



AUDIT AND ADVISORY SERVICES

Construction
Audit
Project No. 16-673
September 30, 2016

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September 30, 2016

Robert Lalanne
Vice Chancellor
Real Estate

Vice Chancellor Lalanne:

We have completed our audit of construction as per our annual service plan in accordance with the Institute of Internal Auditors' *Standards for the Professional Practice of Internal Auditing* and the University of California Internal Audit Charter.

Our observations with management action plans are presented in the accompanying report. Please destroy all copies of draft reports and related documents. Thank you to the staff in the Real Estate division for their cooperative efforts throughout the audit process. Please do not hesitate to call on Audit and Advisory Services if we can be of further assistance in this or other matters.

Respectfully reported,

Wanda Lynn Riley
Chief Audit Executive

cc: Interim Vice Chancellor F. Scott Bidy
Associate Vice Chancellor Rajiv Parikh
Assistant Vice Chancellor Grace Crvarich
Associate Vice Chancellor and Chief Financial Officer Rosemarie Rae
Senior Vice President and Chief Compliance and Audit Officer Sheryl Vacca
Associate Chancellor Khira Griscavage
Assistant Vice Chancellor and Controller Delphine Regalia

**University of California, Berkeley
Audit and Advisory Services
Construction Audit**

Table of Contents

OVERVIEW	2
Executive Summary	2
Source and Purpose of the Audit	3
Scope of the Audit	3
Background Information.....	3
Summary Conclusion.....	4
SUMMARY OF OBSERVATIONS & MANAGEMENT RESPONSE AND ACTION PLAN	5
Documentation Related to Change Orders	5

OVERVIEW

Executive Summary

The purpose of the audit was to assess management's internal controls and practices for administering construction activities in accordance with applicable University of California and campus policies and guidelines. This audit was part of a systemwide audit of construction administration and the report contains observations related to conducting the systemwide audit program at the Berkeley campus.

Based on the results of our review, following the systemwide audit program, we observe that the bidding process, the University of California Insurance Program (UCIP), and processes related to ensure compliance with restrictions and requirements attached to funding appear adequate.

We observe that, for some change orders reviewed, the documentation supporting the change orders did not fully justify or support the amounts charged. Specifically, we identified some instances where support for costs claimed by the sub-contractor was insufficient or missing, primarily in the key areas of labor, materials and consumables, equipment, and freight. In some instances support for the sub-contractor's entire claimed costs was missing. We also noted that one sub-contractor repeatedly did not submit supporting documentation.

Source and Purpose of the Audit

The purpose of the audit was to assess management's internal controls and practices for administering construction activities in accordance with applicable University of California and campus policies and guidelines. This audit was part of a systemwide audit of construction administration and the report contains observations related to conducting the systemwide audit program at the Berkeley campus.

Scope of the Audit

The audit scope, as set by the systemwide audit program, included the bidding process, the UC Insurance Program (UCIP), change orders, and restrictions and requirements attached to funding of construction projects. For the review of change orders we judgmentally selected one large construction project; the Lower Sproul Redevelopment Project. In addition, specific information related to project change orders was identified and forwarded to University of California Office of the President for further analysis.

Background Information

The *University of California Facilities Manual* contains policies and guidelines for facilities management and is based on Regents' policy, federal and state laws, regulations, case law, and results of UC's dispute resolution. The manual applies the term "facility" to any university campus, laboratory, unit of the Division of Agriculture and Natural Resources, or location of any other administrative unit. The common term "facility" refers to a building, structure, site or ground improvement, or other item built or installed to serve the university's mission of providing teaching, research, and public service.

The following sections of the *Facilities Manual* were referenced during the audit:

- Volume 1: University Administration, Chapter 4: Delegations and Limitations of Authority;
- Volume 5: Bidding and Construction Administration, Chapters 1-11 (bidding and construction administration policies, procedures, and guidelines) and Chapter 13: Contract Modifications (instructions for the proper authorization and modification of construction contracts through the use of change orders); and
- Contract Templates – Construction, General Conditions, Section 7 which is a part of all construction contracts and details which costs of extra work are allowed and which are not allowed.

The Real Estate division is responsible for the construction and renovation of UC Berkeley's real estate portfolio. Contract Administration is the unit responsible for the formation and administration of agreements for professionals architectural and construction services. Construction and Design manages the design, construction, retrofitting, and restoration of campus buildings and their surroundings.

The UC Capital Financial Plan for 2015-25 shows that the Berkeley Capital Program provides for new capital projects totaling \$27 million in fiscal year 2015-16 and planned capital projects

through 2020-21, including new construction, replacement, improvements, renovation, and smaller capital projects under \$5 million, totaling \$193 million.

Summary Conclusion

Based on the results of our review, following the systemwide audit program, we observe that the bidding process, the UC Insurance Program (UCIP), and processes related to ensure compliance with restrictions and requirements attached to funding appear adequate. However, we observe that for change orders, the documentation supporting the change orders did not fully justify or support the amounts charged in some cases.

Specifically, we identified some instances where support for costs claimed by the sub-contractor was insufficient or missing, primarily in the key areas of labor, materials and consumables, equipment, and freight. In some instances, support for the sub-contractor's entire claimed costs was missing. We also noted that one sub-contractor repeatedly did not submit supporting documentation.

SUMMARY OF OBSERVATIONS & MANAGEMENT RESPONSE AND ACTION PLAN

Documentation Related to Change Orders

Observation

Based on our review of change orders, we observed that in some cases the documentation supporting the change orders did not fully justify or support the amounts charged. We found one or more instances of the following:

- The supporting documentation for the Cost Proposal Summary (CPS) form did not include detail support for the charges. In one instance, the form was missing entirely.
- Labor charges were not supported. In some of these cases, labor charges were a lump sum amount and were not broken out by job category and/or the rate was not identified.
- Materials and consumables were provided as a lump sum only with no supporting documentation. Sales tax was not separately identified as required on the CPS form. In one instance, there was no unit cost provided for both deleted materials and the corresponding replacement materials.
- Freight was charged that far exceeded the amount of materials charged without support or explanation.
- Equipment rental was not supported.
- Amounts claimed on cost proposals were based on quotes or initial estimates and not actual costs without indication of agreement to pay on this basis.
- Fringe benefits broken out separately were charged at 95% or 91% of labor with no further support.

We noted that for one sub-contractor there were eleven separate instances within one CPS where materials were not supported.

Adequate support for amounts charged by the sub-contractors and contractor is necessary to ensure that only legitimate amounts are claimed for the project. Many of the sub-contractors work on more than one CPS during a construction project. Once insufficient supporting documentation is detected, the contractor should be encouraged to ensure the sub-contractors submit sufficient supporting documentation. There is an elevated risk of fraud and overcharging if there is lack of documentation or inadequate documentation to support amounts claimed for payment.

Management Response and Action Plan

In general, a review of the supporting documents show that in most instances proposals, estimates, and quotes were provided as the back up and work was awarded and paid on that basis. In these instances, no further detailed cost breakdown was required, i.e., timecards, rental equipment billing, material invoices, etc. Additionally, please note that change order 42 CPR 16 was originally \$363,852 and was reduced/negotiated to \$280,067. Per Article 7.3.2 of the General Conditions, the term “cost of extra work” required the “CM/Contractor to demonstrate that the costs are both reasonable and actually incurred”. The university’s project team used their reasonable judgement to evaluate the documentation provided on cost proposals.