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September 1, 2016

Dr. Leroy M. Morishita, President
California State University, East Bay
25800 Carlos Bee Boulevard
Hayward, CA 94542

Dear Dr. Morishita:

Subject: Audit Report 16-10, Warren Hall Replacement Building, California State University, East Bay

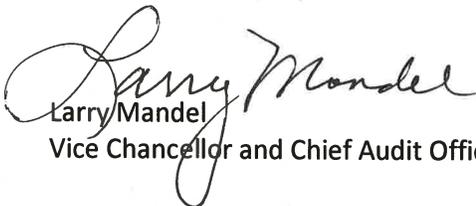
We have completed an audit of the *Warren Hall Replacement Building* construction project as part of our 2016 Audit Plan, and the final report is attached for your reference. The audit was conducted in accordance with the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*.

I have reviewed the management response and have concluded that it appropriately addresses our recommendation. The management response has been incorporated into the final audit report, which has been posted to the Office of Audit and Advisory Services' website. We will follow-up on the implementation of corrective actions outlined in the response and determine whether additional action is required.

Any observations not included in this report were discussed with your staff at the informal exit conference and may be subject to follow-up.

I wish to express my appreciation for the cooperation extended by the campus personnel over the course of this review.

Sincerely,



Larry Mandel
Vice Chancellor and Chief Audit Officer

c: Timothy P. White, Chancellor

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CONSTRUCTION

**California State University,
East Bay**

Warren Hall Replacement Building

Audit Report 16-10
August 15, 2016

EXECUTIVE SUMMARY

OBJECTIVE

The objectives of the audit were to ascertain the effectiveness of construction management policies and procedures related to the fiscal, operational, and administrative controls over construction activities, determine the adequacy of internal controls and processes, identify cost recovery opportunities, and ensure compliance with relevant governmental regulations, Trustee policy, Office of the Chancellor directives, and campus procedures.

CONCLUSION

Based upon the results of the work performed within the scope of the audit, the fiscal, operational, and administrative controls in effect for the Warren Hall Replacement Building project were sufficient to meet the objectives of this audit. Our audit procedures did identify opportunities to improve controls over service agreements and payment applications.

Specific observations, recommendations, and management responses are detailed in the remainder of this report.

OBSERVATIONS, RECOMMENDATIONS, AND RESPONSES

1. SERVICE AGREEMENTS

OBSERVATION

The California State University (CSU) Office of General Counsel did not sign the service agreement between the campus and the inspector of record/construction management firm to certify that it had been examined and was in accordance with the requirements of CSU Contract Law.

The lack of examination and certification from the CSU Office of General Counsel on service agreements increases the risk of litigation and implied obligations due to misunderstandings and miscommunication regarding rights and responsibilities.

RECOMMENDATION

We recommend that the campus ensure that future service agreements are examined and signed by the CSU Office of General Counsel.

MANAGEMENT RESPONSE

We agree. On June 8, 2016, the associate vice president (AVP) of facilities development and operations (FDO) sent a memo to the public works contract administrator, as well as the staff of planning design and construction, emphasizing that Integrated California State University Administrative Manual (ICSUAM) §9210.01 requires that all service agreements be reviewed and approved by the CSU Office of General Counsel. A copy of this memo will be provided to the Office of Audit and Advisory Services (OAAS) by September 6, 2016.

2. MONTHLY PAYMENT APPLICATIONS

OBSERVATION

Contractor monthly payment applications were not always properly approved before they were processed.

We reviewed 23 monthly payment applications, and we found that:

- Two monthly payment applications were not approved and signed by the architect.
- One monthly payment application was not approved and signed by the architect or inspector of record.

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

RECOMMENDATION

We recommend that the campus reiterate to staff that monthly payment applications must be properly approved before they are processed.

MANAGEMENT RESPONSE

We agree. On June 8, 2016, the AVP of FDO sent a memo to the FDO business operations staff and the planning design and construction staff that reiterated that approval signatures from the inspector of record and the architect must be obtained prior to submitting the contractor's monthly payment applications to the campus accounts payable department for payment. A copy of this memo will be provided to the OAAS by September 6, 2016.

GENERAL INFORMATION

BACKGROUND

In January 2013, the Board of Trustees (BOT) approved schematic plans for the California State University, East Bay (CSUEB) Warren Hall Replacement Building project at a cost of \$50,018,000, with funding from lease revenue bonds approved in fiscal year 2011/12.

In June 2012, the campus executed an agreement with the architectural firm LPA, Inc. for services related and incidental to the design and construction of the Warren Hall Replacement Building project. It also executed an agreement with the construction manager (CM), Sundt Construction, Inc., for preconstruction services that included design and bid phase services. In February 2014, the campus executed a guaranteed maximum price (GMP) agreement with the CM for construction phase services, at a construction cost of \$29,265,326, and issued a Notice to Proceed on March 10, 2014, with a completion date of August 9, 2015. The campus filed a Notice of Completion on October 6, 2015, and the State Fire Marshal granted a Certificate of Occupancy on November 1, 2015.

The Warren Hall Replacement Building project is a 66,000-square-foot facility located on the north end of the campus. The CSU Seismic Review Board had ranked the previous Warren Hall building to be the system's most seismically deficient building. The legislature approved the building's demolition based on the costs to repair the structure, correct building code deficiencies, address deferred maintenance/capital renewal, abate asbestos, and more, as compared to the cost of a new building. The five-story building houses offices and support space for the Academic Senate, campus accessibility services, continuing education, faculty development center, parking services, welcome center, faculty, and other student services. The project is seeking 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 CSUEB campus managed the Warren Hall Replacement Building project, and it chose the 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.

Campus presidents have been delegated the authority to directly manage 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 BOT policies; the campus manages capital projects via a process consistent with the provisions of the 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 campus capital outlay management plan 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. Alternatively, the CPDC construction management unit may also perform construction administration and management.

Each campus president (or designee) also has been delegated authority to make all professional appointments relative to capital outlay projects and campus physical development in accordance with applicable statutes, regulations, BOT policies, and ICSUAM provisions; and must ensure the use of systemwide standardized architectural, engineering, and other professional appointment contract forms. Further, each construction administrator, project manager, inspector of record, campus representative, and design professional is required to use the CSU *Construction Management Project Administration Reference Manual*, which contains the CSU construction management policies and procedures that apply to a project.

SCOPE

We visited the CSUEB campus and the offices of the CM and selected subcontractors from April 4, 2016, through May 6, 2016. Our audit and evaluation included the audit tests we considered necessary in determining whether fiscal, operational, and administrative controls for the Warren Hall Replacement Building project were in place and operative.

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, pricing, and tracking of change orders.
- Administration of subcontractor labor rates and associated burden.
- Construction management and overall project cost accounting and reporting.
- Construction allowances and contingency balances.

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.

Our testing and methodology was designed to provide a review of key fiscal, operational and administrative controls, which included detailed testing on a limited number of CM and selected subcontractor transactions. Our review did not examine all aspects of financial controls or encompass all financial transactions for every contractor and subcontractor.

CRITERIA

Our audit was based upon standards as set forth in CSU Board of Trustee policies; Office of the Chancellor policies, letters, and directives; campus procedures; and other sound administrative practices. This audit was conducted in conformance with the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*.

This review emphasized, but was not limited to, compliance with:

- Executive Order (EO) 672, *Delegation of Capital Outlay Management Authority and Responsibility*
- EO 666, *Delegation of Professional Appointments Related to Capital Outlay Projects and Campus Physical Development*
- ICSUAM §9000 through §9005, *Capital Outlay and Public Works Contracts*
- ICSUAM §9200 through §9212, *Professional Services for Campus Development*
- ICSUAM §9230 through §9237, *Project Plan Development for Major Capital Construction Projects*
- ICSUAM §9700 through §9843, *Construction Management for Public Works Contracts*
- CSU *Construction Management Project Administration Reference Manual*
- CSU *Administration of University Property - Equipment Procedures*
- *Contract General Conditions for CM at Risk with Guaranteed Maximum Price Projects*
- Public Contract Code Chapter 2.5, *CSU Contract Law*
- Public Contract Code §4100 et seq., *Subletting and Subcontracting Fair Practices Act*
- Government Code §13402 and §13403

AUDIT TEAM

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Senior Auditor: Jamarr Johnson