

Minnesota State Colleges & Universities  
Office of Internal Auditing

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# Capital Construction Administration Audit

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Final Report  
May 8, 2006

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Capital construction projects represent a major expenditure area for the Minnesota State Colleges and Universities (MnSCU). Colleges and universities spent over \$517 million on capital construction projects for the three and a half years ended December 31, 2004. Much of this expense is incurred in just a few projects. Of the 579 projects that we identified during this time period, five percent of the total (28 projects) accounted for over \$300 million of the expenses.

Vice Chancellor King and Associate Vice Chancellor Allan Johnson recognize the many risks associated with capital construction and sought an internal audit to assess capital construction project administration. This project was added to the Internal Auditing audit plan that was approved by the Board of Trustees for fiscal year 2005.

Overall, we found that the process for administering capital construction projects effectively prevents cost overruns. We cite some recommendations and observations, though, for improving contract administration and oversight.

We conducted this audit in compliance with the *Institute of Internal Auditors: Standards for Professional Practice of Internal Auditing*. We interviewed employees, including facility directors and chief financial officers from all MnSCU colleges and universities. We are grateful to these employees for their assistance. In addition, we conducted detailed testing of 56 construction projects that accounted for nearly half of the capital construction expenses incurred during this time period and analyzed extensive financial and project data.

Ms. Beth Fondell, Southeast Regional Audit Coordinator, was responsible for much of the lead work on this project, including the design and testing of the interview questionnaires and project testing instruments. Ms. Beth Buse, Deputy Director of Internal Auditing, was responsible for the overall project management. Other Internal Auditing employees also contributed significantly to this project. Finally, I would like to acknowledge the expert program assistance that we received from Mr. Allan Johnson and Mr. Bill Breyfogle of the Facilities Unit. These talented individuals have endured our many questions and freely shared their knowledge to guide us through this effort.

Sincerely,

John Asmussen, CPA, CIA, CISA, MBA  
Executive Director  
Office of Internal Auditing

Report Submitted: May 8, 2006

# Capital Construction Administration Audit

## Final Report – April 2006

### Section I: Introduction

The Office of the Chancellor Facilities Unit has overall responsibility for administering capital construction projects within the Minnesota State Colleges and Universities (MnSCU) system. The Facilities Unit is managed by Mr. Allan Johnson, Associate Vice Chancellor for Facilities. Mr. Johnson and Ms. Laura King, Vice Chancellor for Finance – Chief Financial Officer requested that the Office of Internal Auditing conduct an audit of capital construction administration within the system. Internal Auditing added this review to its audit plan for fiscal year 2005, approved by the Board of Trustees.

The Facilities Unit is structured into two groups; Facilities Planning and Programming and Facilities Construction and Support Services. The Facilities Construction and Support Services group consists of four program managers and a director that are responsible for oversight of construction activity within the system.

Over the past few years the Facilities Unit has restructured its administration of capital construction projects. Four years ago the unit directly managed 15 – 20 percent of all capital projects and delegated the administration of the remaining projects directly to colleges or universities. Since that time, the unit has changed its philosophy and focuses its attention on project oversight and not directly managing projects<sup>1</sup>.

The Facilities Construction and Support Services Director assigns a program manager to serve as the key contact for capital construction projects at each college and university. Program managers assist campus representatives in better understanding the process and procedures necessary to accomplish specific requirements during the design and construction phase of a capital construction project. Under the current structure, the program managers are not considered project managers. In most large projects, colleges and universities are requested, in their project delegation letter, to contract with an ‘owner’s representative’ to assist them with project management.

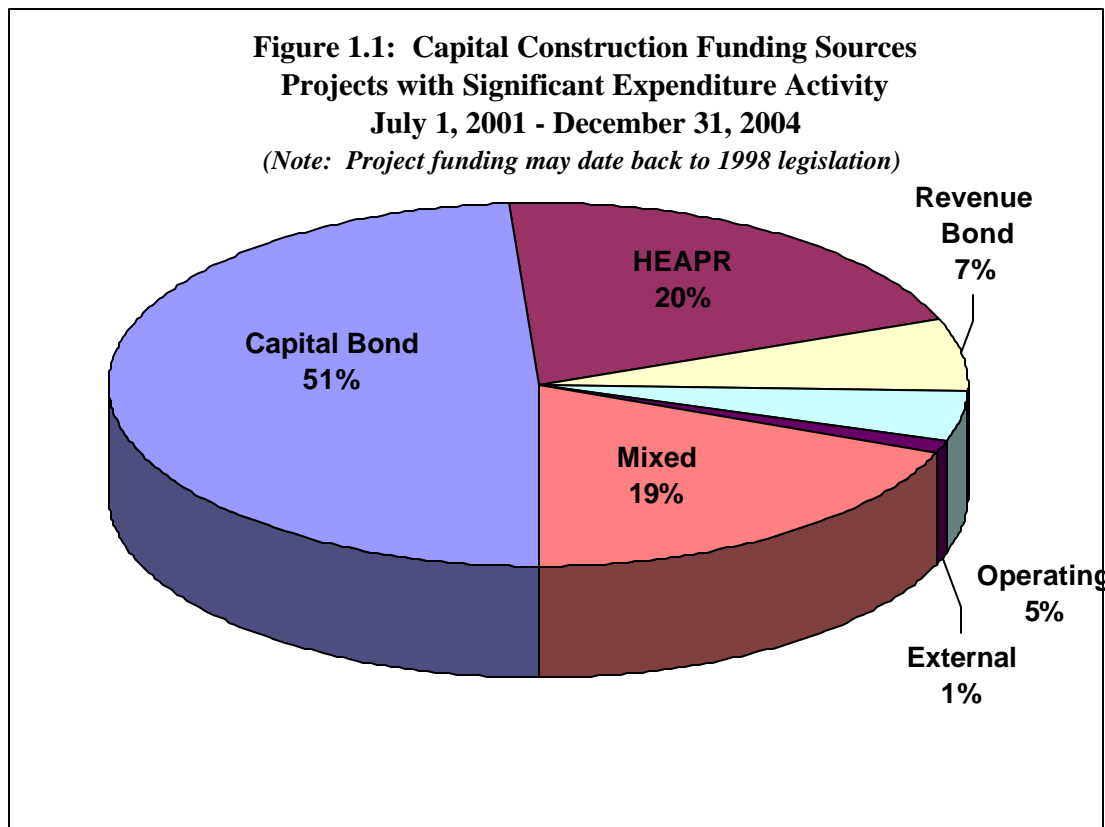
A somewhat distinctive element to the MnSCU capital construction program is that colleges and universities basically spend what they get for a project. For example, if a university receives a \$20 million capital appropriation to construct a new science building, \$20 million is spent. This is accomplished through strict language in contracts with architects to design to specific dollar amounts, building contingencies into budgets for the change orders typical in the construction industry and close scrutiny in managing the projects. For the projects tested, costs were managed within available resources and no significant budget overruns were noted. The audit scope included projects with significant<sup>2</sup> expenditure activity between July 1, 2001 and December 31, 2004. During this timeframe, there were 579<sup>3</sup> projects with significant

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<sup>1</sup> The Facilities Unit still continues to directly manage all roofing projects that are funded with HEAPR funds.

<sup>2</sup> This analysis excluded projects that were substantially completed prior to July 1, 2001, and projects just beginning late in calendar year 2004.

activity and total expenditures of approximately \$517 million. Figure 1.1 shows a breakdown of total capital construction expenditures by funding source. The two largest funding sources are Capital Bond and Higher Education Asset Preservation and Replacement (HEAPR). They are funded with capital appropriations using state general obligation bond proceeds. MnSCU is required to pay one third of the debt on projects funded with state general obligation bonds. The HEAPR program focuses on major repair and replacement that extends the life of buildings. MnSCU does not incur debt on HEAPR projects. Funding for some projects dates back to the 1998, 2000 and 2002 legislative sessions.



The Facilities Unit has established specific requirements for colleges and universities to follow when administering a capital construction project, regardless of the funding source. These requirements are detailed on the Facilities Unit web site and include instructions for construction contracts and forms, project budget worksheets, a Request for Proposal (RFP) template and guidelines for allocating project dollars for works of art. Also included on the web site are the MnSCU design standards that detail the construction specifications required

<sup>3</sup> For this audit, a separate project was defined to include the following: Construction projects defined in Minnesota law and funded with capital bond proceeds; separate allocations made by the MnSCU Facilities Unit for repair and maintenance efforts funded with HEAPR appropriations; construction funded by the revenue bond fund; projects funded by college and university operating funds that exceeded \$50,000; projects funded by external sources, such as foundations; and “mixed” which would include any combination of the above.

on all capital projects. Variances from the published design standards must be authorized in writing by the Facilities Unit.

The audit methodology included:

- Completing data analysis to determine capital construction expenditures during the audit scope.
- Interviews with Facilities Unit staff.
- Visits to all colleges and universities and interviewing employees about capital construction administration.
- Tests of a sample of 56 capital construction projects from all funding sources, including projects managed by the Facilities Unit and those delegated to colleges and universities. The sample was tested to ensure that project administration followed the Facilities Unit requirements and state law. Table 1.1 documents a breakout of projects tested.

The results of the audit are discussed in the remaining sections of this report.

**Table 1.1: Breakdown of Project Population and Sample Tested  
Projects with Significant Expenditure Activity from July 1, 2001 – December 31, 2004**

| <b>Project Expenditure Ranges</b> | <b>Total Project Expenditures</b> | <b>Total Projects within Audit Scope</b> | <b>Number of Projects Tested</b> | <b>Total Amount of Projects Tested</b> |
|-----------------------------------|-----------------------------------|--|----------------------------------|--|
| > \$10 million                    | \$190,295,578                     | 13                                       | 5                                | \$93,397,923                           |
| \$5 - \$10 million                | \$118,808,551                     | 15                                       | 13                               | \$97,683,495                           |
| \$1 - \$5 million                 | \$108,052,180                     | 44                                       | 16                               | \$46,607,742                           |
| \$500,000 - \$1 million           | \$40,445,524                      | 59                                       | 7                                | \$5,290,518                            |
| \$250,000 - \$500,000             | \$31,807,305                      | 90                                       | 7                                | \$2,384,711                            |
| \$100,000 - \$250,000             | \$17,247,503                      | 108                                      | 6                                | \$979,192                              |
| \$50,000 - \$100,000              | \$7,857,026                       | 109                                      | 2                                | \$123,194                              |
| Under \$50,000                    | \$2,918,776                       | 141                                      | 0                                | 0                                      |
| <b>Totals</b>                     | <b>\$517,432,444</b>              | <b>579</b>                               | <b>56</b>                        | <b>\$246,466,775</b>                   |

## Section II: Contract Administration and Compliance

Contracts and other supporting documents create the legal foundation for capital construction projects. This documentation sets forth project objectives and expectations of each party involved. Minnesota Statutes, Board Policies, System Procedures and contract terms establish basic requirements for the contracting process. Additional guidance is provided on the Facilities Unit web site in a section entitled “Construction Contract Guidelines and Forms”<sup>4</sup>.

There was relatively widespread variation from expected contract administrative procedures. These requirements are meant to help protect MnSCU, as the owner, from liability, litigation, and additional costs in the event that something goes wrong during a construction project. While MnSCU is fortunate that most of the variations did not develop into any significant issues, it is important to adhere to the requirements to protect MnSCU in future projects. A summary of the major contract administration and compliance issues noted during the audit follows.

### **1. Colleges, universities and the Office of the Chancellor are not complying with administrative procedures relating to executing contracts.**

Of the 56 projects tested during the audit, all but five projects did not completely follow contract administration procedures and guidelines. However, there was no evidence that the issues resulted in any significant financial loss to the system for the projects tested. Nevertheless, many of these issues may create exposure to the system in the event problems or disputes had occurred with the projects or occur in the future.

Table 2.1 summarizes the contract issues identified during the audit testing. The most prevalent issue dealt with using improper contract forms. Current versions of forms, templates and contracts are available on the Facilities Unit website and have been approved by legal counsel. However, the usability of this site could be improved.

In addition to the issues summarized in Table 2.1, there were other compliance issues identified during fieldwork that were not specific to projects that were tested. These issues are discussed below.

- Encumbrance transactions were not always recorded timely for contracting obligations. In some cases, encumbrance transactions are entered into the accounting system before the letter of award is issued to notify the contractor that they have been awarded the job. In other cases an encumbrance is established when the contract is signed and the contractor is notified that they may proceed with the job. In the remaining cases, the encumbrance was not established until after the contract was signed. There appears to be differing opinions within the Office of the Chancellor regarding the proper practice. Revised guidance was issued internally in January 2005 stating that an encumbrance should be established after the contractor and before MnSCU signs a contract. The guidance included in the “Construction Contract Guidelines and Forms” on the Facilities Unit web site contains different instructions based on the size of the contracts involved.

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<sup>4</sup> The URL for the website is <http://www.facilities.mnscu.edu/mainpage/contractspage.htm>

- Nearly half of the colleges and universities and the Office of the Chancellor were not in compliance with delegation of authority requirements. Issues identified include absence of delegation letters, authority levels exceeded and gaps in delegation periods.
- Some colleges and universities cited the owner as the college or university rather than the Board of Trustees of the Minnesota State Colleges and Universities when completing contracts for capital construction.
- College and university project managers were not aware of the requirement to report independent contractors to the Minnesota New Hire Reporting Center.

The Facilities Unit needs to provide additional guidance and training to colleges and universities on the issues discussed above.

**Table 2.1  
Contract Administration and Compliance Issues**

| Summary of Issues Noted   | # of Projects Cited |
|---|---------------------|
| Use of non-MnSCU forms, templates and contracts.  | 24                  |
| Obsolete or incorrect forms / contracts used.   | 14                  |
| Incorrect or missing contractor signatures on contracts.  | 10                  |
| Mileage, fax and/or copying charge reimbursements were at higher rates than allowed (all noted deviations were relatively immaterial).                          | 10                  |
| Incorrect legal name of entity included in contract. One contract was missing a tax identification number. One contract dollar amounts did not foot accurately. | 10                  |
| Contracts and change orders were signed by MnSCU prior to the contractor, or no dates were associated with signatures.  | 9                   |
| Contracts, change orders or other documents were not signed by MnSCU representatives.   | 6                   |
| Contractor payment requests were not properly approved for payment. In one project, payments were made more frequently than monthly.                            | 5                   |
| Contract end dates and/or substantial completion dates were not extended by amendments or change orders.  | 5                   |
| RFP was not issued for owner’s representative fees exceeding \$100,000. One project did not have sealed bids for a contract exceeding \$50,000.                 | 3                   |
| Contract start date passed before the contract was signed; no 16A letter done.  | 3                   |
| Notice to Proceed was issued prior to complete contract execution.  | 2                   |
| Bid Tabulation sheet was not created or incomplete.   | 2                   |
| Change orders and supplemental agreement occurred after substantial completion.   | 1                   |
| No written Notice to Proceed was prepared.  | 1                   |



### ***Recommendations***

- *The Office of the Chancellor should provide improved, more user-friendly on-line resources for project managers to execute and manage contracts effectively. It is our understanding that the Facilities Unit is currently authoring an on-line E-Manual for this purpose.*
- *Colleges and universities and the Office of the Chancellor must comply with contracting requirements governed by Minnesota Statutes, Board Policies, System Procedures, contract terms and Construction Contract Guidelines and Forms on the Facilities Unit web site.*
- *The Office of the Chancellor should determine the proper timing to establish encumbrance transactions and incorporate the information into on-line guidance and/or a System Procedure.*
- *Colleges and universities and the Office of the Chancellor must comply with Board Policy 1A.2 and System Procedure 1A.2.2 regarding delegation of authority. The Office of the Chancellor should offer guidance and training to improve awareness of delegation of authority requirements.*

## **2. Colleges and universities generally do not understand when a contract should be used on repair and maintenance services.**

Most colleges and universities are not executing contracts for small repair jobs; instead they rely on purchase orders to detail terms of service agreements. While the contracting process is more time consuming, it does provide the project owner with protection. Specifically, a contract documents insurance requirements and liability responsibility for the contractor. Facilities Unit management agreed that contracts should be used regardless of the size of the project or service. For example, except during emergencies, a contract should always be executed with an electrician regardless of the size of the project.

### ***Recommendations***

- *The Facilities Unit should provide additional training to individuals involved in the contracting process.*
- *Employees responsible for capital project management must adhere to the instructions for Construction Contract Guidelines and Forms located on the Facilities Unit web site.*
- *The Facilities Unit should coordinate efforts among colleges and universities to identify efficient methods for contracting for repairs and maintenance services.*

**3. Colleges, universities and the Office of the Chancellor used inconsistent practices when selecting contractors and designers.**

The interpretation of whether bidding contractors demonstrated appropriate acknowledgement of multiple addenda on bid forms is not consistent. Addenda are clarifications of bidding documents provided to bidders that are required to be acknowledged within the bid form in order for the bid to be considered “responsive”. In four cases, there were bid forms in which contractors did not specifically note all addenda as acknowledged; some bids were rejected while others were accepted. Admittedly, the circumstances were different in each case and professional judgment ultimately must determine an acceptable resolution. We believe, however, that there is an opportunity to improve the clarity of the forms so that the responsiveness of contractor’s bids can clearly be distinguished.

In addition, colleges and universities had a general lack of understanding regarding targeted group / economically disadvantaged (TG/ED) businesses. Some confusion exists regarding actions required during the bid/quotation process and the amount of preference allowed for different types of TG/ED entities.

While not as wide-spread, there is misunderstanding regarding the use of the Accelerated Master Contract list and related procedures regarding the selections of designers. The Accelerated Master Contract list is a collection of designers where master contracts have been executed covering a specific time period. This process provides efficiency to colleges and universities in that they can contract with these designers for services up to \$100,000 simply through issuing purchase orders.

***Recommendations***

- *The Facilities Unit should work with the Office of General Counsel to modify language on forms used in the bidding process to clearly define the requirements for bidding contractors to be considered “responsive”.*
- *The Office of the Chancellor should provide additional information regarding TG/ED business usage, qualification rules and actions needed when obtaining bids. A helpful reference would be to add TG/ED status to the on-line Accelerated Master Contract Listing.*
- *Employees responsible for capital construction project management must adhere to the Construction Contract Guidelines and Forms and Accelerated Master Contract Instructions located on the Facilities Unit web site.*

**4. Processes were not in place to ensure that insurance, retainage and final payment requirements were being met.**

Project testing revealed 17 instances where it could not be determined whether contractor certificates of insurance were obtained or whether insurance coverage for the entire project period existed. There was one instance in which contractor insurance limits did not meet

minimum requirements. Lack of contractor insurance documentation could have exposed MnSCU to risk of loss in the event a problem occurred.

Retainage is a reduction in the progress payments to contractors to protect the project owner in the event the contractor does not satisfactorily complete the job. The audit revealed nine instances where withheld retainage amounts exceeded statutory limits or retainage was not for some other reason properly withheld. There was one instance where final payment, including retainage, was issued before all change orders were considered.

IC-134 forms are the mechanism to ensure contractors and their subcontractors have met all state income tax withholding requirements. The testing on 12 projects indicated that final payments were issued to contractors prior to IC-134 forms being obtained and/or properly completed.

### ***Recommendations***

- *Project managers must ensure that the system's exposure is minimized by obtaining contractors' certificates of insurance for entire project periods and verifying adequate limits.*
- *Project managers must ensure procedures to withhold retainage comply with Minnesota Statutes and contract terms.*
- *The Office of the Chancellor should develop checklists for project managers to use to ensure that contractors have completed all required services and that all needed forms and certificates have been completed and obtained before issuing final payment.*

## **5. Incomplete project files and a lack of understanding regarding records retention requirements were found across the system.**

Files did not include all required forms, contracts, reports, certificates and other pertinent documents. The audit detected confusion and inconsistent practices across the system regarding records retention periods for capital projects. Appropriate documentation is important for legal enforcement of contracts and to ensure deficiencies can be remedied through warranty coverage.

### ***Recommendations***

- *Project managers must maintain complete project files that are properly safeguarded.*
- *The Office of the Chancellor should develop a checklist of documents that should be maintained in each project file.*
- *The Office of the Chancellor should provide guidance or implement a system-wide policy regarding capital project records retention.*

**Section III: Potential Areas of Improvement**

It would be difficult if not impossible to implement a process that would envision all the different scenarios that may be encountered during the construction of a building or remodeling project. For example, projects have various contingency groups competing for different requirements within the construction, unforeseen environmental issues may come up during construction and/or building codes may vary within the different regions of the state. Given the unpredictability of the construction process, the Facilities Unit has had to determine the best way to manage projects, given limited resources.

Overall, testing found unique issues on only four of the 56 projects, raising the question on whether MnSCU received full value compared to what was spent. In addition, the unique issues that occurred on these projects resulted in delays for completing the projects as well as many additional hours of work for employees to resolve issues that arose.

Table 3.1 documents a summary of the projects and the notable issues that we identified during testing. There is likely no remedy to recover any costs on the projects. However, there are a few areas where the Facilities Unit could improve its processes to try to prevent similar issues from occurring in the future.

**Table 3.1  
Summary of Projects Tested that had Notable Issues**

| Project Description   | Project Cost  | Noted Problems/Issues <sup>5</sup> and Possible Causes  |
|---|---|---|
| <p>Bemidji State University - Bridgeman Hall Addition</p> <ul style="list-style-type: none"> <li>• New Construction</li> <li>• Project delegation varied during project</li> <li>• University severed contract with initial architect and contracted with a second architect to design the building addition</li> </ul> | <p>\$6.3 million (cost included pre-design work for co-location)</p> <p>Funding Source: Capital Bonds for Design – 1994 and 1998. Construction - 2000</p> | <ul style="list-style-type: none"> <li>• Significant pre-design/design changes: initial architect designed a standalone building. After bids came in over budget, the decision was made to do an addition to an existing building rather than the standalone new building.</li> <li>• Disbursements totaling \$856,000 to the original architect for co-location planning, design and pre-design services that ended up not being utilized.</li> <li>• Payments totaling \$60,000 made to initial architect prior to contract being executed. A \$70,753 payment was made to the initial architect the day the contract was signed.</li> <li>• Payments were made to initial architect for phases of project that were not completed (construction administration - \$70,000).</li> <li>• Turnover of leadership at the university and college.</li> <li>• Communication issues between the college, university, Office of the Chancellor and initial architect.</li> <li>• Multiple-year funding legislation for this project was</li> </ul> |

<sup>5</sup> These projects may have had some of the same issues that were discussed in Section 2; however, we did not repeat those issues in this table.

| Project Description   | Project Cost   | Noted Problems/Issues <sup>5</sup> and Possible Causes  |
|---|--|---|
| <ul style="list-style-type: none"> <li>Project substantial completion – November 2004</li> </ul>  |  | <ul style="list-style-type: none"> <li>confusing.</li> <li>No evidence that consultation with legal counsel occurred during project.</li> </ul>   |
| <p>Mesabi Range - Virginia Science Lab and classroom remodel</p> <ul style="list-style-type: none"> <li>Remodel of existing space</li> <li>Project managed by the Office of the Chancellor</li> <li>Project substantial completion – December 2004</li> </ul> | <p>\$5,996,000</p> <p>Funding Source: Capital Bonds for 1998 – pre-design and design and 2003 – design, renovate and equip</p> | <ul style="list-style-type: none"> <li>Change in college leadership resulted in significant pre-design changes.</li> <li>Pre-design funded with bond proceeds.</li> <li>Architect subcontracted for engineering design work. The subcontractor did work that resulted in numerous contract amendments and change orders. Office of the Chancellor management agrees that additional costs were paid because of the design work but specific costs were not tracked.</li> <li>Significant issues with a painting subcontractor used by the contractor and the installation of special flooring in the remodeled space.</li> <li>Contractor oversight still occurring and final payments have not been made.</li> <li>College management felt there was not a clear agreement on the expectations of the project between the college and the Office of the Chancellor project managers.</li> <li>No evidence that consultation with legal counsel occurred during project.</li> </ul> |
| <p>Alexandria Technical College – Classroom and Technology Building</p> <ul style="list-style-type: none"> <li>New Construction</li> <li>Project managed by the Office of the Chancellor</li> <li>Project substantial completion – May 2004</li> </ul>        | <p>\$9,650,000</p> <p>Funding Source: Capital Bonds for 2000 – design and 2002 - construct</p>                                 | <ul style="list-style-type: none"> <li>Authority to build a \$400,000 storage building with bond proceeds was unclear.</li> <li>Increase in reimbursement payments to architect of \$12,000 for “project design team and additional bid set printing due to a large response in bidding”. There were eight contractors that bid on project. Also, noted that a contract amendment was not done for this additional amount.</li> <li>Change order to contractor for \$59,300 for additional compensation for start-up delays.</li> <li>Materials testing services originally contracted for \$35,000 had a final cost of \$76,000.</li> <li>Noted no documentation or expenditures regarding commissioning services performed.</li> <li>Numerous staffing changes at the Office of the Chancellor on the management of the project.</li> <li>No evidence that consultation with legal counsel occurred during project.</li> </ul>  |
| <p>Minnesota State University (MSU)</p>   | <p>\$20.5 million</p>  | <ul style="list-style-type: none"> <li>There were numerous issues with the concrete work on the project that resulted in some increased costs (e.g.</li> </ul>  |

| Project Description  | Project Cost  | Noted Problems/Issues <sup>5</sup> and Possible Causes   |
|--|---|--|
| <p>Moorhead - New Science Building (Phase 1)</p> <ul style="list-style-type: none"> <li>• New Construction</li> <li>• Project management delegated to university</li> <li>• Project substantial completion – October 2004</li> </ul> | <p>Funding Source: Capital Bonds for 2000 – design and 2002 construct</p> | <p>testing and owner’s representative contract amendments for additional time).<sup>6</sup></p> <ul style="list-style-type: none"> <li>• Reimbursements were made to the university’s general fund from the Capital bond accounts for reimbursement of internal costs related to the construction of the Science Building, including: payroll costs associated with moving, and cabling the building and other general administrative expenses such as food services and travel expenses.<sup>7</sup></li> <li>• Contractor that was low bid on the project and had limited experience with a building project that had significant concrete work.</li> <li>• No evidence of early consultation with legal counsel</li> <li>• The December 31, 2005 Capital Improvement Project Status Report states: The general contractor has filed a claim of approximately \$900,000 for numerous construction related issues on the project. Items include additional monies for change orders, delays, changes in site conditions as well as several others which have not been fully detailed by the contractor. The Attorney General’s office has been notified and is working with the Office of the Chancellor and the university in replying to these items. No resolution has been reached at this time.</li> </ul> |

In both the Bemidji State University (BSU) and Mesabi Range Community and Technical College projects described in Table 3.1, capital bond proceeds were used to fund pre-design work. In addition, the BSU project used bond proceeds to fund co-location planning. The 1998 legislation for both of these projects specifically allowed for the funding of these costs. However, the ability to use bond proceeds for pre-design is uncertain. Current MnSCU practices would prevent this from occurring in the future. The Facilities Unit requires colleges and universities to fund pre-design work from operating costs before bringing a project forward to the legislature for design and construction financing.

**6. The Office of the Chancellor lacks an adequate escalation process for capital projects when significant questions or performance problems are encountered.**

The Office of the Chancellor does not have a process in place to inform or consult specific individuals related to capital construction administration. It is important to consult experts for

<sup>6</sup> MSU Moorhead and representatives within the Office of the Chancellor claim that the contractor completed some flooring upgrades to resolve the concrete issues. However, review has only shown documentation that the university received \$16,000 in credit for a concrete slab analysis.

<sup>7</sup> MSU Moorhead management claim reimbursements to the general fund were stopped once they were made aware that the Facility Unit’s does not allow payroll and other costs to be charged against bond proceeds. The University questions this requirement if the expenses specifically relate to the project.

guidance and inform stakeholders on important decisions, delays or problems encountered during a capital construction project. An escalation process helps:

- Ensure timely resolution of issues and questions;
- Ensure stakeholders are informed so that surprises don't occur; and
- Protect management against future questions or claims that may occur, by ensuring a systematic process was followed.

Depending on the specific circumstances, an escalation process could include: the Associate Vice Chancellor of Facilities, Vice Chancellor of Finance, Office of General Counsel, Minnesota Department of Finance bond counsel, legislative committees, Chancellor and the Board of Trustees.

For example, it would have been appropriate to consult the Office of General Counsel and other parties as warranted for guidance related to the appropriateness of using bond proceeds to construct a new storage building at Alexandria Technical College. As part of the technology building construction project, Alexandria Technical College constructed a \$400,000 storage building using bond proceeds. The 2002 appropriation law gave \$9.1 million “to construct, furnish, and equip a smart classroom and computer laboratory building, including an auditorium, connected to the college’s office education building.” There is no mention of a new storage building within the legislation. The college’s management assumed this was an appropriate use of bond funds since a storage building was removed in order to construct the technology building.

In addition, the Office of General Counsel should have been consulted on the issues in the other projects identified in Table 3.1<sup>8</sup>, including:

- Bemidji State University: Bridgeman Hall project – no evidence of consultation on legislative language, severing the relationship with initial architect, or for payments to initial architect for construction phases not being completed.
- Mesabi Range Community and Technical College: Science lab and classroom remodel – no evidence of consultation on poor performing subcontractors which resulted in contract amendments and additional change orders.
- Minnesota State University Moorhead: Science Building – no consultation on poor performing contractor.

General Counsel advice may help ensure that MnSCU receives the most value on contracts that have been entered into.

Another virtue of an effective escalation process would be to provide timely information to important stakeholders, such as the Board of Trustees. Currently, the primary formal process for informing the Board about capital construction project activity is through a Capital Improvement Projects Status Report sent to Trustees every six months. The reports provide highlights of capital construction activity over a six month timeframe. The reports show

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<sup>8</sup> The Office of General Counsel is now involved in the science building project at Minnesota State University Moorhead since it is likely the contractor will initiate litigation.

limited financial and budget information on specific projects. The reports emphasize the spending rate of projects. This emphasis is a result of past delays with the spending rate of capital appropriations from several years ago. As shown in Table 3.1, the December 31, 2005 report did discuss the potential litigation issue with the MSU Moorhead science building project. The Facilities Unit may want to reevaluate the information provided in its semi-annual status report.

### ***Recommendation***

- *The Office of the Chancellor should develop a process to escalate significant questions or performance problems to appropriate parties.*

### **7. The Facilities Unit has not developed any guidance for colleges and universities on awarding contracts to vendors that are both “responsive” and “responsible” for specific proposals.**

When requesting bids from vendors, two factors are commonly considered when awarding a contract to a vendor; first is to determine whether the vendor was “responsive” in providing its bid and the other is to determine whether the vendor is considered “responsible”.

The Facilities Unit has provided guidance to colleges and universities on responsiveness of bidders but has not provided any guidance on determining whether a vendor is “responsible”. Two areas that should be considered when defining whether a vendor is “responsible” would be the qualifications of the vendor and whether there are know performance issues with a particular vendor.

Testing found that for construction contractors, the low bid contractor was selected if the contractor was responsive in its bid proposal. Management at one institution told us that the contractor on a project had limited experience with the type of project being proposed but because the contractor was the low bid they were obligated to contract with them.

Except for roofing inspections<sup>9</sup>, the Facilities Unit does not place any restrictions on colleges and universities when they contract for capital construction projects. Currently, the Facilities Unit does not collect or compile information on architects, contractors, subcontractors or other vendors known to have had performance issues on past capital construction projects.

According to a report by the Georgia Governor’s Education Reform Study Commission, a common industry best practice that may help prevent performance issues is to pre-qualify contractors. Pre-qualification may include requiring bidding contractors to attend a pre-bid conference and documenting acceptable performance on similar projects.<sup>11</sup> The University of

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<sup>9</sup> Colleges and universities are required to use specific roofing inspectors on any project that involves a roof. Facilities Unit management is convinced that these specific inspectors ensure that quality roofs are installed on MnSCU-owned buildings.

<sup>11</sup> Georgia Governor’s Education and Reform Study Commission. “Construction of Educational Facilities”, November 28, 2000.



Pennsylvania requires bidders to complete a pre-qualification application which is then reviewed by a committee and, if approved, contractors are placed on a solicitation list based on qualifications for a two-year period.<sup>12</sup>

Management at Mesabi Range Community and Technical College was unhappy with subcontractors that were used by both the architect and the contractor on the remodeling project discussed in Table 3.1. A significant part of the project dealt with heating, ventilation and cooling systems and the architect used a subcontractor for the engineering design work. The work of the subcontractor was determined to be deficient and resulted in additional cost to the college. In addition, a subcontractor used by the contractor for painting did unsatisfactory work. College employees spent numerous hours pointing out all of the deficiencies until the contractor finally resolved the issues. College management was not aware that they could have objected to the use of the painting subcontractor. A provision, referenced in the contract used with contractors, is called the American Institute of Architects (AIA) General Conditions for contractors. This document, allows “owners” to object to the use of a subcontractor if the contractor is notified promptly and a reasonable reason is identified. Although this provision is included for contractors, it is not within the standard contract used with architects for MnSCU construction contracts.

### ***Recommendations***

- *The Facilities Unit should consider developing a procedure on contracting with vendors that are both “responsive” and “responsible”. The process could include maintaining a list of known performance issues by past architects, contractors, subcontractors and vendors. In addition, the unit should consider developing procedures for colleges and universities for pre-qualifying vendors.*
- *The Facilities Unit should ensure that program managers, project managers and colleges and universities are familiar with the provisions in the AIA General Conditions document that allow them to object to using sub-contractors on projects given the specific criteria within the AIA document.*
- *The Facilities Unit should work with the Office of General Counsel to modify the standard architect contract (AIA B-141) to add a similar provision for providing reasonable objections for proposed subcontractors on design work.*

### **8. The MnSCU Facilities Unit needs to review the process used to allocate its costs to capital construction projects funded with general obligation bonds.**

As shown in Table 1.1, the majority of capital construction projects within MnSCU are funded by the State of Minnesota through general obligation bonds. The Minnesota constitution limits use of general obligation bond proceeds to eligible capital construction project costs.

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<sup>12</sup> University of Pennsylvania, “Prime Contractor Prequalification Application”. February 20, 2004. <http://www.facilities.upenn.edu/getDone/contractbids/prequalify.pdf>

The Minnesota constitution limits use of general obligation bond proceeds to eligible capital construction project costs. The Minnesota Department of Finance compiled a document<sup>13</sup> of legal opinions to help clarify what is considered an eligible cost that can be funded by bond proceeds. Specific provisions within the opinions emphasize that expenditures must be project specific.

The Facilities Unit within the Office of the Chancellor charges a project management fee<sup>14</sup> on all capital construction projects funded with general obligation bonds. The Facilities Unit does not charge a project management fee on projects funded from other sources. The fee is charged to cover the costs of the program managers within the Facilities Construction and Support group. Program managers do not track the hours they spend on specific projects.

In our opinion, the program managers add clear value to the capital construction administration process and may be legitimately financed by charges against bond proceeds. However, we do feel that the Finance Unit needs to tighten the correlation between work performed by program managers and the fees that are charged to specific projects. A flat or percent based fee structure may not fairly represent the varying demands of specific projects.

In addition to the requirements for using bond proceeds discussed in the legal opinions, the Facilities Unit has placed additional restrictions on the use of bond funds. The unit has instructed colleges and universities that they cannot use bond proceeds to fund payroll costs for employees who are already on the payroll<sup>15</sup>. Project testing noted cases where employee payroll costs were paid but typically this was for overtime costs and could be specifically traced to a project. However, the MSU Moorhead science building project had some employee payroll costs charged to the project that were for regular hours of full-time employees. While this may be considered an allowable construction expense by legal opinion, it is not consistent with MnSCU requirements.

In addition, project testing found some reimbursements charged to the MSU Moorhead science building project that seemed unusual, including food charges, travel expenses and other non-routine expenditures.

### ***Recommendations***

- *The Facilities Unit should review the management fee structure and explore means to strengthen the correlation between work performed and fees charged to specific projects.*

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<sup>13</sup> Minnesota Department of Finance, Appendix 5 of the 2006 Capital Budget Instructions, April 2005. The legal opinions within the document were written by attorneys from the law firm of Dorsey & Whitney LLP and are dated April 24, 1989, March 15, 1990 and July 5, 2000.

<sup>14</sup> In recent years, the fee is calculated by multiplying the cost of the project by 8/10ths of one percent for projects that have been delegated to campuses to manage.

<sup>15</sup> The Facilities Unit has made an exception to allow the salary of a Minnesota State University, Mankato employee that acts as a capital construction project manager on a full-time basis to be funded partially with bond proceeds.

- *The Facilities Unit should work with the Office of General Counsel to determine appropriate uses of bond proceeds and provide documentation and training to colleges and universities on requirements.*

## Section IV: Process Improvement and Other Considerations

The results of project testing and discussions with college, university and Office of the Chancellor staff revealed additional areas where overall process improvements could be made for better administration of MnSCU facilities. Areas where improvements could be made included: management of projects, systematic oversight of facilities management (including capital construction and administration of MnSCU facilities) and the allocation of limited funding resources.

### **9. MnSCU does not have an efficient process for tracking project status or warranty tracking.**

The ISRS system does not provide a comprehensive method to account for capital projects and warranty periods. Encumbrance and spending activity reports can be obtained from ISRS, but the formats are not conducive for effective and efficient capital project management. As a result, some colleges and universities utilize shadow systems to track expenditures, change orders, supplemental agreements, warranty expiration dates and other project-related information. This process results in additional work to input the data into and reconcile the shadow systems to the ISRS accounting system.

Additionally, project testing noted that many colleges and universities had not completed a one-year walkthrough after completion of a project. The one-year walkthrough is an opportunity to have problems remedied with no additional cost to the college or university if it is the result of workmanship or ground settling. By missing this opportunity, colleges and universities may be incurring additional costs to remedy these problems.

#### ***Recommendations***

- *The Office of the Chancellor should consider establishing a system that would provide integrated project management and warranty period tracking capability.*
- *Colleges and universities should complete walkthroughs within appropriate timeframes to ensure that contractors fix or remedy problems covered under existing contracts.*

### **10. Capital asset accounting practices need improvement.**

Project testing and discussions with campus employees revealed a lack of understanding regarding the criteria for asset capitalization. The confusion typically arises in cases where there is not new construction; for example, remodeling projects and equipment replacement projects may qualify partially or entirely as capital assets. Generally Accepted Accounting Principles require that a distinction be made between capital projects that should be expensed at the time of expenditure and assets that should be capitalized and depreciated over the asset lives for appropriate financial statement presentation. Current practices are for the Office of the Chancellor to evaluate projects involving capital bond and HEAPR funding. Colleges and

universities notify the Office of the Chancellor of locally-funded projects that should be capitalized.

There were two cases of inaccurate project capitalization caused by design or contingency funding being accounted for separately and one instance where construction-in-progress was not recorded on the financial statements at fiscal year-end. Although these amounts were not material to the financial statements, it is an area that deserves closer scrutiny.

Retainage balances withheld from contractor payments were not properly recorded as liabilities at fiscal year-end for nine of the projects tested. Currently, there is no systematic method for tracking and recording retainage amounts as progress payments are made to contractors or fiscal year-end.

Other capital asset accounting issues include four instances of inaccurate use of object codes and/or cost centers, five projects including expenditures related to other projects and seven colleges and universities not completing reconciliations to ensure MnSCU and state accounting systems match.

### ***Recommendations***

- *The Office of the Chancellor Financial Reporting Unit should develop improved procedures and provide additional training on capital asset accounting, to include year-end processes, such as recording retainage, as well as ongoing operations.*
- *The Office of the Chancellor should develop a method to ensure that all phases and components of projects that can be capitalized are recorded as assets, regardless of the timing of funding or other reasons that would warrant separate accounting practices.*
- *Colleges and universities should ensure capital projects have accurate and complete accounting. The MnSCU accounting system should be reconciled to the state accounting system on a monthly basis to ensure capital project accounting is complete and accurate.*

### **11. The MnSCU encumbrance accounting process does not integrate properly across system modules.**

Encumbrance accounting ensures timely recognition of future obligations, reduces the likelihood of overspending budgets and provides decision makers with accurate projections of true discretionary account balances. Data analysis found that encumbrances set up by issuing purchase orders are not always recorded in the accounting system. According to Office of the Chancellor Finance and Information Technology Services Division staff this problem is caused by poor design. The deficiency results in each college, university and the Office of the Chancellor having to perform periodic reconciliations and make necessary adjusting entries to correct any errors. Instructions on how to prepare the reconciliations and correct errors, however, are not included in accounting documentation available to accounting personnel.

### ***Recommendation***

- *The Office of the Chancellor Finance Division should work with the Information Technology Services Division to consider upgrading the accounting system to properly interface purchase order encumbrance transactions. In the meantime, the Finance Division should disclose this system interface problem and require reconciliations and correcting entries in MnSCU accounting documentation. Reconciliations should be monitored under the same periodic reporting process currently utilized for other accounting functions.*

### **Other Observations:**

Two additional areas were identified during fieldwork that that may merit revisiting current practices.

- **Project Management Leadership:**

Adequate project management is critical to a successful capital project and comes at a high cost, either through large fees to external owner's representatives or time commitment by on-staff project managers. Because of the wide variety of project sizes, complexities and locations, there is not a single preferred management method that stands out from others. For example, college and university project managers may not have the expertise to manage certain types of projects while management by Facilities Unit staff may not be possible logistically. Limited resources on campuses and in the Facilities Unit create additional challenges. Typically these circumstances result in contracting for an external owner's representative to manage projects for substantial fees. However, management needs to be careful to ensure that there is appropriate oversight of the work performed by these individuals. Institutions have long-term relationships with capital assets, whereas owner's representatives have only short-term interests in the projects. There needs to be knowledgeable employees at the colleges and universities that are responsible for monitoring the projects. One possibility to consider may be to have experts located within regions of the state who would monitor projects for the campuses within that region.

One university is unique in that it has an employee dedicated to capital project management. The university does not incur the high costs associated with external owner's representatives since their own employee provides that functionality. This may be a best practice that other large colleges and universities with ongoing capital construction projects may want to consider.

- **Use of HEAPR Funding:**

According to the fiscal year 2006-2011 Capital Budget Request, HEAPR funds are allocated across colleges and universities based on campus priorities, engineering studies of roofs and mechanical/electrical systems, and campus square footage. In total, MnSCU System needs for HEAPR funds far exceed resources appropriated in this critical area.

Discussions with college and university staff found that deferred maintenance estimates varied significantly across colleges and universities. For example, estimates ranged from \$98 million at one state university to insignificant or no deferred maintenance at another state university. Historical administration of maintenance, repair and replacement at each institution needs to be taken into account for the large disparity in the deferred maintenance figures. No matter how the significant variances came about, the Board of Trustees and the Chancellor have responsibility to ensure that all capital assets are managed and maintained appropriately. Therefore, the Facilities Unit should also consider reducing deferred maintenance variances between colleges and universities when allocating HEAPR funds.

In addition to the original allocation of HEAPR funds, there may be issues associated with the reallocation of residual HEAPR funds. Facilities Unit management explained that colleges and universities can use any residual funds on other HEAPR projects at the campus. Facilities Unit management stated that they want the campuses to notify them when funds are being used for other HEAPR projects, but do not question this allocation since the campuses set their own priorities.

Colleges and universities, though, determine their own estimates on HEAPR projects<sup>16</sup>. Small campuses may not have staff that are knowledgeable in estimating the cost of a needed repair. Given this lack of knowledge they may overestimate funding needs. Testing found one small college that was allocated \$181,000 of HEAPR funds to update restrooms for Americans with Disabilities Act (ADA) compliance. The initial budget included an addition to accommodate the ADA restrooms. The college later discovered that HEAPR funds could not be used to add additional square footage and was able to make existing restrooms ADA compliant with \$30,000 in modifications. The college then transferred the remaining \$151,000 of the funds to a ground water intrusion project that was on the college's HEAPR list.

- **Performance metrics :**

The Facilities Unit provides guidance for colleges and universities on planning and administering capital construction projects. It concentrates on the design phase; however, little is done to monitor progress once a project enters the construction phase. In addition, little is done to evaluate completed projects. Finally, the Facilities

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<sup>16</sup> Pre-design work is required on HEAPR projects that have cost estimates exceeding \$1 million.

Unit does not review or monitor college and university repair and replacement spending.

The Facilities Unit should consider developing indicators or performance metrics to identify projects that may be running into difficulty. Potential metrics or indicators could include:

- Program manager actual hours spent managing projects compared to budgeted hours.
- Notification of turnover of key staff on projects (program manager, college or university project manager, owner's representative, lead architect and contractor).
- Change order activity compared to anticipated levels.
- Percentage of contingency used compared to project phase.

Additionally, unit management should consider requiring program managers to review specific documents prior to project closeout, such as, commissioning documents.

The Facilities Unit does not have an ongoing strategy for completing post occupancy reviews. Currently, the unit has contracted with a consulting firm to complete four reviews on projects completed over a year ago. Once results are received back, management plans to review the results and assess the value of the reviews to determine whether they want to start a more systematic process to require reviews on certain projects.

In addition to a post occupancy review strategy, the unit could develop performance metrics to evaluate completed projects. These metrics may help identify best practices or projects that need to have a more thorough review to understand issues that may have resulted in lost value to the system. Metrics could include:

- Cost per square foot based on type of building (science vs. general education) or construction type (new building vs. remodel).
- Comparison of date of substantial completion to final payment to contractor.
- Energy usage in new space.
- Budget to actual spending comparison by project component (e.g. design, construction and furniture, fixtures and equipment).

Repair and replacement (R&R) spending was discussed with employees at all colleges and universities. All colleges and universities had processes in place for budgeting and prioritizing R&R spending. However, several discussions with staff revealed that this R&R spending has been reduced in recent years because of budget constraints. The Facilities Unit does not review campus budgets to ensure adequate maintenance is being completed on existing buildings at the colleges and universities. Minn. Stat. 16A.11 subd. 6 states:

*...the combined amount to be budgeted each year for building maintenance and betterment in the operating budget and capital budget is one percent of the*



*replacement cost of the building, adjusted up or down depending on the age and condition of the building.*

In addition, the Fiscal Year 2004-2011 Capital Budget Request states that based on a study completed in 1999, an appropriate reinvestment rate for MnSCU facilities to be 2.86% of the replacement value or approximately \$86.2 million annually. In today's dollars, the amount has risen to \$106 million. These rates are assuming all funding sources, including projects funded with bond proceeds. A Facilities Unit's analysis shows the system has only attained this goal in fiscal year 2005. The amount included in their analysis for campus spending is projected. According to audited financial statements, MnSCU spent \$32 million on R&R in 2005.

These observations are for future consideration; there are no specific recommendations.



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May 3, 2006

Board of Trustees  
Members of the Audit Committee  
James H. McCormick, Chancellor

The purpose of this letter is to convey management's response to the observations and recommendations made by the Office of Internal Audit (OIA) in their report *Capital Construction Administration Audit* dated April 7, 2006. This review was sought by management in order to gain assurance that appropriate policies and procedures were in place.

The review found that the overall process for administering construction projects effectively prevents cost overruns. Recommendations are made for improving contract administration and oversight. OIA has conveyed eleven recommendations for areas in need of continued improvement, both in the Office of the Chancellor and at the colleges and universities. Management in the Office of the Chancellor is generally in agreement with the observations of the auditors and will work with the colleges and universities to respond to the concerns. The recommendations of the auditors and a summary of management's response are contained in Attachment A.

We greatly appreciate the comprehensiveness of the audit and the detailed work accomplished by OIA staff.

Warmest Regards,

A handwritten signature in black ink, appearing to read "Laura M. King".

Laura M. King  
Vice Chancellor – Chief Financial Officer

Attachment

c: Allan Johnson, Associate Vice Chancellor for Facilities

**Minnesota State Colleges and Universities**  
**Office of the Chancellor**  
**Finance Division**  
**Response to Capital Construction Administration Audit**  
**Final Report of April 7, 2006**

**1. Colleges, universities and the Office of the Chancellor are not complying with administrative procedures relating to executing contracts.**

- A. The Office of the Chancellor should provide improved, more user-friendly on-line resources for project managers to execute and manage contracts effectively. It is our understanding that the Facilities Unit is currently authoring an on-line E-Manual for this purpose.

Response: The Facilities unit, as mentioned, is in the process of finalizing an eManual which will highlight business processes and forms for use during design and construction. This eManual will be released later this year and will be used as a training tool for college and university project managers.

- B. Colleges and universities and the Office of the Chancellor must comply with contracting requirements governed by Minnesota Statutes, Board Policies, System Procedures, contract terms and Construction Contract Guidelines and Forms on the Facilities Unit web site.

Response: The Finance Division recently developed two separate procurement training seminars, one for general procurement and one specifically tailored for design and construction. A series of regional training conferences are ongoing to train all individuals throughout the system. A training video has been made and will be available to train new personnel.

- C. The Office of the Chancellor should determine the proper timing to establish encumbrance transactions and incorporate the information into on-line guidance and/or a System Procedure.

Response: Encumbrances are established when contracts are signed by the appropriate business office staff. Contracts have been reviewed and signature blocks and routing have been updated to properly establish encumbrance requirements.

- D. Colleges and universities and the Office of the Chancellor must comply with Board Policy 1A.2 and System Procedure 1A.2.2 regarding delegation of authority. The Office of the Chancellor should offer guidance and training to improve awareness of delegation of authority requirements.

Response: Additional guidance and training will be provided in the eManual, during training for project managers and at design kickoff meetings.

**2. Colleges and universities generally do not understand when a contract should be used on repair and maintenance services.**

Most colleges and universities are not executing contracts for small repair jobs; instead they rely on purchase orders to detail terms of service agreements. While the contracting process is more time consuming, it does provide the project owner with protection. Specifically, a contract documents insurance requirements and liability responsibility for the contractor. Facilities Unit management agreed that contracts should be used regardless of the size of the project or service. For example, except during emergencies, a contract should always be executed with an electrician regardless of the size of the project.

- A. The Facilities Unit should provide additional training to individuals involved in the contracting process.

Response: A review of contracts and procedures will address this area. Additional training will be provided in FY 2007.

- B. Employees responsible for capital project management must adhere to the instructions for Construction Contract Guidelines and Forms located on the Facilities Unit web site.

Response: Additional training and eManual will address this area.

- C. The Facilities Unit should coordinate efforts among colleges and universities to identify efficient methods for contracting for repairs and maintenance services.

Response: See response A above.

**3. Colleges, universities and the Office of the Chancellor used inconsistent practices when selecting contractors and designers.**

- A. The Facilities Unit should work with the Office of General Counsel to modify language on forms used in the bidding process to clearly define the requirements for bidding contractors to be considered “responsive”.

Response: A joint review will be conducted to determine changes required to contracts or procedures, and updates will be incorporated into the eManual.

- B. The Office of the Chancellor should provide additional information regarding TG/ED business usage, qualification rules and actions needed when obtaining bids. A helpful reference would be to add TG/ED status to the on-line Accelerated Master Contract Listing.

Response: Procedures for applying TG/ED preference and qualification rules are incorporated in the instructions and forms for construction contracts currently on the facilities website. A more thorough explanation on exactly how to calculate the preference will be incorporated into these documents. The TG/ED status will be added to the on-line Accelerated Master Contract Listing.

- C. Employees responsible for capital construction project management must adhere to the Construction Contract Guidelines and Forms and Accelerated Master Contract Instructions located on the Facilities Unit web site.

Response: Accelerated Contracting Guidelines, Forms and Procedures are currently being updated. Additional training will be conducted for project managers.

**4. Processes were not in place to ensure that insurance, retainage and final payment requirements were being met.**

- A. Project managers must ensure that the system's exposure is minimized by obtaining contractors' certificates of insurance for entire project periods and verifying adequate limits.

Response: Additional oversight from the Facilities Unit program managers will be provided in this area. Project checklists will be developed that address this area.

- B. Project managers must ensure procedures to withhold retainage comply with Minnesota Statutes and contract terms.

Response: Current procedures will be reviewed against statutes.

- C. The Office of the Chancellor should develop checklists for project managers to use to ensure that contractors have completed all required services and that all needed forms and certificates have been completed and obtained before issuing final payment.

Response: Current procedures and forms will be reviewed, and a checklist will be developed and will be part of the eManual.

**5. Incomplete project files and a lack of understanding regarding records retention requirements were found across the system.**

- A. Project managers must maintain complete project files that are properly safeguarded.

Response: A project checklist will be developed and incorporated into the eManual to facilitate setting up files when beginning a project. In addition, a project closeout checklist will be developed which will detail which documents should be retained for the life of the building.

- B. The Office of the Chancellor should develop a checklist of documents that should be maintained in each project file.

Response: See above

- C. The Office of the Chancellor should provide guidance or implement a system-wide policy regarding capital project records retention.

Response: See above

**6. The Office of the Chancellor lacks an adequate escalation process for capital projects when significant questions or performance problems are encountered.**

- A. The Office of the Chancellor should develop a process to escalate significant questions or performance problems to appropriate parties.

Response: A process will be developed and coordinated with Office of Counsel.

**7. The Facilities Unit has not developed any guidance for colleges and universities on awarding contracts to vendors that are both “responsive” and “responsible” for specific proposals.**

- A. The Facilities Unit should consider developing a procedure on contracting with vendors that are both “responsive” and “responsible”. The process could include maintaining a list of known performance issues by past architects, contractors, subcontractors and vendors. In addition, the unit should consider developing procedures for colleges and universities for pre-qualifying vendors.

Response: An information paper was developed in cooperation with the Attorney General’s office and presented at the January 2005 Chief Financial and Facilities Officers (CFFO) conference that addressed this issue. This topic will be addressed in future training scenarios as appropriate and will be posted on the facilities website. Pre-qualification of vendors will be considered for incorporation into current procedures.

- B. The Facilities Unit should ensure that program managers, project managers and colleges and universities are familiar with the provisions in the AIA General Conditions document that allow them to object to using sub-contractors on projects given the specific criteria within the AIA document.

Response: This area will be addressed in future training.

- C. The Facilities Unit should work with the Office of General Counsel to modify the standard architect contract (AIA B-141) to add a similar provision for providing reasonable objections for proposed subcontractors on design work.

Response: A similar clause is currently in the AIA B141 contract.

**8. The MnSCU Facilities Unit needs to review the process used to allocate its costs to capital construction projects funded with general obligation bonds.**

- A. The Facilities Unit should review the management fee structure and explore means to strengthen the correlation between work performed and fees charged to specific projects.

Response: The management fee structure is reviewed with every Capital Bonding Request to ensure fees are appropriate to support the Capital Improvement Program oversight responsibilities of the Office of the Chancellor; adjustments are made as necessary. The

very nature of design and construction work makes it extremely difficult to correlate work performed by OOC personnel to specific projects. This area will be reviewed to see if adjustments are appropriate.

- B. The Facilities Unit should work with the Office of General Counsel to determine appropriate uses of bond proceeds and provide documentation and training to colleges and universities on requirements.

Response: The Facilities Unit, along with the Office of General Counsel, will better define appropriate uses of bond proceeds, and training will be provided to colleges and universities on these requirements.

**9. MnSCU does not have an efficient process for tracking project status or warranty tracking.**

- A. The Office of the Chancellor should consider establishing a system that would provide integrated project management and warranty period tracking capability.

Response: The Facilities Unit is currently in the process of developing system requirements for a web-based Program Management Information System (PMIS) software which will incorporate project management and document imaging technologies.

- B. Colleges and universities should complete walkthroughs within appropriate timeframes to ensure that contractors fix or remedy problems covered under existing contracts.

Response: This requirement is currently in the Architect's (AIA B141) and the General Contractor's (AIA 201) contracts. This item will be highlighted as part of the project closeout checklist.

**10. Capital asset accounting practices need improvement.**

- A. The Office of the Chancellor Financial Reporting Unit should develop improved procedures and provide additional training on capital asset accounting, to include year-end processes, such as recording retainage, as well as ongoing operations.

Response: The Facilities Unit will work with the Financial Reporting Unit to review these requirements, and information will be provided as part of the eManual.

- B. The Office of the Chancellor should develop a method to ensure that all phases and components of projects that can be capitalized are recorded as assets, regardless of the timing of funding or other reasons that would warrant separate accounting practices.

Response: The Facilities Unit completed a Project Budget Worksheet last year in conjunction with the Financial Reporting Unit that lists cost accounting codes that reflect appropriate asset reporting requirements. This information is part of the Facilities website and is used to account for project expenditures.

- C. Colleges and universities should ensure capital projects have accurate and complete accounting. The MnSCU accounting system should be reconciled to the state accounting system on a monthly basis to ensure capital project accounting is complete and accurate.

Response: This requirement will be addressed in the eManual.

**11. The MnSCU encumbrance accounting process does not integrate properly across system modules.**

- A. The Office of the Chancellor Finance Division should work with the Information Technology Services Division to consider upgrading the accounting system to properly interface purchase order encumbrance transactions. In the meantime, the Finance Division should disclose this system interface problem and require reconciliations and correcting entries in MnSCU accounting documentation. Reconciliations should be monitored under the same periodic reporting process currently utilized for other accounting functions.

Response: We share the concerns with the Purchasing Control System (PCS) not interfacing accurately with the accounting module in all instances. These concerns are well noted by ITS, however resolving these concerns will require a major enhancement or replacement of PCS module. The upgrade of PCS is on the priority list, but given other higher priorities PCS improvements will not be addressed in the immediate future.

In the interim we agree with the need to ensure that the accounting module is accurate and accurately reflects any activity processed in PCS. Facilities staff and Financial Reporting Campus Assistance staff will continue to work to educate users regarding the potential problem. We will encourage users to on an ongoing and immediate basis check to ensure that the accounting module and PCS agree and in the event of a discrepancy make any adjustment to the accounting module whereby the accounting module will be accurate. If the accuracy of the accounting module is monitored on an ongoing basis an additional reconciliation should not be necessary.

**Other Observations:**

- **Project Management Leadership:**

The Audit Report notes that day-to-day project management responsibilities are routinely undertaken by external consultants engaged as “Owner’s Representatives” (O/R) and suggests consideration of a regional approach whereby additional Office of the Chancellor staff might assume these management functions. The report further suggests that large colleges and universities consider adding internal staff specifically assigned to capital project management rather than engaging commercial consultants.

Almost all capital projects are delegated to the respective college and university for project execution with oversight by the Office of the Chancellor. In this delegated environment, the engagement of a professional consultant as owner’s representative - project manager is a routine point of discussion for each project. Each college or university chooses the scope of duties for their respective O/R, tailoring services to best complement the capabilities of



their in-house staff. This approach also addresses the peaks and valleys associated with capital project authorization, funding and execution.

Dialog with college and university senior administration will be ongoing relative to this issue as we seek to continually improve the delivery of capital projects.

- **Use of HEAPR Funding:**

The Audit Report notes that the amount of deferred maintenance (DM) varies considerably from campus to campus and suggests reducing these deferred maintenance variances when allocating HEAPR funds.

The Office of the Chancellor recently completed the development of a comprehensive model to annually ascertain the level of campus DM as well as predict funding requirements for future facilities renewal. The variances amongst institutions have been clearly documented. Draft FY2008-2013 Capital Budget Guidelines, to be presented to the Board of Trustees for approval in May 2006, suggest that System capital planning take into account the level of DM at each institution and target reductions in System-wide over a ten-year period. This would include allocation of HEAPR resources.

The Report further notes that some colleges and universities may overestimate HEAPR funding needs since they are responsible for developing cost estimates, and thereby gain more HEAPR funding than they should.

The Office of the Chancellor reviews each HEAPR project request for scope and reasonableness of cost. Major HEAPR projects over \$1.0 million must also be backed up with architectural and/or engineering studies and cost estimates. Nevertheless, there are instances where actual costs are less than originally estimated; although it is more common that actual costs exceed the original estimate and subsequent allocation. However, the practice of allowing a campus to retain whatever HEAPR funds they were originally allocated will be continued, subject to that campus providing a reasonable explanation of the circumstances to the Office of the Chancellor. This is a prudent approach, since all campuses have HEAPR needs well in excess of the funds available.

- **Performance metrics:**

The Report notes a number of issues for consideration:

- a. Monitoring construction progress in the construction phase: While the Facilities Unit monitors construction progress, it relies on the college or university to whom the project has been delegated to provide the day-to-day oversight. This is precisely why professional owner representatives (O/R) are brought into projects to ensure that schedules are maintained and that campus management is informed of problems, delays, etc. In addition, a variety of consultant services are available to campuses to ensure construction quality. The performance indicators noted in the Report are exactly those which should be monitored by the O/R as a matter of course.

- b. Evaluation of completed projects: The degree to which capital projects are evaluated post-occupancy is the subject of continuing improvement in the way projects are executed. Four detailed Post Occupancy Evaluations have recently been completed. These reports, while very useful in providing “lessons learned” for future projects, addressed projects that were completed two years ago or more. A more timely process is being considered for FY2007.
- c. Performance metrics for completed projects: The Facilities Unit is developing a data base of important project metrics such as cost per square foot of completed project; budget comparisons; change order rate; contingency use; and adherence to schedules.
- d. The Report suggests that closer oversight be applied to campus spending for Repair and Replacement (R&R) projects. R&R budgeting and spending is an integral part of campus stewardship and a “partner” with capital renovation and repair budgets. The FY2008-2013 Capital Budget Guidelines recognize this important part of the operating budget, and encourage college and university presidents to budget and spend at least \$1.00 per square foot on R&R. Simultaneously, new financial reporting guidance will be promulgated for FY2007 to accurately capture the amounts being spent at each campus on R&R.