

**Marin General Hospital
Hillside Parking Structure Project**

Close-Out Construction Cost Audit and Controls Review

November 16, 2016

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Mr. James McManus
Chief Financial Officer
Marin General Hospital
100B Drakes Landing Road, Suite 250
Greenbrae, CA 94904

Subject: Hillside Parking Structure Project Close-Out Construction Cost Audit and Controls Review

Dear Mr. McManus:

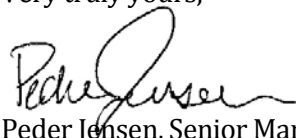
Thank you for the opportunity to perform the close-out construction cost audit and project controls review for the Hillside Parking Structure Project. This report summarizes the results of our close-out review.

This engagement was performed in accordance with Standards for Consulting Services established by the American Institute of Certified Public Accountants as outlined in our professional services agreement dated May 6, 2016. The scope of this engagement is outlined in the body of our report. This report was developed based on information from our review of construction project documentation and records.

This report is intended solely for the use of Marin General Hospital. Moss Adams LLP does not accept any responsibility to any other party to whom this report may be shown or into whose hands it may come.

We appreciate the opportunity to help you continuously improve your construction program performance. Please do not hesitate to contact me at (360) 334-0239 if you have any questions or need further assistance regarding this important matter.

Very truly yours,



Peder Jensen, Senior Manager
for Moss Adams LLP

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EXECUTIVE SUMMARY

The Marin General Hospital Hillside Parking Structure Project (Project) close-out construction cost audit identified noncompliance with contract requirements, potential duplicated costs, and future improvement opportunities to strengthen controls. Our review resulted in \$43,138 of questioned and unsupported costs. Questioned costs are charges that are not allowable per the Design-Build Agreement (Agreement or Contract) between Marin General Hospital and McCarthy Building Companies, Inc. Unsupported costs are costs billed to the Project that lack the proper supporting documentation to verify that the charges are applicable to and allowable for the Project.

For the purposes of the close-out construction cost audit, Marin General Hospital is referred to as “Marin General” or “Owner,” McCarthy Building Companies, Inc. is referred to as “McCarthy” or “Contractor,” Vertran Associates, LLC is referred to as “Vertran” or “Owner’s Representative,” and Moss Adams LLP is referred to as “Moss Adams,” “we,” or “our.”

A. Summary of Good Practices

The following are good practices implemented by the Project team as noted during the close-out construction cost audit:

- 1) The Contractor competitively bid all subcontracts, obtaining three bids, where possible, to ensure competitive pricing for trade work.
- 2) The Contractor, the Owner’s representative, and the Owner have established approval processes for change orders, allowance usage, contingency expenditures, and cost transfers.
- 3) Weekly Owner, Architect, and Contractor meetings were held to discuss project status, schedule, and cost.
- 4) Vertran held regular meetings with the Marin General CEO and CFO to discuss scope, schedule, and cost, allowing for greater transparency between the Owner and the Owner’s Representative acting on its behalf.
- 5) The Contractor has been receptive to audit recommendations and expressed a willingness to improve processes, as necessary, for future projects.

B. Audit Observations

The table below lists the questioned and unsupported costs identified during our review. Summary observations and future improvement opportunities have been provided below.

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Observation	Questioned/Unsupported Costs and Project Controls	Costs Charged
1	Questioned Subcontractor Overhead and Profit Markups	\$19,434
2	Questioned Insurance Markups	13,169
3	Questioned Allowance Costs	9,710
4	Questioned Contractor Self-Performed Work Costs	825
5	Monthly General Conditions	N/A
6	Subcontractor Hourly Wage Rates	N/A
7	Project Reporting Controls	N/A
8	Excessive Contractor Fee	N/A
Total Questioned and Unsupported Costs		<u>\$43,138</u>

Questioned/Unsupported Costs

- 1) **Questioned Subcontractor Overhead and Profit Markups** – The Contractor did not obtain support for subcontractor labor and equipment rates charged to determine if rates were inclusive of overhead and profit markups, resulting in \$19,434 of questioned costs. Project documents included varying language regarding the inclusion and exclusion of overhead and profit within subcontractor labor and equipment rates. However, the Contractor did not obtain an itemized breakdown of labor and equipment rates to be included within change order work to verify the exclusion of overhead and profit that was subsequently included within change orders, resulting in \$19,434 of questioned costs (see Observation No. 1 in the report body).
- 2) **Questioned Insurance Markups** – The Contractor charged insurance markups for change order work that exceeded insurance rates for base contract work, resulting in \$13,169 of questioned costs. Insurance rates applied for general liability insurance, builder’s risk insurance, and McCarthy contractor default insurance within the base contract were lower than those applied to change order work. The contract did not specify any increases in insurance markups for change order work, resulting in the \$13,169 of questioned costs (see Observation No. 2 in the report body).
- 3) **Questioned Allowance Costs** – The Contractor billed insurance and fee markups when utilizing allowances, resulting in an estimated \$9,710 of questioned costs. Per Article 7.0.1.2(c) of the contract, allowances included within the guaranteed maximum price (GMP) were to include “Contractor’s cost for...labor, installation costs, overhead, profit and other expenses contemplated for stated Allowances amounts shall be included within the Allowances.” As described within the contract

language, all costs for insurances and overhead and profit (fee) are to be included within the allowance value and therefore the billing of these amounts separately would result in duplicate cost to the Owner (see Observation No. 3 in the report body).

- 4) **Questioned Contractor Self-Performed Work Costs** – Contractor self-performed labor rates included within Cost Issue (CI) No. 21 and 132 were in excess of those allowable per the Project Stabilization Agreement and the applicable union agreements, resulting in \$825 of questioned costs. Rates charged for laborer foremen within CIs ranged from \$5.54 to \$21.64 per hour higher than the allowable rates (see Observation No. 4 in the report body).

Project Controls

- 5) **Monthly General Conditions** – The Contractor has billed a monthly lump sum amount for general conditions (\$83,625) rather than charging actual costs incurred for labor, supplies, and services. While Article 14.0.6.1 and 14.0.6.2 define the Cost of the Work as “cost necessarily and actually incurred by the Contractor in performance of the work,” it was agreed upon between the Owner, the Owner’s Representative, and the Contractor that the interpretation of the contract allowed for fixed general conditions. A total of \$1,255,262 of general conditions costs had been billed through June 30, 2016, based upon the monthly lump sum rate established at the beginning of the Project (see Observation No. 5 in the report body).
- 6) **Subcontractor Hourly Wage Rates** – Subcontractor hourly rates utilized within change order work were not evaluated by the Contractor to determine compliance with allowable costs per the construction contract. Subcontracts were not evaluated for allowable cost components such as overhead and profit prior to execution, which may have resulted in duplicated costs to the Owner (see Observation No. 6 in the report body).
- 7) **Project Reporting Controls** – Project reporting could be enhanced to provide greater transparency of project dollars. Currently, it is unclear when contingency or allowances are being used to offset costs within CIs. Additionally, allowance and contingency expenditures are not itemized within the CI Log, which inhibits the ability to track costs from inception (i.e., subcontractor change order, allowance usage, contingency expenditure, etc.) through execution of a CI (see Observation No. 7 in the report body).
- 8) **Excessive Contractor Fee** – CIs submitted to the Owner for change order work included a fee in excess of that allowable per the Contractor’s bid and original schedule of values. The base contract fee for the Project was 2.5 percent. However, change order work included a 5 percent Contractor fee as allowable per Article 14.0.5.3 of the contract. Typically, the Contractor fee on change order work is consistent with the base contract fee allowed. If the 2.5 percent fee had been utilized in lieu of the 5 percent fee applied for change order work, the Owner would have saved \$21,352 in excess fees (see Observation No. 8 in the report body).

OBJECTIVE AND SCOPE

The primary focus of the close-out construction cost audit was to evaluate construction project controls and to review construction expenditures for the Project to determine their reasonableness and adherence to terms of the construction contract. This report reflects practices observed and cost documentation reviewed (see Appendix A for additional details) through June 30, 2016. Specific coverage was provided in the following areas:

- Reviewed payment documentation and calculations to assess adequacy of supporting documentation.
- Assessed internal controls surrounding Contractor's processes.
- Reviewed contract terms and identified sensitive accounts for examination of unallowable costs.
- Analyzed change orders.
- Reviewed reimbursable labor expenditures.
- Reviewed allowance and contingency expenditures including approval processes.
- Analyzed direct costs including subcontractor costs and reimbursable supplier/vendor costs.
- Assessed reasonableness and basis for fixed general conditions billed.
- Reviewed lien release and insurance documentation.
- Performed fee testing.
- Performed other testing procedures as necessary.
- Conducted interviews as necessary (see Appendix B for additional details).

PROJECT OVERVIEW

Effective June 4, 2014, a Design-Build Agreement with a Guaranteed Maximum Price (GMP) contract was executed for the construction of the Hillside Parking Structure Project (Project). The Project is a parking garage on the northeast quadrant of the Marin General Hospital campus with approximately 415 parking spaces. The structure is six stories above ground and 57 feet tall with retaining walls on two sides. The Project also includes a surface lot that will be further developed in the future to allow for additional parking. The GMP contract value as of June 30, 2016, was \$21,811,370 including change orders.

We performed this review using the most current Contractor payment application, which was Payment Application No. 17 through June 30, 2016. Costs reviewed included the Project budget and actual expenditures through June 2016. The following table provides a summary of the Project billings:

Cost Category	Contract Amount	Amount Billed	Percentage Complete	Cost Reviewed Through June 30, 2016	Percentage Reviewed
McCarthy Self-Performed Work, Subcontractor Work and Change Orders	\$18,685,070	\$18,282,047	98%	\$15,580,202	85%
General Conditions ¹	1,255,262	1,255,262	100%	1,255,262	100%
Allowances	290,328	199,391	69%	119,032	60%
Contingency	606,938	467,768	77%	450,071	96%
Insurance ²	399,134	395,226	99%	395,226	100%
Fee ²	<u>574,638</u>	<u>574,149</u>	100%	<u>574,149</u>	100%
Total	<u>\$21,811,370</u>	<u>\$21,173,843</u>	97%	<u>\$18,373,942</u>	87%

¹ General Conditions were billed by McCarthy based upon a fixed monthly amount. The components of the monthly estimate were reviewed as was compliance with maximum amounts billable each month and in aggregate to ensure costs billed did not exceed those allowable per the schedule of values.

² General Liability Insurance (GLI), Builder's Risk Insurance (BRI), McCarthy Contract Default Insurance (CDI), and fee were billed based upon a percentage of the cost of work defined by the contract and payment applications. Percentages were verified for accuracy and correct application when billed within payment applications.

DETAILED OBSERVATIONS AND IMPROVEMENT RECOMMENDATIONS

This report section provides a summary of our detailed construction audit observations, risks, and recommendations. The following audit observations have been ranked as high, medium, or low priority based upon our analysis and experience with respect to probability and potential impact on the construction project cost, schedule, and scope goals. The below observations and recommendations reflect the Project status at the time of this review. The following matrix contains our assessment of conditions, criteria, cause, consequences, risk level, and improvement recommendations, prioritized by risk level. Observations below that were Exceptions were rated high (H), medium (M), and low (L) for their risk level.

No.	Condition/Observation	Criteria/Standard	Cause	Consequence/Risk	Risk Level	Recommended Improvements/Corrective Actions	Management's Action Plans
1	Questioned Subcontractor Overhead and Profit Markups – Subcontractor hourly labor rates and equipment rates utilized within change order work included unallowable overhead and profit markups, resulting in \$19,434 of questioned costs. As part of our audit testing, we reviewed costs for six subcontractors. Two subcontracts, for Ghilotti Construction and Westco Iron Works, included Exhibit 1 Section VII, which stated that labor rates are “all-inclusive” for the Subcontractor and Subcontractor’s lower tier Subcontractors and will “include all profit and overhead (including, but not limited to, management, supervision, engineering, services, consumables, supplies, tools...insurance, taxes, licenses, permits, profits, overhead (both jobsite and home office), fees and all other items, tangible or intangible.” Similarly, Exhibit 1	Exhibit 1 Section VIII of Ghilotti Construction and Westco Iron Works subcontracts.	Noncompliance with subcontract terms identified within Exhibit 1 Section VIII.	Payment of unallowable or excessive subcontractor labor and equipment costs, including but not limited to overhead and profit.	H	<p>The Contractor should provide supporting documentation to show that overhead and profit was excluded from subcontractor labor and equipment rates included within CIs. Absent this documentation, the Contractor should provide a \$19,434 credit to the Owner.</p> <p>Contractor Response: The McCarthy Additional Subcontractor Conditions was provided to all of the subcontractors at bid time with instructions as to how the project was to be bid. Section # 35, located in this document, provides the rules in regards to how change orders were to be priced. This section indicates that labor and equipment rates are not to include anything other than direct labor, payroll burden, insurance, and taxes.</p>	<p>Responsible party: Vertran and CFO</p> <p>Due date: July 1, 2017</p> <p>Plan of action: Management and Vertran will implement a process to review select subcontractor CIs to ensure that the Contractor has reinforced its bid instructions and review process.</p> <p>At MGH 2.0 Project – McCarthy and the Owner’s team to work with Contractor already under contract to exclude overhead and profit from their unit rates and to</p>

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No.	Condition/Observation	Criteria/ Standard	Cause	Consequence/ Risk	Risk Level	Recommended Improvements/ Corrective Actions	Management's Action Plans
	<p>Section VIII of these contracts also stated that equipment rates include “all fuel, maintenance, profit and overhead.”</p> <p>While the other four subcontracts excluded this language and McCarthy’s Additional Subcontractor Conditions provided to the subcontractors at the time of bid stated that rates were to exclude overhead and profit, McCarthy did not verify that labor and equipment rates excluded overhead and profit. This is a best practice during subcontractor procurement and also essential in this particular instance where Project documents included contradictory language. While subcontracts allow for 15 percent overhead and profit on subcontractor performed work, it cannot be determined if 15 percent overhead and profit has already been included within the labor and equipment rates charged and therefore \$19,434 has been questioned as detailed within Appendix C.</p>					<p>Overhead and profit were to be calculated separately. In addition, Article 4 (4.6) of the subcontract agreement provides provisions for overhead and profit as well.</p> <p>Our subcontract language in the Exhibit 1 section is written in error and it has now been pointed out to McCarthy's contracts department that the subcontractors were instructed to price change orders per section # 35 of the Additional Subcontractor Conditions, which meant that overhead and profit was not to be included within labor and equipment rates.</p>	<p>establish a baseline.</p> <p>Subcontractors that are not currently under contract will be made consistent to exclude overhead and markup at unit rates to establish baseline rates.</p>

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No.	Condition/Observation	Criteria/Standard	Cause	Consequence/Risk	Risk Level	Recommended Improvements/Corrective Actions	Management's Action Plans												
2	<p>Questioned Insurance Markups – The Contractor's general liability and builder's risk insurance and McCarthy Contractor Default Insurance (CDI) markups included within change orders were in excess of allowable Project insurance markups, resulting in \$13,169 of questioned costs. Base contract work included general liability insurance (GLI) at 0.867 percent, builder's risk insurance (BRI) at 0.405 percent, and CDI at 1.225 percent. However, insurance markups when applied to change order work exceeded those included within the base contract amount. Below are allowable insurance markups and actual markups applied within change orders:</p> <table><tr><th>Type</th><th>Base Contract Markup Applied</th><th>Change Order Markup Applied</th></tr><tr><td>GLI</td><td>0.867%</td><td>1.00 – 1.50%</td></tr><tr><td>BRI</td><td>0.405%</td><td>0.50 – 0.75%</td></tr><tr><td>CDI</td><td>1.225%</td><td>2.0%</td></tr></table> <p>The GLI markup of 0.867 percent was specified as the allowable rate per Article 14.0.6.2(g)(i) of the contract. The BRI and CDI markups were not specified within the construction contract and, therefore,</p>	Type	Base Contract Markup Applied	Change Order Markup Applied	GLI	0.867%	1.00 – 1.50%	BRI	0.405%	0.50 – 0.75%	CDI	1.225%	2.0%	Article 14.0.6.2(g)(i) of the Contract and Payment Applications.	Use of unspecified insurance rates	Over-estimation of insurance premiums, resulting in overpayment by the Owner.	H	<p>The Contractor should provide supporting documentation for the use of increased insurance rates for GLI, BRI, and CDI within change orders. Absent this documentation, the Contractor should provide a credit of \$13,169 to the Owner for unallowable insurance costs included within change orders.</p> <p>For future projects, the Contractor should review all change orders prior to submission for inclusion of allowable insurance markups.</p> <p>Contractor Response: Insurance markups applied to CIs should have been 0.867 percent or a percentage as agreed to by Marin General.</p>	<p>Responsible party: Vertran and CFO</p> <p>Due date: July 1, 2017</p> <p>Plan of action: Management and Vertran will implement a process to review select change orders to ensure that the Contractor has reinforced its process of reviewing for allowable insurance markups.</p> <p>McCarthy will refund the GLI in the amount of \$4,186 and CDI in the amount of \$5,698. McCarthy and Vertran will reconcile the Builder's Risk insurance based on actual cost.</p>
Type	Base Contract Markup Applied	Change Order Markup Applied																	
GLI	0.867%	1.00 – 1.50%																	
BRI	0.405%	0.50 – 0.75%																	
CDI	1.225%	2.0%																	

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No.	Condition/Observation	Criteria/ Standard	Cause	Consequence/ Risk	Risk Level	Recommended Improvements/ Corrective Actions	Management's Action Plans
	the insurance rates documented within the original schedule of values were utilized as the allowable markups. Typically, insurance markups do not vary between base contract and change order work and therefore it would be reasonable to utilize the same insurance rates as those established as part of the base contract. No documentation has been provided by the Contractor to support higher insurance rate markups for change order work, resulting in \$13,169 of questioned costs as identified within Appendix D.						
3	<p>Questioned Allowance Costs – The Contractor included markups for McCarthy CDI, GLI, BRI, and fee within its allowance usage, resulting in \$5,801 of questioned costs for allowances sampled. Per Article 7.0.1.2(c) of the contract, “Contractor’s cost for...labor, installation costs, overhead, profit and other expenses contemplated for stated Allowance amounts shall be included in the Allowances. Contractor’s overhead and profit for stated Allowances shall be included with Contractor’s overhead and profit line item in the Schedule of Values.” CI Nos. 70, 72, and 88 were allowance usages for rock removal and miscellaneous steel that included</p>	Article 7.0.1.2(c) of the contract	Noncompliance with Contract Article 7.0.1.2(c)	Payment of duplicated CDI, GLI, BRI, and fee for allowance usage.	M	<p>The Contractor should provide a \$5,801 credit to the Owner for duplicated CDI, GLI, BRI, and fee included within CIs No. 70, 72 and 88, which included allowance usage. Additionally, upon the Owner’s request, the Contractor should review all other allowance usage CIs for duplicated costs to fully quantify any additional credits due to the Owner.</p> <p>Contractor Response:</p> <p>1) CDI – No CDI amount was carried in Bid Package # 5 so this charge is valid.</p>	<p>Responsible party: Vertran and CFO</p> <p>Due date: July 1, 2017</p> <p>Plan of action: Management and Vertran will implement a process to review select CIs to ensure that the Contractor has reinforced its process of reviewing for duplicated costs.</p> <p>McCarthy will refund the overcharge on allowances in the</p>

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No.	Condition/Observation	Criteria/ Standard	Cause	Consequence/ Risk	Risk Level	Recommended Improvements/ Corrective Actions	Management's Action Plans
	<p>insurance markups as well as fees. The inclusion of these costs within allowance usage CIs has resulted in a duplicated cost to the Owner as they are included within the base contract value (see Appendix E for additional details).</p> <p>Supporting documentation for Bid Package No. 5 indicated a subcontractor that did not perform work on CI No. 70 and, therefore, cannot be utilized to substantiate the need for additional CDI cost within CI No. 70. In any case, as specified within Article 7.0.1.2(c) of the contract, insurance costs should be included within the allowance line item budget.</p> <p>In total, the Design-Build Agreement included \$290,328 of allowances, of which \$199,391 had been billed through Payment Application No. 17. As part of our audit, \$119,032 of allowance expenditures were sampled, resulting in \$5,801 of questioned costs. This questioned cost represents 4.87 percent ($\\$5,801 \div \\$119,032$) of the allowances sampled. Utilizing this information, we can project that approximately \$9,710 ($4.87 \text{ percent} \times \\$199,391$) of cost should be questioned related to duplicated allowance costs.</p>					<p>2) GLI – We agree that these should be zero.</p> <p>3) BRI – We believe these costs are valid since they pertain to change order work and the contract does not specify an allowable cost or BRI percentage.</p> <p>4) Fee – We agree that these should be zero.</p> <p>Total value of questioned cost should be \$5,210.</p>	amount of \$5,210.

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No.	Condition/Observation	Criteria/ Standard	Cause	Consequence/ Risk	Risk Level	Recommended Improvements/ Corrective Actions	Management's Action Plans
4	Questioned Contractor Self-Performed Work Costs – Labor costs billed for the Contractor's self-performed change order work within CI Nos. 21 and 132 were in excess of those allowable by the Project Stabilization Agreement and the applicable union agreements, resulting in \$825 of questioned costs. Hourly rates and fringe benefit costs billed for change order work greatly exceeded those allowable per the Northern California Labor Agreement rates established. Rates charged for laborer foreman within change order work ranged from \$5.54 to \$21.64 per hour higher than those listed within the union rate sheet (see Appendix F for additional details).	Northern California Labor Agreement Rates Effective June 29, 2015	Noncompliance with labor rates as specified per the Northern California Labor Agreement	Excessive labor costs for Contractor self-performed work within change orders.	M	<p>The Contractor should provide a credit of \$825 for unallowable labor costs within change orders. For future projects, the Contractor should implement controls to ensure that labor rates charged for base and change order work are consistent with those allowable per union rate sheets.</p> <p>Contractor Response: We agree that the total questioned costs should be \$825.44.</p>	<p>Responsible party: Vertran and CFO</p> <p>Due date: July 1, 2017</p> <p>Plan of action: Management and Vertran will implement a process to review select Cost Issues to ensure that the Contractor has reinforced its process of reviewing for allowable rates.</p> <p>McCarthy will refund the labor rate over charge in the amount of \$825.</p>

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No.	Condition/Observation	Criteria/Standard	Cause	Consequence/Risk	Risk Level	Recommended Improvements/Corrective Actions	Management's Action Plans
5	<p>Monthly General Conditions – The Contractor charged a fixed amount for general conditions within each monthly payment application rather than charging actual costs incurred for labor, supplies, and services as described within the contract. A monthly amount of \$83,625 was charged for general conditions, which consisted of approximately 93 percent labor and 7 percent other general conditions. Per Articles 14.0.6.1 and 14.0.6.2 of the contract, the Cost of the Work is based on “costs necessarily and actually incurred by the Contractor in performance of the Work.” As such, we expected to review actual cost data such as payroll reports, pay stubs, timecards, receipts, and invoices for general conditions costs billed each month. However, it was the intention of the Project team to bill general conditions at a lump sum amount within each payment application. While the contract language states that actual costs should be utilized for billing purposes, the Contractor, Owner, and the Owner’s representative discussed the use of fixed general conditions and agreed upon an allowable maximum to be charged each month prior to submission of the Contractor’s initial invoice.</p> <p>The cost reimbursable contract does</p>	Articles 14.0.6.1 and 14.0.6.2 of the contract	Discrepancy between contract language and the interpretation/intent of the contract language	Potential overpayment of general conditions costs.	M	<p>Future contracts should clarify any fixed costs allowable within billings. If deviations from contract language have been agreed upon between the Contractor, Owner, and its representative, this should be documented within a contract amendment or change order to accurately capture the approval of the deviation and properly incorporate it into the project documents.</p> <p>Prior to contract execution, a detailed review of the general conditions budget should be conducted and documented by the Contractor and Owner (or its designated representative) to ensure reasonableness of cost, necessity of all cost components (i.e., project management labor, supplies, services, etc.), and duration of fixed general conditions. Additionally, it should be determined, prior to contract execution, if general conditions are allowable for change order work and at what rate they will apply. It is important to determine the allowability of future general conditions when the fixed amount maximum has been reached and the project</p>	<p>Responsible party: Vertran and CFO</p> <p>Due date: July 1, 2017</p> <p>Plan of action: Vertran had reviewed the proposed fixed lump sum amount and deemed it to be reasonable given market rates. In addition, all parties had understood the agreement to be for fixed monthly lump sum amounts. However, the contract language did not reflect this understanding. Management and Vertran will ensure that the contract language is appropriately updated.</p> <p>Amendment has been executed for the Garage and in discussion for the MGH 2.0 project.</p>

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No.	Condition/Observation	Criteria/ Standard	Cause	Consequence/ Risk	Risk Level	Recommended Improvements/ Corrective Actions	Management's Action Plans
	not specify that lump sum billings are allowable. However, given the communication between the Owner, the Owner's representative, and the Contractor, it is understood that the intent may not have been properly reflected within contract language.					has not yet been completed. Contractor Response: General conditions were agreed to be based on a fixed monthly lump sum rate between McCarthy and the Owner's representative.	
6	Subcontractor Hourly Wage Rates – Subcontractor hourly wage rates utilized within change orders were not evaluated by the Contractor prior to execution of each subcontract to determine the rate components and their allowability per contract requirements. Subcontractor hourly rates and their components should have been evaluated as part of each subcontractor's bid package, factored into the selection process for all trade work, and finalized prior to execution of each subcontract. While subcontractor rates were reviewed for reasonableness when change orders were submitted, rates should be established early on to eliminate cost escalation and clearly identify cost components such as insurance, overhead, and profit.	Industry Best Practices	Contractor acceptance of incomplete labor documentation from its subcontractors prior to subcontract execution.	Payment of excessive subcontractor labor costs.	M	For future projects, the Contractor should require subcontractors to submit detailed hourly wage rate breakdown sheets in order to verify compliance with contract terms. Furthermore, subcontractor hourly rates should be reviewed by the Contractor and factored into the selection of each subcontractor to ensure fair pricing of all trade work. Contractor Response: This has been noted to the McCarthy team as an area of improvement moving into the Hospital Replacement Building (HRB) Project.	Responsible party: Vertran and CFO Due date: July 1, 2017 Plan of action: Management and Vertran will implement a process to review select CIs to ensure that the Contractor has reinforced its process of reviewing for allowable subcontractor rates. Unit rates will be requested for all subcontractors to establish baseline rates at the MGH 2.0 project.

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7	<p>Project Reporting Controls – The Contractor has established procedures for issuance of change orders and usage of allowance and contingency; however, enhancements to reporting could improve the execution of these procedures and clarity of project cost detail support. The following items were noted in review of change orders as well as contingency and allowance usage:</p> <p>a) Contingency expenditures and allowance usages were approved using CIs as agreed upon between the Contractor, Vertran, and the Owner. This can be clearly tracked within payment applications; however, it was not clear within CIs when allowances or contingency was being used to offset costs. Select CIs included handwritten reference to the use of contingency or allowances while others did not specify allowance or contingency cost impacts. This allowed for CIs to be executed without clearly identifying project funding for the requested change.</p> <p>b) The CI Log maintained by the Contractor does not track all project CIs or clearly identify how subcontractor change orders, cost issues and Owner change orders are related. In order to clearly understand the relationship of</p>	Industry Best Practices	Insufficient reporting of contingency and allowance expenditures.	Lack of transparency of project costs.	M	<p>The Contractor should implement additional controls to ensure that CIs utilizing contingency or allowances can be clearly identified.</p> <p>Improvements to the CI Log maintained by the Contractor, such as identification of each CI for the project, responsible party (i.e., Owner requested change, design change, etc.), its corresponding subcontractor change orders and/or Owner change orders and project funding source (i.e., allowance, contingency, etc.) would assist in the ability to track project costs and provide greater transparency in one concise document. This will become especially important for future projects where a shared savings plan is anticipated.</p> <p>Contractor Response: This has been noted to the McCarthy team as an area of improvement moving into the HRB project.</p>	<p>Responsible party: Vertran and CFO</p> <p>Due date: July 1, 2017</p> <p>Plan of action: Management and Vertran will collaborate with the Contractor to ensure that the reporting of CIs and related information is clear and consistent.</p> <p>At the MGH 2.0 project the CI cover page has been formatted to identify allowances if utilized to make the use of allowances more transparent.</p>

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No.	Condition/Observation	Criteria/Standard	Cause	Consequence/Risk	Risk Level	Recommended Improvements/Corrective Actions	Management's Action Plans
	these documents, the CI Log should be expanded to include details that will allow for subcontractor change orders, CIs and Owner Change Orders to be properly referenced and reconciled, where necessary.						
8	Excessive Contractor Fee – Costs Issues submitted to the Owner for change order work included fee in excess of that included within the Contractor's bid and original schedule of values. Fee was established for this project at 2.5 percent of the original budget per McCarthy's bid summary; however, per Article 14.0.5.3 of the contract, "Contractor may only mark up any Change Order Work of any of its Subcontractor by an amount not to exceed 5%." Moss Adams agrees that this contract language allowed the Contractor to obtain an additional 2.5 percent profit on all change order work. However, Contractor fee is typically consistent for base work and change order work. If Contractor change order fee markups had been consistent with the allowable fee per the base contract, the Owner would have saved \$21,352 in fee (see Appendix G for additional details).	McCarthy Bid Summary and Article 14.0.5.3 of the contract	Oversight of contract language regarding allowable fee on change order work.	Unnecessary increase in Contractor fee for change order work.	L	<p>Future contract language should be modified to ensure that Contractor fee on change order work does not exceed base contract fee.</p> <p>Contractor Response: The contract allowable fee on change order work is 5 percent per sections 14.0.3.3 (c), 14.0.5.1, 14.0.5.2, 14.0.5.3. There is no language in the contract that specified a 2.5 percent fee.</p>	<p>Responsible party: Vertran and CFO</p> <p>Due date: July 1, 2017</p> <p>Plan of action: In March 2015, prior to this audit, the MGH 2.0 contract with McCarthy was executed and set the fee on change orders at 3.25%, consistent with the original schedule of values.</p> <p>Management and Vertran will review future contract language for clarity and consistency.</p>

APPENDIX A: LIST OF DOCUMENTS REVIEWED

Documents reviewed for this audit are listed below:

- Design-Build Agreement between Marin General Hospital and McCarthy Building Companies
- Change Orders No. 1 through 7, including all supporting documentation
- Payment Applications No. 1 and 6 through 17
- Project Cost Detail Transaction Report through June 30, 2016
- Cost Issues Log
- McCarthy Labor Expenditure Report
- McCarthy General Conditions Monthly Lump Sum Cost Basis
- Project Stabilization Agreement
- CEA Carpenters Master Agreement for Northern California
- CEA Laborers Master Builders Agreement Northern California
- McCarthy Subcontract Status Report
- Retention Release Letters for the following subcontractors: Schnabel Foundation Company, Cornerstone Masonry Inc., Cable Moore Inc., North Bay Overhead Doors, Cabrillo Hoist, Performance Contracting Inc., and Stump & Sons.
- Third-Party Rental Equipment Log
- Insurance Certificates
- Final, Unconditional Lien Releases
- Safety Reports
- Final Inspection Request Forms for plumbing, electrical, mechanical and building inspection
- Temporary Certificate of Occupancy
- McCarthy Contractor Default Insurance Policy

- Sample documents for:
 - Reimbursable Labor: reviewed hourly worker time cards and applicable union rates
 - Direct Cost and Equipment: reviewed sampled direct cost invoices and check vouchers
 - Allowances: reviewed applicable Cost Issues containing sampled allowance usage
 - Contingency: reviewed applicable Cost Issues containing sampled contingency expenditures
 - Subcontractors:
 - Subcontractor samples included review of subcontracts, payment applications, all subcontractor change orders, bid summaries, and lien releases for Ghilotti Construction, Conco, Schetter Electric, Schnabel Foundation and Westco Iron Works

APPENDIX B: LIST OF PERSONNEL INTERVIEWED

The individuals interviewed for this review are listed below with their respective titles:

Name	Company	Title
Bob Parks	McCarthy Building Companies	Senior Project Manager
Gabrielle Nes Gatchalian	McCarthy Building Companies	Senior Project Coordinator
Ron Peluso	Vertran Associates	Owner's Representative
Jean Noonan	Marin General Hospital	Controller

APPENDIX C: QUESTIONED SUBCONTRACTOR OVERHEAD AND PROFIT MARKUPS

The following table provides details of unallowable overhead and profit markups, totaling \$19,434, applied to labor and equipment costs included within subcontractor change orders. Labor and equipment rates, as defined within subcontracts, contain all overhead and profit. However, additional markups were added to change orders that appear to represent a duplicated cost (see Observation No. 1 in the report body).

Subcontractor	SCO No.	CI No.	Labor Cost Charged	Questioned Overhead and Profit on Labor	Equipment Cost Charged	Questioned Overhead and Profit on Equipment	Total Questioned Overhead and Profit	Plus 5% Associated Contractor Markup	Total Questioned Cost	Comment
Conco	4	65	\$2,210.78	\$331.62	\$2,751.00	\$412.65	\$744.27	\$37.21	\$781.48	
Conco	5	60	\$1,481.44	\$222.22	–	–	\$222.22	\$11.11	\$233.33	
Conco	5	60	\$748.84	\$112.33	–	–	\$112.33	\$5.62	\$117.95	
Conco	5	60	\$830.24	\$124.54	–	–	\$124.54	\$6.23	\$130.77	
Conco	7	151	\$1,281.04	\$192.16	–	–	\$192.16	\$9.61	\$201.77	
Ghilotti Construction	2	12	\$628.00	\$94.20	\$416.32	\$62.45	\$156.65	\$7.83	\$164.48	
Ghilotti Construction	2	12	\$148.00	\$22.20	\$192.00	\$28.80	\$51.00	\$2.55	\$53.55	
Ghilotti Construction	3	13	\$268.00	\$40.20	\$74.00	\$11.10	\$51.30	\$2.57	\$53.87	
Ghilotti Construction	3	13	\$1,072.00	\$160.80	\$832.64	\$124.90	\$285.70	\$14.29	\$299.99	
Ghilotti Construction	3	13	\$1,340.00	\$201.00	\$148.00	\$22.20	\$223.20	\$11.16	\$234.36	
Ghilotti Construction	12	61	\$1,371.00	\$205.65	\$1,399.00	\$209.85	\$415.50	\$20.78	\$436.28	
Ghilotti Construction	13	122	\$2,637.00	\$395.55	\$392.00	\$58.80	\$454.35	\$22.72	\$477.07	
Ghilotti Construction	14	119	\$678.00	\$101.70	\$326.00	\$48.90	\$150.60	\$7.53	\$158.13	
Ghilotti Construction	14	119	\$630.00	\$94.50	\$634.00	\$95.10	\$189.60	\$9.48	\$199.08	
Ghilotti Construction	17	157	\$2,121.00	\$318.15	\$2,046.50	\$306.98	\$625.14	\$31.26	\$656.40	
Ghilotti Construction	19	125	\$3,248.00	\$487.20	\$3,064.00	\$459.60	\$946.80	\$47.34	\$994.14	

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Subcontractor	SCO No.	CI No.	Labor Cost Charged	Questioned Overhead and Profit on Labor	Equipment Cost Charged	Questioned Overhead and Profit on Equipment	Total Questioned Overhead and Profit	Plus 5% Associated Contractor Markup	Total Questioned Cost	Comment
Ghilotti Construction	19	125	\$904.00	\$135.60	\$172.00	\$25.80	\$ 161.40	\$8.07	\$169.47	
Schetter Electric	6	9	\$1,948.97	\$292.35	–	–	\$292.35	\$14.62	\$306.97	
Schetter Electric	10	19	\$937.04	\$140.56	–	–	\$140.56	\$7.03	\$147.59	
Schetter Electric	14	46	–	\$451.00	–	–	\$451.00	\$22.55	\$473.55	This CI was an alternate usage (ALT No. 4). Per Article V of Exhibit 1 of Schetter's subcontract, Alternates include, but are not limited to, overhead, profit, insurance, bonds, and all other items tangible or intangible. Questioned Cost is CDI, GLI and BRI as this is a duplicate cost.
Schetter Electric	15	47	\$2,948.53	\$442.28	–	–	\$442.20	\$22.11	\$464.31	
Schetter Electric	17	56	\$23,988.00	\$3,598.20	–	–	\$3,598.00	\$179.90	\$3,777.90	
Schetter Electric	19	85	\$3,270.57	\$490.59	–	–	\$490.59	\$24.53	\$515.12	
Schetter Electric	21	59 R1	\$6,497.64	\$974.65	–	–	\$974.65	48.73	\$1,023.38	
Schetter Electric	22	92	\$8,358.33	\$1,253.75	–	–	\$1,253.75	\$62.69	\$1,316.44	
Schetter Electric	22	92	\$5,829.23	\$874.38	–	–	\$874.38	\$43.72	\$918.10	

Marin General Hospital – Close-Out Construction Cost Audit and Controls Review

Subcontractor	SCO No.	CI No.	Labor Cost Charged	Questioned Overhead and Profit on Labor	Equipment Cost Charged	Questioned Overhead and Profit on Equipment	Total Questioned Overhead and Profit	Plus 5% Associated Contractor Markup	Total Questioned Cost	Comment
Schetter Electric	22	92	\$ 1,677.52	\$251.63	–	–	\$251.63	\$12.58	\$264.21	
Schetter Electric	23	57	\$1,934.77	\$290.22	–	–	\$290.22	\$14.51	\$304.73	
Schetter Electric	25	90	\$642.32	\$96.35	–	–	\$96.35	\$4.82	\$101.17	
Schetter Electric	26	102	\$2,479.52	\$371.93	–	–	\$371.93	\$18.60	\$390.53	
Schetter Electric	26	102	\$1,194.88	\$179.23	–	–	\$179.23	\$8.96	\$188.19	
Schetter Electric	30	152	\$963.48	\$144.52	–	–	\$144.52	\$7.23	\$151.75	
Schnabel Foundation	5	104	\$4,075.28	\$611.29	\$2,834.00	\$425.10	\$1,036.39	\$51.82	\$1,088.21	
Westco Iron Works	7	167	\$842.97	\$126.45	–	–	\$126.45	\$6.32	\$132.77	
Westco Iron Works	8	164	\$14,833.00	\$1,483.30	–	–	\$1,483.00	\$74.15	\$1,557.15	10% markup on labor rather than 15%.
Westco Iron Works	9	109	\$6,036.00	\$905.40	–	–	\$905.00	\$45.25	<u>\$ 950.25</u>	
Total									<u>\$19,434.41</u>	

Marin General Hospital – Close-Out Construction Cost Audit and Controls Review

APPENDIX D: QUESTIONED INSURANCE MARKUPS

The following table provides details of questioned General Liability Insurance (GLI), Builder's Risk Insurance (BRI), and McCarthy Contractor Default Insurance (CDI) costs included in change orders. Varying insurance markups were applied at rates higher than those specified within the contract or allowable per the original schedule of values, resulting in \$13,169 of questioned costs (see Observation No. 2 in the report body).

Change Order No.	Cost Issue No.	Total Direct Cost	GLI Billed ¹	GLI Allowable at 0.867%	Unallowable GLI	BRI Billed ²	BRI Allowable at 0.405%	Unallowable BRI	CDI Billed ³	CDI Allowable at 1.225%	Unallowable CDI	Total Unallowable Cost
(A)	(B)	(C)	(D)	(E) = (C × 0.867%)	(F) = (D – E)	(G)	(H) = (C × 0.405%)	(I) = (G – H)	(J)	(K) = (C × 1.225%)	(L) = (J – K)	(M) = (F + I + L)
3	67	\$ 14,521	\$ 145	\$ 126	\$ 19	\$ 73	\$ 59	\$ 14	\$ 178	\$ 178	–	\$ 33
4	101	64,759	648	561	87	324	262	62	793	793	–	148
5	118	17,523	175	152	23	88	71	17	–	–	–	40
6	110	15,677	157	136	21	78	63	15	192	192	–	36
6	113	6,372	64	55	9	32	26	6	78	78	–	15
6	132	3,421	34	30	4	17	14	3	–	–	–	7
7	N/A	<u>735,238</u>	<u>11,028</u>	<u>6,375</u>	<u>4,653</u>	<u>5,515</u>	<u>2,978</u>	<u>2,537</u>	<u>14,705</u>	<u>9,007</u>	<u>\$5,698</u>	<u>12,889</u>
Total		\$857,511	\$12,251	\$7,435	\$4,816	\$6,127	\$3,473	\$2,654	\$15,946	\$10,248	\$5,698	<u>\$13,169</u>

¹ GLI was billed at 1 percent for Change Orders No. 3 through 6 and 1.5 percent for Change Order No. 7.

² BRI was billed at 0.5 percent for Change Orders No. 3 through 6 and 0.75 percent for Change Order No. 7.

³ CDI was billed at 1.225 percent for Change Orders No. 3 through 6 and 2 percent for Change Order No. 7.

APPENDIX E: QUESTIONED ALLOWANCE COSTS

The following table provides details of unallowable duplicated allowance costs. Per Article 7.0.1.2(c) of the contract, allowances included within the contract value were to include all associated costs and therefore adding McCarthy insurance and fee markups represents duplicated costs of \$5,801 for allowance usage Cost Issues No. 70, 72, and 88 (see Observation No. 3 in the report body).

	Cost Issue No. 70	Cost Issue No. 72	Cost Issue No. 88 ¹	Total Questioned Cost
(A)	(B)	(C)	(D)	(E)
Direct Cost	\$14,736	\$1,308	\$72,893	\$ 0
McCarthy CDI at 1.225%	157	0	0	157
General Liability Insurance at 1%	128	11	729	868
Builder's Risk Insurance at 0.5%	64	6	364	434
Fee at 5%	<u>641</u>	<u>56</u>	<u>3,645</u>	<u>4,342</u>
Total	\$15,726	\$1,381	\$77,631	<u>\$5,801</u>

¹ Based on percentage allocation of 34.8 percent for actual allowance usage of total CI No. 88 cost.

APPENDIX F: QUESTIONED CONTRACTOR SELF-PERFORMED WORK COSTS

The following table provides details of self-performed labor costs billed by McCarthy within Cost Issue Nos. 21 and 132 that exceeded those allowable per the Northern California Labor Agreement, resulting in \$825.44 of questioned costs (see Observation No. 4 in the report body).

Cost Issue No.	Employee Name	Employee Title	Hours	Hourly Rate Charged	Fringe Benefits and Taxes Charged	Total Hourly Rate Charged	Allowable Hourly Rate ¹	Allowable Fringe Benefits and Taxes ²	Allowable Hourly Rate	Variance Per Hour	Total Questioned Costs
(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)	(J)	(K) = (G – J)	(L) = (D × K)
21	Bryan Allen	Labor Foreman	24	\$34.83	\$25.97	\$60.80	\$33.17	\$22.09	\$55.26	\$ 5.54	\$132.96
132	Unknown	Labor Foreman	32	\$45.77	\$31.13	\$76.90	\$33.17	\$22.09	\$55.26	\$21.64	<u>\$692.48</u>
Total											<u>\$825.44</u>

¹ Allowable hourly rates include base rate (\$30.54) plus vacation and supply dues (\$2.63) per the Northern California Laborer's union rate sheet.

² Allowable fringe benefits and taxes are representative of fringes included within the Northern California Laborer's union rate sheet (\$18.57) plus 7.65 percent for FICA.

APPENDIX G: EXCESSIVE CONTRACTOR FEE

The following table provide details of potential savings on change order fee had contract language been modified. The Contractor initially bid the job with 2.5 percent fee. However, when the contract was executed, Article 14.0.5.3 allowed for a 5 percent Contractor fee on change order work. Traditionally, the fee does not increase for change order work. If the fee had remained consistent at 2.5 percent for base work and change order work, the Owner would have saved \$21,352 (see Observation No. 8 in the report body).

Change Order No.	Cost Issue No.	Fee Charged at 5%	Fee Charged at 2.5%	Variance
3	67	\$ 726	\$ 363	\$ 363
4	101	3,238	1,619	1,619
5	118	876	438	438
6	110	784	392	392
6	113	318	159	159
7	140	<u>36,762</u>	<u>18,381</u>	<u>18,381</u>
Total		\$42,704	\$21,352	<u>\$21,352</u>