



Oregon State Hospital Replacement: Good Construction Management Practices Help Protect State Investment

Executive Summary

The Oregon Department of Human Services is in the early stages of constructing two new state psychiatric facilities to replace the outdated Oregon State Hospital. The Oregon State Hospital Replacement Project (OSHRP) is expected to cost approximately \$458 million.

Given the large size of this state investment, we performed this audit to provide early feedback on how well the department is controlling project costs and risks. Specifically, we reviewed whether the department has processes to ensure contract payments, amendments and change orders are in line with applicable rules, contract terms and best practices. We also reviewed whether contractor selections were in accordance with public improvement contract laws.

We found the department has implemented good contract management practices that should help

protect the state's investment by controlling costs and risks. The department performed three main actions that led to its success to date:

1. Assembled an experienced project team
2. Established clear expectations with project contractors
3. Managed contracts to control project costs and risks

We also found that the department selected its contractors in accordance with public improvement contract laws.

AGENCY'S RESPONSE

The Department of Human Services generally agrees with the audit conclusions included in the report. The department's specific response to our recommendation can be found on page 3.

Audits Division

Kate Brown, Secretary of State

Secretary of State Audit Report



Artist's Rendition of The New State Hospital in Salem

Introduction

The \$458 million Oregon State Hospital Replacement Project (OSHRP) is a seven-year project to build two new state psychiatric facilities in Salem and Junction City.

These state-operated facilities will deliver treatment and care to three types of patients: adults found guilty of a crime except for insanity, adults whose mental illness causes them to be a danger to themselves or others, and adults who need mental health treatment until they are prepared to participate in their own defense at trial.

The new facilities will utilize a “centralized” treatment model where patients and staff will engage in treatment and other activities away from the living units, but still within a secure area. This treatment model is a shift from the traditional approach where treatment and other activities take place within the patient’s living area.

The hospitals will consist of renovated historic buildings and new buildings containing areas for patient housing, staff offices, counseling and treatment rooms, and indoor and outdoor recreation.

For construction of the facilities, the department is utilizing a construction manager/general contractor approach, in which construction management and general construction services are provided at a price not to exceed a maximum amount. The department also contracted with an engineering and construction firm to serve as the project manager that oversees the general contractor and construction activity.

Audit Results

We found the department has implemented good contract management practices that should help protect the state’s investment by controlling project costs and

risks. The department performed the following three principal actions that led to its success to date:

1. Assembled an experienced project team
2. Established clear expectations with project contractors
3. Managed contracts to control project costs and risks

We also found that the department selected its contractors in accordance with public improvement contract laws.

Experienced Team Manages Project

The first reason for the department’s success to date is that it assembled an experienced project team to manage and monitor the construction project.

A key element of an effective framework for project management is an experienced project team with clearly established roles and responsibilities, and the skills and authority needed to carry out assigned responsibilities.

Department officials recognized the project’s large size and significance, and assembled a team of department employees and consultants with a wide range of experience in construction contracting, project management, and psychiatric treatment. For example, the project administrator has experience in managing large construction projects and budget administration, and previously worked in a psychiatric care facility. Additionally, the consultant hired to provide technical and managerial assistance has over 30 years experience operating and building state facilities.

The department also clearly defined each team member’s roles and responsibilities. For instance, the department developed a Project Procedures Manual and a checklist of individual responsibilities for use when reviewing contractor

payment requests. The checklist, for example, requires that the project manager review reimbursable expenses and the project accountant confirm the calculations contained in payment requests.

Contractor Expectations Are Clear

The second reason for the department’s success to date is the clear expectations it established with contractors early in the project. The department detailed these expectations in contracts and payment documentation requirements.

Department officials developed and signed formal contracts containing detailed terms and conditions, which should assist the department in protecting the state’s interest. For example, the contracts contained a clearly defined scope of work, measurable deliverables, a system to authorize major changes, and specific allowable fees and reimbursable costs. Also, the contract with the project manager contained a list of key project staff, their allowable hourly rates, and required that timesheets be submitted for all hours billed.

In addition, after reviewing the first contractor payment requests, department officials clarified documentation requirements for reimbursable expenses and made it clear that unallowable charges would not be paid. Department officials notified contractors when supporting documentation was missing, documented questioned costs, and denied charges in written logs, which it forwarded to the contractors for clarification and/or adjustment to future payment requests. To further clarify certain reimbursable costs, department officials conducted additional negotiations with contractors for items such as travel expenses and telephone charges.

Contracts Are Managed to Control Project Costs and Risks

The third reason for the department's success is the multi-layered system of checks and balances it has employed to ensure project costs align with the project objectives and to minimize risk. It also established detailed processes for the review and approval of contractor invoices, amendments and change orders.

The multi-layered system includes a project manager that provides technical advice, tracks deliverables and certifies that invoices submitted by the general contractor and the architect/engineer are in accordance with contract terms and conditions. The project team also holds regular progress meetings to discuss items such as project status, changes affecting the work and future problems that could arise.

The department also requires the project contractors to prepare monthly progress reports. For example, the general contractor provides a report summarizing the prior month's activities and those planned for the next month, actual costs and project progress for the reporting period as compared to estimates, and changes in the work planned.

In addition, the department is managing project costs and risks by establishing a detailed process for reviewing and approving contractor invoices, amendments and change orders. We verified the effectiveness of this review process by testing payment applications and contract amendments. We found that, with one exception noted below, the payment review process was thorough and detailed. Specifically, we noted that project staff had reviewed contractor invoices and timesheets in detail, recalculated charges and corresponded with contractors regarding questioned costs. For example, the architect/engineer

submitted an airfare upgrade charge, which was removed after the reviewer questioned it. We also found that contract amendments appeared to have been reviewed prior to approval.¹

To further ensure project control and reduce risk, both the budget manager and the project manager track the project budget on a regular basis. Additionally, the project accountant verified amounts charged agreed to contract terms.

Finally, we found that contract and payment files were well-organized, clearly marked and contained the following:

- contractor solicitation and selection documents;
- signed contracts and amendments;
- contract negotiation documents;
- contractor payment applications and supporting invoices; and
- correspondence with contractors.

Well-organized project documentation and files are important so that relevant documents can be easily retrieved for review and dispute resolution purposes.

Equipment Rental Practices Could Be Enhanced

According to construction contracting best practices, the total amount paid for equipment rented directly from the contractor should not exceed an agreed-upon equipment price, which takes into account equipment depreciation and maintenance costs.

We found the department has not established agreed-upon purchase prices for equipment rented directly from the general contractor and is not tracking total equipment rental charges to ensure rental charges do not exceed the agreed-upon prices.

¹ There were no contract change orders at the time of our review.

We recommend the department take the following actions to further enhance its equipment rental practices:

- establish agreed-upon purchase prices for equipment rented directly from the general contractor and track total equipment rental charges to ensure agreed-upon purchase prices are not exceeded.

After we discussed this recommendation with the project administrator, she told us the team was in the process of implementing it.

Agency's Response:

We agree with this recommendation. While the agency had initially negotiated a significant rental cost discount with the contractor, we are also in the process of revising project procedures to incorporate this recommendation. We are currently in negotiations with the contractor to agree upon equipment purchase prices that take into account equipment depreciation and maintenance costs.

The Oregon Department of Human Services appreciates the Secretary of State's time and effort that was put into this audit. We believe that this has helped us in improving our process and ensuring that the Oregon State Hospital Replacement Project is in accordance with public improvement contract laws and best practices.

Objectives, Scope and Methodology

The purpose of our audit was to determine whether the department has processes in place to ensure payments to contractors, contract amendments and change orders are in accordance with public improvement contract rules, contract terms and best practices. Our objective was also to determine whether contractor selections for the OSHRP were

conducted in accordance with public improvement contract laws.

To answer the first objective, we interviewed OSHRP team members and contractors to gain an understanding of the review and approval processes for contractor payments and amendments. We also reviewed one of three general contractor payments, three of 14 architect/engineer payments, and three of 15 project manager payments approved as of December 2008. We reviewed all contract amendments approved for the project as of December 2008 and verified they were mathematically accurate and properly approved. We also reviewed the accuracy and completeness of supporting documentation that contractors submitted with their payments. There were no contract change orders at the time of our review.

To answer the second objective, we reviewed the department's construction contracting solicitation and selection procedures, requests for proposals for the project, contractor bid proposals, and contractor scoring and selection documentation.

Additionally, we reviewed the department's project procedures; relevant Oregon Revised Statutes; and contracts and amendments with the general contractor, architect/engineer, and project manager authorized through December 2008.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient and appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.



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Courtesies and cooperation extended by officials and staff of the Oregon State Hospital Replacement team were commendable and much appreciated.

This report, a public record, is intended to promote the best possible management of public resources. Copies may be obtained:

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