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**Thomas P. DiNapoli  
COMPTROLLER**



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**OFFICE OF THE  
NEW YORK STATE COMPTROLLER**

**DIVISION OF STATE  
GOVERNMENT ACCOUNTABILITY**

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**DEPARTMENT OF  
TRANSPORTATION**

**CONSTRUCTION  
CONTRACT PAYMENTS**

**Report 2006-S-8**

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## AUDIT OBJECTIVE

Our objective was to determine whether the Department of Transportation's payments on construction contracts are accurate and appropriate.

## AUDIT RESULTS - SUMMARY

The Department of Transportation (Department) spends more than \$1.5 billion a year to build, repair, and maintain the State's highways, bridges, and other transportation infrastructures. The work is performed by private construction firms under contract with the Department. In most instances, the contractors are paid certain agreed-upon amounts for performing certain agreed-upon work in accordance with the agreed-upon specifications (regular contracts). However, in some instances, the contractors are paid on the basis of their actual costs (Force Account work). As of May 23, 2006, the Department had 744 open construction contracts valued at about \$6 billion. The Department had 225 open contracts with Force Account work valued at \$136.4 million as of June 30, 2006.

We examined the payments on both regular contracts and contracts with Force Account work. We found that the controls over regular contract payments provide reasonable assurance the payments are accurate and appropriate. However, we identified a number of weaknesses in the controls over payments on Force Account work. As a result, there is an increased risk contractors may be overpaid for this work.

For example, on-site inspectors are supposed to monitor Force Account work and record their detailed observations in daily inspection reports. When contractors submit claims listing the costs that were incurred in the performance of the work, Department engineers are supposed to verify the claimed

costs against the daily inspection reports. However, when we reviewed a sample of daily inspection reports from selected projects with Force Accounts, we found the inspection reports generally lacked the details needed to verify the contractors' claims, particularly claims for labor and equipment costs. For example, the inspection reports often did not include the number of workers doing the work, the number of hours they worked, or the types of equipment they used. We therefore question how the Department's engineers could verify the accuracy of the costs claimed by the contractors.

Similarly, to verify the accuracy of certain payroll charges (e.g., payroll taxes, unemployment insurance payments, and workers' compensation insurance payments) claimed by contractors doing Force Account work, Department officials must review certain contractor payroll records and other related documentation. However, we found the Department generally does not require contractors to submit this documentation for review. As a result, the Department is generally unable to determine whether the costs claimed by contractors in these areas were, in fact, incurred. In a 2003 audit by the Office of the State Comptroller, the Department was found to have paid a contractor an estimated \$1.8 million for unemployment insurance and workers' compensation insurance costs that were not incurred. We also found that the correct reimbursement rates may not always be used for contractors' equipment-related costs.

Our report contains ten recommendations for improving the Department's controls over its payments on Force Account work. Department officials generally agreed with our recommendations and have taken steps to implement changes.

This report, dated December 21, 2007, is available on our website at: <http://www.osc.state.ny.us>. Add or update your mailing list address by contacting us at: (518) 474-3271 or Office of the State Comptroller  
Division of State Government Accountability  
110 State Street, 11<sup>th</sup> Floor  
Albany, NY 12236

## BACKGROUND

The mission of the Department of Transportation is to ensure a safe, efficient, balanced, and environmentally-sound transportation system for the people who live, work, and travel in the State. In fulfilling its mission, the Department spends more than \$1.5 billion a year to build, repair, and maintain the State's highways, bridges, and other transportation infrastructures. The work is performed by private construction firms under contract with the Department. Department records show that, as of May 23, 2006, there were 744 open construction-related contracts valued at about \$6 billion. Open contracts include those with active construction and those where construction is complete but the contract is not yet closed out. For the majority of these contracts, the Federal Highway Administration (FHWA) pays 80 percent of the costs and the State pays the remaining 20 percent.

The FHWA relies on the Department to ensure that construction work is completed in accordance with Federal specifications. The Department has a comprehensive system of construction oversight to provide assurance these specifications are, in fact, met and payments are made only for expenses that are valid and appropriate (i.e., actually incurred and authorized). In this system, every construction project is overseen by an on-site Department engineer (the Engineer-in-Charge or EIC), who is responsible for all aspects of

project administration. The EICs, in turn, are overseen by construction supervisors and construction managers in each of the Department's 11 regional offices. The Office of Construction in the Department's Central Office has responsibility for programmatic oversight of the Regional construction program.

The EIC maintains all project documentation, including a project diary (a daily record of events at the project site), and must approve all payments to the contractor. The EIC is assisted by other on-site Department and consultant engineers and/or inspectors, who monitor and inspect the work performed by the contractor. Inspectors are particularly important, as they prepare the Inspector's Daily Report. The Inspector's Daily Report describes the work performed and inspected each day, as well as the materials, labor, and equipment used each day. Prospective payments to the contractor are to be compared against the Inspector's Daily Report before the payments are authorized. In addition, the payment authorizations submitted by the EIC are to be reviewed by Finance Unit staff at the Department's Central Office.

The Department's Manual of Uniform Record Keeping (MURK) provides guidance for construction project administration. It indicates what project records have to be maintained to document that contract work was consistent with FHWA standards. The Department also develops and issues Standard Specifications, a compilation of requirements for construction contracts. They define both the contractor's and the Department's responsibilities. The MURK includes a section called the Construction Administration Manual (CAM), which is intended to assist staff in understanding and interpreting the Standard Specifications.

In addition, quality assurance reviews, known as MURK Reviews, are performed by the regional offices to assess compliance with the policies and procedures in the CAM section of the MURK. MURK reviews include testing a sample of EIC payment records and supporting documentation to ensure compliance with MURK standards. MURK reviews are performed for about half of the active projects each year.

In most instances, the Department's contractors are paid on the basis of "pay items" that are included in their contracts. These pay items cover various facets of the construction project. For example, in a highway construction contract, some pay items could cover the clearing, excavation, and grading of land; other pay items could cover various aspects of the highway construction process; and other pay items could cover various aspects of drainage control and landscaping.

When firms bid on the contract, they submit separate prices for each pay item specified by the Department in its bid solicitation. When the contract is awarded (to the lowest responsible bidder), the prices submitted by the winning bidder for each pay item are incorporated into the contract. The contractor is then paid certain amounts each month (or every two weeks) on the basis of the progress that is made on each pay item. The amount of progress on each pay item is recorded by the on-site inspectors and certified by the EIC.

For example, if 20 percent of one pay item and 10 percent of another pay item are completed during a month, the contractor may be paid 20 percent of the contract amount for the one pay item and 10 percent of the contract amount for the other pay item. Or the contractor may be paid for each completed item (e.g., each tree planted) within the overall pay item (100 trees to be planted

along the highway as part of the final landscaping) at the price specified in the contract (\$150 per tree). In either case, the costs actually incurred by the contractor in performing the work are not tracked by the Department, because they are not relevant to the payment process. Rather, the contractor is paid for the amount of work completed at prices established by the contract.

However, in some instances, contractors are paid on the basis of their actual costs. These instances generally arise when the contractor incurs additional work that was not foreseen in the original contract (e.g., changes in the cost of materials, changes in field conditions, design errors or omissions, or emergency repairs), and the Department and the contractor cannot agree on a price for this additional work.

In these instances, the additional unforeseen work is covered by an amendment to the original contract, and under this amendment, the firm is paid for the actual, reasonable, and verifiable cost of the labor, materials, services, and equipment involved in the work (known as time and materials). Specifically, the contractor is to be reimbursed for 100 percent of these costs, and is to receive an additional 20 or 25 percent of this amount (depending on certain factors) for overhead and profit. To support the payments for this additional work, which is known as Force Account work, the contractor is required to keep extensive records documenting the costs actually incurred in the performance of the work.

As of June 30, 2006, there were 225 open contracts with Force Account work. The Force Account work on these contracts was valued at \$136.4 million, while the contracts themselves totaled about \$3.9 billion.

## AUDIT FINDINGS AND RECOMMENDATIONS

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### *Regular Construction Contracts*

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On regular construction contracts, the contractor is paid certain amounts each month (or every two weeks) on the basis of the progress that is made that month (or two weeks) on the pay items in the contract. The Department uses an automated payment monitoring and authorization system known as the Computerized Engineer's Estimate System (CEES) to control the payment process.

On each contract, the pay items for the winning bid are entered into CEES. On-site staff use CEES to document and track the contractor's progress in completing each pay item (e.g., references are made on CEES to Inspector's Daily Reports and the project diary). When a monthly or biweekly payment is due, the EIC certifies the progress on each pay item. The EIC then forwards the resulting payment authorizations for each pay item, along with the corresponding documentation, to the Finance Unit for processing.

To determine whether pay item information from construction contracts is accurately entered onto CEES, we compared the pay item information in the contracts to the information on CEES for a sample of contracts. We randomly selected for review 30 of the 446 construction contracts that were active on May 23, 2006. The 30 contracts totaled about \$318 million. For each contract, we compared the pay item information in the contract (e.g., prices, quantities, and descriptions of the work to be performed) to the pay item information on CEES. We found that, in all instances, the information in the contracts agreed with the information on CEES.

We also evaluated the adequacy of the overall system of internal control over payments on regular construction contracts (i.e., the use of CEES to control payment amounts and the use of on-site inspections and EIC certifications to affirm that the work to be paid for has been performed). We found that this system of internal control provides reasonable protection against overpayments. We therefore conclude there is reasonable assurance payments on regular construction contracts are accurate and appropriate. We note that, in 2005, the FHWA came to a similar conclusion when it reviewed the adequacy of the Department's internal controls over payments on construction contracts. In its review, the FHWA concluded that the Department's contract payments were supported by adequate documentation.

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### *Force Account Work*

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Contractors performing Force Account work are paid on the basis of their actual costs. The Department has established controls for preventing overpayments for this work, but we identified weaknesses in these controls. As a result, there is an increased risk contractors may be overpaid for Force Account work. The risk of overpayment is greatest for the labor and equipment costs claimed by the contractors.

#### Inspector's Daily Reports

Contractors performing Force Account work must submit a daily record of all completed work on a form prescribed by the Department. On this form, the contractor must list the workers' names, their labor classification, the number of hours worked by each individual, the types and quantities of materials used that day, each equipment item, and the number of hours each equipment item was used that day.

The EIC is expected to compare the contractor's daily records of completed work with the Inspector's Daily Reports. If the information in the Inspector's Daily Reports agrees with the information in the contractor's daily record of work completed, and the Inspector's Daily Reports indicate that the work was completed in accordance with the Department's specifications, the EIC is to authorize payment of the contractor's claimed costs (such payments are made on a monthly or biweekly basis). If the information in the Inspector's Daily Reports does not agree with the information in the contractor's daily record of work completed, the EIC has to resolve the discrepancies before authorizing payment.

If the Inspector's Daily Reports are to provide a reliable basis for the EIC's verification of the contractor's claimed costs, they must be thorough and complete. The CAM states that the Inspector's Daily Reports should contain the following information:

- a description of the work completed that day;
- the contractor or subcontractor who performed the work;
- the start and completion times of the work;
- the materials put in place or received;
- the results of inspection measurements and tests;
- the arrival and departure times of equipment and work crews;
- the length and cause of any delays;
- the orders given to the contractor;
- the work or material rejected and the reasons why; and
- the names of the inspectors who prepared the report.

To determine whether the Inspector's Daily Reports met these requirements and were

sufficiently thorough and complete, we reviewed a sample of Inspector's Daily Reports from seven contracts with Force Account work. We judgmentally selected 7 contracts from 3 regions. The selection was from 90 open contracts with Force Account work in those regions as of June 30, 2006. The value of the Force Account work on the seven contracts selected was about \$19.7 million.

We reviewed a sample of Inspector's Daily Reports from each of the seven Force Account contracts. On each contract, we judgmentally selected one of the payment requests authorized by the EIC, generally selecting the largest payment request on each project. The seven payment requests ranged from \$9,230 to \$845,743, and totaled \$1,291,353.

We found that, on all seven contracts, the Inspector's Daily Reports were neither thorough nor complete, as they did not provide critical information about the contractors' workers and equipment. Specifically, in many instances, they did not indicate the number of workers doing Force Account work, the number of hours they worked, or their names, and they did not indicate what items of equipment were used or the number of hours each item was used. In fact, in some instances, the Inspector's Daily Reports contained no information at all about labor and equipment - they simply referred to the contractors' records for these items. In the absence of critical information from the inspectors, we question how the EICs could verify the accuracy of the costs that were claimed by the contractors.

The Department has a standard form for the Inspector's Daily Reports, and the form requires the inspector to provide information about the contractor's labor and equipment. However, the form does not indicate that this

information should contain certain details required by the CAM, and there is no reminder of this requirement on the form. We recommend the form be modified to require these details.

We also note that the form does not require information about Force Account work to be separate from information about regular contract work when projects have both types of work. As a result, there is a risk the contractor could be paid twice for labor and equipment on regular contract work (once under the regular contract and again under the Force Account amendment). We recommend the inspection form be modified to clearly distinguish Force Account work from regular contract work.

We further note that the CAM does not require that the names of the individual workers be recorded on the Inspector's Daily Report. We recommend the CAM be modified to require these names. As is described later in this report, the names of the workers are needed if the EIC is to be able to verify the accuracy of certain payroll charges (e.g., unemployment insurance and social security taxes) claimed by the contractor for Force Account work.

#### Progress Payments

Contractors are to be paid monthly (and, in some cases, every two weeks) for completed Force Account work. These progress payments are to be based on the actual costs incurred to-date by the contractor in performing the work. The contractor's actual costs are to be (1) documented in the contractor's daily records of completed work, (2) supported by appropriate documentation (such as payroll records and invoices or receipts for materials), and (3) verified against the corresponding Inspector's Daily Reports.

In addition, at least 10 percent of the initial estimated payment amount for a Force Account contract is to be withheld by the Department until the work has been completed and approved. This is intended to protect the State's interests when problems are identified during the final inspection. Thus, the total progress payments for a Force Account contract should never exceed 90 percent of the initial estimated amount.

To determine whether these requirements were met, we interviewed the EICs for the seven Force Account contracts in our sample and reviewed the documentation on file for the payment requests for the seven contracts in our sample. We found that the requirements governing progress payments were not always met, as follows:

- One of the EICs told us that he authorized progress payments on the basis of estimated costs (the estimated percentage of Force Account work that was completed at the time of the payment), rather than actual costs. This is directly contrary to the requirement that payments be based on the actual costs incurred to-date by the contractor. The EIC told us he was not aware of this requirement.
- For six of the seven contracts, in some instances, the portion of the Inspector's Daily Report devoted to labor and equipment simply referred to the contractors' records (no information was entered by the inspector). As a result, in these instances, there was no assurance the inspectors made a genuine effort to independently verify the labor and equipment costs claimed by the contractors. One EIC told us this practice was allowed to save time due to the inspectors' heavy workloads.

We note that this lack of documentation of independent verification on the part of the EICs and inspectors was not detected by any of the Department's various levels of oversight (i.e., regional supervisors, regional managers, Finance Unit, and quality assurance reviews).

- On one project, the costs claimed for 13 different materials (\$4,621) were not supported by invoices or receipts.
- On one project, the progress payments authorized by the EIC exceeded the 90 percent limit. The payments, which should not have exceeded \$831,863, totaled \$924,292.

As a result of this noncompliance with the requirements governing progress payments, there is an increased risk contractors may be overpaid for Force Account work.

We determined that there were no controls in CEES to prevent the 90 percent payment limit from being exceeded. After we presented our finding to Department officials, they told us they added such a control to CEES.

The other instances of noncompliance that we identified appear to be the result of inadequate Department oversight. Officials at one regional office told us that attrition has resulted in the promotion of individuals who are not as familiar with accepted procedures as more-experienced staff. They also noted that EICs have so many responsibilities (e.g., observing contractors, reviewing project documentation, preparing written communications, and processing requests for payment) that they may not always have sufficient time to thoroughly review all project documentation. They further noted that Force Account work can require up to

twice as many staff to monitor as regular construction contracts.

Department officials told us that, even if errors are made during the review of payment requests, they will be caught when the project is completed and final reviews are done. However, four of the projects in our sample were completed, and even in our limited review, we found that errors in the calculations for worker's compensation insurance, unemployment insurance, labor costs, and equipment costs had not been corrected during the final reviews.

We also found that, even though the risk of overpayment increases with Force Account work, the Department's Contracts Audit Bureau performs no audits of contracts with Force Account work. In fact, the Contracts Audit Bureau only performs audits of the Department's contracts with consultant engineers. We recommend the Bureau perform audits of Force Account work. Department officials told us the Bureau will perform such audits in the future.

We also recommend that improvements be made in the Department's ongoing oversight of progress payments on Force Account work. The payments are reviewed by EICs, regional supervisors, regional managers, and the Finance Unit, and are subject to quality assurance reviews. Each stage of this oversight process must be strengthened if the Department is to have reasonable assurance the payments are accurate and appropriate.

In addition, during our review of the seven sampled contracts, we identified a potentially serious problem that is not related to the contract payment process. In contracts involving the construction or repair of asphalt pavement, the contractor and a Department representative are to take core samples from the asphalt and test the samples to determine

whether the asphalt meets the Department's specifications. According to the Department's procedures, the locations for the samples should be selected using either the Department's computer sampling program or a random number table.

However, in one of the contracts we reviewed, the EIC allowed a tester hired by the contractor to determine the sample locations. As a result, there was less assurance all portions of the asphalt pavement were subject to testing, and accordingly, less assurance the pavement fully met the Department's specifications. If these specifications are not met, the asphalt can deteriorate prematurely. The EIC told us he was unaware of the Department's sampling requirements. We recommend the Department ensure all EICs are aware of these requirements, and monitor contract documentation to ensure that the requirements are met.

#### Payroll-Related Charges

Contractors may incur various types of payroll costs while performing Force Account work. Generally, they incur payroll costs for wages, fringe benefits (such as health insurance), payroll taxes (FICA Social Security taxes), unemployment insurance, and workers' compensation insurance.

EICs and inspectors can verify certain aspects of these costs through on-site observations. For example, an inspector can observe the number of workers on a project on a given day and the number of hours they work.

However, many aspects of a contractor's payroll costs cannot be verified through observations alone. For example, the hourly pay rates claimed by a contractor must be verified against appropriate payment documentation (such as a payroll register).

Similarly, the fringe benefits claimed by a contractor must be verified against the appropriate labor agreements. The payroll taxes, unemployment insurance payments, and workers' compensation insurance payments claimed by a contractor also must be verified against the appropriate documentation for each type of payment.

For example, State unemployment insurance payments are made only on the first \$8,500 of an employee's annual earnings, and Federal unemployment insurance payments are made only on the first \$7,000 of the employee's annual earnings. The Department thus needs documentation of each employee's annual earnings to verify the total unemployment insurance payments claimed by a contractor. For worker's compensation insurance, the rates and rules will vary for each contractor, and should be documented in the contractor's business records. The Department thus needs access to these records to verify the total worker's compensation insurance payments claimed by a contractor.

To determine whether the Department was obtaining all the documentation it needed to fully verify the payroll costs claimed by contractors on Force Account projects, we reviewed the documentation on file for the seven projects in our sample. We found that the necessary documentation had been obtained for only one of the seven projects. In the other six projects, the Department had not obtained the documentation it needed to verify the contractors' payroll taxes, unemployment insurance payments, and workers' compensation insurance payments. A total of \$230,622 had been claimed by, and paid to, the contractors for these costs. However, in the absence of the necessary documentation, we question how the Department could ensure that the payments were appropriate.

Documentation requirements are contained in the CAM sections of the MURK and in the Standard Specifications. We reviewed these guidelines and found they do not clearly describe how contractors' payroll taxes, unemployment insurance payments, and workers' compensation insurance payments are to be verified. The guidelines also do not require that the necessary payroll documentation (such as year-to-date earnings per employee) be obtained from the contractor. We recommend the guidelines be modified to require this documentation and clearly describe how the costs are to be verified. We further note that training in the verification of these costs may need to be provided to the EICs, as the EICs for the seven projects in our sample told us that they had not received such training.

We also found that one of the regional offices had implemented its own documentation policy for payroll taxes and unemployment insurance payments, as it required certain payment documentation for all such costs claimed after June 30th of each year. We are not questioning the validity of this policy, but note that no other regional office has this requirement. To promote consistency, all regional offices should have the same documentation requirements.

It should also be noted that the need for better controls in this area was identified in a previous review, as the Office of the State Comptroller's Bureau of State Expenditures found, in 2003, that the Department had paid a construction contractor an estimated \$1.8 million more than was due for unemployment insurance and workers' compensation insurance costs (see report BSE-2003-003).

#### Equipment Costs

Contractors performing Force Account work are to be reimbursed for equipment costs. The

standard reimbursement rates for each equipment item are found in the *Rental Rate Blue Book for Construction Equipment (Blue Book)*, an authoritative construction industry publication. These rates vary depending on whether the items are actually in use or are only in "stand-by" status. Typically, the stand-by reimbursement rates are 50 percent of the in-use reimbursement rates.

Inspectors are required by the CAM to record equipment idle (stand-by) time on the Inspector's Daily Report. However, this information was not recorded on any of the Inspector's Daily Reports we reviewed for the seven sampled Force Account projects. None of these Inspector's Daily Reports made a distinction between an equipment item's in-use time and its stand-by time. (In fact, as was previously noted, the Inspector's Daily Reports often did not specify which particular equipment items were used or the number of hours each item was used.) Only one EIC made any record of the time equipment was in stand-by status in the project diary. As a result, in some instances, the contractors may have been paid the higher in-use rates for equipment that was actually in stand-by status.

Department officials indicated that it can be difficult to distinguish in-use status from stand-by status. For example, if two pieces of equipment are used intermittently on an alternating basis on one operation throughout the day, they can both be considered to be in use for the entire workday. They also noted that equipment does not have to be in continuous motion to be considered in use. The officials said the inspectors and EICs must use their judgment and evaluate each situation on a case-by-case basis.

However, we found that neither the CAM nor the Standard Specifications provide in-depth guidance on this matter, and neither contains

guidelines for verifying whether contractors' reimbursement claims in this area are accurate or even reasonable. In the absence of such guidance, we question whether inspectors and EICs can be consistent in their judgments.

Department officials stated that they do not want inspectors "stop watching" equipment use throughout the day. However, if no effort is made to verify whether claimed equipment use is accurate and fair, payments for equipment use may be higher than they should be. We recommend the Department develop detailed guidance for the inspectors and EICs, and monitor Force Account work to ensure that the guidance is appropriately applied.

Department officials also told us that, in the long run, it may be beneficial for the Department to pay in-use rates for equipment in stand-by status. They indicated that, if contractors were required to claim the lower stand-by rates for equipment that was not actually in use, they might not bring the equipment to the work site until they were certain it would be needed that day, and the Department could end up paying more because of that.

For example, an equipment item might actually be needed only three days during a given week. If the contractor only brought the item to the work site on those three days, the Department would pay less the other two days, because it would not be paying for the equipment on those days. However, it could pay more on the other three days, because it would have to reimburse the contractor for the cost of transporting the item to and from the work site. There could also be delays (which are costly), because it could turn out that the item was needed on days when it was not brought to the work site.

Department officials believe these possible additional costs would more than offset the savings from the lower stand-by rate. However, the Department has not performed any cost analyses to support this position. We also note that it is the Department's own CAM which requires stand-by time to be recorded. We further note that the general lack of information about equipment on the Inspector's Daily Reports (i.e., the failure to specify either the equipment items used or the number of hours they are used) increases the risk of overpayments for equipment.

In addition, the *Blue Book* states that equipment reimbursement rates may need to be adjusted (i.e., lowered) on the basis of an item's age. However, two of the contractors in our sample claimed (and were paid) the reimbursement rates for new items, even though the items were not new. As a result, the contractors may have been overpaid for the items.

### **Recommendations**

1. Ensure that Inspector's Daily Reports for Force Account work contain all the details needed to verify the accuracy of the costs claimed by the contractors, and clearly distinguish Force Account work from regular contract work when projects contain both types of work.
2. Modify the CAM to require the names of individual workers on Force Account projects to be recorded on the Inspector's Daily Reports.
3. Require EICs, regional supervisors, regional managers, and the Finance Unit to more closely monitor progress payments on Force Account work for compliance with Department requirements.

4. Ensure that the Contracts Audit Bureau provides adequate audit coverage of compliance with Force Account work.
5. Ensure that all EICs are aware of the sampling requirements for asphalt core testing, and monitor contracts with this testing to ensure that the requirements are met.
6. Revise the MURK and the Standard Specifications to (1) clearly describe how contractors' payroll taxes, unemployment insurance payments, and workers' compensation insurance payments are to be verified by the Department and (2) require contractors to provide the Department with the payroll records and other documentation that are needed to fully verify these payments.
7. Monitor contracts with Force Account work to ensure that contractors' claims for these costs are properly and consistently verified in all the regional offices.
8. Train EICs in how to verify contractors' claimed payroll taxes, unemployment insurance payments, and workers' compensation insurance payments.
9. Develop detailed guidelines to help inspectors and EICs distinguish in-use equipment from stand-by equipment, and verify whether contractors' reimbursement claims for such equipment are accurate and reasonable. Ensure that the guidelines are appropriately applied.
10. Ensure that the reimbursement rates for equipment are correctly adjusted for the age of the equipment.

## AUDIT SCOPE AND METHODOLOGY

We conducted our performance audit in accordance with generally accepted government auditing standards. We audited the Department of Transportation's oversight of construction contract payments for the period February 1, 2005 through September 15, 2006. To accomplish our objective, we interviewed Department officials, and reviewed Department procedures and records. We also reviewed a random sample of 30 regular construction contracts and a judgmental sample of seven contracts with Force Account work.

We selected the 30 regular construction contracts from the 446 that were active on May 23, 2006. For each contract, we compared the pay item information in the contract to the pay item information on CEES to determine whether the information agreed.

We selected the 7 Force Account contracts from 3 of the Department's 11 regions, selecting 7 of the 90 open contracts with Force Account work in those regions as of June 30, 2006. Four of the seven contracts had been completed and three were in progress. We judgmentally selected the contracts because of their high dollar amount. We visited the project field offices for the three active projects and the regional offices for the four completed projects. For each project, we judgmentally selected one of the payment requests authorized by the EIC, generally selecting the largest payment request on each project. We then traced the costs claimed by the contractors on the seven payment requests to the relevant Inspector's Daily Reports and other supporting documentation. The seven payment requests covered either two weeks or one month, and ranged from \$9,230 to \$845,742.

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In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members to certain boards, commissions and public authorities, some of whom have minority voting rights. These duties may be considered management functions for the purposes of evaluating organizational independence under generally accepted government auditing standards. In our opinion, these functions do not affect our ability to conduct independent audits of program performance.

#### **AUTHORITY**

The audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law.

#### **REPORTING REQUIREMENTS**

We provided a draft copy of this report to Department officials for their review and comment. We considered their comments in preparing this final report, and are included as Appendix A. Appendix B contains State Comptroller's Comments which address matters contained in the Department's response.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the Commissioner of the Department of Transportation shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons therefor.

#### **CONTRIBUTORS TO THE REPORT**

Major contributors to this report include Carmen Maldonado, Gerald Tysiak, Steve Goss, Roger Mazula, Brandon Ogden, Gayle Clas, Raymond Barnes, and Dana Newhouse.

## APPENDIX A - AUDITEE RESPONSE



STATE OF NEW YORK  
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ALBANY, NY 12232  
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ASTRID C. GLYNN  
COMMISSIONER

ELIOT SPITZER  
GOVERNOR

November 8, 2007

Ms. Carmen Maldonado  
Office of the State Comptroller  
Division of State Services  
State Audit Bureau  
123 William Street – 21<sup>st</sup> Floor  
New York, NY 10038

Re: OSC Draft Report #2006-S-8  
Construction Contract Payments

Dear Ms. Maldonado:

Thank you for the opportunity to respond to the subject report. Below is the Department of Transportation's (Department) response.

### RESPONSE TO RECOMMENDATIONS

**Recommendation 1:** Ensure that Inspector's Daily Reports for Force Account work contain all the details needed to verify the accuracy of the costs claimed by the contractors, and clearly distinguish Force Account work from regular contract work when projects contain both types of work.

**Response:** We agree with this recommendation. The Inspector's Daily Report should be completed in accordance with the MURK requirements. The Inspector's Daily Report (MURK 1d) was revised by EB 07-003, dated 1/23/07, and is now called the Daily Work Report (MURK 1). The Daily Work Report includes additional detail to allow the inspector to log the number and classification of labor and the type and identification number of the equipment for up to four different operations per form. Two new forms were also created, the Daily Work Report – Description Continuation (MURK 1-1) and the Daily Work Report – Contract Pay Item Continuation (MURK 1-2).

**Recommendation 2:** Modify the CAM to require the names of individual workers on Force Account projects to be recorded on the Inspector's Daily reports.

**Response:** We do not agree with this recommendation. We believe that the changes made in response to recommendation 1 will provide sufficient detail for verifying the records submitted by the contractors without burdening the inspectors with excessive paperwork. As we conduct our audits of force account work (see recommendation 4) and are able to assess the effectiveness of these new controls, we will make additional process adjustments as needed to provide reasonable assurance that the force account payments are accurate.

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**Comment**  
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It should also be noted, that the Office of Construction has developed and is testing a new electronic force account tracking system called eFAW. The new system will automate and simplify force account tracking and documentation for the contractors, as well as provide more detailed information for the Department's project staff to use in reviewing force account reimbursement requests. This system will include the names of individual workers in a labor resource table.

**Recommendation 3:** Require EICs, regional supervisors, regional managers, and the Finance Unit to more closely monitor progress payments on Force Account work for compliance with Department requirement.

**Response:** We agree with this recommendation. As noted in the report, the Computerized Engineer's Estimate System (CEES) has been modified to include a control that would prevent the 90 percent payment limit from being exceeded. The updated version of CEES is now in use on all Department construction projects.

**Recommendation 4:** Ensure that the Contract Audit Bureau provides adequate audit coverage of compliance with force account work.

**Response:** We agree with the recommendation. The Contract Audit Bureau has had insufficient staff in the past to provide audit coverage of force account work associated with construction contracts. However, we are hiring new staff and will be developing audit planning and risk assessment procedures to identify high risk construction contracts, and begin providing audit coverage of these higher risk contracts using current staff and audit resources supplied by an independent CPA firm currently under contract with the Department. We expect to have adequate coverage of compliance with force account work in place by June 30, 2008.

**Recommendation 5:** Ensure that all EICs are aware of the sampling requirements for asphalt core testing, and monitor contracts with this testing to ensure that the requirements are met.

**Response:** We agree with this recommendation. While the Department contends that the instance identified by the auditors was isolated and not systematic, this topic will be included in the training agenda for Regional EIC Meetings/Training Sessions. The Department will continue to monitor contracts with this testing as part of their normal review with their project staff.

\* See State Comptroller's Comments, page 20

**Recommendation 6:** Revise the MURK and the Standard Specifications to (1) clearly describe how contractors' payroll taxes, unemployment insurance payments, and worker's compensation insurance payments are to be verified by the Department and (2) require contractors to provide the Department with the payroll records and other documentation that are needed to fully verify these payments.

**Response:** We agree with this recommendation. Revisions have been made to the Standard Specifications addressing many of these concerns. §109-05 B. now states:

"At the preconstruction meeting, the Contractor should provide the Engineer documentation supporting its Commercial General Liability Insurance rates for the current period, and provide updates within 30 days after the renewal date, to assist in timely preparation and review of force account reports."

"At the Contractor's option, a labor markup of 15% of all wages, not including supplemental (fringe benefits), for FICA, Medicare, paid holidays, Federal Unemployment tax, and State unemployment insurance in lieu of a detailed accounting."

"Workers compensation insurance rate will be the base rate and the territorial differential only established by the NYS Workers Compensation Insurance Rating Board, subject to the Construction Employment Limitation Program limits. No other additional charges or modifiers will be allowed."

"Insurance and other costs incurred or limited on a weekly basis will be reimbursed based on the percentage of the employees weekly gross wages paid under force account."

Contractors may now use the 15% labor markup, which eliminates the need for tracking payroll taxes and unemployment insurances. If Contractors do not opt to use 15% labor markup, then they must provide a detailed accounting which includes year-to-date payroll information for all workers.

Workers compensation insurance rates are now the rates as established by the NYS Workers Compensation Insurance Rating Board. NYSDOT will no longer need to obtain and verify the Workers Compensation rates provided by each contractor. The Department is continuing with efforts to develop hourly Workers Compensation rates that could be simply applied to each hour of Force Account work completed.

Contract Administration Manual (CAM) revisions to reflect these specification changes will be included in the next CAM update which should be issued prior to the start of the 2008 construction season. In addition, these issues have been and will continue to be addressed at training sessions and meetings with NYSDOT Construction staff and Contractor staff.

**Recommendation 7:** Monitor contracts with Force Account work to ensure that contractors' claims for these costs are properly and consistently verified in all the regional offices.

**Response:** We agree with this recommendation. Force Account documentation is reviewed by project staff, Regional staff, and Office of Construction staff. A Force Account is not considered final until the Force Account final submissions are submitted, reviewed and closed.

**Recommendation 8:** Train EICs in how to verify contractors' claimed payroll taxes, unemployment insurance payments, and workers' compensation insurance payments.

**Response:** As noted in the response to Recommendation 6 above, the Standard Specifications have been revised to address these concerns. CAM revisions to reflect these specification changes will be included in the next update. These revisions and this these topics have been addressed at various training sessions and meetings, including EIC Training, Office Engineer Training, EIC Winter Meetings, and RCE Meetings.

**Recommendation 9:** Develop detailed guidelines to help inspectors and EICs distinguish in-use equipment from stand-by equipment, and verify whether contractors' reimbursement claims for such equipment are accurate and reasonable. Ensure that the guidelines are appropriately applied.

**Response:** Revisions have been made to the Standard Specifications addressing this concern. Standard Specification §109-05B l.c. Equipment now states, "Reimbursement will be made for the product of the hours of actual use or hours it is required to be present, and not available for mobilization elsewhere, multiplied by the hourly rate."

The Specifications and CAM do not address "stand-by" equipment. Reimbursement is made for equipment used or required to be present. Idle equipment is equipment that is not in use or parked, and compensation for idle equipment is allowed only in cases of delay.

**Recommendation 10:** Ensure that the reimbursement rates for equipment are correctly adjusted for the age of the equipment.

**Response:** We agree with this comment. Equipment reimbursement rates should be adjusted by the equipment age factor. This provision will be addressed in greater detail in the next CAM revision.

#### COMMENTS ON SELECT REPORT CONTENT

**Page 2 of 13, paragraph 4.** "However, when we reviewed a sample of daily inspection reports from *selected Force Account Projects* ...."

**Comment:** This phrase should read “However, when we reviewed a sample of daily inspection reports from selected projects with Force Accounts ....”

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Comment  
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**Page 3 of 13, paragraph 2.** “All on-site and regional activity is overseen by the Bureau of Construction Management officials in the Department’s Central Office.”

**Comment:** This sentence should read, “The Office of Construction in the Department’s Central Office has the responsibility for programmatic oversight of the Regional construction program.”

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Comment  
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**Page 4 of 13, paragraph 4.** “These instances generally arise when a contractor must incur additional costs that were not foreseen in the original contract (e.g., unanticipated work, changes in the cost of materials, changes in field conditions, design errors or omissions, or emergency repairs) ....”

**Comment:** To avoid any confusion, this statement should be changed to read “These instances generally arise when a contractor incurs additional work, not incur additional costs. Contractors are paid the costs they bid except in limited specific circumstances cited in the contract provisions. Contractors do not generally receive additional payment simply because costs increase.”

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Comment  
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**Page 6 of 13, paragraph 2.** The second bullet, “the workers who performed the work;”

**Comment:** The CAM states “Indicate who performed the work, Prime Contractor name and/or Subcontractor name.” The intent of the CAM is to record the name of the firm that performed the work, not the names of the individual workers.

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Comment  
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**Page 6 of 13, paragraph 5.** “Specifically, in many instances, they did not indicate the number of hours they worked, or their names, and they did not indicate what items of equipment were used or the number of hours each item was used”

**Comment:** The CAM does not require the inspector to list the names of the individual workers or the hours that the equipment was used.

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Comment  
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**Page 10 of 13, paragraph 5.** “Inspectors are required by the CAM to record equipment stand-by time on the Inspector’s Daily Report”

**Comment:** Neither the Specifications nor the CAM address “stand-by” equipment time. CAM §90 (page 14) states, “If idle equipment is observed it should be noted on the IR.” Idle equipment is generally considered to be equipment that is not in use or parked, and for NYSDOT, is typically associated with equipment that is impacted by delays or stop work orders. Equipment that is in place at an active work site but being used intermittently is generally not considered idle. Standard Specification §109-05B 1.c. Equipment states, “Reimbursement will be made for the product of the hours of actual

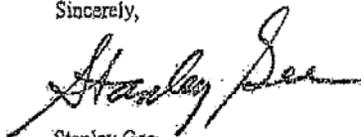
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Comment  
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\* See State Comptroller's Comments, page 20

use or hours it is required to be present, and not available for mobilization elsewhere, multiplied by the hourly rate.”

If you require additional information, please contact me at: 518-485-5364.

Sincerely,

A handwritten signature in black ink, appearing to read "Stanley Gee". The signature is written in a cursive, flowing style.

Stanley Gee  
Executive Deputy Commissioner

cc: Ms. Lisa Ng Division of the Budget

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**APPENDIX B - STATE COMPTROLLER COMMENTS ON AUDITEE RESPONSE**

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1. The Department states that other steps it has taken are sufficient to verify contractor claims without requiring inspectors to record the names of workers on Force Account work each day. These steps include revisions to the Inspector's Daily Report (now called the Daily Work Report) and an electronic tracking system for Force Account work. However, the Department needs to ensure that this method will enable it to verify the costs claimed by contractors, including wages, payroll taxes, unemployment insurance payments and workers' compensation payments related to Force Account work.
2. We have revised the report to reflect information in the Department's response.
3. We agree that the CAM does not require the inspector to list the names of the workers or the hours that the equipment was used. However, this information is necessary to verify the accuracy of the costs claimed by the contractor for Force Account work as noted later in the paragraph. For this reason, our report states that the Inspector's Daily Reports did not provide critical information about the contractors' workers and equipment.
4. We use the term "stand-by" because it is the term used in the Blue Book as noted in the prior paragraph of the report. The CAM uses the term "idle" equipment to refer to equipment not in use. Regardless of the specific term used to refer to equipment that is not in use, our point is that equipment not in use is typically reimbursed at a lower rate than equipment that is in use. Therefore, the Department needs a method to ensure that it accurately reimburses contractors for equipment used on Force Account work.