

Audit and Advisory Services
401 Golden Shore
Long Beach, CA 90802-4210

April 23, 2021

Dr. Mary A. Papazian, President
San José State University
One Washington Square
San José, CA 95192

Dear Dr. Papazian:

Subject: Audit Report 20-61, Student Recreation and Aquatic Center, San José State University

We have completed an audit of the *Student Recreation and Aquatic Center* construction project as part of our 2020-2021 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 will be 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,



Vlad Marinescu
Vice Chancellor and Chief Audit Officer

c: Joseph I. Castro, Chancellor
Adam Day, Chair, Committee on Audit
Jane W. Carney, Vice Chair, Committee on Audit

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CONSTRUCTION

San José State University

Student Recreation and Aquatic Center

Audit Report 20-61

April 23, 2021

EXECUTIVE SUMMARY

OBJECTIVE

The objectives of the audit were to ascertain the effectiveness of operational, administrative, and financial controls related to construction activities; identify cost recovery opportunities; and ensure compliance with relevant governmental regulations, Trustee policy, Office of the Chancellor (CO) directives, construction contract general conditions, and campus procedures.

CONCLUSION

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 the Student Recreation and Aquatic Center as of December 2, 2020, taken as a whole, provided reasonable assurance that risks were being managed and objectives were met.

However, the review did find that improvement was needed in the completion and review of the project final reconciliation. This is a similar observation to the prior construction audit at the campus, which found that the final reconciliation of project costs was not completed. Complete and accurate final reconciliations ensure that cost savings realized by the design-builder in the construction of the project are passed on to the campus. We also identified opportunities for improvement in the tracking and monitoring of project allowances, the formation of the guaranteed maximum price (GMP) for Collaborative Design-Build projects, and the campus permitting process.

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

OBSERVATIONS, RECOMMENDATIONS, AND RESPONSES

1. FINAL ACCOUNTING

OBSERVATION

The final accounting of project costs prepared and submitted during the review by the design-builder (DB) for the Student Recreation and Aquatic Center project was inadequate. This is a similar observation to our prior construction audit at the campus, which found that the final accounting of project costs was not completed.

Specifically, we found that the DB did not provide sufficient documentation demonstrating that the total cost of the project equaled or exceeded the final GMP construction agreement. For example, based on an initial review of the reconciliation and communication with the DB:

- Subcontractor costs on the document did not reflect final close-out costs.
- Direct labor costs appeared to be miscategorized, based on the DB's job cost detail report.
- Contractual fees were not accurately reflected in the reconciliation. Specifically, the design fees and general condition fees in the reconciliation did not reflect the original contract amounts, but instead included additional services, which should have been included elsewhere.

Requiring that the DB submit a final accounting of actual project costs and reviewing this document for accuracy decreases the risk that the campus' payments will exceed actual construction costs (up to the GMP) and that any errors and irregularities will not be detected.

RECOMMENDATION

We recommend that:

- a. The campus require the DB to submit a revised final accounting of project costs for the Student Recreation and Aquatic Center project, and that the campus perform a verification of the costs included.
- b. The chancellor's office Capital Planning, Design and Construction (CPDC) department provide training to campuses on the required elements of the final reconciliation and the process for reviewing the reconciliation.

MANAGEMENT RESPONSE

We concur.

- a. The campus will request and verify a revised final accounting of project costs from the DB.
- b. CPDC agrees to provide training on the required elements of the final reconciliation and the process for reviewing the reconciliation.

| This will be completed by September 3, 2021.

2. PROJECT APPROVALS

OBSERVATION

Campus processes to obtain and document project approvals needed improvement. We reviewed project approval documentation relating to the design and development of the Student Recreation and Aquatic Center project and found that:

- The collaborative design-build construction agreement was executed on August 17, 2016, which was before the California State University (CSU) Board of Trustees (BOT) schematic approval of the project on November 15, 2016.
- Although the campus obtained a conditional mechanical review board approval via email prior to issuance of the building permit, the campus did not obtain the documented final approval until after the project was completed.
- The campus used a phased permitting process for the project. We noted that the final notice to proceed (NTP) for the “construction of the building and all remaining contract scopes not previously released” was executed on December 12, 2016; however, the related building permits for structural work and the balance of the above-ground construction were issued on May 10, 2017, and October 11, 2017, respectively. The campus noted that its use of the NTP was to communicate the start of work, such as preparing design and working drawings and obtaining regulatory and third-party reviews and approvals. However, this was not clear based on the language included in the NTP.

Obtaining appropriate regulatory and third-party plan check approvals before beginning work on a project reduces the risk of noncompliance with state regulations and reduces the probability of rework and increased project costs.

RECOMMENDATION

We recommend that the campus:

- a. Provide a reminder to relevant personnel that construction agreements should not be executed prior to BOT approval, and that plan check approvals should be documented and maintained.
- b. Communicate to relevant personnel that for future phased building projects, the language of the NTP should be reviewed and updated to clarify the scope and intent of the NTP to eliminate confusion.

MANAGEMENT RESPONSE

We concur. The campus will:

- a. Provide a reminder to relevant personnel that construction agreements should not be executed prior to BOT approval, and that plan check approvals should be documented and maintained.
- b. Communicate to relevant personnel that for future phased building projects, the language of the NTP should be reviewed and updated to clarify the scope and intent of the NTP to eliminate confusion.

This will be completed by September 30, 2021.

3. ALLOWANCES

OBSERVATION

Administration of allowances for the Student Services Building project needed improvement.

We found that three credit change orders that were executed to return unused allowances did not include a return of the DB's fee. These fees amounted to \$68,412.

In addition, during the review, due to the way general requirements and DB allowances were recorded, we were unable to identify a sample of these costs during the review to determine whether allowance expenditures were appropriately authorized by the Trustees in writing as required in the contract general conditions, or to determine whether the allowance costs were adequately supported.

Proper administration of allowance costs decreases the risk that allowances will not be used for their intended purpose, and of inappropriate or unsupported project costs.

RECOMMENDATION

We recommend that the campus:

- a. Review the credit change orders noted above to determine whether the DB's fees should be returned to the campus, and document the fee return to the campus or the reason for not pursuing the return of fees.
- b. Provide refresher training to relevant personnel regarding the administration of allowance costs, including tracking allowance usage through an allowance log or other mechanism that allows for easy identification and review of allowance costs, and appropriate authorization, use, and documentation of allowance costs.

MANAGEMENT RESPONSE

We concur. The campus will:

- a. Review the credit change orders noted above to determine whether the DB's fees should be returned to the campus, and document the fee return to the campus or the reason for not pursuing the return of fees.

- b. Provide refresher training to relevant personnel regarding the administration of allowance costs, including tracking allowance usage through an allowance log or other mechanism that allows for easy identification and review of allowance costs, and appropriate authorization, use, and documentation of allowance costs.

This will be completed by September 30, 2021.

4. GMP FORMATION

OBSERVATION

The campus did not structure the GMP agreement for the Student Recreation and Aquatic Center project in accordance with project terms and conditions.

We found that:

- The site management fee was not based on the percentage bid by the DB in its fee proposal. The fee shown in the GMP agreement was \$293,485 more than the calculated fee based on the proposed fee percentage applied to contract direct costs.
- The design fee was not based on the lump-sum amount bid in the DB's fee proposal. The fee shown in the agreement was \$256,654 more than the calculated fee based on the fee percentage stipulated in the RFP and the proposed amount.

The campus indicated that these fees were increased in the GMP agreement due to additional work required for the project and delays in the project start date that were not reflected in the request for proposal (RFP).

Structuring the GMP agreement in accordance with the terms of the RFP and the fee percentages and amounts proposed by the contractor decreases the risk of noncompliance with project terms and conditions, the potential for bid protests, and the likelihood of misunderstandings regarding rights and responsibilities between the campus and the DB.

RECOMMENDATION

We recommend that the campus consult with the chancellor's office CPDC department regarding how to best process increases in proposed fee amounts related to additional scope of work or other factors not reflected in the RFP.

MANAGEMENT RESPONSE

We concur. The campus will consult with CPDC regarding how to best process increases in proposed fee amounts related to additional scope of work or other factors not reflected in the RFP. This will be completed by September 30, 2021.

GENERAL INFORMATION

BACKGROUND

In November 2016, the BOT approved schematic plans for the Student Recreation and Aquatic Center project at a cost of \$131,629,000, with funding from student union program-designated reserves and systemwide revenue bonds.

In April 2015, the campus solicited project bids and selected Hunt Construction as the DB. The campus executed a design and construction agreement with Hunt Construction on August 17, 2016, at a cost of \$110,540,833, and issued the first NTP on August 23, 2016, with a completion date of December 17, 2018. The campus filed the Notice of Completion on August 14, 2019. The final project cost, after all change orders had been processed, was \$112,225,907.

The Student Recreation and Aquatic Center project is a new three-building facility located on the southeast quadrant of the main San José State University (SJSU) campus. The 121,000-square-foot center consists of three indoor basketball courts, one multi-activity court, a weight and fitness center, group exercise rooms, an indoor running track, a rock-climbing facility, sports club organization offices, locker rooms, and administrative support space. The complex also includes a 50-meter competition swimming and diving pool, as well as a recreation pool. The center's focus is to advance the ongoing education of students in the lifelong benefits of athletic activity in both a recreational and competitive format. The multi-activity court and three basketball court areas provide education and training for a variety of recreational sports, including basketball, indoor soccer, indoor hockey, badminton, volleyball, and other sports and activities. The various free weight and strength machine areas are used for individual and group training, as well as for providing instruction on weightlifting technique and safe practices. The project was designed to achieve a Leadership in Energy and Environmental Design (LEED) gold certification. 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 SJSU campus managed the Student Recreation and Aquatic Center project, and it chose the Collaborative Design-Build delivery method. In this method, the campus establishes the project criteria, and the design-builder and architect/engineer propose together as a design-build team. Working closely with the campus, the design-build team establishes a design, specifications, and GMP for the project. The design-build team acts as the design-builder 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 design-build team, 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 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 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.

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 SJSU campus and the offices of the DB and selected subcontractors from February 10, 2020, through December 2, 2020. This was in part due to the limitations of the COVID-19 health emergency, which temporarily suspended our audit between March 2020 and September 2020. Our audit and evaluation included the audit tests we considered necessary in determining whether operational, administrative, and financial controls for the Student Recreation and Aquatic Center are in place and operative. The audit focused on procedures in effect during the planning and construction of the project.

Specifically, we reviewed and tested:

- Delegation of construction management authority.
- Review and approval of project design, budget, and funding.
- Administration of the bid and award process.
- Contract execution and required contract bonds and insurance.
- Construction management and accounting, including allowance and contingency tracking and invoicing and payment applications.
- Review, approval, pricing, and tracking of change orders.
- Subcontractor administration.

- Close-out processes, including completion of required inspections and certifications.

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, which was designed to provide a review of key operational, administrative, and financial controls, included interviews, walkthroughs, and detailed testing on a limited number of design-builder and subcontractor transactions. Our review did not examine all aspects of financial controls or encompass all financial transactions for the design-builder and every subcontractor. Additionally, as noted in the body of the report, we were unable to identify and review a representative sample of allowance transactions for appropriate authorization and usage.

CRITERIA

Our audit was based upon standards as set forth in federal and state regulations and guidance; Trustee policy; Office of the Chancellor directives; and campus (and auxiliary, if applicable) procedures; as well as sound administrative practices and consideration of the potential impact of significant risks. 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:

- 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
- Executive Order (EO) 666, *Delegation of Professional Appointments Related to Capital Outlay Projects and Campus Physical Development*
- EO 672, *Delegation of Capital Outlay Management Authority and Responsibility*
- 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 Collaborative Design-Build Major Projects*

AUDIT TEAM

Director of Audit Analytics, Operations, and Quality Assurance: Wendee Shinsato
 Senior Auditor: Jamarr Johnson