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June 19, 2018

Dr. Joseph I. Castro, President
California State University, Fresno
5241 N. Maple Avenue
Fresno, CA 93740

Dear Dr. Castro:

Subject: Audit Report 17-77, Jordan Research Building, California State University, Fresno

We have completed an audit of the *Jordan Research Building* construction project as part of our 2017 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 recommendations. The management response has been incorporated into the final audit report, which has been posted to 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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The California State University
Audit and Advisory Services

CONSTRUCTION

**California State University,
Fresno**

Jordan Research Building

Audit Report 17-77
March 26, 2018

EXECUTIVE SUMMARY

OBJECTIVE

The objectives of the audit were to ascertain the effectiveness of construction management policies and procedures related to the operational, administrative, and financial 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 and auxiliary procedures.

CONCLUSION

We found the control environment for some of the areas reviewed to be in need of improvement.

Based upon the results of the work performed within the scope of the audit, except for the weaknesses described below, the operational, administrative, and financial controls for construction activities as of January 12, 2018, taken as a whole, provided reasonable assurance that risks were being managed and objectives were met.

The review found that the project was not treated as a public works project, although state funds were used for the project in the form of construction management services provided by the campus. Additionally, the review found that the Agricultural Foundation did not use standard California State University (CSU) construction templates when structuring the construction agreement for the Jordan Research Building, and the use of such templates could have resulted in significant cost savings. The review also noted that the Agricultural Foundation of California State University, Fresno (Agricultural Foundation) performed a function not authorized by its operating agreement and identified opportunities for improvement in the review of hourly labor rates for change order and contingency work.

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

OBSERVATIONS, RECOMMENDATIONS, AND RESPONSES

1. CONSTRUCTION MANAGEMENT

OBSERVATION

The Agricultural Foundation did not treat the construction of the Jordan Research Building as a public works project, as defined in Public Contract Code §10700 and Integrated California State University Administrative Manual (ICSUAM) §9701.09, *Major Capital Outlay Projects Administered by an Auxiliary*.

Public works projects include any construction projects located on California State University property and funded in whole or in part by public funds. Although the construction of the Jordan Research Building was donor-funded, the construction project utilized public funds because the campus provided construction management services for the project without being reimbursed for these services. A memorandum of understanding (MOU) to recover the cost of these services was drafted but not executed.

We noted that management of the project did not always adhere to CSU requirements or public works statutes. For example:

- The project was not publicly advertised. CSU pre-qualified contractors were invited to respond to a request for qualifications that included specific project-related experience and performance criteria, rather than through a competitive bidding process with consideration of cost.
- Although annual statements of economic interest (Form 700) were completed by the individuals involved in the general contractor selection process, these individuals were not required to complete project-specific conflict-of-interest forms.
- The contractor was not required to achieve mandatory 3 percent Disabled Veteran Business Enterprise (DVBE) participation.

RECOMMENDATION

We recommend that the campus consult with the Office of the Chancellor's Capital Planning, Design and Construction (CPDC) department to clarify the proper treatment of construction projects funded by auxiliary organizations, and to ensure compliance with CSU policies and state regulations.

MANAGEMENT RESPONSE

We concur. The campus will consult with CPDC to clarify the proper treatment of construction projects funded by auxiliary organizations. This will be completed by August 1, 2018.

2. USE OF STANDARD TEMPLATES

OBSERVATION

The Agricultural Foundation did not use standard CSU construction templates when structuring the construction agreement for the Jordan Research Building.

Specifically, we found that:

- The Agricultural Foundation structured the GMP agreement to allow overhead and profit percentages, including the costs of bonds and insurance, to be applied to non-direct costs, including site management fees. Generally, overhead and profit percentages are only applied to the direct cost of work. This resulted in an additional \$125,000 being included in the GMP contract price. However, percentages negotiated for fees on change order work were generally lower than other CSU GMP standard agreements.
- In the execution of the GMP agreement, the Agricultural Foundation did not include standard contract provisions discussing the return of costs to the owner if the actual cost of work, plus the construction manager's fee, was less than the final contract cost. In our review of the contractor's job cost detail report, we noted that the costs on this report, plus the contractor's agreed-upon fees, were approximately \$643,419 less than the final contract cost. The contractor stated that the difference in cost was due to general and administrative costs; however, in standard CSU construction agreements, these costs are defined to be part of the contractor's fee and are not allowable as separate project costs.
- A number of other provisions in standard CSU general conditions were altered, without consultation with CPDC.

RECOMMENDATION

We recommend that for future externally funded projects, the campus, in conjunction with any relevant auxiliary organizations, consult with CPDC to ensure the use of the proper agreements and templates and to ensure that any alterations of these documents are appropriate.

MANAGEMENT RESPONSE

We concur. The campus vice president for administration will direct relevant auxiliary organizations to consult with CPDC prior to modifying any CSU template agreements for future auxiliary-funded major capital outlay projects. This will be completed by August 1, 2018.

3. GENERAL CONDITIONS

OBSERVATION

The general conditions used for the Jordan Research Building construction agreement general conditions did not correspond with the delivery method utilized.

Specifically, we found that although the Agricultural Foundation used the Construction Manager at Risk (CM at Risk) with GMP delivery method for the project, the general conditions in the construction agreement corresponded with the Design-Bid-Build delivery method. However, we noted that the CPDC had not provided template general conditions for CM at Risk auxiliary organization projects.

RECOMMENDATION

We recommend that CPDC provide template general conditions or additional guidance that incorporates all major delivery methods to assist auxiliary organizations in contracting for major capital construction projects.

MANAGEMENT RESPONSE

We agree. We are drafting template supplementary general conditions or additional guidance that incorporates all major delivery methods to assist auxiliary organizations in contracting for major capital construction projects. Once completed, we will seek approval by the Office of General Counsel. Estimated completion date is November 30, 2018.

4. OPERATING AGREEMENT

OBSERVATION

The Agricultural Foundation performed a function not authorized by its operating agreement with the CSU Trustees.

Specifically, the Agricultural Foundation’s operating agreement did not include the function of acquisition, development, sale, and transfer of real property and personal property, including financing transactions related to these activities. However, the Agricultural Foundation engaged in some of these activities by providing contract management and administrative services for the Jordan Research Building and entering into contracts for the design and construction of the building. It performed these activities pursuant to an MOU with the California State University, Fresno Foundation (Foundation), which provided the funds for the construction of the building.

Properly crafted and executed auxiliary organization operating agreements provide greater assurance that roles and responsibilities are well defined and understood.

RECOMMENDATION

We recommend that the campus review the Agricultural Foundation’s current operating agreement and make any updates necessary to ensure that it is current and includes all functions performed by the auxiliary organization, including the functions mentioned above, if the Agricultural Foundation will be involved in the construction of future major capital outlay projects.

MANAGEMENT RESPONSE

We concur. The operating agreement for the Agricultural Foundation has been updated to include the provision for execution of real property projects.

5. REVIEW OF HOURLY LABOR RATES

OBSERVATION

The campus review of hourly labor rates submitted for change order, contingency, and credit costs needed improvement.

We reviewed change order and contingency documentation for the Jordan Research Building and found that supporting documentation was insufficient to verify the labor rates claimed for four of the 15 change order costs reviewed and two of the contingency costs reviewed.

Reviewing labor rates submitted for change order, contingency costs, and credit costs decreases the risk that the contractor will charge the campus excess labor costs.

RECOMMENDATION

We recommend that the campus develop a process to verify hourly labor rates for change order, contingency, and credit costs for auxiliary organization projects and document this review.

MANAGEMENT RESPONSE

We concur. The campus will develop and document a process to verify hourly labor rates for change order, contingency, and credit costs for auxiliary organization projects. This will be completed by September 26, 2018.

GENERAL INFORMATION

BACKGROUND

In November 2012, the Board of Trustees (BOT) approved schematic plans for the Jordan Research Building project at a cost of \$23,866,000, with 100 percent of the funding coming from donors Lowell and Hannibal Jordan.

The Foundation, which received the donor funds, entered into an agreement with the Agricultural Foundation to provide contract management and administration services for the Jordan Research Building project. The Foundation and the Agricultural Foundation are recognized auxiliary organizations of the California State University, Fresno (Fresno State) campus.

In August 2011, the Agricultural Foundation executed an agreement with the architectural firm Zimmer Gunsul Frasca Architect, LLP for services related and incidental to the design and construction of the Jordan Research Building project. In October 2014, the Agricultural Foundation executed a GMP agreement with the construction manager (CM), Harris Construction Company, for construction phase services at a construction cost of \$22,147,899 and issued a Notice to Proceed on September 25, 2014, with a completion date of February 10, 2016. The campus filed a Notice of Completion on July 28, 2016.

The Jordan Research Building project is a new 29,866-square-foot facility built on campus land leased to the Agricultural Foundation at the corner of Barstow and Woodrow avenues. The building is the first of its kind in the CSU system. The facility features three floors of dry and wet research laboratories, flexible space, and meeting rooms for Fresno State students and faculty to conduct advanced studies on agriculture, food, and water. The first floor includes research areas for robotics, computer water modeling and visualization, and sensory evaluation and is home to the California Water Institute. The second floor is home to environmental air and water quality and bioenergy system research laboratories. The top level includes genomics, entomology, microbiology, and plant physiology laboratories. The second and third floors have flexible modules built in for future research needs. All three floors include large lounges and interaction areas for collaboration. A spacious conference and training room and a lobby are located near the main entrance. The Jordan Research Building project was made possible by a fully funded donation made by the Jordan family in 2009. The research center was designed to foster collaboration between students and faculty in Fresno State's Jordan College, Lyles College of Engineering, and College of Science and Mathematics, and industry partners.

The Agricultural Foundation and the campus shared construction management duties for the Jordan Research Building. The campus duties included managing the design process, managing the plan check approval process with applicable jurisdictional agencies, and reviewing and recommending approval on all project requisitions, contracts, purchase orders, and contract change documents, for execution by the Agricultural Foundation. Additionally, the campus was in charge of reviewing and approving all invoices and forwarding them to the Agricultural Foundation for payment.

The Agricultural Foundation chose the CM at Risk with GMP delivery method for the Jordan Research Building project. 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.

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. It also includes information on how the campus addresses project management for auxiliary projects. Updated plans are to be submitted when campus operational structure changes are made that impact the plan. Certification is continuous unless a 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.

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 Fresno State campus and the offices of the CM and selected subcontractors from November 6, 2017, through January 12, 2018. Our audit and evaluation included the audit tests we considered necessary in determining whether operational, administrative, and financial controls for the Jordan Research 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 operational, administrative, and financial 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*
- *Contract General Conditions for CM at Risk with Guaranteed Maximum Price Projects*
- *Auxiliary Contract General Conditions for Design-Bid-Build Projects*
- Public Contract Code Chapter 2.5, *CSU Contract Law*
- Public Contract Code §4100 *et seq.*, *Subletting and Subcontracting Fair Practices Act*
- Public Contract Code §10701, §10704, §10708, and §10742
- Title 5, §42500 through §42502, *Functions of Auxiliary Organizations and Requirement for Written Agreements*
- Government Code §13402 and §13403

AUDIT TEAM

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Senior Auditor: Jamarr Johnson