

Construction Management at Risk Audit Activity as of June 30, 2022

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Date: September 26, 2022

To: Board of Trustees
Stephanie S. Elizalde, Ed.D., Superintendent

From: Robert Rubel, MBA, CPA, CIA, CISA
Chief Internal Audit Officer

Subject: Construction Management at Risk Audit Activity as of June 30, 2022

Executive Summary

The Dallas Independent School District (District) Office of Internal Audit (OIA) in collaboration with representatives of R. L. Townsend & Associates, LLC (Consultant) have been conducting on-going audit and advisory services on active Construction Management at Risk (CMAR) contracts.

Overall, OIA and Consultant found the District staff and designated project management (PM) firms have worked effectively together to manage the challenges of delivering CMAR projects on schedule and within the approved budgets. OIA and Consultant are currently working with the owner (District) as well as the architects, CMARs, and PM firms to implement the following:

1. Further develop construction documents prior to submitting for trade contractor bidding
2. Further develop processes for obtaining and reviewing supporting documentation for trade contract adjustments related to allowance and contingency expenditures
3. Establish a standardized administrative process for filing of project related documentation

Implementing the recommendations in this report could improve the District's internal controls over the CMAR procurement process and construction project management.

Background

CMAR

CMAR is a procurement and delivery method for construction contracts in which the CMAR is contracted to deliver a project within a guaranteed maximum price (GMP) and agreed upon timeline. During the procurement process, potential construction managers (CM) will respond to request for qualifications (RFQ) and provide proposed fees. Trade contractors/subcontractors are typically secured by the CM to perform work within the contract and any remaining work that can be self-performed by the CM. Generally, CMs are procured and contracted early in the planning process where they can collaborate with the architect/engineer to complete the contract documents. Throughout the project's lifetime, the CM is tasked with managing the project as well as controlling costs to not exceed the proposed and agreed upon GMP.

GMP

Within certain types of procurement methods, CMs are reimbursed for actual cost plus a fee limited to a guaranteed maximum price. The GMP consists of the sum of the CMAR's estimated cost of work, contractor-controlled contingency, general conditions, and the CMAR fee. GMPs are generally a total cost of work for the entire project; however, they can be separated for different phases or parts of a project. Any costs incurred beyond the GMP are not reimbursed and are the responsibility of the CM. Additionally, any savings collected are passed on to the owner, as all costs submitted for reimbursement must be supported.

Contingency

Contingencies are approved funds set aside for additional or unexpected costs encountered throughout the construction project and do not require the use of a change order. Currently, there are two different types of contingencies utilized for each District CMAR contract: owner-controlled contingency and contractor-controlled contingency. CMAR's must get written approval before utilization of any contingency amount, owner or contractor controlled. All contingency costs must be supported.

Change Orders

Change orders are an amendment to a construction contract that change the CMARs scope of work. Change orders support a material change in scope of work and will generally increase the contract price and/or contract time.

PM Firms

The District has contracted PM firms to comprehensively oversee and manage bond funded construction projects from planning and design to project close out. PM firms have primary management responsibility for projects assigned and coordinate all project matters with the purpose to meet project completion dates within the allotted budget. To assist PM firms in their day-to-day duties, the District employs contract managers.

Managing construction projects can be a difficult task. The District is continuously working to implement controls that will reduce risks. Below are some examples of project cost and schedule challenges the District, architects, CMs, and PM firms are actively working to solve:

- The cost and schedule impact of delays in receiving approved building permits
- The cost impact related to schedule compression resulting from permit delays
- The impact of labor and material escalation costs when planned construction is delayed

Scope

The engagement is focused on current operations and processes relating to the CMAR contracts that were awarded during fiscal year (FY) 2020 as well as two new CMAR projects awarded in FY 2022.

Construction audit advisory services were provided by Consultant to the District beginning September 2020 with the intention of continuing these services on the District's CMAR construction contracts as long as they are active.

Objective

The objective of the engagement is to assist the District by providing oversight for CMAR contract activity.

Methodology

OIA and Consultant reviewed processes, controls, and supporting documentation related to the procurement and contract activity for CMAR projects. OIA and Consultant conducted interviews with key personnel and held periodic discussion meetings with District representatives from Legal Services, Construction Services/Bond Office, Financial Services, Procurement Services, as well as PM firm representatives assigned to manage CMAR contracts. OIA and Consultant also participated in meetings with CMARs where construction contract terms were discussed and agreed upon by authorized District representatives.

OIA and Consultant conducted a review of general processes and controls including, but not limited to, the following:

- Reviewed the District's current processes for CMAR construction projects
- Identified leading practices for CMARs used in Texas school districts and compared to the District's current processes to determine any needed actions
- Reviewed controls surrounding potential conflicts of interest with the staff assigned to work in the District's Construction Services/Bond Office
- Reviewed the competitive procurement processes for CMARs and subcontractors
- Reviewed internal controls surrounding accuracy of GMPs
- Reviewed contract language for architects, CMARs, and PMs

OIA and Consultant have been collaborating with District staff and the designated PM firms to provide audit oversight of the following CMAR projects:

- Thomas Jefferson High School Renovation – CMAR: HCBeck
- Walnut Hill International Leadership Academy (PK-8) – CMAR: HCBeck
- Career Institute North at Walnut Hill – CMAR: Turner | Source JV
- West Dallas STEM (STEM) Renovation – CMAR: Reeder General Contractors, Inc.
- John Lewis Social Justice Academy at Oliver Wendall Holmes Middle School – CMAR: HCBeck
- C. F. Carr Elementary School Renovations – CMAR: Phillips/May

The following is a summary of specific audit activity OIA and Consultant are continuously performing in connection with each of the CMAR projects:

- Review of GMP proposals submitted for approval
- Review of monthly construction payment applications
- Review of documentation related to awarded subcontracts
- Review of documentation for approved contract allowance expenditures
- Review of documentation for approved "contractor contingency" expenditures
- Review of documentation for approved "owner contingency" expenditures

As a part of the above methodology, specific documentation reviewed during this audit period included:

- CMAR delivery method board approval documents
- CMAR contract documents approved by the board
- Advertisements published for approved CMAR procurements
- Minority & Women Business Enterprise (M/WBE) guidelines published for use with CMAR procurements
- RFQ/Request for Proposal (RFP) documents used for CMAR procurements
- Qualification and price proposals received from CMARs
- Evaluation criteria issued for CMAR procurements
- Evaluations submitted by evaluation committees for CMAR procurements
- Draft GMP proposals submitted by CMARs

Recommendations 1, 2, and 3 in this report were noted.

During this audit OIA and Consultant referred to criteria published in the following resources:

- Texas Association of School Boards, School Board Member's Guide to Purchasing
- CVD (LEGAL)-P, Facilities Construction, Construction Manager-At-Risk, issued 11/2/2015
- CV (LOCAL)-X, Facilities Construction, issued March 16, 2020
- CV (LEGAL)-P, Facilities Construction, issued November 22, 2019
- Texas Education Code 44.031, Purchasing Contracts
- Texas Government Code, Chapter 2269 – Contracting and Delivery Procedures for Construction Projects

Audit Observations and Recommendations

Observation 1 – Further develop construction documents prior to submitting for trade contractor bidding

CMARs bid their trade contractors based on the available construction documents. Trade contractors submit their bids based on the scope of work in the construction documents. As such, it is essential these documents be as complete and accurate as possible. An owner-controlled contingency as well as a contractor-controlled contingency is established for the project to fund changes that arise throughout the duration of a project. A significant amount of these available contingency funds is being spent to fund changes for revisions to the construction documents that are made subsequent to the competitive bidding process. As these changes are not a part of the competitive bidding process, the costs incurred are typically greater than they would have been if the work had been covered in the original trade contractor bid. These additional costs could be avoided if the construction documents were further developed prior to release for bid.

Recommendation 1

To minimize the incremental costs of avoidable project changes, the Construction Services/Bond Office should continue to work closely with the architects, CMARs, and PM firms to take specific actions during the preconstruction phase to improve construction documents used in the competitive bidding process. Potential actions could include expediting plan review as well as use of specialized consultants to review design documents for code compliance, constructability, and meaningful value engineering opportunities prior to bid.

Risk Level: Medium¹

Observation 2 – Further develop processes for obtaining and reviewing supporting documentation for trade contract adjustments related to allowance and contingency expenditures

The Construction Services/Bond Office has developed several checklists to use when reviewing and approving project costs. These checklists were developed to ensure proper supporting documentation for project changes is obtained and reviewed prior to approval. However, after review of supporting documentation, OIA and Consultant noted that some documentation submitted by trade contractors to support proposed contract adjustments related to allowance and contingency expenditures could be improved to enhance the District's ability to evaluate the appropriateness of the cost incurred.

Recommendation 2

To help ensure the District receives the best value from construction funds, the Construction Services/Bond Office should continue to work with the architects, CMARs, and PM firms to fine tune expectations for trade contract adjustments related to allowance and contingency expenditures. The District should consider hosting a ½ day joint meeting with key representatives to align expectations for obtaining, reviewing, and approving trade contract proposals related to allowance and contingency usage.

Risk Level: Medium²

¹ See Attachment 1 for definition of Risk Level

² See Attachment 1 for definition of Risk Level

Observation 3 – Establish a standardized administrative process for filing project related documentation

The District's architects and PM firms have worked diligently to review and approve project costs within the board approved GMP amounts. However, there is currently no standardized process in place to require the CMARs to file and maintain project documentation. The current CMARs use a cloud-based storage system (Procore), which is billed by the CMARs to the District. This system is a project management system that has the ability to store and maintain documentation essential to the project for ease of access and review as needed. The methodology for obtaining and maintaining records of the expenditures could be improved to enhance their ability to oversee the costs incurred by the CMARs and billed to the District.

Recommendation 3

To efficiently oversee the costs incurred for CMAR projects, the Construction Services/Bond Office, and the PM firms should work with the CMARs to standardize the use of the Procore filing system. At a minimum, the Procore file folders should contain:

- Subcontract files including:
 - subcontract bids and recommendations for subcontract awards
 - executed subcontracts, including copies of any subcontractor performance and payment bonds purchased
 - executed subcontract changes with all supporting documentation
- Monthly payment applications with all supporting documentation
- Weekly payroll reports from all subcontractors working on the project

Risk Level: Medium³

Conclusion

Overall, OIA and Consultant found the District staff and designated PM firms have worked effectively together to manage the challenges of delivering these CMAR projects within the approved budgets with the objective of delivering the finished CMAR as early as possible.

Implementing the recommendations in this report could improve the District's internal controls over the CMAR procurement process and construction project management.

We would like to thank Procurement Services, Construction Services/Bond Office, M/WBE, and Legal Services for their cooperation and assistance with this audit.

This audit was conducted in accordance with the Institute of Internal Auditor's *International Standards for the Professional Practice of Internal Auditing*. Those standards require OIA plan and perform the audit to obtain appropriate evidence to provide a reasonable basis for our Observations and conclusions based on our audit objectives. OIA believes the evidence obtained provides a reasonable basis for our Observations and conclusions based on our audit objectives.

³ See Attachment 1 for definition of Risk Level

Respectfully submitted,

Robert Rubel

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Chief Internal Audit Officer

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Definition of Risk Level

Risk Level	Definition
High	High probability of occurrence that would significantly impact the District's operations and have a significant financial or compliance risk. These Observations are defined as an issue identified by an internal audit that, if not addressed timely, could directly impact achievement of a strategic or important operational objective of the District.
Medium	Risks are considered to be substantially undesirable and pose a moderate level of risk exposure to District operations. Without appropriate controls, the risk will happen on a consistent basis.
Low	The risks are considered to be undesirable and could moderately expose the District. Without appropriate controls, the risk will occur some of the time.

Management Response

Observation 1 – Further develop construction documents prior to submitting for trade contractor bidding

Acknowledgement of Observation:

- ☒ Agree
☐ Disagree

Management's Response:

The foundation of any construction project's success is accurate and complete construction documents. This helps protect project contingencies and allowances and mitigates the risk of going over budget during the construction project.

Construction Services will continue to work with the Architects, CMARs, and PMs to ensure complete design documents are obtained prior to execution of contracts.

Estimated Implementation Date:
December 15, 2022

Individual responsible for implementation:
Michael Garcia, Executive Director II, Construction, Construction Services/Bond Office

Observation 2 – Further develop processes for obtaining and reviewing supporting documentation for trade contract adjustments related to allowance and contingency expenditures

Acknowledgement of Observation:

- ☒ Agree
☐ Disagree

Management's Response:

The Construction Services/Bond Office acknowledges the need to edit the process for obtaining supporting documentation for the use of project contingencies and allowances. The Construction Services/Bond Office has a process for the use of project contingencies and allowances as listed in DISD's CMAR Procedures Manual. However, more detail is needed for the backup and level of detail that will be required of the CMAR and their trade partners.

Constructions Services/Bond Office has scheduled a workshop training session with Consultant for which expectations and requirements for obtaining and reviewing adjustments related to allowance and contingency expenditures will be determined and communicated. Subsequent to the training, the Construction Services/Bond Office will document these expectations via written processes and procedures and distribute to necessary staff.

Estimated Implementation Date:
December 15, 2022

Individual responsible for implementation:
Michael Garcia, Executive Director II, Construction, Construction Services/Bond Office

Observation 3 – Establish a standardized administrative process for filing of project related documentation

Acknowledgement of Observation:

- ☒ Agree
- ☐ Disagree

Management's Response:

The Construction Services/Bond Office acknowledges the need to modify the process for storing project related documentation. Up until now, the Construction Services/Bond Office Department has allowed the use of one of many project management information systems to house project data. The district does not have an affiliation to any single vendor.

The Construction Services/Bond Office has been working to develop written procedures for filing project related documentation and will continue to finalize these procedures in the coming months.

Estimated Implementation Date:
July 31, 2023

Individual responsible for implementation:
Michael Garcia, Executive Director II, Construction, Construction Services/Bond Office