



City of New York

OFFICE OF THE COMPTROLLER

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COMPTROLLER



FINANCIAL AUDIT

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Deputy Comptroller for Audit

Audit Report on the Department of
Correction Engineering Audit Office's
Compliance with Comptroller's Directive #7

7E14-063A

April 24, 2015

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OFFICE OF THE COMPTROLLER
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BUREAU OF AUDIT

April 24, 2015

To the Residents of the City of New York:

My office has audited the New York City Department of Correction (DOC) to determine whether DOC's Engineering Audit Office (EAO) is complying with the provisions of Comptroller's Directive #7. We audit agency engineering audit offices as a means of ensuring that contractors and vendors have fulfilled their contractual obligations to the City.

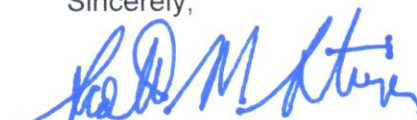
Comptroller's Directive #7 provides guidelines and procedures that agencies' Engineering Audit Officers must follow for independently auditing payment requisitions submitted by construction contractors and consultants. These procedures, which include field and desk audits, are important for ascertaining the accuracy of payment amounts, verifying physically the progress of work, and determining whether work is completed in accordance with plans and specifications and that the City has received appropriate value. In addition, the EAO must verify whether contractors have complied with applicable contract provisions pertaining to prevailing wages and determine the validity and cost reasonableness of change orders. According to DOC, the EAO approved 391 payment vouchers totaling \$162.7 million in Fiscal Year 2012, and 502 payment vouchers totaling \$100.8 million in Fiscal Year 2013.

Our audit found that DOC's EAO did not always follow appropriate audit procedures to ensure compliance with Directive #7. Our review found that the EAO approved \$35.58 million in payment vouchers, but did not maintain adequate documentation to support the approved payments or provide evidence that payment amounts were accurate and appropriate. Further, in several instances we found no evidence that the EAO reviewed the cost reasonableness and classification of change orders it approved and that the EAO had submitted certain change orders to the Comptroller's Office for registration. The audit also identified problems with internal control functions such as failure to segregate duties, an important internal control that is designed to protect the City against potential fraud.

The results of the audit have been discussed with DOC officials, and their comments have been considered in preparing this report. Their complete written response is attached to this report.

If you have any questions concerning this report, please e-mail my Audit Bureau at audit@comptroller.nyc.gov.

Sincerely,



Scott M. Stringer

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THE CITY OF NEW YORK OFFICE OF THE COMPTROLLER FINANCIAL AUDIT

Audit Report on the Department of Correction Engineering Audit Office's Compliance with Comptroller's Directive #7

7E14-063A

EXECUTIVE SUMMARY

The New York City Department of Correction (DOC) provides for the care, custody, and control of individuals charged with crimes in New York City and detainees awaiting the disposition of their case or convicted of a crime and sentenced to one year or less. These individuals are housed in various jails and detention centers and an infirmary on Rikers Island, four borough facilities, and in prison wards in two City hospitals. Various units within DOC manage construction, maintenance, and service projects for these facilities. These DOC units submit to the Engineering Audit Office (EAO) payment requests associated with construction, maintenance, and service projects which are, among other things, reviewed and approved by an engineering audit officer.

New York City Comptroller's Directive #7, entitled "Audit of Requests for Payment Received Under Contracts for Construction, Equipment, and Construction-Related Services," provides agencies' Engineering Audit Officers with guidelines for independently auditing payment requisitions for construction, equipment and related consultant service contracts to ensure that contractors or vendors fulfilled their contractual obligations to the City. In this capacity, the EAO conducts reviews to ascertain the accuracy of payment amounts including prices, quantities and calculations, performs field visits to physically verify work progress, and determines whether completed work is in accordance with plans and specifications and the City has received appropriate value. Based on the results of reviews, the EAO either approves or revises requested payment amounts.

According to DOC records, a total of 391 payment vouchers in the amount of \$162.7 million were approved in Fiscal Year 2012, and 502 payment vouchers totaling \$100.8 million were approved in Fiscal Year 2013.

Audit Findings and Conclusion

Our audit found that the EAO in the Department of Correction did not always follow appropriate audit procedures to ensure compliance with Directive #7. According to Directive #7, the EAO's primary function is to audit contractor, vendor, and consultant payment requests prior to payment approval. However, our review found that the EAO approved a total of \$35.58 million in payment vouchers, but did not maintain adequate documentation to support that approvals were justified

as is required by Directive #7. While it is possible that this work was completed, the EAO files did not adequately document the work, thereby failing to fulfill a basic requirement of the EAO function. In addition, the EAO's files did not contain evidence that a review was conducted to verify that the amounts paid were accurate and appropriate.

Overall, the following problems were identified in our review of 49 sampled vouchers selected from the Fiscal Years 2012 and 2013 vouchers:

- 28 vouchers lacked evidence of required field inspections;
- 4 vouchers reflected amounts approved that were not consistent with supporting documentation;
- 5 vouchers reflected amounts that were reduced without supporting documentation;
- 2 vouchers lacked all certified payrolls and sign-in sheets necessary to comply with prevailing wage requirements; and
- 3 vouchers reflected payments made for equipment purchases prior to delivery.

Further, in several instances we found no evidence that the EAO reviewed the cost reasonableness and classification of the change orders it approved and that change orders were submitted to the Comptroller's Office for registration.

In addition, we found internal control deficiencies such as failure to properly segregate duties which impairs the EAO's ability to maintain independence. Such segregation of duties is an important internal control to ensure that audits are properly conducted and serves as a safeguard to prevent fraud.

Audit Recommendations

This report makes a total of 8 recommendations.

1. To comply with Directive #7, DOC should:

- Conduct field visits to physically verify requested payment amounts;
- Record reasons why field audits were not conducted in the cases when payments were authorized based solely on desk audits and then field audits must subsequently be conducted;
- Retain all notes, documents, reports, and recommendations;
- Ensure that retained documentation is sufficient to support EAO audit findings, payment certifications, disputed payments, or any other actions taken;
- Conduct tests to ensure that contractors are compliant with prevailing wage requirements;
- Ensure that equipment is delivered, accepted, and inspected before approving payment requests unless otherwise provided for in the contract; and
- Maintain complete and accurate payment log and payment reviews.

DOC should:

2. Ensure that the EAO reviews and adequately documents change orders for cost reasonableness and classification;
3. Submit to the General Counsel change orders that are classified as design errors or design omissions for possible recoupment;
4. Only authorize change order payments for change orders that have been registered with the Comptroller's Office;
5. Immediately submit for registration the change orders cited in this report that are still not registered;
6. Ensure that the EAO reports to the agency head and, alternatively, if the EAO reports to a designated agency official, that official should not be responsible for the agency's design or construction functions;
7. Segregate audit review and approval tasks; and
8. Evaluate the necessity for the EAO to audit payment requisitions that do not fall under the scope of Directive #7.

Agency Response

In its response, DOC stated that “the agency believes in strengthening its auditing capabilities and efforts, is making improvements to its staffing levels, and updating its manuals and training to ensure alignment with latest policies and best practices.” In addition, DOC stated that “[o]ur agency is continuing its restructuring by initiating improvements across all departments in order to optimize operations and efficiency, resolve existing problems and prevent the occurrence of new ones.” Although DOC did not respond directly to our recommendations, the agency indicated that it would be implementing various actions that coincide with many of our recommendations.

These actions include: increasing staffing levels to increase the number of field audits and properly document evidence of field audits; revising the EAO operational manual; developing a training guide for new field auditors; revising and updating DOC payment forms; and developing payment check lists for better tracking and document accountability. In addition, DOC stated that the reporting structure of the EAO has been changed to preserve the EAO's independence and a full-time Deputy Engineering Audit Officer has been designated. Additionally, the EAO has conducted training seminars for DOC staff and outside vendors on how to properly complete, document and submit payments to the agency.

DOC, however, challenged our conclusions that the EAO did not comply with Directive #7 when it approved, prior to delivery, three vouchers that reflected payments made for equipment purchases; that in certain instances there was no evidence that the cost reasonableness and classification of change orders were reviewed; and that change orders were not submitted to the Comptroller's Office for registration before approving payments. DOC also claimed that it submitted all documentation to substantiate two other voucher payments.

The full text of DOC's response is included as an addendum to this report.

AUDIT REPORT

Background

DOC provides for the care, custody, and control of individuals charged with crimes in New York City and detainees awaiting the disposition of their case or convicted of a crime and sentenced to one year or less. These individuals are housed in various jails and detention centers and an infirmary on Rikers Island, four borough facilities, and in prison wards in two City hospitals. Various units within DOC manage construction, maintenance, and service projects for these facilities. These units include Design and Engineering, the Construction Management Unit, the Support Service Division, the Management Information System, Environmental Health and Safety, the Fire Safety Unit, and the Nutritional Services Division. All of these DOC units submit to the EAO payment requests associated with construction, maintenance, and service projects which are, among other things, reviewed and approved by an engineering audit officer.

New York City Comptroller's Directive #7, entitled "Audit of Requests for Payment Received Under Contracts for Construction, Equipment, and Construction-Related Services," provides agencies' Engineering Audit Officers (like the Engineering Audit Office, the individual engineering audit officers are also known as EAOs)¹ with guidelines for independently auditing payment requisitions for construction, equipment, and related consultant service contracts. According to Directive #7, the EAO is responsible for performing audits of payment vouchers to ensure that contractors or vendors fulfilled their contractual obligations to the City. In this capacity, the EAO conducts reviews to ascertain the accuracy of payment amounts including prices, quantities, and calculations, performs field visits to physically verify work progress, and determines whether completed work is in accordance with plans and specifications and the City has received appropriate value. To that end, field and desk audits are conducted to ensure that work has been performed and that contractors have complied with applicable contract provisions pertaining to permits, specifications, and prevailing wages. Based on the results of reviews, the EAO either approves or revises requested payment amounts. The EAO is also responsible for determining the validity and cost reasonableness of change order requests and conducts a comparison and analysis of these requests with contract requirements and the allowable project scope. According to DOC's EAO records, a total of 391 payment vouchers in the amount of \$162,728,638 were approved in Fiscal Year 2012, and 502 payment vouchers totaling \$100,836,720 were approved in Fiscal Year 2013.

Objective

The objective of this audit is to determine whether DOC's Engineering Audit Office is complying with the provisions of Comptroller's Directive #7.

Scope and Methodology Statement

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our

¹ Throughout this report, the abbreviation "EAO" is used to refer to both the individual engineering audit officer and to the DOC Engineering Audit Office, which during the audit period, was staffed by only a single engineering audit officer.

findings and conclusions based on our audit objectives. This audit was conducted in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter. This audit was conducted by auditors with engineering backgrounds. Please refer to the Detailed Scope and Methodology at the end of this report for the specific procedures and tests that were conducted.

The scope of this audit covers vouchers for construction, equipment, and consultant service contracts that were approved for payment by the DOC's EAO in Fiscal Years 2012 and 2013.

Discussion of Audit Results

The matters covered in this report were discussed with DOC officials during and at the conclusion of this audit. A preliminary draft report was sent to DOC officials and discussed at an exit conference held on February 6, 2015. After the exit conference, DOC provided auditors additional supporting documentation regarding some of the findings discussed in the preliminary report. Where appropriate, the findings were revised to reflect the additional information submitted. On March 16, 2015, we submitted a draft report to DOC officials with a request for comments. We received a written response from DOC on April 1, 2015.

In its response, DOC stated that “the agency believes in strengthening its auditing capabilities and efforts, is making improvements to its staffing levels, and updating its manuals and training to ensure alignment with latest policies and best practices.” Although DOC did not respond directly to our recommendations, the agency indicated that it would be implementing various actions that coincide with many of our recommendations.

These actions include: increasing staffing levels to increase the number of field audits and properly document evidence of field audits; revising the EAO operational manual; developing a training guide for new field auditors; revising and updating DOC payment forms; and developing payment check lists for better tracking and document accountability. In addition, DOC stated that the reporting structure of the EAO has been changed to preserve the EAO's independence and a full-time Deputy EAO has been designated. Additionally, the EAO has conducted training seminars for DOC staff and outside vendors on how to properly complete, document and submit payments to the agency.

DOC, however, challenged our conclusions that the EAO did not comply with Directive #7 when it approved, prior to delivery, three vouchers that reflected payments made for equipment purchases; that in certain instances there was no evidence that the cost reasonableness and classification of change orders were reviewed; and that change orders were not submitted to the Comptroller's Office for registration before approving payments. DOC defended its lack of compliance by stating that the equipment purchases and change orders pertained to a “DCAS administered contract utilized by DOC. Pursuant to the DCAS interpretation of the contract . . . the ENCORE II contract is considered a government to government purchase and is not subject to PPB rules, pursuant to PPB section 1-02(f)(1) and section 3-13.”² DOC affirmed that “Payments were authorized pursuant to the contract schedule of values” and that “payments for such equipment were made only after the Director of Engineering and the EAO visited the off-site storage location, inspected the equipment and photographically documented such equipment.” In addition, DOC contended that “[t]he work items identified as ‘change orders’ actually are mislabeled by NYPA.”

²The ENCORE II contract was between the New York Power Authority (NYPA) and the Department of Citywide Administrative Services (DCAS).

Regarding two vouchers that lacked certified payrolls and sign-in sheets, DOC stated that “All payroll documents affecting the two vouchers (Con Gen #7 and Sanjiun Electric #24) were submitted to the Comptroller's auditors in support of the payments processed.”

Auditors' Comments

We recognize that, consistent with most of our findings and recommendations, DOC has undertaken changes in its EAO process and has committed to further changes going forward. We encourage them to follow through on all of these efforts and ensure that the agency's EAO complies with City requirements.

However, as we describe in more detail below, we do not find a basis for changing our findings and recommendations related to DOC's approval, prior to delivery, of vouchers that reflected payments made for equipment purchases, and DOC's lack of evidence showing that certain change orders were reviewed for cost reasonableness and the appropriateness of their classification. Moreover, we do not find a basis for changing our finding related to DOC's failure to submit change orders to the Comptroller's Office for registration before approving payments. These problems pertain to a contract between DCAS and NYPA (ENCORE II) that was utilized by DOC to carry out construction work at Rikers Island. Notwithstanding DOC's contention in its response that it did not have to adhere to Directive #7 because the contract was inter-governmental, we were provided with other various explanations by DOC during the course of the audit as to the reasons why Directive #7 would not apply. However, as noted in the following sections of this report, we did not find these explanations to be persuasive, nor backed up by affirmative evidence that would overrule the requirements of Directive #7.

In addition, as noted below, we maintain that DOC did not provide us with all necessary documentation in the form of certified payrolls and sign-in sheets to support the approval of two other vouchers.

The full text of DOC's response is included as an addendum to this report.

FINDINGS AND RECOMMENDATIONS

Our audit found that DOC's EAO did not always follow appropriate audit procedures to ensure compliance with Directive #7. According to Directive #7, the EAO's primary function is to audit contractor, vendor, and consultant payment requests prior to payment approval. However, our review found that while the EAO approved a total of \$35.58 million in payment vouchers, it did not maintain adequate documentation to support that approvals were justified as is required by Directive #7. While it is possible that this work was completed, the EAO files did not adequately document the work, thereby failing to fulfill a basic requirement of the EAO function. In addition, the EAO's files did not contain evidence that a review was conducted to verify that the amounts paid were accurate and appropriate. Further, in several instances we found no evidence that the EAO reviewed the cost reasonableness and classification of the change orders it approved and that change orders were submitted to the Comptroller's Office for registration.

In general, we found internal control deficiencies resulting from the EAO's failure to fully comply with Directive #7. Some of these deficiencies include a failure to properly segregate duties and that this failure impairs the EAO's ability to maintain independence. Directive #7 requires that the EAO's function be overseen directly by the agency head or by a deputy agency head who is not directly responsible for the agency's design or construction functions to preserve the EAO's independence and the integrity of the audit process. We found that this is not the case at DOC. Moreover, during the scope period of this audit, EAO staff consisted of a single auditor, the EAO himself, who both reviewed and approved all payment vouchers. However, pursuant to Directive #7, as well as Comptroller's Directive #1, these specific functions must be segregated. Such segregation of duties is an important internal control to ensure that audits are properly conducted and serves as a safeguard to prevent fraud.

Questionable Payments

According to Directive #7, §5.2, "After completion of the audit, the EAO must retain all notes, documents, reports and recommendations. The documentation must be sufficiently thorough to support the audit findings, payment certifications, disputed payments or any other action taken." Despite this mandate, the EAO failed to maintain the required file documentation to substantiate EAO reviews for payment vouchers totaling \$35,582,375 of \$50,919,405 in 49 sampled payments. (See Appendix I for a list of the 49 sampled payments and problems associated with each.) Moreover, while the sampled payment vouchers maintained by the EAO totaled \$50,919,405, the recorded amounts on the voucher log maintained by the EAO reflected that there should have been \$51,237,680 in vouchers; a difference of \$318,275.

The following problems were identified in our review of the EAO's payment records:

- 28 vouchers lacked evidence of required field inspections;
- 4 vouchers reflected amounts approved that were not consistent with supporting documentation;
- 5 vouchers reflected amounts that were reduced without supporting documentation;
- 2 vouchers lacked all certified payrolls and sign-in sheets necessary to comply with prevailing wage requirements; and
- 3 vouchers reflected payments made for equipment purchases prior to delivery.

Payments are considered questionable where there was insufficient assurance that the voucher requests were appropriately audited by the EAO. Comptroller's Directive #7 requires that the EAO should have maintained documentation, including evidence of field inspections; desk audit reviews; reviews of calculations, prices, and quantities; contractor daily sign-in sheets; and certified payroll reports. All of these are critical to ensure that contractors were paid appropriately.

DOC Response: DOC responded that “the agency has noted the deficiency . . .” and will “Increase staffing levels for the EAO office in order to increase the number of field audits and properly document such.” DOC further stated that it will “[s]taff the Engineering Audit office with a labor law investigator in order to conduct field verification and support compliance with the requirements of the labor law.”

No Field Visits

The EAO failed to maintain any evidence or documentation from which the auditors could ascertain whether the required field inspections were conducted for 74 percent of the sampled payments. Directive #7, §3.2, states that “[a]n essential EAO audit procedure is the performance of field visits to physically verify the requested payment amounts and to evaluate the quality and progress of the work in question.” Of the 49 sampled payments reviewed, 38 were for construction work, which require field visits.³ But for 28 of the 38 payments reviewed (74 percent) totaling \$37,543,009, the files lacked evidence (e.g., comments and inspection reports, dates of visits, and construction photos) that the EAO conducted inspections to verify requested payment amounts and to evaluate the quality and progress of the work.

For example, we reviewed the files for a \$1,192,167 payment to Simplex Grinnell, a vendor who was hired to upgrade the fire system at the DOC's Anna M. Kross Center facility on Rikers Island. Prior to authorizing payment, Directive #7 requires engineering auditors to have physically inspected the work to verify that the vendor had installed sufficient quantities of sprinkler piping and electrical conduit to justify the requested payment. However, the file for this payment did not contain any evidence that such an inspection was made. In another example, the EAO approved an \$8,425,084 payment to NYPA to construct a cogeneration plant at Rikers Island. In this case, engineering auditors should have inspected the work location to verify that the vendor had installed sufficient concrete and steel reinforcing for a switchyard, transformer, and building foundation to justify the requested payment. Again no evidence that such an inspection was undertaken was found in the files. In both these examples, field inspections while the work was in progress were necessary for the engineering auditors to be able to observe work that was either underground, in-wall, or would subsequently be covered by finishing materials in order to discover possible errors, flawed construction and other problems prior to completion.

Directive #7, §3.3 requires that “When payments are authorized based solely on a desk audit, the EAO's records must clearly record the reasons that the field audit was not conducted. When desk audits are conducted, field audit procedures must be performed subsequently to ensure that the payment based on the desk audit was proper.” There was no record in any of the 28 cases as to why the EAO did not conduct field audits. Moreover, as noted above, there was no evidence of subsequent field audits. We were unable to determine why field visits were not conducted for these samples because the EAO in charge during the audit scope was no longer employed by DOC. The acting EAO was unable to provide any explanations beyond what was contained in the file documentation.

³ Eleven payments were for design work for which field inspections would not be required.

DOC Response: “The agency has noted the deficiency and in response to it the DOC will be implementing the following action plan in order to fulfill the requirements of Directive 7, section 5.2.

1. Increase staffing levels for the EAO office in order to increase the number of field audits and properly document such (expected implementation, summer 2015)
2. Full time Deputy EAO has been designated (implemented)
3. The current EAO operational manual will be revised to include necessary policy adjustments for enhanced compliance and a training guide will be developed for new field auditors (completion target date fall 2015)”

Unsubstantiated Payments

Supporting documentation was not adequate as required by Directive #7, §5.2 to substantiate EAO approval for 4 of 49 sampled payment vouchers (8 percent). As detailed in Table 1 below, the total amount of these four payments approved by the EAO was \$3,486,318. However, the amounts supported by documentation totaled \$3,442,267, which is \$44,051 less than the amount approved by the EAO.⁴

Table 1

Unsubstantiated Payment Amounts

No.	Sample #	Contract #	Payment #	Amount Approved by Engineering Audit Office	Amount per Supporting Documents	Unsubstantiated Amount
1	2	20111429608	22	\$ 320,009	\$ 318,326	\$ 1,684
2	3	20111429608	23	\$ 1,555,646	\$ 1,529,026	\$ 26,620
3	30	20111429608	31	\$ 658,918	\$ 643,081	\$ 15,837
4	46	20100009240	24	\$ 951,745	\$ 951,835	\$ (90)
Total				\$ 3,486,318	\$ 3,442,267	\$ 44,051

In addition, there was no documentation as required by Directive #7, §5.2 to substantiate why the EAO reduced requested payment amounts for five sampled vouchers. The EAO reduced these five payments by \$2,316,539.

Adequate supporting documentation as required by Directive #7 is an important safeguard to ensure that vendor payments are properly reviewed and validated and that the City has received appropriate value. Further, unsubstantiated payments and payment adjustments could hinder the City’s ability to defend itself in the event there is a dispute with the vendor over payment and performance.

⁴ After the exit conference, the EAO provided evidence for \$112,634 of the \$156,685 originally unsubstantiated amount associated with nine vouchers; the remaining unsubstantiated amount is \$44,051 (i.e., \$156,685 minus \$112,634)

DOC Response: “The initially identified deficient amount of \$156,685, reflected in nine vouchers was reduced to \$44,051, limited to only four vouchers, upon presentation of additional files and documents by DOC. The agency is reviewing additional archived documents in order to potentially identify the cause of the discrepancy for the remaining four vouchers. In addition, DOC will be implementing the following action plan:

1. The current EAO operational manual will be revised to include necessary policy adjustments for enhanced compliance, including Comptroller and a training guide will be developed for new field auditors (completion target date fall 2015)
2. Increase staffing levels for EAO office (expected implementation, summer 2015)
3. The EAO has revised and updated the DOC payment forms to make them more comprehensive (effective February 2015)
4. The EAO has developed payment check lists for use at the contractors' and the construction management levels for better tracking and document accountability (effective February 2015)
5. The EAO office has conducted training seminars for DOC staff and outside vendors on how to properly complete, document and submit payments to the agency (completed February 2015)”

Lack of Labor Law Compliance

Directive #7, §3.8 requires the EAO to conduct tests “to ensure contractor compliance with prevailing wage requirements.” These tests, which are mandated in §220 of the New York State Labor Law and included in Directive #7 as Attachment A, require “[v]erification that the contractor is compliant with New York State Labor Law, Article 8, §220, paragraph 3-a.a.” Despite this requirement, there was no evidence that the EAO conducted all of the tests, including reviewing certified payroll reports and sign-in sheets before approving payment for two construction vouchers totaling \$8,489,394.⁵ After the exit conference, DOC provided evidence of payroll reports and/or sign-in logs for part of the underlying vouchers totaling \$2,993,964; however, evidence was still lacking for the remaining \$5,495,430. In the event that the EAO finds that records are inconsistent, the EAO must withhold from payment sufficient funds to cover the difference as well as 16 percent per annum simple interest.

DOC Response: “All payroll documents affecting the two vouchers (Con Gen #7 and Sanjiun Electric #24) were submitted to the Comptroller's auditors in support of the payments processed. The two referenced vouchers are part of a series of payments processed for work performed a part of multiple task orders (in the case of Sanjiun Electric). The documents provided are only in reference to the specific two vouchers and did not include supporting documents for other payments that could have been part of the same scope of work, processed earlier, but not included in the audit sample. In addition, DOC will be implementing the following action plan:

1. Staff the Engineering Audit office with a labor law investigator in order to conduct field verification and support compliance with the requirements of the labor law (expected implementation summer 2015)

⁵ The vouchers were for payment #7, contract #85620070002908 (\$8,425,084), and payment #22, contract #07220100009240 (\$64,310).

2. The agency will re-emphasize and offer training for all units involved in construction oversight and payment processing in order to meet the requirements of the labor law.”

Auditor Comment: We disagree with DOC’s claim that it provided all payroll documents affecting the two vouchers. (The actual payroll voucher that was missing documentation was #22, not #24 as DOC stated in its response.) As there was no substantiating documentation in DOC files during the course of the audit, DOC provided us with documentation after the exit conference. Upon our review we were able to substantiate \$2.97 million of \$8.42 million for voucher #7, and \$17,997 of \$64,310 for voucher #22. Accordingly, we revised our finding and adjusted the amounts for which documentation was missing.

Improper Equipment Payment

The EAO did not comply with Directive #7, §3.4.4 when it approved, prior to delivery, three payment requests in Fiscal Years 2012 and 2013 totaling \$9,130,927 for the purchase of gas turbines and compressors for the Rikers Island Cogeneration Plant project. When auditing payment requests for mechanical, electrical, and other equipment, Directive #7, §3.4.4 requires that the EAO ensure that:

- a) Delivery and acceptance are proper and in accordance with contract terms;
- b) Required inspections have been made by designated agency personnel for compliance with contract requirements;
- c) Required test data is on file, and has been accepted by agency; and
- d) A field visit is conducted to physically verify equipment.

DOC officials asserted that the payments were proper because they complied with a provision in the contract with NYPA. However, these officials never identified any such provision to the auditors, and upon our review of the contract we found nothing in the contract that justified these payments prior to purchase, delivery and acceptance of the equipment.⁶ Rather, the contract expressly authorizes payment to be made in a lump sum, payable upon receipt of a NYPA invoice *after completion of installation*.⁷ In January 2014, we observed that the equipment was eventually delivered and installed at the project site. However, paying for equipment before delivery put the City at risk for at least 12 months.⁸ After the exit conference, DOC provided a copy of a NYPA log which indicates that DOC personnel including EAO may have accompanied NYPA to inspect the equipment in Coeymans, New York on September 24, 2012. However, there still was no evidence that the EAO affirmatively approved the acceptance of the equipment.

The decision to make payments for equipment that was not delivered and installed at the project site not only violated Directive #7, the terms of the contract, and prudent business practice, but it also caused DOC to spend an additional \$264,000 above the contract price to store the turbines and compressors for up to 12 months at an off-site location. The City would not have incurred these costs had the EAO declined payment until the equipment was delivered and installed at the project site. By paying for and storing equipment that was not delivered and installed, the City

⁶ CIC III, Rikers Island Cogeneration Plant project, Phase III Major Equipment Purchase.

⁷ CIC III, Attachment C “NYPA ENCORE II: Initial Customer Installation Commitment Summary and Signature Sheet” dated August 20, 2010.

⁸ The EAO approved payments on July 14, 2011 for \$3,539,451, February 21, 2012 for \$691,833 and September 7, 2012 for \$4,899,642.

was at risk if equipment became damaged in the interim and/or did not work as intended once it was installed and before it was accepted by the agency.

DOC Response: “The payment schedule for the purchase of major equipment is clearly outlined in the contract from the manufacturer to the various parties (NYPA/AECOM). Pursuant to the Encore II Agreement between NYPA and the City of New York (DCAS), payment terms were to be set forth in the Customer Installation Commitment (‘CIC’). The CIC’s provided for progress payments to be made upon receipt of NYPA invoices after agreed upon milestones. The equipment that was purchased under the specific CIC was of such size, specialty and cost that no manufacturer would initiate fabrication without approved design drawings and without a considerable down payment because of the uniqueness, customization of the equipment and lead time involved, which would have impacted the construction completion schedule and the delivery of the Power Plant. This is clearly identified in CIC III / Major Equipment Pre-purchase and in the CIC III Executive Summary, whereby NYPA specifies the pre- purchase of the specified equipment (‘The major pieces of equipment described below shall be pre-purchased to control quality, cost, and schedule.’ The equipment listed includes power block, gas compressors, medium voltage switchgear, and power transformers).

Payments were authorized pursuant to the contract schedule of values, the equipment was subsequently certified by the manufacturer and is currently in the final stages of commissioning. Furthermore, payments for such equipment were made only after the Director of Engineering and the EAO visited the off site storage location, inspected the equipment and photographically documented such equipment. Partial payments for such equipment were released only after verification of delivery to the storage site with the contractor's insurance covering such storage and potential damage.

NYC and DOC were protected against potential loss of funds associated with the equipment purchases since under contract the equipment is warranted by the contractor and contractor retains liability for damage to the equipment until incorporation into the work and final acceptance. DOC is in compliance with the contract terms as these relate to the ENCORE II contract.”

Auditor Comment: According to the “NYPA ENCORE II: Initial Customer Installation Commitment Summary and Signature Sheet,” payment for the equipment was to be made as a “Lump Sum payment; payment upon receipt of Authority [NYPA] invoice *after completion of installation.*” (Emphasis added.) This stipulation was signed by NYPA, DOC and DCAS representatives. The only evidence that the DOC Director of Engineering and EAO may have visited the off-site storage location was a notation in a daily log of a NYPA project manager that was provided to the auditors after the exit conference. There was no photographic documentation or affirmation that the EAO had accepted the equipment even had a visit to the off-site location occurred.

DOC recognized some of the shortcomings identified in our audit and promulgated an “Engineering Audit Procedural Manual” in November 2013. The manual contains specific instructions and checklists for auditing payment requests under Directive #7. Adherence with the

steps outlined in the manual could assist with DOC's compliance with Directive #7.⁹ In addition to these measures, we make the following recommendations to DOC to ensure compliance with Comptroller's Directive # 7.

Recommendations

1. To comply with Directive #7, DOC should:

- Conduct field visits to physically verify requested payment amounts;
- Record reasons why field audits were not conducted in the cases when payments were authorized based solely on desk audits and then field audits must subsequently be conducted;
- Retain all notes, documents, reports, and recommendations;
- Ensure that retained documentation is sufficient to support EAO audit findings, payment certifications, disputed payments, or any other actions taken;
- Conduct tests to ensure that contractors are compliant with prevailing wage requirements;
- Ensure that equipment is delivered, accepted, and inspected before approving payment requests unless otherwise provided for in the contract; and
- Maintain complete and accurate payment log and payment reviews.

DOC Response: DOC did not respond directly to this recommendation. It did, however, state that it would implement an "action plan in order to fulfill the requirements of Directive 7 section 5.2." These actions include: increasing staffing levels to increase the number of field audits and properly document evidence of field audits; revising the EAO operational manual; developing a training guide for new field auditors; revising and updating DOC payment forms; and developing payment check lists for better tracking and document accountability.

Auditor Comment: DOC's "action plan" coincides with many of our suggested recommendation points or provides alternative means of fulfilling the requirements of the Directive. We endorse these efforts and expect DOC to carry out its plan with sufficient backing from its senior management.

Problems with Change Order Reviews

Cost Reasonableness

The EAO failed to provide evidence that the cost reasonableness of nine of 53 (17 percent) sampled change orders totaling \$2,482,016 were ever reviewed. Directive #7, §3.5.1(d) states that the EAO must, "[e]nsure that change order costs are reasonable based on appropriate price and cost analysis, consistent with the contract terms and adequately documented in accordance

⁹ Among other things, the manual directs the EAO to: "1) Review the Contractor's Request for Payment. Verify that it has been reviewed and signed by the Resident Engineer, Supervisor, or other authorized personnel. 2) Check work completed against time consumed. This alerts the auditor to any potential construction delays or time extensions. 3) Examine the construction voucher packet submitted to Engineering Audit Office. Determine if all documents required for a proper audit are included. 4) Check computations at random for accuracy. 5) Check actual quantities consumed over the life of the contract against the Engineer's estimated quantities listed on the original bid tab."

with the PPB Rules.” In addition, §4-02(b)(1)(ii) of the Procurement Policy Board Rules mandates that “[a]ny such changes require appropriate price and cost analysis to determine reasonableness.” (See Appendix II for a list of change orders with associated problems.)

Change order costs are usually established by negotiating with the current contractor rather than by obtaining price quotations from multiple bidders. Consequently, the City may pay higher prices for materials, products, and construction services due to the limited price competition. Accordingly, the EAO is required to ascertain a change order’s “cost reasonableness” as an important double check to compensate for the lack of price competition.

DOC Response: “The ENCORE II contract is a DCAS administered contract utilized by DOC. Pursuant to the DCAS interpretation of the contract, as documented on 3/20/15, the ENCORE II contract is considered a government to government purchase and is not subject to PPB rules, pursuant to PPB section 1-02(f)(1) and section 3-13. All of the ‘change orders’ identified as deficient under this category are associated with the CoGen power plant project. According to the registered CIC’s and the approved schedule of values, the work covered under these ‘change orders’ does not represent additional scope of work to the DOC/ NYPA contract nor does it increase the registered amount of the project. The work items identified as ‘change orders’ actually are mislabeled by NYPA. They are work items included under the originally registered CIC amounts. Funds for these work items are being drawn down against the original CIC registered amount and do not increase the CIC registered amounts. As required by the contract (Article III, section 8, Final Customer Installation Commitment), the agency upon completion of the work and after review and verification of all the invoices will reconcile the final project cost and submit a final CIC to DCAS for registration with the Comptroller’s office. It is expected, based on current projections and tracking data that the final CIC cost will not exceed the original budget and registered amount. These work items erroneously identified as ‘change orders’ by NYPA were still subject to multiple levels of reviews, including the design consultant, NYPA project management staff, DOC construction oversight staff, DOC design staff and the DOC EAO office evidenced by acceptance of the work costs, with or without adjustments.”

Auditor Comment: We were informed by DOC staff during the course of the audit that a DCAS “interpretation” of the ENCORE II contract precluded DOC from having to adhere to the Directive #7 requirement to ensure the cost reasonableness of change orders. When asked to provide further information and documentation about this interpretation DOC was unable to do so. Moreover, if DOC believed that this requirement did not apply to this contract, we would have expected that the EAO would not have reviewed the cost reasonableness of any of the ENCORE II change orders. However, our review noted that the EAO did in fact review the cost reasonableness of 29 ENCORE II change orders.

We disagree with DOC’s contention that the change orders do not represent additional work scopes to the contract. According to Directive #7, §3.5.1 “change orders are utilized when an increase or reduction in work is required” Our review of some of the change orders under the ENCORE II contract indicates that work was required because it had been omitted from the original contract scope. For example, change order #9 for curb wall installation (\$24,526) states that “the original contract bid drawing did not depict exterior wall detail at mezzanine level. Drawings have been revised to include this detail.” In another example, change order #13 for turbine room

dampers (\$161,701) states that “the original design did not include motorized dampers on these louvers.” These examples show work that was clearly additional to the original contract scope.

Furthermore, our review of the documentation indicates that the “mislabeled” change orders were indeed “change orders.” We base this conclusion on the following facts: work orders submitted by subcontractors were labeled “change orders;” all communication between NYPA and DOC including substantiating documentation refer to them as change orders; and six change orders, which were necessitated by design omissions, were classified as “design omission change orders.”

Change Order Classification

There was no evidence that the EAO reviewed the appropriateness of change order classifications for 19 of 53 (36 percent) change orders as required by Directive #7, §3.5.1(a). According to this section, an EAO must “[r]eview the appropriateness of the change order classification (e.g., design error, administrative change, etc.) and ensure that there is sufficient documentation to validate the reason for the classification.” The EAO should have reviewed the appropriateness of classifications to ensure that change order work attributable to design errors and omissions was properly identified for possible cost recoupment.

Even when the EAO reviewed change order classifications, the EAO neglected to submit six change orders totaling \$255,036 to DOC’s General Counsel that were classified as design omissions. As required by Directive #7, §3.5.1(g), “[f]or design errors and omissions, the EAO shall confirm that a copy of the change order was forwarded to the agency general counsel for possible recoupment, in accordance with ODC Directive No. 47-Amendment 1, or subsequent directives.”

DOC officials were unable to explain the lack of required change order reviews and why certain change orders were not submitted to the General Counsel. Compliance with these aspects of Directive #7 is an important measure necessary to help ensure that payments are only made for valid and substantiated change orders.

DOC Response: “Pursuant to the DCAS interpretation of the contract, as documented on 3/20/15, the ENCORE II contract is considered a government to government purchase and not subject to PPB rules, pursuant to PPB section 1-02 (f) (1) and section 3-13.

The agency having performed its due diligence associated with the submitted costs, processed the identified work, without classifying it pursuant to Directive 7, section 3.5.1(a) due to its inapplicability.

Based on the contract requirements (Article III, section 8, Final Customer Installation Commitment), a final CIC will be prepared and processed to DCAS for registration with the Comptroller’s office after all the project costs have been finalized and all invoices reviewed and verified.”

Auditor Comment: As noted in our comment above, if DOC believed that the requirement for reviewing the appropriateness of change order classifications did not apply to the ENCORE II contract, we would have expected that the EAO would not have done so for any of the ENCORE II change orders. However, our review noted

that the EAO did in fact review the appropriateness of the classifications for 19 ENCORE change orders. At the very least, inconsistency in reviewing certain change orders but not others reveals a flaw in the agency's procedures or a breakdown in communications between the EAO and other DOC officials.

Comptroller Registration

Directive #7, §3.5, states that “[t]he EAO shall not authorize any payments for change order work until the change orders have been registered with the Comptroller's Office, unless otherwise provided for in the contract.” Despite this requirement, of 53 sampled change orders, 38 change orders totaling \$4,813,921 for cogeneration plant work at Rikers Island were not registered by DOC with the Comptroller's Office prior to the DOC EAO approving payments. All 38 change orders were for work that pertained to two DOC “Customer Installation Commitments (CICs)” under a contract (#85620070002908) between DCAS and NYPA.

DOC officials asserted that these change orders did not have to be registered because they were within the threshold of a contingency to the CICs that had already been registered with the Comptroller's Office, and that this practice was based on instructions by DCAS. However, DOC was unable to provide any documentation from DCAS or provisions in the contract that allowed this practice.

Change order registration is an important oversight function of the Comptroller's Office to ensure that their cost and necessity was properly considered and reviewed by appropriate agency personnel. Although the primary responsibility for carrying out this function rests with agency EAO's, as indicated previously we found instances in which the DOC EAO failed to provide evidence that the cost reasonableness or appropriateness of change order classifications had been reviewed. Consequently, the Comptroller's authority to register change orders is an additional safeguard to protect the integrity of the change order process.

Adequate oversight of the change order process ensures that the City does not pay higher prices for materials, equipment, and labor and that in instances of design errors and omissions, the City does not lose out on the opportunity for possible cost recoupment. Overall, a lack of sufficient oversight could make the change order process susceptible to fraud and abuse.

DOC Response: “Pursuant to the DCAS interpretation of the contract, as documented on 3/20/15, the ENCORE II contract is considered a government to government purchase and not subject to PPB rules, pursuant to PPB section 1-02 (f)(1) and section 3-13.

The identified deficiency is based on a misinterpretation of the terms and conditions of the ENCORE II contract by the auditors. CIC III (Phase III- major equipment pre-purchase) clearly identifies under 4 (B) ‘Responsibility of Parties’ that ‘DCAS shall be responsible for processing any necessary Project related contract registrations with the Comptroller’. Furthermore, the work performed does not constitute ‘change order work’, does not increase the CIC registered amounts and does not impact the overall registered project costs.

Pursuant to section 8 (Final Customer Installation Commitment), the agency upon completion of the work and after review and verification of all the invoices will reconcile the final project cost and submit a final CIC to DCAS for registration with the Comptroller's office.”

Auditor Comment: With respect to the authority of the Comptroller's Office to register change orders, DOC believed it could ignore this requirement because it apparently relied on an interpretation of the PPB Rules that was provided by DCAS. This reasoning is not consistent with representations made by DOC officials during the course of the audit work that the change orders did not have to be registered because they were within the threshold of a contingency to the contract that had already been registered with the Comptroller's Office. In any case, the Directive #7 requirement to register change orders before approving payments remains in effect without the exception that DOC says it relied on here.

Recommendations

DOC should:

2. Ensure that the EAO reviews and adequately documents change orders for cost reasonableness and classification.
3. Submit to the General Counsel change orders that are classified as design errors or design omissions for possible recoupment.
4. Only authorize change order payments for change orders that have been registered with the Comptroller's Office.
5. Immediately submit for registration the change orders cited in this report that are still not registered.

Other Internal Control Problems

DOC's EAO lacked sufficient means and independence to effectively fulfill the requirements of Directive #7. Deficiencies cited in this report attributed to the EAO were the result of a failure to fully comply with Directive #7 as well as provisions of Comptroller's Directive #1.

The EAO, in reporting to a senior deputy commissioner also responsible for overseeing the DOC's design and construction units, did not comply with Directive #7 internal controls designed to preserve the EAO's independence. Directive #7, §2.0 requires the EAO to "report directly to the agency head, or to a deputy agency head ('designee') which the agency head may assign. However, the designee must not be directly responsible for the agency's design or construction functions." The directive prohibits this chain of command to preclude conflicts of interest.

DOC Response: "The reporting structure of the EAO was changed immediately after a review of roles and responsibilities within the organization was conducted by the new administration, which came into place in April of 2014. This was prior to the issuance of the Comptroller's draft report. However, as part of the DOC re-organization, the new EAO reports to the new Deputy Commissioner of Operations who oversees the Office of Quality Assurance and Integrity for the agency and is not associated with any oversight of design or construction operations, currently moved to the Deputy Commissioner for Financial, Facility, and Fleet Administration."

In addition, during the scope period of this audit, EAO staff consisted of a single person, the EAO himself, who both reviewed and approved all payment vouchers rather than segregating these functions. Keeping these responsibilities separate helps to ensure that audits are properly conducted and safeguards against fraud. Moreover, Directive #7, §2.0 requires agencies to

employ a “designated alternate EAO” by registering the “name, functional title and signature specimen” with the Comptroller's Office.” DOC, however, lacked a designated alternate EAO.

DOC Response: “As part of the DOC re-organization, and specifically movement of EAO under the Deputy Commissioner of Operations, DOC has designated a deputy EAO and is in the process of hiring additional auditors in order to bring the EAO up to proper staffing levels. Proper staffing levels will allow for the proper segregation of functions within the EAO, increase the number of audits that will be conducted, and make documentation more complete (expected hiring and implementation, summer 2015).”

The EAO also took on additional responsibilities by auditing payment vouchers whose review may not have been required under Directive #7. According to §3.0, “[t]he EAO's primary function is to audit contractor, vendor, and consultant payment requests . . . *for construction, equipment, and construction related service contracts*” [italics added for emphasis]. In Fiscal Years 2012 and 2013, the EAO approved for payment 893 vouchers totaling \$263,565,358. Of this amount, 347 vouchers totaling \$108,593,644 were clearly related to construction, equipment, and construction-related service contracts. The other 546 payments totaling \$154,971,714 were generally related to service and maintenance work, which was not subject to Directive #7 (e.g., maintaining telecommunications, changing filters, cleaning mechanical equipment, and repairing kitchen equipment). Given that the EAO was staffed by a single auditor during the scope period, the sheer number of payment requests would have been overwhelming and could have been a factor in the scarcity of audit documentation to substantiate whether field inspections and other audit procedures were properly followed.

Recommendations

DOC should:

6. Ensure that the EAO reports to the agency head and, alternatively, if the EAO reports to a designated agency official, that official should not be responsible for the agency's design or construction functions.

DOC Response: “The new EAO reports to the new Deputy Commissioner of Operations who oversees the Office of Quality Assurance and Integrity for the agency and is not associated with any oversight of design or construction operations.”

7. Segregate audit review and approval tasks.

DOC Response: “DOC has designated a deputy EAO and is in the process of hiring additional auditors in order to bring the EAO up to proper staffing levels. Proper staffing levels will allow for the proper segregation of functions within the EAO, increase the number of audits that will be conducted, and make documentation more complete.”

8. Evaluate the necessity for the EAO to audit payment requisitions that do not fall under the scope of Directive #7.

DOC Response: “Although expense vouchers may not be subject to Directive 7 audit procedures, the agency believes that such reviews are beneficial to the agency and

safeguard the interests of NYC overall, and will continue with the auditing of selective expense contracts.”

DETAILED SCOPE AND METHODOLOGY

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. This audit was conducted in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter. This audit was conducted by auditors with engineering backgrounds.

The scope of this audit covered payment requests for construction, equipment, and consultant service contracts that were approved for payment under Comptroller's Directive #7 by the DOC's EAO in Fiscal Years 2012 and 2013.

We obtained background information about DOC from the New York City Charter, the Mayor's Management Report, and the DOC's website. We reviewed the City's Ten-Year Capital Strategy plan to understand the funding allocation for DOC and the Comptroller's Comprehensive Annual Financial Report to determine DOC's capital expenditures.

To understand the policies, procedures, and regulations governing the EAO's compliance with Directive #7, we reviewed:

- Comptroller's Directive #7, "Audit of Requests for Payment Received Under Contracts for Construction, Equipment, and Construction-Related Services;"
- Comptroller's Directive #1, "Principles of Internal Control;"
- New York City Procurement Policy Board Rules (PPB Rules);
- DOC's organization chart; and
- Guidelines used by the EAO to audit payment requests.

To understand DOC's internal controls for reviewing vouchers and compliance with Directive #7, we interviewed the EAO and established how the EAO received payment requests; types of payment requests and how they were tracked; frequency of submittals; and how physical files were maintained. We documented our understanding of these controls in written descriptions.

We also interviewed directors and other relevant personnel of various divisions (i.e., support service, design and engineering, construction management, management information systems, environmental health and safety, fire safety unit, and nutritional services) who submitted payment requests to the EAO. Additionally, we interviewed the assistant commissioner and a payment coordinator in the contract and financial services division who administered payments for requisitions approved by the EAO.

We documented our understanding of operations in narratives and memoranda, whose accuracy we asked DOC officials to review and confirm. Subsequently, we documented our understanding of the internal controls and assessment of risks of fraud in a memorandum.

The EAO provided us with lists of approved payment requests on Excel spreadsheets for Fiscal Years 2012 and 2013. According to these payment tracking logs, the EAO approved 391 payment requests totaling \$162,728,638 in Fiscal Year 2012 and 502 payment requests totaling \$100,836,720 in Fiscal Year 2013 (893 vouchers totaling \$263,565,358). The payment tracking logs did not identify whether or not a payment was subject to Directive #7 review. Subsequently,

we asked the EAO to identify those payments that were subject to Directive #7. The EAO identified 125 payments totaling \$22,993,628 and 222 payments totaling \$85,600,016 that were under the purview of Directive #7 in Fiscal Year 2012 and 2013, respectively (347 vouchers totaling \$108,593,644). The other 546 payments were generally related to service and maintenance work, which was not subject to Directive #7. In order to confirm that payments were or were not related to Directive #7, we conducted tests of reliability, completeness, and accuracy by randomly sampling 100 payments from the overall population of 893 vouchers.

We sorted the 347 payment vouchers by contract classification (i.e., consultant, general construction, plumbing, mechanical, and electrical), and selected a judgmental sample of the largest dollar amounts for each type of classification to determine whether DOC's EAO complied with the provisions of Comptroller's Directive #7. Our sample consisted of 50 vouchers totaling \$51,494,288. The value of the 50 sampled payment requests represented 47 percent of all approved payment vouchers (i.e., \$108.5 million for 347 payments).

We also examined all 53 change orders totaling \$16,112,660 that were reviewed by the EAO during the audit scope to determine whether the office complied with the Comptroller's Directive #7 provision of "Contract Changes."

To determine whether DOC's EAO complied with Directive #7 requirements, we examined file documentation for the sampled 50 payment requests. The EAO was unable to provide one sampled payment file (Payment #9 for \$256,607, Contract #18632). Accordingly, our sample was reduced from 50 to 49 samples totaling \$51,237,680 (i.e., \$51,494,288 minus \$256,607). We determined whether the payments were processed within required Directive #7 timeframes. We reviewed each sample payment file to verify that it contained evidence of the EAO's independent reviews. In addition, we determined whether the office verified invoiced quantities and prices by comparing the amount approved for payment with the supporting documentation.

We looked for evidence in the voucher files to ascertain whether the EAO conducted field visits when necessary to certify that work performed was sufficiently advanced to warrant payment. To determine whether prevailing wages were paid to employees by the contractors, we reviewed the certified payroll reports submitted with payment requests. Finally, we assessed the accuracy of the sampled approved payments by reviewing the supporting documentation for work performed and compared the invoiced amount of work completed.

We evaluated change orders to determine whether they were registered with the Comptroller's Office. We also examined each change order for required EAO approvals and reviews of validity and cost reasonableness.

We asked DOC officials to provide us with any documentation missing from the files. We developed our findings and conclusions on the basis of our analyses. The results of our samples were not projected to the entire population; however, our tests results provided a reasonable basis to determine whether DOC's EAO complied with the provisions of Comptroller's Directive #7.

APPENDIX I

Sampled Payments and Associated Problems

Sample #	Contract #	Payment #	Amount Approved by EAO		Difference between EAO Payment Log and Files	Non-compliance with Directive 7 requirements				
			Per Payment Log	Per Payment Files		Field Audits	Prevailing Wage	Supporting Documents for Approved Costs	Payments for Equipment	Supporting Documents for Adjustment
1	20111429608	21	\$ 103,778	\$ 103,778	\$ -	x				
2	20111429608	22	\$ 320,009	\$ 320,009	\$ -	x		x		
3	20111429608	23	\$ 1,555,646	\$ 1,555,646	\$ -	x		x		
4	20100009552	2-Jul	\$ 56,942	\$ 56,942	\$ -					
5	20100009552	2-Oct	\$ 124,622	\$ 124,622	\$ -					
6	20100009552	13/2	\$ 263,734	\$ 263,734	\$ -					
7	20100009552	14/2	\$ 30,491	\$ 30,491	\$ -					
8	20100009552	15/3	\$ 47,936	\$ 47,936	\$ -					
9	20114318632	8N	\$ 424,444	\$ 424,444	\$ -	x				x
10	20114318632	10N	\$ 660,926	\$ 660,926	\$ -	x				
11	20114318632	11N	\$ 129,370	\$ 129,370	\$ -	x				
12	20114318632	12N	\$ 409,400	\$ 409,400	\$ -	x				
13	2908	14	\$ 3,539,451	\$ 3,539,451	\$ -	x			x	
14	2908	15	\$ 1,077,275	\$ 1,077,275	\$ -	x				
15	2908	16	\$ 691,833	\$ 691,833	\$ -	x			x	
16	2007035306	17	\$ 398,087	\$ 398,087	\$ -	x				
17	35306	18	\$ 270,437	\$ 270,437	\$ -	x				x
18	35306	19	\$ 129,972	\$ 129,972	\$ -	x				
19	2010009240	21	\$ 78,293	\$ 78,293	\$ -	x				
20	20111420191	3	\$ 1,192,167	\$ 1,192,167	\$ -	x				
21	20111420191	4	\$ 548,763	\$ 548,763	\$ -	x				
22	20111420191	6	\$ 701,267	\$ 701,267	\$ -	x				
23	20111420191	7	\$ 684,893	\$ 684,893	\$ -	x				
24	20111420191	9	\$ 956,788	\$ 956,788	\$ -	x				
25	20111429608	24	\$ 1,329,165	\$ 1,329,165	\$ -	x				
26	20111429608	25	\$ 503,090	\$ 503,090	\$ -					
27	20111429608	26	\$ 624,704	\$ 624,704	\$ -	x				
28	20111429608	27	\$ 577,809	\$ 577,809	\$ -	x				
29	20111429608	31	\$ 658,918	\$ 658,918	\$ -	x		x		
30	20080022059	72	\$ 220,217	\$ 220,217	\$ -					
31	20080022059	74	\$ 20,925	\$ 20,925	\$ -					
32	20080022059	80OBCC	\$ 47,081	\$ 47,081	\$ -					
33	20080022059	83CIC8FSNIC	\$ 21,747	\$ 21,747	\$ -					
34	20080022059	87	\$ 20,567	\$ 20,567	\$ -					
35	20111418632	18N	\$ 538,510	\$ 538,510	\$ -	x				
36	20111418632	19N	\$ 732,510	\$ 732,207	\$ 303					x
37	20111418632	20N	\$ 1,246,887	\$ 1,246,887	\$ -					
38	20111418632	22N	\$ 1,601,548	\$ 1,601,510	\$ 38					
39	20111418632	23N	\$ 1,118,108	\$ 1,118,108	\$ -					
40	85620070002908	7	\$ 1,086,683	\$ 1,086,683	\$ -					
41	85620070002908	7	\$ 8,425,084	\$ 8,425,084	\$ -	x	x*			
42	85620070002908	18 (04 CIC III)	\$ 4,899,643	\$ 4,899,643	\$ -	x			x	
43	85620070002908	19 (01 CIC IV)	\$ 5,089,498	\$ 5,089,498	\$ -	x				
44	20100009240	22	\$ 64,310	\$ 64,310	\$ -		x*			
45	20100009240	24	\$ 951,745	\$ 951,745	\$ -			x		
46	20121436575	01 / 01 QDC	\$ 1,544,153	\$ 1,544,153	\$ -	x				
47	20121436575	01 RND	\$ 1,632,641	\$ 1,632,641	\$ -					x
48	20121436575	02 / 01 OBCC	\$ 1,442,506	\$ 1,124,571	\$ 317,935					x
49	20121436575	02MDC	\$ 2,443,108	\$ 2,443,108	\$ -					

Total 49 Samples — per EAO Log **\$ 51,237,680**
 — per EAO Payment Files **\$ 50,919,405**
 Difference (between EAO Log and Payment Files) **\$ 318,275**
 Total Questionable and Improper Payments **\$ 35,582,375**

x* - partial evidence

28 2 4 3 5
 Total Exceptions

APPENDIX II

List of Change Orders with Associated Problems

				Engineering Audit Office Actions Required by Directive 7													
				Reviewed Appropriateness of Classification			Evaluated Whether Work Was Not Required Under Contract			Ensured That Costs Were Reasonable			Confirmed that Design Error/Omission Change Orders Were Forwarded to Counsel			Registered with the Comptroller's office	
No.	Contract #	Change Order No.	Amount	Yes	No	N/A	Yes	No	N/A	Yes	No	N/A	Yes	No	N/A	Yes	No
1	7220101419142	003	\$ 56,405	x**			x**			x**					x	x	
2	7220101419142	007	\$ 58,590	x**			x**			x**					x	x	
3	7220101419142	008	\$ 59,528	x**			x**			x**					x	x	
4	7220100009240	008	\$ 74,653	x**			x**			x**					x	x	
5	7220111429608	006	\$ 174,472	x**			x**			x					x	x	
6	7220131406001	001	\$ 287,031	x**			x**			x**					x	x	
7	7220101401815	001	\$ 338,509	x**			x**			x**					x	x	
8	7220111423673	-	\$ 729,849	x**			x**			x**					x	x	
9	722010000585	-	\$ 795,445	x**			x**			x**					x	x	
10	7220100009552	various	\$ 804,620	x**			x**			x**					x	x	
11	7220100009240	002	\$ 934,841	x**			x**			x**						x	
12	7220101419142	007	\$ 1,241,356	x**			x**			x**					x	x	
13	7220100021070	none	\$ 1,636,489	x**			x**			x**					x	x	
14	7220111429608	002	\$ 1,899,458	x**			x**			x**					x	x	
15	7220111418632	various	\$ 2,207,493	x**			x**			x**					x		
16	8562007002908	1	\$ -	x			x			x *					x		
17	8562007002908	2	\$ 42,000		x			x			x				x		x
18	8562007002908	3	\$ 30,000		x			x			x				x		x
19	8562007002908	4	\$ 1,200,586		x			x			x				x		x
20	8562007002908	5	\$ 70,096		x			x		x **					x		x
21	8562007002908	6	\$ 27,438		x			x		x **					x		x
22	8562007002908	7	\$ 192,000		x			x		x **					x		x
23	8562007002908	8	\$ 121,468	x			x			x ***					x		x
24	8562007002908	9	\$ 24,526	x			x			x ****				x			x
25	8562007002908	10	\$ 114,278		x			x		x **					x		x
26	8562007002908	11	\$ 9,330		x			x		x **							x
27	8562007002908	12 ^															x
28	8562007002908	13	\$ 161,701		x			x		x **				x			x
29	8562007002908	14	\$ 9,564		x			x		x**							x
30	8562007002908	1	\$ 13,755		x			x			x				x		x
31	8562007002908	2	\$ 50,623		x			x			x				x		x
32	8562007002908	3	\$ 387,707		x			x			x				x		x
33	8562007002908	4	\$ 5,340	x			x			x *					x		x
34	8562007002908	5	\$ 61,281		x			x			x				x		x
35	8562007002908	6	\$ 14,281	x			x			x **					x		x
36	8562007002908	7	\$ 69,384	x			x			x **					x		x
37	8562007002908	8	\$ 4,216		x		x			x **				x			x
38	8562007002908	9	\$ 692,237		x			x			x				x		x
39	8562007002908	10	\$ 31,384	x			x			x **					x		x
40	8562007002908	11	\$ 3,827		x			x			x				x		x

APPENDIX II

				Reviewed Appropriateness of Classification			Evaluated Whether Work Was Not Required Under Contract			Ensured That Costs Were Reasonable			Confirmed that Design Error/Omission Change Orders Were Forwarded to Counsel			Registered with the Comptroller's office	
No.	Contract #	Change Order No.	Amount	Yes	No	N/A	Yes	No	N/A	Yes	No	N/A	Yes	No	N/A	Yes	No
41	8562007002908	12	\$ 24,272	x			x			x ***					x		x
42	8562007002908	13	\$ 27,318	x			x			x ***					x		x
43	8562007002908	14	\$ 56,720	x			x			x ***					x		x
44	8562007002908	15	\$ 9,206		x		x			x ***				x			x
45	8562007002908	16	\$ 47,738	x			x			x ***					x		x
46	8562007002908	17	\$ 48,194		x		x			x ***				x			x
47	8562007002908	18	\$ 105,725	x			x			x ***					x		x
48	8562007002908	19	\$ 77,145	x			x			x ***					x		x
49	8562007002908	20	\$ 59,590	x			x			x ***					x		x
50	8562007002908	21	\$ 13,546							x ***					x		x
51	8562007002908	22	\$ 4,506	x			x			x ***					x		x
52	8562007002908	23	\$ 7,193	x			x			x ***				x			x
53	8562007002908	24	\$ 982,820	x			x			x ***					x		x
54	8562007002908	25	\$ 12,926	x			x			x ***					x		x
Total			\$ 16,112,660	19			16			9			6			38	
Change Orders not Registered			\$ 4,813,921														
Lack of Cost Reasonableness			\$ 2,482,016														
Total Design Omissions			\$ 255,036														

Total #s of Change Orders reviewed = 53 (54-1)

*Change order #12 was not submitted

* EAO adjusted change order cost to \$5,209

** EAO signed bottom of change order

*** EAO signed bottom of change order with \$ amount that matched with the proposed cost

**** EAO signed "reviewed and approved for processing"

NEW YORK CITY DEPARTMENT OF CORRECTION
Joseph Ponte, Commissioner

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East Elmhurst, NY 11370
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April 1, 2015

Marjorie Landa
Deputy Comptroller for Audit
City of New York
Office of the Comptroller
One Centre Street
New York, NY 10007

**Reference: Audit Report on the Department of Correction
Engineering Audit Office's Compliance with
Comptroller's Directive No. 7
7E14-063A**

Dear Deputy Comptroller Landa,

In response to the Comptroller's draft report, dated 3/16/2015, covering fiscal years 2012 and 2013, the agency performed a review of its records, analyzed the deficiencies identified, and offers the following responses.

In general, the agency believes in strengthening its auditing capabilities and efforts, is making improvements to its staffing levels, and updating its manuals and training to ensure alignment with latest policies and best practices.

Specific to this audit, the Comptroller's draft report has categorized the deficiencies in one of the following groups:

1. Questionable payments

The Comptroller's report finds a lack of required file documentation to substantiate EAO reviews for forty nine payment vouchers (reference appendix I for list of issues identified) and cites the following recommendations. Specifically:

- a. The report cites lack of evidence of field inspections for 28 vouchers and recommends to "Conduct field visits to physically verify payment amounts", and "record reasons why field audits were not conducted in the cases when payments were authorized based solely on desk audits and then field audits must be subsequently conducted".

DOC response:

The agency has noted the deficiency and in response to it the DOC will be implementing the following action plan in order to fulfill the requirements of Directive 7, section 5.2.

- 1. Increase staffing levels for the EAO office in order to increase the number of field audits and properly document such (expected implementation, summer 2015).*
 - 2. Full time Deputy EAO has been designated (implemented)*
 - 3. The current EAO operational manual will be revised to include necessary policy adjustments for enhanced compliance and a training guide will be developed for new field auditors (completion target date fall 2015)*
- b. The report cites that four vouchers reflected amounts billed that were not consistent with supporting documentation (table 1 in the Comptroller's report) and that five vouchers reflected amounts that were reduced without supporting documentation and recommends to "Retain all notes, documents, reports and recommendations" and "ensure that retained documentation is sufficient to support EAO audit findings, payment certifications, disputed payments or any other actions taken".

DOC response:

The initially identified deficient amount of \$156,685, reflected in nine vouchers was reduced to \$44,051, limited to only four vouchers, upon presentation of additional files and documents by DOC. The agency is reviewing additional archived documents in order to potentially identify the cause of the discrepancy for the remaining four vouchers. In addition, DOC will be implementing the following action plan:

- 1. The current EAO operational manual will be revised to include necessary policy adjustments for enhanced compliance, including Comptroller and a training guide will be developed for new field auditors (completion target date fall 2015)*
 - 2. Increase staffing levels for EAO office (expected implementation, summer 2015).*
 - 3. The EAO has revised and updated the DOC payment forms to make them more comprehensive (effective February 2015)*
 - 4. The EAO has developed payment check lists for use at the contractors' and the construction management levels for better tracking and document accountability (effective February 2015)*
 - 5. The EAO office has conducted training seminars for DOC staff and outside vendors on how to properly complete, document and submit payments to the agency (completed February 2015)*
- c. The report cites that two vouchers lacked certified payrolls and sign-in sheets necessary to comply with prevailing wage requirements and recommends to "Conduct tests to ensure that contractors are compliant with prevailing wage requirements".

DOC response:

All payroll documents affecting the two vouchers (ConGen #7 and Sanjiun Electric #24) were submitted to the Comptroller's auditors in support of the payments processed. The two referenced vouchers are

part of a series of payments processed for work performed as part of multiple task orders (in the case of Sanjiun Electric). The documents provided are only in reference to the specific two vouchers and did not include supporting documents for other payments that could have been part of the same scope of work, processed earlier, but not included in the audit sample. In addition, DOC will be implementing the following action plan:

- 1. Staff the Engineering Audit office with a labor law investigator in order to conduct field verification and support compliance with the requirements of the labor law (expected implementation summer 2015)*
 - 2. The agency will re-emphasize and offer training for all units involved in construction oversight and payment processing in order to meet the requirements of the labor law.*
- d. The report cites that three vouchers (associated with the CoGen power plant) reflected payments made for equipment purchases prior to delivery and recommends to “Ensure that equipment is delivered, accepted and inspected before approving payment requests, unless otherwise provided for in the contract”.

DOC response:

The payment schedule for the purchase of major equipment is clearly outlined in the contract from the manufacturer to the various parties (NYPA / AECOM). Pursuant to the Encore II Agreement between NYPA and the City of New York (DCAS), payment terms were to be set forth in the Customer Installation Commitment (“CIC”). The CIC’s provided for progress payments to be made upon receipt of NYPA invoices after agreed upon milestones. The equipment that was purchased under the specific CIC was of such size, specialty and cost that no manufacturer would initiate fabrication without approved design drawings and without a considerable down payment because of the uniqueness, customization of the equipment and lead time involved, which would have impacted the construction completion schedule and the delivery of the Power Plant. This is clearly identified in CIC III / Major Equipment Pre-purchase and in the CIC III Executive Summary, whereby NYPA specifies the pre-purchase of the specified equipment (“The major pieces of equipment described below shall be pre-purchased to control quality, cost, and schedule.” The equipment listed includes power block, gas compressors, medium voltage switchgear, and power transformers).

Payments were authorized pursuant to the contract schedule of values, the equipment was subsequently certified by the manufacturer and is currently in the final stages of commissioning. Furthermore, payments for such equipment were made only after the Director of Engineering and the EAO visited the off site storage location, inspected the equipment and photographically documented such equipment. Partial payments for such equipment were released only after verification of delivery to the storage site with the contractor’s insurance covering such storage and potential damage.

NYC and DOC were protected against potential loss of funds associated with the equipment purchases since under contract the equipment is warranted by the contractor and contractor retains liability for damage to the equipment until incorporation into the work and final acceptance. DOC is in compliance with the contract terms as these relate to the ENCORE II contract.

The Comptroller's audit draft report furthermore alleges deficiencies identified with processing and accepting change orders (see table in Appendix II) and categorizes them as follows:

2. Problems with Change order reviews

- a. The report cites that the "EAO failed to provide evidence that the cost reasonableness of nine of 53 (17%) sampled orders totaling \$2,482,016 were ever reviewed" and recommends to "Ensure that the EAO reviews and adequately documents change orders for cost reasonableness and classification".

DOC response:

The ENCORE II contract is a DCAS administered contract utilized by DOC. Pursuant to the DCAS interpretation of the contract, as documented on 3/20/15, the ENCORE II contract is considered a government to government purchase and is not subject to PPB rules, pursuant to PPB section 1-02 (f) (1) and section 3-13. All of the "change orders" identified as deficient under this category are associated with the CoGen power plant project. According to the registered CIC's and the approved schedule of values, the work covered under these "change orders" does not represent additional scope of work to the DOC / NYPA contract nor does it increase the registered amount of the project. The work items identified as "change orders" actually are mislabeled by NYPA. They are work items included under the originally registered CIC amounts. Funds for these work items are being drawn down against the original CIC registered amount and do not increase the CIC registered amounts. As required by the contract (Article III, section 8, Final Customer Installation Commitment), the agency upon completion of the work and after review and verification of all the invoices will reconcile the final project cost and submit a final CIC to DCAS for registration with the Comptroller's office. It is expected, based on current projections and tracking data that the final CIC cost will not exceed the original budget and registered amount. These work items erroneously identified as "change orders" by NYPA were still subject to multiple levels of reviews, including the design consultant, NYPA project management staff, DOC construction oversight staff, DOC design staff and the DOC EAO office evidenced by acceptance of the work costs, with or without adjustments.

- b. The report cites that "there is no evidence that the EAO reviewed the appropriateness of the change order classification for 19 of 53 (36%) change orders as required..." and recommends to "Submit to the General Counsel change orders that are classified as design errors or design omissions for possible recoupment".

DOC response:

Pursuant to the DCAS interpretation of the contract, as documented on 3/20/15, the ENCORE II contract is considered a government to government purchase and not subject to PPB rules, pursuant to PPB section 1-02 (f) (1) and section 3-13.

The agency having performed its due diligence associated with the submitted costs, processed the identified work, without classifying it pursuant to Directive 7, section 3.5.1(a) due to its inapplicability.

Based on the contract requirements (Article III, section 8, Final Customer Installation Commitment), a final CIC will be prepared and processed to DCAS for registration with the Comptroller's office after all the project costs have been finalized and all invoices reviewed and verified.

- c. The report cites that "DOC neglected to register 38 change orders totaling \$4,813,921 with the Comptroller's office prior to approving payments" and recommends to "authorize change order payments for change orders that have been registered with the Comptroller's Office" and to "immediately submit the change orders cited in this report that are still not registered".

DOC response:

Pursuant to the DCAS interpretation of the contract, as documented on 3/20/15, the ENCORE II contract is considered a government to government purchase and not subject to PPB rules, pursuant to PPB section 1-02 (f) (1) and section 3-13.

The identified deficiency is based on a misinterpretation of the terms and conditions of the ENCORE II contract by the auditors. CIC III (Phase III – major equipment pre-purchase) clearly identifies under 4 (B) "Responsibility of Parties" that "DCAS shall be responsible for processing any necessary Project-related contract registrations with the Comptroller". Further more, the work performed does not constitute "change order work", does not increase the CIC registered amounts and does not impact the overall registered project costs.

Pursuant to section 8 (Final Customer Installation Commitment), the agency upon completion of the work and after review and verification of all the invoices will reconcile the final project cost and submit a final CIC to DCAS for registration with the Comptroller's office.

3. Other internal control problems

The report cites the following potential internal problems that allegedly contributed to the EAO failure to comply with Directive 7:

- a. EAO reporting to a senior deputy commissioner also responsible for overseeing the DOC's design and construction units

DOC response:

The reporting structure of the EAO was changed immediately after a review of roles and responsibilities within the organization was conducted by the new administration, which came into place in April of 2014. This was prior to the issuance of the Comptroller's draft report. However, as part of the DOC re-organization, the new EAO reports to the new Deputy Commissioner of Operations who oversees the Office of Quality Assurance and Integrity for the agency and is not associated with any oversight of design or construction operations, currently moved to the Deputy Commissioner for Financial, Facility, and Fleet Administration.

b. Understaffed EAO (single staff EAO) and segregation of EAO functions

DOC response:

As part of the DOC re-organization, and specifically movement of EAO under the Deputy Commissioner of Operations, DOC has designated a deputy EAO and is in the process of hiring additional auditors in order to bring the EAO up to proper staffing levels. Proper staffing levels will allow for the proper segregation of functions within the EAO, increase the number of audits that will be conducted, and make documentation more complete (expected hiring and implementation, summer 2015).

c. EAO undertaking additional responsibility of auditing expense contracts not necessarily under Directive 7 purview.

DOC response:

Although expense vouchers may not be subject to Directive 7 audit procedures, the agency believes that such reviews are beneficial to the agency and safeguard the interests of NYC overall, and will continue with the auditing of selective expense contracts.

In closing, our agency is continuing its restructuring by initiating improvements across all departments in order to optimize operations and efficiency, resolve existing problems and prevent the occurrence of new ones.

If you have any questions or require further information regarding this response, please contact Errol Toulon, Deputy Commissioner of Operations, at (718) 546-0930.

Sincerely,



Joseph Ponte
Commissioner

cc: Errol Toulon, Deputy Commissioner of Operations
Basil Szpylka, Engineering Audits