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OFFICE OF THE STATE COMPTROLLER

April 6, 2005

Mr. John L. Buono
Chairman
New York State Thruway Authority
200 Southern Boulevard
Albany, NY 12209

Re: Report 2004-F-47

Dear Mr. Buono:

Pursuant to the State Comptroller's authority as set forth in Article X, Section 5 of the State Constitution and, Section 2803 of the Public Authorities Law, we have followed up on the actions taken by officials of the New York State Thruway Authority (Authority) to implement the recommendations contained in our audit report, *New York State Thruway Authority Administration of Contract C100246 - E-ZPass - ACS State and Local Solutions, Inc.* (Report 2002-R-2).

Background, Scope and Objective

The New York State Thruway Authority is a Public Benefit Corporation created by the New York State Legislature in 1950 to build, operate, and maintain a cross-state superhighway known as the New York State Thruway System (Thruway). In December 1997, Authority officials entered into a five-year, \$33 million cost plus contract with Lockheed Martin (IMS) [later acquired by ACS State and Local Solutions, Inc. (ACS)] to establish and maintain systems, to collect tolls electronically (known as E-ZPass) on the Thruway. The value of the E-ZPass contract was increased in April 2001 to \$71.5 million because customer volume was higher than expected. The length of the contract was extended until December 5, 2004 with a revised value of \$109.5 million. In January 2005, the Office of the State Comptroller approved an additional extension of this contract to April 1, 2005. The contract provides that the Authority will reimburse ACS for all contract-related authorized costs, including personnel and equipment for E-ZPass services. The Authority reported collecting \$222.9 million in tolls electronically (53 percent of total toll revenue) for calendar year 2002 and \$233.7 million in tolls electronically (55 percent of total toll revenue) for calendar year 2003.

Our initial audit report, which was issued on January 12, 2004, reviewed the Authority's oversight and billing practices related to the E-ZPass contract. Our report concluded that the internal controls that the Authority and ACS had established over contract operations were generally adequate. However, we identified improvements that were needed in the areas of contract-related

billings and asset management. Also, while we observed that ACS was delivering the major services required under the E-ZPass contract, the Authority had not developed a comprehensive system of contract monitoring and needed to improve the manner in which it monitored ACS. The objective of our follow-up, which was conducted in accordance with generally accepted government auditing standards, was to assess the extent of implementation, as of January 2005, of the 14 recommendations included in our initial report.

Summary Conclusions and Status of Prior Audit Recommendations

We found that Authority officials have made some progress in correcting the problems we identified. However, additional improvements are needed. Of the 14 prior audit recommendations, Authority officials have implemented five recommendations, partially implemented four recommendations, and have not implemented five recommendations.

Follow-up Observations

Recommendation 1

Conduct timely post audits of ACS billings.

Status - Implemented

Agency Action - Authority officials provided us with copies of their audit results of ACS' monthly billings through May 2004. The Authority's initial audits of these billings did not include a review of any supporting documentation to verify that the indirect cost rates accurately reflected actual costs. We were told that subsequent audit work may result in adjustments for indirect costs or other types of expenditures later selected for more in depth reviews. Audits of ACS' June, July, and August 2004 billings were also in progress as of December 20, 2004, and preliminary results were being reviewed and/or discussed with ACS.

Recommendation 2

Obtain and review the appropriate payroll registers to verify the actual wages paid to contractor staff.

Status - Implemented

Agency Action - Authority officials provided us with the results of their September 2004 audit that verified the actual wages paid to a sample of ACS employees at four sampled E-ZPass locations during June 2003 and January 2004, to the appropriate ACS payroll check registers. We were told that the Authority plans to perform similar reviews on an as-needed basis.

Recommendation 3

Conduct and document occasional site visits to verify that ACS employees are working on Authority E-ZPass related activities.

Status - Not Implemented

Agency Action - According to Authority officials, they used their limited resources to audit the backlog of monthly billings, and address other priorities. During the 2005 calendar year, they now plan to determine if selected ACS contract employees are working at E-Zpass sites, and performing appropriate E-ZPass activities.

Recommendation 4

Obtain documentation that verifies the qualifications of ACS software development employees in Rockville, MD, to ensure that they meet the requirements in accordance with contract terms. If found not to be qualified, replace them with qualified staff.

Status - Not Implemented

Agency Action - According to Authority officials, the Authority awards procurement contracts for services to responsible contractors on the basis of best value, taking into account the contractor's experience and capabilities to perform the required services. They determined that E-ZPass software development needs were, in fact, adequate, and did not agree that verifying the qualifications of software development employees was necessary at this late stage of the contract.

Recommendation 5

Perform periodic audits of the contractor's indirect costs in accordance with contract terms to ensure that they are, in fact, indirect costs related to contracted services and they are fairly represented in the overhead rates.

Status - Not Implemented

Agency Action - According to Authority officials, they plan to accept, for billing/payment purposes, the indirect cost rates submitted by ACS that were reportedly prepared by an independent accounting firm hired by ACS.

The Authority has a contractual obligation to post-audit the contractor's claimed expenses including indirect costs. Authority officials could not explain the rationale for some of the methodology used to apply indirect costs in ACS' compilation. This methodology could have inflated the actual indirect costs and may have resulted in overpayments to the contractor.

Recommendation 6

Analyze the contractor's overhead for years that were not audited to assure management that these costs were, in fact, indirect costs and that they were fairly represented in the overhead rates.

Status - Partially Implemented

Agency Action - According to Authority officials, they have reviewed reports compiled by ACS concerning indirect costs covering the calendar years 1998 through 2002.

Compiling indirect costs rates for the contract is an initial step in checking on the accuracy of indirect costs claimed for reimbursement. However, the Authority has not analyzed the supporting details of those reports. The Authority should also obtain a clear understanding of methodology used to calculate the overhead rates, evaluate the appropriateness of the methodology, and test the accuracy of the financial information used in these calculations.

Recommendation 7

For future years, require contractors to fully support their indirect cost rates.

Status - Implemented

Agency Action - ACS has commissioned M.L. Weekes, Inc. to compile the indirect costs for this contract on an annual basis.

Recommendation 8

Develop a method for searching electronically the contractor's supporting documentation for monthly billings that will make it possible to identify duplicate submissions made within current months and prior months.

Status - Not Implemented

Agency Action - According to Authority officials, they believe that the methods used by the Authority to prevent duplicate payments are effective.

Recommendation 9

Require the submission of vendor invoices with appropriate ACS approvals as supporting documentation to ensure that services paid for are related to the contract.

Status - Implemented

Agency Action - We saw evidence that vendor invoices, with appropriate ACS approvals, are now being submitted to the Authority as justification that services paid are related to the E-ZPass contract.

Recommendation 10

Develop and implement policies and procedures for safeguarding all E-ZPass equipment assets wholly and partially owned by the Authority. These policies and procedures can be directed to the contractor to adhere to or can be assumed by the Authority as part of its overall oversight authority.

Status - Partially Implemented

Agency Action - Authority officials and ACS staff are developing policies appropriate for recording and controlling the contract's fixed assets. Once agreement is reached, the Authority expects ACS to implement the revised fixed asset inventory procedures.

Recommendation 11

Locate the 61 assets identified in this audit as not listed in the inventory records. Recoup the cost of any missing assets from ACS.

Status - Not Implemented

Agency Action - According to ACS reports on file, all of the missing items were located by ACS. However, the Authority relied upon ACS to locate and explain the causes of the missing inventory items, and did not verify that the items were, in fact, located at E-ZPass sites. The Authority should verify that the missing inventory items were actually located and that the equipment location is accurately recorded on ACS' fixed asset inventory.

Recommendation 12

Expand on the testing performed in this audit, verifying that all assets with a material value purchased as part of this contract do exist and are being utilized in accordance with the contract.

Status - Partially Implemented

Agency Action - We noted that the Authority has performed specific inventory steps, designed to determine if ACS inventory controls over assets owned, in part or completely, by the Authority were effective, and if the Authority's fixed assets existed. They performed testing for this at the Buffalo E-ZPass Center on October 24, 2003; the Spring Valley E-ZPass Center on July 26, 2004, and the Yonkers E-ZPass Center on July 28, 2004. The Authority is still evaluating the results of this work.

Recommendation 13

Take an active role in overseeing the E-ZPass tag inventory.

Status - Implemented

Agency Action - We determined the Authority is actively involved in overseeing operational improvements designed to resolve E-ZPass tag storage problems. The boxes used to store returned customer E-ZPass tags, including tags that were inoperable, have historically been commingled in the same room with the boxes used to store new tags. In addition, the design of the inventory storage space coupled with inadequate and insufficient shelving did not facilitate the taking of reliable physical inventories. In April 2004, the Authority hired a company to remove and destroy inoperative E-ZPass tags.

Recommendation 14

Develop procedures that will result in effective monitoring of E-ZPass contract deliverables. For example, develop a method of identifying all contract deliverables that allows for the measurement of the contractor's actual performance.

Status - Partially Implemented

Agency Action - According to Authority officials, they are in the process of identifying contract deliverables in connection with the development of a new Request For Proposal to solicit bids for the delivery of E-ZPass services after the expiration of the current contract.

Major contributors to this report were Frank Patone, Anthony Carbonelli, and John Lang.

We would appreciate your response to this report within 30 days, indicating any actions planned or taken to address any unresolved matters discussed in this report. We also thank the management and staff of the New York State Thruway Authority for the courtesies and cooperation extended to our auditors during this process.

Very truly yours,

William P. Challice
Audit Director

cc: Robert Barnes, Division of the Budget