

**MINNESOTA STATE COLLEGES AND UNIVERSITIES
BOARD OF TRUSTEES
Agenda Item Summary Sheet**

Name: Audit Committee

Date: June 18, 2014

Title: Review Results from Capital Construction Audit Pilot

Purpose (check one):

- | | | |
|---|---|---|
| <input type="checkbox"/> Proposed
New Policy or
Amendment to
Existing Policy | <input type="checkbox"/> Approvals
Required by
Policy | <input type="checkbox"/> Other
Approvals |
| <input checked="" type="checkbox"/> Monitoring /
Compliance | <input type="checkbox"/> Information | |

Brief Description:

Review results from an independent auditor of capital construction projects at Minneapolis Community and Technical College and Hennepin Technical College.

Scheduled Presenter(s):

Beth Buse, Executive Director, Office of Internal Auditing
Matt Gardner, Risk Advisory Services Manager, Honkamp Krueger & Co.

**BOARD OF TRUSTEES
MINNESOTA STATE COLLEGES AND UNIVERSITIES**

BOARD INFORMATION

REVIEW RESULTS FROM CAPITAL CONSTRUCTION AUDIT PILOT

1 In fiscal year 2013, as part of a pilot program, the Office of Internal Auditing contracted with an
2 external audit firm with expertise in construction auditing to complete a contract compliance
3 audit of two capital construction projects in coordination with the Finance Division facilities
4 unit.

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6 The firm of Honkamp Krueger & Co. P.C. completed audit work on projects at Hennepin
7 Technical College (Learning Resource Center and Student Service Center Renovation project)
8 and Minneapolis Community and Technical College (Workforce Program and Infrastructure
9 Renovation project).

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11 Over the next few months, Internal Auditing and the facilities unit plan to evaluate the results of
12 the pilot and come back to the board with recommended future steps for construction audits
13 within the system.

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15 See the attached executive summary reports from Honkamp Krueger & Co.
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36 *Date Presented to the Board of Trustees: June 18, 2014*
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Executive Summary for Hennepin Technical College Renovation Project

Project Description

At the request of the Minnesota State Colleges and Universities' (MNSCU) Internal Audit department, Honkamp Krueger & Co. P.C. (HK) completed an audit of the construction cost incurred by MNSCU for the work on the Hennepin Technical College (HTC) Learning Resource Center and Student Service Center Renovation project. The project consists of small additions for main entrances and construction renovations for the Library/Learning Resource Centers (LRC), Student Services and Bookstore areas at both the Eden Prairie and Brooklyn Park Campuses. The project will provide new, updated main entrances to both campuses as well as significant remodeling for improved student facilities. A stipulated sum contract was used to secure the services of LS Black Constructors (LS Black), who worked with the other members of the MNSCU and HTC Project Management Team (PMT) to organize and construct the project plan and timelines, execute the required subcontracts, and coordinate all aspects of the project. Pre-construction began on the project in January 2012 with a final completion date of September 2013. As of the time of completed fieldwork, March 18, 2014 (Pay request #19), total construction cost incurred for the project was \$8,693,908 with approximately \$240,473 still retained by MNSCU. No additional costs are expected to be incurred by LS Black. Fieldwork was performed at the LS Black office located in North St. Paul, MN.

Objective & Scope

The objective of the audit was to review documentation of costs incurred by LS Black and paid for by HTC in completion of the project to determine if the requests for reimbursement were in alignment with the applicable contracts. The scope of the audit included all costs invoiced by LS Black including subcontractor costs. Additionally, HK verified MNSCU's Stipulated Sum and Prevailing Wage requirements were met for LS Black and all subcontractors secured on the project.

Audit Approach

The following approach was taken in order to successfully achieve the objectives of the audit:

- Conducted interviews with LS Black and HTC Project Managers.
- Summarized posted transaction details for the project provided by LS Black.
- Reviewed payroll registers, time sheets, and labor contracts for LS Black and major subcontractors.
- Reviewed the accuracy of labor burden rates for LS Black and major subcontractors.
- Tested material, equipment, and insurance transactions on a sample basis for LS Black and major subcontractors.
- Reviewed LS Black major subcontractor contracts and change orders and agreed to LS Black payment applications.
- Recalculated contractor's fee, markups, bonds, and general insurance add-ons.

Summary of Audit Results

Overall, it appears the confusion of contract verbiage and LS Black project manager turnover resulted in a lack of cost containment normally associated with a project of this size as well as the volume of change orders and costs for completion of the project. We noted a number of compliance issues with the contract that appear to be in part due to misinterpretation of the contract, specifically key clauses concerning change order requirements, lack of supporting documentation, labor and labor burden costs, and costs to be included in markup percentages. The cost recovery amount identified and the final amount recovered by HTC/MNSCU through negotiation with the contractor(s) is summarized below along with best practice suggestions for improvement of HTC/MNSCU processes and contract controls. Detailed descriptions of each cost recovery opportunity along with suggestions for improvement are provided in the Cost Recovery Detail and Best Practice Suggestions Detail sections below.

As of the time of completed fieldwork, March 18th, LS Black has not responded or indicated whether a credit will be issued for some or all of the cost recovery opportunities identified. HK will continue to initiate conversations with LS Black to reach an agreement on these cost recovery opportunities. HK recommends HTC/MNSCU to continue to withhold payment until negotiations continue and agreement is reached for the costs in question.

<p>Cost Recovery Opportunities Identified by HK Total cost recovery opportunities not in alignment with the contract that were identified by HK.</p>	<p>\$32,937</p>
<p>Cost Recoveries Obtained by HTC/MNSCU Total cost recoveries obtained by MCTC/MNSCU through negotiation with the contractor(s) based on the opportunities noted by HK.</p>	<p>\$0</p>

Best Practice Suggestions

The following recommendations are based on observations noted in conducting the audit and are being presented to MCTC/MNSCU for consideration to improve upon their current processes and related controls:

1. Revise contract language to ensure clarity and mutual understanding by all parties involved.
2. Review and agree upon subcontractor labor rates prior to start of project.
3. Update contract to more clearly define general conditions reimbursable expenses.
4. Define personnel allowed to charge time in the contract.

Thank you again for the opportunity to provide Minnesota State Colleges and Universities and Minneapolis Community and Technical College with our Construction Audit Services. We appreciate the assistance and cooperation of MCTC/MNSCU and LS Black staff members.

Respectfully,

Team Leader:
 Matt Gardner – Construction Audit Services Practice Leader

Executive Summary for Minneapolis Community & Technical College Renovation Project

Project Description

At the request of the Minnesota State Colleges and Universities (MNSCU) Internal Audit department, Honkamp Krueger & Co. P.C. (HK) completed an audit of the construction cost incurred by MNSCU for the work on the Minneapolis Community and Technical College (MCTC) Workforce Program and Infrastructure Renovation project. The project consists of the extensive remodel of approximately 82,000 GSF for workforce programs such as nursing, architectural technology, air traffic control, barbering, computer security, jewelry and gemology, heating, ventilation, air conditioning and refrigeration, and photography/digital imaging, student services testing center located throughout the five floors of the T-building. This project will reduce an estimated \$7.6 million in deferred maintenance, eliminates the need for 67,400 sq. feet of leased space in Eden Prairie and resolves significant long standing fire code and life safety issues. Infrastructure upgrades will include: the installation of elevators and improve stair access to all levels; increase ventilation and install cooling in the trades areas on the lower level; and resolve code related issues. A Construction Manager at Risk Guaranteed Maximum Price (GMP) contract was used to secure the services of M.A. Mortenson Company (Mortenson), who worked with the other members of the MNSCU and MCTC Project Management Team (PMT) to organize and construct the project plan and timelines, execute the required subcontracts, and coordinate all aspects of the project. Pre-construction began on the project in September 2012 with the final completion date of January 2014. As of the time of completed fieldwork, May 30, 2014 (Pay request #22), final construction cost for the project was \$12,623,768.68. Fieldwork was performed on the MCTC campus located in Minneapolis, MN.

Objective & Scope

The objective of the audit was to review documentation of costs incurred by MCTC and Mortenson and paid for by MCTC in completion of the project to determine if the requests for reimbursement were in alignment with the applicable contracts. The scope of the audit included all costs invoiced by Mortenson including sub-contractor costs. Additionally, HK verified MNSCU Construction Manager at Risk and Prevailing Wage requirements were met for Mortenson and all subcontractors secured on the project.

Audit Approach

The following approach was taken in order to successfully achieve the objectives of the audit:

- Conducted interviews with Mortenson and MCTC Project Managers.
- Summarized posted transaction details for the project through January 31, 2014 provided by Mortenson.
- Reviewed payroll registers, time sheets, and labor contracts for Mortenson and major subcontractors.
- Reviewed the accuracy of labor burden rates for Mortenson and major subcontractors.
- Tested material, equipment, and insurance transactions on a sample basis for Mortenson and major subcontractors.
- Reviewed Mortenson major subcontractor contracts and change orders and agreed to Mortenson payment applications.
- Recalculated contractor's fee, markups, bonds, and general insurance add-ons.

Summary of Audit Results

Overall, it appears different interpretations of contract verbiage resulted in a minor lack of cost containment normally associated with a project of this size. We noted a number of compliance issues with the contract that appear to be in part due to different interpretations of the contract, specifically key clauses concerning labor and labor burden costs, costs to be included in markup percentages, and overhead and profit markups. The cost recovery amount identified by the audit and the final amount recovered by MCTC/MNSCU through negotiation with the contractor(s) is summarized below along with best practice suggestions for improvement of MCTC/MNSCU processes and contract controls. Detailed descriptions of each cost recovery opportunity along with suggestions for improvement are provided in the Cost Recovery Detail and Best Practice Suggestions Detail addendums attached to this report.

Cost recoveries opportunities identified during closeout testing are currently in negotiation with Mortenson and the final credit amount owed to MCTC/MNSUC has yet to be determined. Cost recovery opportunities currently in negotiation are indicated in the Cost Recovery Detail section below (issues 6-8)

<p>Cost Recovery Opportunities Identified by HK Total cost recovery opportunities not in alignment with the contract that were identified by HK.</p>	<p>\$27,252</p>
<p>Cost Recoveries Obtained by MCTC/MNSCU Total cost recoveries obtained by MCTC/MNSCU through negotiation with the contractor(s) based on the opportunities noted by HK.</p>	<p>\$14,795</p>

Note: The amount recovered was in excess of the amount identified due to additional change orders processed after audit fieldwork was completed.

Best Practice Suggestions

The following recommendations are based on observations noted in conducting the audit and are being presented to MCTC/MNSCU for consideration to improve upon their current processes and related controls:

1. Revise contract language to ensure clarity and mutual understanding by all parties involved.
2. Review and agree upon subcontractor labor rates prior to start of project.
3. Update contract to more clearly define general conditions and change order reimbursable expenses.
4. Define personnel allowed to charge time in the contract.
5. Define bidding procedures when competitive bids are not available for all scopes of work; specifically self performed work.

Thank you again for the opportunity to provide Minnesota State Colleges and Universities and Minneapolis Community and Technical College with our Construction Audit Services. We appreciate the assistance and cooperation of MCTC/MNSCU and Mortenson staff members.

Respectfully,
 Matt Gardner – Construction Audit Services Practice Leader