CAPITAL PROGRAMS

PROJECT CLOSE-OUT PROCESS REVIEW

AUDIT REPORT #16-2103

Audit & Advisory Services

September 2016

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Background

In accordance with the Campus fiscal year 2015-16 audit plan, Audit & Advisory Services (A&AS) conducted an audit of key construction project close-out processes and their related activities within the UCLA Capital Programs (CP) department.

*Capital Programs Overview*

The CP department is responsible for conceptualizing, planning, designing, and constructing major capital construction and renovation projects at UCLA. Projects having total costs of $750,000 and above are considered major capital construction. CP develops financial strategies, obtains project approvals, reviews plans and specifications, completes environmental reviews, prepares and negotiates construction contracts, coordinates staging plans, and serves as a repository for project records and as-built plans.

The department’s mission is to create projects that “support the instruction and research mission of the University by providing a physical campus environment that fosters excellence, creativity, and a sense of community.” Capital projects are developed to take into account UCLA land use priorities, established physical designs, University policies and procedures, environmental and regulatory requirements, and community interests.

The CP department consists of the following three areas:

*Capital Planning and Finance* – responsible for planning, environmental assessment, project budgeting, and project financial services including contracts administration. This area is led by an Associate Vice Chancellor who reports to the Vice Chancellor and Chief Financial Officer.

*Design and Construction* – responsible for project design, engineering, permitting and inspection services, project management, and construction management activities. This area is led by an Associate Vice Chancellor who reports to the Vice Chancellor and Chief Financial Officer.

*Administrative Services* – includes building operations, information technology, and personnel, and is overseen by a Director who reports to the Vice Chancellor and Chief Financial Officer.

*Close-Out Process – Overview*

Project close-out is an important, distinct phase of a construction project that requires its own management process. The process can be lengthy and challenging depending on a project’s size, complexity, duration, and physical environment. It is important because it facilitates project commissioning and ensures fulfillment of contractual and legal obligations before releasing final payment to the contractor. Administratively, a well executed close-out process is one indicator that a given construction project was properly managed throughout its duration.

The close-out process is synchronized to, and driven by the construction contract and includes negotiating final change orders, completing punch list items, release of final payment and retention to the general contractor, and maintaining builders risk insurance. It also includes obtaining required documentation such as Operating and Maintenance (O&M) manuals for equipment systems, warranty information, and “as-built” drawings. Close-out accounting processes include reconciling and closing-out of project accounts and funds, finalizing project capitalization, and preparing the Capital Improvement Budget (CIB). Monitoring of the process is performed by the Construction Site Manager, Project Manager, Financial Services, and Contracts & Records Management through ongoing meetings with the general contractor; review of various project schedules and budget and expense reports; and effort coordination of the overall construction process with CP staff.

CP personnel prepare reports, schedules, and other relevant project close-out information using the following software applications: CapSTAR (Capital Projects Status, Tracking and Reporting), a relational database management system designed for the tracking and accounting of major capital improvement projects; SharePoint, a business collaboration software that manages content for search and sharing on intranet and internet sites; Expedition, a contract management and project administration application; Primavera, a project portfolio management application; and Microsoft Excel.

The close-out phase can be defined as the period from when the project owner can occupy the structure for its intended use and completion of all contractual requirements, to the point when the contractor receives final payment and release of retention. As a result, project close-out is a sequence of tasks performed at the end of construction that prepares the project for final acceptance by the owner.

The CP “Design & Construction Services” group and “Capital Planning & Financial Services” group include staff that specializes in design, engineering, construction, and management services as well as project development, financial, contract, and records management services. Each specialized area is overseen by a Director, and each group is headed by an Associate Vice Chancellor.

Purpose and Scope

The primary purpose of the review was to ensure that internal controls and related systems and procedures surrounding project close-out are conducive to accomplishing Capital Programs’ business objectives. Where applicable, compliance with campus and University requirements was also evaluated. The scope of the audit focused on the following areas:

* Timeliness of Project Close-Outs
* Required Documentation
* Training

The review was conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing* and included such tests of records, interviews, and other auditing procedures considered necessary in achieving the audit purpose.

Summary Opinion

Based on the results of the work performed within the scope of the audit, CP’s organizational structure and controls are generally conducive to accomplishing its business objectives related to project close-out processes. However, controls and business practices could be further strengthened by implementing the following:

* Final invoice payment information for Builders Risk Insurance (BRI) should be obtained on a timely basis prior to the closing of a project’s plant account.
* Post-completion capital improvement budgets and close-out letters should be prepared on a timely basis.
* Develop and implement a formal, standardized capital project close-out training program for all project managers.

The audit results and corresponding recommendations are detailed in the following sections of the report.

Audit Results and Recommendations

Sample Selection

A judgmental sample of six recently closed-out capital projects administered by CP project managers was selected for testing. Capital projects usually have a build life of approximately three to five years. Within the six sample projects, three have an expenditure range of $3.5 million to $10.9 million, and three have an expenditure range of $34.8 million to $316 million (see table below). The latter three projects were selected to review the University Controlled Insurance Program (UCIP). A discussion of UCIP is presented later in this report.

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| **Project Number** | **Project Name** | **Expenditure** |
| 945880 | Santa Monica/Orthopedic Replacement Hospital | $316,350,310 |
| 948272 | Pauley Pavilion Renovation & Expansion | $122,805,491 |
| 946770 | Intramural Field Parking Structure | $34,832,579 |
| 943930 | Wilshire Center Exterior Repairs and Refurbishment | $10,973,940 |
| 945997 | Dentistry Oral Cancer Research Center | $3,855,955 |
| 945954 | Institute for Informatics Data Center | $3,516,215 |

Plant Account

Interviews were conducted with CP management to obtain an overview of departmental processes, procedures, and controls over the timely closure of project plant accounts. Departmental procedures for plant account close-out were reviewed for adequacy. CapSTAR system reports, various correspondences, and other source documentation was summarized and used to prepare a timeline to verify the chronology and timeliness of plant account close-out for the projects reviewed.

The financial plant account close-out process occurs after the project has been physically closed-out (i.e., construction contract requirements of the build have been met). The plant account remains open during the warranty period since vendor invoices and billings are still being received, remaining encumbrances are being released, punchlist items are being resolved by the contractor, and unused funds (if any) are being returned to their funding source. Once the Project Manager determines the above mentioned items are completed, Certificate of Occupancy has been received, and Notice of Completion has been filed, the plant account is closed. Departmental procedures for plant account close-out were found to be adequate. The timeline developed by A&AS was used as an evaluation tool to summarize information. It was subsequently used to measure the timeliness of testing attributes such as receipt of vendor and consultant final invoices, return of unused funds to their source, and preparation of the post-completion CIB.

There were no significant control weaknesses noted in this area.

Unused Funding

Meetings were held with CP personnel to determine the departmental procedures and controls over the timely return of unused funding to its source relative to project close-out. For the three projects selected, various reports from the department’s CapSTAR system, correspondence, and other source documentation were reviewed to verify the type and status of the funding for each project tested. An information summary and timeline was prepared to verify the chronology and timeliness of each project’s remaining fund balance. For the projects tested, it was disclosed that funds were either transferred to a management approved remediation fund, any unused budgeted appropriations were closed, or funding was closed out in consideration of other contingency appropriations from the Chancellor’s commitments to Capital Programs and the Office of Academic Planning and Budget.

There were no significant control weaknesses noted in this area.

Final Billings and Invoices

Discussions with CP management and project managers were conducted to identify the key departmental processes and internal controls for monitoring construction costs, including the tracking and receipt of final vendor and consultant invoices. CapSTAR Budget Tracking Reports (BTRs) were reviewed to evaluate the methodology utilized by project managers to confirm that all contracts have been paid out, there are no remaining encumbered balances, and vendors and consultants have fully invoiced projects.

There were no significant control weaknesses noted in this area.

Builder’s Risk Insurance

BRI is based on the construction value of the construction contract. The BRI amount usually changes as a result of approved construction contract change orders. Upon obtaining an overview of the departmental processes and controls for monitoring the receipt of final invoices and/or final BRI invoice remittance information, A&AS selected three test projects for review. Various reports from the Capital Programs’ CapSTAR system, campus General Ledger, and other source documentation was used to prepare a summary and timeline to verify the timeliness of the receipt of final BRI invoice remittance information relative to closing the plant account and returning any unused funds and/or closing of funding appropriations. Departmental procedures for closing-out plant accounts were also reviewed for adequacy. The following was noted:

A. Builder’s Risk Insurance – Final Invoice

Final BRI invoices for two of three capital construction projects tested were received after the related plant accounts were closed. As a result, the premiums due for the late received BRI invoices were paid with funds other than the original primary funding source(s).

For project #945997, Dentistry 73006-2 Oral Cancer Research Center, the plant account was closed on March 21, 2014, and the final BRI invoice in the amount of $979.69 for the project was received on June 30, 2014, (101 days after the plant account was closed). The plant account for project #945954, Institute for Informatics Data Center was closed on August 16, 2013, and the final BRI invoice in the amount of $1,639.00 for the project was received on June 30, 2014 (318 days after the plant account was closed). Both of these invoices were paid from Chancellor discretionary funds since original funding sources were closed. The final BRI invoice information is controlled by the University of California, Office of the President (UCOP), and is subsequently provided to CP staff after reconciliation has been completed with the insurance broker.

Based on CP departmental plant account project close-out procedures, the plant account is to remain open until all project invoices are received, encumbrances and memo liens are released, unused funds are returned to the original funding source, and notification to close the plant account is received from the project manager. By not ensuring that final invoices, including final BRI invoices, are received on a timely basis prior to closing a project’s plant account, original funding sources might be unavailable to pay the final invoices. As a result, other funding sources may be required to be identified and used to remit expense payments.

Management is responsible for its stewardship of available funding resources. As such, it should be proactive in monitoring the status of final BRI invoices to minimize the risk of delays in receiving final BRI invoice information. By doing so, internal controls over funding resources will be strengthened.

Recommendation: Management should coordinate efforts with the UCOP Construction Services Unit to ensure that final invoices for project BRI are received on a timely basis relative to closing out the plant account.

Response: Project Managers will continue to coordinate with UCOP to obtain timely final invoicing of Builders Risk Insurance that align with project close-out. However, this activity remains outside of Capital Programs’ control as the billing is dependent upon the insurance company billing UCOP and UCOP transferring the expense to the plant account. Project Managers will continue to keep accounts open until they are told by UCOP that all insurance items have been billed. This activity will require continuous coordination between the Project Manager and UCOP, but will always be dependent upon the quality and timeliness of the information the Project Manager receives from UCOP.

University Controlled Insurance Program

A&AS met with CP management and project managers to ascertain the departmental processes and controls established over timely implementation of the UCIP in applicable capital project bid documents. A&AS also reviewed the UC Major Capital Projects Implementation information dated November 3, 2011, and relevant sections of the UC Facilities Manual. For our three test projects with budgeted costs greater than $25 million, supporting documentation including “advertisement for bids” was obtained from department management and evaluated for timely inclusion of the UCIP terms and conditions.

UCIP information must be incorporated into each project’s solicitation package (bid documents), all advertisements for bids, and all pre-proposal meetings, etc., for capital project bidders to communicate the University’s intention to use UCIP coverage. The three test projects have “advertisement for bid” dates prior to January 2010. Per UCOP Risk Management staff, projects issued for bid prior to the UCIP implementation date were not required to have UCIP associated with the contract, even in instances where the bid opening date was after the UCIP implementation date. Consequently, there were no final invoices for the UCIP to test for timely submittal relative to project close-out.

There were no significant control weaknesses noted in this area.

Post-Completion Capital Improvement Budget

A post-completion CIB is prepared from project information contained within the CP CapSTAR system. It functions as a timeline that provides a comparison of certain financial aspects of capital projects with budgeted costs exceeding $10 million. For capital projects with budgeted costs of less than $10 million, a post-completion CIB close-out letter is prepared. The post-completion CIB close-out letter provides less detail since smaller projects tend to have one general contractor and are usually less complex. Both the post-completion CIB and post-completion CIB close-out letter are transmitted to the Vice Chancellor and Chief Financial Officer. A&AS reviewed the post-completion CIBs and close-out letters to determine their date of issuance relative to the project plant account close-out.

A. Post-Completion Capital Improvement Budget Close-out Letter

One of three capital projects tested had a post-completion CIB close-out letter that was issued on January 19, 2016, 22 months after the project’s plant account was closed on March 21, 2014. The post-completion CIB close-out letter and its cost data function as a financial chronology by capital project expense type, is prepared at the physical close of a project by the Assistant Director for Planning & Finance – Capital Programs (which is prior to its financial close), and is used for projects that have a cost of less than $10 million. When post-completion CIB close-out letters are not issued on a timely basis, capital investment decisions and related funding objectives may be affected by outdated information.

Recommendation: Management should strengthen its controls to ensure that post-completion CIBs or close-out letters for all projects are prepared on a timely basis. By doing so, management will have the most current post-completion CIB information available to use as an evaluation tool for a project’s capital improvement costs.

Response: Close-out CIBs are routinely prepared following the receipt of an automated notice from CapStar indicating that the account is no longer active. The delayed release of the post-completion CIB cited above was an oversight. It was discovered by our team during a periodic check of previously completed projects.

Close-Out Process – Required Documentation

Relevant sections of the UC Facilities Manual were reviewed to identify required capital project close-out documentation to be delivered by the contractor to the University representative. Supporting documentation including project submittal logs, certificates of occupancy, notices of completion, and contractor payment information was analyzed to verify timely receipt, filing prior to final payment, or release of retention to the contractor.

Test work indicated “as-built documents” and the “operating and maintenance data” for equipment incorporated into the project were received prior to the final payment to the contractor and release of retention. The final payment and release of retention were paid after the dated certificate of occupancy and dated notice of completion for each project. Each project’s submittal log(s) accounted for the timely receipt of the “as-built” drawings and the “operating and maintenance data” for equipment incorporated into the project.

There were no significant control weaknesses noted in this area.

Close-Out Process – Project Manager Training

Interviews with CP management were conducted to determine if formal, standardized capital project close-out training has been developed by CP personnel and provided to project managers, including those working for entities with delegated authority to execute construction contracts, such as UCLA Health, Facilities Management, and Housing & Hospitality Services. CP management indicated during audit interviews that each project manager serves as the key control to ensure all financial and administrative aspects of their respective capital projects are properly managed on a timely basis.

A. Close-Out Training – Project Managers

Management has not developed and implemented a standardized capital project close-out training program for project managers. Generally, project managers have existing project management experience and are provided additional UCLA Capital Programs project close-out information as part of their on the job training. The project close-out phase is an important, distinct and challenging phase of a capital construction project. Operationally, consistency in the application of project close-out processes and procedures, and use of related systems is necessary to properly control the capital program. Without a formal, standardized project close-out training program, project managers might not obtain essential knowledge necessary to effectively and efficiently administer close-out procedures of capital construction projects.

Recommendation: Management should consider developing and implementing a formal, standardized project close-out training program for project managers. The investment in a training program could help strengthen project management and other key skills for applicable personnel, promote increased productivity, and decrease the amount of supervision required because staff are enhancing their skill set.

Response: Management agrees that developing and implementing a formal, standardized project close-out training program for project managers would be beneficial to the Capital Program. Capital Programs will outline and implement a training program within fiscal year 2016-17.

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