LA24-04

STATE OF NEVADA

Performance Audit

Nevada System of Higher Education
Capital Construction Projects
2022

Legislative Auditor
Carson City, Nevada

Audit Highlights

Highlights of performance audit report on the Nevada System of Higher Education, Capital Construction Projects issued on January 12, 2023.

Legislative Auditor report # LA24-04.

Background

The Nevada System of Higher Education (NSHE) oversees all state-sponsored higher education in the state of Nevada. The mission of NSHE is to provide higher education to the citizens of the State at an excellent level of quality consistent with the State's resources. Sections 4 and 7 of the Nevada Constitution vest governance and administration of NSHE in the Board of Regents (Board). The Chancellor is appointed by the Board, and is responsible for NSHE administration and financial management, and implements Board policies and directives.

The net value of capital assets for NSHE was approximately $2.2 billion according to the fiscal year 2021 audited financial statements. NSHE capitalizes all expenditures for constructing a new building, including major improvements, additions, or major building alterations that involve an expenditure of at least $250,000. Funding for capital construction comes through a variety of sources including state, federal, institution, and private funds.

Purpose of Audit

The purpose of the audit was to determine if the University of Nevada, Las Vegas and the University of Nevada, Reno managed capital construction projects in accordance with laws, policies, and appropriate management standards. Our audit included a review of capital construction projects that were solicited, in progress, or completed between fiscal years 2019 and 2021.

Audit Recommendations

This audit report contains four recommendations to improve compliance with state laws and sound budgeting practices regarding capital construction financing and management, nine recommendations to help control change orders and strengthen project close out practices, and five recommendations to strengthen procurement practices.

NSHE accepted the 18 recommendations.

Recommendation Status

NSHE's 60-day plan for corrective action is due on April 10, 2023. In addition, the 6-month report on the status of audit recommendations is due on October 10, 2023.

Capital Construction Projects

Nevada System of Higher Education

Summary

The Nevada System of Higher Education needs to enhance its policies and procedures to ensure institutions' capital construction project funding and management practices comply with state laws, NSHE policies, and contract terms. Funding of some capital construction projects used state-appropriated operating funds, and institutions did not have authority to manage some state-funded projects. In addition, change order documentation was not always adequate to ensure contractors' billed amounts complied with contract terms, and some unallowed amounts were billed. Furthermore, better project planning is needed to limit unnecessary modifications to construction contracts' scopes of work. Proper controls over construction project management are critical for ensuring compliance with applicable state laws and NSHE policies, and to safeguard financial resources.

Better controls over project solicitation and procurement practices are needed to ensure compliance with state law and NSHE practices. Specifically, some project solicitations did not comply with state law regarding the disclosure of selection criteria weights. In addition, delays in evaluating contractor proposals and reviewing contract documents added $1.8 million to a project contract. Furthermore, institutions used some nontraditional procurement methods for capital construction projects. Current practices associated with the use of these methods may limit institution control over project construction when compared to more traditional methods.

Key Findings

The University of Nevada, Las Vegas (UNLV) and the University of Nevada, Reno (UNR) used almost $5 million in state operating funds to help pay for capital construction. For 10 of 27 (37%) projects tested, UNLV and UNR used state operating funds. The Appropriations Act designates these funds for instructional and operating costs, and not capital construction. Institutions use of these funds was often done so they would not revert to the State. (page 7)

UNLV and UNR's management of capital construction projects using state operating funds did not always comply with state laws and NSHE policy. State law requires that contracts for the construction of NSHE projects with 25% or more state appropriations use the construction management services of the Department of Administration, State Public Works Division (SPWD). For 3 of 27 (11%) projects tested, the use of state funds represented more than 25% of the total project funding. Neither the institutions nor NSHE requested authority from SPWD to manage these projects. (page 11)

Change order documentation was often not adequate to determine compliance with contract terms. When a change to a project is needed, involving contract amount or timing, change orders are required to amend construction contracts. We tested 49 change orders worth $8.3 million related to 27 capital projects. For almost $3.1 million (37%), supporting documentation did not include detailed labor, material, equipment, or overhead and profit markup fees. In addition, unallowed costs or incorrect markup fees were charged. For change order items with adequate documentation, we found 38 of 49 (78%) change orders included unallowed costs or incorrect markup fees. This resulted in over $200,000 in inappropriate payments to contractors. (page 17)

Scope modifications to the original construction contract increased project costs by $5.5 million and resulted in additional overhead and profit markup fees of more than $800,000. These changes to the projects' scopes could have been included in the original solicitation process with better project planning. When a project's scope is modified through change orders, noncompetitive pricing and overhead and profit markup fees drive up the cost of these changes. (page 22)

Institutions' project closeout processes did not ensure compliance with state law regarding reporting requirements or ensure important documentation was received prior to the final project payment. In addition, excess project funding was not transferred timely. (page 25)

Institutions are using nontraditional procurement methods to complete capital construction projects. For one project, a public-private partnership was used for the construction of a new $125 million medical education building, at a cost of $25 million to the State. However, it is unclear whether institutions have statutory authority to use this method. In addition, the use of nontraditional methods compared to traditional methods resulted in less control and oversight over construction project management and financial activities. (pages 29)

STATE OF NEVADA

LEGISLATIVE COUNSEL BUREAU

CARSON CITY OFFICE
LEGISLATIVE BUILDING
401 S. CARSON STREET
CARSON CITY, NEVADA 89701
(775) 684-6800

LAS VEGAS OFFICE
GRANT SAWYER STATE OFFICE BUILDING
555 E. WASHINGTON AVENUE, SUITE 4400
LAS VEGAS, NEVADA 89101
(702) 486-2800

Legislative Commission
Legislative Building
Carson City, Nevada

This report contains the findings, conclusions, and recommendations from our performance audit of the Nevada System of Higher Education, Capital Construction Projects. This audit was required of the Legislative Auditor by Assembly Bill 416 (Chapter 467, Statutes of Nevada 2021). The purpose of legislative audits is to improve state government by providing the Legislature, state officials, and Nevada citizens with independent and reliable information about the operations of state agencies, programs, activities, and functions.

This report includes 18 recommendations to improve capital construction project solicitation and management. We are available to discuss these recommendations or any other items in the report with any legislative committees, individual legislators, or other state officials.

Respectfully submitted,

Daniel L. Crossman, CPA
Legislative Auditor

December 27, 2022
Carson City, Nevada

Nevada System of Higher Education Capital Construction Projects

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Introduction

Background

The Nevada System of Higher Education (NSHE), formally the University and Community College System of Nevada, was formed in 1968 to oversee all state-sponsored higher education in the state of Nevada. The mission of NSHE is to provide higher education to the citizens of the State at an excellent level of quality consistent with the State's resources. Sections 4 and 7 of the Nevada Constitution vest governance and administration of NSHE in the Board of Regents (Board). The Chancellor is appointed by the Board and is responsible for NSHE administration, financial management, and implementing Board policies and directives. NSHE includes eight institutions; however, Assembly Bill 416 of the 81st Session of the Nevada Legislature directed our audit to include only capital construction at the University of Nevada, Las Vegas (UNLV) and the University of Nevada, Reno (UNR).

Capital Improvement Project Process at the Nevada System of Higher Education

The net value of capital assets[1] for NSHE was approximately $2.2 billion according to the fiscal year 2021 audited financial statements. NSHE capitalizes all expenditures for constructing a new building, including major improvements, additions, or major building alterations that involve an expenditure of at least $250,000. Funding for capital construction projects comes through a variety of sources, including state, federal, institution, and private funds. The Board sets priorities for institutions' capital construction projects. Exhibit 1 shows capital construction spending for fiscal years 2019 to 2021.

[1] Net value of capital assets as calculated here includes buildings, land improvements, and machinery and equipment.

Nevada System of Higher Education Capital Construction Spending Fiscal Years 2019 to 2021 **Exhibit 1**

Fiscal Year	UNLV and UNR Combined	System Total	UNLV and UNR as a Percentage of System Total
2019	$110,754,000	$193,118,000	57%
2020	99,681,000	141,630,000	70%
2021	50,462,000	85,861,000	59%
Totals	**$260,897,000**	**$420,609,000**	**62%**

Source: Auditor prepared from NSHE financial statement information.
Note: Amounts are based on annual expenses categorized as construction in progress.

State laws and NSHE policies provide the framework used by NSHE institutions to procure capital assets. Nevada Revised Statutes (NRS) Chapters 338 and 341 establish requirements for the procurement and management of NSHE projects. The specific applicability of these statutes to an individual project is impacted by the amount of state-appropriated funding. According to NRS 341.1407(1), construction projects with 25% or more state-appropriated funding are to be procured and managed by the Department of Administration, State Public Works Division (SPWD). The State's Capital Improvement Program (CIP) is generally used for projects funded with state-appropriated funds and involves executive and legislative branch review and approval.

Another source of state funding for institutions' deferred maintenance projects comes from an annual excise tax on slot machines. This tax is imposed at $250 per machine on any slot machine operated in the State. The Nevada State Treasurer credits these funds to the State Education Fund, the Capital Construction Fund for Higher Education (HECC), and the Special Capital Construction Fund for Higher Education (SHECC). These funds and other allocations made by the Legislature amount to about $15 million per biennium and are to be used for NSHE's deferred maintenance costs. The Board developed a process to allocate HECC and SHECC funds between institutions based on the percentage of total maintained square footage for buildings greater than 5 years old.

Exhibit 2 shows HECC and SHECC funding and state appropriations for UNLV and UNR projects funded through the CIP process during the past three legislative sessions.

State CIP, HECC and SHECC Approved Funding By Institution and Biennium **Exhibit 2**

Institution/Project	2018-2019	2020-2021	2022-2023	Totals
University of Nevada, Las Vegas				
Hotel College Building Furniture and Fixtures	$ 1,400,000	$ -	$ -	$ 1,400,000
New Medical School Building	25,000,000[(1)]	-	-	25,000,000
New Engineering Building	1,750,000	-	36,844,345[(2)]	38,594,345
HECC/SHECC (Deferred Maintenance)	4,912,381	4,857,560	4,727,300	14,497,241
Totals	**$33,062,381**	**$4,857,560**	**$41,571,645**	**$79,491,586**
University of Nevada, Reno				
New Engineering Building	$41,500,000	$ -	$ -	$41,500,000
HECC/SHECC (Deferred Maintenance)	5,249,422	5,363,731	5,454,696	16,067,849
Totals	**$46,749,422**	**$5,363,731**	**$ 5,454,696**	**$57,567,849**

Source: Auditor prepared from Capital Improvement Program and NSHE financial reports.

[(1)] Funding was approved as part of the 2017 CIP, but later reverted to the General Fund. The amount was reappropriated by Senate Bill 434 of the 2021 Legislative Session.

[(2)] Funding was approved at $20 million state funds as part of the 2019 CIP, but later reverted to the General Fund. A new amount was reappropriated in 2021.

For projects with no state-appropriated funding, NSHE has the primary responsibility for the procurement and management of those projects. Both UNLV and UNR have professional staff that perform procurement and project management functions. However, SPWD is responsible for all plan review and inspections of NSHE construction projects on state land.

Construction Project Management and Change Orders

Either SPWD or institution staff manage capital construction projects. A general contractor is usually selected and coordinates the various trades required to complete the project. Usually, a single contract between NSHE and a general contractor is used to procure project construction services. However, companies and individuals used to perform trade specific work are referred to as subcontractors, and can include concrete, electrical, plumbing, and other work.

State agencies and general contractors are responsible, among other things, for ensuring payment of prevailing wages and that subcontractor work complies with the applicable project specifications and building codes. Sometimes changes to the scope of work for a project are necessary and are facilitated by using change orders that modify the construction contract. These changes can be the result of various circumstances including unforeseen conditions, inadequate planning, or other circumstances. Unforeseen conditions are issues that were not considered when planning the project like hazardous materials found on the construction site.

Change orders modify the construction contract price or timeline. Construction contracts at UNLV and UNR allow the general contractor and subcontractors to add a 10% to 15% overhead and profit markup fee for each change order item. These fees compound depending on how many subcontractors are used as each level of subcontractor adds its fee. The subcontractor then passes that along to the general contractor who is allowed to add a markup fee to the work performed by the subcontractors.

Procurement of Capital Construction Projects at the Nevada System of Higher Education

NSHE is exempt from NRS Chapter 333—the State Purchasing Act. However, the Board established procurement policies for NSHE institutions and purchasing offices in both northern and southern Nevada.

Per NSHE policy, a formal solicitation is required for capital construction projects valued at $100,000 or more. The following are common types of procurement methods used by institutions:

- **Invitation to Bid** — is the most common construction solicitation method and is awarded to the lowest qualified bidder.

- **Construction Manager at Risk (CMAR)** — awards the project to a general contractor under a guaranteed maximum price, who provides construction consultation before, during, and after the design of the facility. In addition, the CMAR can provide the project management services for construction. This is the most common procurement method for new construction or major renovations.

- **Design-Build** — uses a single contract with the intention of the architect working more closely with the contractor to provide a single source of responsibility for the design and construction of the project. This procurement method is rarely used by the universities.

For both the CMAR and Design-Build procurement methods, a selection committee designated by the institution's purchasing office is used to evaluate vendor proposals and award the project construction contract.

Other Construction Procurement Methods Used

Institutions have also used other methods to procure capital construction projects, including lease-purchase agreements and public-private partnerships. Lease-purchase agreements are created uniquely for each project depending upon the circumstance. Generally, a third party manages construction and retains ownership upon completion. After an agreed upon time and payment amount, ownership is transferred to the institution. A lease-purchase agreement can also be dually funded by the lessor and the institution. An example of this can be where the lessor funds construction of the building and the institution also pays certain construction costs upfront to modify for use the area to be leased.

Another method is a public-private partnership, which operates in a similar manner as a lease-purchase agreement, but project funding is 100% donor funded and the donor oversees the entire project. An example of this is the medical education building at UNLV, in which institutional oversight is in the form of weekly meetings and walkthroughs of the building construction throughout the project.

Scope and Objective

This audit was required of the Legislative Auditor by Assembly Bill 416 (Chapter 467, Statutes of Nevada 2021), included in Appendix A, and was conducted pursuant to the provisions of NRS 218G.010 to 218G.350.

The scope of our audit included a review of capital construction projects that were solicited, in progress, or completed between fiscal years 2019 and 2021. Our audit objective was to:

- Determine if the University of Nevada, Las Vegas and the University of Nevada, Reno managed capital construction projects in accordance with laws, policies, and appropriate management standards.

The Legislative Auditor conducts audits as part of the Legislature's oversight responsibility for public programs. The purpose of legislative audits is to improve state government by providing the Legislature, state officials, and Nevada citizens with independent and reliable information about the operations of state agencies, programs, activities, and functions.

Noncompliance with Capital Construction Funding and Management Requirements

The Nevada System of Higher Education (NSHE) needs to enhance its policies and procedures to ensure institutions' capital construction project funding and management practices comply with state laws and NSHE policies. Specifically, almost $5 million in state-appropriated operating funds were used for capital construction, which did not comply with the Appropriations Act and NSHE policy. In addition, institutions did not have authority to exclusively manage projects that utilized state funding, and some projects exceeded realized funding. Proper use of state-appropriated operating funds helps ensure instructional and operating costs are appropriately funded, project management laws are followed, and limited financial resources are preserved.

State-Appropriated Operating Funds Used for Capital Construction

The University of Nevada, Las Vegas (UNLV) and the University of Nevada, Reno (UNR) used almost $5 million in state-appropriated operating funds to help pay for the capital construction projects we tested. These state operating funds were not appropriated by the Legislature for use in capital construction. The State and NSHE have specific processes to fund capital construction projects with state funds that are separate from institutions' operating budgets and require the involvement of the Department of Administration, State Public Works Division (SPWD), Governor, and Legislature. The practice of using state operating funds for capital construction was often associated with institutions wanting to spend state operating funds that otherwise would be reverted to the State if not spent by fiscal year end.

Ten of 27 (37%) projects tested at UNLV and UNR used state operating funds. For three of these projects, the use of state operating funds equaled 25% or more of the projects' funding.

Exhibit 3 shows the total funding for the 10 projects and the amount of state operating funds used for the projects.

State-Appropriated Operating Funds and Total Project Costs **Exhibit 3**

Institution/Project	Description	State Funds	Total Project Cost	State Funding Percentage
UNLV				
Project 9	Remodel Several Buildings	$1,437,200	$ 2,421,000	59%
Project 11	Remodel Existing Building	649,999	1,722,499	38%
Project 12	Remodel Existing Building	221,466	1,313,643	17%
Totals		**$2,308,665**	**$ 5,457,142**	**42%**
UNR				
Project 16	New Building	$ 186,070	$ 56,307,253	0.3%
Project 18	New Building	565,919	37,622,001	2%
Project 22	Remodel Existing Building	378,420	5,308,052	7%
Project 23	Remodel Existing Building	867,811	4,909,708	18%
Project 25	Remodel Several Buildings	53,184	2,398,686	2%
Project 26	Remodel Several Buildings	32,676	1,438,023	2%
Project 28	Remodel Existing Building	515,936	515,936	100%
Totals		**$2,600,016**	**$108,499,659**	**2%**
Combined Totals		**$4,908,681**	**$113,956,801**	**4%**

Source: Auditor prepared from NSHE financial records.

As shown above, for two projects, state operating funds represented all or a majority of the projects' total funding. The Legislature did not approve the use of these state-appropriated operating funds for any of the projects. Additional information regarding project funding sources can be found in Appendix B on page 36.

State operating funds were often used for costs directly related to the construction of the project. These costs included payments for the general contractor, architect, or equipment and furniture. Exhibit 4 shows how state operating funds were used for the 10 projects tested with operating funds.

Use of State-Appropriated Operating Funds **Exhibit 4**

Institution/Project	Construction and Design Services	Equipment and Furnishings	Other	Totals
UNLV				
Project 9	$1,211,994	$180,386	$44,820	$1,437,200
Project 11	649,999	-	-	649,999
Project 12	221,466	-	-	221,466
Totals	**$2,083,459**	**$180,386**	**$44,820**	**$2,308,665**
UNR				
Project 16	$ 186,070	$ -	$ -	$186,070
Project 18	535,466	30,453	-	565,919
Project 22	378,420	-	-	378,420
Project 23	867,811	-	-	867,811
Project 25	51,240	1,944	-	53,184
Project 26	32,676	-	-	32,676
Project 28	478,767	37,169	-	515,936
Totals	**$2,530,450**	**$ 69,566**	**$ -**	**$2,600,016**
Combined Totals	**$4,613,909**	**$249,952**	**$44,820**	**$4,908,681**

Source: Auditor prepared from NSHE financial records.
Note: Other includes signage, accessories, and miscellaneous services.

As shown above, these state operating funds were not used for typical maintenance costs like carpet and paint, which would have been included in institutions' state-funded operating budgets approved by the Legislature.

State Separately Funds Building Maintenance

The State has established processes for funding deferred maintenance using state appropriations. For deferred maintenance projects, $15 million in Higher Education Capital Construction and Special Higher Education Capital Construction funding is given to NSHE each biennium for disbursement to institutions for deferred maintenance. In addition, state-funded operating budgets can include funding for facility maintenance. The State Budget Building Manual defines facility maintenance as minor remodeling, repairs, and maintenance work of a nonstructural nature, costing less than $100,000. This may include items like carpet, drapery, paint, etc. Facility maintenance should be requested in an institution's operating budget.

Funding for capital construction projects using state appropriations is determined in the Capital Improvement Program (CIP) portion of the state budget process. The State Budget Building Manual defines a capital construction project as infrastructure requirements over $100,000. These projects require structural modifications, affect exiting and egress plans, and other building modifications. The CIP is reviewed and approved through an executive and legislative process that is separate from an institution's budget.

State Funds Spent to Avoid Reversions

We observed the practice of using state operating funds for capital construction projects is done so these funds will not revert to the State. For example, documentation for one project showed institution staff issued a change order to use state operating funds that otherwise should have reverted to the State at the end of fiscal year 2019. This change order increased the project scope to add floor insulation material at a cost of $190,655.

In another example, one institution transferred over $6.5 million in construction costs from a $20 million project to an account for state operating funds. This transfer of expenses took place in April 2021. In June 2021, before fiscal year end, the institution transferred these expenses again to a different account used for student General Improvement Fees, as it was determined the state-funded account would be overspent. While in the end state operating funds did not pay for this project's costs, it indicates an intent to use these funds so they would not revert to the State.

Through the Appropriations Act, unused state operating funds provided to NSHE must be reverted to the State, unless the funds are used to match documented research grants, in which case they can carry forward for a maximum of 2 fiscal years.

In our discussions with System Administration, management agreed the use of state operating funds for capital construction projects is not appropriate. The Board of Regents (Board) policy states funding derived through state funds must be used to the greatest extent possible in support of student credit-based instruction. It also indicates the use of these funds for other purposes should only be under the most unusual conditions, and approved by institutions' Presidents, the Chancellor, and the Board.

NSHE has developed a process for identifying and requesting state appropriations for capital construction through the CIP process and to restrict the use of state operating funds for noninstructional uses. However, NSHE does not have adequate controls to ensure state operating funds are not used for capital construction projects. In addition, System Administration does not have sufficient controls over accounting transactions performed by institutions and relies on each institution to ensure accounting transactions are appropriate.

When institutions use state operating funds for capital construction, these funds are not being used for their intended purposes, which is the funding of positions and associated costs for the instruction of students. Therefore, important instructional support staff positions may go underfunded, and registration and other student fees may be higher than necessary. Lastly, state operating funds are not being reverted to the State General Fund at year end, which is not in compliance with the Appropriations Act.

Solicitation and Management of State-Funded Projects Did Not Comply with Law and Policy

UNLV and UNR's management of capital construction projects using state operating funds did not always comply with state law and NSHE policy regarding public works. State law requires NSHE projects funded by at least 25% of state appropriations use the construction management services of the SPWD. A total of 3 of 27 (11%) projects tested used state funds greater than 25% for construction. In addition, NSHE policy requires all projects, funded in whole or part with state appropriations, be managed by SPWD. However, another seven projects used state funds and were not managed by SPWD. The construction of capital projects requires specialized skills and it is important that laws and policies be followed to help ensure appropriate building standards are followed and state funds are properly used.

In total, SPWD did not manage the construction for 10 of 27 (37%) projects tested that used state funds. Specifically, we observed the following at each institution:

- **UNLV** — a total of 3 of 14 (21%) projects tested used state funds. For two of these projects, state funds represented more than 25% of the total project construction funding. One of these projects used over $1.4 million in state funds, which represented over 92% of the project construction funding.

- **UNR** — a total of 7 of 13 (54%) projects tested used state funds; however, only one project's state funds represented more than 25% of the total project construction funding. For this project, over $500,000 of state funds represented the entire amount for project construction.

Delegation of State Public Works Division Authority Was Not Obtained

Neither the institutions nor NSHE requested authority from SPWD to manage the three projects tested with more than 25% state funds. While state law does not allow SPWD to delegate its authority as the building official, law does allow for the administrator of SPWD to delegate, upon the request of a state agency, all other duties on construction contracts with greater than 25% of funding being state appropriations.

State law, as codified in NRS 341[2], declares it is the policy of this State that all planning, maintenance, and construction of buildings on property of the State be supervised by and final authority for its completion and acceptance be vested in SPWD. Among other things, SPWD is tasked with overseeing projects, including the solicitation, award, and management of a construction contract. In addition, SPWD acts as the building official that reviews construction plans, issues building permits, and inspects construction work.

For NSHE projects, state law allows institutions to perform most contract management duties for projects with less than 25% state

[2] NRS 341.1405 to .145

funds. However, NSHE policy requires any construction project funded with state funds to use SPWD for the solicitation, award, and management of construction contracts. Specifically, the System of Higher Education Procedures and Guidelines Manual provides that the process for designing and constructing all projects financed in whole or part by state funds will be the responsibility of SPWD.

Several factors contributed to UNLV and UNR not complying with state law and NSHE policy. At one institution, management believed NRS 341 lacked clarity and SPWD only managed projects funded through the State's CIP process. In addition, neither NSHE nor the institutions have entered into agreements with SPWD to define which state funded projects will be managed by SPWD and which will be managed by the institutions.

Although large institutions like UNLV and UNR have staff to manage construction projects, they are not in compliance with legislative or NSHE intent if they do not use SPWD in the management of projects with state funding. It is important to follow established laws and policies to help ensure project construction meets appropriate building standards to protect the safety and welfare of the public.

Project Costs Exceeded Funding

Completed construction projects exceeded funding and project accounts carried a deficit, sometimes for years. For 4 of 24 (17%) completed projects tested, the expenditures exceeded the budget and project funding. Prudent financial management includes establishing and following a budget to control and safeguard resources.

Both UNLV and UNR had projects that exceeded the funding for the project, including two projects with state funds. The following was observed for the four projects that exceeded project funding:

- Project 1 (UNLV) — expenditures of $32 million, which exceeded the available funding and budget by $6.6 million.

- Project 23 (UNR) — expenditures of $4.9 million, which exceeded available funding and budget by $22,103. This project included $867,811 in state funds.

- Project 24 (UNR) — expenditures of $3.4 million, which exceeded the available funding and budget by $190,969.
- Project 26 (UNR) — expenditures of $1.4 million, which exceeded available funding and budget by $64,703. This project included $32,676 in state funds.

During our testing, we observed the accounts for these projects had deficit balances from 1.5 to 3.5 years after payment of the final construction contract amounts. Because institutions have various funding resources, project accounts can operate at a deficit since funds to pay commitments is available from other institutional sources. Accounts with deficits can be cleared by additional income or gifts received at a later date.

For example, scope modifications for one project increased construction costs from $19 million to $29 million, without a commensurate increase in anticipated or realized funding. Almost all the original construction financing, $18 million, was expected to come from gifts and donor pledges; however, this funding only amounted to $9.5 million by the time the project was completed. A bank loan was used to obtain $15.5 million in initial project funding, while awaiting donor funds.

Moreover, because of the funding shortfall, the institution used $6.6 million of self-supporting funds to pay the remaining project costs and pledged to use investment income to balance the project budget if donor funds do not materialize. However, this is not assured as our testing found institutions used a wide variety of funding sources to balance capital construction project accounts when deficits occur. This includes state operating funds which are not appropriate uses for funding shortfalls unless properly reviewed and approved by the Legislature. Therefore, additional controls to ensure funding is solidified prior to project commencement, as well as ongoing monitoring of project funding, is important.

A budget helps ensure projects' costs match available resources. NSHE policy requires project expenditures be consistent with the budget. In addition, policies require System Administration and institutions to develop budgetary controls and review financial information to ensure resources are used appropriately.

Multiple factors contributed to project deficits. Although NSHE monitors deficits in some accounts, this is not true for capital construction project accounts. Therefore, System Administration is not aware when projects are underfunded. When funding capital projects, institutions often use multiple funding sources, including bonds, loans, investments, student fees, state funds, and donor funds. This allows institutions to be less concerned with project costs and budgets.

In addition, institutions did not prioritize the collection of funding owed by institution departments or foundations. For 2 of 4 projects with deficits, the institutions indicated they are still awaiting department or donor funds. For the other two projects, the institutions had not yet identified additional sources of funding to clear the project deficit.

When project budgets are not firmly established and monitored, a necessary control is not in place to ensure funding will be available and project costs are appropriate. If project costs exceed budgeted funding, institutions will look to other sources to cover funding shortfalls. Projects should be funded prior to significant commitment of financial resources. In addition, budgets should represent as accurate an estimation of project costs as possible. Ongoing monitoring helps ensure the appropriate use of state funds as well as reducing the likelihood of needing more expensive financing sources to complete projects.

Recommendations

1. Revise policies and procedures to clarify state-appropriated operating funds are not to be used for capital construction and develop controls to help ensure compliance.
2. Revise policy regarding the management of construction projects using state appropriations and develop procedures to ensure involvement of the State Public Works Division where required and appropriate.

3. Work with the State Public Works Division on an agreement regarding the management of projects funded with state appropriations to ensure compliance with statute and Board of Regent policies.
4. Develop policies for monitoring construction project accounts, identifying potential funding shortfalls, and ensuring original project scopes and any modifications are appropriate considering realized funding or anticipated funding shortfalls.

Construction Management Practices Need Strengthening

Institutions need stronger oversight of capital construction project management to improve the accountability of contractors and project managers. Nearly $3.1 million in change order documentation was not sufficient to determine compliance with contract terms. We also found over $200,000 in unallowed costs and inaccurate markup fees. In addition, scope modifications increased project costs by $5.5 million and resulted in more than $800,000 in additional markup fees. Furthermore, institutions failed to comply with state law regarding project closeout reporting and did not obtain appropriate documentation prior to the final contractor payment. Proper controls over construction project management are critical for ensuring compliance with applicable state laws and NSHE policies, and to safeguard financial resources.

Change Order Review Not Adequate

Change orders were not properly reviewed to ensure proper amounts were paid. Specifically, supporting documentation did not always include adequate detail to determine whether proper amounts were paid. For change orders with adequate supporting documentation, we identified unallowed costs and inaccurate markup fees. In addition, a lease-purchase agreement was used to perform two construction projects where the agreement did not adequately address change order fees. As a result, the contractor could charge inappropriate amounts for change orders. Finally, contractual overhead and markup fees for two different projects were allowed to be increased but were not consistent with the contract.

Lack of Supporting Documentation

We observed at both institutions that change order documentation was often not sufficient to determine compliance with contract terms. We tested 49 change orders worth $8.3 million from 27 capital projects. For almost $3.1 million (37%), supporting documentation did not include detailed labor, material, equipment, or overhead and profit markup fees. This detail is necessary to ensure contractors bill appropriate amounts that are in compliance with contract terms. Exhibit 5 shows the number and dollar amounts of unsupported change orders tested at UNLV and UNR.

Unsupported Change Order Number and Amounts UNLV and UNR Projects Tested **Exhibit 5**

Institution	Change Order Number Tested	Unsupported Number	Percentage of Unsupported	Change Order Amount Tested	Unsupported Amount	Percentage of Amount
University of Nevada, Las Vegas	24	22	92%	$3,491,788	$1,244,523	36%
University of Nevada, Reno	25	20	80%	4,817,602	1,834,674	38%
Totals	**49**	**42**	**86%**	**$8,309,390**	**$3,079,197**	**37%**

Source: Auditor prepared from review of change order documentation.

While overall 37% of the total dollars tested did not have sufficient supporting documentation, the percentage was higher for some change orders. Specifically, 12 of 49 (25%) change orders tested lacked detailed supporting documentation for 70% or more of the amount billed.

The contract terms require change order documentation to include detailed information regarding labor, materials, and equipment costs. When a significant amount of change order costs lack sufficient detail to evaluate their validity, abuse and fraud can occur and go undetected, and overall project costs can significantly increase unnecessarily.

Unallowed Costs and Inaccurate Markup Fees

For change order items with adequate documentation, we observed 38 of 49 (78%) change orders tested had unallowed costs or incorrect markup fees. This resulted in over $200,000 in inappropriate payments to contractors. Examples of unallowed costs and incorrect markup fees included:

- At UNLV, a general contractor charged $14,400 for supervision and project administration on top of the $6,100 (10%) overhead and profit markup fee. Supervision and project management is included in the markup fee per the contract.

- At UNLV, a subcontractor charged over 32% instead of the 15% allowed by the contract for overhead and profit. This resulted in an overcharge of $1,055 on $5,968 in material and labor costs.

- At UNR, both the general contractor and a subcontractor charged $1,427 and $1,803 for bond fees. Furthermore, the subcontractor charged $2,475 for project management in addition to the overhead and profit markup fee of 10%. Per the contract, bond and project management costs are part of the markup fee. After recalculating allowed costs with applicable overhead and profit markup, UNR was overcharged $6,548 for one change order item.

- At UNR, the subcontractor charged a 15% overhead and profit markup fee when the contract allowed 10%. After recalculating the allowed markup fee, UNR was overcharged $8,387.

In addition, one contract had two different overhead and profit markup fee rates for subcontractors, one set at 10% and another at 15%. Although some overcharged amounts may not be individually significant, the lack of controls over change orders could have much larger implications.

According to the construction contracts used by UNLV and UNR, change order costs may be increased to include a fixed fee for subcontractor overhead and profit, general contractor overhead and profit on subcontractor work, and overhead and profit on work done by the general contractor's own employees. This overhead and profit markup fee is limited to 10% or 15% depending on the cost of the change order. In addition, the change order fee is to be full compensation for the cost of supervision, overhead, profit, tools, insurance, bonding, and all other expenses associated with completing the change in the scope of work.

Institutions did not have policies and procedures to thoroughly review change order costs including subcontractor costs. UNR has now developed a process within its project management system that requires project managers to indicate they reviewed a change order. However, without specific policies and procedures detailing how a review should be done, this new process may be nothing more than a checklist that will not ensure a thorough review is performed.

Furthermore, NSHE does not have standardized contract terms for overhead and profit markup fees on construction contract change orders, and contract terms do not adequately define allowed and unallowed costs. For example, contract language states contractors are allowed to charge for equipment costs for equipment utilized to perform the change order work, but terms do not adequately define what equipment represents.

Processing change orders without adequate supporting documentation or detailed review can lead to increased project costs. For example, we calculated $229,671 (3%) in overpayments to contractors, $156,054 at UNR and $73,617 at UNLV. Independent of our audit, one project manager at UNR recognized similar exceptions and recovered over $61,000 in overpayments for one of the projects tested in our audit.

Lease-Purchase Agreement Lacked Controls for Change Orders

UNLV entered into a lease-purchase agreement that lacked controls over change order costs. As part of a lease-purchase agreement and for a 4% overhead and markup fee per change order, the lessor had the authority to manage the construction projects on the property and to select a general contractor and subcontractors. The general contractor then performed two construction projects to modify the leased building according to UNLV's needs. Subcontractors for these projects charged 6% to 11% over the contractual overhead and profit markup fee. We also observed exceptions to change order costs for both projects.

The lease-purchase agreement used for the construction of these two projects did not address what change order fees would be charged by the general contractor and subcontractors, and UNLV relied on the “good faith” of the general contractor and subcontractors to only charge a 4% overhead and profit markup fee. In addition, UNLV did not adequately review change order documentation to ensure compliance with expectations regarding fee amounts.

Contract Change Order Terms Not Followed

For two change orders related to different projects, UNLV allowed an Associate Vice President to increase the contractual overhead and profit markup fee. For one project, a 10% overhead and profit markup fee was charged and paid on a change order instead of the 7% allowed by the contract. The deviation from the contract terms was approved through an email and did not provide any justification as to why the deviation from the contract terms was warranted.

On another project, with a cost of $59,527, the institution identified the invoice exceeded contract terms; however, instead of requiring the contractor correct the amount, or modify the payment to the correct amount, the institution paid the higher fee. This was accomplished by again requesting and receiving approval from management by email. The $1,623 difference was nominal; however, intentional bypassing of internal controls is problematic.

According to the project agreements, change order overhead and profit markup fees were limited to no more than 7% of the change order amount, as both change orders exceeded $10,000. Furthermore, NSHE purchasing offices are an important control for institutional procurement; however, the purchasing office did not enforce the contract terms and instead sought exception to established policies and related controls. While these overpayments may not be significant, the bypassing of controls could have much larger implications.

Change Order Processing Violated Nevada System of Higher Education Policies

The processing of some change orders violated NSHE policies. A change order for $50,435 exceeded 10% of the original contract value of $343,998 but was not approved by the Chancellor. Furthermore, three change orders for a project were not reviewed by the institution's purchasing office, bypassing a key control. These change orders totaled $338,382.

NSHE policy states change orders must have the Chancellor's approval if the amount exceeds 10% of the original contract amount. Furthermore, NSHE policy requires all purchases and competitive procurements shall be made by the institution's purchasing office, and change orders will be approved in the same manner as the original contract.

UNLV did not have proper oversight to ensure compliance with change order processes and procedures. When change orders fail to receive the proper review and approval, there is an increased risk of unnecessary cost escalation and management may not be aware or approve of changes to a project's scope.

Scope Modifications Increased Project Costs

We found scope modifications to the original contract increased project costs by $5.5 million and resulted in additional overhead and profit markup fees of more than $800,000. Institutions frequently used change orders for scope modifications to construct projects. However, these changes to the projects' scopes could have been included in the original solicitation process with better project planning.

Inadequate Planning Increases Project Costs

At UNLV we tested $3.7 million in change orders and found $2.5 million (69%) were the result of scope modifications and not related to unforeseen circumstances. A change order is an amendment to the agreement issued by the institutions purchasing office authorizing a change in work, an adjustment in the contract amount, or a change in the contract time. The following examples reflect change order costs that deviated from the original project's scope:

- $190,655 was spent to add insulation to portions of a building not originally included in the project's scope. Review of available documentation indicated this change was made specifically to spend down fiscal year state appropriations so amounts would not be reverted.

- $441,607 was paid to upgrade paint for a parking garage after a department requested it, despite the original project scope including high-performance paint.

- $256,274 was spent to modify a façade to a structure after a department requested it, citing continuity with an existing structure, which was not considered in the initial design planning process.

- $139,797 was paid, which included $6,751 in overhead and profit markup fees, for the purchase of laundry equipment.

At UNR we tested $5.7 million in change orders and observed scope modifications increased project costs by over $3 million (53%). The following examples reflect change order costs that deviated from the original project's scope:

- $72,146 was spent to revise recital hall acoustical millwork panels and grilles by installing wood reflectors.

- $59,522 was paid for additional planters, curbs, pavers, and asphalt.

- $46,097 was spent to provide additional security cameras and revise the location and model system type.

With enhancements to project planning processes, including more robust involvement of departments directly impacted or benefiting from projects, these types of change orders can largely be avoided.

Scope modifications lead to increased project costs in which the institution is unable to guarantee a competitive price from general contractors and their subcontractors. For example, labor was paid in the amount of $216 per hour to modify an information technology room. Furthermore, both UNLV and UNR used change orders to remove and dispose of furniture. At one institution, the subcontractor charged a labor cost of $75 per hour when the prevailing wage rate was $29 per hour. Both institutions have moving staff that could have performed this function with adequate planning.

Scope Modifications Include Additional Costs

Overhead and profit costs are a part of business and included in construction contract pricing. For example, CMAR contracts at institutions often included a 4% to 4.6% profit amount. However, additional overhead and profit costs of 10% to 15%, on top of the noncompetitive pricing, compound when change orders are used for scope modifications. More than $806,000 (14%) in overhead and profit fees were paid to contractors for those scope modifications tested.

For example, one scope modification required three subcontractors perform additional work. In addition to the $349,000 in material and labor costs billed, the subcontractors charged over $52,000 in overhead and profit fees, or 15% of the material and labor costs. Furthermore, the general contractor charged over $40,000 to process the change order. In total the percentage of fees to materials and labor costs for this scope modification equaled 27%.

Scope modifications were the result of several factors including inadequate planning, delayed user requests, and to use “excess” funding. For example, project managers from both institutions indicated a main cause for scope modifications originated from university departments and it was difficult to enlist departments to fully participate in the planning process. Furthermore, UNLV had initiated a change order to a project for the purpose of spending down state funds before they expired and would be subject to reversion to the State.

Procurement processes required by Board policy are intended to guarantee the buyer procures services at a competitive price, to help ensure transparency, and for equal and fair opportunities for vendors. When scope modifications are not used for legitimate reasons like emergencies and unforeseen circumstances, it can lead to waste and abuse.

Project Closeout Process Can Be Strengthened

Institutions need to improve their project closeout process to ensure compliance with state law, guarantee appropriate documentation is collected prior to final payment, and safeguard project funding. UNLV and UNR did not comply with law as they failed to notify the Labor Commissioner of project completion and issued final payments to contractors before notifying the Labor Commissioner. In addition, the institutions did not obtain critical documentation before final contractor payments, or in some cases, never obtained critical documentation for project closeout. Finally, UNLV failed to identify remaining project funds and revert or transfer them timely.

Labor Commissioner Not Notified of Project Completion
The Labor Commissioner was not always notified of project completion. One of 22 (5%) projects did not have documentation to support that project completion was reported to the Labor Commissioner. In addition, 8 of 22 (36%) projects were not reported to the Labor Commissioner until after the final contractor payment. Furthermore, the average time between final payment and reporting to the Labor Commissioner was 16 months. When institutions do not comply with law related to timely notification to the Labor Commissioner, there is a risk prevailing wage laws will not be properly enforced, and workers might experience difficulty recovering wages owed them.

NRS 338.013(4) states the public body which awarded the contract shall report the completion of all work performed under the contract to the Labor Commissioner before the final payment. While project managers at both institutions are aware of this requirement, proper oversight was not given to ensure the Notice of Completion was submitted to the Office of the Labor Commissioner. Furthermore, there was some confusion at the institutions as to who was responsible for retaining this documentation and the Notice of Completion had to be requested from SPWD following an auditor inquiry.

Final Payment Issued Without Critical Project Closeout Documentation

Critical project closeout documentation was either never obtained, issued, or received in a timely manner. Specifically, required project closeout documentation was never obtained for 11 of 22 (50%) completed projects tested. In addition, final payment was issued before receiving documentation for 19 of 22 (86%) projects. For example, the following was observed:

- A certificate of substantial completion was not issued for 7 of 22 (32%) projects. For 6 projects, this certificate was never obtained and for 1 project it was obtained 9 months after final payment to the general contractor.

- As-built drawings were not obtained for 2 of 22 (9%) projects. For 3 projects, these drawings were received between 1 to 3 months following the final payment to the general contractor.

According to construction agreements, project closeout documentation like certificates of substantial completion and as-built drawings are required before final payment is made to the general contractor.

Several factors contributed to the lack of project closeout documentation. First, construction management staff at the institutions did not make the collection and retention of project closeout documentation a priority. Also, staff were not aware they should be collecting and retaining this documentation. Finally, four construction contracts did not include clauses to require a certificate of substantial completion.

When contractors are paid before important project closeout documentation is received, institutions are at higher risk of not receiving these critical documents, or not being able to enforce critical contract provisions like liquidated damages and warranties.

Project Ending Balances Not Reverted Timely

Excess project funds were not reverted timely. Specifically, at UNLV, 7 of 13 (54%) completed projects had excess funding upon project completion. Surplus funding totaled $352,788 and had remained in the project accounts an average of 2 years after final construction payment was made to the general contractor. For two of these projects, UNLV began the process of returning the excess funds once we brought them to the institution's attention.

In contrast, 2 of 11 (18%) completed projects at UNR had excess funding remaining in the project accounts after project completion. These funds were returned to the appropriate sources within a few months of the final construction payment to the general contractor. To help revert excess funding timely, UNR uses a project management software program and reviews its accounting report once a project is completed to vet project funding and costs, and to return excess funding.

The Board delegates to its Business, Finance and Facilities Committee responsibility and authority for year-end review of major current year budget revisions and/or transfers, including use of reserves (unappropriated fund balances) and excess income over budget. In addition, NSHE policy requires all professional campus staff ensure the satisfactory completion of all construction projects and funds should only be retained following project closeout for partial occupancy or substantial completion for deficiencies.

Despite the guidelines mentioned above, NSHE does not have clear policies and procedures for the reversion of unused project funds and timeframes for project closeout processes. Unused project funds are also not being monitored and information is not being shared between budget managers and accounting. When unused project funds are not reverted timely, the funds are not available for other institutional needs. Funds may also be at risk of being forgotten about and may not be used for their intended purposes.

Recommendations

5. Develop standardized construction contracts that define allowable overhead and profit markup fees for both general contractors and subcontractors, and clearly define unallowable charges.

6. Implement proper controls so institution personnel do not deviate from contract terms.
7. Ensure all construction projects funded by institutions have construction contracts that control costs and allow institutions access to all pertinent cost information, regardless of the procurement method.
8. Develop policies and procedures to thoroughly review change order costs, including subcontractor overhead and profit markup fees.
9. Develop a systemwide policy to help ensure appropriate entities, including the departments that will be the users of the project, fully participate in project planning and to limit changes to project’s scopes after the awarding of the construction contract.
10. Develop a systemwide policy to help ensure all project costs are identified and included in the project construction budget before awarding the construction contract, and to ensure change orders are not used to spend additional funding or unused state appropriations.
11. Develop procedures to ensure institutions comply with state law and notify the Labor Commissioner prior to final contractor payment.
12. Ensure that essential project closeout documentation is obtained prior to final contractor payment.
13. Require institutions to develop policies and procedures to monitor project balances and to ensure unused project funds are reverted timely.

Systemwide Guidance Needed for Construction Procurement

NSHE needs to enhance its policies and procedures related to procuring construction projects in two areas. First, in recent years, institutions have used nontraditional methods in some situations to procure construction projects. These methods may offer advantages but may limit institutions' control over the contractor and the project when compared to traditional methods. Second, weaknesses in project solicitation led to instances of noncompliance with NSHE policy and state law, including solicitations not advertising the weights for evaluation criteria and $1.8 million added to a project contract not awarded timely. Additional guidance is needed from the Board to ensure the institutions' and state's resources and interests are safeguarded on capital construction projects and ensure the transparency of project solicitation.

Nontraditional Procurement Methods Warrant Additional Review

Although nontraditional procurement methods offer new opportunities for institutions, additional safeguards are needed. UNLV used one of these methods on a few large capital construction projects and UNR plans to use them for future projects. Under these methods, institutions may have less control and oversight over procurement management and financial activities for construction projects than traditional methods. In addition, it is unclear whether institutions have statutory authority to use one of the methods. As these procurement methods are becoming more common at both institutions, there is an increased risk projects will be constructed without adequate oversight. Therefore, seeking clarification on state laws and developing policies and procedures would help ensure capital construction projects best serve the needs of the State and institutions.

Public-Private Partnership
One nontraditional construction procurement method used by UNLV is referred to as a public-private partnership (P3). UNLV utilized this method on a new medical education building completed in 2022. Using this method, UNLV entered into an agreement with a nonprofit that contributed about $100 million for project construction on land provided by UNLV. The agreement transfers ownership of the building to UNLV in 2030. Under this method, the nonprofit selects the general contractor and oversees all aspects of construction and pays the contractor directly. However, since the institution does not have a contract with the general contractor, it loses some control over the management of the project, including accountability for the use of state-appropriated funds and the right to modify the project as needed.

In addition, it is unclear under state law whether institutions have authority to use the P3 method when procuring capital construction projects. Under NRS 338.1587, public bodies are authorized to enter into P3s for the construction of transportation facility projects. The institutions believe they have authority to use P3s because state law does not specifically prohibit its use for non-transportation facilities. It would be prudent for NSHE to seek clarification on its statutory authority to use P3s on capital construction projects.

Lease-Purchase Agreement
UNLV used a lease-purchase agreement in a nontraditional manner to perform two capital construction projects. The State has also used these agreements as a method to finance and purchase buildings. These agreements allow a state agency to lease a building from a developer for a certain time with the right to purchase the building at the end of a specified term. Under this method, UNLV used the agreement with the developer to perform capital construction projects. The developer was allowed to select the general contractor, manage project construction, and collect construction payments from the institution. The developer also had the authority to modify the project as deemed necessary. Similar to the P3 method, since the institution does not have an agreement with the general contractor, it has limited authority over project construction.

During the 2005 Legislative Session, Senate Bill 426 created an advisory group to conduct an interim study concerning lease-purchase agreements by public entities. Based on the findings of the advisory group, NSHE required institutions to adopt specific procedural language for lease-purchase agreements on or before December 31, 2007. However, both institutions failed to comply with this mandate and NSHE did not enforce this policy. Without proper guidance, institutions are at risk of entering into agreements that may not allow them proper authority to protect the interests of NSHE or the State.

State Funds Appropriated for Medical Education Building

While nontraditional methods of procurement provide opportunities for institutions, without proper guidance and consideration, there is a lack of safeguards for public money. For instance, while UNLV's medical education building was primarily funded with donations, state-appropriated funds were also utilized. Specifically, $25 million in state-appropriated funds was requested for furnishings and equipment, despite the development agreement between the Board and the nonprofit stating furniture and equipment was the responsibility of the nonprofit.

In April 2022, UNLV requested these funds to be transferred to the nonprofit without supporting documentation to ensure funds were spent in accordance with legislative intent. Documentation provided by the nonprofit showed project expenses were $122.7 million as of November 2022, but the nonprofit indicated additional expenses to complete the project will likely bring the final project expense to about $125 million. Total funding for the project was $143.7 million, including the $25 million state appropriation. According to the nonprofit, excess funding will be used to complete additional projects at UNLV.

During the 2021 Session, Senate Bill 434 provided the $25 million appropriation. Legislative committee meetings regarding the appropriation indicated the funding would be used for furniture and equipment, and should be the last dollars spent. Although the language of the bill was general and appropriated the funds for construction, the bill did include a reversion clause for unspent funds. Based on the general language in Senate Bill 434 and the contract between UNLV and the nonprofit, it is unclear if any of the $25 million appropriation should be reverted to the State. Additional NSHE policies and procedures would help ensure the institutions' and State's interests are protected when nontraditional procurement methods are used.

Noncompliance Regarding Project Solicitation

UNLV and UNR generally complied with laws and institution policies regarding capital construction procurement. This included requirements related to approvals by the Board and Chancellor, obtaining multiple bids, and awarding contracts based on scoring criteria. However, we observed some noncompliance with statutes regarding construction contractor solicitation, and delays in awarding a contract which led to higher project costs.

Solicitations for four of six (67%) CMAR projects did not advertise the weights for evaluation criteria as required by NRS 338.1692(2). Institutional personnel stated they were unaware of this statutory requirement. When relative weights are not advertised in solicitations as required by law, it limits the transparency of the solicitation to interested and bidding vendors.

Furthermore, 1 of 20 (5%) design solicitations was missing an executed agreement and instead utilized the solicitation itself as the agreement. NRS 338 provides guidance relevant to the preparation of construction contracts for public works. Contracts for services must be entered into through an agreement and no contract shall be considered effective until the contract is fully executed. A contractual obligation is a legal obligation and depending upon the terms of the contract could put NSHE in a position of considerable liability, or disadvantage to ensure contractor compliance, if required clauses and safeguards are not included in the contract documents. However, institution personnel believed a formal agreement was not necessary when a vendor was chosen through an informal solicitation process.

Lastly, the cost for a project solicited through the Design-Build method increased as the review committee took almost 3 months to evaluate bid proposals for the project. In addition, another 2 months lapsed before the institution's legal counsel completed review of the contract. After exceeding the 120-day project closeout deadline specified in the solicitation documents, the price escalation clause came into effect adding $1.8 million to the construction contract amount. The institution did not have policies and procedures in place to help ensure projects solicited using more complex delivery systems, like Design-Build instead of low-bid, were evaluated and awarded timely. However, when brought to the attention of the institution they identified measures to minimize the risk of this occurring in the future.

Recommendations

14. Seek clarification of state law to determine whether institutions have the authority to enter into public-private partnerships to construct capital projects.
15. Develop systemwide policies and procedures for the use of public-private partnerships to construct capital projects and enforce existing policies related to institutions development of lease-purchase procurements.
16. Develop policies and procedures to help ensure that capital construction solicitations comply with laws and adhere to both the Nevada System of Higher Education and institutional policies and procedures.
17. Develop policies and procedures for construction project solicitations that include a defined procurement schedule and proper monitoring to ensure contracts are awarded timely.
18. Revise policy to clarify the use of written agreements with appropriate terms to ensure design and construction contracts protect Nevada System of Higher Education interests.

Appendix A

Assembly Bill 416, Chapter 467 From the 2021 Legislative Session

Assembly Bill No. 416–Committee on Education

CHAPTER..........

AN ACT relating to higher education; requiring the Legislative Auditor to conduct an audit of the Nevada System of Higher Education; making an appropriation; and providing other matters properly relating thereto.

Legislative Counsel's Digest:

This bill requires the Legislative Auditor to conduct a performance audit during the 2021-2023 biennium of the Nevada System of Higher Education for the Fiscal Years 2018-2019 to 2021-2022. This bill sets forth the requirements for the audit and makes an appropriation to the Legislative Fund for overtime and travel costs related to conducting the audit.

EXPLANATION – Matter in ***bolded italics*** is new; matter between brackets ~~[omitted material]~~ is material to be omitted.

THE PEOPLE OF THE STATE OF NEVADA, REPRESENTED IN SENATE AND ASSEMBLY, DO ENACT AS FOLLOWS:

Section 1. 1. The Legislative Auditor shall conduct a performance audit during the 2021-2023 biennium of the Nevada System of Higher Education, including, without limitation, any related foundations, institutions or agencies, for the Fiscal Years 2018-2019 to 2021-2022 and any additional fiscal years the Legislative Auditor deems necessary to audit. The audit must include, without limitation, an examination and analysis of:

(a) The sources and uses of money privately donated to each school within the System and the System, including, without limitation, adherence to the terms and agreements of the donations;

(b) Capital projects at the University of Nevada, Reno, and the University of Nevada, Las Vegas; and

(c) The reserve accounts and self-supporting budget accounts in the System.

2. On or before February 4, 2023, the Legislative Auditor shall present a final written report of the audit performed pursuant to this section to the Audit Subcommittee of the Legislative Commission.

3. The provisions of NRS 218G.010 to 218G.350, inclusive, apply to the audit performed pursuant to this section.

4. Every officer and employee of a school within the System or the System, including any related foundations, institutions or agencies, shall cooperate fully with and provide such information as is required by the Legislative Auditor to assist with the completion of the audit.

Appendix A

Assembly Bill 416, Chapter 467 From the 2021 Legislative Session (cont.)

– 2 –

5. As used in this section, "System" means the Nevada System of Higher Education.

Sec. 1.5. There is hereby appropriated from the State General Fund to the Legislative Fund created by NRS 218A.150 for overtime and travel costs related to conducting the audit required by section 1 of this act the following sums:

For the Fiscal Year 2021-2022.................................... $80,250
For the Fiscal Year 2022-2023.................................. $128,750

Sec. 2. Notwithstanding the provisions of NRS 218D.430 and 218D.435, a committee, other than the Assembly Standing Committee on Ways and Means and the Senate Standing Committee on Finance, may vote on this act before the expiration of the period prescribed for the return of a fiscal note in NRS 218D.475. This section applies retroactively from and after March 22, 2021.

Sec. 3. This act becomes effective on July 1, 2021.

20 ~~~~~ 21

81st Session (2021)

Source: Nevada Legislature.

Appendix B

Project Funding Sources
UNLV and UNR Projects Tested

Institution/Project	Bond/Loan	Gift/Donor	Investment Income	Department	Capital Improvement Fee	General Improvement Fee	State Appropriation	Other Source[1]	Total Project Funding[2]
UNLV									
Project 1	$ 15,510,925	$ 9,505,070	$ -	$ 500,000	$ -	$ -	$ -	$ -	$ 25,515,995
Project 2[3]	20,016,593	-	2,901,094	4,500,000	-	-	-	-	27,417,687
Project 3	-	-	1,500,000	-	3,853,338	600,000	-	-	5,953,338
Project 4	-	-	-	-	-	5,626,788	-	-	5,626,788
Project 5	-	-	2,995,000	316,000	32,068	-	-	-	3,343,068
Project 6	-	-	-	311,500	2,100,000	520,500	-	-	2,932,000
Project 7	-	-	-	-	2,727,737	350,000	-	-	3,077,737
Project 8	-	-	-	1,902,222	-	-	-	-	1,902,222
Project 9	-	-	-	983,800	-	-	1,437,200	-	2,421,000
Project 10	-	-	-	1,826,704	-	-	-	-	1,826,704
Project 11	-	-	-	1,072,500	-	-	649,999	-	1,722,499
Project 12	-	-	-	-	1,042,177	50,000	221,466	-	1,313,643
Project 13	-	686,649	-	-	-	-	-	-	686,649
Project 14	-	-	-	85,153	282,291	325,000	-	-	692,444
Project 15[3]		118,707,836	-	-	-	-	25,000,000	-	143,707,836
Totals	**$ 35,527,518**	**$128,899,555**	**$ 7,396,094**	**$11,497,879**	**$10,037,611**	**$ 7,472,288**	**$27,308,665**	**$ -**	**$228,139,610**
UNR									
Project 16	$ 48,649,060	$ -	$ -	$ 7,472,123	$ -	$ -	$ 186,070	$ -	$ 56,307,253
Project 17[3]	-	-	-	2,785,870	-	-	-	44,003,276	46,789,146
Project 18	17,568,447	16,203,895	-	2,299,702	-	984,038	565,919	-	37,622,001
Project 19	-	-	4,905,252	-	1,200,000	13,794,075	-	-	19,899,327
Project 20[4]	-	-	-	48,876	-	-	-	13,776,148	13,825,024
Project 21	-	-	-	9,357,043	-	-	-	-	9,357,043
Project 22	-	1,736,123	-	3,193,509	-	-	378,420	-	5,308,052
Project 23	-	-	-	-	-	4,041,897	867,811	-	4,909,708
Project 24	3,151,428	-	14,688	-	-	19,768	-	-	3,185,884
Project 25	-	-	-	96,629	-	2,199,829	53,184	49,044	2,398,686
Project 26	-	1,405,347	-	-	-	-	32,676	-	1,438,023
Project 27	-	-	503,608	780	1,160,000	-	-	-	1,664,388
Project 28	-	-	-	-	-	-	515,936	-	515,936
Totals	**$ 69,368,935**	**$ 19,345,365**	**$ 5,423,548**	**$25,254,532**	**$ 2,360,000**	**$21,039,607**	**$ 2,600,016**	**$57,828,468**	**$203,220,471**
Combined Totals	**$104,896,453**	**$148,244,920**	**$12,819,642**	**$36,752,411**	**$12,397,611**	**$28,511,895**	**$29,908,681**	**$57,828,468**	**$431,360,081**

Source: Auditor prepared from NSHE financial records.

(1) Other funding is primarily insurance money for projects 17 and 20. For project 25, other funding is slot tax proceeds.

(2) Includes funding for design, construction, project management, equipment, furnishings, etc. As discussed in the report, funding was not always equal to total project cost.

(3) Project was not completed at the time of testing.

(4) Project was not closed, however received final payment.

Appendix C

Project Construction Cost Changes Due to Change Orders
UNLV and UNR Projects Tested

Institution/Project	Original Construction Contract Amount	Final Contract Payment Amount	Difference
UNLV			
Project 1	$ 19,399,152	$ 28,991,388	49%
Project 2[(1)]	23,624,659	24,660,813	4%
Project 3	4,409,611	4,489,704	2%
Project 4	4,427,480	4,239,651	(4%)
Project 5	3,492,537	2,971,136	(15%)
Project 6	2,039,882	2,239,473	10%
Project 7	1,500,000	1,874,448	25%
Project 8	1,499,500	1,554,306	4%
Project 9	1,213,340	1,546,642	27%
Project 10	1,437,525	1,499,647	4%
Project 11	999,800	1,383,182	38%
Project 12	1,060,862	1,124,388	6%
Project 13	570,913	582,437	2%
Project 14	343,998	427,499	24%
Project 15[(2)]	108,617,474	N/A	N/A
Totals	**$174,636,733**	**$ 77,584,714**	
UNR			
Project 16	48,958,721	49,211,739	1%
Project 17	41,971,108	46,137,488	10%
Project 18	30,813,000	32,663,300	6%
Project 19	17,544,586	17,077,729	(3%)
Project 20	11,316,555	11,620,416	3%
Project 21	6,913,978	7,572,369	10%
Project 22	3,801,732	4,476,120	18%
Project 23	3,437,564	3,835,784	12%
Project 24	2,784,297	2,877,944	3%
Project 25	1,880,000	2,031,255	8%
Project 26	975,225	1,277,024	31%
Project 27	1,140,642	1,231,071	8%
Project 28	414,484	445,150	7%
Totals	**$171,951,892**	**$180,457,389**	
Combined Totals	**$346,588,625**	**$258,042,103**	

Source: Auditor prepared from contract and change order documentation.

(1) Project not completed or closed at the time of testing.

(2) Project not managed by UNLV.

Appendix D

Project Unsupported and Unallowed Change Order Amounts
UNLV and UNR Projects Tested

Institution/Project	Original Construction Contract Amount	Change Order Number	Change Order Amount	Unsupported Amounts	Percent Unsupported	Unallowed Amounts	Percent Unallowed
UNLV							
Project 1	$19,399,152	CO1	$ 279,929	$ 17,163	6%	$ -	0%
Project 1	-	CO2	283,160	-	0%	-	0%
Project 2	23,624,659	CO1	1,036,136	397,346	38%	24,905	2%
Project 3	4,409,611	CO2	153,170	44,972	29%	7,154	5%
Project 3	-	CO4	44,290	8,822	20%	4,181	9%
Project 4	4,427,480	CO1	21,080	10,593	50%	446	2%
Project 4	-	CO3	40,772	10,280	25%	3,228	8%
Project 5	3,492,537	CO1	94,564	38,943	41%	2,595	3%
Project 5	-	CO2	35,804	-	0%	163	0%
Project 6	2,039,882	CO1	140,064	86,830	62%	2,500	2%
Project 6	-	CO2	59,527	26,098	44%	2,001	3%
Project 7	1,500,000	CO1	374,998	96,105	26%	17,061	5%
Project 8	1,499,500	CO2	33,537	26,329	79%	1,673	5%
Project 8	-	CO3	31,403	22,884	73%	-	0%
Project 9	1,213,340	CO1	190,655	169,170	89%	-	0%
Project 9	-	CO2	99,116	12,337	12%	185	0%
Project 10	1,437,525	CO1	30,642	13,281	43%	1,756	6%
Project 10	-	CO2	28,216	12,334	44%	977	3%
Project 11	999,800	CO1	136,661	70,065	51%	702	1%
Project 11	-	CO2	224,330	103,786	46%	1,734	1%
Project 12	1,060,862	CO1	63,526	4,224	7%	1,285	2%
Project 13	570,913	CO1	11,523	9,321	81%	-	0%
Project 14	343,998	CO1	28,250	14,986	53%	-	0%
Project 14	-	CO2	50,435	48,654	96%	1,071	2%
Project 15[1]	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Totals	**$66,019,259**		**$3,491,788**	**$1,244,523**	**36%**	**$73,617**	**2%**

Appendix D

Project Unsupported and Unallowed Change Order Amounts
UNLV and UNR Projects Tested (continued)

Institution/Project	Original Construction Contract Amount	Change Order Number	Change Order Amount	Unsupported Amounts	Percent Unsupported	Unallowed Amounts	Percent Unallowed
UNR							
Project 16	$ 48,958,721	CO1	$ (335,161)	$ -	0%	$ -	0%
Project 16	-	CO2	154,635	131,486	85%	-	0%
Project 17	41,971,108	CO1	1,612,989	9,360	1%	40,895	3%
Project 17	-	CO2	614,567	342,945	56%	15,453	3%
Project 17	-	CO3	354,586	21,165	6%	11,099	3%
Project 18	30,813,000	CO10	244,009	30,664	13%	6,632	3%
Project 18	-	CO16	421,081	62,655	15%	19,102	5%
Project 19	17,544,586	CO2	(466,857)	-	0%	-	0%
Project 20	11,316,555	CO2	85,010	77,282	91%	-	0%
Project 20	-	CO1	643,710	554,110	86%	21,963	3%
Project 21	6,913,978	CO5	249,971	-	0%	18,603	7%
Project 21	-	CO6	120,491	-	0%	4,212	3%
Project 22	3,801,732	CO8	194,767	136,500	70%	8,388	4%
Project 22	-	CO12	159,422	86,570	54%	814	1%
Project 23	3,437,564	CCD3	143,437	103,139	72%	1,970	1%
Project 23	-	CCD8	53,879	-	0%	1,009	2%
Project 24	2,784,297	CO1	93,647	74,136	79%	1,791	2%
Project 25	1,880,000	CO1	52,671	43,819	83%	276	1%
Project 25	-	CO2	32,982	4,559	14%	1,236	4%
Project 26	975,225	CO1	187,070	72,007	38%	882	0%
Project 26	-	CO4	127,326	75,746	59%	450	0%
Project 27	1,140,642	CO2	15,917	1,872	12%	-	0%
Project 27	-	CO5	39,001	5,020	13%	747	2%
Project 28	414,484	CO2	10,354	1,639	16%	135	1%
Project 28	-	CO7	8,098	-	0%	397	5%
Totals	**$171,951,892**		**$4,817,602**	**$1,834,674**	**38%**	**$156,054**	**3%**
Combined Totals	**$237,971,151**		**$8,309,390**	**$3,079,197**	**37%**	**$229,671**	**3%**

Source: Auditor prepared from contract and change order documentation.

(1) Project 15 change orders were not processed by UNLV and therefore were not tested for inappropriate charges.

Appendix E

Project Increases Due to Scope Modifications
UNLV and UNR Projects Tested

Institution/Project	Original Construction Contract Amount	Change Order Amount	Percentage Change Order Increase	Scope Modification Amount	Percentage Scope Modification Increase
UNLV					
Project 1[(1)]	$ 19,399,152	$ 563,280	3%	$ 437,974	78%
Project 2[(1)]	23,624,659	1,157,467	5%	1,062,919	92%
Project 3	4,409,611	197,460	4%	150,892	76%
Project 4	4,427,480	61,852	1%	61,852	100%
Project 5	3,492,537	130,368	4%	45,256	35%
Project 6[(1)]	2,039,882	216,159	11%	206,709	96%
Project 7	1,500,000	374,998	25%	182,958	49%
Project 8	1,499,500	64,940	4%	35,376	54%
Project 9[(1)]	1,213,340	292,079	24%	251,786	86%
Project 10	1,437,525	58,858	4%	41,845	71%
Project 11[(1)]	999,800	366,237	37%	-	0%
Project 12[(1)]	1,060,862	69,206	7%	13,174	19%
Project 13[(1)]	570,913	27,403	5%	20,629	75%
Project 14	343,998	78,685	23%	3,427	4%
Project 15[(2)]	N/A	N/A	N/A	N/A	N/A
Totals	**$ 66,019,259**	**$3,658,992**	**6%**	**$2,514,797**	**69%**
UNR					
Project 16[(1)]	$ 48,958,721	$ 154,635	0%	$ -	0%
Project 17[(1)]	41,971,108	2,599,725	6%	1,464,818	56%
Project 18[(1)]	30,813,000	720,977	2%	619,099	86%
Project 19[(1)]	17,544,586	-	0%	-	0%
Project 20[(1)]	11,316,555	734,393	6%	102,610	14%
Project 21[(1)]	6,913,978	378,673	5%	-	0%
Project 22	3,801,732	354,188	9%	354,188	100%
Project 23	3,437,564	197,315	6%	197,315	100%
Project 24	2,784,297	93,647	3%	93,647	100%
Project 25[(1)]	1,880,000	97,494	5%	56,631	58%
Project 26	975,225	314,396	32%	126,239	40%
Project 27	1,140,642	54,918	5%	14,201	26%
Project 28	414,484	18,451	4%	18,451	100%
Totals	**$171,951,892**	**$5,718,812**	**3%**	**$3,047,199**	**53%**
Combined Totals	**$237,971,151**	**$9,377,804**	**4%**	**$5,561,996**	**59%**

Source: Auditor prepared from contract and change order documentation.

(1) Change order amounts are before deductive change order amounts were noted.

(2) Project 15 change orders were not processed by UNLV and therefore were not tested for scope modifications.

Appendix F
Audit Methodology

To gain an understanding of capital construction at UNLV, UNR, and NSHE, we interviewed staff, reviewed statutes, regulations, and policies and procedures significant to its operations. We also reviewed financial information, prior audit reports, legislative committee minutes, and other information describing NSHE activities. Furthermore, we documented and assessed NSHE's controls related to the management of capital construction project solicitation, funding, and management.

Our audit included a review of NSHE, UNLV, and UNR's internal controls significant to our audit objective. Internal control is a process effected by an entity's oversight body, management, and other personnel that provides reasonable assurance that the objectives of an entity will be achieved. Internal control comprises the plans, methods, policies, and procedures used to fulfill the mission, strategic plan, goals, and objective of the entity. The scope of our work on controls related to the solicitation, funding, and management of capital construction projects at UNLV and UNR, included the following:

- Design control activities (Control Activities);
- Implement control activities through policy (Control Activities);
- Evaluate performance and enforce accountability (Control Environment); and
- Perform Monitoring Activities (Monitoring).

Deficiencies and related recommendations to strengthen NSHE's internal control systems are discussed in the body of this report.

The design, implementation, and ongoing compliance with internal controls is the responsibility of agency management.

To develop our sample of capital construction projects to test at UNLV and UNR, we requested a list of projects, with a total project cost equal to or exceeding $250,000, and that were active between fiscal years 2019 and 2021. To assess the reliability and completeness of these lists, we compared project information to NSHE accounting and project management systems, and capital project information maintained by the SPWD. In addition, we discussed the project lists with applicable NSHE personnel.

We used the project lists from UNLV and UNR to judgmentally select a total of 28 projects (15 UNLV and 13 UNR) for testing. Our judgmental selection was based on procurement method, total project cost, number and cost of change orders, and percentage of project completion. Although we selected 28 projects, not all projects were included in each of our tests as some information tested did not apply to all projects.

To determine if NSHE has adequate controls over capital project expenditures, we judgmentally selected 135 general contractor or architect payments for 27 of 28 projects selected. Our judgmental selection was based on the dollar amount, payment timing, and contractor type. Project accounting information was not available for one project at UNLV. We reviewed contractor invoices for compliance with contract terms, supporting documentation, and proper authorization. In addition, we judgmentally selected a total of 25 miscellaneous payments based on the largest payments that were not general contractor or architect payments. We tested these payments to verify the proper solicitation, relevance to the project, review prior to payment, and mathematical accuracy.

To verify general contractor total payment amounts agreed to the contract and proper retainage was withheld for the 27 projects funded by NSHE institutions, we reviewed all general contractor project invoices totaling 315 payments. We tested each invoice for compliance with NRS 338.515 and reconciled the total payments to the contract amount.

Next, using our judgmentally selected sample of 28 projects, we calculated funding sources and project expenditures by using NSHE's financial system, institution project management software, inquiries to the nonprofit managing the UNLV medical education building, and verifying project funding sources with UNLV and UNR management. Data reliability of the NSHE financial system was performed as part of our NSHE audit on Self-Supporting and Reserve Accounts (LA24-03). Auditors determined the data was sufficiently reliable for testing purposes. For some projects that were not completed, we obtained financial information through September 2022. We tested project funding sources for proper approvals and compliance with state law and Board policy regarding project funding and management. For projects that used bonds, loans, or student fees, we verified they were approved according to Board policies. In addition, we tested if project accounts were fully funded.

To determine if project change orders were appropriate and complied with contract terms and NSHE policies, we judgmentally selected a total of 49 of 156 (31%) change orders to test from the 27 projects we selected that were funded by UNLV and UNR. Our judgmental selection was based on the dollar value of the change order, by selecting the two highest dollar change orders when there were multiple change orders, or the only change order for projects with one change order.

We then reviewed the change orders for duplications by searching for similar wording, dollar amounts, and reasoning provided for each change order item. Then, we assessed if change orders were properly reviewed and approved based on cost percentage and dollar amount, aligned with the contract terms, and modified the original intent of the project scope. We did not assess the scope of work for change order items that were due to unforeseen circumstances.

To evaluate whether change orders included supporting documentation and did not charge unallowed costs, we requested and reviewed supporting documentation. In addition, we verified that general contractors and their subcontractors charged for labor, material, and equipment costs allowed by contract, and applied the appropriate percentages for overhead and profit markup fees.

To determine whether projects followed appropriate closeout processes for the 22 projects completed as of October 2022, we obtained supporting documentation such as the Certificate of Occupancy, Certificate of Substantial Completion, Labor Commissioner's Notice of Completion, and other closing documentation. We tested to verify these documents were maintained and issued before the final contractor payment. Furthermore, we determined whether final payment and retainage was paid without the appropriate closeout documentation. Finally, we examined project funding balances to determine whether excess funds were reverted to their original account.

To determine if UNLV and UNR had adequate controls over project solicitation for 25 of 28 projects sampled that were procured as Construction Manager at Risk, Design-Build, or Invitation to Bid, we tested the solicitations for compliance with NSHE policies, and NRS 338 and 341. For 2 of 28 projects sampled that were procured as lease-purchase agreements, we tested these solicitations for Board approval and for appropriate agreement provisions.

To assess if a project at UNLV procured as a public-private partnership was authorized by law and included proper approvals and oversight, we reviewed statutes regarding construction procurement methods and the agreement with the nonprofit overseeing the project. In addition, we reviewed Board meeting minutes and discussed the project with institution management. To determine if state appropriations for the project were used according to legislative intent, we reviewed legislation that provided the appropriation, legislative committee minutes that discussed the appropriation, documentation provided by the Governor's Finance Office, and project financial information provided by the nonprofit.

We used nonstatistical audit sampling for our audit work, which was the most appropriate and cost-effective method for concluding on our audit objective. Based on our professional judgement, review of authoritative sampling guidance, and careful consideration of underlying statistical concepts, we believe that nonstatistical sampling provided sufficient, appropriate audit evidence to support the conclusions in our report. We did not project exceptions to the population of capital construction projects because our sample was judgmentally selected.

Our audit work was conducted from July 2021 to October 2022. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

In accordance with NRS 218G.230, we furnished a copy of our preliminary report to the Chancellor of the Nevada System of Higher Education. On December 16, 2022, we met with NSHE officials to discuss the results of the audit and requested a written response to the preliminary report. That response is contained in Appendix G, which begins on page 46.

Contributors to this report included:

James T. Thorne, MPA, CCM
Deputy Legislative Auditor

Lupita Cruz, MPA
Deputy Legislative Auditor

Lori Kroboth, MBA
Deputy Legislative Auditor

Laura Harwood, MBA
Deputy Legislative Auditor

Todd Peterson, MPA
Audit Supervisor

Shannon Riedel, CPA
Chief Deputy Legislative Auditor

Appendix G

Response From the Nevada System of Higher Education

Nevada System of Higher Education

System Administration
4300 South Maryland Parkway
Las Vegas, NV 89119-7530
Phone: 702-889-8426
Fax: 702-889-8492

System Administration
2601 Enterprise Road
Reno, NV 89512-1666
Phone: 775-784-4901
Fax: 775-784-1127

MEMORANDUM

Date: December 23, 2022

To: Daniel L. Crossman, Legislative Auditor

From: Dale A.R. Erquiaga, Acting Chancellor

Re: NSHE Response to the 2022 Performance Audit of Capital Construction Projects

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INTRODUCTION

Thank you for the opportunity to respond to the 2022 Performance Audit findings. The Nevada System of Higher Education (NSHE) appreciates that the intent of this audit was to assess compliance with NSHE policies and procedures as well as with legislation and regulations established by the State of Nevada, and to provide recommendations on how NSHE can improve compliance within its operations.

We understand the value of the audit as it identified deficiencies that need to be addressed, opportunities for improvement to enhance accountability and operational management, and areas where differences in interpretation of the guidance or expectations may exist. NSHE has begun work to address the findings in the audit related to capital construction projects.

Below are the Legislative Counsel Bureau audit recommendations and NSHE's related responses.

RECOMMENDATIONS AND RESPONSES

Recommendation 1: Revise policies and procedures to clarify state-appropriated operating funds are not to be used for capital construction and develop controls to help ensure compliance.

Response: NSHE agrees with and accepts this recommendation.

NSHE will work with the institutions to develop a policy within NSHE's Procedures and Guidelines Manual that clearly defines the use of state-appropriated operating funds, including year-end procedures to prohibit unallowable transfers. This policy will also include appropriate monitoring parties for the funds to help ensure compliance.

Recommendation 2: Revise policy regarding the management of construction projects using state appropriations and develop procedures to ensure involvement of the State Public Works Division where required and appropriate.

Response: NSHE agrees with and accepts this recommendation.

NSHE will work with the institutions to ensure a revised policy surrounding management of construction projects using state appropriations aligns within institutional policy, purchasing guidelines, NSHE Procedures and Guidelines Manual, and NRS 341.1407. This will include monitoring of initial project budgets to ensure State Public Works Division involvement when required and appropriate.

Recommendation 3: Work with the State Public Works Division on an agreement regarding the management of projects funded with state appropriations to ensure compliance with statute and Board of Regent policies.

Response: NSHE agrees with and accepts this recommendation.

NSHE will work with the institutions to develop an agreement with the State Public Works Division that outlines the expectations of each party's management responsibilities for the various phases of the project when state appropriation funding is utilized.

Recommendation 4: Develop policies for monitoring construction project accounts, identifying potential funding shortfalls, and ensuring original project scopes and any modifications are appropriate considering realized funding or anticipated funding shortfalls.

Response: NSHE agrees with and accepts this recommendation.

NSHE will work with the institutions to ensure development of an aligned policy to evaluate actual funding and resources, anticipated shortfalls, and the details to monitor construction project budgets more closely.

Recommendation 5: Develop standardized construction contracts that define allowable overhead and profit markup fees for both general contractors and subcontractors, and clearly define unallowable charges.

Response: NSHE agrees with and accepts this recommendation.

NSHE will work with the institutions to develop, review, and/or revise construction contracts to define the allowable terms for overhead and markup fees, while also defining unallowable charges.

Recommendation 6: Implement proper controls so institution personnel do not deviate from contract terms.

Response: NSHE agrees with and accepts this recommendation.

NSHE will work with institution personnel to ensure monitoring of the construction contract terms. This will include identification of the key terms and costs during the payment approval process, and implementation of a periodic contract to actual cost review to ensure compliance throughout the life of the project.

Recommendation 7: Ensure all construction projects funded by institutions have construction contracts that control costs and allow institutions access to all pertinent cost information, regardless of the procurement method.

Response: NSHE agrees with and accepts this recommendation.

NSHE will work with the institutions to evaluate the current construction contract review process to ensure all costs and pertinent cost information are included in a periodic review.

Recommendation 8: Develop policies and procedures to thoroughly review change order costs, including subcontractor overhead and profit markup fees.

Response: NSHE agrees with and accepts this recommendation.

NSHE is working with the institutions in the development of standardized policies and procedures to enable a thorough review of change order costs, including detailed guidelines of how to process and approve a change order and allowable terms of change orders.

Recommendation 9: Develop systemwide policy to help ensure appropriate entities, including the departments that will be the users of the project, fully participate in project planning and to limit changes to project's scopes after the awarding of the construction contract.

Response: NSHE agrees with and accepts this recommendation.

NSHE will work with the institutions to develop a systemwide policy that identifies the project team most appropriate to facilitate and provide feedback in the construction project planning process. This team will include representatives from impacted departments.

Recommendation 10: Develop a systemwide policy to help ensure all project costs are identified and included in the project construction budget before awarding the construction contract, and to ensure change orders are not used to spend additional funding or unused state appropriations.

Response: NSHE agrees with and accepts this recommendation.

NSHE will work with the institutions to develop an aligned, systemwide policy that identifies required project costs to be considered in the project budget prior to the award.

Recommendation 11: Develop procedures to ensure institutions comply with state law and notify the Labor Commissioner prior to final contractor payment.

Response: NSHE agrees with and accepts this recommendation.

NSHE will work with the institutions to review and update policies to ensure all university policies, purchasing guidelines, and the NSHE Procedures and Guidelines Manual are revised to align with NRS 338.013(4).

Recommendation 12: Ensure that essential project closeout documentation is obtained prior to final contractor payment.

Response: NSHE agrees with and accepts this recommendation.

NSHE will work with the institutions to ensure review and, if necessary, revision of the construction contract to include a certificate of substantial completion. This will be performed in conjunction with the corrective action of recommendation #5 (develop, review, and/or revise construction contracts to define the allowable terms for overhead and markup fees, while also defining unallowable charges).

Recommendation 13: Require institutions to develop policies and procedures to monitor project balances and to ensure unused project funds are reverted timely.

Response: NSHE agrees with and accepts this recommendation.

NSHE will work with the institutions to develop an aligned policy that details the timelines for project close out and the reversion of any unused project funds.

Recommendation 14: Seek clarification of state law to determine whether institutions have the authority to enter into public-private partnerships to construct capital projects.

Response: NSHE agrees with and accepts this recommendation.

NSHE will work to seek clarification of state law to determine whether institutions have the authority to enter into public-private partnerships to construct capital projects and will apprise the institutions of any determination. If submission of a Bill Draft Request (BDR) is required, NSHE would like to work with your staff to secure the BDR.

Recommendation 15: Develop systemwide policies and procedures for the use of public-private partnerships to construct capital projects and enforce existing policies related to institutions development of lease-purchase procurements.

Response: NSHE agrees with and accepts this recommendation.

NSHE will work with the institutions to develop an aligned, systemwide policy that defines the use of a public-private partnership to construct capital projects as well as language for lease-purchase agreements.

Recommendation 16: Develop policies and procedures to help ensure that capital construction solicitations comply with laws and adhere to both the Nevada System of Higher Education and institutional policies and procedures.

Response: NSHE agrees with and accepts this recommendation.

NSHE will work with the institutions to review current capital construction solicitation policies and revise as needed to ensure compliance. The process surrounding projects solicited through the Design-Build method will be more clearly defined.

Recommendation 17: Develop policies and procedures for construction project solicitations that include a defined procurement schedule and proper monitoring to ensure contracts are awarded timely.

Response: NSHE agrees with and accepts this recommendation.

NSHE will work with the institutions to develop an aligned policy that includes a defined timeframe to evaluate and award the contract timely.

Recommendation 18: Revise policy to clarify the use of written agreements with appropriate terms to ensure design and construction contracts protect Nevada System of Higher Education interests.

Response: NSHE agrees with and accepts this recommendation.

NSHE will work with the institutions to propose a policy revision that clarifies the use of written agreements with appropriate terms to ensure design and construction contracts protect NSHE interests.

CONCLUSION

Thank you for the opportunity to meet and discuss the audit findings. As noted, NSHE has accepted all recommendations and has begun the important work necessary to properly address the findings. We look forward to reporting detailed improvements surrounding these recommendations in the future and will keep you apprised should there be any deviation from our expectations.

Nevada System of Higher Education's Response to Audit Recommendations

	Recommendations	Accepted	Rejected
1.	Revise policies and procedures to clarify state-appropriated operating funds are not to be used for capital construction and develop controls to help ensure compliance	X	
2.	Revise policy regarding the management of construction projects using state appropriations and develop procedures to ensure involvement of the State Public Works Division where required and appropriate	X	
3.	Work with the State Public Works Division on an agreement regarding the management of projects funded with state appropriations to ensure compliance with statute and Board of Regent policies	X	
4.	Develop policies for monitoring construction project accounts, identifying potential funding shortfalls, and ensuring original project scopes and any modifications are appropriate considering realized funding or anticipated funding shortfalls	X	
5.	Develop standardized construction contracts that define allowable overhead and profit markup fees for both general contractors and subcontractors, and clearly define unallowable charges	X	
6.	Implement proper controls so institution personnel do not deviate from contract terms	X	
7.	Ensure all construction projects funded by institutions have construction contracts that control costs and allow institutions access to all pertinent cost information, regardless of the procurement method	X	
8.	Develop policies and procedures to thoroughly review change order costs, including subcontractor overhead and profit markup fees	X	
9.	Develop systemwide policy to help ensure appropriate entities, including the departments that will be the users of the project, fully participate in project planning and to limit changes to project's scopes after the awarding of the construction contract	X	

Nevada System of Higher Education's Response to Audit Recommendations (continued)

	Recommendations	Accepted	Rejected
10.	Develop a systemwide policy to help ensure all project costs are identified and included in the project construction budget before awarding the construction contract, and to ensure change orders are not used to spend additional funding or unused state appropriations	X	
11.	Develop procedures to ensure institutions comply with state law and notify the Labor Commissioner prior to final contractor payment	X	
12.	Ensure that essential project closeout documentation is obtained prior to final contractor payment	X	
13.	Require institutions to develop policies and procedures to monitor project balances and to ensure unused project funds are reverted timely	X	
14.	Seek clarification of state law to determine whether institutions have the authority to enter into public-private partnerships to construct capital projects	X	
15.	Develop systemwide policies and procedures for the use of public-private partnerships to construct capital projects and enforce existing policies related to institutions development of lease-purchase procurements	X	
16.	Develop policies and procedures to help ensure that capital construction solicitations comply with laws and adhere to both the Nevada System of Higher Education and institutional policies and procedures	X	
17.	Develop policies and procedures for construction project solicitations that include a defined procurement schedule and proper monitoring to ensure contracts are awarded timely	X	
18.	Revise policy to clarify the use of written agreements with appropriate terms to ensure design and construction contracts protect Nevada System of Higher Education interests	X	
	TOTALS	18	