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May 10, 2019

Dr. Lynnette Zelezny, President
California State University, Bakersfield
9001 Stockdale Highway
Bakersfield, CA 93311

Dear Dr. Zelezny:

**Subject: Audit Report 19-61, Humanities Office and Humanities Classroom Buildings,
California State University, Bakersfield**

We have completed an audit of the *Humanities Office and Humanities Classroom Buildings* construction project as part of our 2019 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,
Bakersfield**

**Humanities Office and
Humanities Classroom Buildings**

Audit Report 19-61
April 19, 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 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 the Humanities Office and Humanities Classroom projects as of March 8, 2019, taken as a whole, provided reasonable assurance that risks were being managed and objectives were met.

In general, the audit did not reveal any significant internal control 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 Division of State Architect (DSA) access reviews are completed timely. In addition, we noted some issues with the formation of the guaranteed maximum price (GMP) for collaborative design-build projects and in the review process for change order, allowance, and contingency work.

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 general contractor to submit a final accounting of project costs for the Humanities Office and Humanities Classroom projects.

Specifically, we found that the general contractor did not provide sufficient documentation demonstrating that the total cost of the projects equaled or exceeded the final GMP construction agreements. The documentation should include, but not be limited to, all actual subcontractor costs, direct material and labor provided by the general contractor, and a reconciliation of contractual fees paid by the campus.

Submittal of a final accounting of actual project costs by the general contractor decreases the risk that the campus' payments will exceed actual construction costs (up to the GMP) and that any errors and irregularities will 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 general contractor to submit a final accounting of project costs for both the Humanities Office and Humanities Classroom projects and perform a verification of the costs. In the event the total actual cost is less than either of the respective construction agreements, the campus should notify CPDC and request that the difference be returned to the campus.

MANAGEMENT RESPONSE

The campus will review the final accounting of project costs for both the Humanities Office and Classroom projects and perform a verification of cost with the contractor. In this process, the campus will consult with CPDC regarding the required reconciliation to ensure it is in line with CPDC expectations. This will be completed by the campus by October 3, 2019.

2. DIVISION OF STATE ARCHITECT REVIEW

OBSERVATION

The campus did not timely obtain the DSA access review for the Humanities Office and Humanities Classroom projects.

We found that the campus building permit and Notice to Proceed were issued for these projects in December 2016, before the campus obtained approval from the DSA for access compliance. DSA approval for access compliance was obtained in July 2017.

Obtaining DSA approval prior to issuing a notice to proceed for construction reduces the risk of noncompliance with state regulations and accessibility standards, reduces the probability of rework based on DSA review, and facilitates the incorporation of DSA comments prior to building occupancy.

RECOMMENDATION

We recommend that the campus consult with the CPDC’s architecture and engineering department as to the appropriate timing of DSA access reviews and remind relevant personnel that DSA approval should generally be obtained before the Notice to Proceed is issued.

MANAGEMENT RESPONSE

The campus will consult with CPDC regarding the appropriate timing of DSA access reviews and will take appropriate actions in future projects by October 3, 2019.

3. GUARANTEED MAXIMUM PRICE FORMATION

OBSERVATION

The campus did not structure the GMP agreement for the Humanities Office project in accordance with project terms and conditions.

According to the project request for proposal (RFP), if the direct construction cost as bid during the phase two contract is less than the direct construction cost portion of the GMP, the difference shall be retained by the Trustees.

We found that when the direct construction costs were bid, they were less than the direct construction cost portion of the GMP. However, instead of reducing the GMP and crediting the difference back to the Trustees, we found that the cost savings were used as follows:

- Approximately \$51,366 of the savings were added to contractor preconstruction and site management and fees, because they had been calculated incorrectly in the original GMP.
- Approximately \$20,645 of the savings were added back to contractor overhead and profit (OHP) fees. However, this amount was inflated and incorrectly calculated.
- The campus created a \$25,000 allowance for the acceleration of construction activities. All allowances are supposed to be identified in the original GMP.
- The campus created an extra owner’s contingency in the amount of \$21,268. Since 30 percent of unused contingency costs were credited back to the general contractor, and there was a large amount of unused contingency on the project, this effectively gave the general contractor an additional \$6,380 at the end of the project.
- The campus added costs for site telecom relocation that were not included in the original GMP, and therefore should have been processed via change order, to the direct cost portion of the GMP.

Correctly structuring the GMP decreases the risk of noncompliance with project terms and conditions and decreases the likelihood of misunderstandings regarding rights and responsibilities between the campus and the general contractor.

RECOMMENDATION

We recommend that the campus:

- a. Provide refresher training to relevant personnel on GMP formation for collaborative design-build (CDB) projects that includes review of the GMP exemplar provided on the CPDC website and review of GMP-related terms and conditions in the CDB RFP template, and emphasizes that additional allowances and contingency costs should not be added to a project after GMP formation, except when processed through a change order.
- b. Review the calculation of OHP and determine whether any part of the \$20,645 in OHP that was added to the original GMP should be credited back to the campus.

MANAGEMENT RESPONSE

The campus will provide refresher training to relevant personnel and review the calculation to determine whether the funds needs to be credited back to the campus by October 3, 2019.

4. CHANGE ORDERS, CONTINGENCY COSTS, AND ALLOWANCES

OBSERVATION

The campus review of subcontractor change orders, contingency costs, and allowances for both the Humanities Office and Humanities Classroom projects needed improvement.

We reviewed eight subcontractor change orders, seven contingency costs, and the return of subcontractor bond allowances for the two projects and found that:

- In three instances, supporting documentation to substantiate subcontractor contingency costs was not obtained.
- In one instance, the general contractor erroneously charged overhead and profit for contingency costs.
- In one instance, supporting documentation to substantiate the general contractor's costs for change order work was not obtained.
- Supporting documentation to substantiate the costs incurred for subcontractor bonds was insufficient. For the two subcontractors that were bonded on each project, it appeared that a portion of the bond costs were included in the GMP, and therefore should not also have been claimed as part of the subcontractor bond allowance.

Appropriate review of change orders, contingency costs, and allowances decreases the risk of inappropriate or unsupported project costs.

RECOMMENDATION

We recommend that the campus:

- a. Provide refresher training to relevant personnel relating to the review process for change orders, contingency, and allowance costs, including ensuring that appropriate supporting documentation is provided and general contractor mark-up is appropriate.
- b. As part of the review of the final accounting of project costs above, verify the actual subcontractor bond costs expended, and, if applicable, request reimbursement for any subcontractor bond costs that were also included in the GMP for the two projects.

MANAGEMENT RESPONSE

The campus will provide refresher training to relevant personnel and review the final project costs to verify that the actual subcontractor bond costs were expended by October 3, 2019.

GENERAL INFORMATION

BACKGROUND

In November 2015, the Board of Trustees (BOT) approved schematic plans for the Humanities Office building project at a cost of \$7,790,000, with funding from systemwide revenue bonds and designated campus capital reserves. In June 2016, construction for an adjacent Humanities Classroom building project was approved by the chancellor's office, at a cost of \$3,600,000, with funding from systemwide revenue bonds and designated campus capital reserves.

In March 2015, the campus solicited project bids and selected S.C. Anderson Inc. as the design-builder for the Humanities Office project. The campus executed a design and construction agreement with S.C. Anderson Inc. on March 28, 2016, at a cost of \$6,397,555, and issued the Notice to Proceed on April 1, 2016, with a completion date of March 13, 2018. The campus filed the Notice of Completion on February 16, 2018.

In March 2016, the campus executed an agreement with the architectural firm Teter, LLP for services related and incidental to the design and construction of the Humanities Classroom project. It also executed an agreement with the construction manager, S.C. Anderson Inc., for preconstruction services that included design and bid phase services. In December 2016, the campus executed a GMP agreement with the general contractor for construction phase services at a construction cost of \$2,843,013 and issued a Notice to Proceed on December 23, 2016, with a completion date of November 2, 2017. The campus filed a Notice of Completion on February 16, 2018.

The Humanities Office project is a new 13,865-square-foot two-story complex located at the northwest quadrant of the California State University, Bakersfield (CSUB) campus. The new facility replaced the existing Faculty Building, which was demolished as part of the scope of this project. The Humanities Office project centralized the six humanities departments — English, history, philosophy, humanities, religious studies, modern language, and communication — creating a humanities quad to enhance academic interaction among students and faculty. The project provided for 50 faculty offices, the dean's office for the School of Humanities and Social Sciences, and four departmental offices. After the approval of the Humanities Office project, the campus decided to add classrooms to the project. In June 2016, the chancellor's office approved the Humanities Classroom project. This project included adding an adjacent building which houses three new classrooms and is similar in design to the Humanities Office project. The classrooms are designated for the humanities departments. These projects were designed to achieve 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 CSUB campus managed the Humanities Office 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.

The CSUB campus managed the Humanities Classroom project, and it chose the Construction Manager at Risk (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 general contractor, 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 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 CSUB campus and the offices of the general contractor and selected subcontractors from January 22, 2019, through March 8, 2019. Our audit and evaluation included the audit tests we considered necessary in determining whether operational, administrative, and financial controls for the Humanities Office and Humanities Classroom projects 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.
- Professional services agreements and any extra services changes.
- 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 general contractor and 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 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*
- *CSU Construction Management Project Administration Reference Manual*
- *Contract General Conditions for CM at Risk with Guaranteed Maximum Price Projects*
- *Contract General Conditions for Collaborative Design-Build Major Projects*
- *Request for Proposals for Collaborative Design-Build Services*

AUDIT TEAM

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