

**CONSTRUCTION**  
**CALIFORNIA STATE UNIVERSITY,**  
**FULLERTON**  
**COLLEGE OF BUSINESS AND ECONOMICS**

**Audit Report 10-10**  
**June 23, 2010**

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**Members, Committee on Audit**

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**BOARD OF TRUSTEES**  
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## **ABBREVIATIONS**

BOT	Board of Trustees
CBE	College of Business and Economics
CM at Risk	Construction Manager at Risk
CPDC	Capital Planning, Design and Construction
CRB	Certification Review Board
CSU	California State University
CSUF	California State University, Fullerton
EO	Executive Order
GMP	Guaranteed Maximum Price
ODC	Office of Design and Construction
OUA	Office of the University Auditor
SUAM	State University Administrative Manual

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## **EXECUTIVE SUMMARY**

At its January 2010 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, Fullerton campus and the offices of the construction manager and selected subcontractors from March 1, 2010, through April 9, 2010, and audited the College of Business and Economics (CBE) 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 CBE 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.

### **PRE-CONSTRUCTION AND BID PROCESS [7]**

The campus did not ensure that the construction manager included all required trade subcontractors on its expanded list of subcontractors submitted with its Guaranteed Maximum Price contract documents.

### **CONSTRUCTION MANAGEMENT AND ACCOUNTING [8]**

Certain construction manager monthly payment applications contained minor mathematical errors in the calculation of retention.

### **CHANGE ORDER ADMINISTRATION [9]**

Certain change orders were not always approved by the project architect.

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## INTRODUCTION

### **BACKGROUND**

In November 2003, the Board of Trustees (BOT) approved a campus master plan revision for the California State University, Fullerton (CSUF) campus, which included a future state-funded College of Business and Economics (CBE) facility. In July 2004, the BOT approved a request to name the CBE facility the Steven G. Mihaylo Hall in recognition of a \$3 million commitment to the campus by Mr. Mihaylo. In December 2004, CSUF executed an agreement with the architectural firm of Hellmuth, Obata + Kassabaum, Inc. for services related and incidental to the design and construction of the CBE project. In February 2005, CSUF executed an agreement with the construction management firm of Turner Construction Company for pre-construction services, which included design and bid phase services. In July 2005, the BOT approved schematic plans for the CBE at a project cost of \$73,948,000 with \$47,417,000 of funding from the 2004 Higher Education Capital Outlay Bond Fund; \$20,166,000 jointly provided from increased donor funding and a loan from a campus auxiliary organization; and \$6,365,000 from future 2006 Higher Education Capital Outlay Bond Fund proceeds.

In January 2006, CSUF executed an agreement for site preparation services with Turner Construction Company at a construction cost of \$3,069,484 and issued the Notice to Proceed on January 17, 2006. This agreement allowed the construction manager to begin the extensive site preparation, including demolishing and asbestos abatement of temporary buildings that were previously located on the site. In July 2006, CSUF executed an agreement for structural phase services with Turner Construction Company at a construction cost of \$12,193,064 and issued the Notice to Proceed on July 7, 2006. This agreement allowed the construction manager to begin foundation, concrete, and structural steel activities for the CBE project. In December 2006, CSUF executed an agreement for building phase services with Turner Construction Company at a construction cost, including the previous structural agreement, of \$60,221,745 and issued a Notice to Proceed on December 18, 2006, with an expected contract completion date of June 5, 2008, that was subsequently extended to July 14, 2008. The State Fire Marshal granted a Conditional Certificate of Occupancy on July 11, 2008, for the purpose of installing the furniture and preparing the building for fall semester classes. The campus filed a Notice of Completion on August 15, 2008.

The CBE facility consists of a 196,229 gross square foot complex of three buildings, including a five-story classroom and office building and two, two-story classroom and lecture hall buildings, all enveloping a central courtyard. The facility accommodates up to 1,853 students in a wide variety of classroom configurations, 220 faculty offices, the dean of the College of Business and Economics suite, and several conference facilities and student support services. The lobby of the main building includes a coffee house and a variety of seating areas and alcoves that facilitate student and faculty interaction. The project also included improvements to the six-lane entrance to the campus and an adjacent parking lot, a new service yard, and extensive landscaping throughout the site.

The CSUF campus managed the CBE project, and it chose the Construction Manager at Risk (CM at Risk) with Guaranteed Maximum Price (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 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 to campus presidents the authority to manage directly 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 policies of the BOT; the campus manages capital projects via a process consistent with the provisions of the State University Administrative Manual (SUAM); 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 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 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.

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 the 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 CBE 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 CBE 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.

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INTRODUCTION

- ▶ 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.

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## OBSERVATIONS, RECOMMENDATIONS, AND CAMPUS RESPONSES

### PRE-CONSTRUCTION AND BID PROCESS

The campus did not ensure that the construction manager included all required trade subcontractors on its expanded list of subcontractors submitted with its Guaranteed Maximum Price (GMP) contract documents.

We found that one trade subcontractor who was paid in excess of one-half of one percent of the base contract was not included on the expanded list of subcontractors provided to the campus with the GMP contract documents. The original value of the trade subcontract was \$2,114,539.

Public Contract Code §4104 and §4110 state that the specifications prepared for the work or the general conditions under which bids will be received shall set forth that the prime contractor will provide the name and location of each subcontractor who will perform work or labor or render services to the prime contractor in an amount in excess of one-half of one percent of the prime contractor's total bid. A prime contractor violating any of the provisions of this chapter (the Subletting and Subcontracting Fair Practices Act, Public Contract Code §4100 *et seq.*) violates his or her contract and the awarding authority may exercise options, including cancelling the contract or assessing the prime contractor a penalty in an amount of not more than ten percent of the amount of the subcontract involved.

The *Contract General Conditions for CM at Risk with Guaranteed Maximum Price Projects* §4.04.c states that when requested by the construction administrator, the construction manager shall submit a subcontractor status report, which will be compared with the expanded list of subcontractors. If any subcontractors are still outstanding at the time of submittal, a follow-up request will be made. Further, if any firms are substituted without approval of the Trustees in accordance with Section 4107(a) of the Public Contract Code, or if subcontractors are added and perform work in excess of one-half of one percent of base contract, penalties are applicable per Section 4110 of the Public Contract Code.

The associate director of the office of design and construction (ODC) stated that the campus was unaware that the construction manager had not listed all required trade subcontractors on the expanded list of subcontractors.

Failure to ensure that the general contractor provides a complete expanded list of subcontractors results in non-compliance with the Subletting and Subcontracting Fair Practices Act and increases the risk that violations of the act will not be detected.

#### **Recommendation 1**

We recommend that the campus reiterate to staff and future construction managers that a complete expanded list of subcontractors must be submitted and any additions or substitutions must be communicated and approved. Further, the campus should consider assessing a penalty of not more

than \$211,454 to the construction manager for violation of the Contract General Conditions and Public Contract Code.

### **Campus Response**

We concur. The campus will reiterate to staff by September 30, 2010, and future construction managers that a complete expanded list of subcontractors must be submitted and any additions or substitutions must be communicated and approved and will consider assessing a penalty to the construction manager for violation of the Contract General Conditions and Public Contract Code.

## **CONSTRUCTION MANAGEMENT AND ACCOUNTING**

Administration of construction manager monthly payment applications required improvement.

The construction manager submitted monthly payment applications requesting payment for construction activities completed to date. We reviewed 65 payment applications and found 37 payment applications with mathematical errors in the calculation of retention.

State University Administrative Manual §9805 states that absent an escrow agreement, from each monthly payment due the contractor, a minimum of five percent is retained until completion of all contract work. The contractor's payment request form for this project indicated five percent.

The ODC associate director stated that the construction manager's standard business practice is to withhold 10 percent retention from all subcontractor payments. He further stated that the construction manager requested the campus withhold this amount from each monthly payment application request; however, the payment request form was not modified to indicate this agreed upon change.

Inadequate administration of construction manager monthly payment applications may result in unwarranted changes and reconciliation issues between campus and construction manager project accounting records, and increases the risk that errors and irregularities will not be detected.

### **Recommendation 2**

We recommend that the campus reiterate to staff that construction manager monthly payment applications should be free of mathematical errors. If errors are detected, the campus should return the payment request to the construction manager, who should then submit a revised payment application to the campus.

### **Campus Response**

We concur. The campus will reiterate to staff by September 30, 2010, that construction manager monthly payment applications should be free of mathematical errors, and if errors are detected, the

payment request should be returned to the construction manager, who should then submit a revised payment application to the campus.

## **CHANGE ORDER ADMINISTRATION**

Certain change orders were not always approved by the project architect.

Specifically, we found that the final 11 change orders, totaling \$492,684, were not approved by the project architect.

The CSU *Construction Management Project Administration Reference Manual* §4.05a states that the design professional shall complete four original copies of the contract change order form, all four copies with original signatures (including the design professional's signature), attach to each copy all back-up materials, and send all four copies to the contractor for signature.

The ODC associate director stated that the campus elected not to retain the architect during the last couple of months of the College of Business and Economics project because their requested fee was excessive for work that was required, including the approval of the final change orders. He further stated that the change order request had already been approved by the architect; it was merely the change order cover sheets that lacked his signature.

Inadequate approval of change orders increases the risk that errors and irregularities will not be detected in a timely manner and may result in unwarranted changes and excess charges and expenses.

### **Recommendation 3**

We recommend that the campus reiterate to staff that change orders are to be approved by the project architect.

### **Campus Response**

We concur. The campus will reiterate to staff by September 30, 2010, that change orders are to be approved by the project architect.

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## APPENDIX A: PERSONNEL CONTACTED

### Name

### Title

#### Office of the Chancellor

Elvyra San Juan

Assistant Vice Chancellor,  
Capital Planning, Design and Construction

#### California State University, Fullerton

Milton A. Gordon

President

Jack Bage

Associate Director of the Office of Design and Construction

Jay Bond

Associate Vice President for Facilities Management

Beverly Burelli

Project Management Assistant

Pat Carroll

Executive Assistant to the President

Naomi Goodwin

Assistant Vice President for Administration and Finance

Willie Hagan

Vice President for Administration and Finance/  
Chief Financial Officer

Bahram Hatefi

Director of Internal Audit



President's Office

800 N. State College Blvd., Fullerton, CA 92831 / T 657-278-3456 / F 657-278-2649

RECEIVED  
UNIVERSITY AUDITOR

AUG - 3 2010

THE CALIFORNIA STATE  
UNIVERSITY

**DATE:** July 21, 2010  
**TO:** Larry Mandel  
University Auditor  
**FROM:** Milton A. Gordon *MA.G.*  
President

**SUBJECT:** Response for College of Business & Economics Audit Report 10-10

I am pleased to forward California State University, Fullerton's official response to the three (3) recommendations in the College of Business & Economics Audit Report 10-10.

Once again, we would like to thank the University Auditor and his staff for conducting the audit in a professional manner in identifying meaningful ways to improve campus construction management policies and procedures, processes and internal controls.

The Campus Auditor, Bahram Hatefi, will also forward the responses to you electronically for your convenience. Should you have questions, please contact Bahram at (657) 278-7299 or [bhatefi@fullerton.edu](mailto:bhatefi@fullerton.edu).

#### Attachments

cc: Jay Bond, Associate Vice President for Facilities Management  
Pat Carroll, Executive Assistant to the President  
Naomi Goodwin, Assistant Vice President, Administration & Finance  
Willie Hagan, Vice President, Administration & Finance CFO  
Bahram Hatefi, Director of CSUF Internal Audit

**CONSTRUCTION**  
**CALIFORNIA STATE UNIVERSITY,**  
**FULLERTON**  
**COLLEGE OF BUSINESS AND ECONOMICS**  
**Audit Report 10-10**

**PRE-CONSTRUCTION AND BID PROCESS**

**Recommendation 1**

We recommend that the campus reiterate to staff and future construction managers that a complete expanded list of subcontractors must be submitted and any additions or substitutions must be communicated and approved. Further, the campus should consider assessing a penalty of not more than \$211,454 to the construction manager for violation of the Contract General Conditions and Public Contract Code.

**Campus Response**

We concur. The campus will reiterate to staff by September 30, 2010 and future construction managers that a complete expanded list of subcontractors must be submitted and any additions or substitutions must be communicated and approved and will consider assessing a penalty to the construction manager for violation of the Contract General Conditions and Public Contract Code.

**CONSTRUCTION MANAGEMENT AND ACCOUNTING**

**Recommendation 2**

We recommend that the campus reiterate to staff that construction manager monthly payment applications should be free of mathematical errors. If errors are detected, the campus should return the payment request to the construction manager, who should then submit a revised payment application to the campus.

**Campus Response**

We concur. The campus will reiterate to staff by September 30, 2010 that construction manager monthly payment applications should be free of mathematical errors and if errors are detected the payment request should be returned to the construction manager, who should then submit a revised payment application to the campus.

## CHANGE ORDER ADMINISTRATION

### **Recommendation 3**

We recommend that the campus reiterate to staff that change orders are to be approved by the project architect.

### **Campus Response**

We concur. The campus will reiterate to staff by September 30, 2010 that change orders are to be approved by the project architect.

THE CALIFORNIA STATE UNIVERSITY  
OFFICE OF THE CHANCELLOR

BAKERSFIELD

CHANNEL ISLANDS

August 26, 2010

CHICO

DOMINGUEZ HILLS

**MEMORANDUM**

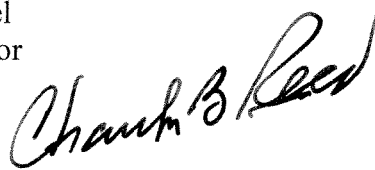
EAST BAY

TO: Mr. Larry Mandel  
University Auditor

FRESNO

FULLERTON

FROM: Charles B. Reed  
Chancellor



HUMBOLDT

SUBJECT: Draft Final Report 10-10 on the *College of Business and Economics*,  
California State University, Fullerton

LONG BEACH

LOS ANGELES

MARITIME ACADEMY

In response to your memorandum of August 26, 2010, I accept the response as submitted with the draft final report on the *College of Business and Economics*, California State University, Fullerton.

MONTEREY BAY

NORTHRIDGE

POMONA

CBR/amd

SACRAMENTO

SAN BERNARDINO

SAN DIEGO

SAN FRANCISCO

SAN JOSÉ

SAN LUIS OBISPO

SAN MARCOS

SONOMA

STANISLAUS