

CONSTRUCTION
CALIFORNIA STATE UNIVERSITY,
NORTHRIDGE
STUDENT HOUSING – PHASE I

Audit Report 09-25
February 17, 2010

Members, Committee on Audit

Melinda Guzman, Chair
Raymond W. Holdsworth, Vice Chair
Herbert L. Carter Carol R. Chandler
Kenneth Fong Margaret Fortune
George G. Gowgani William Hauck
Henry Mendoza

Staff

University Auditor: Larry Mandel
Senior Director: Janice Mirza
Audit Manager: Aaron Bolin
Senior Auditor: Gordon Eng

BOARD OF TRUSTEES
THE CALIFORNIA STATE UNIVERSITY

CONTENTS

Executive Summary	1
Introduction.....	2
Background	2
Purpose.....	4
Scope and Methodology	5

OBSERVATIONS, RECOMMENDATIONS, AND CAMPUS RESPONSES

Construction Management and Accounting	6
Project Reporting	6
Payment Applications	6

APPENDICES

APPENDIX A:	Personnel Contacted
APPENDIX B:	Campus Response
APPENDIX C:	Chancellor's Acceptance

ABBREVIATIONS

BOT	Board of Trustees
CM at Risk	Construction Manager at Risk
CPDC	Capital Planning, Design and Construction
CRB	Certification Review Board
CSU	California State University
EO	Executive Order
GMP	Guaranteed Maximum Price
OUA	Office of the University Auditor
Housing	Student Housing – Phase 1
SUAM	State University Administrative Manual

EXECUTIVE SUMMARY

At its January 2009 meeting, the Board of Trustees directed the Office of the University Auditor (OUA) to review construction activity. Construction auditing had been performed by KPMG since fiscal year 1997/98 with coordination from the OUA. In fiscal year 2008/09, OUA staff began performing construction audits.

We visited the California State University, Northridge campus and the offices of the construction manager and selected subcontractors from July 20, 2009, through August 17, 2009, and audited the Student Housing – Phase I (Housing) project focusing on the construction management policies and procedures and internal controls and processes in effect at that time.

Our study and evaluation did not reveal any significant construction management or internal control problems or weaknesses that would be considered pervasive in their effects on construction activity controls. However, we did identify other reportable weaknesses that are described in the executive summary and body of this report. In our opinion, the operational and administrative controls in effect for the Housing project were sufficient to meet the overall audit objective stated below.

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.

The following summary provides management with an overview of conditions requiring attention. Areas of review not mentioned in this section were found to be satisfactory. Numbers in brackets [] refer to page numbers in the report.

CONSTRUCTION MANAGEMENT AND ACCOUNTING [6]

Quarterly capital outlay status reports for the Housing project were not submitted to the chancellor's office Capital Planning, Design and Construction department for the quarters ending March and June 2008. In addition, one monthly payment application for \$656,087 was not approved by all required parties.

INTRODUCTION

BACKGROUND

In March 2006, the Board of Trustees (BOT) approved a campus master plan revision for the California State University (CSU), Northridge campus, which included additional student housing. In June 2006, the CSU Northridge campus executed an agreement with the architectural firm of AC Martin Partners, Inc. for services related and incidental to the design and construction of the Student Housing - Phase I (Housing) project. In July 2006, the campus awarded a contract to the construction management firm of Bernards Bros., Inc. for pre-construction services, which included design and bid phase services. In January 2007, the BOT approved schematic plans for the Housing project at a project cost of \$30,286,000 with funding from CSU systemwide revenue bonds.

In December 2007, the CSU Northridge campus executed an agreement with Bernards Bros., Inc. at a construction cost of \$23,305,317 and issued the Notice to Proceed on December 12, 2007, with a contract completion date of April 17, 2009, that was subsequently extended to June 30, 2009. The campus issued a change order on July 10, 2009, to notify the construction manager that it would be taking occupancy effective on the close of business July 9, 2009; and the State Fire Marshal granted a Certificate of Occupancy on July 7, 2009. A Notice of Completion was still pending as of the last day of audit fieldwork. Pending items included minor punch list items and further negotiation of final dollar amounts for completed change order work.

The Housing complex consists of two, four-story wood-framed buildings incorporating 94,000 gross square feet. The housing complex provides 400 additional beds designed with double-occupancy rooms and bathrooms shared between two bedrooms. The project is located within the existing University Park student-housing complex and includes spaces for administrative offices, study lounges, meetings, and social/community activities.

The CSU Northridge campus managed the Housing project, and the Construction Manager at risk (CM at Risk) with a Guaranteed Maximum Price (GMP) delivery method was chosen. 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.

Executive Order (EO) 672, *Delegation of Capital Outlay Management Authority and Responsibility*, dated July 25, 1997, delegates the authority to directly manage state and non-state funded capital outlay projects to campus presidents. This delegated authority is issued subject to compliance with the capital outlay certification procedure, whereby a request for Delegation of Capital Outlay Management Authority is submitted by the campus for review by the Certification Review Board (CRB) and approval by the executive vice chancellor and chief financial officer in the chancellor's office. Further, the campus president is responsible for ensuring that delegated authority is exercised in compliance with applicable statutes, regulations, and policies of the BOT; the process for management of campus capital

projects is consistent with the provisions of the State University Administrative Manual (SUAM); and appropriate internal controls and processes are in place 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 certification procedure required by EO 672 includes submission of a capital outlay management plan, which 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 which impact the plan. Certification is continuous unless a Capital Planning, Design and Construction (CPDC) post project performance review determines that problems existed due to 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.

For those campuses that are not certified, the chancellor's office may execute a Memorandum of Delegation for a capital outlay project, which delegates administration, including construction management, to the campus. The CPDC Construction Management unit may also perform construction administration and management.

EO 666, *Delegation of Professional Appointments Related to Capital Outlay Projects and Campus Physical Development*, dated March 7, 1997, delegates the authority to each campus president or designee to make all professional appointments relative to capital outlay projects and campus physical development. Further, the campus president or designee is responsible for ensuring compliance with all applicable statutes and regulations, BOT policies, and SUAM guidelines; and use of systemwide standardized architectural, engineering, and other professional appointment contract forms.

The SUAM, in part, contains an overview of all CPDC policies and procedures associated with the capital outlay process. SUAM §9700 through §9843, *Construction Management for Public Works Contracts*, describe the requirements for preparing and administering public works contracts under the provisions of Public Contract Code §10700 *et seq.* SUAM §9200 through §9212, *Professional Services for Campus Development*, describe the requirements for developing and administering professional services agreements with service providers such as architects and engineers and for testing services and project-related studies.

The CSU *Construction Management Procedures Manual* contains the CSU construction management policies and procedures that apply to a project, and each construction administrator, project manager, inspector of record, campus representative, and design professional is required to use this manual as appropriate during the construction administration of a project.

PURPOSE

The overall audit objective was to ascertain the effectiveness of construction management policies and procedures and internal controls and processes related to the administration of construction activities and, specifically, the Housing project.

Within the overall audit objective, specific goals included determining whether:

- ▶ Delegated authority to manage capital outlay projects exists, and the campus capital outlay management plan is current for campus-managed projects.
- ▶ Project development is in accordance with statutory and CSU policy requirements, including required BOT and CPDC approvals.
- ▶ Administration and management of the project provide effective internal controls and processes consistent with the campus capital outlay management plan and the SUAM.
- ▶ Professional appointments are in accordance with statutory requirements, BOT policy, and the SUAM; and systemwide standardized professional appointment contract forms are used, approved by the Office of General Counsel, and fully executed prior to performance of work.
- ▶ Extra services are appropriate, authorized, and separately tracked; and an evaluation is performed for each professional service provided.
- ▶ The bidding process is rigidly controlled, performed in accordance with statutory requirements and the SUAM, and incorporates the contract documents maintained on the CPDC website.
- ▶ Contract documents are complete, routed to the Office of General Counsel as appropriate, and timely executed; required contract bonds and insurance are received; and a Notice to Proceed is issued.
- ▶ Subcontractors are adequately monitored, and requests for subcontractor substitutions are handled in accordance with statutory requirements and the SUAM.
- ▶ Operational and administrative controls ensure maintenance of financial accountability and completion of the project within the approved scope, schedule, and budget.
- ▶ Contract and service agreement payments are adequately supported, appropriately approved, and timely paid; and retention is handled in accordance with statutory requirements and the SUAM.
- ▶ Equipment is procured in the most economical method; purchased materials meet specifications required by construction documents and drawings; and all required inspections and tests are timely and properly performed and adequately documented.

- ▶ Change orders are appropriately approved, supported, accurately priced, and sufficiently tracked; and construction allowances and contingency balances are adequately administered and controlled.
- ▶ Project completion is adequately administered, including completion of pre-final/final inspections, punch list items, project closeout checklist, and Notice of Completion; preservation of project files, equipment manuals/warranties, and spare parts/materials; and resolution of any liquidated damages.

SCOPE AND METHODOLOGY

The scope of audit included, but was not limited to, the review of design budgets and costs; the bid and award process; invoice processing and payment; change orders; construction management, architectural, and engineering services; use of major equipment/materials; the closeout process; administration of liquidated damages; and overall project cost accounting and reporting. This included any transactions or activity performed by the campus, construction management firm, and trade subcontractors.

Our study and evaluation were conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing* issued by the Institute of Internal Auditors, and included the audit tests we considered necessary in determining that operational and administrative controls are in place and operative. This review emphasized, but was not limited to, compliance with state and federal laws, BOT policies, and Office of the Chancellor and campus policies, letters, and directives.

We focused primarily on the operational and administrative controls in effect for the Housing project with an emphasis on compliance with the CSU *Construction Management Procedures Manual*, SUAM policies and procedures associated with the capital outlay process, the campus capital outlay management plan, and construction contract general conditions. We evaluated the effectiveness of construction management policies and procedures and adequacy of internal controls and processes, and sought opportunities for improvement to further the success of CSU's capital outlay program.

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, and tracking of change orders.
- ▶ Direct labor and associated burden.
- ▶ Construction management and overall project cost accounting and reporting.
- ▶ Construction allowances and contingency balances.
- ▶ Administration of the project closeout process and resolution of any liquidated damages.

OBSERVATIONS, RECOMMENDATIONS, AND CAMPUS RESPONSES

CONSTRUCTION MANAGEMENT AND ACCOUNTING

PROJECT REPORTING

Quarterly capital outlay status reports for the Student Housing – Phase I project were not submitted to the chancellor’s office Capital Planning, Design and Construction (CPDC) department for the quarters ending March and June 2008.

Executive Order 672, *Delegation of Capital Outlay Management Authority and Responsibility*, dated July 25, 1997, states that the campus shall submit quarterly project status financial reports to CPDC in the chancellor’s office on all projects. Further, additional reports pertaining to capital outlay expenditure projections shall also be provided.

The associate vice president for facilities development and operations stated that CPDC had not updated the quarterly outlay status report to include the Housing project; therefore, the omission of its status information was an oversight.

Failure to complete and submit quarterly capital outlay status reports with financial and capital outlay expenditure projections increases the risk of inaccurate reporting for the California State University-managed capital outlay program.

Recommendation 1

We recommend that the campus reiterate to staff that quarterly capital outlay status reports are to be submitted to CPDC.

Campus Response

We concur. The campus has reiterated to staff that quarterly capital outlay status reports are to be submitted to CPDC.

PAYMENT APPLICATIONS

One monthly payment application was not approved by all required parties.

We reviewed 19 monthly construction manager payment applications and found one payment application that had not been approved by the architect and inspector of records prior to payment processing. This was the project’s first payment application for \$656,087 and was only approved by the campus manager of construction services.

State University Administrative Manual §9803 states that the contractor’s properly submitted monthly payment request must be approved and signed by the project manager/construction inspector, the design professional, and the construction administrator before payment.

The associate vice president for facilities development and operations stated that the monthly payment in question was the first one of the project and that the manager of construction services was acting as the project manager prior to the assignment of a consultant project manager. He added that during the processing of the payment application, the architect was unavailable due to vacation. He further stated that the decision was made to process the payment, which was only 2.8% of the contract value, on a timely basis rather than be subject to a late payment penalty in accordance with the California Prompt Payment Act.

Inadequate approval of monthly payment applications increases the risk that errors and irregularities will not be detected in a timely manner and may result in unwarranted changes.

Recommendation 2

We recommend that the campus reiterate to staff that monthly payment applications should only be processed with all required approvals.

Campus Response

We concur. The campus has reiterated to staff that all monthly contractor payment applications are to be signed by the project architect prior to approval by the campus project manager.

APPENDIX A: PERSONNEL CONTACTED

Name

Title

Office of the Chancellor

Tom Kennedy

Chief of Architecture and Engineering

Elvyra San Juan

Assistant Vice Chancellor,
Capital Planning, Design and Construction

James Sowerbrower

Chief of Construction Management

California State University, Northridge

Jolene Koester

President

Colin Donahue

Associate Vice President for Facilities Development and Operations

Howard Lutwak

Director, Internal Audit

Tom McCarron

Vice President for Administration and Finance and
Chief Financial Officer

Ken Rosenthal

Manager of Construction Services

California State University
Northridge

Office of the Vice President
Administration and Finance

March 17, 2010

RECEIVED
UNIVERSITY AUDITOR

MAR 23 2010

THE CALIFORNIA STATE
UNIVERSITY

Mr. Larry Mandel, University Auditor
Office of the University Auditor
The California State University
401 Golden Shore, 4th Floor
Long Beach, CA 90802

Subject: Campus Response to Recommendations of Audit Report Number 09-25
Student Housing – Phase I at California State University, Northridge

Dear Larry:

Enclosed please find the California State University, Northridge (CSUN) response to the recommendations of the audit, as requested in your e-mail of March 13, 2010. We have also sent this document via e-mail to adouglas@calstate.edu.

We have read the report including the observations and recommendations, and agree with them. Corrective action to implement all of the recommendations has been taken. By separate correspondence, the applicable documents evidencing completion of our implementation process and corrective action for each recommendation will be provided.

Should there be questions regarding the contents of the response, they may be addressed to Howard Lutwak, Director of Internal Audit, at (818) 677-7647.

We appreciate the recommendations to improve CSUN's systems of internal control.

Sincerely,



Tom McCarron
Vice President Administration and Finance and CFO

Enclosures

cc: Dr. Jolene Koester, President
Howard Lutwak, Director of Internal Audit

CONSTRUCTION
CALIFORNIA STATE UNIVERSITY,
NORTHRIDGE
STUDENT HOUSING – PHASE I
Audit Report 09-25

CONSTRUCTION MANAGEMENT AND ACCOUNTING

PROJECT REPORTING

Recommendation 1

We recommend that the campus reiterate to staff that quarterly capital outlay status reports are to be submitted to CPDC.

Campus Response

We concur. The campus has reiterated to staff that quarterly capital outlay status reports are to be submitted to CPDC.

PAYMENT APPLICATIONS

Recommendation 2

We recommend that the campus reiterate to staff that monthly payment applications should only be processed with all required approvals.

Campus Response

We concur. The campus has reiterated to staff that all monthly contractor payment applications are to be signed by the project architect prior to approval by the campus project manager.

THE CALIFORNIA STATE UNIVERSITY
OFFICE OF THE CHANCELLOR



BAKERSFIELD

April 9, 2010

CHANNEL ISLANDS

CHICO

MEMORANDUM

DOMINGUEZ HILLS

EAST BAY

TO: Mr. Larry Mandel
University Auditor

FRESNO

FROM: Charles B. Reed
Chancellor

FULLERTON

HUMBOLDT

SUBJECT: Draft Final Report 09-25 on *Student Housing – Phase I*,
California State University, Northridge

LONG BEACH

LOS ANGELES

In response to your memorandum of April 9, 2010, I accept the response as submitted with the draft final report on *Student Housing – Phase I*, California State University, Northridge.

MARITIME ACADEMY

MONTEREY BAY

NORTHRIDGE

CBR/amd

POMONA

SACRAMENTO

SAN BERNARDINO

SAN DIEGO

SAN FRANCISCO

SAN JOSÉ

SAN LUIS OBISPO

SAN MARCOS

SONOMA

STANISLAUS