



**Review of
Judicial Center Expansion
(Now Referred to as Lake County Courthouse)**

**Division of Inspector General
Neil Kelly, Clerk of the Circuit and County Courts
Audit Report**

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**Report No. BCC-150
December 19, 2016**



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December 19, 2016

Board of County Commissioners

We have conducted our review of the Judicial Center Expansion project, now referred to as the Lake County Courthouse, as scheduled per the Clerk's Annual Inspector General Audit Plan. The review was conducted during the ongoing course of the construction project which began in 2010 and continued into 2016.

We appreciate the cooperation and assistance provided by the Facilities and Fleet Management Department and PPI Project managers contacted during the course of our review.

Respectfully submitted,

Bob Melton

Bob Melton
Inspector General

cc: The Honorable Neil Kelly, Clerk of Circuit & County Courts
David Heath, County Manager
Kristian Swenson, Facilities and Fleet Management Department Director

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INTRODUCTION

Scope and Methodology

We conducted a review of the Judicial Center Expansion project, now referred to as the Lake County Courthouse, as requested by County management and as scheduled per the Clerk's Annual Inspector General Audit Plan. The review was conducted during the ongoing course of the construction project which began in 2010 and continued into 2016. The objectives of the ongoing review were to determine that:

1. Owner Direct Purchases made directly by the County for use on this project include all necessary documentation, approvals, and receipts of goods in accordance with contract documents and county policy.
2. All change orders and the associated documentation include appropriate approvals, financial reconciliation, and administration of the documentation in accordance with contract documents and county policy.
3. All contractor pay requests and the associated documentation include the appropriate approvals and are in compliance with statutory payment requirements, contract documents, and county policy.

To determine whether Owner Direct Purchases made directly by the County for use on this project included all necessary documentation, approvals, and receipts of goods in accordance with contract documents and county policy, we reviewed Owner Direct Purchases and their supporting documentation for adequacy and approvals, consulted with the county attorney, and vouched actual ODPs and deliveries to Purchase Order documents.

To determine whether all change orders and the associated documentation included appropriate approvals, financial reconciliation, and administration of the documentation in accordance with contract documents and county policy, we reviewed the contract change orders and the underlying detail for proper documentation, support, and approval, and made inquiries of Facilities personnel for additional information.

To determine whether all contractor pay requests and the associated documentation included the appropriate approvals and were in compliance with statutory payment requirements, contract documents and county policy, we reviewed the pay requests for adequate documentation and support, verified the mathematical accuracy, made inquiries of Facilities personnel for additional information, reviewed the payments for timeliness, and reviewed for adequate review and approval at the department level.

Over the course of the project, we met several times with Facilities staff and PPI Project managers to obtain information and follow up on questions that we had. We appreciate the cooperation of both parties during the process. Opportunities for Improvement have been reported to management on an interim basis throughout the construction process. This report includes those Opportunities for Improvement.

Overall Conclusion

We conclude that Owner Direct Purchases made directly by the County for use on this project include all necessary documentation, approvals, and receipts of goods in accordance with contract documents and county policy. We conclude that the change orders and the associated documentation included appropriate approvals, financial reconciliation, and administration of the documentation in accordance with contract documents and county policy. We also conclude the contractor pay requests and associated documentation include the appropriate approvals and are in compliance with statutory payment requirements, contract documents, and county policy. Opportunities for Improvement are included in this report.

Background

In 2005, a master plan was developed for additional government facilities and the expansion of the Judicial Center. Phase I of the Downtown Tavares Governmental Facilities Project included a 2-story building at 320 West Main Street for the Tax Collector and Property Appraiser, an 8-story parking garage, and a central energy plant. All were completed by June 1, 2009 by PPI Construction Management (CM). This part of the process was not included within the scope of this audit.

Phase II of the Downtown Tavares Governmental Facilities Project as originally envisioned included a 298,290 square foot expansion to the Judicial Center. During 2009-2010, staff and the Board of County Commissioners evaluated the final size and scope of this project in light of the economic conditions. The architect for the redesign of the Judicial Center expansion was HLM Design, a division of Heery International, Inc. On June 15, 2010 the Board approved an amendment to PPI's contract for Phase II of the project, including a 168,026 square foot expansion and renovation of the Judicial Center.

Construction on the Judicial Center expansion began on July 26, 2010. On July 22, 2013, the new entrance on Main Street opened to the public. Final payment was made on December 22, 2015.

The CM's Guaranteed Maximum Price (GMP) for the Judicial Center expansion is \$39,949,581, with an amount approved for allowances and contingency of \$5,425,000. Additional cost estimate for

renovation of the existing Judicial Center amounted to \$5,000,000. The total estimated cost of Phase II is \$50,374,581. Existing bond funding is available for \$41,349,727 of the expansion costs, with the balance of \$9,024,854 to be funded by Sales Tax (Fiscal Years 2011-2014).

The County purchased significant quantities of materials through the Owner Direct Purchase program (ODP), which resulted in Sales Tax savings. This program included materials purchased by the County, which is exempt from Sales Tax, instead of the subcontractor, which is not exempt from Sales Tax. Sales Tax savings under this program were over \$340,000.

OPPORTUNITIES FOR IMPROVEMENT

Our review disclosed certain practices that could be improved. Some of these Opportunities for Improvement were previously reported to management on an interim basis. Our review was neither designed nor intended to be a detailed study of every relevant procedure or transaction. Accordingly, the Opportunities for Improvement presented in this report may not be all-inclusive of areas where improvement may be needed.

1. No County Representative Was Present To Observe The Bid Opening Process By PPI.

During the course of our review, we found that no "Owner's Representative" was present at the private bid openings conducted by PPI. An invitation to attend was extended by PPI; however, the County declined to attend. County staff indicated they did not attend due to other controls they put in place such as obtaining a third party GMP estimate to be used as a comparison and their active participation in negotiating the GMP. However, this does not mitigate the need to ensure propriety by attending the bid openings. We also found that the process used by PPI to select final subcontractors was not clear to Facilities Management.

Chapter 2, paragraph 3.1.6 of Appendix A of the PPI Contract dated September 21, 2007 states: "The Construction Manager shall conduct private bid openings in the presence of the Owner's Representative."

A lack of understanding and oversight of the bid and award process could lead to violations of policies and procedures as well as reduced competitive bidding practices. Having a county representative at the bid openings would help ensure that proper controls are in place and that County policies and procedures are followed.

We notified management of this issue on September 12, 2011.

We Recommend for future contracts that a County representative be present at all private bid openings performed by third party contractors and that management obtain a complete understanding of the bid award process to be used.

September 12, 2011 Management Response: This finding was submitted to the Office of Procurement Services for comment. They have commented as follows: It is first noted that similar text is included in the CM On-Call contracts, and that this response applies to all CM contracts having similar text. We recommend that the contracts having this text be modified to exclude that requirement. This is based on the fact that attending a bid opening offers little or no insight into

the CM's bidding process, and the fact that budget shortfalls now curtail the ability of County staff to attend such events. We fully concur in the need for County management to obtain a complete understanding of the bid award process to be used by all CM vendors. We opine that such understanding can be gained by the procedures stated in the "conditions" section of the finding, but further recommend a new requirement for quarterly meetings of CM, Facilities, and Procurement staff to review bidding procedures and results. It is specifically noted that while compliance with overall County procurement policy is anticipated, none of the CM contracts require adherence to every procurement procedure established for the County's in-house procurement operation.

2. Changes To GMP Subcontractors Were Made By PPI Without Prior Written Notice Or County Approval.

During our audit testing, we noted one actual subcontract that was awarded to a different subcontractor and for a different amount than indicated on the approved GMP Schedule of Values. Facilities Management had not been made aware that any changes to subcontractors in the GMP had been made. Subsequently, PPI notified the County of this change and seven additional subcontractors that had been changed from the original GMP.

Chapter 2, paragraph 2.7.5.5 of Appendix A of the PPI Contract dated September 21, 2007 states: "During the course of the Work, the Construction Manager; shall promptly inform the Owner in writing of any proposed replacements, the reasons therefore, and the name(s) and qualification(s) of proposed replacement(s). The Owner shall have the right to reject any proposed replacement for good cause."

When County management is not made aware of changes to subcontractors, then changes could occur that are not in line with the desires and best interests of the County. Thorough detailed review of pay applications could assist in detecting unauthorized changes to subcontractors.

We notified management of this issue on September 12, 2011.

We Recommend for future contracts that any changes to subcontractors, along with justification for the change, be provided to the County in writing and that all changes be approved by the County prior to the change being made.

September 12, 2011 Management Response: Agree with finding. A letter was sent to PPI on 4/1/2011 instructing them about the required written request and the necessary County authorization needed to change subcontractors.

3. Differences Between Actual Cost Of Work And GMP Amount Were Not Adequately Accounted For Or Tracked On The Schedule Of Values.

During our audit testing, we noted 11 actual subcontract amounts that were lower than the amount shown on the Schedule of Values submitted with the Application for Payment. The total of these differences resulted in \$400,096 of uncommitted budget that should be re-classed in the GMP and only used if properly justified. Historically, the reconciliation of actual amounts to the Schedule of Values has been done at the conclusion of the project rather than throughout the project. We found no unauthorized use of funds; however we found no means in place to track and account for the use of these uncommitted funds on a regular basis.

Chapter 3, paragraph 15.2 of Appendix A of the PPI Contract dated September 21, 2007 states: "The Construction Manager's schedule of values shall be presented in the format, and with such detail and supporting information, requested by the Professional or Owner. The Construction Manager shall not imbalance or artificially inflate any element of its schedule of values."

Without adequate detail and accurate tracking, the uncommitted budget may be spent inappropriately.

We notified management of this issue on September 12, 2011.

We Recommend for future contracts that the Schedule of Values be changed to reflect the actual subcontract amounts, any uncommitted budget be tracked and accounted for each month, and the use of these funds be properly reviewed and approved by management prior to use.

September 12, 2011 Management Response: Agree with finding. Current GMP accounting can be established throughout the project with the suggested reconciliation timing and will make final payment easier. This process has been adopted.

4. The Department Did Not Perform A Thorough Detail Review Of Pay Applications.

During the course of our audit testing, we found that even though a review of each pay application was being performed, the detailed financial review was not being performed thoroughly. Facilities had undergone several organizational changes, and key elements of review were apparently not clearly communicated to staff. The review performed consisted of recalculating the figures on the front page of the pay application. It appeared that no one was reviewing or agreeing the supporting documentation to the pay application detail. Change orders to subcontractor pay applications were not always supported due to timing issues. We found one questionable charge that was not discovered or investigated at the time of review. Differences between actual subcontract price and budget were not being reviewed or reconciled. Changes to subcontractors from the approved GMP were not discovered or addressed during the review.

Lake County Procedure LC-20 Contract Administration, Section III provides general user department duties in regards to contract administration. Specifically, their duties are to, "inspect and/or monitor all vendor-provided goods, work and services to ensure adherence to the contract, and to confirm proper scheduling and fiscal compliance" and "review, verify and forward invoices in a timely, accurate, and effective manner to Finance for payment."

Without a detailed financial review, mistakes and errors in the pay application may go unnoticed and result in a loss to the County.

We notified management of this issue on September 12, 2011.

We Recommend for future contracts that the review procedures for all pay applications be improved including, but not limited to:

- A. Reviewing in detail the supporting documentation,
- B. Agreeing billed amounts to supporting documentation,
- C. Thoroughly investigating and resolving questionable charges,
- D. Analyzing variances between actual and budget,
- E. Ensuring subcontractors awarded the work are actually performing the work,
- F. Reviewing the calculation of General Conditions and Management Fee for accuracy, and
- G. Ensuring that the schedule of values accurately presents all financial information.

September 12, 2011 Management Response: Agree with findings. The method and process of reviewing pay applications was improved prior to this report and is currently consistent with the above mentioned recommendations.

5. One Item Included In The General Conditions Of The Contract Was Also Included In The GMP Schedule Of Values.

During our audit testing, we found that bid package 02H Surveying was not supported by a subcontractor bid. After further inquiry, it was explained by the project manager that this line item was included in the General Conditions of the contract and should not be included in the GMP and that it would be removed and placed in the uncommitted budget section of the Schedule of Values. The description of what is included in the General Conditions of the contract is vague and makes it difficult to ascertain what should or should not be included in the GMP.

Appendix K of the PPI Contract, dated September 21, 2007, is the Construction Management and General Conditions Fee Outline and details items included in the General Conditions fee. The Construction Preparation section of this appendix indicates that Construction Layout & Base Lines is a cost included in the General Conditions fee.

When sufficient detail is not provided for a proper review, the County could be charged in error for items that should be included in the General Conditions of the contract.

We notified management of this issue on September 12, 2011.

We Recommend for future contracts that the General Conditions section be detailed enough for proper review and that management review all GMP bids for compliance with the contract.

September 12, 2011 Management Response: Agree with finding. This charge has been removed. The new On-Call CM contract the department is using itemizes the various General Conditions. This process will assist to ensure the contractor is not doing this.

6. All Payments Were Not Being Made Timely.

HLM Design (Heery) was designated as the Owner's Professional Representative, or agent, pursuant to Appendix A, chapter 11 of the contract. In our early construction testing of the pay applications, we noted that Heery did not mark any of the six pay applications reviewed as received on the date it was delivered to them. Therefore, in calculating the due date for each pay application, we used the date it was certified by the architect. We found that four of the six pay applications reviewed were paid up to 36 business days after the date it was certified by Heery. The average number of days from Heery to Facilities was 8 days, the average number of days from Facilities to Finance was 22 days, and the average number of days from Finance to payment was 5 days.

Chapter 1, paragraph 4.3.2 of the PPI Contract dated September 21, 2007 states: "Payment requests shall be processed and paid in accordance with Part VII, Chapter 218, Florida Statutes." Section 218.735(1)(a) requires that "if an agent must approve the payment request or invoice before the payment request or invoice is submitted to the local governmental entity, payment is due 25 business days after the date on which the payment request or invoice is stamped as received as provided in s. 218.74(1)." Section 218.74(1) provides that "each local governmental entity shall establish procedures whereby each payment request or invoice received by the local governmental entity is marked as received on the date on which it is delivered to an agent or employee of the local governmental entity."

Without being marked as received by the architect, it is difficult to determine the most accurate start date to use in calculating the due date. Per section 218.735(9), Florida Statutes, payments not made within the specified time period shall bear interest at a rate of one percent per month. This would add undue cost to the project.

We notified management of this issue on September 12, 2011.

We Recommend for future contracts that each pay application be marked as received by the agent on the date it is delivered, that prompt review by the architect and the Facilities Department be performed, and that pay applications be forwarded to Board Finance timely to ensure that payments are made in accordance with the contract and Florida Statutes.

September 12, 2011 Management Response: Agree with finding. Staff is implementing these changes and is working to reduce review times. The contractor has indicated they would prefer a slightly delayed review versus a rejection as it resets the time clock.

7. Management Should Maximize Sales Tax Savings Allowable Under State Law.

Lake County could have saved \$18,416 in sales tax expenditures if appropriate procedures had been in place. The GMP contract for the Judicial Center Expansion project is essentially a fixed price contract as 98-99% of the subcontractor costs are fixed under the contract.

The primary reason the County needlessly paid the additional sales tax is because the construction manager and county management chose to remove a \$306,105 purchase from the Owner Direct Purchase Program (ODP) rather than risk possible disclosure of concerns expressed by a County representative about a conflict of interest between a subcontractor and its supplier. In this instance, the County issued an Owner Direct Purchase (ODP) purchase order on August 24, 2011 for materials in the amount of \$306,105. This reflected a tax savings of \$18,416 as the total amount of the purchase to the subcontractor before the Sales Tax Recovery program was \$324,521. In February 2012, during a review of documents from the supplier, Facilities Management became aware for the first time that the supplier and the subcontractor were related parties. The supplier from which the subcontractor purchased materials is located in the same building as the subcontractor, and the same people are the manager/members of both limited liability companies. PPI, the construction manager, stated they were not aware that the relationship would need to be disclosed, as the subcontractor had provided the low bid regardless (meaning the subcontractor was responsible for any cost differential among potential suppliers). After discussion with PPI, Facilities Management decided to cancel the ODP purchase order on February 24, 2012 in order to protect the County from the appearance of a conflict of interest. Consequently, the subcontractor purchased the materials directly, paid sales tax, and passed the sales tax amount on to the County for reimbursement.

On the invoice from the supplier, the subcontractor was identified as the recipient of the materials. The recipient has the responsibility of ensuring all items have been received and that the items meet specifications.

The primary way to reduce the costs under this contract is to utilize the Sales Tax Recovery program allowed under Florida Statutes Section 212.08(6)(a). This program allows the county, which is tax-exempt, to purchase materials directly from the subcontractor's supplier without paying sales tax. Without this program, the subcontractor purchases the materials from their supplier and passes the sales tax through to the county.

When transactions such as these are not made at arm's-length, the normal internal controls are compromised. Although the contractor may verify the materials, the controls are weakened whenever transactions are made among related parties. Therefore, related-party relationships should be disclosed to and approved by the County in advance.

The total sales tax savings initially estimated under the contract was \$360,382. By canceling the purchase order and forfeiting the savings, the County unnecessarily forfeited 5% of the total sales tax savings estimated under this contract.

We notified management of this issue on November 30, 2012.

We Recommend for future contracts that management:

- A. Establish procedures that require the disclosure of related contracting parties in future contracts.
- B. Use the ODP on all possible purchases in all construction contracts.

November 30, 2012 Management Response:

- A. Staff will look to add this revision to future contracts.
- B. Staff will continue to utilize ODP where feasible in the construction process. Staff will continue to review possible purchases in regard to vendor terms and conditions, construction schedule impacts, as well as savings compared to organizational costs.

8. Subcontractor Work Requested By The Construction Manager Should Go Through The Formal Change Order Process.

The payment application included additional work that was requested of subcontractors by the Construction Manager (CM). However, these requests were not reviewed and approved by the County Manager. Changes such as these requested by the CM still result in an increase to the amount the County pays under the contract. Therefore, the requests for additional work of subcontractors by the CM should go through a formal process and be approved by the County Manager. This same approval process should also be used when reallocating unused allowances within the contract. We also noted the cost of the additional work was offset against the uncommitted budget reserve. The uncommitted budget reserve is primarily composed of credits to the contract amount from subcontractor amounts that were overstated in the final Schedule of Values. It was previously recommended that the "use of these funds be properly reviewed and approved by management prior to use." (See Opportunities for Improvement No. 3.) However, the use of these funds did not go through the approval process up to the County Manager.

The requests for additional work of subcontractors by the CM should go through a formal process and be approved by the County Manager. When the use of funds is not formally approved, the funds may be spent inappropriately.

We notified management of this issue on November 25, 2013.

We Recommend for future contracts that management:

- A. Ensure the requests for additional work of subcontractors by the Construction Manager go through a formal process and be approved by the County Manager. This process should also be used when reallocating unused allowances within the contract.
- B. Ensure the use of the uncommitted budget reserve funds be properly reviewed and approved by management prior to use.

November 25, 2013 Management Response: Agree with finding. The contract is based upon a GMP; staff will analyze the audit recommendation in conjunction with the GMP based contract language and make modifications as appropriate.

9. Some ODPs Were Closed Out For Materials Not Purchased But Incurred Sales Tax.

The documentation for some Owner Direct Purchases (ODPs) stated that the original ODP request was overstated and should be closed out. When each purchase order was closed out, the amount of the overstatement was paid to the subcontractor. This amount included sales tax in total of \$9,081 on the estimated cost of the overstated materials. However, since the material was overstated and never purchased, the sales tax was never incurred by the subcontractor. The subcontractor has no liability to the state for the sales tax amount. No public purpose was served by paying sales tax to a subcontractor who would not remit the sales tax to the state.

The county paid the subcontractor for sales tax for which it had no liability. The County Attorney opined that the subcontractor was allowed to keep the amount that would have been paid in sales tax. Sales taxes should be collected on sales made and remitted to the state.

We discussed this issue with management on May 19, 2015.

We Recommend for future contracts that management set the maximum amount that could be returned to the subcontractor as an amount up to the cost of the materials, with no addition for sales tax that was never incurred.

May 19, 2015 Management Response: Disagree with finding. The finding was reviewed by the County Attorney's Office and determined that the contract is based upon a GMP. Therefore, the funds should be returned to the contract balance with no further deductions.

10. ODP Reconciliations And Closeout Adjustments Should Be Performed Timely.

Owner Direct Purchases (ODPs) were established under the contract so that the county would not have to pay sales taxes for certain materials. When an ODP is closed out, the dollars remaining in the purchase order are transferred back to the subcontractor under the construction contract who is then paid the remaining amount plus the related sales tax. In our review of the closeouts of ODPs, we noted the following concerns:

- A. An ODP closeout was not calculated separately or reconciled against the purchase order resulting in a subcontractor overpayment of \$2,150.71. The closeout amount should be recalculated independently and also reconciled to the detail in the accounting system. Otherwise, errors in calculations from the contractor may go unnoticed and result in an overpayment to the contractor.
- B. During the review of a contract change order, a closeout adjustment needed to be made to the underlying purchase order of an Owner Direct Purchase Order. The closeout adjustment was not made until about three months after the change order. When an adjustment is not made timely, there is a risk of it being missed. This could also create additional research and effort in closing or carrying forward the purchase order balance at year-end.

We Recommend for future contracts that management:

- A. Ensure calculated amounts are recalculated independently and detailed listings are obtained from the contractor and reconciled to the detail in the accounting system.
- B. Ensure purchase orders related to the construction, for example, Owner Direct Purchase Orders, are adjusted and closed out timely.

Management Response: Agree with the finding. Efforts will be made to close out ODP reconciliations more timely. The example of an overpayment is felt to be characterized differently. There was a double counting of \$2,150.71 that occurred in one ODP closeout; however, it is not felt that any overpayment occurred. This is further exhibited by the closeout change order which resulted in the County receiving a \$325,868.12 credit that contained a \$70,000 project settlement credit.