

# UCLA AUDIT & ADVISORY SERVICES

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April 17, 2015

SENIOR VICE PRESIDENT/CHIEF COMPLIANCE AND AUDIT OFFICER SHERYL VACCA  
EXECUTIVE VICE CHANCELLOR & PROVOST SCOTT WAUGH:

Re: Housing & Hospitality Services – Construction Audit Report #15-2232

Enclosed is the audit report covering our review of internal controls over selected construction activities executed and managed by the Housing & Hospitality Services (H&HS) department.

The primary purpose of the audit was to assess the effectiveness of construction management policies and procedures, and internal controls and processes related to the administration of construction activities. Where applicable, compliance with University policies and procedures, including the University of California Facilities Manual (UC Manual), was evaluated.

The scope of the audit focused on the following areas:

- Inspections
- Field and Change Orders
- Applications for Payment

Based on the results of the work performed within the scope of the audit, the H&HS Project Management unit has adequate systems of internal controls relating to inspections, field and change orders, and payment applications for construction projects. However, some business practices pertaining to field orders could be further strengthened to ensure that controls consistently function as intended. Specifically, for field orders based on Actual Cost Plus Contractor Fee, management should ensure that a “not-to-exceed price” is stipulated, actual costs records are being reviewed by the general contractor, and these records are submitted to the University for review in a more timely manner.

The corrective actions implemented by management satisfactorily address the audit concerns and recommendations contained in the report. In accordance with our follow-up policy, a review to assess the implementation of our recommendations will be conducted approximately four months from the date of this letter.

Please feel free to contact us if we can be of further assistance.

A handwritten signature in black ink, appearing to read 'Edwin D. Pierce'.

Edwin D. Pierce, CPA, CFE  
Director

Enclosure

cc: J. Powazek  
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HOUSING & HOSPITALITY SERVICES  
CONSTRUCTION  
AUDIT REPORT #15-2232

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Background

In accordance with the UCLA Administration fiscal year 2014-15 audit plan, Audit & Advisory Services (A&AS) conducted an audit of internal controls over selected construction activities executed and managed by the Housing & Hospitality Services (H&HS) department. Within H&HS, staff from the Project Management (PM) unit are charged with administering the department's construction program, including project management, construction management, interior design, and architectural services. As of November 2014, the unit was comprised of 11 staff, and headed by the Director of Project Management.

For the 15-month period ended October 30, 2014, H&HS reported five construction projects as completed and one currently in progress for total construction costs of about \$100 million. (See Table 1)

Table 1  
List of Completed and Current H&HS Construction Projects

| Project Name                                       | Notice to Proceed Date (a) | Cert. of Occupancy Date (b) | Final Construction Cost |
|--|----------------------------|-----------------------------|-------------------------|
| Landfair Apartments Redevelopment                  | 11/13/2012                 | 9/22/2014                   | \$66,047,541            |
| Glenrock Apartments Redevelopment                  | 1/11/2013                  | 9/24/2014                   |                         |
| Dykstra Repairs and Refurbishment                  | 2/1/2012                   | 8/8/2013                    | \$29,167,000            |
| Hitch Suites Renovation                            | 6/1/2013                   | 8/28/2014                   | Pending                 |
| Sunset Village - Canyon Point Renovation           | 9/10/2013                  | 5/29/2014                   | \$3,928,713             |
| Sunset Village - Delta Terrace Mailroom Renovation | 6/1/2013                   | 9/20/13                     | \$1,646,481             |
| <b>Total</b>                                       |                            |                             | <b>\$100,789,735</b>    |

Notes:

(a) Notice to Proceed Date – indicates the date when the contractor can begin work at the job site. Date is issued to the contractor by the UCLA Capital Programs department; (b) Certificate of Occupancy Date – indicates the date the project has been certified as ready for occupancy by the UCLA Campus Building Official, UCLA Fire Marshal, UCLA Building Inspector, and other project team members.

## Purpose and Scope

The primary purpose of the audit was to assess the effectiveness of construction management policies and procedures, and internal controls and processes related to the administration of construction activities. Where applicable, compliance with University policies and procedures, including the University of California Facilities Manual (UC Manual), was evaluated. The UC Manual provides campuses access to important policies, procedures, and guidelines for the management and operation of university facilities. It is based on Regents' policy, federal and state laws, regulations, case law, and results from past disputes involving the UC.

The scope of the audit included the following activities:

- Inspections
- Field and Change Orders
- Applications for Payment

The review was performed in accordance with the *International Standards for the Professional Practice of Internal Auditing* and included such 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, the H&HS PM unit has adequate systems of internal controls relating to inspections, field and change orders, and payment applications for construction projects. However, some business practices pertaining to field orders could be further strengthened to ensure that controls consistently function as intended. Specifically, for field orders based on Actual Cost Plus Contractor Fee, management should ensure that a “not-to-exceed price” is stipulated, actual costs records are being reviewed by the general contractor, and these records are submitted to the University for review in a more timely manner.

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

## Audit Results and Recommendations

### Inspections

Inspections are required and occur throughout every key phase of construction projects. At a high-level, there are two categories of inspections: (1) life safety and compliance with building codes, and (2) quality assurance inspections to ensure work and materials used is in accordance with contract specifications. Inspections include, but are not limited to, fire alarm systems and sprinklers, structural, welding, concrete, framing, electrical, plumbing, and soil. Inspections are performed by a variety of personnel including:

- UCLA Capital Programs Inspectors – primarily focused on life safety and compliance with building and construction code. There are inspectors that are specialized in key trades such as plumbing or electrical.
- UCLA Fire Marshal – responsible for fire safety related inspections.
- Outside Inspectors – hired for certain inspection tasks that require continuous monitoring such as welding or concrete and rebar work. Also other specialties such as testing soil or for hazardous materials are performed by outside inspectors. These outside vendors are hired through professional service agreements.

Interviews were conducted with H&HS PM personnel to obtain an overview of how inspections are performed. A judgmental sample of five projects was selected from a list of H&HS projects completed between July 2013 to October 2014. A&AS reviewed inspections documentation to assess whether inspections were properly documented, whether all fire and life safety inspections were performed and passed before buildings were occupied, and whether final inspections were performed and punch list items were all addressed before closing out the contract.

#### A. Fire & Life Safety Inspections

All Certificate of Occupancy forms were completed with all required approval signatures; however, an outdated Fire and Life Safety form was used for two of the five projects. H&HS PM staff indicated that they thought it was a new form, while the

Fire Marshal indicated that it was not the current form and was used in error (the Certificate of Occupancy was the correct form). Subsequent discussions with H&HS PM staff disclosed that the outdated form had been provided by Fire Marshal's Office staff and, as such, was not questioned. The form in question has not been used again. Reviewing the comprehensiveness of the inspection forms was not within the scope of this audit and all required Certificate of Occupancy approval signatures were complete.

There were no significant control weaknesses found in this area.

B. Quality Assurance Inspections

Based on the work performed, all five projects tested had final inspection documentation that included all required approvals indicating work was completed. Unexecuted change order items were noted for two projects (Hitch Suites and Sunset Village - Canyon Point) on their Notice of Completion, but both were for time extension (no cost).

Two Final Inspection Acceptance forms that included unexecuted change orders did not have signatures on the Contracts - Change Order Clearance line. According to two H&HS construction managers, the Contracts - Change Order Clearance line has not typically been used by H&HS or UCLA Capital Programs personnel; however, the Final Inspection Acceptance form is a UCOP form and the signature line is used by the other UC campuses. Because the signatures of the Executive Architect/Engineer, Construction Manager, General Inspector, and Project Manager were present on the forms reviewed, A&AS found no lapse in the required approvals.

There were no significant control weaknesses found in this area.

## Field and Change Orders

### *Field Orders*

Chapter 13 (Sec. 13.1) of the UC Manual defines the following pertaining to field orders:

If a change in the work must be accomplished before the University and contractor agree upon all terms of the change, a field order describing the change in the work scope and estimated contract sum and contract time adjustments, if applicable, may be issued by the University with or without the contractor's agreement.

Field orders are used only when (1) emergency conditions exist where life or property are endangered, (2) the extent of the work cannot be determined due to unknown conditions, or (3) a delay in proceeding with the work would affect the critical path and cause a delay to the entire Project. Field orders are not to be issued when the scope of the work and an estimated cost can be determined. A change order or a directed change order must be used instead.

In general, most change order work begins before a formal change order is issued. According to H&HS staff, this occurs because tight project deadlines do not allow enough time to wait for the formal change order to be issued. Obtaining firm cost proposals from contractors before work commences would be ideal; however, with building renovations there are often unforeseen conditions for which the extent of additional work cannot be determined.

For the field orders that were able to be identified, A&AS selected a sample of five test items to determine the following:

- Field orders were only used when (1) emergency conditions existed where life or property were endangered, (2) the extent of work could not be determined due to

unknown conditions, or (3) a delay in proceeding with work would have affected the critical path and cause a delay to the entire project;

- Cost proposals were obtained and reviewed for reasonableness before field orders were issued, when feasible. When the extent of work could not be determined and contractors were paid based on actual cost plus contractor fee, the field order stipulated a “not-to-exceed price.”
- All field orders were subsequently incorporated into change orders;
- Payments for the field orders were not made until a change order was issued.

For the field orders reviewed, the construction managers indicated the extent of work could not be determined due to unknown conditions or a delay in proceeding would have caused a delay to the entire project. Examples of additional work directed per these field orders included rework to meet fire protection ratings, additional asbestos abatement, electrical wiring work to meet code compliance, and replacement of shower parts due to unforeseen conditions. Without being a part of the construction project team and having a complete picture of what information was available at the time these field orders were issued, A&AS could not determine one way or another if there would have been sufficient time to wait for the change order to be formally issued or if a cost estimate could have been obtained.

Changes in work were directed by the construction managers via documented responses to Requests for Information, bulletins, responses to e-mails, or field orders. When change order requests were submitted by the contractor, cost proposals and/or time and material records were provided and reviewed in detail by the construction managers. The field orders were subsequently incorporated into the change orders. Payments for the field orders were not made until a change order was issued.

#### A. Not-to-Exceed Price

For field orders compensated based on Actual Cost Plus Contractor Fee, the UC Manual (Vol. 5, Chap. 13, Sec. 13.2.1) indicates that a “not-to-exceed-price” must be stipulated. Of the five field orders reviewed, three included work compensated based on this methodology; however, for all three field orders a “not-to-exceed-price” was

not stipulated. One of the construction managers indicated they try to avoid obtaining a “not-to-exceed-price” from the contractors because they will usually provide a price that is very high that incorporates all their risks. Although that may be true, the “not-to-exceed price” should be defined by the University. Construction managers indicated estimated costs and time are discussed and evaluated by the project team prior to issuing field orders.

To help monitor the costs for Actual Cost Plus Contractor Fee work, the UC Manual states “The contractor is required to keep daily records of its actual costs, and submit them on a weekly basis for approval by the University’s Representative.” Although daily records of actual costs were maintained by the contractor and/or subcontractors, these records were not submitted to the University for review until after all the work had already been completed. For example, for one project these records were not submitted to the University until more than a year after the work was performed.

Recommendation: For field orders compensated based on Actual Cost Plus Contractor Fee, management should ensure that a “not-to-exceed price” is stipulated, actual costs records are being reviewed by the general contractor, and these records are submitted to the University for review in a more timely manner.

Response: We concur that for field orders in which an Actual Cost Plus Contractor Fee applies, management should submit a “not-to-exceed” price in a timely manner. However, in accordance to the policies in the *UC Facilities Manual* (Section 13.1), there are certain circumstances in which exceptions to this may occur: “(1) Emergency conditions exist where life or property are endangered, (2) the extent of the work cannot be determined due to unknown conditions, or (3) a delay in proceeding with the work that would affect the critical path and cause a delay to the entire Project.”

### *Change Orders*

A&AS selected and reviewed one change order request >\$100,000 from each of the five construction projects and noted the following:

- Documentation to support the costs for the change orders were provided by the contractor.
- Justifications for not competitively bidding out change orders were documented.
- Change orders were approved by all applicable University personnel.

There were no significant control weaknesses found in this area.

### Applications for Payment

A breakdown of all anticipated costs by division/trade for construction costs must be provided by the General Contractor (GC) at the beginning of the project. This cost breakdown spreadsheet is the core document used by the GC to report their percentage of work completed per division/trade, and which drives the amount the GC is requesting payment. Applications for Payment are submitted on a monthly basis.

The construction manager in H&HS is the primary reviewer of the payment requests. Since the construction manager is primarily responsible for overseeing the construction project and GC, they are in the best position to verify if the percentage of work reported is accurate. Through weekly status meetings with the construction project team and daily visits of the job sites, construction managers know what work has been completed. The construction manager signs the application for payment and forwards it to the project manager for review and approval. Upon the project manager's approval, it is sent to the Capital Programs Accounting department for payment.

GCs and subcontractors must complete and sign waivers indicating they have received progress payments and release their rights to file liens, stop notices, and bond rights specific to the amount of the progress payment. The construction manager is responsible for verifying that these waivers are provided by all GCs and subcontractors.

A. Applications for Payment

Interviews were conducted with H&HS PM management and staff to obtain an overview of how payment applications are completed. One payment application from each of the five construction projects sampled was examined for evidence of review and approval by the project manager and construction manager. Calculations were performed to identify whether the requested payment amount matched the percentage of work completed.

All five payment applications tested included approval signatures from both the project manager and construction manager. The requested payment amount matched the percentage of work completed.

There were no significant control weaknesses found in this area.

B. Waiver and Release Upon Progress Payment

Documentation was reviewed to verify whether Waiver and Release Upon Progress Payments form(s) were completed for each payment application. Subcontractor names and corresponding work activity on each Waiver and Release Upon Progress Payments form(s) were reviewed to verify whether all subcontractors listed performed work related to the payment application. Documentation for all five Applications for Payment tested included Waiver and Release Upon Progress Payment forms from the GC.

There were no significant control weaknesses found in this area.