

*A REPORT BY THE NEW YORK STATE
OFFICE OF THE STATE COMPTROLLER*

Alan G. Hevesi
COMPTROLLER



**NEW YORK STATE THRUWAY AUTHORITY
ADMINISTRATION OF CONTRACT C100246
E-ZPASS**

ACS STATE AND LOCAL SOLUTIONS, INC.

2002-R-2

DIVISION OF STATE SERVICES



Alan G. Hevesi
COMPTROLLER

Report 2002-R-2

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

Dear Mr. Buono:

The following is a report of our audit of Contract C100246 (E-ZPass) between the New York State Thruway Authority and ACS State and Local Solutions, Inc.

This audit was conducted pursuant to the State Comptroller's authority, as set forth in Article X, Section 5, of the State Constitution, and Section 2503 of the Public Authorities Law. We list major contributors to this report in Appendix A.

Office of the State Comptroller
Division of State Services

January 12, 2004

EXECUTIVE SUMMARY

NEW YORK STATE THRUWAY AUTHORITY

ADMINISTRATION OF CONTRACT C100246 - E-ZPASS ACS STATE AND LOCAL SOLUTIONS, INC.

SCOPE OF AUDIT

The New York State Thruway Authority (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 contract provides that the Authority will reimburse ACS for all contract-related authorized costs, including personnel and equipment, for E-ZPass services during the five-year period. The Authority reported collecting slightly more than \$188.4 million in tolls electronically (46 percent of total toll revenue) for calendar year 2000 and \$207.2 million (50 percent of total toll revenue) for calendar year 2001.

We audited the Authority's oversight and billing practices related to the E-ZPass contract for the period July 1, 2000 through January 31, 2003. Our financial-related audit sought to answer the following questions:

- Are contractor billings supported adequately and appropriate for contract purposes?
- Do Authority officials monitor contractor operations effectively to ensure compliance with terms of the contract?

AUDIT OBSERVATIONS AND CONCLUSIONS

We found that the internal controls the Authority and ACS have established over contract operations are generally adequate. However, improvements are needed in the area of contract-related billings and asset management. Also, while we observed that ACS is delivering the major services required by the

E-ZPass contract, the Authority has not developed a comprehensive system of contract monitoring and needs to improve the manner in which it monitors ACS.

In addition to direct costs, the E-ZPass contract allows for reimbursement of indirect costs (e.g., fringe benefits, overhead, etc). When we tested the calculations for 60 indirect cost applications for the contract period, we found that all of the rate calculations had been applied accurately. However, we were unable to test the accuracy of the underlying cost data supporting the rates submitted by ACS, because no detailed information was available. In addition, the Authority has not exercised its contractual right to audit the accuracy of the cost data supporting the rates submitted by ACS. Further, the Authority has relied on the unaudited cost data in its negotiation process for a contract extension. We also noted that some contract-related payments were made without either vendor invoices or required approval signatures. Thus, the Authority has no assurance that these items represent services that were actually received and that were related to this contract. The Authority needs to strengthen its controls over reviews of the supporting documents for billings. (See pp. 5-11)

E-ZPass equipment assets, including tags, are the property of the Authority, and its E-ZPass partners (The Metropolitan Transportation Authority, and The Port Authority of New York and New Jersey). As such, they are collectively or individually responsible for securing these assets. Our audit determined that the Authority delegated its inventory control responsibility to ACS – which we found was not handling this responsibility effectively. We found that many of the ACS inventory records we reviewed lacked purchase dates (66 percent), cost data (63 percent), model numbers (37 percent), serial numbers (35 percent), and/or the item description (16 percent). Authority officials have not taken a physical inventory of E-ZPass assets; nor have they periodically obtained E-ZPass tag inventory records from ACS. ACS does not investigate variances (overages/underages) between the physical counts of tags and the inventory records; it simply adjusts the records to agree with the physical count of tags in inventory. We also tested a sample of 16 invoices representing the purchase of 63 assets including computer processors and servers. We were unable to locate 61 of these items valued at \$2.1 million. (See pp. 13-17)

We observed that the E-ZPass system is functioning and that ACS is delivering the major services required by the contract. For example, the contractor is providing tag distribution services, customer service, customer outreach, account maintenance, toll collection, invoicing services, security, violations processing, and performance-reporting services. However, because contract deliverables are not being monitored sufficiently by the authority, it does not know the levels of effectiveness and efficiency with which all of these contract services are being provided. We found that the Authority has not developed a comprehensive system of contract monitoring and needs to improve the manner in which it monitors ACS. (See pp. 19-21)

COMMENTS OF AUTHORITY OFFICIALS

While Authority officials did not fully concur with all of our observations, they concurred with most of our recommendations and indicated steps being taken to implement them.

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INTRODUCTION

Background

The New York State Thruway Authority (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), the longest toll highway system in the United States. Policies of the Authority are determined by a three-person Board whose members are appointed by the Governor, with the consent of the New York State Senate.

The Authority is responsible for a 641-mile system of highways crossing New York State (State). Its mission is to manage the user fee-supported operation in such a way that it delivers high levels of safety and service. In July 1993, the Authority began collecting tolls electronically on the Thruway. As part of this effort, Authority officials entered into a five-year, \$33 million cost-plus contract with Lockheed Martin, IMS, during December 1997 to establish and maintain systems to collect Thruway tolls electronically (known as E-ZPass). In April 2001, the value of the E-ZPass contract was increased to \$71.5 million because customer volume was much higher than expected. Four months later, ACS State and Local Solutions, Inc. (ACS), acquired Lockheed Martin, IMS. (ACS maintains separate but similar agreements with the Port Authority of New York and New Jersey, and the Metropolitan Transportation Authority (MTA), Triborough Bridge and Tunnel Authority [MTA Bridges and Tunnels], and five other political venues.) The Authority reimburses ACS for those costs that are related to E-ZPass services under the contract, and allows ACS to earn a maximum in gross profits of \$3.4 million. The Authority has exercised the option in its contract with ACS that permits a two-year extension that could increase the total value of the contract to more than \$109 million, resulting in a corresponding increase in the contractor's gross profit.

ACS has administrative offices in Teaneck, New Jersey; and oversees the daily operations of eight E-ZPass Walk-In Centers (service locations) throughout the State (Albany, Buffalo, College Point, Grand Island, Spring Valley, Syracuse, Yonkers,

and Staten Island). ACS maintains in Westchester its database systems that support E-ZPass.

The Authority reported collecting slightly more than \$188.4 million in E-ZPass tolls (46 percent of total toll revenue) for calendar year 2000, and \$207.2 million (50 percent of total toll revenue) for calendar year 2001.

Audit Scope, Objectives, and Methodology

We audited the Authority's oversight and bill payment practices related to the E-ZPass contract for the period of July 1, 2000 through January 31, 2003. The objectives of our financial-related audit were to determine whether the Authority's bill payment practices ensured that contractor billings were adequately supported and were appropriate for contract purposes, and whether the Authority's oversight of contractor operations ensured compliance with the terms of the contract.

To accomplish our objectives, we evaluated the internal controls, policies, and procedures of the Authority and ACS, as well as other internal processes related to contract operations. Our evaluation was based on meetings with Authority and ACS officials; and reviews of applicable laws, rules and regulations, and relevant agency records. We also visited three E-ZPass Walk-In Centers (Albany, Spring Valley, and Syracuse) to verify the physical presence of 15 employees, and selected assets purchased with contract funds.

We conducted our audit in accordance with government auditing standards generally accepted in the United States of America. Such standards require that we plan and perform our audit to adequately assess those operations which are included within our audit scope. Further, these standards require that we understand the internal control structure of the Authority and ACS and their compliance with those laws, rules, and regulations that are relevant to the operations which are included in our audit scope. An audit includes examining, on a test basis, evidence supporting transactions recorded in the accounting and operating records and applying such other auditing procedures as we consider necessary in the circumstances. An audit also includes assessing the estimates, judgments and decisions made by management. We believe that our audit provides a reasonable basis for our findings, conclusions and recommendations.

We use a risk-based approach when selecting activities to be audited. This approach focuses our audit efforts on those operations identified through a preliminary survey as having the greatest probability for needing improvement. Consequently, by design, we use finite audit resources to identify where and how improvements can be made. Thus, we devote little audit effort to reviewing operations that may be relatively efficient or effective. As a result, our audit reports are prepared on an “exception basis.” This report, therefore, highlights those areas needing improvement and does not address activities that may be functioning properly.

Internal Control and Compliance Summary

Our consideration of the internal control structure the Authority and ACS have established over contract operations found that it is sufficient to capture and record relevant contract-related financial transactions. However, as described later in this report, improvements are needed in the areas of contract-related billings, inventory record-maintenance, as well as contract monitoring.

Response of Authority Officials to Audit

A draft copy of this report was provided to Authority officials for this review and comment. Their comments were considered in preparing this report, and are included as Appendix B.

While Authority officials did not fully concur with all of our observations, they concurred with most of our recommendations and indicated steps being taken to implement them.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the Executive Director of the New York State Thruway Authority 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.

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CONTRACTOR'S MONTHLY BILLINGS

According to Authority officials, it conducts a pre-payment audit before authorizing the payment of ACS's bills, and also performs a subsequent post audit of each billing. Overpayments that result from the post-audit process are recouped through adjustments to later billings. In fact, audits by the Authority's Office of Fiscal Audit and Budget (Fiscal Audit) of ACS's first 60 billings had disallowed more than \$1.8 million. However we noted that the audit of the most recent ten of these billings had been delayed significantly because the auditors position was vacant for nine months.

To determine whether ACS's monthly billings are supported adequately and related to the contracted services, we reviewed the controls established by the Authority for this process. We found that the Authority needs to strengthen its controls over reviews of the supporting documents for billings.

Payroll Costs

ACS payroll costs reimbursable under its contract with the Authority for the scope of this audit were more than \$10.5 million. We sought to determine whether the payroll costs were accurate. To do this, we randomly selected a sample of payroll records for 50 ACS employees, 25 employees on the payroll as of September 2001, and 25 employees on the payroll as of March 2002. For these 50 employees, using source documents such as, personnel files, payroll registers, and time and attendance records, we documented the number of hours each worked, as well as each person's pay rate, gross pay, and employment location. We then made a comparison between the payroll data submitted with the selected monthly billings and the information in the original source documents. We observed no exceptions.

Currently, Fiscal Audit staff review the time sheets of a sample of 20 ACS employees from each monthly billing. This review consists of multiplying the number of hours worked times the employee's pay rate to arrive at a gross salary. However, the hours reported on employee time sheets are not compared with

the appropriate payroll registers to verify that the wages paid were for hours actually worked. Also, the Authority does not verify that ACS actually paid the employee the wages submitted for reimbursement. We believe the Authority should periodically review ACS payroll registers to ensure that the wages submitted for reimbursement under the contract were actually paid. From the payroll registers, we selected each employee's start date and pay rate for verification with the individual's personnel folder. We observed no exceptions.

Employee Verification

In the past, the Authority has conducted random site visits to verify that employees whose salaries were being charged to the contract were present and working on their designated E-ZPass tasks. However, this practice has been discontinued because of staff shortages and because Authority officials indicated that the site visits did not discover any unexplained discrepancies. Therefore, we conducted our own test to determine whether select ACS staff being billed to the contract were accounted for.

Utilizing ACS's February 2003 work schedule, we judgmentally selected a total of 15 employees – 5 from the staff of each of 3 Walk-In Centers we visited –and sought to verify their existence. Of the 15 employees, 11 were present during our visits. Appropriate documentation was available for all four of the remaining employees; two were taking pre-approved vacation days, while the other two had called in absent due to bad weather or illness. Our subsequent review of time sheets for these four employees revealed that all four had charged leave time appropriately for their absences. In addition, during May 2003 we re-visited the three Walk-In Centers and physically verified the existence of the four employees not present during our original visit; all employees were accounted for.

Because the computer programming function is critical to the success of the electronics-based E-ZPass program, we also sought to verify the qualifications of five ACS software development employees located in Rockville, MD, through a review of their personnel folders. According to the contract, these individuals, who are paid a total of \$168,000 annually, were required to have the necessary skills, training, and expertise to perform the services described in the contract. However, the folders for this group of employees were not

available at either Staten Island, New York, or Teaneck, New Jersey, as originally represented by ACS. Authority officials told us they do not check the qualifications of their Rockville, MD, personnel; they said they judge the qualifications of such employees by examining their work product. We believe the Authority should review the background of ACS personnel to verify that they are able to provide the technical services in accordance with the contract's terms.

Overhead Indirect Cost Rates

ACS is reimbursed for actual costs incurred that are directly-attributable to employee salaries, direct out-of-pocket expenses, and its own overhead costs. The actual overhead, or indirect costs, are initially paid on the basis of estimated rates that are subject to adjustment following a post audit. The contract calls for three estimated overhead rates, with capped limits, that fall within the following ranges over the life of the contract: Fringe Benefit Rate (40.2 percent to 42.2 percent); Line of Business Overhead (8.75 percent to 9.75 percent); and General Administrative (20.75 percent to 21.75 percent). For the five-year period that ended in December 2002, ACS has been reimbursed for the following indirect costs:

**Total Indirect Cost
For the Five Years Ending in December 2002**

| Indirect Cost Category | Amount |
|----------------------------------|---------------|
| Fringe Benefit | \$4,287,750 |
| Line of Business Overhead | \$4,217,974 |
| General Administrative | \$3,408,577 |
| Total | \$11,914,301 |

We tested the calculations for 60 indirect cost applications out of 480 billed for the contract period, and found that all of the rate calculations had been applied accurately. However, we were unable to test the accuracy of the underlying cost data submitted by ACS because no detailed information was available. Thus, we could not determine whether the Authority was paying for only appropriate indirect costs. The Authority has not exercised its contractual right to audit the accuracy of the cost data submitted by ACS.

Further, the Authority has relied on the unaudited cost data provided by ACS in its negotiation process for a contract extension.

In November 2001, after more than two and a half years into the contract period, the Authority requested indirect cost data from ACS for the three years of 1998, 1999, and 2000. Authority officials advised us that they had reviewed the indirect cost data and determined that the data was reasonable. However, the Authority could provide no documentation to support its review.

(In response to our draft report, the Authority indicated that a CPA firm completed an audit of indirect cost rates for 1998, 1999 and 2000, and found small variances. This firm is in the process of auditing the 2001 and 2002 rates. ACS assured the Authority that, in the future, audits will be done annually.)

In October 2002, the Authority's Board of Directors authorized the negotiation process for a two-year contract extension through December 2004, as allowed by the contract. In December 2002, as part of the contract-extension process, the Authority requested indirect cost data from ACS for 2001 and 2002. Authority officials concluded once more that the data were reasonable, but had no documentation indicating how they arrived at this conclusion.

Although they reviewed the indirect cost data for 2001 and 2002 and determined that they were reasonable, Authority officials were unable to provide us with the components of certain indirect cost categories. Nor were they able to clarify the relationship of these costs to the contract's indirect costs, based on the information submitted by ACS. Authority officials also did not obtain additional supporting schedules for large cost categories that ACS had reported in lump sum amounts. For example, for 2002, ACS reported indirect costs of more than \$5.8 million for Line of Business Overhead and more than \$2 million for General Administrative Overhead costs. However, the Authority did not request further information or supporting schedules that would have explained what these costs represented. Rather, the Authority accepted ACS's indirect cost data as reasonable, without conducting a comprehensive analysis of the data.

As part of the contract-extension process, the Authority is also negotiating the indirect cost rates for this contract period, basing

its estimates of future indirect cost rates on the data ACS provided. The estimates are made without any detailed knowledge of what these costs represent or any assurances that this information is an accurate representation of ACS's actual overhead costs.

Duplicate Payment Test

Since the inception of the contract in December 1997 through January 2003, ACS has received more than \$66.7 million for contracted services. In September 2001, the company began submitting its monthly invoices electronically on a compact disc that includes images of vendor invoices paid for contracted services. For the 14-month period ending in October 2002, we identified 8,171 vendor invoices, with a value of more than \$32.9 million, that ACS had paid.

Our initial analysis identified 346 paid vendor invoices with a value of more than \$2.4 million, that might have been duplicates either because of identical vendor invoice numbers, billing amounts, purchase dates, etc. From these, we judgmentally selected for further refinement 50 that had a total value of more than \$2.3 million. We observed no exceptions for the data verified.

Reasonableness and Authenticity of Billings

From the 14 electronic monthly billings submitted by ACS for the period that ended in October 2002, we judgmentally selected a sample of 50 vendor invoices that were valued at more than \$111,000. In addition, we requested the original supporting documentation for 12 of these vendor invoices, to ensure the authenticity of photo-imaged documents submitted for reimbursement.

When we tested the 14 billings for reasonableness according to the terms of the contract, we found that 3 (6 percent) of the invoices, totaling about \$1,511, were originally identified as unrelated to the contract. Fiscal Audit staff had already rejected one for \$1,461 as not related to the contract. The remaining two items, for about \$50, were from contractor billings that had been paid but had not yet been audited by Fiscal Audit. The invoices for these items were illegible and had to be resubmitted by the

contractor. We observed no discrepancies for the remaining 12 vendor invoices.

We also observed during our testing for duplicate invoices, that 22 (44 percent) of the 50 items sampled, with a value of more than \$2.2 million for postage, did not have vendor invoices or ACS approval signatures authorizing vendor payment. Thus, the Authority has no assurance that these items represent services that were actually received and that were related to this contract.

(The Authority advised us that ACS uses an auto-pay process to ensure that sufficient pre-paid funds are available for postage. The process requires a pre-authorization document signed by ACS authorized personnel prior to payment. This documentation will be included in future ACS billings.)

Recommendations

1. Conduct timely post audits of ACS billings.
2. Obtain and review the appropriate payroll registers to verify actual wages paid to contractor staff.
3. Conduct and document occasional site visits to verify that ACS employees are working on Authority E-ZPass-related activities.

(The Authority indicated that it will implement Recommendations 1, 2, and 3 as resources allow.)

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.

(The Authority does not agree that verifying these employees' qualifications is necessary at this time.)

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.

Recommendations (Cont'd)

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.

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

(Regarding Recommendations 5, 6, and 7, the Authority indicated that an independent CPA firm has audited the indirect costs for 1998-2000. The CPA is in the process of auditing the 2001 and 2002 rates and will perform annual audits in the future years.)

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.

(The Authority maintains that its manual system is effective. However, it will review the feasibility of an electronic system.)

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.

(The Authority stated that it will be receiving further documentation from ACS to support postage cost.)

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ACCOUNTABILITY FOR CONTRACT EQUIPMENT

E-ZPass equipment assets, including tags, are owned by the Authority or are owned by the Authority and its E-ZPass partners (MTA, and The Port Authority of New York and New Jersey). Accordingly, these assets should be adequately accounted for through a comprehensive and current inventory control system. Minimally, such a system should identify each equipment item along with its cost, model name and number, serial number, and procurement date. In addition, an adequate inventory control system should provide for the taking of periodic physical inventories so that actual assets on hand can be compared to what is recorded in the inventory records. In this way, the theft or loss of items can be detected and inaccurate inventory records can be corrected. It is also important that the inventory control system addresses all classifications of assets such as computer hardware, software and telecommunications and references appropriate forms and information systems used to maintain equipment accountability.

The Authority's equipment inventory control procedures are included in a manual, *Procedures for Equipment Decal and Property Control*. We noted that the manual was neither current nor comprehensive. It was last updated in 1979 and does not specifically address controls over Authority equipment assigned to a contractor. The manual does not include provisions for establishing the minimum value of assets to be accounted for in the inventory record or for taking physical inventories. The manual does not reflect policy and procedures for using decals to being computer hardware, software and telecommunications items under inventory control. It also still references accounting for assets on manual forms and records instead of using available computer information systems.

Authority officials told us, however, that the manual does not apply to E-ZPass equipment items. Instead, the Authority has delegated the responsibility for E-ZPass equipment inventory to ACS. Authority officials explained that they do not maintain their own accountability for E-ZPass equipment assets, because only a portion of these assets are solely owned by the Authority. If the Authority is going to delegate responsibility for E-ZPass equipment inventory to ACS, it is essential that the ACS system

meets the standards of an adequate inventory control system regardless of whether the Authority wholly or partially owns such equipment. In addition, it is essential that the Authority periodically verify the effectiveness of the ACS system by, for example, taking periodic physical inventories of E-ZPass assets under ACS control.

We examined ACS's inventory control system and records as of June 2002 for E-ZPass equipment assets. From this examination we found that the records show that the Authority owns or jointly owns 3,314 equipment items with only a combined estimated value of more than \$454,000, substantially understating the total value of E-ZPass equipment assets. (See table below.) However, the inventory control system was not designed with procedures that enabled us to determine the actual cost of all the contracted assets included on the records, whether all contracted items were accounted for on the records, or whether the assets procured for E-ZPass all still existed and were being utilized for intended purposes. In particular, we found the following deficiencies with the ACS equipment records for E-ZPass:

- 2,191 items (66 percent) lacked purchase dates.
- 2,079 items (63 percent) lacked cost data.
- 1,211 items (37 percent) lacked model numbers.
- 1,157 items (35 percent) lacked serial numbers.
- 542 items (16 percent) lacked the model name.

**NEW YORK STATE THRUWAY AUTHORITY
INVENTORY SUMMARY
MISSING INVENTORY DATA**

| Description | E-ZPass Equipment (1) | Authority Equipment (2) | Authority & Port Authority Equipment (3) | Total | Percentage of Missing Data |
|----------------------------|-----------------------|-------------------------|--|-------|----------------------------|
| Total Assets Listed | 2,687 | 274 | 353 | 3,314 | 100% |
| Purchase Date | 1,965 | 65 | 161 | 2,191 | 66% |
| Cost Information | 1,773 | 215 | 91 | 2,079 | 63% |
| Model Numbers | 951 | 108 | 152 | 1,211 | 37% |
| Serial Numbers | 908 | 125 | 124 | 1,157 | 35% |
| Model Name | 431 | 73 | 38 | 542 | 16% |

- (1) E-ZPass Equipment – Owned by all three entities
- (2) E-ZPass Equipment – Wholly owned by NYS Thruway Authority
- (3) E-ZPass Equipment - Jointly owned by NYS Thruway Authority and the Port Authority

The following subsections of this report detail our findings with respect to specific tests we performed to establish accountability for E-ZPass equipment and our observations with respect to control over E-ZPass tags.

Testing of Inventory Records

Recognizing the deficiency with ACS’ inventory records, we then sought to determine, at a minimum, whether the sampled equipment inventory could be accounted for. We selected from the ACS inventory records, a sample of 26 items to physically verify that they existed. We visited 3 E-ZPass Walk-In Centers (Albany, Spring Valley, and Syracuse) and were able to locate 23 (88 percent) of those we selected. Subsequently, ACS was able to provide sufficient documentation for the three missing assets, which had been transferred to other locations. However, the inventory records had not been updated to reflect these changes.

As part of our visits to these 3 locations, we identified 27 owned assets that we attempted to trace back to the inventory records provided by ACS. Using the inventory tag numbers and serial numbers, we located 24 (88 percent) of these 27 assets. For example, our search of the inventory records for a fax machine by tag number, instead identified a security system that had been listed under the same tag number.

We also judgmentally selected a third inventory sample from 16 invoices, from a total of more than 8,100 invoices, that

represented the purchase of 63 assets (computer processors and servers, and ancillary mainframe computer hardware) valued at more than \$2.1 million during the 14-month period that ended in October 2002. For this sample, we reviewed the paid invoices and ACS-provided inventory records in an attempt to verify that accurate records had been maintained on the purchased items. Just two items (3 percent) appeared on the inventory records. Because the remaining 61 were not on the inventory list, we did not have a location for them and could not find them. Further, we were unable to ascertain which entities owned them. Consequently, neither we nor the Authority can be assured that those 61 items, valued at more than \$2.1 million, exist; or that they are being utilized for this contract.

(In response to our draft report, Authority officials stated that they had subsequently located the missing inventory items. However, upon further inquiry, we were told that ACS had performed the follow-up review, instead of the Authority, using various methodologies not detailed in the Authority's response—and these methodologies did not include tracing serial numbers from purchase documents to the actual equipment/products purchased. Therefore, the Authority still needs to follow-up on our recommendation to positively identify the unlocated items and seek recoupment from ACS as appropriate.)

E-ZPass Tag Inventory Control

We also noted that the Authority does not control the E-ZPass tag inventory, and has not monitored ACS's performance in this area. As of November 2002, the Authority reportedly had on hand with ACS, an inventory of 178,104 E-ZPass tags valued at more than \$4.2 million. For inventories with high turnover and/or substantial financial value, inventory records should be compared with the physical count of assets on hand over short time intervals so that discrepancies can be identified and investigated immediately. Authority officials have not taken a physical inventory of these assets; nor have they periodically obtained tag inventory records from ACS. As with the equipment inventory discussed previously, ACS maintained those records.

Recommendations

10. Develop and implement policies and procedures for safeguarding all E-ZPass equipment assets wholly or 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 responsibility.
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.
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.
13. Take an active role in overseeing the E-ZPass tag inventory.

(The Authority indicated that it will implement Recommendations 10, 12, and 13. Regarding Recommendation 11, as explained in the body of our report, the Authority still needs to determine the disposition of the 61 items.)

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CONTRACT MONITORING AND OVERSIGHT

We observed that the E-ZPass system is functioning and that ACS is delivering the major services required by the contract. For example, the contractor is providing tag distribution services, customer service, customer outreach, account maintenance, toll collection, invoicing services, security, violations processing, and performance-reporting services. However, because contract deliverables are not being monitored sufficiently by the Authority, Authority officials cannot adequately assess the levels of effectiveness and efficiency with which all of these contract services are being provided. We found that the Authority has not developed a comprehensive system of contract monitoring and needs to improve the manner in which it monitors ACS.

Monitoring of Contract Deliverables

An organization needs to develop and implement a contract monitoring system that will enable it to determine whether all services paid for by the organization are being delivered in accordance with the contract and in an acceptable manner. The principles of such a monitoring system, as described in *The State Comptroller's Procurement and Disbursement Guidelines*, published by the New York State Office of the State Comptroller, would include the following:

- A contract manager familiar with the type of work performed and the specific terms of the contract;
- Site visits that include observations of the performance of contract-related work;
- Written reports documenting the Authority's monitoring and oversight efforts;
- Description of services to be performed; and
- Standards used to measure performance, taking into consideration the quantity and quality of the work

performed, and the timely submission of contract deliverables.

The E-ZPass contract requires ACS to maintain complete and accurate records that substantiate compliance with the quality assurance requirements of the Authority's Statement of Work (SOW) and ACS's own contract proposal. The SOW should identify the contract deliverables, set the times and dates of delivery, and specify criteria for measuring the contractor's performance. ACS is to submit all deliverables for Authority review and approval in accordance with the specific requirements of the SOW and its contract proposal. Authority officials advised us that a SOW has not been developed. In its place, they said they rely on the Authority's request for proposals, the contractor's technical proposal, the contract, the contract implementation plan (Plan), E-ZPass policy and procedures, and change request orders as criteria for the services to be provided and corresponding time frames.

Completion of Contract Deliverables

From the contractor's technical proposal, we selected a contract deliverable that required an outside consultant to conduct monthly tests of changes that were made to computer hardware and software before they were implemented. The contractor subsequently informed us that such tests by an outside consultant firm had been dropped from the contract, and that they are now being performed internally. (The contractor indicated that many deliverables have been added and deleted from the contract since its inception.) However, the Authority has no documentation demonstrating that any of these contractually-required oversight functions for computer hardware and software has occurred. As a result, the Authority has no assurance that these controls and contract deliverables related to computer hardware and software changes are being executed.

Authority officials advised us that they hold bi-weekly status meetings with representatives of ACS, the Port Authority, and MTA Bridges and Tunnels. They described these meetings as critical devices in the management of the contractor; and explained that they are held to gain an understanding of the contract deliverables, to monitor the status of the deliverables, and to discuss project development and new projects as well as routine day-to-day transactions. However, Authority officials

pointed out that minutes from such meetings do not provide a good source document that can be reviewed for monitoring contractor progress or contract deliverables. Authority officials indicated that only the most critical items are discussed, and that deliverables discussed in one meeting are not necessarily discussed in following meetings.

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.

(The Authority indicated that it will review its monitoring and identify areas where improvements can be made.)

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MAJOR CONTRIBUTORS TO THIS REPORT

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John L. Buono
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Michael R. Fleischer
Executive Director
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October 3, 2003

William Challice
Division State Services
State Audit Bureau
123 William Street - 21st Floor
New York, NY 10038

Dear Mr. Challice:

This letter is in response to the Office of the State Comptroller's draft audit of the New York State Thruway Authority's Administration of Contract C100246 (E-ZPass).

As noted in the audit, the Thruway Authority ("Authority") has a contract with ACS State & Local Solutions ("ACS") to operate and maintain the Authority's electronic toll collection system, known as E-ZPass. E-ZPass service is critical to the Authority's mission to provide a "high level of safety and service" to its customers because it has helped to decrease congestion and increase throughput at toll plazas, defray future expansion costs, and reduce some operational costs. Today, over 50% of the Thruway's revenue is collected through E-ZPass.

ACS provides similar services to nine other tolling authorities and agencies in the Northeast utilizing E-ZPass, including the Metropolitan Transportation Authority Bridges & Tunnels ("MTAB&T"), Port Authority of New York & New Jersey ("PANY&NJ") and New York State Bridge Authority ("NYSBA"). To achieve economies of scale, the Authority, MTAB&T, PANY&NJ, and NYSBA have established the New York Customer Service Center ("NYCSC"), a central location at which ACS provides E-ZPass operational services to all of these New York authorities. The NYCSC is the largest customer service center in the E-ZPass system.

Mr. William Challice
October 3, 2003
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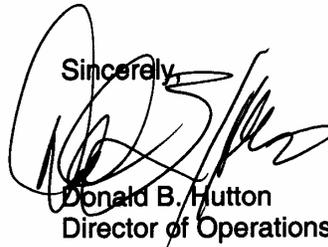
NYCSC Statistics

- 2.7 - million accounts maintained
- 5.7 - million active tags
- 628 - million transactions processed annually
- 12 - million statements issued annually
- 20 - million website hits annually
- 6.6 - million phone calls processed annually

The Authority has assigned staff from its Departments of Operations and Finance to work full-time on monitoring the performance of ACS; their work is augmented by the efforts of staff from the Authority's Legal, Information Technology, and Administrative Services Departments. Authority staff routinely meets with ACS, conducts site visits, monitors service and works with the Authority's NYCSC partner authorities to ensure that the NYCSC is delivering a high level of service. In 2001, the Authority surveyed its customers; 90.4% found their experience with E-ZPass to be favorable.

The Authority has reviewed the draft report and offers the attached comments in response.

Sincerely,

A handwritten signature in black ink, appearing to read "D. B. Hutton", is written over the printed name and title.

Donald B. Hutton
Director of Operations

Authority's Comments to Draft Contract Audit Report 2002-R-2

Contractor's Monthly Billings

The Authority conducts a preliminary audit of each ACS bill before making payment. The Authority Program Manager for E-ZPass Operations reviews each bill to determine if it is reasonable and necessary for the amount of work performed during the billing period and the Authority Bureau of Fiscal and Toll Audit confirms insurance and billing mathematics. After payment the invoice is then subjected to a detailed audit by the Authority Department of Finance, which identifies individual items that need further documentation or should be disallowed. The Authority deducts disallowed amounts from future payments to ACS. The amounts deducted from the payments are less than 1.2% of the total billings in the same period. The Authority disagrees with the statement that invoices # 61-70 were paid before they were audited because those invoices were pre-audited prior to payment.

Payroll Costs

The Authority has not previously sought to audit ACS' payroll registers because there had been no indication of discrepancies on this issue. The Authority's assessment that this is a low risk issue was confirmed by fact that no exceptions were found in this audit.

Employee Verification

In the past, the Authority did conduct random site visits to the NYCSC and E-ZPass walk-in centers to verify that ACS employees were working at their designated locations. The Authority discontinued this practice because it had not noted any unexplained discrepancies during the site visits and Authority staff shortages required a reprioritization of resources. This assessment of low risk was confirmed by the audit findings that all employees were accounted for.

The Authority evaluated ACS' technical qualifications during the procurement selection process and determined they were adequate. The Authority can determine whether or not the required services are being provided. The Authority retained a qualified vendor to provide services that the Authority could not provide for itself. As such, the Authority does not try to determine the technical qualifications for individual positions but rather evaluates ACS on its ability to deliver the services specified in the contract.

Overhead Indirect Cost Rates

On July 7, 2003, the Authority received an audit of ACS' indirect rates conducted by M.L. Weekes & Company. The audit was for the period from 1998 to 2000. The audit found small variances between the billable rates and the actual rates. The Authority will adjust future payments to ACS to reflect these variances.

M.L. Weekes has begun auditing ACS' indirect rates for the years 2001 and 2002. Further, ACS has assured the Authority that in the future, these audits will be completed annually.

Duplicate Payment Test

ACS maintains an Access database of all subcontractor billings, which includes such information as invoice number, date and amount. Prior to including a subcontractor invoice in a billing to the Authority, ACS checks the database to determine if any duplicates exist. After submitting a subcontractor invoice to the Authority for payment, ACS adjusts the database to reflect that activity. In addition, the Authority checks for duplicate payments in its post-payment audit of ACS billings. While this process is not conducted electronically, it has proven successful given that this audit identified no exceptions.

Reasonableness and Authenticity of Billings

The 22 items identified in the audit as lacking vendor invoices were payments for postage. Postage payments are deposited into prepaid accounts, which ACS draws down for mailings needed to service E-ZPass accounts, including those processed by American Direct Mail (ADM). The authorities replenish these accounts at the beginning of each month with a pre-approved amount to ensure that there are no delays in this critical aspect of the operation. ACS utilizes an auto-pay process to ensure that sufficient pre-paid funds are available. The auto-pay process requires a pre-authorization document signed by ACS authorized personnel prior to payment. This information will be included in future ACS billings that will further substantiate postage payments.

Recommendations

- 1. Conduct timely post audits of ACS billings. The Authority has filled the vacant audit position and as resources allow will complete post audits timely.**
- 2. Obtain and review the appropriate payroll registers to verify actual wages paid to contractor staff. The Authority will conduct such**

reviews as resources allow.

3. Conduct and document occasional site visits to verify that ACS employees are working on Authority E-ZPass related activities. **The Authority will conduct annual field audits as resources allow.**
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. **The Authority does not agree that verifying the qualifications of software development employees in Rockville, MD is necessary at this time.**
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 contract services and they are fairly represented in the overhead. **The Authority has received the audit of ACS's indirect costs for the years 1998 through 2000, performed by the independent accounting firm M.L. Weekes & Company, Inc. The Authority is currently reviewing the results.**
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. **ACS has commissioned M.L. Weekes & Company, Inc., an independent accounting firm, to conduct an indirect cost audit for the years 2001 and 2002. The Authority will review the results of that audit when it is available.**
7. For future years, require contractors to fully support their indirect cost rates. **ACS has commissioned M.L. Weekes & Company, Inc. to conduct indirect cost audits on an annual basis starting with 2003.**
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. **The Authority believes that the current system is effective given its experience and the fact that no duplicate invoices were found as part of this audit. However, the Authority will investigate this option and conduct a cost/benefit analysis of implementation.**
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. **The Authority will be**

receiving further documentation from ACS to support postage payments.

Accountability for Contract Equipment

The Authority's contract with ACS includes maintaining proper inventory of all Authority-owned equipment. ACS maintains an asset listing in an Access database. However, to improve this function ACS will be procuring an asset management software package that can better track the assets more effectively and efficiently. In addition, ACS will be transferring this responsibility to its Finance Department to ensure that invoices are linked to the asset listing. The members of the NYCSC will also be developing a comprehensive policy on asset management for this E-ZPass contract. This will provide ACS the proper guidelines to effectively track Authority assets. The Authority will also monitor and test the accuracy of the asset listing.

Testing of Inventory Records

ACS has identified all 61 of the assets referenced in the preliminary report. ACS determined that 29 of the 61 items were assigned a single inventory tag because they were part of an upgrade to the E-ZPass computer processing system. Because the upgrade was considered one large project, multiple assets were listed as one item. ACS has since reassigned individual asset numbers to each of those items and the asset tags are now posted on the base of the computer. The additional 32 items were located. Several of the items should not have been listed as equipment because they were either computer software or computer supplies (tapes). The remainder of those items were assigned asset numbers. The asset listing will be verified pending the development of the asset policy.

E-ZPass Tag Inventory Control

ACS is responsible for controlling the E-ZPass tag inventory, as it is part of its contractual obligations. However, the Authority does monitor the E-ZPass tag inventory. ACS provides the Authority with a bi-weekly tag inventory that the Authority uses to verify that new orders have been placed into inventory and to calculate the need for new tag orders. The Authority is reviewing the policy and procedures for tag inventory and will be making some changes to make it more effective and efficient.

Recommendations

10. Develop and implement policies and procedures for safeguarding all E-ZPass equipment assets wholly or 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 responsibility. **The Authority will be working with its NYCSC partners to develop and implement a comprehensive policy and procedure for E-ZPass asset management.**

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. **These items have been identified and are all associated with the E-ZPass project.**
12. Expand 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. **The Authority will ensure that the asset listing is complete and accurate.**
13. Take an active role in overseeing the E-ZPass tag inventory. **The Authority is reviewing the tag inventory process and will make changes as appropriate, including periodic observation of the physical tag inventory process.**

Contract Monitoring and Oversight

The Authority works diligently to monitor its E-ZPass services contract with ACS. Staff from the Authority's Departments of Operations and Finance work full-time on monitoring the performance of ACS; their work is augmented by the efforts of staff from the Authority's Legal, Information Technology, and Administrative Services Departments as needed. Further, the Authority works with its NYCSC partners to provide consistent direction to ACS and monitoring of ACS' work.

Monitoring of Contract Deliverables

The Authority disagrees with the inference that the Authority is not operating in accordance with the contract monitoring principles outlined in the report.

- The Authority does have a contract manager familiar with the type of work performed and the specific terms of the contract.
- The Authority does perform site visits regularly.
- While the Authority does not have written reports of all of its monitoring activities, it does have significant documentation regarding the program.
- The contract contains a description of the services to be performed.
- The contract contains numerous performance standards that the Authority uses to monitor performance.

Completion of Contract Deliverables

The general required services being performed by the contractor (transactions processing, customer service, account maintenance, statement issuance, billing, website, toll-free number and violation processing) are being provided by ACS. What has changed over time is how each of these services are being provided. For example, hard copy statements are still being issued to E-ZPass customers but now the frequency is bi-monthly versus monthly. In addition, customers have the option of receiving a monthly statement by e-mail rather than the hard copy mailed bi-monthly. These types of changes have been made to make certain processes more effective, cost efficient or provide an additional customer service.

Recommendations

14. Develop procedures that will result in effective monitoring of E-ZPass contract deliverables. For example, develop a method of identifying all contract deliverables of the contractor's actual performance. **The Authority will review its monitoring of the ACS contract and identify areas where improvements could be made.**