



**Office of the Inspector General
Los Angeles Unified School District**

**Audit Report of
Hensel Phelps Construction Co.
CO T-704, T-705, T-706 and T-707,
Contract No. 1710027/4400005798**

CA 22-1333

April 21, 2022



Los Angeles Unified School District Office of the Inspector General

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Interim Inspector General

April 21, 2022

Ms. Judith Reece, Chief Procurement Officer
Procurement Services Division
Los Angeles Unified School District
333 S. Beaudry Avenue, 28th Floor
Los Angeles, CA 90017

RE: Hensel Phelps Construction Co. (HPCC) - Contract No. 1710027/4400005798, CO T-704, 705, 706 & 707

Dear Ms. Reece,

This is the final report on our audit of Hensel Phelps Construction Co. (HPCC) - Contract No. 1710027/4400005798, CO T-704, 705, 706 & 707. Please contact our office if you have any questions.

Sincerely,

Austin E. Onwualu

Austin Onwualu, CPA, CIG
Deputy Inspector General, Audits

Salvatore Randazzo

Salvatore Randazzo
Interim Inspector General

c: Richard Lui
Cheri Thomas

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Audit of Hensel Phelps Construction Company

Contract No. 1710027/4400005798,

CO T-704, 705, 706 and 707

Introduction

The Los Angeles Unified School District Office of the Inspector General (OIG) audited the change Orders awarded by the Los Angeles Unified School District (District) to Hensel Phelps Construction Company (HPCC) related to the revision of baseball and softball fields.

On July 7, 2017, the District entered into Contract No. 1710027/4400005798 with HPCC to design and build Venice High School Comprehensive Modernization Project. In October 2021, the Facilities Services Division (FSD) executed Change Order T-704 in the amount of \$862,882 to replace all existing Musco Light fixtures at the baseball field; T-705 in the amount of \$2,471,039 to replace existing high netting fences surrounding the Baseball & Softball fields with taller 90 foot fences at Baseball field and 50 foot fences at Softball field; T-706 in the amount of \$718,179 to change all the hardscape areas in the Baseball field to accommodate the new layout of the field; and T-707 in the amount of \$535,570 to provide and install fencing for backstops, dugouts, bullpens and batting cages, and fences and gates along first and third bases. The FSD requested OIG to verify whether HPCC's proposed change order costs were fair and reasonable.

Objectives and Scope

The objectives of the examination were to determine whether (i) the change order amount was adequately supported, fair and reasonable and (ii) the change order process complied with the Facilities Services Division's Change Order Procedures.

Methodology

For objective (i), we performed the following procedures:

- Traced the changes to the approved/authorized change order and reviewed the approval signatures on the change order.
- Reviewed the fair cost estimate (FCE) on file and compared the fair cost estimate amount with the proposed amount and final approved change order amount.
- Reviewed the Record of Negotiations on file.
- Reviewed the change order cost breakdown.
- Reviewed HPCC's detailed job cost ledgers.
- Reviewed HPCC's internal change orders with its subcontractors (SCO) related to the change orders.

For objective (ii), we performed the following procedures:

- Reviewed LAUSD Facilities Services Division's Change Order Procedures
- Reviewed the change order files in accordance with the Change Order Procedures



**Audit of Hensel Phelps Construction Company
Contract No. 1710027/4400005798,
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Results of Audit

I. Determination of whether the the change order amounts were adequately supported, fair and reasonable

The claimed amount for each change order is presented below:

CO#	Amount	
T-704	\$ 862,882	
T-705	2,471,039	
T-706	718,179	
T-707	535,570	
	<u>\$ 4,587,670</u>	

We traced the amount in each change order to the change order approval and authorization document, reviewed the fair cost estimate (FCE) on file, compared the FCE amount with the proposed amount and final approved change order amount, reviewed the Record of Negotiations on file and change order cost breakdown, analyzed HPCC's actual job cost records and validated HPCC's internal change orders with its subcontractors (SCO) related to the change orders. We found the following:

Finding No. 1 – Proposed/Claimed 1st Tier Subcontractor Overhead & Profit in Excess of Contract Allowable Limit

Per contract terms and conditions, the maximum overhead and profit that can be claimed by any 1st tier subcontractor is 15% of the base subcontract cost. Our test of change order T-705 revealed that the proposed/claimed overhead and profit amount of \$450,480 for Judge Netting, HPCC's 1st tier subcontractor, was 24% of the total base subcontract cost of \$1,876,994. We questioned the excessive 1st tier subcontractor overhead and profit plus associated general contractor's fee and bond cost for a total of \$179,151 (see calculation details below).



**Audit of Hensel Phelps Construction Company
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Judge Netting - Subcontract	Claimed	Audited	Questioned
Subcontract Work	\$ 1,876,994	\$ 1,876,994	\$ -
Subcontract Profit/OH**	450,480	281,549	168,931
Total Subcontract Cost	2,327,474	2,158,543	168,931
GC Cost			
Subcontract Fee	117,669	109,222	8,447
Bond, Insurance, Gross Receipt Tax	25,896	24,122	1,774
	143,565	133,345	10,220
Grand Total	\$ 2,471,039	\$ 2,291,888	\$ 179,151
** Per Contract, maximum allowable 1st tier subcontractor overhead and profit is 15%			

FSD Response

Due to the competitive lump-sum bid approach used in selecting and awarding the change order subcontract, Facilities does not find it appropriate to deduct \$179,151.

HPCC Response

HPCC does not concur because the subcontract cost was based on lump-sum competitive bid.

OIG Response

General Conditions of the Design-Build Contract, Section 7.7.1.1 (1) contained specific provisions for the basis of Change Order pricing calculations. Even with a lump-sum proposal/bid, we still need to review and analyze allowable costs and allowable markups that are properly itemized for reasonableness. Section 7.7.5.2 (a) states: "The Allowable Markup to the first-Tier Subconsultant or Installation Subcontractor shall be fifteen percent (15%)". We thus determined that a 24% markup was excessive, and in violation of specific Contract terms and conditions regarding allowable Change Order costs.

Recommendation

We recommend that Procurement Services Division deduct the entire questioned cost from the balance of HPCC's contract account.



**Audit of Hensel Phelps Construction Company
Contract No. 1710027/4400005798,
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Finding #2 – Claimed Subcontractor Cost in Excess of Actual Cost.

In the draft report, OIG questioned a total of \$3,526 subcontractor cost in excess of the actual cost plus the associated general contractor’s fee. HPCC provided additional information to clarify the initial finding and Facilities Services Division also provided their calculation to support the claimed amount. In the review of the additional information provided after the draft report was issued, OIG concurred with the clarification of the question cost and therefore will not pursue the initial questioned amount.

Audit Results Summary				
	CO#	Claimed	Audited	Questioned
	T-704	\$ 862,882	\$ 862,882	\$ -
	T-705	2,471,039	2,291,888	179,151
	T-706	718,179	718,179	-
	T-707	535,570	535,570	-
		<u>\$ 4,587,670</u>	<u>\$ 4,408,519</u>	<u>\$ 179,151</u>

Except for the above-mentioned questioned cost, the claimed cost for each change order was adequately supported, fair and reasonable.

II. Determination of whether the change order process complied with the Facilities Services Division’s Change Order Procedures

We reviewed FSD’s Change Order Procedures (Procedure), analyzed the change order package, interviewed the Owner’s Authorized Representative and other District personnel, and noted that the change order was approved by authorized personnel. We also observed that the District’s fair cost estimate was prepared, negotiation meetings were conducted, and required documents were prepared and submitted, and relevant files were maintained. We determined that the change order process complied with FSD’s Change Order Procedures.

Audit Team

This audit was performed by the following auditors:

Rey Bejerano, Audit Manager
Mindy Qu, Principal Auditor
Tony Li, Senior Auditor



**Audit of Hensel Phelps Construction Company
Contract No. 1710027/4400005798,
CO T-704, 705, 706 and 707**

Independent Auditor's Report

We have examined the costs of Change Order No. T-704, T-705, T-706 and T-707 (Change Orders) awarded by the Los Angeles Unified School District (District) to Hensel Phelps Construction Company (HPCC) under Contract No 1710027/4400005798. HPCC's management is responsible for complying with the contract terms and conditions in the preparation of the change orders proposals. Our responsibility is to express an opinion based on our examination.

Our examination was conducted in accordance with the standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and accordingly, included examining, on a test basis, evidence supporting HPCC's compliance with the contract requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion. Our examination does not provide a legal determination on HPCC's compliance with the specified requirements.

In our opinion, the proposed/claimed change orders costs were adequately supported, fair and reasonable, and the Facilities Services Division's change order procedures were complied with in the execution of the change orders.

However, our examination found \$179,151 of overbilled 1st tier subcontractor overhead and profit under T-705. We recommend that Procurement Services Division deduct the overbilled amount from the balance of HPCC's Contract account.

Austin E. Onwualu

Austin Onwualu, CPA, CIG,
Deputy Inspector General, Audits

February 14, 2022

Los Angeles Unified School District Procurement Services Division

ALBERTO M. CARVALO
Superintendent

MEGAN K. REILLY
Deputy Superintendent



DAVID D. HART
Chief Financial Officer

JANICE SAWYER
Business Manager

JUDITH REECE
Chief Procurement Officer

April 8, 2022

Mr. Austin Onwualu, Deputy Inspector General, Audits
Los Angeles Unified School District
Office of the Inspector General (OIG)
333 S. Beaudry Avenue, 12th Floor
Los Angeles, CA 90017

**RE: RESPONSE TO DRAFT CHANGE ORDER AUDIT REPORT NO. CA-00-000
HENSEL PHELPS CONSTRUCTION CO.
CO T-704, T-705, T-706, T-707 CONTRACT NO. 1710027/4400005798**

Dear Mr. Onwualu,

Procurement Services Division (PSD) is in receipt of the above-referenced draft incurred cost audit report dated March 3, 2022. PSD agrees with Facilities Services Division in their responses provided below.

Determination No. 1: Determination of whether the change order amounts were adequately supported, fair and reasonable.

Finding No. 1 Proposed/Claimed 1st Tier Subcontractor Overhead & Profit in Excess of Contract Allowable Limit

Per contract terms and conditions, the maximum overhead and profit that can be claimed by any 1st tier subcontractor is 15% of the base subcontract cost. Our test of change order T-705 revealed that the proposed/claimed overhead and profit amount of \$450,480 for Judge Netting, HPCC's 1st tier subcontractor, was 24% of the total base subcontract cost of \$1,876,994. We questioned the excessive 1st tier subcontractor overhead and profit plus associated general contractor's fee and bond cost for a total of \$179,151.

Recommendation for Finding No. 1

We recommend that Procurement Services Division deduct the entire questioned cost from the balance of HPCC's contract amount.

Facilities Responses to Recommendations for Determination No. 1:

Facilities required Hensel Phelps to competitively bid the work in T705 due to the size of the change order. Three bids were received and after a thorough scrubbing of the bids, Judge Netting was found to be the lowest responsible bidder for this scope of work. In fact, Judge Netting's cost was lower than the District's Independent Fair Cost Estimate. Due to this lump-sum competitive bid approach, Facilities does NOT find it appropriate to deduct the \$179,151.

PROCUREMENT SERVICES DIVISION
333 S. Beaudry St., 28th Floor, Los Angeles, CA 90017
Telephone (213) 241-3087 ♦ Fax (213) 241-8945

Finding No. 2 Claimed Subcontract Cost in Excess of Actual Cost

Our test of T-707 revealed that the claimed total subcontract cost of \$507,795 exceeded the actual total subcontract cost of \$504,455 by \$3,340. We questioned the overclaimed subcontract cost plus the associated general contractor's fee and bond cost for a total of \$3,526.

Recommendation for Finding No. 2

We recommend that Procurement Services Division deduct the entire questioned cost from the balance of HPCC's contract account.

Facilities Responses to Recommendations for Determination No. 1:

There appears to be a difference on how the change order is being calculated. After reviewing our calculations, Facilities Change Order amount comes to \$535,570. Please see steps below:

Change Order calculations:

STEP 1

\$ 459,106 = Subcontractor costs
+ \$ 22,955 = 5.0 % OHP, GC's markup
\$ 482,061 = Subtotal cost of work

STEP 2

\$ 482,061 = Subtotal cost of work
+ \$ 4,821 = 1.0 % Bond
\$ 486,882 = Estimator's FCE

STEP 3

\$ 486,882 = Estimators FCE
+ \$ 48,688 = 10% OAR adjustment to FCE for exceptional project difficulty
\$ 535,570 = Final Change Order amount

Determination No. 2: Determination of whether the change order process complied with the Facilities Services Division's Change Order Procedures

Facilities Responses to Recommendations for Determination No. 2:

Audit findings that "the change order process complied with FSD's Change Order Procedures" is appreciated by the project team. Award of these large change orders on an abbreviated time frame in order to complete the work as promised to the community was an exceptional challenge for the project team. The team went out of their way to ensure they appropriately followed all District procedures and we are pleased by the audit's confirmation that the policies were followed correctly.

If you have any questions, please do not hesitate to contact Yeghishe Minassian at yeghishe.minassian@lausd.net.

Sincerely,



JUDITH REECE
Chief Procurement Officer

- c: M. Hovatter
- R. Kapoor
- J. Woessner
- R. Lui
- C. Thomas



March 29, 2022

Austin Onwualu
Deputy Inspector General, Audits
Los Angeles Unified School District
333 South Beaudry Avenue
Los Angeles, California 90017

Subject: HPCC – Contract No. 1710027/4400005798, CO T-704, 705, 706 & 707
Hensel Phelps Response – Draft Audit Report Recommendations

Dear Mr. Onwualu:

This letter shall serve as Hensel Phelps Construction Co.'s formal acknowledgement of receipt of LAUSD's independent audit findings and draft report dated March 3, 2022 which contains acceptance and/or recommendations regarding prime contract change orders T-704, T-705, T-706 & T-707.

Upon review of the comments, findings, and recommendations made, Hensel Phelps offers the following in response to this draft audit report for your consideration:

T-704

Hensel Phelps agrees with the audit team that the "costs presented were adequately supported, fair and reasonable".

T-705 "Finding No. 1 – Proposed/Claimed 1st Tier Subcontractor Overhead & Profit in Excess of Contract Allowable Limit"

Hensel Phelps was provided clear instruction from the LAUSD PEX team to submit to a competitive bid process in which multiple bidders would provide cost proposals to complete the High Netting scope of work for the baseball and softball fields. As this was a specialty scope of work which could not be completed by one of the Subcontractors already working on site, we were directed to take the scope to bid. It was the expressed position of LAUSD that the lowest responsible bid would be selected by the District and a subcontract would be awarded based on a thorough review of the included scope and overall cost. Based on this bidding and subsequent review process by the District, Judge Netting was deemed the lowest responsible bid and was therefore awarded the scope at their full bid value. As this was a competitive bid, the costs provided by each responsive bidder were reviewed and compared as lump sum prices by the District PEX team against their own internal estimate. It should also be noted that no additional cost negotiation became necessary as I believe the bid value provided by Judge Netting fell within the District's own FCE value and was therefore accepted. Hensel Phelps believes that the bid process described above was in keeping with District procedures and feels that no further action ought to be taken in this regard.

T-706

Hensel Phelps agrees with the audit team that the "costs presented were adequately supported, fair and reasonable".

OUR VALUES

OWNERSHIP | INTEGRITY | BUILDER | DIVERSITY | COMMUNITY



T-707 – “Finding No. 2 – Claimed Subcontract Cost in Excess of Actual Cost”

Hensel Phelps believes there may be a difference in how 5% OH&P, 1% misc. insurance costs, and OAR 10% markups were applied by the Audit team while reviewing this change order. The correct breakdown, as originally presented in the provided COP, would be as follows:

- 5% OH&P applied to the cost of work = \$482,061
- 1% misc. markups (incl. insurance costs) = \$486,881.61
- 10% OAR settlement markup = **\$535,570**

We assert that this cost as calculated is correct and fair as presented and request that no further action be taken in this regard.

Hensel Phelps continues to work closely with the LAUSD PEX team to ensure all change order procedures, including costs and time extensions which are submitted are provided with sufficient backup and merit, and are consistent with the prime contract terms and with applicable District procedures.

Sincerely,

HENSEL PHELPS CONSTRUCTION CO.

Brandon McBeth
Project Manager

OUR VALUES

OWNERSHIP | INTEGRITY | BUILDER | DIVERSITY | COMMUNITY

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Tell us about it.

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Maybe you know something about fraud, waste, or some other type of abuse in the school district.

The Office of the Inspector General has a hotline for you to call. You can also email or write to us.

If you wish, we will keep your identity confidential. You can remain anonymous, if you prefer. And you are protected by law from reprisal by your employer.

Whistleblower Protection

The Board approved the Whistleblower Protection Policy on February 12, 2002. This policy protects LAUSD employees who make allegations of improper governmental activity from retaliation or reprisal. To assure the reporting of any activity that threatens the efficient administration of the LAUSD, reports that disclose improper governmental activities shall be kept confidential.

General Contact Information

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