##### UCLA HEALTH

##### HOSPITAL ADMINISTERED CONSTRUCTION PROJECTS

##### AUDIT REPORT #16-1206

##### Audit & Advisory Services

October 2016

##### UCLA HEALTH

##### HOSPITAL ADMINISTERED CONSTRUCTION PROJECTS

##### AUDIT REPORT #16-1206

Background

In accordance with the Health Sciences audit plan for fiscal year 2015-16, Audit & Advisory Services (A&AS) conducted an audit of internal controls and associated procedures governing selected construction activities managed by the UCLA Health organization. Along with the other ten University of California (UC) campuses and Lawrence Berkeley National Laboratory, A&AS executed a plan of audit tests and procedures that were developed in cooperation with a working group comprised of campus and UCOP audit staff representing various UC locations.

The UCLA Health Real Estate Planning, Design & Construction (PDC) department was established in 2008 to assist with the transition and opening of the Ronald Reagan UCLA Medical Center. Acting under a delegation of authority not to exceed $10 million, the PDC is responsible for all UCLA Health construction and interior design projects for the following facilities:

* Ronald Reagan UCLA Medical Center
* Santa Monica UCLA Medical Center
* Numerous medical office buildings
* Over 150 off-site clinics

Since its inception in 2008, the PDC department has administered 462 projects with estimated project costs of nearly $156 million. In addition, PDC manages and administers over 1 million square feet of leased space, and another 2.6 million square feet of UCLA owned space. PDC is staffed by 22 employees and is headed by the Executive Director of General Services.

As reported in the “2015-25 University of California Capital Financial Plan,” UCLA’s Capital Program for fiscal year 2015-16 consists of 13 campus projects budgeted at $340.1 million, and another four medical center projects budgeted at $164.2 million, for a total Capital Program budget of $504.3 million (67% campus, 33% medical center). Projected capital program expenditures for the 10-year period presented in the plan total about $2.3 billion.

The UC Facilities Manual (UC Manual) provides campuses access to important policies, procedures, and guidelines for the management and operation of university facilities. The UC Manual is based on Regents' policy, federal and state laws, regulations, case law, and results from past disputes involving the UC. UCOP's Facilities Management, in collaboration with UCLA’s PDC department, is charged with developing the strategies and policies that underpin the operation and maintenance of university facilities systemwide. These strategies and policies then, in turn, become the framework for the UC Manual. The current UC Manual is organized into six volumes, each focused on a different aspect of Facilities Management and operation.

Purpose and Scope

The purpose of the systemwide audit was to assess the effectiveness of construction management policies and procedures, and internal controls and processes related to hospital-administered construction activities, including contractor bidding and award selection, change order execution, job order contracts (JOCs), and compliance with project funding requirements. Where applicable, compliance with University policies and procedures were evaluated.

The scope of the audit included the following areas:

* Contractor Bidding Process
* Utilization of Contractors and Subcontractors
* Change Orders
* Restrictions and Requirements Attached to Funding

The Systemwide Audit Program also included audit procedures designed to assess the extent of campus compliance with the University Controlled Insurance Program (UCIP). However, because no PDC construction projects met the $25 million minimum dollar threshold for program participation during the audit period, an evaluation of UCIP compliance was not applicable to the projects within the scope of this audit. Consequently, a discussion of UCIP as it relates to our evaluation of hospital-administered construction activities is omitted from this report.

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

### Summary Opinion

Based on the results of the work performed within the scope of the audit, we noted that the PDC department generally has adequate systems of internal controls relating to the contractor bidding process, utilization of contractors and subcontractors, change order execution, and restrictions/requirements accompanying construction project funding. There are, however, some procedures that should be implemented or amended to ensure that controls consistently function as intended. The following will help strengthen internal controls:

* Management should direct staff to review existing approval and sign-off procedures governing change orders to better align them with UC Manual requirements.
* Review existing procedures and, where necessary, revise procedures for change order documentation to ensure uniform compliance with the UC Manual.
* Ensure that PDC personnel and the University Representative exercise due diligence in their review of cost proposals that support change orders.
* Strengthen oversight of JOCs to ensure they are executed within the established terms and time frame of the agreement.

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

# Audit Results and Recommendations

### Contractor Bidding Process

Meetings and discussions were held with key PDC and UCLA Capital Programs personnel to identify the internal policies, procedures, and business practices used to administer the contractor bid and award process for the various types of construction projects. Multiple on-site visits were conducted with PDC staff at their offices to review presentation materials, and to walk through a sample of construction project binders and files. In addition, A&AS reviewed applicable requirements from the State of California, University policies, and other related departmental procedures. These resources included:

* California Public Contract Code – Sections 10500-10506
* UC Facilities Manual – Volume 5, Chapter 1:  “Method of Contractor Selection”
* UCOP Informal Bid Flowchart
* UCOP Bid and Award Flowchart
* PDC General Services Presentation documents
* PDC Minor Capital Accounting Presentation documents

PDC personnel indicated that the type of construction contract used for a particular project is typically driven by the amount of estimated construction costs. For example, projects with estimated construction costs below $50,000, a non-competitive bid contract type such as a Facilities Service Request, Mini Form Contract, or a negotiated contract may be used; projects with estimated construction costs between $50,000 and about $200,000, an informal bidding method may be used such as JOCs or Mini Form Contract; and projects between $200,000 and $10,000,000, a formal competitive bidding process is used.

UC Manual, Vol. 5, Chap. 1.3, indicates that a contract may be negotiated with a contractor if the construction cost of the project does not exceed $50,000. The contract sum is negotiated between the University and the contractor. For negotiated contracts, the contractors must be selected on a rotating basis from a pool of contractors able to perform the type of project work required. A memorandum stating the conditions warranting such an award, and a justification of the accepted price as being reasonable (such as an independent estimate), must be written by the University's Designated Administrator and placed in the project file.

As of January 1, 2015, construction contracts with estimated costs of more than $50,000 but less than $200,000 may use an informal bid method without pre-qualifying contractors; contracts between $200,000 and $640,000 may also use an informal bid method, but must first pre-qualify general contractors and mechanical, electrical, or plumbing (MEP) subcontractors; and contracts over $640,000 must be awarded through formal competitive bidding. PDC typically chooses to use a formal contracting method for projects at a lower dollar threshold ($300,000 or greater) than is required by the parameters of the state’s Public Contract Code or UC Manual.

To determine whether bid-related and associated construction documents (designs, project scope, building requirements, etc.) were reviewed and approved in accordance with the type of contracting method being used, and the construction contract generally complied with the UC Manual, A&AS judgmentally selected PDC Project #11M2003 – the Connie Frank Kidney Transplant Center – for audit testing. The Center is located at Medical Plaza 200, Suite 565, and is also known as Capital Programs Project #945396.01. The Kidney Transplant Center project used a prequalification process to determine bidder responsibility. Subsequently, a Long Form (Lump Sum) construction contract was awarded based on a winning bid of $4,289,000. The final construction cost for the project was $4,752,982.

A&AS reviewed construction documents that were maintained by UCLA Capital Programs within the department’s SharePoint application to determine the propriety of approvals. In addition, A&AS performed audit procedures to evaluate compliance with applicable sections of the UC Manual and attributes noted in the Systemwide Audit Program.

Based on test work performed, processes and construction documents maintained by PDC and UCLA Capital Programs for the sample project reviewed, it was determined that the project documentation, reviews, and approvals generally complied with applicable requirements.

There were no significant control weaknesses noted in this area.

Utilization of Contractors and Subcontractors

Two separate listings were generated by the PDC department (UCLA Health) and UCLA Capital Programs (Campus) of all construction projects from the three most recent fiscal years (2012-13 through 2014-15). For the PDC department, 14 projects were listed with estimated construction costs of $16.5 million. For UCLA Capital Programs, 357 construction projects were reported with estimated construction costs of $438.9 million. These listings were reviewed to assess compliance with established bid process requirements, and to evaluate the utilization of prime contractors and subcontractors that were awarded contracts for construction projects during the period. Because UCLA does not actively participate in selecting particular subcontractor(s) that a prime contractor must use on a specific project, A&AS did not review the level of compliance with applicable requirements related to subcontractor selection. Additionally, upon discussion with PDC management, it was noted that construction contracts for off-campus (leased properties) are managed and executed by the property’s landlord, not by PDC or UCLA Capital Programs personnel. As such, projects for these off-campus properties were not included in our analysis.

From the information provided in the two project listings from the PDC department and UCLA Capital Programs, A&AS determined the number of prime contractors used during the period, the number and dollar amount of contracts awarded, and the relative percentage of contracts and dollars awarded to contractors.  Additionally, Excel pivot tables were created to determine the population of subcontractors, the number and dollar amount of contracts awarded to subcontractors, and the percentage of contracts and dollars awarded to subcontractors.

A&AS identified one contractor with the highest number of awarded contracts and one contractor with the highest awarded contract dollars to perform additional analysis. For the contractor awarded the highest number of contracts, and the contractor awarded the highest total contract dollars, two projects were judgmentally selected from each contractor (total of four) for additional review to determine why these particular contractors received the largest volume or dollar amount of construction contracts. For each of the four projects tested, the "Bid Summary Report" was reviewed to determine the reason(s) for the contractor selection (i.e., lowest apparent bidder, past experience with the university, etc.).

Based on our analysis of contractor and subcontractor award activity for the past three fiscal years, as described earlier, the following were noted:

PDC

* Contractors De La Secura, Inc. and Weiser Construction were each awarded three construction contracts from a total of fourteen (a 21.4% share each of the total number awarded). The six contracts for these two contractors totaled $1.8 million which represented about 10.6% of contract dollars for the period.
* The contractor awarded the highest contract dollar volume was New Creation Engineering & Builders with $6 million in construction contracts (36.4% of total contract dollars). The contractor receiving the second largest dollar volume of contracts was Harry H. Joh Construction, Inc., with $5 million.
* Of the 82 total subcontractors awarded contract work by the prime contractors, eight different subcontractors received two contracts each. In aggregate, these eight subcontractors comprised 19.5% of the total subcontracts awarded for the period.

UCLA Capital Programs

* The contractor awarded the largest number of contracts was Interlog, Inc., with 10 contracts from a total of 357 (2.8% of the total number awarded). The 10 contracts totaled $3.1 million which represented 0.7% of contract dollars for the period. The next three most awarded contractors each received eight contracts.
* The contractor awarded the highest contract dollar volume was PCL Construction Services with $138.5 million in construction contracts (31.6% of total contract dollars). The contractor receiving the second largest dollar volume of contracts was Icon West, Inc., with $62.9 million.
* Of the 1,012 total subcontractors awarded contract work by the prime contractors, one subcontractor received 14 contracts (1.4% of total contracts), one received 13 contracts (1.3% of total contracts), and three subcontractors received 12 contracts each (1.2% of total contracts). In aggregate, these top five subcontractors comprised 6.3% of the total subcontracts awarded for the period.

A&AS analysis of the four prime construction contracts tested indicated that all appeared to be properly awarded and in compliance with applicable requirements, and each was also the lowest responsible bidder of those responding. In addition, our analysis of subcontractor awards did not disclose any trend that would indicate that a relatively few subcontractors were improperly receiving a significant percentage of the construction work.

There were no significant control weaknesses noted in this area.

### Change Orders

According to the UC Manual (Vol. 5, Chap. 13.2), a Change Order (CO) is “a post-award modification to the contract. A CO may revise, add to, or delete previous requirements of the work, adjust the contract sum, or adjust the contract time.” Moreover, by signing a CO, a contractor agrees to the cost and time, if applicable, of the contract modification. COs may not be executed until the contract has been signed by the University and contractor. By signing a CO, the contractor agrees to the cost and time, if applicable, of the contract modification; however, the University has the right to order changes in the work by issuing a field order. COs should not be used in pre-award negotiations to negotiate a change in the scope of work, contract sum, or contract time. COs may not be executed until the prime contract has been signed by both the University and contractor.

Discussions were held with the PDC management and Project Managers to gain a detailed understanding of CO procedures, including any dollar thresholds, PDC personnel accountable for COs, and the necessary supporting documentation required for COs to be executed. The Change Order Request (COR) can be initiated by either the University or the contractor.  In the situation where the University needs to change the scope of the project, a Request for Estimate (RFE) is submitted to the prime contractor for a review of estimated costs.  Similarly, when the prime contractor thinks that additional work to the project is needed, a COR is submitted to the University for review of the additional work and cost.

The RFE and COR are reviewed for legitimacy by the respective parties.  Once agreed upon, a COR is submitted with the proper cost proposals, which will then officially request an amendment to the original contract.  A CO form will be populated and once it is signed by the Project Manager, prime contractor representative, the University representative, and the UCLA Capital Programs Accountant, the COR becomes a CO. The purpose of this multi-level review is to ensure the proper delegation of authority is observed and the University's interest is properly protected according to the original contract terms with the prime contractor.

A&AS selected the UCLA Health project, “MP200 MRI Radiotherapy Renovation” (also known as “View Ray MR-RT Installation”), project #9450750.01, as the sample project for CO review and audit testing. This project had a contract cost, including COs through September 8, 2014, of $1.7 million.

For the MP200 MRI Radiotherapy Renovation project, A&AS reviewed the CO Log that was provided by the PDC Senior Project Manager.  Current PDC protocol is that project management staff compile multiple CORs into a single Change Order Group (COG) before submitting for review and processing. Based on that practice, A&AS selected a sample of six CORs from one COG and performed audit testing as an individual CO.  The judgmental sample of CORs was chosen with a focus towards higher dollar CORs.  The COG itself has a total cost of $300,088. A brief description of the six CORs selected for review follows:

* + - COR #R3 ($16,066 – 6th largest in COG): Ferroguard - User requests an installation of a new MRI Ferroguard for patients and staff safety.
		- COR #R16 ($25,650 – 4th largest in COG): RF shielding - Due flooring and ViewRay change, ETS additional RF shielding set up.
		- COR #27 ($106,005 – largest in COG): Electrical - Additional electrical work needed to help ViewRay set up the MRI system.
		- COR #34 ($25,737 – 3rd largest in COG): HVAC - New automated city water system change over for MRI safe off.
		- COR #37 ($47,186 – 2nd largest in COG): Steel - Provide custom stainless steel plate, bracket and metal gate at MRI.
		- COR #41 ($22,226 – 5th largest in COG): Siemens - Automation of city water change over Siemens Building Management System control.

The following were noted:

1. Authorization of Change Orders

The supporting documents for COs are retained by the relevant Project Manager.  Depending on the Project Manager, some prefer to keep documents physically stored in hard copy format while others prefer to store documents electronically.  Test work indicated the CO package normally contains a lead sheet with management’s approval, followed by the original copies of the CORs, and their respective supporting documents, including cost proposals, labor rates, and bill of sale for materials.

The COGs were all approved by the Construction Manager, Prime or Subcontractor, Project Manager, UCLA Capital Programs Accountant, University Representative, and Executive Director of General Services for UCLA Health.  According to the UC Manual, Vol. 5, Chap. 13.2.2; Change Order Execution: "After the Facility Project Manager reviews and recommends the change order, and the accounting office verifies sufficient funds are available, and the University's Representative recommends the change order, it is sent to the contractor for acceptance.  After receipt of the signed change from the contractor, the Facility approves the change order.  Executed change orders are then distributed to all signature parties.  The original and all backup is placed in the project file."

During review of the contract COs; however, A&AS noted that the CO cover pages were consistently signed off by the Project Manager and general contractor prior to being authorized by the University Representative and University Fund Accounting representative. Audit test work disclosed that in all four COs reviewed, the UCLA Capital Programs Accountant was the last individual to sign the CO document. Additionally, in COGs #1 and #3, signature dates for the University Representative and Contractor Representative, respectively, were missing from the documents.  The UC Manual requires the Accounting Officer to verify the project's funding status prior to the execution of the Agreement by the Contractor.

PDC management indicated that because most construction projects are funded by hospital reserves, there is generally a low risk that funds would not be available for a CO. However, PDC also noted that there should be a way to document that the UCLA Health Finance unit has already verified that adequate funding was available prior to UCLA Capital Programs’ review and sign off. It was suggested that one possibility could be an earlier, additional sign off by PDC staff.

Recommendation: Management should require that existing approval and sign-off procedures governing CO agreements are reviewed and, if necessary, revised to better align them with those prescribed in the UC Manual.  If management determines that current practices and due diligence procedures adequately address the intent of UC Manual requirements, management would then assume any residual risk that might arise from deviations with what the UC Manual prescribes.

Response: Procedure for approval and execution of change orders needs to align with the UC Manual. For projects where accounting is managed by Capital Programs (major Capital projects), upon review of the change order by the project manager, the change order will be sent to Capital Programs Accounting office for verification of sufficient funds. For projects where accounting is managed by the PDC project manager (minor Capital projects), the change order will be sent to the PDC Finance Manager for verification of sufficient funds. Upon verification of funds, the University Representative will recommend the change order and send to the contractor for acceptance.

1. Justification for Change Order Bidding

PDC procedures and practices indicated that a CO will not be treated as a new contract, as long as the work is related to the scope of the original project contract. Additionally, COs are not competitively bid to additional contractors after the original project work has been awarded to a prime contractor. PDC personnel noted that efficiency and accountability issues could arise from having multiple prime contractors.

UC Manual (Vol. 5, Chap. 13.2.7) states that “If the cost of a change in the scope of work to be accomplished by a change order or series of change orders exceeds $100,000, or if the proposed changes in design are not incidental to the scope of the work as bid, the work may not be performed by change order unless it can be convincingly demonstrated that no advantage would be gained by conducting an advertised bid for the work.” The Manual further indicates that “It is the Facility’s responsibility to document the rationale for a substantial change order. The written justification for the substantial change order shall identify the primary factors supporting the decision to proceed by change order.” This requirement applies to additive COs in excess of $100,000, and where the work is not competitively bid. In addition, the following factors must also be considered in the written justification to determine if a change order is justified:

*Cost* – Will competitive bidding save money? To what extent will site conditions, storage, limited accessibility, etc. restrict interest of bidders for new work if the new work is bid as a separate project and thereby increase cost?

*Rework* – To what extent will rework be necessary to coordinate with new work? Will competitive bidding of new work affect the University’s ability to obtain correction of deficiencies in specialty work or integrated systems due to a division of responsibilities?

*Incidental* – Is the new work incidental to existing work? A change order is inappropriate if there is a significant difference in function or in the programmatic features or additions to the as-bid design.

*Schedule* – To what extent will competitive bidding of the new work affect the existing/current schedule? To what extent will competitive bidding of the new work affect use of the completed space if the new work is competitively bid either during the performance of the existing contract or later?”

The sample of six CORs and the COG were reviewed to determine if COs in excess of $100,000 were competitively bid and, if not, whether the aforementioned supporting documentation was maintained for those instances. In addition, the sample CORs and COG were tested to determine if costs were based on a lump sum amount and whether those costs were supported by a detailed cost breakdown in those cases where a lump sum method was used.

Of the six CORs reviewed, only one had a value over $100,000. The COG selected for testing consisted of 19 CORs, including the six CORs reviewed. Neither the single COR above $100,000, nor the CO itself, had the required memo justifying why competitive bidding was not utilized. PDC staff confirmed that a justification memo was not created for this CO. By not ensuring that mandatory documentation is maintained to justify the use of additional contractor work directed through non-competitive COs, PDC staff are not in compliance with UC Manual requirements, and important details about the rationale for needing a CO may be lost over time.

A&AS also reviewed the sampled CORs to determine the extent to which a lump sum pricing method had been used. Testing results indicated that none of the CORs had been priced using a lump sum amount method. CORs typically included a detailed cost breakdown and COR cost totals were not rounded to the nearest thousands of dollars, ten thousands, or hundred thousands.

Project managers indicated that they were unaware of the UC Manual requirement to prepare a justification memo for any CO series exceeding $100,000 that was not competitively bid. Management was aware that PDC project managers bundled several CORs together into a single CO for processing and payment. Management further stated that if the UC Manual requires a justification memo for these types of COs, then they would make sure that one is prepared going forward.

Recommendation: Management should require its project managers to review existing procedures, and revise if necessary, to focus appropriate efforts on ensuring uniform compliance with UC Manual requirements. For additive COs (those exceeding $100,000), project managers should prepare and retain sufficient documentation of the facts and conditions to justify not issuing an advertised bid for additional contractor work.

Response: PDC project managers will comply with the UC Manual requirements. For additive change orders, sufficient documentation will be provided to justify not issuing an advertised bid for additional contractor work.

1. Cost Proposal Authorization

When it is determined either by the University or the contractor that a CO is needed during a construction project, the related cost must first be determined using a cost proposal before it can be prepared for execution. UC Manual Vol. 5, Chap. 13.2.1, prescribes the following four methods that may be used to determine cost:

* Unit Prices Listed in the Subagreement
* Agreed-upon Unit Prices
* Agreed-upon Lump Sum Supported by a Cost Proposal
* Actual Cost Plus a Contractor Fee

The UC Manual further states that "When requested by the University, the Cost Proposal form, or an approved version thereof, must be used by the contractor. Instructions for the contractor are included on the form. The contractor's fee, which includes overhead and profit, is defined in the Cost Proposal and in General Conditions, Subparagraph 7.3.4. The University's Representative is required to review and recommend the submitted proposal."

During A&AS review of the CORs discussed earlier, it was noted that none of the six cost proposals tested were signed by the University Representative as evidence of approval. Without a documented sign off and approval, there is no supporting documentation that a review of the costs submitted was performed or that the CO was legally binding once executed. An approval by the University Representative is required to be in compliance with the general contract terms and conditions (Article 7.3.4).

Recommendation: Management should ensure that appropriate PDC personnel and the University Representative exercise due diligence in their review of all cost proposals submitted by contractors in support of a proposed CO. Such a review should be completed prior to authorizing the proposal via a valid approval signature.

Response: Cost proposals submitted by contractors in support of a proposed change order will be fully reviewed and signed by the University Representative as evidence of approval. This will be done prior to authorizing the proposal.

1. Cost Proposal Calculations and Documentation

As a part of our analysis of the six CORs discussed earlier, A&AS examined the supporting documentation and recalculated each of the cost proposals underlying the CORs in the sample. Additionally, the four COGs reviewed were also recalculated for accuracy and completeness. Based on our verifications performed, A&AS found no significant mathematical errors in either the six CORs or the four COGs. However, several calculation errors and a pattern of inadequate supporting documentation were disclosed through our review. The errors identified are described below:

* COR # 27 – the Cost Proposal Summary (CPS) was incorrectly completed; the subcontractor fee rate submitted on the form was 5%, yet the fee was calculated using the 15% rate (an overage of $8,711). No justification was documented as to why the change was made. There was also a $268.26 difference in the total cost calculated in the CPS and the CO form. Additionally, there was no documentation to support either the labor or material costs included in the cost proposal.

* COR #34 – the CPS indicated that a change in labor costs was needed, but A&AS recalculation of the COR from the subcontractor disclosed that there was no change in the material and labor cost included in the CPS. Three of seven CORs submitted by the subcontractor (I-Tech) had no detailed breakdown of either the labor or material cost pricing. While the CPS totals might be accurate as presented, the lack of detailed pricing information precluded any validation of the total costs reported.
* COR #37 – the CPS was not properly completed; the material costs were recorded in the Labor Overtime section of the form. There was also no documentation to support the labor costs. The invoices submitted by the contractor as supporting evidence only accounted for material costs. One of the six invoices provided as supporting documentation did not itemize the invoiced items. Only the total amount was recorded. Again, while the CPS in total might be correct, the calculations were not properly documented. As a result, PDC project managers probably could not have performed a detailed review to substantiate the charges.
* COR #41 – the CPS was not properly completed; although labor costs were included, there was no documentation to support the contractor’s labor charges. A&AS noted that the contractor provided supporting documentation for the subcontractor labor costs, but not for their own.

PDC management indicated that a higher level of scrutiny on COs needs to be performed by staff. However, it was also stated that the high workloads of project managers (about 40 projects per manager versus 12 per manager in industry) may be a root cause for the lack of detailed oversight on COs, Cost Proposals, and the related supporting documents that A&AS has noted in this report. Furthermore, PDC indicated that they were not surprised that occasionally, details can be missed during a project manager’s review. Additionally, PDC stated that staff needs to do a better job at educating contractors on how to correctly complete CPS paperwork.

Recommendation: Management should ensure that project managers thoroughly review and verify proposed contractor costs submitted with COR documents. In addition, management should consider identifying training needs of both project management staff and contractors, and then implement an appropriate training program to strengthen its controls over the CO process. By establishing such measures, the potential risk that unnecessary costs will be incurred by the University could be reduced.

Response: PDC Management has requested an FTE to manage quality assurance/quality control for the department. This individual would be responsible for identifying training needs for project management staff and contractors, and implementing a training program/manual to strengthen department controls over the change order process, as well as other UC Manual requirements.

### Job Order Contracts (JOCs)

According to the UC Manual (Vol. 4, Chap. 1, Sec. 1.3.7), a JOC is a contract for a fixed term or maximum dollar value, whichever occurs first, in which a contractor is selected based on a competitive bid to perform various separate job orders in the future, during the life of the contract. Procurement for this type of contract must still follow the requirements of California Public Contract Code sections 10500-10506; it is a contract, not a purchase order. Failure to follow the Public Contract Code provisions can result in a void contract and/or criminal penalties.

In practice, a JOC operates as a contract for a one-year term with two options to extend the term for one year each. The maximum value of each contract term is $5 million and the maximum value of an individual job order issued under a single JOC is $1 million. A JOC’s scope is exclusive to the contractor. JOCs are typically used for well-defined, recurring or repetitive work where quick execution is essential, not for single projects. The Gordian Group is the UC systemwide provider for JOC services.

Based on discussions with PDC and UCLA Capital Programs personnel, there were three active JOCs during the audit period: Santa Monica Hospital – Office of Statewide Health Planning and Development (OSHPD), UCLA Medical Center – OSHPD, and Santa Monica/UCLA Medical Center – non-OSHPD. JOCs are competitively bid and awarded by UCLA Capital Programs. After the JOC has been awarded, it is the responsibility of PDC to properly execute and manage individual job orders against the JOC. The Project Manager determines whether a JOC is an appropriate contracting method for the project and whether each job order falls within the scope of the JOC. Each job order is created for the project and executed against the JOC. Job orders are reviewed and approved by the UCLA Health Executive Director of General Services. PDC uses e-Gordian, a web portal from The Gordian Group, to monitor JOC activity.

From the three active JOCs, A&AS judgmentally selected a sample of eight job orders for review (four executed against the Santa Monica JOC, two executed against the Medical Center JOC, and two executed against the Non-OSHPD JOC). A&AS performed audit procedures to verify that job orders were executed timely, were in agreement with the terms of the related JOC, and in compliance with applicable sections of the UC Manual.

Based on A&AS review of the eight job orders, the following results were noted:

* In two instances, the Notice to Proceed (NTP) was authorized (as indicated by the Project Manager's signature) after the JOC had already expired.  Specifically, one job order was authorized 301 days after the JOC expiration date, while another job order was authorized 153 days after the expiration date.
* In one instance, the NTP was signed by the Project Manager 16 calendar days after the Construction Start date noted on the NTP.

Job orders executed after the expiration date of the JOC could potentially expose the University to contractual and liability risks.  Job orders should be executed within the terms and time frame of the associated JOC to ensure that all work complies with contract terms and conditions, and both the University and contractor are protected.

A&AS selected the Santa Monica OSHPD JOC for additional review to determine whether this choice of contracting option appeared reasonable for the type of work required or would a more formal contracting method have been more appropriate. The Santa Monica Hospital JOC with New Creation Engineering & Builders was executed in February 2011, and subsequently renewed for two additional terms (the maximum allowable). The final expiration date was February 16, 2015, for the maximum potential contract amount of $6 million. Based on the review, it appeared that the JOC option was reasonable for the types of job orders used.

Recommendation: Management should strengthen controls and oversight governing JOCs to ensure that all job orders are executed within the terms and time frame of the umbrella JOC. This could include designating specific personnel to ensure compliance with established contract requirements.

Response: PDC has designated one team member to be responsible for the oversight of the JOC program. This role will include weekly JOC management meetings for each JOC contract where project schedules, values, and contract requirements are reviewed and discussed with project managers and the JOC Contractor Representative.

Restrictions and Requirements Attached to Funding

Discussions with PDC and UCLA Capital Programs personnel were conducted to identify the types of funding sources utilized for UCLA Health and Campus capital construction projects, whether specific challenges were related to particular funding sources, typical restrictions/requirements related to those funding sources (if any), extent of any linkage between funding source and project type, and adequacy of monitoring to ensure compliance with funding restrictions.

From the two listings of construction projects generated by the PDC department (UCLA Health) and UCLA Capital Programs (Campus) discussed earlier, A&AS identified the types of funding used during the past three fiscal years (2012-13 through 2014-15). For UCLA Health construction projects, 17 different funding sources were used during the period. These funding sources were in the broad categories of Hospital Reserves, Gift Funds, and Donor Funds. For UCLA Capital Programs campus projects, 161 different funding sources were used. The categories comprising these funding sources included: Campus Funds (including department funds, Chancellor funds and loans, Capital Reserves – reserves associated with auxiliary and business enterprises, hospitals, housing, parking, and other self-supporting facilities, student fees); State and Federal Funds and Grants, Gifts, and External Debt Financing. UCLA Capital Programs personnel indicated that, especially for large projects, a diverse layer of funding sources is almost always necessary to get the project accomplished. If use requirements are not adhered to, the State could revoke the funding and seek recovery of the funds provided. From the data provided by the PDC department:

|  |  |  |
| --- | --- | --- |
| Funding Source | % Funding Sources | % Construction Dollars |
| UCLA Health |  |  |
| Hospital Reserves | 70% | 76% |
| Gift Funds | 18% | 21% |
| Donor Funds | 12% | 3% |
| UCLA Capital Programs -Campus (Top 5) |  |  |
| UCOP Taxable/Tax Exempt Commercial Paper | 12% | 30% |
| Group A Housing Res-Cap Outlay | 12% | 9% |
| Transfers from Current Funds | 12% | 6% |
| Transfers from Chancellor Funds | 11% | 8% |
| Transfers from Hospital | 10% | 1% |

For each of the major categories of fund sources used, PDC and UCLA Capital Programs personnel indicated their perspectives on the benefits and challenges of using each type of fund source in the table below.

|  |  |  |
| --- | --- | --- |
| Fund Source | Benefits | Challenges |
| Hospital Reserves | PDC is able to request funding in small segments, making cost estimates more accurate | No general challenges noted |
| Healthcare Department Funds | No general benefits noted | Some of the logistics of having to use Full Accounting Units (FAUs) to charge/receive payments from other departments |
| Gift/Donor Funds | Gift/Donor funds more flexible for Capital Programs (campus) projects | While PDC Gift/Donor funded projects are in the minor project range (under $750,000), Gift/Donor projects must still have a plant account created even though not required for minor projects |
| Campus Funds | Department funds more flexible for Capital Programs (campus) projects | No general challenges noted |
| State Funds | No general benefits noted | Generally the most restrictive in terms of fund usage.  If not used properly, the state may revoke the funding and seek restitution of the funds from the University |
| Grants | No general benefits noted | No general challenges noted |
| External Financing | No general benefits noted | No general challenges noted |

From various meetings held with PDC and UCLA Capital Programs personnel, A&AS determined the range of restrictions and requirements placed upon the University for utilizing each category of construction funding source. A table summarizing the restrictions and requirements of each commonly-used funding source is presented below.

|  |  |  |
| --- | --- | --- |
| Fund Source | Restrictions | Requirements |
| Hospital Reserves | All funds must be used for the stated scope of the project | All Hospital Reserve Funding proposals must be approved by the Capital Committee. |
| Healthcare Department Funds | The department's discretion on the application of fund | Project scope needs to be signed off by the department.  Some departments may require a list of expenses. |
| Gift/Donor Funds | In the case of restricted Gift/Donor funds, some funds may only be used for donor-directed purposes | PDC has to work with the Development office to obtain approval of funds.  Some donors (mostly companies) may require a detailed list of expenses. |
| Campus Funds | The department or campus' discretion on the application of the fund | Depending on the source, approvals may be required from the UC Regents, UCLA Chancellor, or department management. |
| State Funds | General Purpose Fund: Standard bond debenture clauses.State Lease Revenue Bond Fund: Facilities space usage restrictions (only certain amount of private use allowed) | Annual reporting procedures in which the campus reports to UCOP for compliance (particularly space usage, and construction progress, etc.) |
| Grant | Common restrictions related to grants and funding. Must be applied for grant directed usage. | Reporting requirements |
| External Financing | Restrictions may be related to financial term and debenture restrictions | Annual reporting to UCOP Capital Market Department for compliance. |

As a part of our evaluation of procedures and controls to ensure that funding restrictions and requirements are complied with and, as such, potential penalties for non-compliance are minimized to the greatest extent possible, we identified the various campus units/positions with responsibilities related to project funding. The following units, departments, or individuals have responsibility in monitoring campus compliance with construction project funding restrictions and requirements:

|  |  |
| --- | --- |
| Department/Title | Responsibility |
| UCLA Capital Programs -Finance Unit |  |
| Associate Vice Chancellor of Capital Planning and Finance | Leader of project planning; fund source origination; project financial transactions (including fund transfer and invoice payment) oversight. |
| Accountant | Prepare journal entries for financial transactions, review and recommend fund releases. |
| UCLA Health - PDC Department |  |
| Assistant Director | General oversight of construction progress and project management practices. Approve Capital Equipment Request (CER) prior to being presented to Executive Director the Hospital Capital Committee. |
| Project Manager | Manage the project budget; have the fiduciary duties to ensure the project is completed within budget on time; a major role is played in monitoring restrictions and requirements, when applicable. |
| Construction Manager | Manage daily construction activities. |
| UCLA Health |  |
| Executive Director of General Services | Delegated University Representative for hospital construction projects; prior to being presented to Capital Committee, approval and review of CERs are required by Executive Director. |
| Capital Committee | Approval of hospital reserves project funding based on information provided by PDC and hospital department’s recommendations. |

After identifying the responsible campus units involved, and their respective roles in administration and oversight, A&AS performed a variety of document reviews, interviews with key PDC department personnel, and a review of three sample construction project files.

The sample projects had the following project costs and funding sources:

|  |  |  |
| --- | --- | --- |
| Project | Total Project Cost | Funding Source |
| Santa Monica Hospital OSHPD JOC 2011 | $6,000,000 | Hospital Reserves (JOC) |
| SMUMC AHU #6 Replacement | $2,288,832 | Hospital Reserves |
| Lockheed Telemedicine |  $462,000 | Gift/Donor |

A&AS review of the sample projects funding documents noted the following restrictions and/or requirements:

Santa Monica Hospital OSHPD JOC 2011 (Hospital Reserves – JOC)

* + JOCs must be authorized by the University Representative, which at the time of the contract was the UCLA Health Associate Vice Chancellor. Once job orders are requested, the Project Manager and delegated University Representative have to sign off on the individual job orders. Additionally, the UCLA Capital Programs Associate Vice Chancellor of Capital Planning and Finance must approve the transfer of funding from Hospital Reserves to the project plant account. While there was no documentation observed that formalizes this process, the Hospital Reserve funds requested must also be approved by the Hospital Capital Committee before being transferred into the project's plant account.

SMUMC AHU #6 Replacement (Hospital Reserves)

* The project must be authorized by the following: Director of UCLA Medical Center; CFO of UCLA Medical Center; CEO of UCLA Medical Center; Associate Vice Chancellor of Capital Planning and Finance; Vice Chancellor of Finance, Budget, and Capital Programs; and the UCLA Chancellor. Additionally, the Associate Vice Chancellor of Capital Planning and Finance must approve the transfer of funding from the Hospital Reserves to the project plant account. The Hospital Reserve funds requested must be approved by the Hospital Capital Committee before any funds can be transferred into the project's plant account. The Capital Equipment Request (CER) was found in the supporting documentation.

Lockheed Telemedicine (Donor Funds)

* Typically, for most fund sources the main restriction is that funds are required to be used for the stated scope of the project. In the case of gift/donor funds, the donor may restrict the funds to be used for a specific purpose. In addition, PDC staff have to work with the UCLA Development Office to have gift/donor funds authorized for the specified project.

A&AS reviewed the project documentation relating to funding for all three sample projects and did not identify any detailed restriction statement regarding the funding sources. It was noted; however, that for their respective funding sources, all required authorizations were included in the project file documents. For both the Santa Monica Hospital OSHPD 2011 and the SMUMC AHU #6 Replacement projects, the funds were properly approved by the Hospital Capital Committee. All fund transactions relating to these projects were authorized and monitored by pertinent UCLA Capital Programs personnel. For the Lockheed Telemedicine project, documents showed proof of authorization and assistance from the UCLA Development Office. Additionally, all fund transactions were authorized by pertinent UCLA Capital Programs personnel.

Our review also noted that, while particular funding restrictions/requirements did have a relationship with the source of funds (e.g., different authorizing officials, such as Hospital Capital Committee, department management approvals, UCLA Development Office, etc.), there appeared to be no correlation between project type or size and their respective funding sources.

The UCLA Health PDC department structure is formalized through organizational charts and specific lines of authority and reporting duties. Based on A&AS test work performed, the PDC department followed the UC Manual and the respective funding restrictions and requirements. PDC does not have any procedures or manuals to address funding compliance and monitoring specifically. The PDC project managers, UCLA Health Capital Committee, and UCLA Capital Programs Finance personnel are essential components necessary to ensure that funds are allocated to projects and spent in accordance with specified funding restrictions. In the situation where a project expense was improperly allocated to an erroneous project funding source, UCLA Capital Programs Finance personnel could reverse the appropriate journal entries to the correct charge.

Based on our review of the overall compliance monitoring controls, A&AS concluded that the PDC department, along with UCLA Capital Programs Finance unit, and the UCLA Health Capital Committee, are effectively monitoring and would likely detect any significant instances of funding source noncompliance.

There were no significant control weaknesses noted in this area.

160526-2

REP