Grossmont Healthcare District Proposition G Bond Program 2010 Performance Audit

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MAY 2010

1.0: EXECTUIVE SUMMARY

At the request of the Independent Citizens Bond Oversight Committee (ICBOC), AF Consultants (AFC) was retained by the Grossmont Healthcare District (District) to review the overall performance of the $247.0 M Proposition G Bond Program. The work was performed by AFC pursuant to an RFP issued by the District on January 8, 2010. Our response to the RFP outlined significant areas we believed should be incorporated in the review. Consistent with our agreed upon work plan, we performed our evaluation by interviewing District and Sharp HealthCare personnel, reviewing documentation as posted on the Parsons "Impact" web site, and by testing selected contracts, documents, and the District's Policy and Procedures Manual.

We began our engagement on March 10, 2010 by preparing a checklist of documents for review and by collecting information from District files, primarily the Impact web site. On March 18, 2010 we meet with the ICBOC Sub-committee on Audit and Finance to review our scope of work. During the course of our engagement we performed the following activities:

- Reviewed and assessed the current District Policy and Procedures Manual
- Reviewed all Board and ICBOC meeting minutes from program inception to the present
- Assessed and analyzed the current District construction project execution methodology
- Reviewed documentation on all active projects concentrating on the recently completed ED/CCU project
- Evaluated processes currently in place and made observations and recommendations for improvement where we found areas of concern

The Program is the first of its size and complexity that the District has undertaken and presents significant challenges and risks to the entire organization. The District has taken steps to address and manage several of these challenges with the engagement of Parsons as Program Manager and the development of a critical Policy and Procedures Manual. The program management is unique in that shared duties have been arranged between the District, the owner, and Sharp, the tenant, under a Memorandum of Understanding to provide all program services.

Generally, AFC found the program to be reasonably well managed. Several issues identified in this report are well on their way to being resolved. Because the program will intensify during the coming few years it is imperative that process improvements continually are made and that the ICBOC and administration be constantly vigilant to concerns regarding the budget, scope, and schedule for projects. Our observations and comments, if implemented, can only strengthen the integrity of the program.

We completed our work on the program assessment on May 1, 2010, have discussed our observations and recommendations with the administration and Program Management Team, and have scheduled a presentation to the full ICBOC, the GO Bond Committee, and the Board of Directors.

2.0 SUMMARY OF OBSERVATIONS

AFC's program evaluation methodology included an analysis of the fundamental components of the Prop G Bond Program, including:

- Program Strategy, Organization and Administration
- Design Team and Other Consultants Fees
- Program Management Fees (Parsons and Sharp HealthCare)
- Operational Procedures, Budgeting and Controls

Our observations in each of these program components are summarized below. The detailed observations and recommendations are included in each section of the report.

Section 6A: Program Strategy, Organization and Administration

Program Strategy, Organization and Administration establish how a project or program will be structured, delivered and executed throughout the entire project lifecycle. We observed that the Policy and Procedures Manual had not be revisited since its inception in January 2008 and suggested that now would be a good time to revisit and update the manual. We made the following observations and recommendations:

Recommendation 6A.1:

Review the Memorandum of Understanding (MOU) for consistency with the adopted Policy and Procedures Manual (PPM). Realign joint responsibilities and job descriptions. Consider additional financial support.

Recommendation 6A.2:

The District should consider designating one individual as responsible for overall management of the program

Recommendation 6A.3:

The District should consider reviewing its current construction program organizational staffing levels and consider developing revisions to the Program Organization Chart. Further, the District should consider clarifying the relationship, roles and responsibilities of the respective Program Managers and consider adding an additional financial management position reporting to the District

Recommendation 6A.4:

Review and expand on the current Policy and Procedures Manual prior to the start of construction on the next project or on a schedule as agreed to by the Grossmont Healthcare District management. Pay particular attention to design standards, risk management and the close out process

Because we felt that the Monthly Update Reports should contain additional information we recommended:

Recommendation 6A.5:

The PMT should consider expanding the Monthly Update Reports to include additional information for stakeholders

Because we were concerned about the integration of the Health Occupations Training Center into the program management system and the future storage, archiving and retrieval of documents we recommended:

Recommendation 6A.6:

The District should review the document management system and discuss how it will integrate the entire program and archive documents in the future

Section 6B: Design Team and Other Consultant Fees

Design team and other consultant fees were reviewed as well as the process of procuring architectural and other consulting services. We made the following recommendations:

Recommendation 6B.1:

In the future consider distributing a sample of the A/E agreement and Selection Matrix as part of the RFP

Recommendation 6B.2:

Consider streamlining the selection process for "service providers" and clarify a more detailed process for A/E selection within the Policy and Procedures Manual

Recommendation 6B.3

The PMT should review proposals in detail to insure that the final contract language is consistent with the agreed upon service

Recommendation 6B.4:

The District should consider setting aside sufficient funds for Extra Services in the budget for each project and should monitor inspection, testing and other services on a monthly basis through a risk management matrix

Recommendation 6B.5

The PMT should develop a form letter for formally notifying vendors when payments are withheld and should develop a log to track "time to payment"

Section 6C: Program Management Fees

The fees charged by Parsons and the reimbursements provided to Sharp HealthCare were reviewed and we made the following recommendations:

Recommendation 6C.1:

On future Program Management contracts consider broadening the definition of tasks assigned to the Program Manager with a specific scope of services

Recommendation 6C.2:

The District should consider re-evaluating the assumptions made with respect to the program administrative costs

Recommendation 6C.3:

Sharp/GHC should consider preparing a monthly report which generates a detailed allocation to specific projects for the general program management costs

Recommendation 6C.4:

The District should consider preparing a report which tracks all incidental capital expenditures whether purchased by Sharp or the District such that at program completion they are properly capitalized or disposed of if no longer needed

Section 6D: Operational Procedures, Budgeting and Controls

Because we were concerned about the change and risk management process, the development of design standards and specifications, budgeting and estimating, scheduling and the conduct of compliance audit reviews we made the following recommendations:

Recommendation 6D.1

The District should consider developing a Risk Management policy and procedure process

Recommendation 6D.2:

The District should consider the use of a pre-qualification process for General and Sub-contractors

Recommendation 6D.3:

The District should consider amending the General Conditions of the contract with respect to labor burden and allowable costs for change orders

Recommendation 6D.4:

The District should consider performing a comprehensive review of its insurance coverage for the program

Recommendation 6D.5:

The District should consider amending the General Conditions of the contract with respect to audit provisions

Recommendation 6D.6:

The District should consider preparing and confirming the scope, budget, and schedule for the HOTC project such that sufficient funds are available for its completion

Recommendation 6D.7:

The District should consider developing an internal audit plan for construction that includes a combination of policy and procedures, records compliance testing, on-going contract compliance testing, and project close out reviews

7.0: Selected Project Audit

We selected the completed ED/CCU Build Out project for a detailed examination of the project records such that we could understand the process utilized during construction and made the following recommendations:

Recommendation 7.1:

As a good business practice and close out procedure, AFC recommends that the District consider conducting a "post performance" evaluation on each project

Recommendation 7.2:

In the future, the District should ensure that all bid documents have received the necessary OSHPD approvals prior to the bid issuance date.

Recommendation 7.3

In the future, the District should strive to keep the time between bid and award to less than 60 days and to issue a Notice to Proceed within 30 days thereafter

Recommendation 7.4:

In the future, the District should be more pro-active in soliciting bidders from the construction community

Recommendation 7.5:

In the future the Program Manager should track Architect/Engineers errors and omission as a separate reason code category

Recommendation 7.6:

In the future the District should consider adding the following language to A/E contracts:

> *Expected Standard of Care for Errors and Omissions*
>
> *The District recognizes and acknowledges that liability attaches only when the Architect/Engineer's act or failure to act falls below a "standard of care" applicable to design professionals in the same or similar circumstances.*
>
> *A determination of "standard of care" is a judgment call that will vary depending upon individual project circumstances. For the purposes of this Agreement, the District shall consider incurred costs due to errors and omissions by the Architect/Engineer of up to three percent (3%) of the initial awarded construction cost as being within the " standard of care". The incurred costs due to errors and omissions above this range shall cause the District to progressively consider actions to recover damages.*
>
> *In determining valuations, "omissions" will be calculated at a rate of 20% of the change order costs to provide the respective missing element whereas "errors" will be calculated at the full change order value to correct the condition.*

Recommendation 7.7:

The PMT should require that the signature of the architect be affixed to all change orders

Recommendation 7.8:

On future projects consider maintaining all change order documentation in one file with all original estimates and revised backup attached

Recommendation 7.9:

On future projects ensure the mathematical accuracy of all change order calculations by sub-contractors and suppliers

Recommendation 7.10:

On future projects consider developing contract language which defines the allowable costs to be added to change orders by sub-contractors

A detailed narrative of our observations and recommendations is contained in the balance of the report.

3.0: SCOPE OF SERVICES

The scope of this construction program evaluation included assisting the Grossmont Healthcare District (District) and their Independent Citizen's Bond Oversight Committee (ICBOC) with assessing the strengths and weaknesses of policies, procedures, processes, and controls relating to the Prop G Bond Program and project development. The objectives of this evaluation were to assess, with a reasonable degree of certainty, the following program elements:

- Summarize and evaluate program strategy, organization, and administration of the program by conducting interviews with key personnel and participants in the program, reviewing the organizational management team in place, reviewing the Memorandum of Understanding (MOU) and relationship between the District and Sharp HealthCare, reviewing the current Policy and Procedures Manual and its application, and assessing whether the management information reports delivered to the ICBOC are adequate enough to allow them to fulfill their oversight duties.
- Evaluate design team and other consultants cost to determine if fees were reasonable and consistent with "best practice" by evaluating the procurement process, contract formats, extra service requests, and invoices/payments to date.
- Evaluate the on-site Program Management Team (PMT) and Parsons, the key provider, to determine if their fees were reasonable and consistent with "best practice" by evaluating the procurement process, contract formats, and hourly rates for personnel, extra services, and invoices/payments to date. In addition, evaluate the Sharp HealthCare personnel and their interface activities with Parsons.
- Assess and evaluate current operational procedures and controls, design/budget review and control techniques, bidding processes, and change order management/policies to reduce risk.
- Evaluate financial and cost management processes and controls in place within the District by reviewing cash flow projections, accounting reports, and payment procedures.

In addition to the evaluation of current policies and procedures, we selected the recently completed ED/CUU 2-4-5 Build Out for a specific project review and audit. The objectives of this audit were to:

- Audit construction management practices utilized in the execution of the project and benchmark them against industry standards.
- Review contract documents, contract terms, and General Conditions to insure that the Owners' interests have been protected and to make recommendations for contract improvements where we observe deficiencies, if any.
- Review the consultant and contractor selection processes as well as comment on alternative procurement strategies which may be successfully applied in the future.
- Review change order requests and sample change orders to insure they were appropriately justified, authorized, and supported by adequate documentation.

- Verify the appropriateness of labor, labor burden, material, equipment, indirect costs, and mark-up percentages on change orders.
- Review copies of escrow agreements, lien releases, the Notice of Completion, and warranty items and the processes used for handling of same.
- Summarize costs for each facet of the project and benchmark them against typical projects of similar scale and complexity. We have suggested conducting comprehensive "lessons learned" from this project review.

In conclusion, where possible based on our observation, we have identified areas needing attention or corrective action and have provided recommendations for improvement on future projects. We have also identified areas of potential cost reduction or avoidance, where they have come to our attention, and have identified areas where further reviews may be warranted.

4.0: PROGRAM BACKGROUND AND OVERVIEW

Grossmont Healthcare District is a public agency which was initially formed in 1952 as the Grossmont Hospital District to construct Grossmont Hospital. The hospital, opened in 1955, serves an area of 750 square miles with the primary mission of supporting health related community programs and services in the East County region of San Diego. In 1991, the hospital formed the non-profit Grossmont Hospital Corporation (GHC) for the express purpose of leasing the facilities to Sharp HealthCare for 30 years for the operation and provision of services to the local community and taxpayers. The primary function of the District, as the landlord, is the ownership of property and buildings composing the Grossmont Hospital campus and to provide monetary grants for the improvement and enhancement of the physical plant, hi-tech equipment, and other health care programs.

Based on a Facilities Master Site Plan developed by Sharp Grossmont Hospital, with input from medical and nursing staff, professional and support personnel, the District proposed a General Obligation Bond to address some of the future health care needs of the area. The bond would be coupled with other funding sources including hospital revenue, potential revenue bonds, and donations to supplement the program. In June 2006 the voters in the District approved a General Obligation Bond, Proposition G, of $247.0 M to meet some of those needs. Included were:

- The completion of the Emergency and Critical Care Center
- Seismic safety upgrades, additions, repairs and upgrades to medical facilities.
- Facilities to accommodate medical technology for diagnosis, treatment, and recovery of patients.
- The upgrade of cardiac care facilities.

As part of the Prop G Bond Program the District agreed to the establishment of an Independent Citizen's Bond Oversight Committee (ICBOC) to oversee the development of the program and ensure that no funds were being used for administrative or staff salaries and operating expenses.

The central components of the program as currently established are:

- **ED/CCU 2-4-5 Build Out** – Build out of approximately 75,000 square feet on three floors of the existing ED/CCU west wing, adding a total of 90 beds. This project valued at $41.1 M was recently completed and final occupancy is contingent on the resolution of minor issues. Construction of this project began in November 2007 with substantial completion in September 2009.

- **Diagnostic and Treatment Center (D&T)** – A new $97.9 M three story building housing multipurpose procedural rooms, catheterization labs, pharmacy, and clinical laboratories. This project is currently in the Construction Documents and OSHPD review phase and construction of this facility is anticipated in the first quarter of 2011.

- **Central Energy Plant (CEP)** – A new $54.3 M two story, 18,000 square foot facility to house an electrical substation, refrigeration equipment, and combustion turbine generators to provide power for new and existing facilities. This project is currently in the Construction Documents phase and its completion is critical to the completion of the D&T facility.

- **East Tower (ET)** – A $42.0 M renovation to the existing levels 2, 3, 4, & 5 of the East Tower with upgrades to infrastructure and modernization/conversion of patient rooms and the nursing units. This project is currently in the Schematic Design phase and is not scheduled for construction until 2011.

- **Make Ready Projects** – A Utility Master Plan/Ring Road project which will relocate utilities and re-align the campus ring road and provide an interim relocation of loading docks, both to make a site ready for the construction of the D&T Building. These projects will be constructed prior to the start of the D&T Building.

- **Health Occupations Training Center (HOTC)** – A new $7.5 M, 20-35,000 square foot building on adjacent campus land for the training of nurses and other health professionals in a joint program with the local community college. This project is currently in the programming phase and a construction schedule has not yet been developed.

To manage this complex effort, including architectural design, engineering, procurement, and construction, the District issued an RFP in March 2007 and by May 2007 selected Parsons for the technical management and project execution of the hospital projects as program managers. The District simultaneously selected Gafcon, Inc. to provide administrative support to the ICBOC and to provide program management for the HOTC Building. In addition, staff is provided by Sharp HealthCare under the Memorandum of Understanding (MOU) created between the District and Sharp. Those firms and staff are currently working on the campus.

In order to provide the Grossmont Healthcare District and the ICBOC with external, independent observations and recommendations aimed at assisting the District to manage the costs and risks of its overall construction program, the District engaged AF Consultants (AFC) to perform a program evaluation of the construction program. Our tasks were to identify strengths and weaknesses in current policies, processes, and controls governing the planning, delivery, tracking and reporting of the program.

5.0: APROACH AND METHODOLOGY

For numerous organizations, whether governmental, private, or public, capital programs are the means to execute a business strategy and respond to the pressures and demands that cannot be addressed within the organizations' existing limitations. While most capital programs are unique and involve a degree of uncertainty and risk, there are fundamental components common to all capital programs and projects. The success or failure of a capital program can be measured by how well an organization plans, manages, and executes the individual components for each project.

The Grossmont Healthcare District is in a unique position as a landlord of a hospital campus leased to Sharp HealthCare. They are a local health care district established in the State of California under the California Health and Safety Code, and as such are able to sell General Obligation Bonds to finance, construct or otherwise improve the health care facilities owned by the District. This can be done by increasing property taxes within its jurisdiction subject to a two thirds vote of the electorate.

With the passage of the $247.0 M Proposition G Bond Measure, the District found itself in a position of having limited staff to manage and execute projects or fulfill the management needs of their capital program. Fortunately, steps were taken soon after the passage of the bond to craft a Memorandum of Understanding with Sharp HealthCare for the joint management of the program and to secure additional consulting assistance from Parsons and Gafcon to provide the overall program management necessary to execute the program.

As part of our engagement, we normally review the common components of all capital programs to assess the degree to which they have been implemented and to assess whether they have been successful thus far. Some of the common overarching areas and specific issues we examined in our approach are as follows:

A. Program Strategy, Organization and Administration:

- Establish how projects were structured, will be delivered, and executed
- Examine the strategy for delivering the projects and their integration with other projects
- Examine the roles and responsibilities for managing the program and projects, particularly under the MOU between the District and Sharp HealthCare and the relationship of outside consultants
- Review the communication planning and project reporting to the ICBOC, Board, and other stakeholders
- Review the policies and procedures for document management
- Review the program infrastructure and tools being used for project reporting and program management

B. Design Team and Other Consultants Costs and Fees:

- Establish how the procurement of architectural/engineering and other services were conducted
- Establish the basis for contract negotiations, contract administration, and contract closeout
- Examine the contract format to confirm the alignment of services with the scope, budget, and schedule of the individual projects
- Examine extra service requests and invoices to assess the fairness and validity of those requests

C. Program Management Fees and Costs:

- Establish how the procurement of program management services was conducted
- Establish the basis for contract negotiations, contract administration, annual extensions, and contract closeout
- Examine the contract format to align services with the scope, budget, and schedule for the program
- Examine extra services requests and invoices to validate those requests

D. Operational Procedures, Budgeting and Controls:

- Examine the process for managing changes to contracts
- Define key processes, tools, and techniques for managing known and unknown risks factors, changes, and potential external influences
- Examine the bid process, construction contract format, and insurance provisions
- Examine design standards and specifications, operations and maintenance interface
- Examine value engineering, design management, and constructability reviews
- Examine budget, estimating, and forecasting models being used
- Examine quality control procedures, inspection, regulatory compliance reviews, and compliance auditing
- Conduct a general accounting policy review and review project cost reporting

E. Specific Project Audit (ED/CCU):

- Examine and sample the ED/CCU project file for compliance with the above concepts
- Trace sample change orders, procurement methodology, schedule management, and other budget controls
- Verify the appropriateness of contractor mark-up percentages on change orders, review lien releases, warranty requirements, and processing of payments
- Provide a lessons learned checklist and recommendations for future project implementation

AF Consultants has taken the approach that these significant areas of analysis will provide the District and the ICBOC with the degree of transparency necessary to understand how the program has performed thus far. Our analysis should also provide areas where the program performance can be improved and identify areas of risk which can be successfully mitigated with further action.

In the preparation of our report we have relied solely upon documents provided to us on the Grossmont Healthcare District web site at www.grossmonthealthcare.com, its ICBOC portal and information housed therein, the access afforded us to the project files on the Parsons "Impact" project and team web sites at www.3di.com/Grossmont , and interviews conducted with the following persons:

- Barry Jantz – CEO Grossmont Healthcare District
- Tom Saiz – CFO Grossmont Healthcare District
- Timothy Meehan – Sr. Program Manager, Parsons
- Daniel Mc Daniel – Sr. Program Manager, Sharp HealthCare
- Mary Dauphine – Sr. Financial Analyst, Sharp HealthCare

We also acknowledge the guidance and discussions with the Audit and Finance Sub-committee of the Independent Citizens' Bond Oversight Committee:

- Walt Heiser, Chair, ICBOC Audit & Finance Sub-Committee
- Robert Ayres, Member, ICBOC Audit & Finance Sub-Committee
- Ernie Ewin, Chair of the ICBOC

6.0: PROGRAM OBSERVATIONS

SECTION 6A. STRATEGY/ORGANIZATION AND ADMINISTRATION

Project Strategy, Organization and Administration establish how a project or program is or will be structured, delivered and executed throughout the entire project lifecycle. Our review framework for Project Strategy, Organization and Administration encompassed the review of the following project components:

- Review of Grossmont Healthcare District's Board and Administrative roles, responsibilities, and activities
- Review of Independent Citizens' Bond Oversight Committee (ICBOC) roles, responsibilities, and activities
- Review of the Memorandum of Understanding (MOU) between the District and Sharp HealthCare.
- Review of Program Infrastructure and Staffing: Program Management Consultants and Sharp staff roles and responsibilities
- Review of Policy and Procedures Manual
- Review of Communication Planning and Project Reporting
- Review of Document Management systems

1. GROSSMONT HEALTHCARE BOARD AND ADMINISTRATIVE ROLES:

AF Consultants reviewed the District Board meeting minutes from June 2006 to the present. The Board is composed of five (5) members and the District is administered by a Chief Executive Officer, Chief Financial Officer, outside General Counsel, and administrative staff. The role of the Board is to administer the Prop G Bond Program and other District healthcare programs. With the passage of the Bond program in 2006, the Board established a GO Bond and Planning Committee to oversee the specific development of the program. That committee, made up of the District and Sharp management, reviews Monthly Management Reports, Board Memos, and hears presentations from the Project Management Team. They also review change orders, budget revisions, and the award of contracts prior to their enactment by the full Board. The full board meets bi-monthly and has been actively involved in the program development. The District CEO has authority to sign contracts, approve change orders, authorize extra services , and execute other agreements within the authority granted by the Board. The Board approves all financial transactions related to the program development.

Observations

District management appears to adhere to the Policy and Procedures Manual and practices adopted by the Board. Project issues are brought to the attention of management in a timely manner by the Project Management Team (PMT). Monthly management reports are generated

at a high level with a summary of project status, schedule, and costs by the PMT and these are shared with the GO Bond Committee, District management, ICBOC, and the general public.

2. INDEPENDENT CITIZENS' BOND OVERSIGHT COMMITTEE (ICBOC) ROLES AND ACTIVITIES:

As part of the Prop G Bond Measure approved by voters in June 2006, the bond language included accountability provisions for the establishment of an Independent Citizens' Bond Oversight Committee within 90 days of a successful ballot initiative. In demonstrating full accountability to taxpayers the District voluntarily included this language in the ballot proposition. The ICBOC was to consist of nine (9) members to be selected through a public application process and to serve without compensation. It was to include one active member each of a taxpayer's organization, senior citizens organization, and business organization, one nurse or physician, and five at-large members. The purpose of the ICBOC was to review and monitor the bond transactions and construction process throughout the life of the bond and to prepare periodic and annual reports. Further, the ICBOC was to oversee the construction of the various hospital projects to insure that taxpayer funds were being spent wisely and not used for administrative salaries or operational expenses.

Observations

The District's Board of Directors approved the establishment of an ICBOC in May 2006, prior to the passage of the bond measure. This demonstrated an early commitment of the District Board and Administration to the placement of a "watchdog" committee for the proposed capital outlay program. After the election was certified, applications were solicited and in September 2006 a committee consisting of a District Board member, Sharp HealthCare Senior Management, and a local mayor selected the committee members. Because there were numerous qualified applicants, they also recommended that the committee be expanded to eleven (11) members. Following ratification of the District Board, the ICBOC met for the first time on October 18, 2006. In May 2007, the By Laws were revised and by July 2007 four (4) sub-committees were formed to review Audit, Finance, Construction, and Communications. These were eventually collapsed into three (3) sub-committees with Audit and Finance combined. As a best business practice, the sub-committee structure allowed for detailed reviews and discussion of these areas outside of the full ICBOC structure. The full ICBOC meets quarterly with sub-committee meetings held more frequently as the need arises.

AFC had the opportunity to review all of the minutes and discussion of the ICBOC and sub-committees posted on the District web site from its formation in 2006 through early 2010. The selection of Gafcon in July 2007 to assist the committee and sub-committees in assembling agendas, posting and taking minutes, and updating the web site has been a positive step and we found that the web site is well organized.

Several important functions that the ICBOC and the sub-committee's have performed during their on-going review are:

- Members attend meetings and act as observers of the selection process for professional service providers to the Source Selection Authority (SSA) as well as reviewing Requests for Proposals/Qualifications (RFP/RFQ) prior to their issuance
- As a policy, the committee reviews change orders over $750,000 prior to Board approval (This has since been revised to $250,000)
- Reviews design, extra service requests, and budget issues and discusses Monthly Update Reports provided by Parsons, the Program Manager, in detail
- Posts and discusses relevant correspondence, news releases, and general issues of concern and trends in hospital construction and the healthcare industry
- Reviews bond issuance documents, stays current with cash flow projections, financial issues, and monitors revisions to the Policy and Procedures Manual
- Prepares both Annual and Mid-Year reports for the community stakeholders at large

AFC was impressed by the depth of review that this particular ICBOC had with regard to the program. Other programs we have reviewed have not had as much interaction and involvement by committee members in the program as this ICBOC. **It is obvious that a transparent environment exists with an effective working relationship in place between the ICBOC, District Board, administrative staff, and Program Management Team.** We believe that the level of review is sufficient and the correct tools are in place to satisfy taxpayers that their interests are being protected. Some of the recommendations we have made in our report should, if implemented, provide the ICBOC with additional information to gain a better understanding regarding the program.

3. MEMORANDUM OF UNDERSTANDING (MOU)

On January 8, 2007 a Memorandum of Understanding (MOU) was executed between the Grossmont Healthcare District (District) and Sharp HealthCare (Sharp)/Grossmont Hospital Corporation (GHC) for the purpose of coordinating efforts and activities related to the execution of the projects and programs resulting from the Prop G Bond Program. The MOU established the basic roles and responsibilities of each of the parties with respect to the program.

Under the agreement the District was to issue Bonds, act as the contracting agency for the Program, make payments from bond proceeds, provide Program Management services in connection with the Program, and provide liaison services to the ICBOC. Additionally, the District would reimburse GHC or Sharp for the costs of salaries, wages, and benefits for Program Agent Services (staff salaries) associated with providing full time services to the Program. No indirect costs were to be borne by the District.

Sharp or GHC was to be responsible for purchasing, staging, and storing equipment, paying for licenses and permits necessary for the operation of the facilities, and the design, programming and scoping of projects. The District Board of Directors, however, reserved final approval of all health care related design matters and issues. In addition, Sharp or GHC was to assist in the establishment and review of all District Program Agreements, provide assistance with strategy,

review, analyses, recommendations, and provide the District with cash flow projections to enable the District to adequately fund the Program.

A Project Process outline, Exhibit 2.5, was attached to the MOU agreement summarizing procedures for funding, contracting, design and construction, staffing, and the outfitting/occupancy of facilities. A list of positions and brief job descriptions, Exhibit 2.6, was also attached listing salary and benefit ranges for the anticipated staff provided by Sharp to be reimbursed from Bond proceeds.

Observations

Concurrent with the passage of the Prop G Bond Program in June 2006, the District needed to move quickly to establish the ground rules for a cooperative understanding of the roles and responsibilities to be assigned to the District and Sharp in the process of executing the program. The District initially had no staff expertise in managing a program of this magnitude whereas Sharp possessed a greater degree of expertise since it managed several facilities within San Diego County and had an active capital construction program.

The District, as owners of the Grossmont Hospital and the responsible party for the issuance of bonds and disbursement of the proceeds to fund construction, took appropriate initial steps to secure management of the program through the procurement of a Program Manager, issue bonds, disburse bond proceeds, and be the holder of all contracts with regard to the program. They also established and managed the ICBOC activities and took responsibility for that activity.

AFC believes that the District is the appropriate entity to manage the program through its Program Manager, Parsons. We believe that Sharp, as the tenant and operator of the hospital, is the appropriate entity to prepare and manage the programming of projects and provide design management of the facilities it will use. Likewise, they should manage the purchase of equipment, occupancy schedule, and start-up for the facilities.

Based on our interviews, we understand that the Financial and Project Controls Management is being executed by Sharp under the MOU agreement. As oversight, we understand that the District–CFO provides financial and project controls on a monthly basis by conducting an audit of all financial transactions and reconciling them to accounts using an Excel Quick books format. This activity appears to provide the necessary financial controls, however we believe that stronger financial support is needed by the District. Because the project activity will accelerate over the next few years, we believe an additional position is warranted.

Further, since the Program Manager has had an opportunity to fully execute one project from beginning to end, now would be a good time to revisit the MOU and ensure it is consistent with the Policy and Procedures Manual.

Recommendation 6A.1:

Review the Memorandum of Understanding (MOU) for consistency with the adopted Policy and Procedures Manual (PPM). Realign joint responsibilities and job descriptions. Consider stronger financial support.

4. PROGRAM INFRASTRUCUTRE AND STAFFING

AFC reviewed the Program Infrastructure and Staffing Plan contained in Volume 1 of the Project Orientation Manual prepared by Parsons and approved by the Board on January 18, 2008. The document contains an organization chart outlining the individuals charged with various facets of the program.

Observations

The organization chart contains the names of the initial staff put in place in late 2007 to manage the program, principally for the ED/CCU 2-4-5 Build-Out Project. The organization chart indicates a dual role of Program Manager between Parsons and Sharp HealthCare. Parsons also provided a Design Manager and Project Engineer. Sharp provided a Financial Manager and on-site Project Manager for the ED/CCU 2-4-5 Build-Out project.

Through the interview process we were able to identify additional staff not shown on the organization chart, namely the Project Engineer, an Estimator, and a part-time Scheduler provided by Parsons. As of this date the ED/CCU on-site Project Manager has completed his duties since that project has been completed. The Parsons Project Engineer is currently facilitating the project close out duties. Other positions diagrammed in the chart remain unfilled as projects have not reached the construction stage. Parsons has indicated that several of these positions will be filled shortly, namely an Equipment Manager and Document Control specialist to be provided by Sharp. Other positions will be filled as needed, presumably by Sharp staff.

We observed that Volume 1 of the PPM contains a brief statement of the Parsons Program Manager's role, but contains no detailed job descriptions for the other positions. We also found it unusual to have dual Program Manager positions without some definition of the exact roles and responsibilities for each. While both Program Managers are currently cooperating and "teaming" to provide consistent management of the program, there is a certain "tension" which could be eased with more definition of project roles and responsibilities. Should either of those Program Managers choose to leave the program during its development then an incumbent would need to be carefully chosen. We also are a proponent of assigning the major responsibility for the overall management of a program to one individual or Program Management firm. Should catastrophic failure occur with the program the responsible party can be more easily identified.

We also believe that additional assistance and back-up is needed in the area of financial management. As the program develops and several projects are active at one time it will be

important that financial transactions, document control, change order processing, payment scheduling and controls, audit, and accounting transactions be accurately controlled. We suggest that the District consider whether the open Document Manager position can be this back-up or if another position is warranted.

Overall, we note that the organization chart in the Project Orientation Manual has not been revised or updated since its approval by the Board in early 2008.

Recommendation 6A.2: The District should consider designating one individual as responsible for the overall management of the Program.

Recommendation 6A.3:

The District should consider reviewing its current construction program organizational staffing levels and consider developing revisions to the Program Organization Chart. Further, the District should consider clarifying the relationship and roles and responsibilities of the respective Program Managers and consider adding an additional financial management position reporting to the District.

5. POLICY AND PROCEDURES MANAUAL

AFC reviewed the current Projects Procedure Manual (PPM) in place for the Grossmont Healthcare District's Prop G Program in detail. In addition, we had the opportunity to review and compare this manual with the Policy and Procedures Manual for two other healthcare institutions. One, in the State of California has recently embarked on an $800.0 M capital construction program, the other; an East Coast hospital has an on-going capital construction program exceeding $100.0 M per year. Our review consisted of trying to assess if the current manual was comprehensive enough to execute all facets of construction from project inception to completion and if the requisite check and balances were in place to achieve success. The current PPM is broken down into eight (8) volumes covering:

- Volume 1 : Project Orientation
- Volume 2: General Administration Procedures
- Volume 3: Pre-Construction
- Volume 4: Project Controls
- Volume 5: Agency Reviews/Interface/Permits
- Volume 6: Project and Construction Management
- Volume 7: Contract Document Control/Plan Room (This document was not posted on the "Impact" system, but is classified as a user manual for access and use of that system)
- Volume 8: Disputes and Claims

Observations

The current District Policy and Procedures Manual address most of the significant areas necessary to execute the program. We found sections which address consultant and design management, bidding and award procedures, bidder pre-qualification processes, capital project funding, encumbering processes, cost estimating, value engineering, scheduling processes, change orders/ contract changes, submittals, contractor substitutions, and contract claims processes, to name a few.

As previously noted, the manual was adopted in early 2008 and has not had a significant review since its adoption. There are also several areas of the manual which are incomplete. One revision has been made concerning the consultant's travel reimbursement policy. This has not been incorporated in the manual but is posted on the web site. Another revision was made to Volume 8, concerning the policy of raising the level for claims review to $350,000 to be consistent with the Public Contract Code. We understand from interviews that there may be other suggestions for modification as the District approaches the next phase of projects. Now would be an excellent time to review the "lessons learned" from the ED/CCU project and incorporate those changes. It is possible that a staff retreat or series of meetings may be necessary to discuss these modifications and align them with the goals of the program.

Based on our review of other Policy and Procedure Manuals used by other healthcare institutions there are some areas that do not appear to be addressed in the manual. We list some of those areas for consideration and discussion as follows:

Design Specifications and Standards:

In our discussion with staff we understand that Maintenance & Food Service Operations of the hospital facilities are undertaken by a third party under contract with Sharp HealthCare. That party does not participate in the review of design documents or have consistent input into the design process. Typically, we would find an active interest from maintenance personnel in the planning of security systems, IT systems, mechanical and electrical equipment standardization, life safety equipment, and other building standards for ease of maintenance. There does not appear to be any formal design standards which identify minimum standards of quality which can be given to architectural consultants to act as a baseline for the development of standard specifications. Instead individual architects develop design specifications for each project. Additional costs due to non-standard equipment and materials, higher operational costs due to unique equipment and layout, and the increased potential for design errors and omissions can occur without design standards.

Elements normally included in design standards would be specifications for:

- Doors, hardware and security system devices, including card access systems
- Standard HVAC equipment, controls and energy management systems

- Medical/Surgical standards
- Elevators and Conveying Devices
- Toilet Accessories
- Electrical lighting, uninterrupted power systems, communication systems, television and fire alarm systems

OSHPD requirements and checklists could also be incorporated into these standards.

Propreitary standards are different than design standards. Sole source justifications for proprietary systems, preferred vendors, major equipment purchases and existing system specifications such as pneumatic tubing systems can also be developed prior to project execution, approved and incorporated in the design standard. Some of these appear to be currently in place but are not included in a comprehensive manual.

The lack of comprehensive design standards manual is a missed opportunity which if developed can save significant long term maintenance costs. Sole sourcing can also facilitate the material selection process for both capital expenditures and equipment.

We highly recommend that a design standards manual be developed by the PMT.

Risk Management:

Multiple risk events often cause budgetary and schedule overruns. Project risk is an uncertain event or condition that has a positive or negative effect on a project objective. Occasionally key decisions are made under false assumptions or executive management is not informed of key project risks or their potential impact to the program. Risk management is a systematic process of identifying, analyzing, and responding to project risk. We often find that a program manual will develop a risk management policy which contains a risk identification matrix which includes both a qualitative and quantitative assessment of risks to the project program. These risks may be classified as technical in nature, schedule delays or acceleration, cost risks, or safety risks. Development of a tracking and reporting mechanism can be valuable to the program and decision makers through risk monitoring and control.

Close-out Process:

The current manual does not address a comprehensive close out process. Discussion should include filing of a Notice of Completion, final payment, warranty, commissioning, as-built drawing production and delivery, and complete document review. Documentation and retention requirements can focus on establishing standards and practices to ensure compliance with regulatory, legal, audit, and organizational needs. Permits, Certificates of Occupancy, health department approvals, contractor evaluation forms, LEED construction phase submission documents, and other logs can be kept. On the financial side a discussion of project financial

close-out processes and audit should be included. The long term electronic storage and recovery of documents should also be considered.

Safety:

While the manual discusses procedures for crisis management, security incident reporting, and hazardous material storage there are no sections which discuss overall project safety, and working in a hospital environment. Environmental safety is also a key issue. An all-inclusive safety manual is often developed. This should be included in the contract bid specifications but should also be referenced in the Policy and Procedures Manual such that staff is informed and aware of the significance of it to project performance.

Recommendation 6A.4:

Review and expand on the current Policy and Procedures Manual prior to start of construction of the next project or on a schedule as agreed to by the Grossmont Healthcare District management. Pay particular attention to design standards, risk management and the close out process

6. COMMUNICATION PLANNING AND PROJECT REPORTING:

AFC reviewed the Monthly Update Reports generated by the Project Management Team (PMT) from June 2008 to January 2010. The reports contain an Executive Summary, detailed project summaries with project status and issues, a summary of overall costs/budgets by project, a contracts summary by project, an overall budget summary of Prop G spending, and a summary of schedule and other impacts and activities. On a project specific level a summary of all change orders to date is maintained and reported. These reports are shared with the District administration, the ICBOC, the sub-committee on Construction and the general public at their meetings. The reports provide accurate and timely information for management review and decision making.

Observations

We believe that these reports are informative, consistent, and communicate the necessary information to stakeholders. Recently a graphic section has been added to illustrate project performance measures. The PMT is doing an excellent job of reporting all program activities. Several areas of reporting that we did not see that might help management be more informed would be:

- Forecasting of schedule progress and completion dates for both architectural services and construction
- Errors and Omissions tracking within the change order matrix
- Forecasting of potential change orders
- Preparing a risk management matrix and forecasting major project risks
- Project safety issues, reportable lost day cases, and incident rates

We noted also that not all facets of the project reports tie accurately to the summaries. As part of the monthly report a "Prop G - Costs/Budgets by Project" report indicates project to date accrued costs. We found this to be quite different than the summaries of contracts and summary of budgets presented in other portions of the monthly report. Although these reports are purposely meant to represent two different financial models, a reconciliation or expansion of this report would help explain the differences.

Recommendation 6A.5:

The PMT should consider expanding the Monthly Update Reports to include additional information for stakeholders

7. DOCUMENT MANAGEMENT SYSTEMS:

All program and project management documents are maintained on a Project Information Management System (PIMS). This electronic system is a Parsons owned proprietary system known as "Impact" which is set up to manage document control and provide information tracking for the Prop G Program. On line user manuals and help facilities allow for user and contractors training. Access is afforded to all PMT members. Vendors are given access to file payment requests on line, track projects, submit RFI's, and file change order documentation.

Observations

AFC had the opportunity to gain access to the PIMS to prepare our report. We found it to be user friendly and easy to navigate. All RFI logs, proposed and final Change Orders and back-up, contracts by project, submittals, budgeting and project accounting, bidding information, specifications and documents, management reports, and project data are kept on the system.

We often find that a typical Capital Program and Project Management (CPPM) system is a vital part of an organizations capital program management and financial system. Prior to the introduction of this system neither the District nor Sharp Healthcare utilized a CPPM. On the project level, these systems reduce errors and omissions, provide better forecasting and control, improve quality, decrease workload and turn-around time, and minimize project risks. At the organizational level they improve budget forecasting, provide an audit trail, reduce communication costs, and provide better risk management.

We found several global areas of concern when reviewing the document management system that the District should consider:

- During interviews we were informed that the contractors and some of the architects were not well trained in using the system to submit invoices or interact with the PMT. This is somewhat problematic but could be corrected with some focused training. Most of these CPPM systems have been in use for at least the last ten years and a sophisticated vendor/contractor should be able to follow and utilize a simple tutorial.

While the contracts for each mandate the use of the system, more specific training may be warranted.

- The CPPM system currently being used is a Parsons provided "Impact" system which is only being used to manage the hospital portion of the Bond Program. When the projects are completed and Parsons is no longer engaged, the documents will need to be migrated to another system for storage and future retrieval, or an extension to the Parson contract for maintenance of their system will be required.
- The HOTC project will presumably be managed using another system when Gafcon becomes the Program Manager for that project. We believe all documents should be kept within one system and we suggest the District discuss how it will integrate that project with the current system for proper archiving and management of that portion of the program.

Recommendation 6A.6:

The District should review the document management system and discuss how it will integrate the entire program and archive documents in the future.

6.0: PROGRAM OBSERVATIONS:

SECTION 6B. DESIGN TEAM AND OTHER CONSULTANT FEES

Design team and other consultant fees are often a concern expressed by organizations for review. We often look at the process and framework for fairly selecting consultants based on their professional competence, rather than a fee, to see that the process was transparent. We examine the contracts to see if fees paid are reasonable given the complexity of the project and if they are consistent with the best practice in the industry. We also look at the contract format to see that it addresses the needs of the project with respect to scope, budget, and schedule. Have there been excessive extra services or modification requests to the contract on the part of the professional? And finally, have we compensated the professional in a timely and consistent manner?

Our review framework for testing and validating those questions most commonly asked regarding design team and other consultant fees encompassed the review of the following program components:

- Review of the Request for Qualifications/Request for Proposal process utilized by the District for the selection of professional Architect/Engineering firms and other consultants on projects
- Review of the contract format and language being utilized for consistency with the delivery of the scope of architectural/engineering services for projects
- Review of the architectural/engineering fee structure within the contracts and comparing those with other fee structures utilized within the healthcare industry
- Review of contracts and contract format for other service providers such as inspection, materials testing, soils investigation, estimating, and civil surveying work to compare them with typical fees paid in the healthcare industry
- Review of Extra Service requests and the method of processing and approving those requests
- Review of invoices and payments made, process for approval and payment, and controls to align deliverables with the contract requirements at each phase of project development

1. PROFESSIONAL ARCHITECT SELECTION PROCESS

AFC reviewed the professional architect selection process for four (4) projects. All solicitations for professional services were done utilizing a Request for Proposal (RFP) process. The RFP's reviewed and processes were for the following projects:

- Diagnostic and Treatment Center
- Central Energy Plant
- East Tower
- Health Occupations Training Center

Observations

All of the RFP's related to the above projects were posted on the PIMS Impact web site with the exception of the Health Occupations Training Center. We were also unable to locate the RFP process for the ED/CCU project as this was conducted prior to the District taking over management of the program.

The RFP's for the most part followed a similar format to that used by Sharp HealthCare in the past. That process, closely aligned with the requirement of the California Contract Code, involved the formal advertisement and solicitation of proposals from interested architects/engineers, followed by an initial screening of proposals by a Source Selection Board (SSB) composed of a key Project Managers and several Sharp users. Criteria were established for evaluation of the proposals, points assigned, and weighted to various components. A detailed format for submittal, evaluation criteria, and scope of work was published in the RFP. Point scales or weighted criteria however, were not published. After initial screening and ranking, the top firms were then submitted to a Source Selection Authority (SSA) composed of key Sharp and District management who conducted a similar process and interviewed candidates for selection. In most cases after the interview process was concluded both committees met to discuss and agree on the finalist. Members of the ICBOC were also in attendance as observers and have posted their comments on the ICBOC web site. They generally found the process to be transparent and fair. We concur with their findings and observations.

For the Diagnostic & Treatment Center (D&T) there were over seventeen (17) submittals. The SSB was composed of a Prop G Program Manager and four (4) users. The SSB forwarded eight (8) proposals to the SSA who selected five (5) for interview. The SSA used a team selection matrix to evaluate firms during and after the interviews. The SSA recommended the firm of Kaplan McLaughlin Diaz to the District Board who ultimately approved entering into negotiations with that firm. There were two addenda issued during the proposal period clarifying logistics.

For the Central Energy Plant (CEP) an RFP was issued in June 2007 and followed a similar process. The RFP, however, was primarily for the development of initial conceptual engineering studies. The District allowed for the opportunity to engage the selected firm to complete the entire project after schematic studies were concluded. The firm of Syska Hennessey was then selected as the engineering firm and forwarded to the District Board for final approval.

For the East Tower (ET), an RFP was also issued in June 2007. Six firms were selected by the SSB and forwarded to the SSA for interview. Stantec Architecture was selected as the finalist. A similar RFP process was used in this solicitation.

For the Health Occupations Training Center (HOTC) we found no published RFP on the District web site. We did understand by reviewing the report issued by the ICBOC, which was posted on their web site that eight (8) firms responded to the RFP which was advertised. Four (4) firms were selected for interview. The process, since it was under control of the District, and there

were no identified users, was more streamlined and eliminated the use of a SSB committee deferring to a three (3) person panel of interviewers. This ultimately led to the selection of Mosher Drew Watson Ferguson (MDWF) as the architect for that project.

We believe that the selection process as published in Volume 3, Section B.3 of the Policy and Procedures Manual was the one utilized for the selection of the architect for the HOTC. The manual had not been adopted by the Board when the selection occurred for the prior three projects, however we understand that the process utilized was recommended by Parsons when they initially began work as the Program Manager.

Overall, we found the process to be transparent and fair. There was active participation by each of the committee members, there was no solicitation of fee during the selection process, and key administration or Board members were not contacted during the process. While the selection of architects for the major projects has been concluded, we made the following observations for consideration in the future.

First, as a policy, we like to see included in the RFP package a sample of the architectural agreement format which will be used to negotiate the contract and a statement that "proposers should understand that substantial alterations to the agreement will not be entertained" Often architects assume that an agreement similar to the AIA Standard Form of Agreement between Owner and Architect will be used. Because of the unique contract developed by the District, publishing the agreement with the RFP will seek to clarify any ambiguities in contract language prior to final selection and negotiation. Firms seeking indemnity from insurance requirements or without the ability to adhere to the terms of the contract would thus be eliminated.

Secondly, we see no reason why the point scale and criteria for selection cannot be disclosed. Often when there is a protest raised, the point scale and selection matrix becomes the area of concern. Publishing those criteria will seek to minimize protests on future work.

Lastly, we believe the District should review the Policy and Procedures Manual to clarify the exact process for procuring both major architectural services and the services of other minor vendors. With small contracts for "service providers" the process may be more streamlined and thus different than for larger architectural contracts. We often see Owners saving time by conducting an annual solicitation for materials testing, on-call engineering services, hazmat abatement, and other common services. When a vendor for a project of minor nature is needed they are then drawn from a pre-qualified list and asked to propose.

Recommendation 6B.1:

In the future consider distributing a sample of the A/E agreement and Selection Matrix as part of the RFP.

Recommendation 6B.2:

Consider streamlining the selection process for "service providers" and clarify a more detailed process for A/E selection within the Policy and Procedures Manual.

2. CONTRACT FORMAT - ARCHITECTURAL CONTRACTS

AFC reviewed four (4) architectural agreements on file. All agreements were tailored to the design-bid-build construction methodology. The agreements reviewed were as follows:

- ED/CCU 2-4-5 Build Out – The Design Partnership
- Diagnostic and Treatment Center – Kaplan McLaughlin Diaz
- Central Energy Plant – Syska Hennessey Engineers
- East Tower – Stantec Architecture

We also had the opportunity to review, compare and contrast architectural agreements being utilized by two (2) other healthcare organizations and the associated fees being paid by those institutions.

In past performance reviews for other programs, AFC has found numerous issues with architectural agreements among which are:

- Scope of Work and contract developed by the Architect rather than by the District
- Poorly defined responsibilities of the parties to the contract
- Poorly defined basic and extra services. Each phase (schematics, preliminary drawings, construction working drawings, bidding phase and construction administration) should be broken down into deliverables and requirements
- No record drawing phases and post construction phases
- No definition of how compensation will be paid and scheduled
- No definition of reimbursable expenses or hourly rates
- No integration of the latest technology (BIM)
- No definition of how the OSHPD reviews will be conducted and method of compensation
- Contracts which do not fit the methodology of construction being selected.
- Overlapping and redundant estimating, constructability, value engineering, and other tasks assigned to architects when program managers and builders are assigned similar scopes of work

As such, the above noted flaws would normally be cause for concern. It would likely indicate that the program was not in total control of the scope, budget, or schedule for the projects and corrections to contract language should be made. As part of our review we would then make suggestions for contract language improvement.

Observations

As background, AFC reviewed the original contract authored in August 2001 between the Grossmont Hospital Corporation and The Design Partnership for the construction of 164,620 square feet of hospital space which included the shell space on floors 2-4-5. The budget for that project was $29,553,810 and the architect's fee was $2,257,810 or 7.6% of the base construction budget. The architect was selected and fees were negotiated by Sharp HealthCare prior to the passage of the Prop G Bond. Numerous provisions within the contract format were revised or eliminated. This construction project was the precursor to the currently completed ED/CCU 2-4-5 Build Out project. The contract format used was an AIA B141 (Part 1 & 2) Standard Form of Agreement between Owner and Architect with Sharp HealthCare revisions to the General Conditions portion of the agreement. Fees for sub-consultants by discipline were broken down and attached as Exhibit B. Work on the original project was completed in 2004. We were unable to track invoices and payments on the original agreement since they were handled by Sharp.

As early as November 2006 Sharp HealthCare and the architect were anxious to continue the completion of the update of the shelled floors and revise the program to meet current needs. In the fall of 2006, architectural work continued on updating the plans under a contract with Sharp. Significant OSHPD review had occurred or was in process and it seemed merely a matter of updating the documents prior to bid. By March 2007 over $2.0 M had been committed by Sharp, primarily to the Architect. However, the District was now the contracting authority and did not reach agreement on the MOU with Sharp and the Grossmont Hospital Corporation until January 2007. On June 11, 2007 a proposal was made by The Design Partnership, subsequently revised on September 20, 2007, to continue work on the build out of the ED/CCU and plans were made to transfer the contract to the District. The same AIA B141 contract format was proposed for use.

AFC reviewed an agreement dated October 17, 2007 between the District and The Design Partnership which added District conditions, incorporated the B141 – 1987, Part 1 & Part 2, the Architect's proposal, and Supplement Service Agreements (SSA) 1, 2, 3, & 8 previously authorized by Sharp into a final contract transferring the contract to the District. Given the transfer of responsibility as Owner to the District and considering the agreements then in place, this was the most expeditious method of execution.

We believe that the original contract with the Design Partnership was flawed and possessed some of the pitfalls we have highlighted previously. It is unfortunate that the District was unable to be the original author of this agreement. In reviewing contracts utilized by other healthcare providers we found similar problems such as are contained in this original agreement, the results of which are numerous requests for extra services as the project develops. The AIA B141 Agreement, while useful as a basis for normal contracts does not contain enough provisions to protect the Owner, does not address the standard of care for errors and omissions, contains no specialized breakdown for OSHPD reviews, and other

concerns particular to the healthcare environment. With other healthcare systems we have previously reviewed, we normally recommend that they and their General Counsel become the author of a carefully crafted agreement drafted specifically for healthcare and the specific project parameters.

We can state with no uncertainty that the two other healthcare providers we surveyed are using the AIA documents and are currently having numerous difficulties during the design process with additional service requests, late delivery of services, and ambiguous language interpretations.

We continued our review by examining the contract format for the three (3) remaining projects. These contracts are well crafted and contain numerous provisions such as:

- Architects Estimate of Probable Costs to establish the fee, backed up by an estimate from the Program Manager
- Provisions for dealing with project cost escalation factored into the budget and the basis for calculating the fee
- Provisions for additional services for Building Information Modeling (BIM) and the use of that technology
- Provisions for OSHPD review on a time & material basis rather than as part of the basic fee
- Audit provisions
- Schedules for the Payment of Service at each phase of completion
- Specific schedules for the delivery of architectural services and approvals to advance to subsequent phases
- Response time during construction administration for the review of RFI's, submittals, change orders, etc.
- Travel reimbursement policy, insurances, and other requirements.

We understand that the contract format was authored by the District's General Counsel. We found the contract format currently in use to be outstanding. We therefore have no recommendations for contract format improvement.

3. ARCHITECTURAL FEE STRUCTURE

AFC reviewed the architectural fees paid to date to the various firms on the four (4) projects noted above. The basic fees are in most cases based on the escalated construction cost at time of contract issue. A modest amount is set aside for reimbursable expenses within the contract. Following are the basic fees as indicated in the contracts:

Project	Construction Cost Escalated	Basic Fee ($)	Reimbursable Expenses	Total Fee	Fee (%)
ED/CCU	*$27,350,000	$1,665,606	$166,000	$1,831,606	6.08%
Diagnostic & Treatment	$58,380,320	$6,120,000	$200,000	$6,320,000	10.48%
Central Energy Plant	$30,000,000	$3,203,291	$55,000	$3,258,291	10.67%
East Tower	$26,650,212	$3,116,127	$200,000	$3,336,127	11.69%
Note: * The budget for the ED/CCU was unknown at the time the contract was executed, therefore the bid price has been used for comparison.					

Observations

Since the ED/CCU was in process and consisted of the completion of previously approved shell construction the fee is expected to be lower and slightly skewed. All other fees are generally in the ranges we would anticipate for this type of healthcare work. The East Tower is a renovation and is expected to be slightly higher than the other new facilities because of the nature of renovation. On other renovation projects we have seen, fees have usually been in the 10-15% range. We believe therefore that the District's fees for these projects meet anticipated healthcare industry standards.

As a comparison AFC surveyed two (2) other healthcare providers to ascertain architectural fees for projects similar in scope to the ones being executed at the District. While it is difficult to get an exact comparison since site conditions may differ, the scope may differ, and the review agencies from state to state may decrease or increase fees, we believe these comparisons validate that the fees paid by the District are fair and reasonable. Following are those comparisons:

Project	Construction Cost ($)	A/E Fees ($)	% of Construction
New Hospital - CA	$121,851,586	$11,301,140	9.27%
New Hospital - CA	$305,718,432	$34,768,172	11.37%
ED Remodel - CA	$23,590,891	$2,140,131	9.07%
New Hospital - TX	$22,650,700	$2,067,546	9.12%

Of note in the comparison is that the hospital project in Texas is approximately 1.0% below those in California. Much of this is due to enhanced seismic requirements and the detailed OSHPD review required in California.

AFC noted that all architectural fees were negotiated as lump sum fixed fees based on proposals submitted by the Architects after selection. Proposals were then attached as amendments to the contract. Each proposal we reviewed contains a breakdown of hours by task for each phase of work (schematic, design development, construction documents, etc.). Each proposal contained a man-hour loaded schedule, staff category and hourly rates, and total fee anticipated for each phase. These are then matched up with the total fee breakdown as a

percentage of completion of services. Often these schedules do not match the allowable billing percentage as listed in the contract, and billings would presumably often lag the actual effort required to perform the service. Sub-consultants fees are also broken down in most proposals to distinguish the effort of each discipline.

We noted that the District Design Manager has created a detailed Task, Hours, and Fee Summary for both the Central Energy Plant and the East Tower as a tracking mechanism. We found this to be a valuable tool.

4. CONTRACTS AND FEES FOR OTHER CONSULTANTS

AFC reviewed and sampled some of the contracts associated with other consultants for each of the active projects. Since the only project completed thus far is the ED/CCU project, there is an incomplete record of the extent of services provided such that we can capture the overall costs for those services as a function of total project costs and report whether those service appeared to be within industry standards. Our analysis of the ED/CCU (Section 7 of this report) gives more detail for that specific project as it relates to these services.

The selection process for other consultants utilized by the District follows a similar process for the selection of major architectural services and follows the format as indicated in the Policy and Procedures Manual, Volume 3, Section B. With that process, the Project Management Team (PMT) drafts the scope of work for the consultant in an RFP, identifies a list of potential consultants, seeks the District CEO's approval of the RFP, and advertises the RFP in a local trade paper. On receipt of a minimum of three proposals, a selection committee is formed and a selection is made. The PMT then negotiates a fee for the services. Typically those services are on a lump sum basis or hourly rates with a not-to-exceed budget. Once agreement is reached the PMT seeks the approval of the CEO and General Counsel and prepares a Board Memo to forward to the Board of Directors for approval. Any extra services (Supplemental Service Agreements) related to the contract follow a similar Board approval process.

Observations

Typical contracts issued in support of project development to other consultants consist of contracts for:

- Preliminary and detailed soils testing and geotechnical investigation
- Design estimating assistance
- Constructability reviews
- Materials testing
- Topographical surveying
- As-built investigation
- Inspector of record
- Final building commissioning

Some of these services can be performed as an extra service by the Architect but we often find that Owners execute separate agreements for these services. Some, such as geotechnical investigation and inspector of record work, are always kept as direct consultants as a result of liability and ownership concerns.

Some of the highlights of the typical consultant contracts we focus on are:

- **Inspection Services:** Assure that inspectors are OSHPD qualified, excessive overtime is monitored, and inspection services remain within 1.0 – 2.0 % of construction costs.
- **Materials Testing:** Assure that proposals are not under estimated, there are no excessive half-day charges, or repetitive testing caused by poor quality work on the part of the contractor. Testing should be in the range of 0.75% - 1.50% of construction cost.
- **Geotechnical investigation:** Assure that a complete preliminary investigation is conducted and that a follow-up investigation is performed prior to project bid. Often during design development, ground water conditions may change, or the building footprint may shift warranting further investigation. Geotechnical work ranges between 1.0 – 4.0% of construction depending on soils and site conditions.
- **Topographic Work:** Assure that the project site topography is based on a known benchmark and that contractor layout and design can proceed from the data given.

Thus far, the District has executed a minimal amount of contracts in support of design activities currently underway for the D&T Building, Central Energy Plant, and East Tower projects. Most of the contracts have been related to utility surveying, topographic surveying, estimating, and other pre-bid work. We would recommend that as these contracts are developed they be benchmarked against the ranges we describe above and that final cost reports showing the extent of those services are developed at project completion.

All contracts issued thus far have been executed utilizing a District created contract format. In most cases the vendor's proposal is attached as an exhibit to the contract. In some of the contracts we reviewed we found a difference in the actual contract language and the attached exhibit (the consultant's proposal or fee scale) and would caution the District that ambiguity between vendor generated proposals and actual final contract language can be problematic. Often there will be language in vendor proposals indemnifying the vendor or language containing exclusions. We therefore, often recommend that Owners carefully review those proposals, strike out any conflicting language, or write their own scope of work rather than attach proposals.

Recommendation 6B.3

The PMT should review proposals in detail to insure that the final contract language is consistent with the agreed upon service.

5. EXTRA SERVICE REQUESTS

Normally extra services paid to the architect or other consultants are those fees necessary to cover additional work as authorized by the Owner over and above the basic services as defined by the contract. Extra service amendments can also be utilized to pay for specialty consultants such as interior design services, financial feasibility services, programming, making measured drawings of existing conditions, renderings and other services not included in the contract as basic services. These extra services can either be defined, when known, at the beginning of the project or may occur during the course of the work for additional design services required to address scope changes authorized by the Owner during construction. The extra services may be amendments to the contract based on agreed upon hourly rates or as negotiated in the initial agreement. Extra services are not normally paid for architects' errors and omissions.

We normally caution Owners to budget sufficient funds within the architectural fees to allow for extra services as the project matures. We recommend that 5% of the architect's fee be budgeted as an allowance for extra services. Major scope changes which increase the budget by more than 10% should be considered for separate design contracts rather than treated as an Extra Service.

The process utilized by the District is documented in the Policy and Procedures Manual in Volume 3, Section B.4. Briefly, these extra services (Supplemental Service Agreements or SSA's) are reviewed by the District CEO and PMT. After review, a recommendation is made to the District CEO by the PMT and if agreement is reached, a delegation letter is prepared and a Notice to Proceed (NTP) is issued. The PMT then monitors the performance of the service. SSA's are taken to the Board of Directors for final ratification.

Observations

AFC reviewed Supplemental Service Agreements for architects and other consultants as posted on the project web site. Following is a summary of SSA's issued to date by project not including Program Management, Contractor Change Orders and internal adjustments:

Project	Category	Original Contract Amount	No of SSA's	Cost Increases	% Increase Contracts
ED/CCU 2-4-5 Build Out	Arch/Engineering	$1,005,760	22	$205,553	20.43%
	IOR/Testing/Other	$641,856	15	$601,474	93.70%
TOTAL		**$1,647,616**	**37**	**$807,027**	**48.98%**
Diagnostic & Treatment Center	Arch/Engineering	$8,551,651	11	$366,608	4.28%
	IOR/Testing/Other	$203,215	11	$56,238	27.67%
TOTAL		**$8,754,866**	**22**	**$422,846**	**4.80%**
Central Energy Plant	Arch/Engineering	$3,794,850	4	$332,770	8.76%
	IOR/Testing/Other	$31,700	2	$24,350	76.81%
TOTAL		**$3,826,550**	**6**	**$357,120**	**9.33%**
East Tower	Arch/Engineering	$361,860	1	$24,630	6.81%
	IOR/Testing/Other	$160,885	3	$18,677	11.61%
TOTAL		**$522,745**	**3**	**$43,307**	**3.57%**

As the chart indicates over 37 SSA's were issued with regard to the ED/CCU project. A/E Services added approximately 20% to the A/E fees. In looking at the SSA (Change Order) transaction list for The Design Partnership, AFC noted that several major credits were also taken which skew the actual amount indicated. There were far more additions made to the A/E services than the list indicates. Also noted is that approximately 94% was added to contracts in the areas of inspection and testing. We discuss both these issues further in Section 7.

Since the three (3) remaining projects have not yet reached the construction stage it is difficult to tell if they will eventually reach similar percentages of increase as experienced on the ED/CCU project. Based on our "rule of thumb" of budgeting at least a 5.0% percent increase in A/E fees, all the current projects have neared or exceeded that level at this stage. We caution that the District should anticipate an increased level of extra services and explore ways to keep the budgets within the various ranges we cited or allot sufficient budget to contain allowance for these possible events. One possible way to monitor costs for inspection, testing and other services is through the development of a risk matrix which monitors these costs on a monthly basis as a percentage of job completion.

Recommendation 6B.4:

The District should consider setting aside sufficient funds for Extra Services in the budget for each project and should monitor inspection, testing and other services on a monthly basis through a risk management matrix.

6. ARCHITECT AND OTHER CONSULTANT INVOICES

AFC reviewed and sampled architectural design service invoices paid on the Diagnostic & Treatment (D&T) project to Kaplan McLaughlin Diaz (KMD) from August 31, 2008 until July, 31, 2009 at which time 60% of the Construction Documents (CD) phase was complete. The project then entered the OSHPD review phase and we believe the architect has recently been authorized to complete the 90% CD phase. We also reviewed Extra Service (SSA'S) agreement payments made from August 31, 2008 until March 10, 2010 on several SSA's.

Observations

All invoices were submitted by the architect electronically and automatically entered in the Impact system. An electronic copy of the formal invoice is scanned and recorded in the system for routing through an approval process. The process follows approval steps from an A/E Billing Clerk to the Sr. Financial Manager and is then approved by the Design Manager, Sharp Program Manager, and Parsons Program Manager. A discussion page is also kept to share information regarding issues with the payment request and other topics of concern regarding the invoicing. Once approved by the core Program Management Team (PMT) the invoice is routed to the District CFO and finally approved by the District CEO. Payment is issued through a corporate trust fund held by Union Bank of California by letter of approval jointly signed by the District-CEO and the District Board President or Treasurer. A record of the period when the service was

performed, when the invoice is dated, when the invoice is entered into the system, approval dates, and when the invoice is finally approved is maintained. There is also a time sensitive date recorded as a "due date" for payment approximately 30 days after the invoice is entered into the system.

AFC tracked payments and balanced them against the contract amounts and payment schedule listed in the contract with KMD for the D&T Building. We found the amounts generally tracked the contract and were accurate. We noticed that often the payment approval process took more than 30 days to process from the time it was entered into the system until the warrant was approved for payment. Especially troubling was a slow-down in payment processing and approval of the completion of 60% CD's for this project. Apparently corrections were required to the documents and the PMT withheld approval until the corrections were made. Payment for an invoice that was submitted on August 10, 2009 was actually withheld until March 14, 2010 until these corrections were made. We could find no record of a formal rejection of the invoice however we are sure the PMT communicated a correction list to the Architect and the Architect was aware of his need to perform.

Often we find in the case of rejection of a payment request there is verbal or rather informal communication of the reasons for the withholding of payments. Since the District is committed to paying all vendors within 30 days from the time it approves an invoice, we are more inclined to recommend that a formal rejection letter be developed communicating the reasons for the withhold. We also normally recommend that an overall "time to payment" log be kept which formally tracks the actual time until the warrant is issued.

Recommendation 6B.5

The PMT should develop a form letter for formally notifying vendors when payments are withheld and should develop a log to track "time to payment."

6.0: PROGRAM OBSERVATIONS

SECTION 6C. PROGRAM MANGEMENT FEES AND COSTS

As part of the analysis of Program Management fees and costs, AFC began by establishing how the procurement of Program Management services was conducted. We followed that with a review of the contract negotiations, structure of the contract, hourly rates, contract fees paid to date, annual extensions, and an examination of the extra services and invoices paid to date. Our focus was to assess the fees paid and compare those fees to industry standards. Since Sharp HealthCare was providing staff to manage the program under the Memorandum of Understanding (MOU) we also reviewed those reimbursements and commented on those costs. The overall Program Management costs are a function of the combined cost of both of these segments.

1. Program Management Services - RFP Procurement Process

On March 23, 2007 the Board of Directors approved the issuance of and RFP for Program Management Services for the overall program. The RFP issued was both for the Program Management services for the bond program and for administrative services to support the Independent Citizen's Bond Oversight Committee (ICBOC).

Interviews were held with two out of three responders to the RFP on April 30, 2007 and May 3, 2007 utilizing a similar process to the procurement of Architectural Services. A decision was made to award the major portion of Program Management services to Parsons Commercial Technology Group, Inc. and Program Management service for the Health Occupations Training Center (HOTC) and the administrative services for the ICBOC to Gafcon, Inc. Both firms made presentations to the ICBOC during May 2007 and were ultimately approved by the Board.

Observations

We found the RFP selection process to be open and transparent. We were surprised that so few firms submitted proposals as this was an excellent opportunity for a Program Management firm, however we note that during the early months of 2007 there was an enormous amount of construction work which had been committed or underway and many of the available local PM firms were fully engaged.

2. Program Management Services -Contract Format and Hourly Rates

Since the ED/CCU Build Out project had bid early and the MOU had only recently been executed, it was important for the District to get Program Management activities in place. In order to facilitate immediate action until a final agreement could be executed, the District entered into an interim agreement with Parsons for services to begin on June 1, 2007. A two month interim agreement was executed and followed by Amendment #1 for $220,000 covering the period from September 1, 2007 to November 29, 2007, and Amendment #2 for $192,000

for the period from November 29, 2007 to January 28, 2008. The Interim Agreement contained hourly rates for personnel and reimbursable expenses, as agreed.

In February 2008 a Master Service Agreement was executed for the period February 1, 2008 to January 31, 2009 in an amount not-to-exceed $1,379,436 plus reimbursable expenses of $71,820. The primary focus of the agreement was to provide a Sr. Program Manager and Project Engineer, a part-time Scheduler, Estimator, and IT Support to manage the ED/CCU project and to provide Design Management on the D&T, CEP, and East Tower projects. The agreement contained an Exhibit "A" which detailed out the hourly rates for staff and reimbursable expenses for the Program Management. An allocation of $606,978 was made to the ED/CCU project and $772,458 was allocated to all the other projects.

On January 5, 2009, an Amendment #1 was made to the Master Service Agreement for $1,295,786 plus $67,000 for reimbursable expenses for the period February 1, 2009 to January 31, 2010 with similar terms. An allocation of $202,040 was made to the ED/CCU project and $1,093,098 was made to all the other projects. Distributions of fee were made to each project based on their construction value as a percentage of the overall program.

On January 21, 2010, an Amendment #2 was made to the Master Service Agreement for $1,446,060 plus $36,520 in reimbursable expenses for the period February 1, 2010 to January 31, 2011. Additional distributions were made to each project in a similar manner as above.

In addition, during the course of the work on the projects, the Program Management firm has proposed on several RFP's to perform design/document constructability review services and has been awarded additional Supplemental Service Agreements (SSA's) as well as SSA's for other miscellaneous duties and tasks. These extra services were procured in a competitive manner with other firms providing proposals.

Observations

The initial contract agreement with Parsons Commercial Technology Group, Inc. lays out the types of personnel to be provided to the District for the performance of the work and commensurate hourly rates for those employees. The District initially desired to procure a full-time Sr. Program Manager, Design Manager and Project Engineer, and part-time employees for Estimating, Scheduling, and IT support. The District initially tasked Parsons to perform Program Management services on the ED/CCU project and Design Management Service on the other three projects. The contract contained provisions for extending the agreement on an annual basis. We observed that the contract described the types of individuals but did not specifically describe the tasks to be performed in sufficient detail. An all encompassing agreement may have contained more specific detail of the anticipated tasks. Some of the critical duties and functions that we often see in a Program Managers contract would be:

- *Under minimal supervision the Program Manager shall be responsible and accountable for the coordinated management of multiple related projects directed toward*

organizational objectives. These programs contain complex activities that span functions, organizations, and alliances. The Program Manager shall bring credibility, establish rapport, and maintain communication with stakeholders at multiple levels including those external to the organization. They shall work with the District staff, ICBOC and report to the Board frequently.

- *The Program Manager should define and initiate projects and assign personnel to manage cost, schedule and the performance of projects. They are required to maintain continuous alignment of program scope with objectives and make recommendations to modify the program to enhance effectiveness. They should have advanced skills in finance, leadership, communications, negotiations, and conflict resolution. As an extension of staff, they keenly focus on making themselves and others accountable to the Board.*

Critical duties might include:

- *Developing and managing the program by maintaining a master schedule to insure that all projects will be completed on schedule and within budget*
- *Maintaining a master budget, developing and administering a financial system that reconciles with the District's financial system and developing monthly reports to the Governing Board, ICBOC and District*
- *Providing monthly "look ahead" schedules, forecasting change orders and leading value engineering sessions with other consultants*
- *Coordinating all internal and external communications and acting as liaison with OSHPD, other agencies, and the District on all matters related to the program*
- *Participating in and coordinating the solicitation of all RFP's for consultants, conducting contractor outreach programs and administering/monitoring the competitive bid process with District staff*
- *Assisting the District in exploring alternate delivery methods, options to enhance revenues, maintaining cash flows, and taking a proactive stance as the District moves forward*

While we believe that Parsons is essentially performing these functions and there is a tacit understanding between the parties, the contract does not describe in full detail the tasks to be performed.

Recommendation 6C.1:

On future Program Management contracts consider broadening the definition of tasks assigned to the Program Manager with a specific scope of services.

3. Program Management Services – Hourly Rates and Reimbursable Expenses

Hourly rates and reimbursable expenses were initially stated for each of the employees and were outlined for each of the employees within the original contract and subsequent

amendments. Amendments made to the original agreement adjusted the hourly rates and reimbursable expenses. Following is a summary of the hourly rates within each amendment:

Personnel	Hourly Rates							Program
	Interim Agreement	Master Service Agreement	Increase (%)	Amendment MSA #1	Increase (%)	Amendment MSA #2	Increase (%)	Increase 2007 to 2011
Lead Program Manager	$225/hr	not used	0	not used	0	not used	0	0
Sr. Program Manager	$180/hr	$187/hr	3.88%	$194/hr	3.74%	$192/hr	-1.00%	6.66%
Design Manager	$180/hr	$187/hr	3.88%	$194/hr	3.74%	$190/hr	-1.00%	5.55%
Project Engineer	$125/hr	$110/hr	-12.00%	$114/hr	3.63%	$110/hr	-3.60%	-12.00%
Scheduler	$120/hr	$125/hr	4.16%	$125/hr	0	$125/hr	0	4.16%
Estimator	$120/hr	$125/hr	4.16%	$125/hr	0	$120/hr	-4.00%	0
IT Support	$85/hr	$ 80/hr	-5.89%	$83/hr	3.75%	$80/hr	-3.60%	-5.89%
Project Manager	not used					$130/hr	0	0
Equipment Manager	not used					$130/hr	0	0

The original interim agreement contained standard Parsons hourly rates with a proposed adjustment anticipated for 2008 of 4.0%. In most cases these rate adjustments were included in the Master Service Agreement (MSA) executed in January 2008. MSA Amendment #1 adjusted those rates an additional 4.0% upward in January 2009. The most recent Amendment, MSA #2 has adjusted those rates downward by 4.0% for all but the key Design and Program Manager.

Observations

AFC was able to conduct several comparative analyses of the rates charged by Parsons to the program to assess whether the rate schedules were fair and reasonable. Following are some rates being charged by another Program Management firm in the San Diego area compared to the Parsons rates:

Personnel 2008/09 Rates	Hourly Rate Parsons	Other PM Firm	Difference (+/-)
Lead Program Manager	$225/hr	$203/hr	$22.00
Sr. Program Manager	$187/hr	$192/hr	($5.00)
Design Manager	$187/hr	$192/hr	($5.00)
Project Engineer	$125/hr	$130/hr	($5.00)
Estimator	$120/hr	$166/hr	($46.00)
Scheduler	$120/hr	$130/hr	($10.00)
IT Support	$85/hr	$94/hr	($9.00)

In all cases the above chart validates the reasonableness of the Parsons fee for the Program Management work. We would have anticipated that because of the complexity of healthcare work, that those rates might have been at least 10% higher than a competing firm without the healthcare experience. We also evaluated the change in rates from year to year based on an inspection of the Consumer Price Index (CPI). Although this is a generalized statistic kept by the U.S. Department of Labor Statistics, it might indicate a need for an adjustment to the rates based on inflation. The CPI has risen approximately 4.94% over the period from late 2007 until

January 2010 and was actually slightly negative for 2009 (.0036). This also somewhat validates the increases in Parsons' rates from the execution of the interim agreement until 2010 and the recent stabilization of rates in the annual renewal.

AFC then listed the reimbursable expenses as charged to the program by Parsons as follows:

Personnel	Reimburseable Expenses				Total Expenses 2/07 to 2/11
	Interim Agreement	Master Service Agreement	Amendment MSA #1	Amendment MSA #2	
Sr. Program Manager		$1,580/mo	$1,900/mo	$460/mo	
Design Manager		$1580/mo	$1,900/mo	$760/mo	
Project Engineer			$100/mo	$100/mo	
Scheduler		$1,000/mo		$600/mo	
Estimator		$1,500/mo	$100/mo	$700/mo	
IT Support		$300/mo	$300/mo	$300/mo	
Project Manager				$100/mo	
Equipment Manager				$400/mo	
General Staff Travel			$2,000/mo		
Total /Month	$8,320/mo	$5,960/mo	$6,300/mo	$3,420/mo	$4,870/mo
Total Contract	unknown	$71,820	$67,000	$36,520	$175,340

Reimbursable expenses can normally be requested for several items of project support including per diem expenses for lodging, travel, moving expenses, telephone and internet expenses, and meals. We often find that experienced personnel are brought into the project site and are reimbursed for normal living expenses while away from their principal place of residence. This was the case for the Parsons Program and Design Managers under the Master Service Agreement. We do not find this unusual in the construction industry. Had the PM and Design Manager been charged at a higher hourly rate to absorb these expenses on an annual basis, their hourly rates would have been approximately $9.00/hour greater. This offsets the difference in hourly rates charged by the other Program Management firm we described above.

Overall, our conclusion is that the Parsons fees are fair and reasonable and comparable to those charged by qualified firms in the Program Management industry.

4. Program Management Services – Fees Compared to Construction Cost

The projected fees to be paid to Parsons through February 2011 are $5,178,612.86 including individual SSA's (1-9) for extra services related to design document reviews. Based on the only completed project to date, the ED/CCU, where the construction and equipment cost budget is $35,245,760, the Parsons fees are projected at $1,402,818 to date or approximately 3.98% of construction costs. For most programs we have reviewed in the past, 4.0% is the average fee paid to outside consultants. Given that Sharp HealthCare is providing a complement of staff to

support the program their costs may make up another 5.0 - 6.5%. When assessing internal staff we normally find that typical salaries and benefits will range between 2.0 - 2.5% for direct program management salaries and benefits and an additional 3.0 – 4.0% for the ancillary services of purchasing and contracts staff, accounting and accounts payable, environmental health and safety, and other personnel involved in the process. Therefore, the true cost of managing the program could be in the range of 9- 12.0%.

Observations

For most programs, we analyze the Program Management costs as a percentage of total construction and equipment costs to assess whether adequate budget has been projected to complete the program. As a comparison we prepared a chart which shows the anticipated administrative costs which have been currently budgeted by the District as a percentage of construction and equipment costs as follows:

Project	Construction Budget (CC)	Equipment Budget (EQ)	Total CC+EQ	Budgeted Admin. Costs	Budgeted Admin % of Total
ED/CCU Build Out	$ 33,478,573	$ 1,767,187	$ 35,245,760	$ 3,812,882	10.82%
Diagnostic & Treatment	$ 72,617,207	$ 9,615,206	$ 82,232,413	$ 6,071,091	7.38%
Central Energy Plant	$ 43,170,696	included	$ 43,170,696	$ 5,063,735	11.73%
East Tower	$ 34,419,689	$ 906,165	$ 35,325,854	$ 2,355,008	6.66%
TOTAL	**$ 183,686,165**	**$ 12,288,558**	**$ 195,974,723**	**$ 17,302,716**	**8.83%**

As the chart indicates with the completed ED/CCU project administrative costs will near 11.0%. This is comparable to our anticipated forecast. The projected administrative costs for the Central Energy Plant also appears to be in line with our forecast, however the D&T and East Tower appear to be forecasted on the lower end of anticipated administrative costs. The District may want to verify if these forecasted budgets are correct.

Recommendation 6C.2:

The District should consider re-evaluating the assumptions made with respect to the program administrative costs.

5. Program Management - Sharp Healthcare Reimbursement

AFC reviewed and sampled the reimbursements for Program Management from the District to Sharp Healthcare/GHC posted under the various project summaries. The reimbursements consist of the salaries and benefits of key staff (management, technicians, & clerical), supplies and services, reprographics, utilities for the trailer office, other purchased services, and furniture/equipment purchases. The terms of the Memorandum of Understanding (MOU) spell out the responsibilities of Sharp/GHC as providing program agent services, design programming

and scoping for projects, providing equipment not financed with bond proceeds, and the outfitting and occupancy of the buildings. Salary ranges and benefits are listed for a Program Manager, Construction Manager, Design Manager, Finance and Project Controls Manager, and Administrative Assistants.

Observations

From the sample we inspected the salary ranges posted for reimbursement fell within the ranges as described in the MOU.

The monthly invoice summary reports we reviewed are posted to each of the projects in their entirety. We found no breakdowns contained in the reports which allocated the costs to each project as a percentage of total construction cost or program costs. It was unclear to us how these costs were being allocated to projects even though we found proportionate allocations being made by Parsons. For instance, in December 2009, under Other Purchased Services, a $24,750 charge was made for asbestos removal. Although it was posted under the ED/CCU project, it was unclear in which of the facilities this work occurred since it also appeared under the D&T posting. Several similar type of charges also appeared in other invoices. We would expect more detail in the invoices or reports generated that show a detailed allocation of the work involved to a specific building or project.

AFC also found that Sharp/GHC purchased items of furniture, computers, and equipment for the program mobile office and these items were charged to the District bond fund. The mobile office itself was also purchased by the District and posted entirely to the D&T Building. Other capital items may have also been purchased in support of the program. We believe there should be a separate report generated which tracks all capital purchases such that at the completion of the program there is a reconciliation of items no longer needed, disposal of same, and a proper capitalization of the asset.

Recommendation 6C.3:

Sharp/GHC should consider preparing a monthly report which generates a detailed allocation to specific projects for the general program management costs.

Recommendation 6C.4:

The District should consider preparing a report which tracks all incidental capital expenditures whether purchased by Sharp or the District such that at program completion they are properly capitalized or disposed of if no longer needed.

6. Program Management – Future Staff

As the program accelerates within the next few years the District will likely have to consider adding additional staff. According to the organization chart in the Policy and Procedures Manual as many as three (3) additional Project Managers and three (3) Project Engineers will be

needed to manage the D&T, Central Energy Plant, and East tower projects through 2013. An Equipment Manager position will likely also be added. We have all ready previously noted the need for additional financial management support.

With typical programs we normally calculate approximately 4.0 FTE positions per $25.0 M of construction and equipment put in place per year. The program expects to generate an additional $194.0 M over the next three years. This translates to a total staff with approximately 12.0 FTE positions. Based on this statistic we believe that the District will have to add seven (7) positions to the staff either by having Sharp/GHC provide the positions or by contracting with Parsons to provide extended staff.

6.0: PROGRAM OBSERVATIONS

SECTION 6D. OPERATIONAL PROCEDURES, BUDGETING AND CONTROLS

Project operational procedures and controls include the following component areas:

- Change Management
- Risk Management
- Bidding/Contracting Practices and Insurance
- Design Standards and Specifications
- Value Engineering/Design Management and Constructability Reviews
- Budgeting, Estimating, Scheduling and Forecasting
- Compliance Audit Reviews
- General Accounting Policy

1. CHANGE MANAGEMENT

Change management is concerned with a.) Influencing the factors that create changes to ensure changes are agreed upon, b.) Determining that the change has occurred and c.) Managing actual changes when they occur. The original project scope and performance baselines must be maintained by continuously managing changes to the baseline budget. This is done by rejecting new changes or by approving changes and incorporating them into a revised project baseline budget. Change management requires maintaining the integrity of the performance measurement baselines and coordinating changes across project functional areas. Projects lacking a formal change control system will always be at risk for major cost overruns, contractor disputes and claims, and potential "gold plating." Once changes begin, it can be difficult to stop the flow of resources and gain control of the project without jeopardizing the entire project and the corresponding relationships. Occasionally we find that changes are incurred prior to a fully executed change order or extra service agreement.

Observations

AFC examined the District's policies and procedures with regard to change management for both consultants and contractors, and reviewed change orders and Supplemental Service Agreements (SSA's) posted on the Impact site for the completed ED/CCU project and other active projects.

SSA's for consultants are initially reviewed by the PMT and the District CEO. After review the PMT prepares a recommendation and if agreement is reached a delegation letter is prepared and issued to the consultant. Upon execution a Notice to Proceed is issued to the consultant and the PMT monitors the consultant's performance of the services. We found no SSA's that were issued without a formal approval in place and no services that were performed prior to an SSA being issued. We have provided additional information in our review of design services in Section 6B.

Volume 4 discusses the signature authority and process for incorporating change orders into the contract and schedule. Change order signature authority lies with the District CEO and all scope changes over $10,000 must be approved by the CEO as well. We have provided an extensive review of change orders issued to Jaynes on the ED/CCU and have made several observations and recommendations in Section 7 of our report.

Overall, we found the change management process to be well defined.

2. RISK MANAGEMENT

Project risk is an uncertain event or condition that has a positive or negative effect on a project objective. Risk management is the systematic process of identifying, analyzing, and responding to project risk. It includes maximizing the probability of positive events and minimizing the probability and consequences of negative events. To succeed, organizations must commit to addressing risk management throughout the project. According to the Project Management Institute, the major risk processes are:

- Risk Management Planning – deciding how to approach and plan risk management activities for the project
- Risk Identification – determining which risks might affect the project and document their characteristics
- Qualitative Risk Analysis – performing a qualitative analysis of risk and conditions to prioritize their effect n project conditions
- Quantitative Risk Analysis – measuring probability and consequences of risks and estimating their implications for project objectives
- Risk Response Planning – developing procedures and techniques to enhance opportunities and reduce threats to the project objectives
- Risk Monitoring and Control- monitoring residual risk, identifying new risks, executing risk reduction plans and evaluating their effectiveness

Observations

AFC identified that the current District risk management process and activities are informal and not at a level we would expect for a program of this magnitude. We found no evidence of formal risk tracking, identification or contingency planning. We believe that risk management policies and procedures need to be developed for all future projects. Risk management plans should contain a risk rating matrix, a risk register, and a risk response plan for all high priority risks. The risk register should include assumptions and dollar impacts for all major events. The Monthly Update Report should include an analysis of potential risks to the schedule and analysis of potential impacts to the budget.

Recommendation 6D.1

The District should consider developing a Risk Management policy and procedure process

3. BIDDING/CONTRACTING PRACTICES AND INSURANCE

AFC reviewed the contract documents prepared for the ED/CCU project and have provided observations and comments in Section 7 of this report. In addition to this review, we observed several areas of the contract documents which might be improved on in the future, some of which are:

A. Contractor Pre-Qualification:

Based on the bid documents released for the project there appeared to be a requirement that contractors demonstrate that they had 5 years experience with hospital construction. As we understand it the bidders indicated experience but had limited recent experience and limited experience with OSHPD. As a result the final contract with Jaynes contained an addendum which required that Jaynes hire a superintendent who had 5-years experience with OSHPD and hire a Quality Control support position which had experience with OSHPD Testing, Inspection, and Observation (TIO) program and experience working with Inspectors of Record and OSHPD field staff. Had a tighter pre-qualification process been implemented this contract addendum may not have been necessary.

A major risk to the program would be hiring unqualified or non-licensed contractors or continuing to use underperforming contractor/vendors due to lack of historical data and available information. Claims avoidance, fake or faulty materials and equipment, and missing key scopes of work items can be prevented with a rigorous pre-qualification process.

Many state agencies pre-qualify prospective bidders and keep a pre-qualification file. Some of the items utilized in the pre-qualification process are:

- Company financial statement with working capital and net worth
- Experience of personnel assigned to projects and performance factors on other similar projects
- Name of bonding company and bonding capacity
- Types of licenses held
- Claims experience on similar public works projects
- Safety qualifications with experience modification rates (EMR) based on lost work day history

While we have not investigated the CA Health and Safety Code to see if a pre-qualifications process is possible we would encourage the District to consider investigating its use.

Recommendation 6D.2:

The District should consider the use of a pre-qualification process for General and Sub-contractors

B. Change Orders - Establishment of Labor Burden

It is common with design-bid-build contracts to see more definition of allowable labor burden to be charged when a change order is executed. It is imperative that the Owner, at project initiation and during the course of the work, collect contractor payroll records periodically. We have seen contract language which also requires the contractor to submit an "Hourly Labor Rate Worksheet" at the beginning of the contract to verify wage and labor burden to be used in the event of a change order. We also recommend the contract documents contain a strict definition of the allowable and unallowable costs. No labor costs should exceed the prevailing wage for the specific trade. Often contractors will inflate wages and labor burden to achieve higher returns on change order work. This should be prevented with tighter contract language.

Recommendation 6D.3:

The District should consider amending the General Conditions of the contract with respect to labor burden and allowable costs for change orders

C. Insurance

Recently public agencies and other Owners have been investigating Owner Controlled Insurance Programs (OCIP). In lieu of having the General Contractor provide the necessary insurances, the Owner provides the necessary coverage. Several layers of insurance exist within a typical organization including: property insurance, Builders Risk, traditional insurance, Subguard, Performance & Payment bonds, and a contractor controlled insurance program. These insurance requirements are often not well coordinated and there may be gaps, overlapping coverage, or inconsistencies which should be coordinated. We often recommend that Owners investigate their insurance coverage and needs as part of managing risk. While there may be savings with an OCIP program, often bid documents include provisions for the bidder to breakdown the cost for insurances such that the Owner can decide if they can provide it for a lesser cost or have the contractor provide the necessary insurances.

Recommendation 6D.4:

The District should consider performing a comprehensive review of its insurance coverage for the program

D. Audit Provisions

Many state agencies insert audit provisions into their contracts to alert contractors that they are subject to an audit for up to three (3) years after the completion of the contract. The audit

would be conducted to detect overcharges on change orders, false claims, and short payments to subcontractors among other concerns. We find that audit provisions give the Owner the opportunity to recover costs and to validate claims. Audit provisions also tend to achieve better contractor compliance especially on lump sum projects.

Recommendation 6D.5:

The District should consider amending the General Conditions of the contract with respect to audit provisions

4. DESIGN STANDARDS AND SPECIFICATIONS

In our narrative in Section 6A we have suggested that the District develop design standards and specifications as part of their Policy and Procedures Manual. Currently there are no design standards and each architect develops his own specifications for each project. We strongly recommend that design standards be developed. There is an increased potential for design errors and omissions, additional costs for non-standard equipment, and a higher operational cost that can be avoided with a formal design manual.

5. VALUE ENGINEERING/DESIGN MANAGEMENT AND CONSTRUCTABILILTY REVIEWS

Currently Volume 3 of the Policy and Procedures Manual lays out a process for Design Management and review. Estimates are prepared at the end of Schematic Design, Design Development, and 50% and 100% Construction Documents phases by the architect. The PMT prepares similar estimates in the same format. The estimates are reconciled at the end of each phase.

Likewise design reviews are prepared in a similar fashion and comments transmitted to the architect. User input to the process is sought at periodic meetings to ensure that design objectives and District standards are met. The PMT reviews these comments with the District CEO and subsequently monitors their incorporation into the documents.

Value Engineering (V/E) is a systematic process of analyzing materials, systems, and components in order to achieve the stated project criteria at the lowest possible cost. V/E techniques include conducting performance and cost comparisons of potential alternate methods of satisfying project objectives. The PMT can provide these services or an outside consultant can be brought in to perform those services. Life cycle cost is an important function of any V/E study. Volume 4 of the PPM lays out the process for performing V/E studies.

Observations

AFC reviewed the design management and estimating process currently underway with the Diagnostic & Treatment facility design. We found the information to be compliant with the procedure in place. As a result of an RFP issued on August 27, 2008 Parsons was competitively

selected to conduct design reviews at Schematic. Design Development and 60% Construction Document phases. An SSA #3 was issued for $198,500 to Parsons for these reviews on October 8, 2008 and approved by the Board of Directors. A similar SSA was issued to DSCIS for OSHPD compliance review. Both reviews have been conducted during the course of the design work. We found the process to be well documented on the Impact system.

Overall, the design review, estimating and value engineering process employed by the PMT is well crafted and working well.

6. BUDGETING, ESTIMATING, SCHEDULING AND FORECASTING

Since most, if not all, of the project funds are derived through bond revenues from Prop G, costs can only be expended for the expansion, improvement, construction, and acquisition of medical related facilities as approved by the voters.

Budgets were created initially prior to the passage of the bond issue and have since been adjusted periodically. Project budgets and cost control are established by allocating the available funds to various line items within the project budgets. These baselines or Budget Allocation Summaries (BAS) contain five levels of detail broken down into 1.) Project, 2.) Consultant and vendor services, 3.) Consultant management and support services provided by Parsons and Sharp Healthcare, 4.) Contracts and purchase orders, and 5.) Individual Schedule of Value (SOV) line items. Using this structure, project reports are prepared comparing the budgets to estimated costs, commitments, or forecasted costs. Transfer of costs within each category or the addition of new budget can only be executed with the approval of the District CEO and a documented BAS Change which is entered into the Impact system.

Following are the initial master budgets and adjustments made to those budgets to date:

PROJECT	Budget Nov-06	Budget Jan-08	Budget Feb-08	Budget May-09	Budget Oct-09
ED/CCU Build Out	$41,448,000	$41,093,543	$41,093,543	$41,093,543	$41,093,543
Diagnostic & Treatment	87,990,000	110,417,623	110,417,623	107,301,730	97,912,970
Central Energy Plant	57,096,000	56,918,773	50,811,832	50,811,832	54,372,469
East Tower	38,466,000	34,331,803	34,331,803	34,331,803	42,067,640
Sub-total	**$225,000,000**	**$242,761,742**	**$236,654,801**	**$233,538,908**	**$235,446,622**
Health Occupations Training Ctr.	7,500,000	7,500,000	7,500,000	7,500,000	7,500,000
Bond Issuance Costs	12,350,000	3,811,093	3,811,093	3,811,093	3,811,093
Contingency	2,150,000	2,150,000	2,150,000	2,150,000	2,150,000
TOTAL	**$247,000,000**	**$256,222,835**	**$250,115,894**	**$247,000,001**	**$248,907,715**
Deficit	$0	($9,222,835)	($3,115,894)	$0	($1,907,715)

Observations

The initial project budgets were prepared during the 2004 Master Plan developed by NBBJ and became the basis for moving ahead in November 2006. As the chart indicates there has been a fairly consistent allocation of funds for the ED/CCU project and the Health Occupations Training

Center (HOTC) with major adjustments to the budgets for the other projects occurring at least on annual intervals. These budget adjustments are made periodically by the Board of Directors after a detailed evaluation and presentation by the PMT. An opinion of probable cost is prepared for each project and "rolled up" into the total program cost. The latest revision indicates that there is a deficit of $1,907,715 in program funding as of the October 2009 revision.

The PMT prepares a master schedule for the program as well as project master schedules and detailed phase schedules for the individual projects utilizing Primavera Project Planner software. Schedules are updated on a monthly basis. Schedules are used to manage the consultant's performance as well as contractors during construction and published in the monthly update reports. Revisions to the schedules are prepared separately, reported with a narrative analysis. Before schedule changes are incorporated into the master schedule they are approved by the District CEO.

AFC observed that the process for budgeting is clear and concise and provides the necessary check and balances. Formal cost baselines have been established and reports are generated which track budget, cost estimate and schedule changes with a record of when the change was made and why the change was necessary. We believe the process is transparent and interactive. We believe that detailed budgets are typically accurate to within 10% of actual because of the detailed estimates of probable cost prepared by the PMT.

We would be remiss if we did not address the lack of information regarding the HOTC project. While the focus of our review was concentrated on the hospital portions of the program under management by Parsons, we observed that no adjustments were made to the HOTC project budget since inception. We believe that a more detailed budget for that project is necessary at this time and would encourage the District to engage the Program Manager to estimate the probable cost of that project based on current planning information. The scope of the project as we know it is to build a 20-35,000 square foot building. Based on our "lunch bag" estimate we would estimate that cost to be between $6.0 M and $9.0 M. Since the budget was established almost four years ago, and costs have likely increased, it would be wise to confirm both the preliminary scope of the project and to forecast a preliminary budget. Budget adjustments should be made once these estimates are made.

Recommendation 6D.6:

The District should consider preparing and confirming the scope, budget, and schedule for the HOTC project such that sufficient funds are available for its completion.

7. COMPLIANCE AUDIT REVIEWS

AFC reviewed the Policy and Procedures Manual for references to compliance auditing as a way to ensure the execution of complete records compliance testing, project cost reviews and

reconciliation, on-going contract compliance testing and project close out reviews. A discussion of the overall annual internal financial audit plan is also not included. We reviewed the protocol for setting the baseline Budget Allocation Summary (BAS), encumbering funds, and making payments, however we found no discussion of compliance audit testing.

Observations

As we understand the process, when a contract, purchase order, or consultant agreement is initiated and approved by the Board, funds are encumbered by the District CEO and forwarded to the District CFO. The Sr. Financial Manager enters the encumbrance in the Impact system and tracks all contract payment requests and transactions. No funds can be transferred between encumbrances without them being formally recorded in the Impact system and an adjustment made to the BAS with a formal approval.

While we understand from interviews that the Sr. Financial Manager conducts a review of all submitted invoices against encumbrances and occasionally rejects them, there is no formal plan in place to conduct periodic compliance audits. We believe that such a process would be beneficial and ensure the accuracy, transparency and completeness of project costs in preparation for annual financial audits. If audit provisions are included in future contracts a formal audit plan can also be developed to periodically audit contractors for compliance as well.

Recommendation 6D.7:

The District should consider developing an internal audit plan for construction that includes a combination of policy and procedures, records compliance testing, on-going contract compliance testing, and project close out reviews

8. GENERAL ACCOUNTING POLICIES

Project costs are reconciled by the PMT and the District CFO monthly in the Purchasing Accounting System (PAS) as proscribed by the Policy and Procedures Manual Volume 4. The Sr. Financial Manager is responsible for entering the financial information and maintaining the project cost data in the Impact system. There are twice monthly meetings to reconcile contract billings and invoices and a monthly reconciliation process using Excel Quick Books. These processes lead to the generation of both monthly and yearly PAS reports.

AFC examined payment processing for vendors on all contracts by reviewing invoices and time to payment logs on the Impact system. The District is striving to keep the payment processing to within 30 days.

Given the current volume of transactions the process seems to be working well, however as recommended in Section 6A the District may need additional financial staff to assist the District CFO as project activity accelerates in the future.

SECTION 7.0: SELECTED PROJECT AUDIT

ED/CCU 2-4-5 BUILD OUT

As part of our review, AFC often selects a specific project for an in-depth review to track the administration of the project, design fees, program management fees and costs, operational controls utilized, schedule management, bidding/contracting and change order management, and specific post performance data to provide a "lessons learned" for future project implementation.

Since the District has completed only one project, the ED/CCU project, we have taken the approach that an analysis of this particular project may provide the District and the ICBOC with some guidance in structuring the remaining three (3) projects before they are bid and under construction.

It is our opinion that "post performance review" reports are generally beneficial and we believe that they can be useful tools to the District and ICBOC. In fact, many agencies conduct "post-performance" project reviews of specific projects in an effort to capture best business practices, lessons learned, and to demonstrate administrative accountability to the public. We therefore offer the following outline of topics which may be covered in such a report and some of which we will attempt to capture in our analysis:

Executive Summary:

- Prepare a detailed project scope description, budget, and schedule for the project
- Summarize all facets of the project including initial and final funding (Some agencies prepare standardized data sheets for future use in budgeting)

Administrative:

- Did the project follow the approved administrative/operational procedures (This is usually in compliance with an approved Policy and Procedures manual)
- Did the project follow the required regulatory compliance procedures (These would include OSHPD review, final close out , and acceptance, as well as Hazmat, local or other special reviews)

Planning:

- Did the project follow the District's Long Range Facilities Master Plan(LRFMP)
- Did the project abide by all mitigation measures required by CEQA (This should be coordinated with overall CEQA compliance documents for the LRFMP)
- Did the project follow the approved District design/material standards
- Were approvals received and authorization given at each phase of project development per contract

Design:

- Did the project follow the originally approved review timelines through each phase of project development? Were there significant project delays.
- Were constructability reviews and value engineering sessions conducted at each phase
- Review of A/E Contracts, including approved fee, Extra Service authorizations and reimbursable expenses
- Review A/E performance measures: Errors and Omissions, A/E caused delays
- Were as-built drawings completed and delivered on time
- Review of Bid documents, alternates, and general and supplemental general conditions
- Were building official requirements followed: OSHPD, Inspection, Certificates of Occupancy, and close out requirements
- **Prepare an A/E evaluation form for "lessons learned"**

Construction:

- Was a pre-bid review done; were bid alternates used
- Review timetable for advertisement, bid, award, and Notice to Proceed
- Were there pre-qualification requirements for contractors, outreach, DVBE requirements
- Review service agreements for testing, geotechnical, and other costs and services
- Review any escrow agreements, stop notices and handling of same
- Review payment processing procedures, applications for payment, time to approval
- Were there labor claims, labor compliance requirements
- Review contractor claims, merit, disposition, and budget
- Review Notice of Completion, lien releases, warranty requirements
- **Prepare a Contractor Evaluation form for "lessons learned"**

While these are some of the highlights we normally see in a "post performance" review there may be others that are of particular interest to the District. These can be added as needed to meet District requirements. Reports should especially highlight ways in which the program may be improved. Since we were not intimately involved in the ED/CCU project, we cannot accurately evaluate the architect or contractors performance. We leave this evaluation and final report writing to Parsons, the Program Manager.

Recommendation 7.1:

As a good business practice and close out procedure, AFC recommends that the District consider conducting a "post performance" evaluation on each project.

1. SCOPE OF WORK

The scope of work for this project included the build out of approximately 75,000 square feet on three (3) patient floors in the existing ED/CCU (West Tower), adding 90 new beds. Level 2 consists of 24 Critical Care rooms configured into three (3) eight bed pod units organized around three (3) separate nursing stations. Level 4 & 5 contained 33 Acute Care Nursing rooms per floor arranged around two (2) primary nurse stations.

The scope of work included the installation of new air handlers and related equipment on the mechanical level (level 6) as well as providing Reverse Osmosis/De-ionized Water equipment for the use in dialysis. A new chiller was included in the construction package at the exterior of the building. The work involved maintaining existing hospital operations continuously, phased scheduling, and observing stringent life safety procedures and OSHPD constraints.

The total project cost as of January 2010 was $40,286,501 of which $33,206,706 was construction and $1,041,428 was for equipment. Project construction began on November 19, 2007 with completion in September 2009. As of the date of our report, the project has not been completely finalized and closed out. The project was consistent with the scope as described in the Grossmont Hospital Master Plan prepared by NBBJ in August 2004.

2. PROJECT BUDGET

The initial budget for this project was established in November 2006 along with the other buildings in the program. Allocations were made to all projects to match the total GO Bond funds of $247.0 M. The ED/CCU project was initially allocated $41,448,000. A subsequent adjustment to the budget was made in January 28, 2008 when Parson began work and detailed out an estimate of probable costs for all the projects. This budget of $41,093,543, created after the project was bid, became the baseline budget for the project. That budget has been maintained throughout the project. Baseline budgets are revised by issuing an internal Budget Allocation Summary (BAS) sheet transferring funds from one category to another or augmenting budgets from contingency. The project has been completed within the budget.

3. ARCHITECTURAL SERVICES

AFC has previously commented on the architectural contract entered into with the Design Partnership on October 17, 2007 when the contract ownership was transferred from Sharp HealthCare to the District. Section 6B of our report contains our detailed comments. To date Architectural/Engineering costs of $2,458,990 have accrued to the project.

4. BID PROCESS

Based on construction documents completed in March 2007, bids were advertised on April 2, 2007 for the ED/CCU project. The project had been permitted by OSHPD but the contract drawings and manual revisions had not been approved by OSHPD as of the date of the release of documents for public bid. Revisions had been submitted to OSHPD and the architect was

updating documents as well as responding to bid questions simultaneously. Subsequently, four (4) Addenda were issued during May and June 2007. Extensive revisions to the drawings and manual were released with Addendum #1 on May 8, 2007. Addendum #1 contained the General Conditions, requirements for listing of sub-contractors, performance and payment bonds, and schedule requirements. Fire Protection plans made up the bulk of Addendum #2 released on May 18, 2007 and minor clarifications were included in the following two Addenda (Nos. 3&4). Addendum #3 indicated that no Supplemental General Conditions or Special Conditions were forthcoming. The contract time was stipulated as 260 working days or 365 calendar days. AFC reviewed the bid documents and all the addenda issued during bidding.

The AIA General Conditions A 2001-1997 was attached to the contract with no modifications. Division 1 of the specification manual spelled out the specific conditions of the contract for work at the Grossmont Hospital site and included special provisions for Life Safety, Infection Control, and Hazmat procedures. Other standard Construction Specification Institute (CSI) Divisions 1-16 were issued and reviewed.

Bids were taken on June 13, 2007. There were three (3) bidders on the project with the Jaynes Corporation being the low bidder at $27,350,000. The highest bid received was for $31,747,256. The project was bid within the available funds and the PMT , as part of risk management, began conducting a due diligence process since the low bidder had minimal experience with hospital construction, had no previous OSHPD experience and there were numerous corrections to the documents that need to be incorporated by change order. Presentations to the Board were made regarding whether the project should have been re-bid given the circumstances with the OSHPD revisions, the construction market and potential for higher pricing, and the potential delays to the project and postponement of the bond sale. After discussion, a decision to award was made to Jaynes on August 10, 2007 and construction was scheduled to commence on November 19, 2007 with the issuance of a Notice to Proceed. During the period from bid to the start of construction, Jaynes continued to assess the cost of changes and revisions being made to the drawings and manual as a result of back checks being conducted by OSHPD. The final building permit was not issued by OSHPD until September 4, 2007. The elapsed time from bidding to award was over eight months.

Observations

AFC believes that seeking bids on a project which had not been approved by OSHPD was premature and an unwise decision. Most state agencies mandate that all approvals be received prior to bid and we would agree. In a case we are familiar with that occurred in 1984 an agency bid and awarded a project without having the appropriate seismic safety approval. After the approval was received (approximately four (4) months after award) the agency found that it would costs an additional $4.0 M to make the necessary revision to comply. It was without the necessary funds to do so and had to suspend the project for six months while it sought additional funds. This delay caused another $2.0 M in delay costs resulting in a total of $6.0 M

for this event. While we think the District took the necessary precautions prior to award of the ED/CCU we see it as problematic for the future.

Recommendation 7.2:

In the future, the District should ensure that all bid documents have received the necessary OSHPD approvals prior to the bid issuance date.

AFC also understands that there was some urgency in bringing this project to the marketplace early because of rising construction costs and an OSHPD permit that expired in August 2007. During late 2006 and early 2007 construction costs were escalating at rates between 15-25% and a re-bid likely would have resulted in much higher costs for the project. Because of the 5-6 month delay in awarding this project, additional price increases could also have been expected and a rebid may have taken the project start well into mid-2008. We believe that the District was fortunate to keep the final costs within budget. This can be attributable to excellent cost and program management and not the good will of the construction industry. Regardless, we believe that an award and Notice to Proceed should be issued promptly.

Recommendation 7.3

In the future, the District should strive to keep the time between bid and award to less than 60 days and to issue a Notice to Proceed within 30 days thereafter.

5. CONTRACTOR SELECTION AND CONSTRUCTION METHODOLOGY

Based on our review of the CA Health and Safety Code Section 32132 which governs the bidding of Public Works projects by the District, the District must bid any project with a value greater than $25,000 to the lowest responsible bidder. It is unfortunate that the District cannot take advantage of the more sophisticated project delivery processes currently being used by other private healthcare organizations. Several of our current healthcare clients are using a Construction Manager at Risk (CMR) or Guaranteed Maximum Price (GMP) process which allows for early procurement of the contractor based on bidding General Conditions and Fee, eventually selecting the contractor to manage the project for a cost plus the fee and GC's. We have also recently seen a trend toward constructing healthcare projects utilizing a Design-Build process where the contractor assumes the risk of building the entire project for a set price (budget) including providing the Architect of Record. Both of these processes are more rewarding to the contractor and Owner alike. We particularly like utilizing the GMP process since the architect remains under the control of the Owner throughout. This is especially necessary given the extensive review process by OSHPD. While we are not at liberty to recommend one of these processes be explored by the District we would hope that eventual revisions to the "code" might allow these processes to be used in the future.

AFC noted the lack of adequate bidder participation on this project. Securing only three (3) bidders on a project worth $28.0 M indicates that a more pro-active contractor outreach

program may be necessary or that the risk was too high to participate. During 2007, we noticed that the local construction community was especially reluctant to bid on design-bid-build lump sum projects because of rising and unpredictable material and labor costs. This may have resulted in the lack of participation on this project. We believe as new projects are currently programmed and in design the District should alert the construction community concerning upcoming projects, post potential bid dates through the media and otherwise encourage bidder participation.

Recommendation 7.4:

In the future, the District should be more pro-active in soliciting bidders from the construction community.

6. CHANGE ORDERS

As part of our review AFC selected and sampled change orders for the ED/CCU project. Typically change orders associated with construction are the results of the following conditions:

- Unforeseen site or other conditions
- Scope changes authorized by the Owner
- Unavailable materials or changes in the specifications
- Errors and Omissions in the documents prepared by the Architect
- Changes caused by on-site field review by governing agencies, typically OSHPD

Normally we find that change order rates are between 3-10% of the initial construction value. The average Change Order rate for new construction is generally 5%, and for renovation work, a rate of no more than 10%. Renovation change order rates are usually higher because of project complexities, the incompleteness of as-built documents, and unknown conditions which may be present at the site. We believe that change order rates of 3% or less are admirable, thus we were interested in observing how this project had performed. Change order rates are also typically higher as a percentage of construction on smaller projects than on larger projects.

Change order rates are typically at the higher end of the range with the traditional Design-Bid-Build methodology, lower for a trade bid contract methodology (CM Multi-Prime), and technically non-existent with a Design-Build contract. Because the District was required to execute the ED/CCU project with a Design-Bid-Build methodology, we would expect the change order rate to be on the higher end of the range. We also expected to see a higher than average change order rate because of the need to incorporate post-bid revisions as a result of OSHPD's review and the "back check" approval process undertaken with the project. These ranges do not include any added scope of work that the Owner may elect to exercise to enhance the overall quality of the final product. We also paid particular attention to Owner authorized changes to ascertain if there were any changes that could have been avoided had a decision been made at the Board or a higher administrative level than was utilized. In general, we often find that certain types of projects have higher "user" generated change orders, that there may

be favoritism given with regard to certain users, or that the changes were not necessary and not fully justified as reasonable. For this project, we found limited scope changes which might have been of concern.

A. Change Order Review Approach

Our review approach encompassed sampling ten (10) change orders to insure that they were appropriately justified authorized and supported by adequate documentation. We also inspected the appropriateness of labor, labor burden, material and equipment, indirect costs and mark-up percentages on change orders to verify that they matched the terms of the contract.

B. Authority to Approve Change Orders

The authority for approving change orders utilized by the District authorizes the CEO to approve change order up to $25,000. Change order exceeding $25,000 must be approved by the GO Bond Committee and then the Board of Directors. Change orders in excess of $250,000 must be reviewed by the ICBOC. The District CEO must also approve any scope changes in excess of $10,000. No other individuals are authorized to sign change orders on behalf of the District. Proceed Orders may be used to authorize work prior to a fully executed change order when circumstance dictate that starting or continuing work is essential to avoid contractor claims for delay.

C. Tracking Reason Codes

We typically recommend that Owners codify and track the purpose or reason for each change order. This can assist in quantifying the cost and number of Owner initiated scope changes, unforeseen site conditions that may be avoided on future projects, the cost of agency initiated changes as a result of code interpretations, and principally to track errors and omissions on the part of the design professional. If we find numerous change orders attributable to errors and omissions caused by the architect's drawings, we would be concerned that the quality of the design documents was poor.

The construction industry suggest that the "standard of care" for change orders attributable to errors and omissions should be no more than 3% of the construction cost. It is purely a judgment call made by the Owner and liability only attaches when the Architect acts below the standard of applicable care. The standard can be described as part of the contract documents and is at the discretion of the Owner. In order to determine if the standard of care has been compromised, we calculate 100% of the error related change orders and only 20% of the omission related change orders. If contractual working drawings omit design details, it is presumed that related costs were never included in the original construction contract to cover these omissions. However, it is industry standard that suggests that change orders inherently are 20% higher than if the work was originally included in the construction contract as bid work. We further recommend that the Owner, or his representative, codify all change order reason codes, rather than rely on contractor codification.

Rather than adopt the standard reason codes we normally find in the construction industry, the District adopted the following reason codes:

- ***A – OSHPD (review agency changes)***
- ***B- District Requested***
- ***C- Sharp Requested (User)***
- ***D- Unforeseen Conditions***
- ***E- General Contractor Requested***
- ***F- A&E Revisions (Architect Requested)***

In the case of the ED/CCU project analyzed, several of the reason codes attached to change orders showed a shared responsibility between two parties. Architect's errors and omissions were not kept as a separate category but blended with A&E revisions. There was no separate category kept for back charges or for specification changes caused by the unavailability of materials.

Following is a chart displaying the change orders logged in the Monthly Update Report of January 2010:

ED/CCU Change Orders					
Category	**Type of Change by Reason Code**	**No. of CO's**	**CO Amount**	**% of CO's**	**% of Contract $27,350,000**
A	OSHPD Request	21	$598,882	10.64%	2.19%
B	District Request	9	$330,323	5.87%	1.21%
C	Sharp Request	33	$1,065,800	18.94%	3.90%
C-1	CO #71	1	$416,399	7.40%	1.52%
D	Unforeseen Conditions	33	$238,277	4.23%	0.87%
E	Contractor Request	5	$583,807	10.38%	2.13%
F	A/E Revisions	126	$2,393,270	42.53%	8.75%
	TOTAL	**228**	**$5,626,758**	**100.00%**	**20.57%**

Observations

There have been 220 change orders logged to date with 8 additional change orders classified as shared responsibility. The overall change order rate was 20.57% of the original contract sum. This far exceeds the standard we would expect on a project of this nature. The majority of changes were the result of A&E revisions. As the chart shows, approximately 42.0% of the number of change orders and costs were the result of A&E revisions. Since the District did not break down these changes and identify errors and omissions we could not tell how these have been evaluated. Additionally, during the first year of construction approximately $663,473 of change orders were the result of OSHPD back check comments, contract addenda incorporated post-bid, or updated deferred approvals of systems. These were items which likely would have been included in a completed bid set had OSHPD approval been received in a timely fashion prior to bid and is a major explanation of the variance.

Recommendation 7.5:

In the future the Program Manager should track Architect/Engineers errors and omission as a separate reason code category.

Because errors and omissions can be costly to the District we believe that not only tracking them would be beneficial but that contract language should be considered to alert Architects/Engineers of the standard of care expected of professional services. AFC is familiar with language which is used by another state agency and offers the following for consideration:

Recommendation 7.6:

In the future the District should consider adding the following language to A/E contracts:

> ***Expected Standard of Care for Errors and Omissions***
>
> ***The District recognizes and acknowledges that liability attaches only when the Architect/Engineer's act or failure to act falls below a "standard of care" applicable to design professionals in the same or similar circumstances.***
>
> ***A determination of "standard of care" is a judgment call that will vary depending upon individual project circumstances. For the purposes of this Agreement, the District shall consider incurred costs due to errors and omissions by the Architect/Engineer of up to three percent (3%) of the initial awarded construction cost as being within the " standard of care". The incurred costs due to errors and omissions above this range shall cause the District to progressively consider actions to recover damages.***
>
> ***In determining valuations, "omissions" will be calculated at a rate of 20% of the change order costs to provide the respective missing element whereas "errors" will be calculated at the full change order value to correct the condition.***

D. Sampled Change Orders

AFC sampled ten (10) change orders totaling $1,655,448 or approximately 30.0% of the total population. Change orders sampled ranged from $8,973 to $500,000 in value. We reviewed the change orders to see if the appropriate approval was received and signatures affixed to the change order and if the backup was sufficiently detailed and documented.

Observations

Of the change orders we sampled, the Program Manager and District followed the signature of authority delegation as assigned by the Board. The CEO signed all change orders. If there was a change order in excess of $25,000 the memo to the Board was attached to the documents. Although there is no signature required from the Board or GO Bond Committee on the change order or included with the change order documentation, we assume that approval of the

change was granted at a formal meeting. Two (2) of the change orders we reviewed were in excess of $250,000 and would have also required the review of the ICBOC, however the change order documents contained no memo to the ICBOC or back up indicating that those changes were reviewed. In several cases a Proceed Order was necessary to continue the work while a price was being negotiated. Proceed orders were attached to the change order documents when those directives were given.

With most contract situations the architect is responsible for preparing change orders and reviewing cost. In the case of this project we believe Parsons provided estimates and prepared the change orders. None of the change orders we reviewed had the signature of the architect on the formal change order. Most agencies require that the architect sign the change order. Under an architectural agreement he is responsible for making decisions, giving recommendations, and leaving the responsibility to others. While the Owner is the ultimate person who makes the decision and signs the change order the architect should indicate his approval as well. A change order should stand on its own as a separate contract document. Without an architect's signature the Owner cannot tell if the architect agrees with the price, has reservations, or in the case of an error and omission, disagrees with it as his responsibility.

Recommendation 7.7:

The PMT should require that the signature of the architect be affixed to all change orders

E. Documentation, Estimating & Contractor Mark up

Adequately documenting change orders is an area that can also be problematic. Documentation should include an explanation of what additional work is necessary and why. We look to see that the documentation included in the file is adequate and justifies the change order properly.

Estimating the cost of the change is another challenging area. Often language in the contract stipulates the basis for estimating changes. Occasionally a standard is established at the beginning of the work and agreement is reached by the mutual parties if no standard is published in the documents. The District was fortunate to have Parsons and the PMT capable of validating estimates provided by the contractors.

Contractor mark up on change orders is also stipulated in the contract, General Conditions or Supplemental General Conditions. In the case of the ED/CCU project the General Contractor was allowed to mark-up his self performed work by 15% and to mark up the work by sub-contractors by 5%. Sub-contractors were allowed to mark-up their work by 15%. Both were allowed to add 1% for bonds and 1% for liability insurance. An agreed upon daily rate for General Conditions cost is established for extended time on the project. In the case of the ED/CCU project, the agreed upon GC rate was $4027/day.

Observations

From the sampled change orders we evaluated we found the following:

- Change Orders (# 69 & # 70R1) contained a cover sheet indicating the final change order price but the backup contained extended General Conditions which did not match the signed change order. It appears that the PMT disallowed the additional days when the final change order was approved but did not include a back up sheet recalculating this change. CO #69 was for $500,000 and CO #70R1 was for $136,000.
- Change Order #8 for $81,413 was for various RFI's associated with Headwall revisions. The file was not well documented with the entire backup supporting the change. While this back up may have been included in other proposed change orders or been documented elsewhere it should be included in the final change order file. We also noted an error in the calculation of one sub-contractors cost in the favor of the District.
- Change Order #51 for $79,765 associated with door security wiring contained a quote from the primary sub-contractor. This appeared to be a proposal based on an RFQ issued by the General Contractor. The backup contained no breakdown of materials and labor and insufficient detail to ascertain if the costs or allowable mark up were legitimate. We assume that the PMT estimated this work to verify the quote but found nothing in the file.
- A similar circumstance was found with CO #71 for $416,399 associated with the Telephone and Data system where a lump sum quote was received on 5/22/08 based on an RFQ. No breakdown was given for the work. Had there been a dispute regarding labor or materials or changes in this work after the change order was authorized it would have been difficult to interpret. While this could be considered as a "mini-bid" it should be treated as a separate contract under the same conditions as the main contract.
- Change Orders #45 for $170,000, CO #85 for $148,742, CO #173 for $32,120, and CO #175 for $8,978 which were reviewed all seem to have adequate backup and documentation. In one case work was authorized on a Time & Materials basis and time tickets were attached and verified by the PMT. In another an estimate by the PMT was found to be greater than the quote given by the General Contractor and the lesser value was taken.
- Change Order #44R3 for $87,036 was authorized for MEP coordination. We noted that in reviewing one sub-contractors estimate that charges were made for sundries, safety meetings, as-built drawings/engineering, storage, and cartage/handling. These items when added to the cost of the change amounted to an additional 4.6%. We would normally disallow these types of cost in contract provisions and exclude those from the contract.

As a result of our review of change orders we have the following recommendations for consideration:

Recommendation 7.8:

On future projects consider maintaining all change order documentation in one file with all original estimates and revised backup attached

Recommendation 7.9:

On future projects ensure the mathematical accuracy of all change order calculations by sub-contractors and suppliers

One way we have found to eliminate mathematical errors and insure that only the allowable costs are utilized is to develop a standard change order form that must be used by all General Contractors and sub-contractors. This can be an Excel format which automatically calculates the costs and restricts entries to only those costs which are allowable under the contract.

Recommendation 7.10:

On future projects consider developing contract language which defines the allowable costs to be added to change orders by sub-contractors

7. PROJECT SUMMARY COSTS:

AFC prepared a chart to show the total project costs to date and to highlight areas of interest:

ED/CCU 2-4-5 BUILD OUT					
CONSTRUCTION CATEGORY	COST ($)	CHANGE ORDERS	TOTAL COST	CO (%) OF COSTS	% OF HARD COSTS
HARD CONSTRUCTION COSTS:					
Contract Construction Cost	$27,350,000	$5,626,758	$32,976,758	20.57%	
Other Construction	3,000.00	(2,000.00)	1,000.00	-66.67%	
Sub-Total Hard Construction Costs	**$27,353,000**	**$5,624,758**	**$32,977,758**	**20.56%**	
SOFT COSTS:					
Architect/Engineering	$1,005,760	$205,553	$1,211,313	20.44%	3.67%
Program/Project Mangement	1,200,778	202,040	1,402,818	16.83%	4.25%
Sharp Reimbursement	3,021,607	0	3,021,607	0.00%	9.16%
Testing	192,182	131,420	323,602	68.38%	0.98%
Inspector of Record	250,000	472,054	722,054	188.82%	2.19%
Other Soft Costs	196,674	0	196,674	0.00%	0.60%
Sub-Total Soft Costs	**$5,867,001**	**$1,011,067**	**$6,878,068**	**17.23%**	**20.86%**
Equipment Costs	**$1,041,428**		**$1,041,428**	**0.00%**	**3.16%**
TOTAL PROJECT COSTS	**$34,261,429**	**$6,635,825**	**$40,897,254**	**19.37%**	
Hard Cost % of Project	79.84%		80.64%		
Soft Cost % of Project	17.12%		16.82%		
Equipment Costs % of Project	3.04%		2.55%		
	100.00%		100.00%		

Several interesting overall outcomes are worth reporting:

- We have previously reported that the Change Order rate for the overall project was 20.57% which is exceedingly high.
- The SSA's issued against the A/E contract as extra services were 20.43% of the original contract fee. We understand that some of the costs reimbursed to Sharp included over $825,845 in previously paid architectural fees. On the whole, this is not reflected in the actual percentage of A/E fees shown above as 3.67%. Were it included the A/E fees would have been 6.08% which is a normal range.
- Testing services as a percentage of total hard costs was 0.98%. This falls within a range we normally find on projects of this nature that range being between 0.5 and 1.5% of hard costs.
- Inspector of Record cost at 2.18% of hard costs is slightly higher than we would anticipate for the project. Inspector of Record costs normally range between 1.0 - 2.0% of hard costs.
- Program Management costs were 4.25% of hard costs. Coupled with the reimbursements paid to Sharp, overall PM costs were 13.4%. If the cost of A/E services, fees paid to OSHPD, and equipment purchased and reimbursed to Sharp be taken out the total costs, it would have been in the range of 6.0 to 10.0% which we found to be normal.
- The overall ratio of hard costs (construction) to soft costs (administration & services) was roughly 80/20. We often find this ratio to be upward of 70/30 in many projects, therefore we conclude that the District did not spend excessive funds on administering the project.