



**METROPOLITAN GOVERNMENT OF
NASHVILLE AND DAVIDSON COUNTY**

OFFICE OF INTERNAL AUDIT

Professional Audit and Advisory Service

FINAL REPORT



**Audit of the Music City Convention Center Construction
Project**

**INTERIM REPORT VI
AUGUST 1, 2012 THROUGH MARCH 31, 2013**

Date Issued: April 30, 2013

Office Location and Phone Number

1417 Murfreesboro Pike
Nashville, Tennessee 37217
615-862-6110

*The Metropolitan Nashville Office of Internal Audit is an independent audit agency
reporting directly to the Metropolitan Nashville Audit Committee*

Table of Contents

INTRODUCTION.....	1
Audit Initiation.....	1
Audit Completion.....	1
Project Status.....	1
Project Milestones.....	2
APPENDIX A - EXPERIS AUDIT REPORT	3

INTRODUCTION

Audit Initiation The performance audit of the Music City Center construction project was conducted as part of the approved Audit Work Plan by the Metropolitan Nashville Audit Committee. This is the sixth in a series of interim reports that will be issued throughout the duration of the construction project.

Audit Completion Experis (formerly Jefferson Wells) Risk Advisory Services was retained by the Metropolitan Nashville Office of Internal Audit to perform the performance audit scope related to construction change orders.

The audit report prepared by Experis Risk Advisory Services can be found in Appendix A.

Project Status **Exhibit A - Project Budget Status as of March 31, 2013**

<i>Description</i>	<i>Budget</i>	<i>Paid to Date</i>	<i>Paid Percentage</i>	<i>Cost to Complete</i>
Direct Construction Costs	\$450,657,757	\$419,403,816	93.1	\$31,178,941
Land Acquisition & Relocation Costs	58,150,000	73,591,336 ¹	126.6	2,636,496
Architectural Design & Engineering	40,759,684	40,309,344	98.9	450,340
CCA Project Management	10,993,758	8,458,069	76.9	2,535,689
Project Insurance & Programs	7,994,322	7,269,772	90.9	724,549
Legal, Financing, Audits, and Consultants	2,794,480	2,329,909	83.4	464,571
MCC Furniture, Fixtures, and Equipment	13,650,000	2,122,294	15.5	11,602,706
Totals	\$585,000,000	\$553,484,542	94.6	\$49,593,290

Source: Convention Center Authority Project Financial Summary

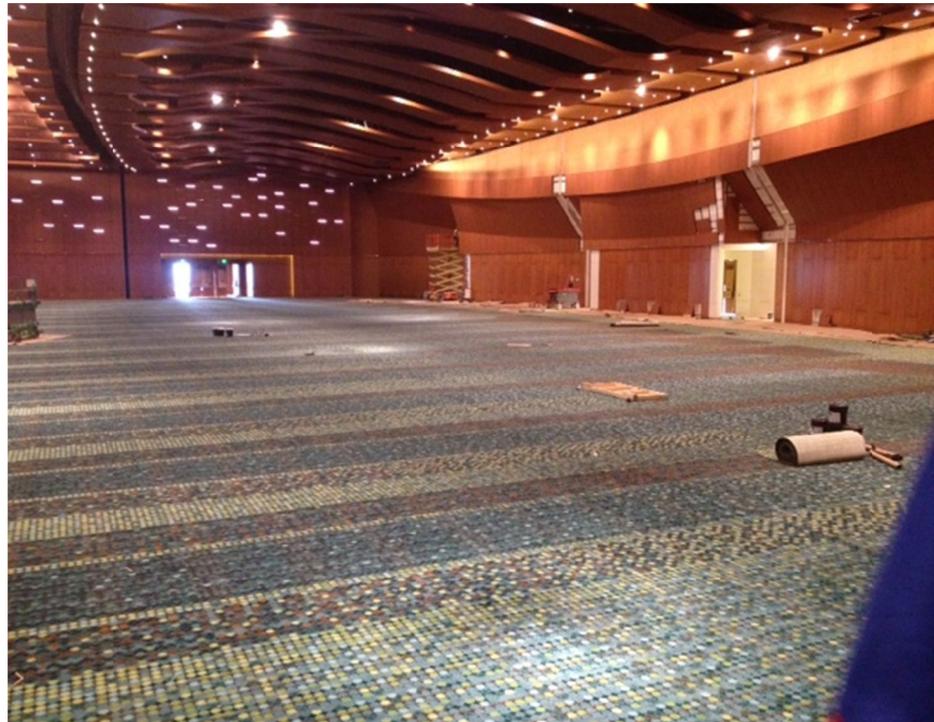
¹ Increase in Land Acquisition and Relocation Costs were due to \$18 million escrow payments to Tower Investments.

***Project
Milestones***

Significant project milestones as of April 29, 2013, include:

- **Use and Occupancy permit and substantially completing the building - prior to the April 30 deadline.**

Exhibit B – Preparing the Ballroom



APPENDIX A - EXPERIS AUDIT REPORT

- Audit Report Starts on Next Page -

Metropolitan Nashville

Music City Center

Construction Audit Final Audit Report

APRIL 29, 2013

EXPERIS
(FORMERLY JEFFERSON WELLS)
RISK ADVISORY SERVICES
ATLANTA OFFICE

This report is intended solely for the use of Metropolitan Nashville and Davidson County Government and is not intended to be and should not be used by any other parties without the prior written consent of Experis.

EXECUTIVE SUMMARY

April 30, 2013

Results in Brief	Background and Recommendations										
<p>The Metropolitan Nashville Office of Internal Audit engaged Experis Finance to perform an audit of the Music City Convention Center construction project. Key areas reviewed included:</p> <ul style="list-style-type: none"> • Change Order Process. • Change Orders. • Contract language for risks and potential language changes. <p>Audit objectives and conclusions were as follows:</p> <ul style="list-style-type: none"> • <i>Does the change order process have sufficient controls in place?</i> <p>Yes. Procedures currently in place provide reasonable assurance that the program is managed effectively and efficiently.</p> • <i>Are the change orders appropriate and in accordance with the contract?</i> <p>Yes. The review of a sample of change orders verifies they have been processed in accordance with the written policy, and approved in accordance with the terms of the contract.</p> • <i>Are there risk areas and/or contract language recommendations for change in future contracts?</i> <p>Yes. Risk areas include general conditions, general requirements, fixed labor rates, and self-performed work.</p> 	<p style="text-align: center;">Change Orders As of February 20, 2013</p> <table border="1" style="margin-left: auto; margin-right: auto; border-collapse: collapse;"> <thead> <tr> <th style="width: 80%;"></th> <th style="width: 20%; text-align: center;">Total Costs</th> </tr> </thead> <tbody> <tr> <td>Original GMP</td> <td style="text-align: right;">\$415,000,000</td> </tr> <tr> <td>GMP Change Orders</td> <td style="text-align: right;">6,392,020</td> </tr> <tr> <td>Non-GMP Change Orders</td> <td style="text-align: right;">13,171,698</td> </tr> <tr> <td>Current Contract</td> <td style="text-align: right;">\$434,563,718</td> </tr> </tbody> </table> <p>Key recommendations of this report include:</p> <ul style="list-style-type: none"> • Review lump sum general conditions costs prior to executing the contract. • Review fixed labor rates in detail before executing the contract. 		Total Costs	Original GMP	\$415,000,000	GMP Change Orders	6,392,020	Non-GMP Change Orders	13,171,698	Current Contract	\$434,563,718
	Total Costs										
Original GMP	\$415,000,000										
GMP Change Orders	6,392,020										
Non-GMP Change Orders	13,171,698										
Current Contract	\$434,563,718										

TABLE OF CONTENTS

INTRODUCTION.....	1
Audit Initiation.....	1
Background.....	1
OBJECTIVES AND CONCLUSIONS.....	2
OBSERVATIONS AND RECOMMENDATIONS.....	5
<i>A – Lump Sum General Conditions Costs and Fixed Labor Rates</i>	5
GENERAL AUDIT INFORMATION.....	6
Statement of Compliance with GAGAS.....	6
Scope and Methodology.....	6
Criteria.....	6
Consultant Acknowledgement.....	6
MANAGEMENT ACCEPTANCE.....	7

INTRODUCTION

Audit Initiation

The continuous performance audit of the Music City Center (“MCC”) construction is conducted as part of the approved 2011 Audit Work Plan of The Metropolitan Nashville Office of Internal Audit. This is the sixth in a series of interim reports that will be issued throughout the duration of the construction project. These reports will culminate with a consolidated performance audit report at the conclusion of construction related activities. Significant observations and recommendations noted throughout these interim reports will be incorporated in the final report.

Background

The project is on track to be Leadership in Energy and Environmental Design (LEED) Certified at the Silver level.

In fiscal year 2010, Metropolitan Government of Nashville and Davidson County began construction on a 1.2 million square foot convention facility on a 16 acre site encompassing approximately 4 city blocks. The facility features a 350,000 square foot exhibit hall, a 57,000 square foot grand ballroom and 18,000 square foot junior ballroom, as well as about 1,800 parking spaces. It also offers 90,000 square feet of meeting room space – approximately 60 meeting rooms.

The Office of Internal Audit has put in a continuous monitoring/audit plan for the Project. Past audits have reviewed policies, procedures and practices relating to labor rates and classifications, employment eligibility, payment and performance bonds, prevailing labor rate requirements, wage and benefits, Diversity Business Enterprise program, local labor participation and the Owner Controlled Insurance Program (“OCIP”).

The contract is a guaranteed maximum price contract (“GMP”), but most of the elements of construction have been subcontracted as lump sum, firm fixed price arrangements. This strategy enables the owner to fix the financial expenditures related to specific items of scope and provides relative certainty with respect to cost. However, to the extent there are changes in scope or some unforeseen circumstances, change orders are presented to the Owner which will increase the cost of the project.

Change orders are a normal and expected process of construction. Prudent business practices dictate that a policy should be in place to ensure control over the review and approval of scope deviations and their associated costs. The focus of this audit is to evaluate the adequacy of the process controls and test compliance thereof.

OBJECTIVES AND CONCLUSIONS

GMP change orders amount to \$6,392,020, or approximately 1.5 percent of the GMP.

1. *Does the change order process have sufficient controls in place?*

Yes. In the course of assessing the management and administration of the change order process, assurances that the program is managed efficiently and effectively were observed through the evaluation of both quantitative and qualitative evidence. The review highlighted several commendable attributes observed:

- Reviews and recommendations by various team members pertaining to their area of expertise.
- Diligent recordkeeping and documents management by the Owner's management team.
- Proactive negotiation of change order costs by the management team to minimize the cost to the Owner.
- Established procedures for reviewing and approving Potential Change Order Requests ("PCO").
- Completeness of status reports and Potential Change Order logs with updates to maintain control over the project costs.
- Working with the Construction Manager to keep change order costs within budgeted projections.

In its entirety, all the acquired, reviewed and observed data indicates that the management team is achieving its goals and objectives, and managing the Construction Manager for effective cost, quality and schedule control.

2. *Are change orders appropriate and in accordance with the contract?*

Yes. Experis tested a selection of change orders for various attributes including propriety of entitlement, review and approval of required project team members and inclusion of a detailed cost analysis. The results indicated that the change orders were appropriate and in compliance with the terms and conditions of the contract.

There are three classifications of change orders: 1) Change orders that released funds from contingency to specific line items; 2) Change orders for scope modifications to the Music City Center facility and increased the guaranteed maximum price contract price and 3) Change orders for scope of work that were separate from the work contemplated in the guaranteed maximum price contract. Non-Guaranteed Maximum Price contract Change Orders are changes to the work outside the Music City Center facility (i.e. utility relocations, solar panels, street improvements, sidewalks and landscape/hardscape) as well as non-construction related work such as project-wide art work. This enabled the team to track core

Music City Center costs and other costs which may have come from alternate funding sources.

All 180 Potential Change Orders on the Potential Change Order Log with a monetary impact were reviewed, and a sample of 30 Potential Change Orders was selected for in-depth analysis. Records were accurate and complete, including proper authorization, original detailed cost proposals and the history of negotiated prices. A summary of items reviewed is as follows:

Description	Change Orders Audited		
	In-depth Audit of Change Orders	Total Change Orders	Percentage Audited
Contingency Reclassification	11,702,000	14,350,000	82%
GMP Change Orders	2,594,000	6,392,020	41%
Non-GMP Change Orders	10,485,984	13,171,698	80%
	24,781,984	33,913,718	73%

A large portion of the “Contingency Reclassification” was the result of updated pricing as the plans and specifications progressed and were refined and clarified in greater detail. These are changes in the classification of anticipated costs.

3. *Are there risk areas and/or contract language recommendations for change in future contracts?*

Yes. A guaranteed maximum price contract is intended to shift the risk of cost overruns from the Owner to the Construction Manager/General Contractor, by limiting the price to be paid by the Owner, and providing a means of potential cost savings if the cost of the project plus the Construction Manager fee is lower than the guaranteed maximum price.

The contract between Metropolitan Development Housing Agency and Bell/Clark, a Joint Venture, has increased the risk of overpayment and limited the potential savings of the Owner by stipulating that the general conditions costs are a lump sum/ fixed price amount rather than being reimbursable based on actual cost. The scope of project management and project overhead is typically harder to define at the beginning of a project than other specific work packages such as concrete or steel work. Though the cost for this scope is fixed, there is a potential for overpayment for this work. The best way to reduce the risk of overpayment of lump sum general conditions would be to perform a detail audit of the proposed general conditions prior to executing the contract and then track personnel on site to ensure that all staff proposed (and paid for), are actually on site and working on the project.

The contract provides for fixed rates of reimbursement to the Construction Manager for supervision and self-performed labor incurred. These rates are inclusive of all employer taxes and employee benefits such as medical insurance, holidays, vacations, any other paid time off, and may include bonuses for employees. In our experience, contractually fixed labor rates are generally higher than actual costs incurred. There was no self-performed work on Music City Center and for this project, there is no impact.

OBSERVATIONS AND RECOMMENDATIONS

A – Lump Sum General Conditions Costs and Fixed Labor Rates

As noted in audit objective question number three (3) above, the guaranteed maximum price contract provides for reimbursement of Construction Manager general conditions as a lump sum/firm fixed price arrangement. Also, Construction Manager labor charges for self-performed work are at contractually fixed rates. Though there are benefits associated with this strategy, it is our experience that the resulting costs are higher than they would be if these items were contractually cost reimbursable.

Criteria:

Prudent business practices

Risk:

There is a potential of greater cost of work associated with this contracting strategy.

Recommendations:

If on future construction projects, management chooses to employ the strategy of awarding lump sum contracts for these types of costs, it should perform an in-depth audit of all costs proposed to ensure propriety. Also, management should employ a tracking mechanism to ensure all scope contemplated in the lump sum arrangement is provided (e.g. Construction Manager staffing levels).

Convention Center Authority Management Response		
Corrective Action Plan	Assigned Responsibility	Estimated Completion
Accept.	Convention Center Authority Senior Project and Development Manager	Ongoing – to the extent that the Convention Center Authority enters into future construction contracts

GENERAL AUDIT INFORMATION

Statement of Compliance with GAGAS

We conducted this construction audit from February 2013 to April 2013 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our observations and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our observations and conclusions based on our audit objectives. Our audit included tests of management controls that we considered necessary under the circumstances.

Scope and Methodology

The audit period focused primarily on change orders to the general construction contract.

The methodology employed throughout this audit was one of objectively reviewing various forms of documentation, including written policies and procedures, financial information, various forms of data, reports and information pertaining to the guaranteed maximum price contract and change orders. For many of our procedures we used project contracts, change order files and payment applications. Additionally, select project management employees were interviewed.

Criteria

In conducting this audit, construction of Music City Center facility was evaluated for compliance with:

- *The Committee of Sponsoring Organizations Internal Control - Integrated Framework*
- Prudent Business Practices

Consultant

William M. Consolie, CPA – Experis Director

Acknowledgement

Lawrence Harris, CPA – Experis Engagement Manager

MANAGEMENT ACCEPTANCE



Project Management & Development

April 29th, 2013

Mr. Mark Swann
Metropolitan Auditor
222 Third Avenue South, Suite 401
Nashville, TN 37201

RE: Audit of the Music City Convention Center Construction Project (interim report 8/1/12-3/31/13)

Dear Mr. Swann,

I write to acknowledge receipt of the audit report for the Music City Center Construction Project (interim report 8/1/12-3/31/13), by the Metropolitan Government's Office of Internal Office, my review of the audit report, and its recommendations.

I concur with the finding and have provided a response to the recommendation. I have also assigned responsibility and completion date to address each item.

We appreciate the review and the ability to improve our operations and reporting.

Sincerely,

A handwritten signature in blue ink, appearing to read "R.P. Johnson", with a long horizontal flourish extending to the right.

Ryan P. Johnson

The Convention Center Authority of the Metropolitan Government of Nashville & Davidson County
413 Fifth Avenue South ♦ Nashville, TN 37203 ♦ 615-880-1450