for the areas reviewed to be effective.

Based upon the results of the work performed within the scope of the audit, the operational, administrative, and financial controls for the Student Housing Phase II project as of January 28, 2019, taken as a whole, provided reasonable assurance that risks were being managed and objectives were met. Our review did identify an opportunity for improvement in the identification, tracking, and usage of allowance costs.

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

1. PROJECT ALLOWANCES

OBSERVATION

Administration of allowance usage for the Student Housing Phase II project needed improvement.

We reviewed the campus process for establishing the guaranteed maximum price (GMP) of the construction contract and noted that proper identification and segregation of allowances did not always occur. Additionally, allowances were not always properly tracked or supported by documentation to ensure that costs were appropriate. Further, overages of allowances were included in the final project reconciliation; the design-builder should bear the risk of the costs associated with these overages.

The campus project manager stated that these processes are no longer in place and that new procedures have been established for current and future projects.

Proper identification, tracking, and approval of project allowances decreases the risk that errors and irregularities will not be detected.

RECOMMENDATION

We recommend that the campus provide evidence that new procedures for the usage of allowances have been established and implemented.

MANAGEMENT RESPONSE

We concur. The campus will provide evidence that new procedures for the usage of allowances have been established and implemented by May 1, 2019.
GENERAL INFORMATION

BACKGROUND

In March 2015, the Board of Trustees (BOT) approved schematic plans for the Student Housing Phase II project at a cost of $54,935,000, with funding from housing program-designated reserves and systemwide revenue bonds.

In February 2014, the campus solicited project bids and selected Otto Construction as the design-builder. The campus executed a design and construction agreement with Otto Construction on August 14, 2015, at a cost of $44,958,295, and issued the Notice to Proceed on August 20, 2015, with a completion date of June 11, 2017. The campus filed the Notice of Completion on November 30, 2017.

The Student Housing Phase II project is a new 124,930-square-foot four-story residence hall located at the northern end of campus. The building consists of two separate wings: one houses incoming freshmen, and the other houses sophomores. The design provided for 400 beds with single- and double-occupancy rooms and shared bathroom facilities. The ground floor has a communal space that includes a large multipurpose room with a kitchen, recreation and laundry facilities, and an administrative office suite for housing and residential education. Additional amenities include a roof terrace for outdoor common space with views of the American River and shared recreation rooms. The new construction is consistent with the existing architectural style of the north housing quad, and the building uses wood-framed walls, floors, and roof-deck systems. Site improvements included a courtyard with hardscape paths, large trees, and drought-tolerant landscape elements, with an irrigation system that will use reclaimed water. The project was designed to achieve a Leadership in Energy and Environmental Design (LEED) gold certification. 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 California State University, Sacramento campus managed the Student Housing Phase II project, and it chose the Collaborative Design-Build delivery method. In this method, the campus establishes the project criteria, and the general contractor and architect/engineer propose together as a design-build team. Working closely with the campus, the design-build team establishes a design, specifications, and GMP for the project. The design-build team 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 design-build team, 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 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. 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 California State University (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 California State University, Sacramento campus and the offices of the design-builder and selected subcontractors from November 5, 2018, through December 19, 2018. Our audit and evaluation included the audit tests we considered necessary in determining whether operational, administrative, and financial controls for the Student Housing Phase II project were in place and operative. The audit focused on procedures in effect during the planning and construction of the project.

Specifically, we reviewed and tested:

- Delegation of construction management authority.
- Review and approval of project design, budget, and funding.
- Administration of the bid and award process.
- Contract execution and required contract bonds and insurance.
- Construction management and accounting, including allowance and contingency tracking and invoicing and payment applications.
- Review, approval, pricing, and tracking of change orders.
- Subcontractor administration.
- Close-out processes, including completion of required inspections and certifications.
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, including interviews, walkthroughs, and detailed testing on a limited number of Design-Builder and selected subcontractor transactions. Our review did not examine all aspects of financial controls or encompass all financial transactions for every contractor and subcontractor. Additionally, at the time of audit completion, there were several outstanding requests for documents that the general contractor was unable to provide. Although we believe these outstanding documents would not materially impact the outcome of the audit, we were unable to fully ensure compliance with all contract terms and conditions.

CRITERIA

Our audit was based upon standards as set forth in federal and state regulations and guidance; Trustee policy; Office of the Chancellor directives; and campus procedures; as well as sound administrative practices and consideration of the potential impact of significant risks. 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:

- 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
- 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
- Contract General Conditions for Collaborative Design-Build Major Projects

AUDIT TEAM

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Senior Auditor:  Jamarr Johnson