



Internal Audit

Bond Funded Projects - Competitive Sealed Proposals Audit (Construction)

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Date: February 15, 2023

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

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

Subject: Bond Funded Projects - Competitive Sealed Proposals Audit (Construction)

Executive Summary

The Dallas Independent School District (District) Office of Internal Audit (OIA) has completed the Bond Funded Projects - Competitive Sealed Proposals (CSP) Audit (Construction).

This audit was conducted in two phases. The audit report for the first phase, made final at the Audit Committee on November 10, 2022, focused on the Procurement Services Department's processes for contracting general contractors (GCs) for bond-funded projects using the CSP method. This report for the second phase of the audit, focuses on the Construction Services/Bond Office Department's (Construction Services) processes and controls surrounding the management of the GC contracts.

Overall, Construction Services has processes in place for managing bond-funded construction projects procured using the CSP method. Construction Services collaborates with Procurement Services, Architect/Engineer (A/E) firms, and Project Management (PM) firms to oversee that construction projects are completed and provide the best value to the District and the community.

Opportunities for improvement were identified in the following areas:

1. Detailed supporting documentation for contingency allowance expenditure authorizations (CAEAs) should be obtained and reviewed prior to approval.
2. Overhead and profit limits should be reviewed for allowability and contract compliance.

Implementation of the recommendations in this report could assist Construction Services to improve the management of bond-funded construction projects.

Background

Construction Services' mission is to provide quality sustainable facilities to enhance student achievement. Their goals are to manage the architectural and engineering design for bond-funded construction projects; manage the construction of bond-funded school projects; oversee the procurement of real property for new schools and expansion of existing campuses; manage the procurement of fixtures, furniture, and equipment for new schools and additions; assist in the administration of construction-related warranties; and oversee a construction safety program to ensure safe activities on all campuses during construction projects.

Bond Program

The District currently has two bond programs in place. The 2015 bond program was approved to fund \$1.6 billion in facility and campus improvements as well as new schools. The 2020 bond program was approved at \$3.4 billion to fund \$3.2 billion of repairs and upgrades for more than 200 District campuses and \$270 million for purchasing and District technology updates.

Competitive Sealed Proposals

The District uses the CSP method to procure GCs for the majority of its construction projects. Use of competitive procurement methods, such as CSPs, initiates competition amongst bidders to provide better value for the District. CSP, under Texas Government Code Chapter 2269, is a procurement delivery method used for construction contracts in which the District requests proposals for the project, evaluates and ranks the offerors, negotiates the offer, and then contracts with a GC to complete the project. First, a solicitation must be created to include the following: scope of work, 100% completed construction/design documents, budgets, and estimated completion date. Architects/engineers are selected to prepare the construction documents based on input from the District, the community, and other stakeholders. Based on the solicitation, contractors typically submit offers to complete the project scope within a given timeframe for a lump sum price. Allowances and owner-controlled contingency amounts may also be determined on the proposal.

General Contractors

GCs are procured to coordinate the construction project and manage the job site. GCs are contracted within the A101 and A201 contract documents to perform a determined scope of work for a lump sum price plus any pre-determined owner-controlled contingency. Once contracted, GCs will either self-perform work and/or hire subcontractors to complete the required scope of work. GCs submit applications for payment on a monthly basis for which the District makes progress payments to the GC based on the percentage of work completed and materials obtained and stored. A five percent retainage fee is withheld from each progress payment and released upon substantial completion of work. A final payment is made when the contract is fully performed and work completed has been accepted by the Board of Trustees.

Budgets

Project budgets are overall budgets determined by the District, which includes all amounts estimated to complete the entire project. The project budget will account for the PM firm budget, A/E budget, construction budget, furniture, fixtures, equipment (FF&E) budget, etc.

Managed budgets are utilized by the District to signify the services to be managed by the assigned PM firm throughout the life of the project. Generally, managed budgets include everything except for the PM firm budget, overtime budget, and FF&E budget; however, it can vary by project.

Scope to budget is the estimated amount needed for the GC to complete the determined scope of work for a bond construction project. The scope to budget is typically prepared and set by the A/E firm and includes a construction cost limitation (CCL) amount, which is the maximum amount required for the cost of work including any owner-controlled contingency.

Change Orders

When a project requires a material change in scope of work or will need additional funds outside of the project budget, a change order must be submitted and approved by the Board of Trustees. Change orders are amendments to the contract and are not submitted for competitive bid. As such, it is important that change orders provide detailed documentation to support the cost.

Contingency

Owner-controlled contingencies are a part of the board approved project budget and consist of funds set aside for unexpected costs encountered throughout the construction project. These funds typically represent around 5-10% of the project budget. As these amounts are approved with the original project budget, additional board approval is not required when funds are used; however, GCs must get written approval by Construction Services before utilization of any contingency amount. A CAEA must be submitted that documents the need for the contingency usage. Contingency costs are to be supported with detailed breakdowns of labor, materials, fees, and other associated costs. Any owner-controlled contingency funds not utilized are kept by the District and may be allocated to other construction projects.

Architect/Engineer Firms

The District contracts A/E firms to provide professional architect services for design and oversight of construction projects. A/E services are divided into basic services and additional services, which are compensated differently. Basic services typically include schematic design, document production and review, and construction administration. Basic services are compensated based on a fee percentage multiplied by the construction cost limitation and contingency budget. Any additional services performed outside of the basic services are compensated based on an agreed upon manner between the District and A/E firm.

Project Management Firms

In addition to A/E firms, the District also contracts PM firms to oversee and manage bond-funded construction projects from planning and design through project close out. PM firms are responsible for managing all project matters with the purpose of meeting the project completion date within the allotted budget. The district currently contracts five different firms, each of which are made up of around 10 – 21 employees solely working on District projects. Each PM firm manages, on average, approximately 46 projects for the District. PMs are paid on a fee-based structure based off the managed budget and are paid monthly based on the percentage of the project's completion. To assist and oversee the PM firms, the District employs contract managers. There are currently four contract managers on staff, each of which have an average of 59 projects. The contract managers, A/E firms, and PM firms work closely together to coordinate and execute construction projects.

Construction Project Document Management

Construction projects require an extensive amount of documentation to properly manage, track, and monitor progress for timely completion within the allotted budget. To manage this documentation, Construction Services and the PM firms use a shared electronic folder (X: drive) to maintain records pertinent to construction projects. Additionally, Construction Services licenses a software called Owner Insite, which the GCs, A/Es, PM firms, and District representatives have access to use for project management and document retention. The District and the PM firms also manage Construction Management at Risk (CMAR) contracts. For management of these projects, a cloud-based storage system (Procore) is utilized that has the ability to store and maintain documentation essential to the project for ease of access and review as needed. Procore is billed by the CMARs to the District.

Scope

This second phase of the audit included a review of Construction Services current processes and procedures for construction projects funded by the 2015 and 2020 bond program.

Objective

The objective of the audit was to review the District's processes and controls surrounding the management of bond-funded construction projects procured using the CSP delivery method.

Methodology

Change Management Testing

Auditors obtained a listing of 2015 and 2020 bond-funded projects procured using the CSP method. Auditors then filtered to include only renovations, additions, and/or new construction projects that were at least substantially completed from July 2021 through August 2022, totaling 20 projects with original contract amounts totaling \$330,667,820. From the population of 20 projects, auditors judgmentally selected eight projects totaling \$243,069,187. For each of the eight projects, auditors obtained the CAEA listings with a combined amount of 599 CAEAs totaling \$13,801,553 and randomly selected 34 CAEAs totaling \$3,997,746 and conducted the testing below:

1. To determine if CAEAs were properly supported, reviewed, and approved, auditors requested the supporting documentation for the CAEAs to verify the documentation was complete; contained a detailed breakdown of pricing, labor, and units; and the CAEA had evidence of approval by the architect, PM firm, and the owner.
See Recommendation 1 in this report.
2. To determine if charges for contingency usage were accurate, auditors obtained the supporting documentation for the CAEAs and recalculated the itemized costs and reconciled to the total amount listed on the CAEA.
See Recommendation 1 in this report.
3. To determine appropriateness and reasonableness of prices and quantities for changes presented on the CAEAs, auditors reviewed detailed documentation of material pricing and material quantities along with labor pricing and hours.
See Recommendation 1 in this report.
4. To determine if overhead and profit charges were appropriate, auditors obtained detailed documentation for the CAEAs and verified overhead and profit did not exceed limits set by the contract document A201.
See Recommendation 1 in this report.
5. To determine that reasoning and justification for contingency usage was appropriate and did not contain material changes in scope or price that would necessitate the use of a change order, auditors reviewed the reasoning for the change listed on the CAEA and compared to the supporting documents and scope of work determined in the contract.
No observations were noted; however, results were communicated to management for review.

Change Management Analysis

To determine if contingency allowances were appropriate and usage was in compliance with contract terms, auditors used the audit population from change management testing above and analyzed the determination of contingency allowance per project and verified the contingency usage did not exceed the contracted amount.

No observations were noted; however, results were communicated to management for review.

General Contractor Final Reconciliation Testing

To determine if GCs were properly paid, auditors used the audit population from change management testing above. From the 20 projects in the population, auditors filtered projects that were listed as "closed" under their status, leaving seven projects total. Of those seven projects, auditors selected all projects with a construction cost limitation greater than \$1M, totaling six projects for testing amounting to \$170,317,443. For each of the six projects, auditors obtained the final payment reconciliations and supporting documentation for testing of the below:

1. To determine if payments were accurate, auditors obtained the GC's final reconciliation and tied the base price plus contingency price to the A101/A201 contract, purchase order, and the Oracle payment detail.
No observations were noted.
2. To determine if retainage was calculated and paid correctly, auditors recalculated 5% of the total amount charged and verified that amount was withheld on the Oracle payment detail. In addition, auditors reviewed the Oracle payment detail to verify 10% of retainage after project completion.
No observations were noted.
3. To determine if the GC's payments were fully supported, auditors verified the amounts listed on the final reconciliations were supported by the following:
 - Summary listing of CAEAs
 - Summary listing of CAELs
 - Summary listing of AERAs
 - Support for custodial overtimeNo observations were noted.
4. To determine if proper approvals were obtained prior to final payment, auditors verified the approvals and dates on the final reconciliations were prior to the final payment date listed on the Oracle payment detail. In addition, auditors reviewed board agendas to ensure approval dates from the Board of Trustees preceded release of the remaining retainage to the GC.
No observations were noted.

Project Management Firm and Architect/Engineer Payment Testing

To determine if PM firms and A/Es were properly paid, auditors used the sampled projects from the final reconciliation testing above and conducted the following:

PM Firm Payments

1. Verified the fee percentage listed on the purchase order was in accordance with the fee listed on the PM firm's master agreement

2. Recalculated the PM firm's total project payment by multiplying the fee in the master agreement by the managed budget in the purchase order documentation
3. Verified the recalculated amount did not exceed the amount paid on the Oracle payment detail

No observations were noted

Architect/Engineer Payments

1. Verified the fee percentage listed on the purchase order was in accordance with the fee listed on the A/E's master agreement
2. Recalculated the total project payment by multiplying the fee in the master agreement by the approved scope to budget
3. Verified the recalculated amount did not exceed the amount paid listed on the Oracle payment detail
4. Verified any additional services paid were fully supported and were not a part of basic services.

No observations were noted

Primary criteria used for this audit were:

- 1) Construction Services A101 and A201 Contract Documents, dates vary based on contract date
- 2) Project Management Firms Master Agreements and Addendums, 2015 Bond Program and 2020 Bond Program
- 3) A/E Firms Master Agreements, 2015 Bond Program and 2020 Bond Program
- 4) CV (Local), Facilities Construction, issued June 29, 2022

Audit Observations and Recommendations

Observation 1 – Detailed supporting documentation for contingency allowance expenditure authorizations (CAEAs) should be obtained and reviewed prior to approval.

Condition

Auditors selected 34 CAEAs for testing to determine if proper support was retained, reviewed, and approved. See below for exceptions noted:

- For five of the 34 CAEAs tested (15%), no documentation was maintained to support the change.
- For four of the 34 CAEAs tested (12%), documentation did not contain a detailed breakdown of pricing.
- For eight of the 34 CAEAs tested (24%), only some of the documentation included a detailed breakdown.
- In addition, 12 of the 34 CAEAs (35%) were not properly approved by the architect.

For the CAEAs noted above that did not have complete documentation to support the change, auditors were unable to test that they were accurate and appropriate.

Criteria

Dallas ISD Construction Contract Document A201, Article 7, Changes in the Work – Dec 2018
7.1.4

The Contractor, upon receipt of written notification by the Architect of a proposed item of change in the Work, shall prepare as soon as possible a Change Proposal in such form or forms as directed by the Architect. Each separate Change Proposal shall be numbered consecutively and shall include materials, costs, labor costs, fees, overhead and profit. The Proposal shall specify all cost related to the proposed Change in the Work, including any disruption or impact on performance. The Subcontractor's itemized accounting shall be included with the Change Proposal. Upon written approval of a Change Proposal by the Owner, the Architect, and the Program Manager; the Architect will prepare a Change Order authorizing such change in the Work.

Cause

The District contracts five PM firms, which all have different internal methods for obtaining, reviewing, and storing support for CAEAs. These processes are often manual and time-consuming. The PM firms are required to put the documentation for CAEAs on the department's X: drive; however, the firms also use other repositories to store the documentation, and documentation is not always able to be located on the shared X: drive. In addition, the X: drive can be difficult to search and navigate making it hard to track and monitor CAEA documentation along with other vital project documentation.

Effect

Without complete or detailed documentation to support project changes, Construction Services is unable to determine if changes requested are reasonable and, in turn, may result in inappropriate or costly charges. In addition, lack of proper review by the architect may allow for inappropriate or unnecessary changes to be requested and charged.

Recommendation 1

Construction Services should consider implementing processes to ensure detailed documentation to support changes is obtained, reviewed, and approved. Potential solutions are provided below:

- Construction Services should consider implementing a universal project management software to be used by the District, PM firms, architects, and contractors to manage critical aspects of construction projects. A project management system would allow for construction projects to be centrally tracked and monitored. Workflow approval processes could be implemented as well as dashboards and other reporting tools that may be useful to managing construction processes.
- As noted as a recommendation on the CMAR audit report dated June 30, 2022, Construction Services should consider developing standard templates to be utilized by the GCs when submitting detailed documentation for CAEAs as well as for the PM firms to use when completing their review process. The template should require the GCs to provide detailed units, prices, fees, and labor, etc.

Risk Level for Observation 1: Medium¹

Observation 2 – Overhead and profit limits should be reviewed for allowability and contract compliance.

To determine if overhead and profit charges were appropriate and in accordance with contract terms, auditors selected 34 CAEAs for testing noting six of the 34 CAEAs (18%) did not have detailed supporting documentation to test if overhead charges were appropriate. For the remaining 28 CAEAs with supporting documentation to be tested, eight (29%) had charges that exceeded the contract terms. Overhead and profit fees overages noted on the CAEAs tested ranged from \$209 to \$21,188.

Criteria

Dallas ISD Construction Contract Document A201, Article 7, Changes in the Work – Dec 2018
7.1.5

The combined overhead and profit included in the total cost to the Owner of a change in the Work shall be based on the following schedule:

1. For the Contractor, for Work performed by the Contractor's own forces, ten (10%) percent of the cost.
2. For the Contractor, for Work performed by the Contractor's Subcontractor's, four (4%) percent of the amount due the subcontractors.

¹ See Attachment 1 for Definition of Risk Level.

3. For each Subcontractor involved, for Work performed by that Subcontractor's own forces, ten (10%) percent of the cost.
4. For each Subcontractor involved, for Work performed by the Subcontractor's Sub-subcontractors, four (4%) percent of the amount due the Sub-subcontractor.
5. Cost to which overhead and profit is to be applied shall be determined in accordance with Subparagraph 7.3.7.
6. In order to facilitate checking of quotations for extras or credits, all proposals except those so minor that their propriety can be seen by inspection, shall be accompanied by a complete itemization of cost including labor, materials and Subcontractors. Labor and materials shall be itemized in the manner prescribed above. Where major cost items are Subcontractors, they shall be itemized also.

Cause

Incorrect charges are due to a lack of obtaining and properly reviewing supporting documentation. As noted in Observation 1, the large scale of documentation along with manual processes to obtain, review, and store the documentation make it difficult to track and monitor CAEAs and effectively oversee the costs incurred for construction projects.

Effect

Without proper retention and review of detailed documentation to verify pricing and fees comply with the contract language, the District may be overpaying on CAEAs and change orders for construction projects.

Recommendation 2

See Recommendation 1 - Construction Services should consider implementing processes to effectively oversee costs charged for changes to construction projects. Potential solutions are provided below:

- Construction Services should consider implementing a universal project management software. The system could provide automated field checks for overhead and profit charges based on the fees determined in the contract to ensure GCs do not submit overages.
- Construction Services should consider developing standard templates to be utilized by the GCs when submitting the documentation for CAEAs as well as for the PM firm's when they are completing their review process. The template should require the GCs to provide detailed units, prices, fees, and labor, etc. Templates could consist of formulas to automatically calculate the appropriate overhead and profit charges to act as an automated guide and/or check.

Note: Recommendations 1 and 2 are similar, however, each recommendation is tailored to the conditions stated in the separate observations.

Risk Level for Observation 2: Medium²

² See Attachment 1 for Definition of Risk Level.

Conclusion

Overall, Construction Services has processes in place for the management and execution of GC contracts procured using the CSP method for bond-funded construction projects. Implementation of the recommendations in this report could assist Construction Services to improve the processes surrounding monitoring bond project performance and contingency use management.

We would like to thank Construction Services and the PM firms for their cooperation and assistance with this audit.

The audit was conducted in accordance with the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*. Those standards require OIA to plan and perform the audit to obtain sufficient and 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.

Respectfully submitted,

Robert Rubel

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

Cc: Pamela Lear, Ed.D., Deputy Superintendent, Chief of Staff and Racial Equity Officer
Dwayne Thompson, Deputy Superintendent, Business Services, Financial Services
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Definition of Risk Level

Risk Level	Definition
High	High probability of occurrence that would significantly impact District operations and have a significant financial or compliance risk. These observations are defined as an observation 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 – Detailed supporting documentation for contingency allowance expenditure authorizations (CAEAs) should be obtained and reviewed prior to approval.

Acknowledgement of observation:

- ☒ Agree
- ☐ Disagree

Management's Response:

Construction Services is taking steps to ensure quality control of the CAEA process by introducing a Change Management Form, which explains in detail the rationale of the contingency expenditure, and requires the architects review and approval and program manager and district personnel review and approval. An additional step is also being taken to aid in the level of detail required for the supporting documentation. Construction Services Department is working on standardizing a CAEA form which puts in place unit pricing per change and puts limits on overhead and profit per the contract agreement.

Estimated Implementation Date: March 1, 2023

Individuals responsible for implementation:

Michael Garcia, Executive Director, Construction Services/Bond Office

Observation 2 – Overhead and Profit limits should be reviewed for allowability and contract compliance.

Acknowledgement of observation:

- ☒ Agree
- ☐ Disagree

Management's Response:

Construction Services will monitor the general contractor, architect, program manager and district staff to review and approve the limits on overhead and profit on each CAEA. Construction Services is implementing a new standardized form that will set limits on overhead and profit amounts on each CAEA to avoid misinterpretation of the limits set forth in the contract.

Estimated Implementation Date: March 1, 2023

Individuals responsible for implementation:

Michael Garcia, Executive Director, Construction Services/Bond Office