

**OFFICE OF CAPITAL PROJECTS
AUDIT OF MAJOR CONSTRUCTION PROJECTS**

THE UNIVERSITY OF NEW MEXICO

**Report 2007-06
April 13, 2009**



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ABBREVIATIONS

Board of Regents.....	The University of New Mexico Board of Regents
OCP.....	Office of Capital Projects
Purchasing.....	The University Financial Services Division Purchasing Department
UBP.....	University Business Policy and Procedures
University.....	The University of New Mexico
UNM	The University of New Mexico

EXECUTIVE SUMMARY

As part of the fiscal year 2008 audit plan, the Internal Audit Department conducted an audit of The University of New Mexico (University) Office of Capital Projects (OCP). The audit included a review of contract document files, general and payroll expenses, change orders, inspections, bonds, and insurance. The purpose of our audit was to review OCP operations, business practices and processes, and to subsequently provide recommendations for improvements. Fieldwork included reviewing OCP operations as they related to: two capital projects, compliance with State statutes, Board of Regents Policies, University Business Policy and Procedures (UBP) and general internal controls.

In summary, OCP should develop and publish updated policies and procedures for their operations. Many of the findings are based on a lack of written policies and procedures to ensure that tasks are performed in a consistent manner. In addition, OCP and The University Financial Services Division's Purchasing Department (Purchasing) management need to review the standard written construction contract and general conditions to ensure they protect the University's interest.

POLICIES AND PROCEDURES

OCP management should develop and/or update policies and procedures for the following areas:

- General OCP Policies and Procedures Manual,
- Certified payroll examination for federally-funded projects,
- OCP and Purchasing bidding evaluation process,
- Project files,
- Record retention,
- Plan deposits, and
- Change orders.

The Directors of OCP and Purchasing agreed with the above recommendation.

CONTRACT LANGUAGE

OCP and Purchasing management should evaluate the language for the construction contract and general conditions to ensure that OCP has clearly defined authority and responsibility for the management oversight of the projects, and to ensure that the requirements for paying expenses are reasonable and can be met by the University. The Directors of OCP and Purchasing agreed with the above recommendations.

INSURANCE

Purchasing management should establish written processes to ensure that insurance is maintained throughout the construction period. The Director of Purchasing agreed to establish written processes.

INTRODUCTION

BACKGROUND

The Office of Capital Projects (OCP) was created in the 2006 reorganization of the Department of Facility Planning. OCP is an in-house professional services organization specializing in new facility and existing space design, project development, and construction management. OCP exists to serve the students, faculty, staff, and administration of UNM by interpreting, coordinating, and implementing the capital project directives of Institutional Support Services.

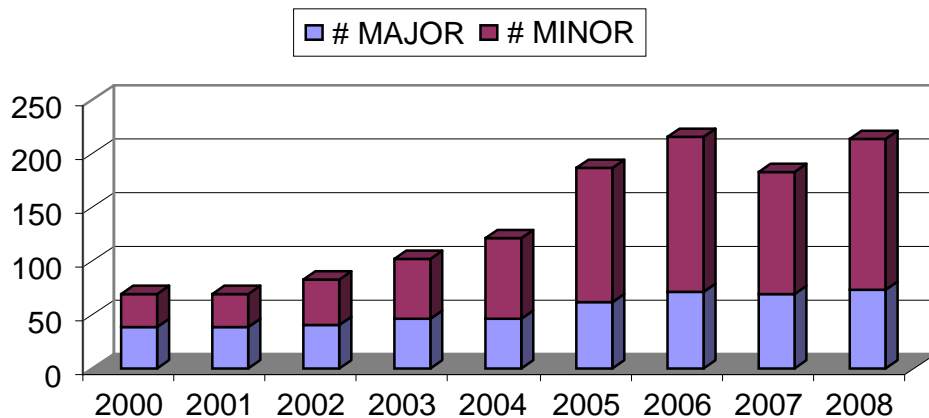
OCP was established as an internal service center, funded 100% by percentage-based fees for professional project management services. The fee methodology and schedule were reviewed and approved by the university administration and Financial Services Division. Periodic adjustments are allowed to accommodate fluctuations in project load.

OCP oversees all capital projects on Main Campus, Health Sciences Center (except University Hospital), South Campus, and all branch campuses. The capital project process includes: having initial contact meetings; performing the feasibility study; developing the project scope, including the budget and schedule; securing approvals and necessary permits; procurement of services and goods; administration of the construction, installation, and occupancy; and closeout. OCP works closely with Planning & Campus Development, the Real Estate Office, Physical Plant Department, Safety & Risk Services, Information Technology Services, Purchasing, and Property Accounting.

The OCP Financial Officer provided the following charts illustrating the growth of capital projects (both number of active projects and their dollar amount) from Fiscal Year 2000 through 2008.

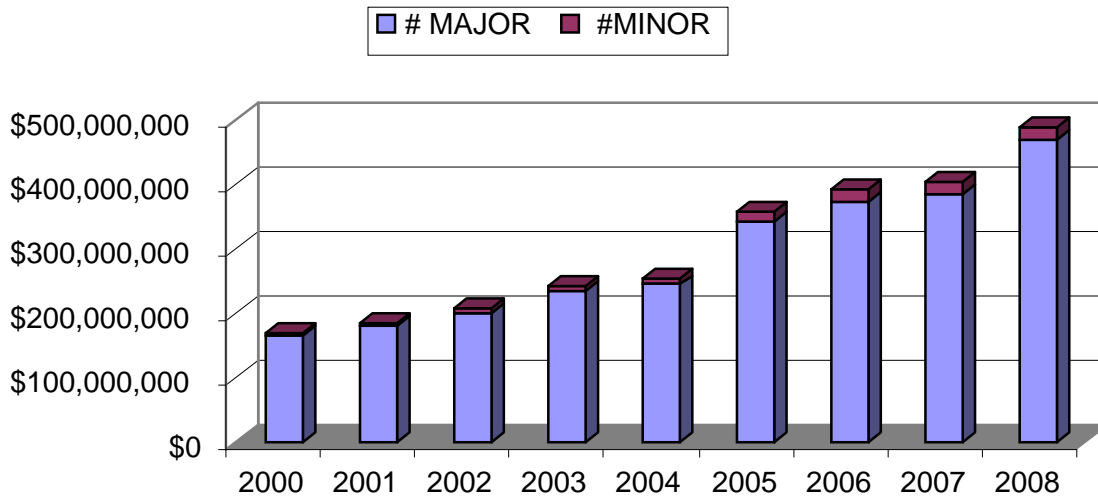
Number of Active Capital Projects

(Source: DFP/OCP Cap Proj Status Rpts)



Active Capital Project Dollars

(Source: DFP/OCP Cap Proj Status Rpts)



PURPOSE

The purpose of our audit was to review the processes for procuring goods and services, and supervising the construction projects at the University, while ensuring University policies are followed and internal controls are adequate to reduce the risk of waste and over-spending.

SCOPE

The scope of the audit covered reviewing the major facets of construction projects, including contract files, bid processes, material expenses, change orders, inspections, bonds and insurance.

For this audit, we selected two capital projects that were in the construction phase at the beginning of the audit and were scheduled to be completed by December 31, 2008. We chose two diverse projects: a classroom/department building on main campus with unrestricted funding and an estimated budget of over \$40 million, and, a research lab on North Campus with some federal funding and an estimated budget of under \$9 million.

We documented the processes, analyzed information provided, interviewed various University employees, and reviewed and tested financial information. The fieldwork was completed on February 17, 2009.

To meet the audit objectives, our audit included the following:

- Performing a contract document review to ensure the contract files are complete and contracts are well-written.
- Evaluating the adequacy of documentation, testing the internal controls and compliance with University policies and state laws regarding the construction bidding process.
- Reviewing and testing controls over the payment process for general and payroll expenses.
- Reviewing internal controls over change orders.
- Verifying adequacy of inspection procedures over completed work and work-in-progress.
- Ensuring that all specified bonds and insurance were purchased for the specified amounts.

OBSERVATIONS, RECOMMENDATIONS AND RESPONSES

POLICIES AND PROCEDURES

An organization uses policy documents to record their rules and regulations and to identify how they would like their operations managed. Policies are often structured to comply with Federal and State laws. The University has three primary sets of policies: The University of New Mexico Board of Regents' Policy Manual, the University Business Policy and Procedures Manual (UBP), and the University of New Mexico Office of the Secretary Faculty Handbook.

Within the University, there are over 300 separate organizational areas. Each of these areas is responsible for their own operations. Therefore, these areas must develop and maintain the policies necessary to define the rules and regulations specific to their area.

Procedures identify how the policies are to be implemented to ensure compliance with University policies, departmental policies, and Federal and State laws. Written procedures are used to establish what should be done as well as how, when and by whom. The procedures normally identify the step-by-step processes of how to implement and carry out the policy including identifying the specific tasks, and clarifying roles and responsibilities. They should be used to provide consistency in the processes, which can increase overall efficiency. Procedures can also be used to improve communications, establish strong internal controls for regulatory compliance, and standardize bookkeeping to help reduce waste, fraud and abuse.

Well-defined policies and procedures can be used to provide orientation and training for new employees and to refresh the skills of current employees. In addition, they can reduce the risk of confusion, the potential for litigation, and provide documentation for auditors and program reviewers.

Policies and procedures should be widely accessible. This will provide employees with the information needed to effectively make decisions at the most appropriate level, streamline administrative processes, and provide the basis for individual and departmental accountability.

Written Policies and Procedures

OCP does not have an updated policy manual and the existing manual is not readily accessible to staff. Their policy manual is from the Department of Facility Planning and is dated April of 2001. OCP has changed management and operations significantly since that time. In addition, the policy manual was not centrally located or accessible electronically.

A policies and procedures manual helps the organization establish and maintain uniformity among employees. A manual demonstrates how processes are to work, helps employees understand how to accomplish their jobs, and assures the information is located in one place for easy reference.

There were several circumstances during our audit where OCP employees were not consistent in their work processes and maintaining documents. The following paragraphs include areas of concern that came to our attention during the audit.

Certified Payroll

Certified payroll for Federally-funded construction is not always reviewed for compliance with the Davis-Bacon Act. For the Federally-funded project we reviewed, OCP employees collected and stored copies of the certified payroll, but they did not examine or compare the wage rates paid to the federally-approved wage rate.

The external audit report addressed this issue in 2007. Finding 2007-01, states: “According to Davis-Bacon requirement in the A-133 Compliance Supplement, certified payrolls shall be obtained and examined by the non-federal entity for all construction contracts exceeding \$2,000 financed by Federal Funds.”

OCP has written procedures assigning weekly examination of certified payrolls to the project manager. A subsequent email delegates the responsibility to the construction manager. The Financial Officer stated that the construction managers are to send him the certified payrolls monthly with a status memo regarding their findings of the review. There is no standardized procedure in this area to ensure compliance.

When OCP does not comply with Davis-Bacon Act, the contractor may not be paying workers according to established wage rates.

Project Files

Some bid and purchasing-related documents were kept by Purchasing; Board of Regents’ meeting notes and approvals are kept by the University Architect and University Secretary; and inspection reports are maintained in with the Construction/Program Manager files until the project is complete. Except for the documents listed above, the construction project files were complete and maintained in the OCP offices. The project file includes all of the documentation on the construction project from inception to completion.

Good business practice requires that project files be complete and the information be in one location. There are no state statutory requirements identifying what construction documents need to be retained for future access.

OCP is relying on others to maintain information related to the project. If there are problems, they may or may not be able to get the information needed.

Record Retention

The Project/Construction Manager for one of the reviewed projects stated that he did not know how long they were to keep the inspection reports. He stated that OCP did not have written procedures on how to store the records (i.e., download to server, hard drive, place in boxes, etc.) and/or how long to keep the records.

OCP should have clear written records retention policies to ensure that employees are aware of who is responsible for retaining what documents, what they are to keep, where the documents are to be stored, and how long to keep the documents.

OCP is a relatively new department and they understand that they need written policies and procedures to cover various areas of operations. However, due to the workload they have not prioritized this task. The risk of not having a policy is that records may not be saved that are needed later and/or employees wasting energy and time saving records that other employees are saving (duplication of work).

Plan Deposits

At the time of our audit, the Financial Officer of OCP was holding, in a secure location, six checks totaling \$1,275 from contractors for construction drawing deposits. The Project Managers had not advised the Financial Officer whether the checks were to be held, returned or deposited. Since this time, the checks have either been returned or deposited.

OCP does not have written policies or procedures for handling plan deposits. Policies would clarify how and when monies would be held, returned, or deposited. Procedures would document the process to assure proper depositing of monies in order to protect the University and the employees handling the monies.

OCP is a new department with individuals from different areas and backgrounds who have been busy with day-to-day work, and not with establishing the necessary policies and procedures. Without policies and procedures there is a risk of monies being lost, not returned and/or deposited when appropriate. Employees could also be exposed to undue risk if accused of mishandling money due to lack of documentation and controls.

Change Orders

For the two projects we reviewed, the change orders were not handled (reviewed and approved) consistently. An itemized breakdown of charges was not always submitted with each change order. OCP employees were not always reviewing the document support for the change orders. In addition, we found one change order with a \$500 addition error that was not caught during the review process.

To initiate a change in the project, the contractor and University use a Change Order Request (preliminary form to the final Change Order). There are written guidelines in the General Conditions which are applied to all general contractor agreements.

General Conditions of the Contract for Construction, Article 7, Section 7.2.2, requires that change orders be supported by an itemized breakdown of the costs, inclusive of materials, labor and labor burden.

OCP lacks procedures to provide for consistent review and approval of Change Order Requests. Without proper supporting documentation, one can not verify that Change Order Requests are reviewed and approved at the appropriate level prior to the commencement of work.

Recommendation 1

The OCP management team should update and revise the current policies and procedures manual for OCP operations. This manual should include all of the above concerns, comply with University policies, and be made available to all staff.

Response from the Director of OCP

The OCP Director agrees to update OCP written policies and procedures to specifically address Project Files, Record Retention, Plan Deposits, and Change Orders by September 30, 2009. Updated procedures have already been written regarding Certified Payroll and Insurance, which will be formatted and forwarded to the Audit Office for review within the next month, no later than April 30, 2009.

University of New Mexico Capital Development is guided by Regent Policy, University Policies, University Standards, State Procurement Regulation, a variety of State and National design and construction codes, and a variety of good practice considerations in programming, design, bidding, construction, project management and construction management. Consequently, the creation and maintenance of an up-to-date Policy and Procedures Manual requires a steady investment of focused effort.

By March 31, 2010, subsequent to updating Project Files, Record Retention, Plan Deposits, and Change Orders, OCP will complete the aggregation of all currently documented policies and procedures into single tabulated volume. We will then establish a complete Capital Projects Policy and Procedures Manual Index. Finally, also by March 31, 2010, OCP will add close-out and warranty guideline sections to the Manual.

In each subsequent six month period, OCP will select and write or update discrete procedure guideline sections until a complete Manual has been written and published.

Bidding Process

The construction bid evaluation committee that selected the contractor for one of the two projects we reviewed did not provide adequate documentation to Purchasing to support the bid tabulation. There was no identification of the raters and/or the date the evaluation was performed. In addition, the contractor earning the highest score (who would normally be awarded the contract) had a higher price than the University could afford. A note in the file stated, “. . . an attempt was made at value engineering and negotiation . . .” but the company “. . . was not able to sufficiently reduce their price.” There was no documentation or support for this statement (i.e., who was contacted at the company, what was discussed, or when they met, who was present, or names of persons involved in the conversations).

There should be written documentation to support the contract award decision. If the contract award decision is challenged, OCP and Purchasing do not have adequate documentation for the following: to show that there was more than one rater; who performed the evaluations; and, that the company who rated the highest was contacted but was unable to amend its proposed price.

OCP and Purchasing have no standard written procedures on the construction bid evaluation process, i.e., what information is to be documented and where the information is to be maintained.

Recommendation 2

The OCP and Purchasing management teams should develop written procedures for the construction bidding process.

Response from the Director of OCP

By September 30, 2009, OCP will develop written procedures for the proposal evaluation process.

Response from the Director of Purchasing

The UNM Purchasing department has written policies and procedures in place for all bids through the State Procurement Code and University Purchasing Regulations 5-7. The current rules, regulations and guidelines specifically address processes and procedures for conducting construction bids and proposals. Efforts will be directed towards bringing OCP and Purchasing practices in synch with each other in relation to the existing bidding process.

Purchasing accepts the responsibility for redefining the roles and relationships of OCP and Purchasing on all construction-related bids and proposals. Purchasing will complete internal procedures between OCP and Purchasing in reference to the proposal evaluation process by June 30, 2009.

CONTRACT LANGUAGE

For each project, the University has a contract with both the architect and the general contractor. For the projects we reviewed, the contracts referred to the University General Conditions of the Contract for Construction (General Conditions). In the contract, the University and the contractor agree to follow these General Conditions. As part of our audit, we compared some sections of the University's General Conditions to the language recommended by the Construction Audit and Cost Control Institute (CACCI).

Update/revise the OCP General Conditions

The University contract language assigns the architect more authority than the CACCI standard recommends. When we discussed this issue with OCP management, we found that the University contract language was written when the office was smaller. At that time, they did not have the number of staff, the breadth of knowledge, or the management that they currently have. Because of these factors, they relied on the architect, and gave the architect the highest level of authority and responsibility. In addition, management stated that the current language was written from the American Institute of Architects guidelines, which give the architect the greatest level of responsibility.

Because of the current standard contract language, the University may be giving the architect more authority and responsibility than is either necessary or in the University's best interest. In addition, although OCP currently addresses the issues in their contract language, the CACCI has recommended language regarding Change Order Pricing, the Right of Audit, and Business Ethics Expectations that OCP may want to consider.

Recommendation 3

The OCP and Purchasing management teams should review, update, and revise (where necessary) the current General Conditions. They should consider giving OCP management more responsibility for the oversight of the projects. They should also consider the recommended CACCI language with regard to Change Order Pricing, the Right of Audit, and Business Ethics Expectations.

Response from the Director of OCP and Director of Purchasing

The Office of Capital Projects working together with Purchasing and the Physical Plant has been engaged for the last two years in a comprehensive review and renewal of General Conditions language for the Owner / Consultant Agreement and the Construction Contract General Conditions for Construction. By September 30, 2009, the Owner / Consultant Agreement update will be completed. By March 31, 2010, the Construction Contract sections that address Change Order Pricing, the Right of Audit, and Business Ethics will be reviewed and updated to enhance Owner management authority.

Timely Payments

For one of the projects we reviewed, we noted that the contract between the University and the contractor and the General Conditions of the Contract were in conflict with respect to what constitutes a timely payment. In addition, the contract did not allow for a reasonable amount of time for the University to receive a request for payment, review it, and make payment to the contractor. The contract guidelines for a timely payment require that a payment be made within a specified time subsequent to the time the architect receives the request for payment, approves it, and forwards it to the University. However, the University has no control over how long the architect holds the request prior to submitting it to the University for payment.

For two of the four progress payments made to the contractor, there was not enough documentation to determine if the University made the payments on time. One of the four payments reviewed appeared to have been made late.

Untimely payments could bring a halt to construction and lead to delays in project completion.

Recommendation 4

OCP and Purchasing management teams should review and revise the standard contract and the General Conditions to better define what constitutes a timely payment. All variables should be under University control.

Response from the Director of OCP and Director of Purchasing

By September 30, 2009, OCP and Purchasing management will review all Consultant and Construction contract language for consistency with regards to timely payment, and for consistency with State Statutes. As needed, we will revise the contract language to clearly define timely payment.

INSURANCE

Insurance Requirements

For one of the projects we reviewed, neither the architect nor the general contractor had the minimum amount of insurance as required in the Standard Agreement for the Architects and in the General Conditions of the Contract for contractors. For the other project, the contractor did not have the minimum amount of insurance required.

The Standard Agreement for the Architects and General Conditions of the Contract for Construction identify the minimum amounts of insurance required by the architect and the

contractor. The minimum amount of insurance is identified and considered as part of the Request for Proposal.

There are not clear procedures and delineated responsibilities between OCP and Purchasing. For example, it is not clear who reviews each document, and what are the requirements to ensure that there is a Certificate of Insurance. From our review, it appears that neither office is ensuring that both the architect and contractor meet the minimum standard required before starting construction.

Therefore, the University is not receiving the minimum services as specified in the bid. In addition, a company may have been awarded a bid (due to a lower price quote than from companies whose bids include the University's minimum required insurance) because they estimated and provided less insurance than was required.

Recommendation

OCP and Purchasing should develop written procedures to identify who will be responsible for ensuring that the insurance certificates have adequate coverage to meet the written requirements stated for the project.

Resolution

During the course of the audit, OCP and Purchasing worked together to resolve this control weakness. Purchasing is responsible for determining insurance coverage. They use a written check-list that is completed by the buyer and approved by the manager to ensure that the architect and contractor have the minimum amount of insurance required.

Monitoring Insurance Certifications

For one of the two projects we reviewed, Purchasing did not have current insurance certificates for the architect. Since the Banner financial accounting system was implemented, Purchasing has been working on a system to identify when certifications are due to expire in order to request/require new certifications be sent to the University. However, at this time, there are no written procedures for this process.

Good internal controls would require the University to have current certificates for insurance on file. This is to ensure that the architect and contractor are still providing an adequate level of insurance for the project.

Recommendation 5

Purchasing should develop written procedures to ensure that they have current certificates for insurance on file for all architects and contractors during the period of construction.

Response from the Director of Purchasing

Purchasing has recently created an electronic database to record and track expiration dates associated with insurance certificates, performance and payment bonds and on-call construction contracts. The database will allow Purchasing to develop periodic reports enabling us to be proactive in monitoring and ensuring the renewal of expiring documents. Purchasing will complete working on establishing internal procedures as to what will be scanned & monitored by June 30, 2009.

General University Insurance Requirements

The University did not have written or posted information regarding the minimum amount of liability insurance required. We were unable to find any criteria or basis for the amount of insurance that should be required in State statutes or in the University Policies. Discussions with the Purchasing Director, the Safety and Risk Services Director, and the Manager of Insurance and Claims from Safety and Risk Services revealed that, in general, the University requires \$1,000,000 of liability insurance.

The amount of liability insurance should be stated in writing, so that others doing business on campus are aware of the requirements. It does not necessarily have to be in the University Business Policies and Procedures Manual because the minimum amounts could change on an “as needed” basis. However, it should be documented in writing, perhaps on the Purchasing and/or Safety and Risk Services websites.

The minimum insurance requirement was not published in writing, because it was assumed. Individuals signing performance agreements are verbally informed they must have \$1,000,000 of insurance.

Recommendation

Purchasing and Safety and Risk Services should develop and publish all insurance requirements to reduce the overall risk to the University.

Resolution

During the course of the audit, Purchasing and Risk Services worked together to resolve this issue. The Purchasing website now includes the University Insurance Requirements.

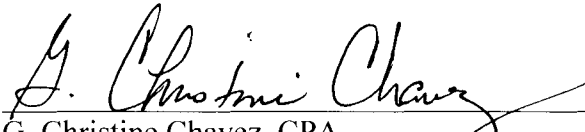
CONCLUSION

In the audit we found that OCP management was:

- Maintaining contract document files.
- Working with Purchasing to ensure compliance with State laws and policies regarding the bidding process.
- Reviewing and providing oversight over the general and payroll expenses, change orders, inspection reports, bonds, and insurance.

We also found that the problems and discrepancies we noted during the audit could be attributed to a lack of up-to-date written policies and procedures.

APPROVALS



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Approved for Publication



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