

CONSTRUCTION
CALIFORNIA STATE UNIVERSITY,
LOS ANGELES
STUDENT UNION REPLACEMENT

Audit Report 09-29
April 27, 2010

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ABBREVIATIONS

BOT	Board of Trustees
CPDC	Capital Planning, Design and Construction
CRB	Certification Review Board
CSU	California State University
CSULA	California State University, Los Angeles
EO	Executive Order
FPC	Facilities Planning and Construction
ITS	Information Technology Services
OUA	Office of the University Auditor
Student Union	Student Union Replacement
SUAM	State University Administrative Manual
Union	University-Student Union Board, California State University, Los Angeles

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, Los Angeles campus and the offices of the design-builder and selected subcontractors from October 26, 2009, through December 3, 2009, and audited the Student Union Replacement (Student Union) 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 Student Union 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.

GENERAL CONTROL ENVIRONMENT [7]

The facilities planning and construction accountant and facilities planner/project manager were not connected to the campus server shared drive, which hindered the daily backup and off-site storage of project records and other department data.

CONSTRUCTION MANAGEMENT AND ACCOUNTING [7]

The campus did not submit quarterly capital outlay status reports for the Student Union project to the chancellor's office Capital Planning, Design and Construction department for the duration of the project.

CHANGE ORDER ADMINISTRATION [8]

Inflated labor rates for one trade subcontractor and an erroneous burden computation by another trade subcontractor inflated labor costs by \$11,763. Further, the hourly labor rate for a third trade subcontractor lacked sufficient detail to support fringe benefits and burden rate charges.

INTRODUCTION

BACKGROUND

In October 2004, California State University, Los Angeles (CSULA) executed an agreement with the architectural firm of Tate Snyder Kimsey to develop a conceptual design and schematic plans for the Student Union Replacement (Student Union). In May 2005, the Board of Trustees (BOT) approved schematic plans for the CSULA Student Union project at a project cost of \$39,882,000. The project was jointly funded with \$11,500,000 from University-Student Union Board, California State University, Los Angeles (Union) reserves and the remaining \$28,382,000 through the California State University (CSU) Systemwide Revenue Bond Program. The BOT also acknowledged and determined that the project was consistent with the already adopted master plan for the university, as the Student Union project was a replacement of the previous existing building.

In May 2005, the campus also executed a construction agreement with Douglas E. Barnhart, Inc., with two Notices to Proceed. Phase I, the design phase, was to commence on June 7, 2005. Phase II, the construction phase, was to commence on May 2, 2006, with a contract completion date of November 3, 2007. Due to various construction and site condition delays, the completion date was revised to August 4, 2008.

The Student Union, designed by HMC Architects, is a 92,000 gross square foot facility, which replaced a previous student union building. The new facility is a primary gathering place for student activities and a major pedestrian axis point between various buildings. The building includes expanded food services, outdoor space for a variety of activities, and a new westerly entrance point. The overall building form and site plan is an oval shape urban plaza styled for student gatherings. The second floor has entrances to food services and dining, a computer center, a multipurpose 200-seat theater, and a fitness center. The building also includes meeting rooms and (Union) administrative and staff offices.

The CSULA campus managed the Student Union 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 CSU's 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 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 Student Union 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 Student Union 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.

INTRODUCTION

The scope of the audit was limited because one of the subcontractors selected for review was no longer in business, preventing our review and inquiry into its construction activity and transactions. We obtained the design-builder's assistance as much as possible for all transactions relating to this trade subcontractor.

OBSERVATIONS, RECOMMENDATIONS, AND CAMPUS RESPONSES

GENERAL CONTROL ENVIRONMENT

The facilities planning and construction (FPC) department data backup procedures required improvement.

We found that the FPC accountant and facilities planner/project manager were no longer connected to the campus server shared drive due to a change in office location, which hindered the daily backup and off-site storage of project records and other department data. The FPC department currently performed manual backups onto flash memory drives and compact discs, on either a weekly or a tri-monthly basis, and kept those backup media in a desk draw on-site.

The California State Information Security Office, *Information Security Program Guide for State Agencies*, dated April 2008, states that best practices include establishing procedures for an agreed-upon backup policy and strategy, including the extent (e.g., full or differential/incremental), frequency, off-site storage, testing, physical and environmental protection, restoration, and encryption.

The FPC interim director stated that since his office had moved to its present temporary facilities, it had not been given access to the campus shared drives, which would have permitted automated daily data backup.

Insufficient data backup procedures increase the risk that project records and other department data will not be recovered in the event of a disaster or loss, which would require employees to spend significant time recreating the department's daily workflow of information.

Recommendation 1

We recommend that the campus migrate FPC department data onto network shared drives that are backed up daily by the campus information technology service center.

Campus Response

The FPC department is working with the information technology services (ITS) to create a network drive for FPC which is maintained by ITS. The anticipated completion date is July 31, 2010.

CONSTRUCTION MANAGEMENT AND ACCOUNTING

The campus did not submit quarterly capital outlay status reports for the Student Union Replacement (Student Union) project to the chancellor's office Capital Planning, Design and Construction (CPDC) department for the duration of the project.

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 FPC interim director stated that it was an oversight that the capital outlay status reports were not updated for the Student Union project.

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 2

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

Campus Response

Procedures regarding submission of the quarterly capital outlay status reports were reiterated to staff in May 2010.

CHANGE ORDER ADMINISTRATION

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

We reviewed labor rates charged by three trade subcontractors and noted variations from the hourly rate worksheets previously submitted to the campus.

- ▶ The hourly labor rates for one trade subcontractor included inflated rates for federal unemployment taxes and health/welfare fringe benefits resulting in a \$7.59 per hour overcharge. Based on the total hours this trade subcontractor billed, labor cost for this trade subcontractor was inflated by \$8,513.
- ▶ The labor burden for the second trade subcontractor was erroneously computed on the hourly base rate plus fringe costs rather than solely on the base hourly rate. This erroneous computation inflated labor cost for this trade subcontractor by \$2,960.
- ▶ The hourly labor rate for the third trade subcontractor lacked sufficient detail to support fringe benefits and burden rate charges.

The *Contract General Conditions for Design-Build Projects* §37.01.b (1) states that costs are allowed for the actual payroll costs to the design-builder for labor, field supervision of changed work, and engineering or technical services directly required for the performance of the changed

work. Costs include payments, assessments, or benefits required by lawful labor union collective bargaining agreements, compensation insurance payments, liability insurance premiums on labor only, contributions made to the state pursuant to the Unemployment Insurance Code, and for taxes paid to the federal government required by the Social Security Act.

The FPC interim director stated that although they did receive the labor rate worksheets and payroll records for all the subcontractors, their review was based upon reasonableness of the wage rates compared to prevailing wages.

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

Recommendation 3

We recommend that the campus:

- a. Pursue recovery of the \$11,473 in inflated labor costs for federal unemployment taxes, health/welfare fringe benefits, and burden rates.
- b. Conduct staff training to ensure that hourly labor rates and the associated labor burden charged by trade subcontractors are appropriate and accurate in accordance with §37.00, Changes in the Work, of the *Contract General Conditions for Design-Build Projects*.

Campus Response

- a. The campus recovered \$11,710 from the design builder in March 2010.
- b. The campus is coordinating with CPDC to conduct staff training session to ensure that hourly labor rates and associated labor burden charged by the trade subcontractors are appropriate and accurate. We anticipate completion by June 30, 2010.

APPENDIX A: PERSONNEL CONTACTED

Name

Title

Office of the Chancellor

Elvyra San Juan

Assistant Vice Chancellor,
Capital Planning, Design and Construction

California State University, Los Angeles

James M. Rosser

President

Lisa Chavez

Interim Vice President for Administration/Chief Financial Officer

Roger Christman

Interim Director, Facilities Planning and Construction

Tanya Ho

University Internal Auditor

George Pardon

Vice President for Administration/Chief Financial Officer
(At time of review)

Sarab Singh

Facilities Planner/Project Manager



CALIFORNIA STATE UNIVERSITY, LOS ANGELES

OFFICE OF THE PRESIDENT

June 16, 2010

RECEIVED
UNIVERSITY AUDITOR

JUN 17 2010

THE CALIFORNIA STATE
UNIVERSITY

Mr. Larry Mandel, University Auditor
Office of the University Auditor
Office of the Chancellor – The California State University
401 Golden Shore, 4th Floor
Long Beach, CA 90802-4210

Re: *University's Response to Recommendations Contained in Report Number 09-29
Student Union Replacement Construction Audit*

Dear Mr. Mandel:

Attached are the University's responses to the recommendations contained in Report Number 09-29,
Student Union Replacement Construction Audit.

Please contact Tanya Ho, University Internal Auditor, at (323) 343-5102, if you wish to discuss any matter
contained herein.

Sincerely,

A handwritten signature in black ink, appearing to read "James M. Rosser".

James M. Rosser
President

Attachment

cc: (with attachments)
Lisa Chavez, Interim Vice-President for Administration and Chief Financial Officer
Mae Santos, Interim Assistant Vice-President for Administration
Roger Christman, Interim Director, Facilities Planning and Construction
Tanya Ho, University Internal Auditor
Jill Carnahan, University Compliance Officer

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GENERAL CONTROL ENVIRONMENT

Recommendation 1

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Campus Response

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CONSTRUCTION MANAGEMENT AND ACCOUNTING

Recommendation 2

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

Campus Response

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CHANGE ORDER ADMINISTRATION

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We recommend that the campus:

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THE CALIFORNIA STATE UNIVERSITY
OFFICE OF THE CHANCELLOR



BAKERSFIELD

CHANNEL ISLANDS

July 2, 2010

CHICO

MEMORANDUM

DOMINGUEZ HILLS

EAST BAY

TO: Mr. Larry Mandel
University Auditor

FRESNO

FULLERTON

FROM: Charles B. Reed
Chancellor

HUMBOLDT

SUBJECT: Draft Final Report 09-29 on the *Student Union Replacement*,
California State University, Los Angeles

LONG BEACH

LOS ANGELES

MARITIME ACADEMY

In response to your memorandum of July 2, 2010, I accept the response as submitted with the draft final report on the *Student Union Replacement*, California State University, Los Angeles.

MONTEREY BAY

NORTHRIDGE

POMONA

CBR/amd

SACRAMENTO

SAN BERNARDINO

SAN DIEGO

SAN FRANCISCO

SAN JOSÉ

SAN LUIS OBISPO

SAN MARCOS

SONOMA

STANISLAUS