



## Fact Sheet

# GOVERNMENT AUDIT OF K-TOWN MALL FINDS DOZENS OF FAILURES IN PROJECT OVERSIGHT

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Chairman, Committee on Oversight and Government Reform

On June 22, 2007, the Air Force Audit Agency issued an audit report on the Defense Department's construction of the Kaiserslautern Military Community Center.<sup>1</sup> This project, called the "K-Town Mall," is being built on Ramstein Air Base in Germany and will include a new 844,000 square foot multi-use retail facility with an eight-story, 350-room hotel and visiting quarters, a four-plex movie theater with stadium seating, a sports bar, slot machines, and a spa. Managed by the Air Force, the \$200 million K-Town Mall is the Pentagon's largest single facility construction project in the world.

In its report, the Air Force Audit Agency found at least 35 significant deficiencies in critical areas, including: (1) project planning and construction design; (2) solicitation and award oversight; (3) construction change orders; (4) cost and schedule growth; (5) improper contractor payments; and (6) architect-engineer liability. The auditors concluded that the Air Force made fundamental errors in planning the project and overseeing its German contracting agent, Landesbetrieb Liegenschafts -und Baubetreuung (LBB). Despite agreeing with the auditor recommendations, the Air Force refused to cure defects in key areas.

### Project Planning and Construction Design

The auditors found that the Air Force failed to properly plan and oversee the design of the K-Town Mall. The auditors concluded that the Air Force:

- "did not conduct thorough project planning or architectural design reviews" (p. i);
- "did not establish policy to estimate and mitigate risk" (p. 3);
- "did not provide adequate oversight of the planning procedures" (p. 3);
- "did not perform pre-design validation reviews" (p. 2);
- "did not conduct a 65 percent architectural design review to estimate and mitigate project risk" (p. 2); and
- "did not follow up on 35 percent review comments to ensure they were properly incorporated in subsequent designs" (p. 3).

As a result of these deficiencies, the auditors reported that "at least 173 change orders reviewed, totaling €5.2 million (\$6.1 million), were preventable" (p. 3).

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<sup>1</sup> Air Force Audit Agency, *Installation Report of Audit: Military Construction Project — Kaiserslautern Military Community Center (KMCC), United States Air Forces in Europe, Ramstein AB Germany (F2007-0065-FDE000)* (June 22, 2007).

## **Solicitation and Award Oversight**

The auditors found that the Air Force failed to properly oversee the solicitation process used by the contractor, as required by the ABG-75, the bilateral agreement between the U.S. and Germany that governs this project. The auditors concluded that the Air Force:

- “did not ensure the bid process was properly documented” (p. 6);
- did not “establish[] a process for the contractors to provide contractor qualifications for US review” (p. 6);
- “did not request the LBB provide contractor qualification documents in accordance with German contract law” (p. 7);
- “did not establish policies or procedures to submit contractor quality, qualification, and timeliness concerns to the LBB” (p. 7);
- “did not ensure KMCC contracts included all clauses necessary to protect U.S. interests” (p. 9); and
- did not obtain “assurance the contractors could be held liable if they are incapable of performing all contract requirements” (p. 9).

As a result of these deficiencies, the auditors reported that “the US did not have the opportunity to reject a contractor or provide evidence to support that rejection prior to selection” (p. 7).

## **Construction Change Orders**

The auditors concluded that the Air Force failed to oversee the process by which the contractor increased its scope of work through hundreds of change orders. The auditors concluded that the Air Force:

- “did not properly monitor and approve all construction change orders” (p. 11);
- “did not receive or adequately follow up to ensure the LBB provided 427 of 490 (87%) LBB or contractor-initiated change order (CO) documents” (p. 11);
- “did not effectively establish construction change order review processes to ensure change orders were valid, authorized, and within project scope prior to payment” (p. 12); and
- “did not request notification of construction change orders from the LBB prior to change order implementation” (p. 12).

As a result of these deficiencies, the auditors reported that the Air Force “was not able to validate at least €11.9 million (\$13.7 million) in construction change orders for which the contractor could potentially bill and receive payment” (p. 13).

## **Cost and Schedule Growth**

The auditors concluded that the Air Force failed to properly control increases on project cost or schedule delays. The auditors concluded that the Air Force:

- “did not effectively monitor the KMCC military construction project changes to limit cost and schedule growth” (p. 15);
- “did not track construction change order amounts, description, resulting projected schedule delays, or costs” (p. 15);

- “did not verify design review comments were appropriately incorporated in project designs” (p. 16);
- began construction “before designs were completed” (p. 16);
- “approved the use of trade-wise agreements, essentially forcing the LBB to act as a general contractor without implied general contractor authority or liability” (p. 16);
- “did not implement internal controls to obtain and review construction orders prior to implementation” (p. 16);
- “did not review and validate cost estimates or justifications for the aforementioned 427 construction change orders before implementation” (p. 16);
- “did not establish procedures directing project managers to review and validate cost estimates” (p. 16); and
- failed to “discuss construction task sequencing as schedule changes occurred” (p. 16).

As a result of these deficiencies, the auditors estimated that costs for the K-Town Mall have increased from \$131.1 million to at least \$201.6 million (pp. 16-17). Although the project was originally scheduled to be operational by the end of 2005, the auditors reported that it is only 65% finished and has no determined completion date (p. 17).

### **Improper Contractor Payments**

The auditors found that the Air Force failed to properly oversee the process by which it paid contractor invoices. The auditors concluded that the Air Force:

- “did not properly monitor and approve contractor payments” (p. 24);
- “paid ... for materials in excess of approved contract quantities” (p. 24);
- “did not receive change order documentation for €3,172,625 (52 percent) of these payments” (p. 24);
- “did not implement established invoice review procedures to validate contractor invoices with contract and change order specifications and actual contractor work completed prior to authorizing payment” (p. 25); and
- “did not properly appoint certifying and accountable officials” (p. 25).

As a result, the auditors reported that the Air Force “improperly paid KMCC contractors over €5.9 million (\$6.7 million) for 248 contract line items on 3 invoices” (p. 25). The auditors also warned that the Air Force “may be in violation of the ABG-75 agreement, German contract law (VOB), and Section 8137 of Public Law 103-335 and could be held pecuniarily liable for improper payments made” (p. 25).

### **Architect-Engineer Liability**

The auditors found that the Air Force failed to properly evaluate the potential liability of the Architect-Engineer contractor, which is supposed to oversee that quality, accuracy, and coordination of services. The auditors concluded that the Air Force:

- “did not assess and pursue A-E contractor liability” (p. 29);
- “did not request the LBB assess liability for 21 deficiencies confirmed by an independent expert as design errors which could have been prevented” (p. 29);
- “did not establish A-E liability assessment policy and procedures, provide training, implement detection controls, or provide management oversight required to identify design errors and report them to the LBB” (p. 31); and

- allowed a situation in which “A-E contractors were also selected as construction managers and, therefore, not independent” (p. 31).

As a result, the auditors reported that the Air Force “cannot verify investigations and recovery actions will be pursued in a cost-effective and timely manner to mitigate damages, minimize administrative costs, strengthen the likelihood for full recovery, and allow the reuse of project funds” (p.32).

### **Air Force’s Refusal to Implement Audit Recommendations**

While the Air Force agreed with the auditors’ recommendations, it refused to cure defects in key areas, such as properly reviewing change orders and invoices before paying contractors.

For example, when the auditors recommended that the Air Force “[i]mplement internal controls to review construction change orders prior to implementation” (p. 18), the Air Force responded that it would “maintain existing internal controls” (p. 21). The auditors disagreed with this approach, stating:

“[M]anagement comments are non-responsive to the issues raised in the report, and management does not plan to take action to correct the problems noted. ... [A]udit disagrees that existing internal controls to obtain and review construction change orders prior to change order implementation were effectively implemented prior to the audit. Further, [the Air Force] did not provide any evidence to validate their statement that adequate internal controls over construction change orders were in place since the project start” (p. 22).

Similarly, when the auditors recommended that the Air Force “[i]mplement established invoice review procedures to ensure invoices are validated with contract and change order specifications, and that work is completed prior to payment” (p. 26), the Air Force responded that, “[s]ince the beginning of the project, [Air Force] personnel have been checking LBB validated/certified invoices to verify work was accomplished according to contract price and quality” (p. 27). Again, the auditors disagreed, stating:

“[A]lthough management concurred with our audit results and recommendation, they do not plan to take action which we believe will correct the deficiency. ... Specifically, [Air Force] personnel have not been properly reviewing LBB validated/certified invoices to verify work was accomplished according to contract price and quantity ‘since the beginning of the project’ per their statement. ... The improper payments occurred because construction managers did not properly validate contractor invoices with contract and modification specifications and actual contractor work completed prior to authorized payment” (p. 28).