CONSTRUCTION

CALIFORNIA STATE UNIVERSITY,
SAN MARCOS

UNIVERSITY STUDENT UNION

Audit Report 14-10
September 24, 2014

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ABBREVIATIONS

BOT  Board of Trustees
COC  Certification of Completion
CPDC Capital Planning, Design and Construction
CRB  Certification Review Board
CSU  California State University
CSUSM California State University, San Marcos
EO   Executive Order
ICSUAM Integrated California State University Administrative Manual
LEED Leadership in Energy and Environmental Design
NOC  Notice of Completion
OAAS Office of Audit and Advisory Services
PDC  Planning, Design and Construction
USU  University Student Union
EXECUTIVE SUMMARY

At its January 2014 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, San Marcos campus and the offices of the design-builder and selected subcontractors from June 2, 2014, through July 3, 2014, and audited the University Student Union (USU) 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 USU 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.

PROJECT COMPLETION AND CLOSEOUT [7]

The campus filed the Notice of Completion for the University Student Union project approximately two months prior to completing the certification of completion.
INTRODUCTION

BACKGROUND

In July 2010, the Board of Trustees (BOT) approved an amendment to the 2010/11 non-state-funded capital outlay program to include a proposed student union project for California State University, San Marcos (CSUSM). In March 2011, the BOT approved schematic plans for the CSUSM University Student Union (USU) at a project cost of $43,981,000, with $30,181,000 in funding from systemwide revenue bonds, to be repaid from student fees and San Marcos University Corporation reserves of $13,800,000.

In August 2010, the campus solicited project bids and selected PCL Construction Services, Inc. as the design-builder. The campus executed a design and construction agreement with PCL Construction Services, Inc. on April 26, 2011, at a cost of $31,950,000, and issued the Notice to Proceed on February 8, 2012, with a completion date of September 26, 2013. The campus took beneficial occupancy on December 23, 2013, and filed the Notice of Completion on May 9, 2014.

The USU project is a new 90,000-square-foot facility located southwest of the Clarke Field House that includes a large ballroom, meeting rooms, Associated Students and student organization offices, food services, and recreational areas. The USU has four levels, conforming to the natural slope declination from the top Forum Plaza level down to Cesar Chavez Circle. The design utilizes a steel-braced frame that wraps around an interior courtyard with a presentation stage and terraced seating. Much of the building’s facade is a composition of large-scale, stone-like textured ceramic tiles and a floor-to-ceiling glass curtain wall. Sustainable features include extensive use of day lighting, high-performance glazing, and photovoltaics on a significant portion of the flat roof areas. The project achieved a Leadership in Energy and Environmental Design (LEED) gold rating. 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 CSUSM campus managed the USU project, and it chose the Design-Build delivery method. In this method, the design and construction aspects are contracted with a single design-builder who has full responsibility for finalizing and implementing a design that meets or exceeds California State University’s (CSU) performance expectations. The design-build entity is responsible for the adequacy of design and any construction defects, which allows the CSU to avoid these types of claims and limits errors and omissions change orders. Further, the design-build approach shortens project completion by overlapping the design and construction project phases. This approach also minimizes the university’s need to schedule and coordinate the overall project, although clear specifications of CSU performance requirements and high-quality inspection of work in progress are required to fully realize the benefits of this approach.
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 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.
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 USU 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 USU 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 MANAGEMENT RESPONSES

PROJECT COMPLETION AND CLOSEOUT

The campus filed the Notice of Completion (NOC) for the University Student Union (USU) project approximately two months prior to completing the certification of completion (COC).

Integrated California State University Administrative Manual (ICSUAM) §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 planning, design, and construction (PDC) director stated that PDC reviewed the criteria and did not believe there was a requirement for the two documents to be completed sequentially, and therefore, did not believe there was any violation.

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

Recommendation 1

We recommend that the chancellor’s office Capital Planning, Design and Construction department provide clarification of the closeout process and address when the COC and NOC should be filed.

Management Response

We concur. The chancellor’s office Capital Planning, Design and Construction division will modify as recommended the two construction management forms used in the project closeout process, the project closeout checklist form and the certification of completion form, now called the Certification of Completion/Release of Retention form.

This recommendation will be completed by December 2014.
## APPENDIX A: PERSONNEL CONTACTED

<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
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<tbody>
<tr>
<td><strong>Office of the Chancellor</strong></td>
<td></td>
</tr>
<tr>
<td>Steve Relyea</td>
<td>Executive Vice Chancellor and Chief Financial Officer</td>
</tr>
<tr>
<td>James Hoffman</td>
<td>Chief of Construction Management, Capital Planning, Design and Construction</td>
</tr>
<tr>
<td>Michael P. Redmond</td>
<td>Acting Assistant Vice Chancellor, Headquarters Building Security and Strategic Initiatives</td>
</tr>
<tr>
<td>Elvyra San Juan</td>
<td>Assistant Vice Chancellor, Capital Planning, Design and Construction</td>
</tr>
<tr>
<td><strong>California State University, San Marcos</strong></td>
<td></td>
</tr>
<tr>
<td>Karen S. Haynes</td>
<td>President</td>
</tr>
<tr>
<td>Candace Bebee</td>
<td>Assistant to the Vice President, Finance and Administrative Services</td>
</tr>
<tr>
<td>Gary Cinnamon</td>
<td>Associate Vice President, Facilities Development and Management</td>
</tr>
<tr>
<td>Brad Fenton</td>
<td>Director, Planning, Design and Construction</td>
</tr>
<tr>
<td>Linda Hawk</td>
<td>Vice President, Finance and Administrative Services</td>
</tr>
<tr>
<td>Steve Ramirez</td>
<td>Project Manager, Planning, Design, and Construction</td>
</tr>
<tr>
<td>Katy Rees</td>
<td>Associate Vice President, Administration</td>
</tr>
<tr>
<td>Mui Sullivan</td>
<td>Capital Budget Analyst, Planning, Design, and Construction</td>
</tr>
<tr>
<td>Melinda Thurmond</td>
<td>Project Manager, Planning, Design, and Construction</td>
</tr>
<tr>
<td>Randy Wood</td>
<td>Inspector of Record, Planning, Design, and Construction</td>
</tr>
</tbody>
</table>
DATE: November 6, 2014

TO: Larry Mandel
    Vice Chancellor and Chief Audit Officer

FROM: Steve Relyea
      Executive Vice Chancellor and
      Chief Financial Officer

SUBJECT: University Student Union Construction, CSU San Marcos Audit Report #14-10

In response to the "Incomplete Draft" report dated September 24, 2014, we are providing the enclosed management response.

Should you have any questions, please contact us.

SR: mpr

Attachment

c: Elvyra San Juan, Assistant Vice Chancellor, Capital Planning, Design, and Construction
   Mike Redmond, Acting Assistant Vice Chancellor, Headquarters Building Security and
   Strategic Initiatives
PROJECT COMPLETION AND CLOSEOUT

Recommendation 1

We recommend that the chancellor’s office Capital Planning, Design and Construction department provide clarification of the closeout process and address when the COC and NOC should be filed.

Management Response

We concur. The chancellor’s office Capital Planning, Design and Construction division will modify as recommended the two construction management forms used in the project closeout process, the Project Closeout Checklist form and the Certification of Completion form, now called Certification of Completion/Release of Retention form.

This recommendation will be completed by December 2014.
December 2, 2014

MEMORANDUM

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

FROM:      Timothy P. White
            Chancellor

SUBJECT:   Draft Final Report 14-10 on the University Student Union,
            California State University, San Marcos

In response to your memorandum of December 2, 2014, I accept the response
as submitted with the draft final report on the University Student Union,
California State University, San Marcos.

TPW/amd