

Continuous Audit - Bond Funded Construction Projects

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Date: May 15, 2024

To: Board of Trustees
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Subject: Continuous Audit - Bond Funded Construction Projects

Executive Summary

The Dallas Independent School District (District) Office of Internal Audit (OIA) has completed the Continuous Audit - Bond Funded Construction Projects for fiscal year (FY) 2023-2024.

Auditors reviewed processes and tested transactions on a continuous basis to ensure proper controls were in place surrounding bond funded construction projects.

This review focused on current processes. Specifically, OIA reviewed a sample selection of Contingency Allowance Expenditure Authorizations (CAEAs) from July 1, 2023, through February 15, 2024.

Overall, Construction Services have designed and continue to enhance their processes for the management and execution of bond funded projects procured using the Competitive Sealed Proposal (CSP) and Job Order Contract (JOC) methods. No observations requiring management's response were noted. OIA will continue to assist Construction Services throughout the term of the bond to ensure the strongest controls are implemented.

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 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 general contractors (GC's) for most of its construction projects. Use of competitive procurement methods, such as CSPs, initiates competition amongst bidders to provide better value for the District. A 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. 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.

Job Order Contracting

JOC is utilized by the District typically for smaller construction projects. It involves a multi-year agreement and relationship between the District and Board approved JOC vendors, who are pre-selected through a competitive bidding process. During the competitive bidding process of a JOC, instead of providing lump sum proposals as in CSPs, prospective JOC vendors propose a coefficient, or multiplier, which will later be used along with a unit price book to accurately estimate their future assigned job order projects.

General Contractors

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 final payment is made when the contract is fully performed, and work completed has been accepted by the Board of Trustees.

Architect/Engineer Firms

The District contracts with Architect/Engineer (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 plus 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 Project Management (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 has contracts with 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. The contract managers, A/E firms, and PM firms work closely together to coordinate and execute construction projects.

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 which documents the need for the contingency usage. Contingency costs are to be supported with detailed breakdowns of labor, materials, fees,

and other associated costs. Current District procedures include providing contractors requesting use of contingency funds with a detailed breakdown template, or green sheet. This template provides a format which separates detailed pricing between three individual categories: labor, materials, and equipment. Distinct columns for categories found in the template enable contractors to easily detail individual line items under each category and calculate subtotals. Along with the three categories above, the template includes areas for the contractor to detail additional allowable charges such as labor burden and overhead and profit.

Labor Burden

Whereas hourly rates and salaries for employees are considered direct labor costs, indirect labor costs such as workers compensation, insurance and benefits, taxes, and other overhead costs fall under the umbrella of labor burden. Generally, labor rates are presented as an hourly rate and labor burden is expressed as a percentage. Both direct and indirect labor costs are permissible to be included as line items in proposals, however, each have an alternative method of calculating their totals.

Direct labor costs are calculated by multiplying hours proposed by a specified hourly rate. Hourly rates may vary depending on the type of specialty or trade. Using the total direct labor costs of a proposal, the proposed labor burden percentage is then multiplied by the total direct labor costs. Labor burden total and direct labor totals are then added together to reach a total labor cost of the proposed project or change in work.

Overhead and Profit

As required in current construction contract documents utilized by the District, any changes necessary to a complete a project must be accompanied by an approved CAEA. The CAEA proposal process differs as it uses the cost-plus pricing model. Line items for labor, both direct and indirect, materials, and equipment are detailed and itemized by the amounts to be reimbursed by the owner at actual costs. To reach a subtotal of their proposal, contractors will add together labor, material, and equipment totals. Subtotals are then multiplied by the allowable overhead and profit percentage stated in the contract to achieve the proposal grand total which is presented to the District in the CAEA form with supporting documentation.

Scope

The audit period included activity and transactions occurring in fiscal year 2023-2024.

Objective

The objective of the audit is to continuously review transactions for the District's construction/bond projects, primarily for projects procured using the competitive sealed proposal and job order contract procurement methods.

Methodology

Contingency Allowance Expenditure Authorization Testing

Auditors obtained the change management logs from July 1, 2023, through February 15, 2024, containing 235 CAEA's totaling \$5,395,137 over 39 projects. From the change logs, auditors selected 25 CAEA's totaling \$2,052,236 from 13 projects and conducted the following:

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 District.
No observations were noted; however, results were communicated to management for review.
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.
No observations were noted; however, results were communicated to management for review.
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.
No observations were noted; however, results were communicated to management for review.
4. To determine if overhead and profit charges were appropriate and accurate, auditors obtained detailed documentation for the CAEAs and verified overhead & profit did not exceed limits set by the contract document A201.
No observations were noted; however, results were communicated to management for review.
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.

Primary criteria used for this audit were:

- 1) Construction Services A101 and A201 Contract Documents, dated October 27, 2022.

Results

CAEAs often contain large volumes of information. OIA has worked closely with Construction Services to streamline this documentation to avoid overlooking any incorrect or inappropriate charges. Although streamlined review processes have been implemented, there is still often large amounts of documentation that must be reviewed to ensure contingency usage is accurate and appropriate. As such, auditors provide an additional review by making a sample selection of CAEAs from CSP and JOC projects and performing the steps noted in the methodology.

Auditors were able to obtain reasonable assurance from testing that controls were in place and functioning as intended; and as such, no formal observations were identified. Auditors also offered and discussed the below possible improvements to current procedures which could enhance and strengthen the CAEA review and approval process.

- Clarification statements could be made on the allowable way to calculate labor burden totals in the required detailed breakdown document provided to contractors by the District and PM firms.
- Enhancements could be made to the detailed breakdown template provided to contractors to include formulas that automatically calculate charges such labor totals, equipment totals, material totals, labor burden amounts, and overhead and profit. In the excel

template, cells with formulas can be locked to ensure changes are limited and are brought to the attention of the PM firm if requested by the contractor. These automated field checks would not eliminate the need for review from the District and PM firms, however, would assist in decreasing review time of CAEA detailed breakdowns.

- Continued workshops could be held with PM Firms and contractors on how to correctly complete the detailed breakdown template provided by the District to include emphasis on labor burden and overhead and profit line items.
- A reasonable predetermined percentage for labor burden could be determined and processes implemented to inquire and/or request additional documentation to support the higher charges for CAEAs that propose percentages exceeding those predetermined limits.
- If needed, contract language could be added to current AIA contract documents to clarify allowable labor burden rate limits for all future projects. As labor burden percentages vary between hourly and salaried, contract language could be separated to limit percentages between the two types of employee classifications.

Auditors will work with Construction Services to assist in implementation of any of the above suggestions. Additionally, OIA will continue to assist the department by reviewing CAEA's on a continuous basis.

Conclusion

Overall, Construction Services have designed and continue to enhance their processes for the management and execution of bond funded projects procured using the CSP and JOC methods.

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,

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Acknowledgments:

Eva Narten, CPA, CIA, CISA, Deputy Chief, Internal Audit
Shelly Kelley, CPA, Audit Director
Zachary Ornelas, CFE, Auditor II
Jamie Benitez-Renteria, Auditor I