CONSTRUCTION

CALIFORNIA STATE UNIVERSITY,
CHANNEL ISLANDS

CLASSROOM AND FACULTY OFFICE
RENOVATION/ADDITION – NORTH HALL

Audit Report 13-13
March 27, 2014

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ABBREVIATIONS

AVP          Associate Vice President
BOT          Board of Trustees
CM           Construction Manager
CM at Risk   Construction Manager at Risk
CPDC         Capital Planning, Design and Construction
CRB          Certification Review Board
CSU          California State University
CSUCI        California State University, Channel Islands
EO           Executive Order
GMP          Guaranteed Maximum Price
ICSUAM       Integrated California State University Administrative Manual
North Hall   Classroom and Faculty Office Renovation/Addition – North Hall
OAAS         Office of Audit and Advisory Services
EXECUTIVE SUMMARY

At its January 2013 meeting, the Board of Trustees directed the Office of Audit and Advisory Services (OAAS) to review construction activity. Construction auditing had been performed by KPMG since fiscal year 1997/98 with coordination from the OAAS. In fiscal year 2008/09, OAAS staff began performing construction audits.

We visited the California State University, Channel Islands campus and the offices of the construction manager and selected subcontractors from December 2, 2013, through January 17, 2014, and audited the Classroom and Faculty Office Renovation/Addition – North Hall (North Hall) project focusing on the construction management policies and procedures and internal controls and processes in effect at that time.

In our opinion, the fiscal, operational, and administrative controls in effect for the North Hall project were sufficient to meet the objectives stated in the “Purpose” section of this report.

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 accurately included all required trade subcontractors on its expanded list of subcontractors submitted with its Guaranteed Maximum Price contract documents.

CONSTRUCTION MANAGEMENT AND ACCOUNTING [8]

Administration of Group II equipment needed improvement. Specifically, one high-risk equipment item classified as a non-capitalized asset was missing an asset tag, and two telecom switches, both classified as non-capitalized assets, were not listed on the property inventory records.

CHANGE ORDER ADMINISTRATION [9]

Administration of trade subcontractor labor rates and associated labor burden needed improvement. Specifically, one subcontractor charged an inflated labor rate by calculating labor burden rates on federal and state insurance contribution payments and fringe benefits, thus increasing the labor cost for this trade subcontractor by $2,154.
PROJECT COMPLETION AND CLOSEOUT [10]

The campus filed the Notice of Completion for the North Hall project three months prior to completing the certification of completion.
INTRODUCTION

BACKGROUND

In May 2008, the Board of Trustees (BOT) approved schematic plans for the California State University, Channel Islands (CSUCI) Classroom and Faculty Office Renovation/Addition – North Hall (North Hall) project at a cost of $33,826,000, with funding from lease revenue bonds and the Higher Education Capital Outlay Bonds Funds of 2004 and 2006.

In October 2007, the campus executed an agreement with CO Architects for services related and incidental to the design and construction of the North Hall project. It also executed an agreement with the construction manager (CM), HMH Construction, Inc., for pre-construction services that included design and bid phase services. In September 2010, the campus executed a guaranteed maximum price (GMP) agreement with the CM for construction phase services at a cost of $24,795,840, and issued a Notice to Proceed on September 3, 2010, with a completion date of September 2, 2012. The State Fire Marshal granted a Certificate of Occupancy on August 24, 2012, and the campus filed the Notice of Completion on September 20, 2012.

The North Hall project included renovating an existing 45,023-square-foot unoccupied two-story building and adding a new 27,149-square-foot three-story building at the south end of the North Quad. As part of the project, faculty offices and office support spaces were renovated, and new classrooms, instructional laboratory stations, instructional support space, administrative offices, and a lecture hall were built. Site improvements included the development of a courtyard south of the project and the creation of landscaped sections along the southern portion. The project included the re-use of three-quarters of the existing structure, improvements to the thermal envelope, installation of new windows and glass doors, and extensive use of natural light and ventilation. In addition, the landscaping made extensive use of drought-tolerant plants and reclaimed water for all irrigation, and protected at least 20 mature trees in the courtyard adjacent to the existing building for solar protection and decreased heat-island effect.

The CSUCI campus managed the North Hall 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 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 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 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 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.

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 ICSUAM guidelines; and the use of systemwide standardized architectural, engineering, and other professional appointment contract forms.

The ICSUAM, in part, contains an overview of all CPDC policies and procedures associated with the capital outlay process. ICSUAM §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. ICSUAM §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 California State University (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 North Hall 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 ICSUAM.
- Professional appointments are in accordance with statutory requirements, BOT policy, and the ICSUAM; 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 ICSUAM, 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 ICSUAM.
- 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 ICSUAM.
- Group II equipment is properly managed and accounted for, purchased materials meet specifications required by construction documents and drawings, and all required inspections and tests are timely and properly performed and adequately documented.
INTRODUCTION

- 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 whether fiscal, 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 North Hall project with an emphasis on compliance with the CSU Construction Management Procedures Manual, ICSUAM 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

PRE-CONSTRUCTION AND BID PROCESS

The campus did not ensure that the construction manager (CM) accurately 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 final expanded list of subcontractors, and bid amounts on the expanded list for two other subcontractors were significantly below the actual bid. The value of the trade subcontract not listed was $341,000, and the combined total understatement of the bids from the other two subcontractors was $3,937,225.

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 CM 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 the base contract, penalties are applicable per Section 4110 of the Public Contract Code.

The associate vice president (AVP) for facilities services stated that the one subcontractor was not listed on the expanded list of subcontractors due to oversight, and the incorrect bid amounts for the other two subcontractors were due to typographical errors.

The absence of a complete and accurate expanded list of subcontractors results in noncompliance 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:

a. Reiterate to staff and future CMs that the expanded list of subcontractors submitted with the GMP contract documents must be complete and accurate.

b. Consider assessing a penalty of not more than $34,100 on the CM for violation of the Contract General Conditions and Public Contract Code.

Campus Response

a. The campus will reiterate to staff and future CMs that the expanded list of subcontractors submitted with the GMP contract documents must be complete and accurate. This will be included as a part of a training program. A copy of the training agenda and sign-in sheet will be provided by August 31, 2014.

b. The campus will consider assessing a penalty of not more than $34,100 on the CM for violation of the Contract General Conditions and Public Contract Code. Results of the assessment will be reported by August 31, 2014.

CONSTRUCTION MANAGEMENT AND ACCOUNTING

Administration of Group II equipment needed improvement.

Specifically, we found that:

- One of ten sensitive and high-risk equipment items classified as non-capitalized assets that we reviewed was missing an asset tag.

- Two telecom switches, both classified as non-capitalized assets, were not listed on the property inventory records.

California State University, Channel Islands (CSUCI) Procedures for Asset Tagging Computers states in part that when the computer arrives in shipping and receiving, the operations, planning, and construction department enters the receipt information into CMS, and it is then physically delivered to information technology, and the technician images the computer, prepares software, and places an asset tag on the computer.

CSUCI University Property Guidelines states in part that non-capitalized assets consist of any campus property, tangible or intangible, with an acquisition cost greater than $1,000 but less than $5,000 per unit including tax, shipping, and installation costs. Property inventory records keeps a listing of capitalized and non-capitalized assets. The data stored includes the asset tag, date acquired, description, purchase order number, location description, and fund.
The AVP for facilities services stated that the computer was untagged due to oversight or because students had removed the tag. He further stated that the telecom switches were not listed on the property inventory records due to anticipated changes to the property guidelines regarding dollar thresholds on asset tagging and classification of non-capitalized assets.

Insufficient control over equipment increases the risk of theft, loss, or unauthorized use of state property and misstated property records.

**Recommendation 2**

We recommend that the campus:

a. Properly tag all Group II equipment, including sensitive and high-risk equipment and items classified as non-capitalized assets, with a unique identification number.

b. List all non-capitalized assets on the property inventory records, including the asset tag, date acquired, description, purchase order number, location description, and fund.

**Campus Response**

a. The campus will tag and provide a list of all Group II equipment with unique identifying numbers assigned by August 31, 2014.

b. The campus will provide copies of property inventory records to include the asset tag number, date acquired, description, purchase order number, location description, and fund by August 31, 2014.

**CHANGE ORDER ADMINISTRATION**

Administration of trade subcontractor labor rates and associated labor burden needed improvement.

We reviewed hourly labor rates and the associated labor burden charged by two subcontractors for a sample of change orders, and we found that one subcontractor charged an inflated labor rate by calculating labor burden rates on federal and state insurance contribution payments and fringe benefits. The inclusion of these inflated rates increased the labor cost for this trade subcontractor by $2,154.

The *Contract General Conditions for CM at Risk with Guaranteed Maximum Price Projects* §6.01.b (1) states that the construction manager and trade contractors shall submit a fully detailed breakdown of the cost of every labor classification to be utilized on a proposed change on the hourly labor rate worksheet. The unit cost of labor shall be an accurate accounting of actual costs being paid.

The AVP for facilities services stated that the CM and trade contractors were instructed to use the spreadsheet templates provided by the California State University Capital Planning, Design, and
Construction (CPDC) website and that the campus did review the labor rate sheets; however, the errors may have been due to oversight.

Insufficient review of hourly labor rates and the associated labor burden charged to the project may result in increased project costs.

**Recommendation 3**

We recommend that the campus:

a. Pursue recovery of the $2,154 in inflated labor costs charged by the trade subcontractor and determine, as appropriate, if other change order work performed by the trade subcontractor was cost-inflated in a similar manner. The results of this recovery should be reported to the CPDC.

b. Conduct staff training to ensure that hourly labor rates and the associated labor burden charged by trade subcontractors are properly reviewed and accurate in accordance with §6.00, Changes in the Work, of the Contract General Conditions for CM at Risk with Guaranteed Maximum Price Projects.

**Campus Response**

a. The campus will pursue recovery of the $2,154 charged by the trade subcontractor by sending a demand letter to the general contractor. A copy of the demand letter and any response to it, as well as results of the review of hourly labor rate worksheets, will be submitted by August 31, 2014.

b. The campus will conduct staff training to ensure that hourly labor rates and the associated labor burden charged by trade subcontractors are properly reviewed and accurate in accordance with §6.00, Changes in the Work, of the Contract General Conditions for CM at Risk with Guaranteed Maximum Price Projects. This will be included as a part of a training program. A copy of the training agenda and sign-in sheet will be provided by August 31, 2014.

**PROJECT COMPLETION AND CLOSEOUT**

The campus filed the Notice of Completion (NOC) for the North Hall project three months prior to completing the certification of completion (COC).

Integrated California State University Administrative Manual §9830, *Contract Completion and Acceptance of Construction*, states that the process for inspection and acceptance of completed contract work includes a pre-final inspection of construction, which may include preparation of a punch list for any deviations or delinquencies in the work, and a final inspection, which includes completion of the project closeout checklist and certification of completion by the designer/architect, project manager/construction inspector, and construction administrator. Upon completion, the
construction administrator files a Notice of Completion with the county recorder of the county where the project is located.

The AVP for facilities services stated that after the first and second floors were completed, the CM, HMH Construction, Inc., closed its business and could not complete the third floor. He stated that at this point, management decided to redesign the original plan for the third floor, which meant that the project had to be separated into two contracts, with a separate contract for the third floor. He further stated that this situation led to management filing the NOC earlier than the COC, as it was decided to be in the best interest of the Trustees.

Filing the NOC before completing the COC increases the risk of misunderstandings and miscommunication regarding rights and responsibilities.

**Recommendation 4**

We recommend that the campus reiterate to staff that the COC should be prepared prior to the filing of the NOC.

**Campus Response**

The campus acknowledges that unique circumstances caused deviation from this standard campus practice. Regardless, the campus will reiterate to staff during training that the COC should be prepared prior to the filing of the NOC. A copy of the training agenda and sign-in sheet will be provided by August 31, 2014.
### APPENDIX A:
### PERSONNEL CONTACTED

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<tr>
<td><strong>Office of the Chancellor</strong></td>
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<tr>
<td>James Hoffman</td>
<td>Chief of Construction Management</td>
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<tr>
<td>Elvyra San Juan</td>
<td>Assistant Vice Chancellor, Capital Planning, Design and Construction</td>
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<td>Richard R. Rush</td>
<td>President</td>
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<td>Manager of Administrative Services, Facilities Services</td>
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<td>Associate Director, Planning, Design and Construction</td>
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**California State University, Channel Islands**

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May 2, 2014

Mr. Larry Mandel
Vice Chancellor and Chief Audit Officer
The California State University
401 Golden Shore, 4th Floor
Long Beach, CA  90802-4200

RE: Campus Responses to Recommendations: Audit Report 13-13 North Hall

Dear Mr. Mandel,

Attached please find CI’s campus response to the North Hall Audit 13-13.

Upon acceptance, we will follow up with your office to provide supporting documentation for each of the recommendations by the anticipated completion dates.

Please let me know if you have any questions or would like further information related to the attached response.

Sincerely,

Ysabel Trinidad
Vice President for Business and Financial Affairs

Enclosure

cc: President Richard Rush
CONSTRUCTION
CALIFORNIA STATE UNIVERSITY,
CHANNEL ISLANDS
CLASSROOM AND FACULTY OFFICE
RENOVATION/ADDITION – NORTH HALL
Audit Report 13-13

PRECONSTRUCTION AND BID PROCESS

Recommendation 1

a. Reiterate to staff and future CMs that the expanded list of subcontractors submitted with the GMP contract documents must be complete and accurate.

b. Consider assessing a penalty of not more than $34,100 on the CM for violation of the Contract General Conditions and Public Contract Code.

Campus Response

a. The campus will reiterate to staff and future CMs that the expanded list of subcontractors submitted with the GMP contract documents must be complete and accurate. This will be included as a part of a training program. A copy of the training agenda and sign-in sheet shall be provided by August 31, 2014.

b. The campus will consider assessing a penalty of not more than $34,100 on the CM for violation of the Contract General Conditions and Public Contract Code. Results of the assessment will be reported by August 31, 2014.

CONSTRUCTION MANAGEMENT AND ACCOUNTING

Recommendation 2

a. Properly tag all Group II equipment, including sensitive and high-risk equipment and items classified as non-capitalized assets, with a unique identification number.

b. List all non-capitalized assets on the property inventory records, including the asset tag, date acquired, description, purchase order number, location description, and fund.

Campus Response

a. The campus will tag and provide a list of all Group II equipment with unique identifying numbers assigned by August 31, 2014.
b. The campus will provide copies of property inventory records to include: the asset tag number, date acquired, description, purchase order number, location description, and fund by August 31, 2014.

CHANGE ORDER AUTHORIZATION

Recommendation 3

a. Pursue recovery of the $2,154 in inflated labor costs charged by the trade subcontractor and determine, as appropriate, if other change order work performed by the trade subcontractor was cost-inflated in a similar manner. The results of this recovery should be reported to the CPDC.

b. Conduct staff training to ensure that hourly labor rates and the associated labor burden charged by trade subcontractors are properly reviewed and accurate in accordance with Section 6.00, Changes in the Work, of the Contract General Conditions for CM at Risk with Guaranteed Maximum Price Projects.

Campus Response

a. The campus will pursue recovery of the $2,154 charged by the trade subcontractor by sending a demand letter to the general contractor. A copy of the demand letter and any response to it, as well as, results of the review of hourly labor rate worksheets will be submitted by August 31, 2014.

b. The campus will conduct staff training to ensure that hourly labor rates and the associated labor burden charged by trade subcontractors are properly reviewed and accurate in accordance with Section 6.00, Changes in the Work, of the Contract General Conditions for CM at Risk with Guaranteed Maximum Price Projects. This will be included as a part of a training program. A copy of the training agenda and sign-in sheet shall be provided by August 31, 2014.

PROJECT COMPLETION AND CLOSEOUT

Recommendation 4

We recommend that the campus reiterate to staff that the COC should be prepared prior to the filing of the NOC.

Campus Response

The campus acknowledges unique circumstances caused deviation from this standard campus practice. Regardless, the campus will reiterate to staff that the COC should be prepared prior to the filing of the NOC during training. A copy of the training agenda and sign in sheet shall be provided by August 31, 2014.
May 9, 2014

MEMORANDUM

TO: Mr. Larry Mandel
Vice Chancellor and Chief Audit Officer

FROM: Timothy P. White
Chancellor

SUBJECT: Draft Final Report 13-13 on the
Classroom and Faculty Office Renovation/Addition – North Hall,
California State University, Channel Islands

In response to your memorandum of May 9, 2014, I accept the response as
submitted with the draft final report on the Classroom and Faculty Office
Renovation/Addition – North Hall, California State University, Channel Islands.

TPW/ amd