



Neil Kelly
Clerk of the Circuit and County Courts
Lake County, Florida

Judicial Center Expansion Review

Pay Application Numbers 13 - 23

Internal Audit Division **Interim Audit Report**

Bob Melton, CIA, CFE
Director of Internal Audit

Review Conducted by:
Cindy McLaughlin, CPA, CIA

BCC-103
November 30, 2012



Internal Audit Division

Clerk of the Circuit Court • County Court • Board of County Commissioners

Post Office Box 7800, Tavares, FL 32778

Phone: (352) 253-1644 Fax: (352) 253-1645

November 30, 2012

Board of County Commissioners

We have conducted an interim review of the Judicial Center Expansion project, as scheduled per the Clerk's Annual Internal Audit Plan.

We appreciate the cooperation and assistance provided by the Facilities Management department during the course of this review.

Respectfully submitted,

Bob Melton, CIA, CFE
Director of Internal Audit

BM/cm

cc: Honorable Neil Kelly, Clerk of Circuit & County Court
David Heath, County Manager
Kristian Swenson, Facilities Development and Management Director

TABLE OF CONTENTS

INTRODUCTION.....	1
Scope and Methodology	1
Overall Conclusion	1
Background	2
OPPORTUNITY FOR IMPROVEMENT	3
Management Should Maximize Sales Tax Savings Allowable Under State Law.	3

INTRODUCTION

Scope and Methodology

We are in the process of reviewing the Judicial Center Expansion Project as requested by County management and as scheduled per the Clerk's Annual Internal Audit Plan. We have conducted an interim review of the Judicial Center Expansion project, which includes Pay Application Nos. 13 through 23. The objectives of this ongoing review are 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.

Activities performed by Internal Audit include reviewing Owner Direct Purchases and their supporting documentation, vouching actual ODPs and deliveries to Purchase Order documents; reviewing contract Change Orders for proper documentation, support and approval; reviewing all applications for payment for proper documentation and support, verifying mathematical accuracy, ensuring payment is timely, and that the applications are adequately reviewed at the department level.

Over the course of the project, we have met several times with Facilities staff and PPI Project managers to obtain information and follow up on any questions that we have had. We appreciate the cooperation of both parties during this process.

Overall Conclusion

As a result of our work to date, 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 also conclude 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. There were no significant

change orders during the period of this portion of our review. We noted one Opportunity for Improvement, which is 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).

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. The construction and renovation is expected to be complete by August, 2013.

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).

As of the construction period through June 25, 2012, the County paid the CM \$26,836,185 for Phase II, not including retainage withheld by the County in the amount of \$1,412,431. During the period covered by this interim report, retainage was reduced from 10% to 5% per section 218.735(8)(b) of the Florida Statutes.

The County purchases significant quantities of materials through the Owner Direct Purchase Program (ODP), which results in Sales Tax savings. This program includes materials being purchased by the County, which is exempt from Sales Tax, instead of the subcontractor, which is not exempt from Sales Tax. Estimated Sales Tax Savings as of June 25, 2012 were \$360,382.

During the period of this interim report, the Senior Financial Coordinator was transferred from Facilities Management to the Office of Budget and assumed new responsibilities.

OPPORTUNITY FOR IMPROVEMENT

Our review disclosed certain practices that could be improved. Our review was neither designed nor intended to be a detailed study of every relevant procedure or transaction. Accordingly, the Opportunity for Improvement presented in this report may not be all-inclusive of areas where improvement may be needed.

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 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 through the sales tax to the county.

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. When this transaction is not made at arm's-length, the normal internal controls are compromised. Although PPI stated that they also 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 estimated under the contract are \$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 Recommend 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.

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.