Mr. Joseph H. Boardman  
Commissioner  
Department of Transportation  
State Office Building Campus, Building #5  
Albany, NY  12232  

Re: Turboliner Modernization Project  
SSSI Payment Verification and  
Close-out Costs  
Report 2004-S-10  

Dear Mr. Boardman:  

Pursuant to the State Comptroller’s authority as set forth in Article V, Section 1 of the State Constitution, and Article II, Section 8 of the State Finance Law, we have audited the Department of Transportation’s payments to Super Steel Schenectady, Incorporated (SSSI) for work performed on the Turboliner Modernization Project (Project) Trainsets 3 through 7 for the period July 1, 2002 through January 31, 2004 and the costs associated with the proposed reduction in scope to SSSI’s contract. This is the fourth in a series of audits addressing Project activities. Our first audit (Report 2002-S-52) addressed project delays; our second audit (Report 2002-S-54) addressed the Department of Transportation’s (Department) monitoring and inspection of Project activities; and our third audit (Report 2002-S-15) addressed Department payments for the project from February 1998 through June 30, 2002. These audit reports were issued on June 10, 2003.

A. Background  

In September 1998, the Governor and Amtrak officials publicly announced a five-year, $185 million High Speed Rail Improvement Program (Program) to improve passenger rail transportation in the Empire Corridor (New York City to Buffalo). The Department administers this Program, which is jointly funded by the Department, Amtrak and the Federal Railroad Administration (FRA). A key component of this Program is the Project to remanufacture seven 30-year old Amtrak trainsets to diesel-powered trains that can travel up to 125 miles per hour and meet current Federal safety and accessibility standards. A trainset has five cars: a power car at each end, two passenger coach cars and one food service car.
The Department contracted with SSSI to remanufacture the seven trainsets. The original contract, approved in February 1998, was for the first two trainsets, called prototype trainsets, which were scheduled for revenue service early in 1999. However, as described in a prior audit, the remanufacturing process was subject to extensive delays, and the prototype trainsets did not enter revenue service until April 2003. Initially, the remaining five trainsets (production trainsets) were to be ready for revenue service between June and December 2002. However, because of more delays, only one production trainset (Trainset 3) was completed by September 2003. This trainset was not in service as of May 2004 because Amtrak had not completed tests needed to accept the trainset for service.

SSSI’s contract, which authorized payments to SSSI of $21.4 million, has been amended eight times since 1998. The first supplemental agreement (supplemental), which authorized payments of up to $50.4 million, included remanufacturing of the 5 production trainsets and change orders on the 2 prototypes. The second supplemental, which authorized payments of up to $2.6 million, added change orders for all 7 trainsets, increasing the total contract cost to $74.4 million. The third supplemental authorized no added contract amounts, but changed the terms for material payments. The fourth, fifth and sixth supplementals simply extended the contract. We were advised that two more supplementals (seventh and eighth), both approved in April 2004, authorized, respectively, another $3.9 million for change order work and a contract extension to June 1, 2004. The Department and the FRA agreed to pay equal shares of remanufacturing costs of up to $25 million ($12.5 million each) for the 2 prototypes, with the Department paying any costs in excess of $25 million. (At the time we were auditing the close-out costs, the Department provided information that showed the first two trainsets cost about $34 million.) The Department and Amtrak were to pay equal shares of remanufacturing costs for the five production trainsets.

The Department also contracted with one engineering firm to develop the original Project Request for Proposal (RFP), and with another engineering firm, TLEngineering Services (TLE), to develop technical aspects of the RFP and to monitor contract work. Consultant costs totaled about $3.5 million at the time of our audit. The Department and Amtrak also agreed to buy new turbines and to have transmissions rebuilt for the remanufactured power cars at a total cost of about $12.2 million. Thus, at the time of our audit, total Project costs were expected to exceed $90 million.

The Department’s original contract stated SSSI would be paid on a time and material basis. However, the first supplemental stated that SSSI would be paid for completing specific remanufacturing activities (milestones) and reimbursed for the purchase of high-cost materials and equipment; the second supplemental stated SSSI would be paid an agreed upon amount when change orders were satisfactorily completed; and the third supplemental stated SSSI would be paid separately for minor materials based on verification by the Department’s on-site inspector that materials were received and vendors were paid. The remaining supplemental agreements did not change payment terms. Between July 1, 2002 and January 31, 2004, the Department reviewed and approved 35 SSSI payment requests (Payment Requests 58-92) totaling $13,212,270. Our prior audit (Report 2002-S-15) addressed payments made to SSSI prior to June 30, 2002.

Due to financial constraints among the partners in the Program, the Department and SSSI proposed a contract modification in July 2003 to reduce the Project’s scope from seven trainsets to five trainsets, plus two coach cars, thereby eliminating Trainset 7 and three cars from Trainset 6. SSSI developed a proposal for its close-out costs. This proposal included costs incurred to date for
the eight cars that would not be completed under the proposed scope reduction; change orders related to the remaining five trainsets; and the work needed to remanufacture the additional two coach cars. The proposed changes reduced the contract’s cost from $74.4 million to $71.8 million.

B. **Audit Scope, Objectives and Methodology**

We audited the Department’s payments to SSSI for work on the Project for the period July 1, 2002 through January 31, 2004 (Payment Requests 58 through 92), excluding costs related to Trainsets 1 and 2, and we also audited the close-out costs submitted by SSSI on September 23, 2003. The Department did not receive or approve SSSI payment requests between September 2003 and December 2003, but it did approve Payment Requests 91 and 92 in January 2004. The objectives of our financial-related audit were to determine whether the payment requests submitted by SSSI and the payments authorized by the Department were accurate and in compliance with the contract, and whether the close-out costs claimed by SSSI were verified by supporting documentation.

To accomplish our objectives, we compared 33 payment requests submitted by SSSI for the period July 1, 2002 through January 31, 2004 to the payments that were approved and paid and examined this data in detail. In addition, we determined the amount of the close-out costs proposed by SSSI that could be audited; the appropriate value of items audited; and items that were unauditable (these items related to estimates provided by SSSI as part of its close-out costs). In the course of this examination, we reviewed and analyzed records maintained by the Department, SSSI and TLE, and interviewed managers and staff of the Department, SSSI and TLE. We also visited SSSI’s remanufacturing plant and physically verified much of SSSI’s inventory.

We conducted our audit in accordance with Generally Accepted Government Auditing Standards. Such standards require that we plan and do our audit to adequately assess those procedures and operations included within the audit scope. Further, these standards require that we understand the Department’s internal control systems and compliance with those laws, rules and regulations that are relevant to the Department’s procedures and operations that 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 our audit provides a reasonable basis for our findings, conclusions and recommendations.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State, several of which are performed by the Division of State Services. These include operating the State’s accounting system; preparing the State’s financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members to certain boards, commissions and public authorities, some of whom have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under Generally Accepted Government Auditing Standards. In our opinion, these management functions do not affect our ability to conduct independent audits of program performance.
C. Internal Control and Compliance Summary

Our consideration of the Department’s internal control structure focused on the controls over payments made to SSSI. We identified certain weaknesses in these controls, which are discussed in detail in the section of this report entitled Verification of Payments.

D. Results of Audit

We audited 33 SSSI payment requests approved by the Department for a total of $11.89 million. For the most part, the 31 payment requests paid under Supplementals 1, 2, 4 and 5, totaling $10.31 million, were properly approved and accurately paid. We identified just two instances of overpayment, totaling $6,958, which the Department recovered in Payment Requests 91 and 92. However, our review of the two payment requests paid under Supplemental 3 (Payment Requests 87 and 88) revealed numerous instances in which SSSI billings for minor materials were unsupported or incorrect. Although the Department reviewed these two payment requests before approving a total payment of $1.58 million, the Department was unable to reconcile billed amounts to approved amounts, and did not completely document its disallowances. Since SSSI may have been overpaid for materials, we recommend the Department reevaluate Payment Requests 87 and 88 and recover any overpayments.

We also audited $6.77 million of the $15.4 million in proposed close-out costs related to SSSI’s scope reduction for the Project. We did not audit the remaining $8.69 million in close-out costs because they were audited by the Department ($3.97 million); were based on undocumented estimates ($3.75 million); contained unverifiable labor charges ($1.14 million); or were for individually immaterial items ($0.83 million). Of the total audited amount, we determined that $3.64 million in costs were substantiated and paid; $1.74 million were substantiated costs for which vendors were not yet paid; and $1.39 million were costs that could not be substantiated, and should be disallowed. Disallowances were the result of our identification of data entry errors, incorrect calculations, unsupported costs or misclassification, such as identifying a valid vendor contract for almost $235,000 as a cancellation cost. We recommend that the Department reduce any future contract amendment by the $1.39 million in disallowed costs, and that it verify vendors were paid the $1.74 million in costs before reimbursing SSSI. We also recommend the Department audit and document the $4.72 million in costs that neither we nor the Department have audited.

1. Verification of Payments

The Department approved 35 SSSI payment requests, totaling $13,212,270, for charges relating to Trainsets 3-7 from July 1, 2002, through January 31, 2004. (See Table 1) We did not audit 2 of these 35 payment requests, totaling $1,312,455, because they represent retainage paid on Trainsets 1 and 2, both of which were completed and in service at the time of our fieldwork. We audited the remaining 33 payment requests, which totaled $11,899,815.
All SSSI payment requests submitted through September 2003 (Payment Request 90) were reviewed by TLE, the technical consultant, by a Department on-site inspector and by the Department’s Project Manager before Department payment was approved. No payment requests were submitted between September and December 2003. As of December 2003, payment requests for materials were reviewed only by the Department’s Project Manager. Under a new process, begun in December 2003, the Project Manager reviews an electronic file containing SSSI billing information to verify that amounts billed for minor materials have been incurred and paid by SSSI, and to determine the Department’s approved payment amount.

### a. Payments Under Supplemental Agreements 1, 2, 4 and 5

The Department’s first supplemental stated that SSSI would be paid for completing specific remanufacturing activities (milestones) and reimbursed for the purchase of high-cost materials and equipment. The second supplemental stated SSSI will receive an agreed-upon amount when change orders are satisfactorily completed. The fourth supplemental extended the contract for Trainset 3 charges until September 1, 2003, and the fifth supplemental extended the entire contract term until January 31, 2004.

We reviewed 31 Department-approved payment requests that included payment for milestones, change order work and major materials reimbursement. These 31 payment requests, totaling $10,319,403, were made under supplemental 1 ($9,047,446), supplemental 2 ($135,801), supplemental 4 ($389,478) and supplemental 5 ($746,678). Altogether, we audited 123 progress payments, 35 change order payments and payments for 486 items of major materials contained on 261 invoices. Our review did not include two progress payments (totaling $374,933) and two change orders (totaling $3,423) that related to Trainset 2. We found most payments were supportable and appropriate.

We identified just two exceptions, with a total value of $6,958. In the first instance, the Department overpaid SSSI $4,330 for change order work related to frame repairs on two power cars. SSSI billed the Department twice for the same power cars, both as components of Trainset 7 in
Payment Request 51, and as components of Trainset 6 in Payment Request 62. As a result of our identification of this overpayment, the Department’s Project Manager informed SSSI of the $4,330 overpayment and SSSI made the related reduction on Payment Request 91. In the second instance, the Department overpaid SSSI by $2,628 for an invoice for major materials that was billed twice on the same payment request. The Department recovered this overpayment from SSSI on Payment Request 92.

b. Payments for Minor Materials Under Supplemental Agreement 3

Supplemental 3 was intended to help alleviate SSSI cash flow problems by allowing SSSI to bill for minor materials (including materials previously included in milestones) before milestones were completed, provided the Department’s on-site inspector could verify the materials were received and paid for. Supplemental 3 increased the total amount of materials allowed under the contract by $1,853,264 to $23,378,904 and reduced the milestones and change orders by an equivalent amount, leaving the total contract value at $74.4 million. SSSI submitted Payment Requests 87 and 88, totaling $2,418,878, under supplemental 3, along with printouts of supporting vouchers and copies of cancelled checks. After TLE and the Department’s Project Manager had reviewed the payment requests, the Department approved payment of $1,580,412, as noted in Table 1, and paid SSSI $1,501,391 (the approved amount less 5 percent retainage) in July 2003.

Our review of Payment Requests 87 and 88, as submitted and approved by the Department, revealed numerous instances in which billed, disallowed and approved amounts were unsupported or contradicted by available data. The Department did not document, and was unable to reconcile, amounts SSSI billed to amounts the Department approved, and did not document amounts the Department disallowed. We concluded the Department may have overpaid SSSI for materials costs.

Listed below are examples of the exceptions we identified in Payment Requests 87 and 88.

- SSSI billed, and was paid for, more than the costs allowed for minor materials.

SSSI calculated that minor materials costs included in all progress payments totaled $1,853,264. According to detailed exhibits in Supplemental 3, SSSI had already been paid $840,892 of the $1,853,264 for materials in milestone progress payments paid prior to March 31, 2003. Thus, SSSI was eligible to receive only the remaining $1,012,372 for materials costs. However, in Payment Request 87, SSSI’s gross bill for materials was $2,417,959, from which it deducted the $840,892 already paid to arrive at a net bill of $1,577,067. This amount is $564,695 more than the $1,012,372 available. Further, the Department’s approved payment for Payment Requests 87 and 88, at $1,580,412, is $568,040 more than the amount allowed for minor materials.
• TLE recommended making across the board reductions for Payment Request 87.

To verify that SSSI had paid vendors for billed materials, the Department and TLE selected a sample, comprising 214 larger dollar-value line items, from SSSI’s 143-page voucher printout containing 7,149 line items. In reporting review results, TLE stated that payment checks for 144 of these items agreed with supporting vouchers. However, payment checks for 70 of the 214 items (almost 33 percent) were greater or less than the amounts on supporting vouchers. Given the number of exceptions found, TLE concluded the entire bill was suspect, and recommended reducing the amount requested for both the sampled exceptions and for all non-sampled line items in Payment Request 87.

• There is no audit trail for disallowed amounts for Payment Request 87.

Based on the Department’s review and TLE’s recommendations for Payment Request 87, the Department disallowed $806,590 before retainage. However, rather than approving $770,477 ($1,577,067 less $806,590), the Department approved only $738,601 before retainage. When we attempted to verify disallowed amounts using Department and SSSI records, we could not identify $288,360 of the Department’s total disallowance. Further, the Department’s disallowance memorandum to SSSI does not relate disallowed amounts to specific items.

• The approved amount for Payment Request 87 is not computed accurately.

Using Department and SSSI records, we calculated a total approved amount of $779,992, which is $41,391 more than the Department’s approved amount of $738,601. In reviewing the first 27 pages of the Department’s sample of approved items, we found mathematical errors that produced an overpayment of $1,834, and 14 different items, totaling $3,779, that were both approved and disallowed.

• The approved amount for Payment Request 88 is not supported by documentation.

SSSI billed the Department $841,811 in Payment Request 88. The Department approved this amount for payment, even though the SSSI voucher printout totaled only $674,988 for SSSI payments to vendors. We were unable to reconcile the amount billed to supporting documentation, and the Department could not provide an audit trail for this payment request.

• Disallowed amounts may have been rebilled on Payment Request 88.

TLE’s letter for Payment Request 88 recommended that the Department reconcile the difference between the total payment requested in Payment Request 87, the sum of approved payments and deductions for this request, and the amount SSSI subsequently requested in Payment Request 88.

As a result of the numerous errors we found in reviewing Payment Requests 87 and 88, as well as the absence of documentation and reconciliation needed to support approved and disallowed amounts, we question the accuracy of the Department’s $1,580,412 approved amount for Payment
Requests 87 and 88. We believe the Department may have paid SSSI more than it should have paid for minor materials costs.

In response to our audits of the Project, Department officials are obtaining a new technical consultant. Officials report that they have also changed their review process in response to our audits by assigning a Project management team in September 2003. This team includes a new Project Manager and team members with financial experience. The Project team modified the process for reviewing and approving materials payment requests effective December 2003. Under the revised process, SSSI provides an electronic file of all items billed on the payment request and all cancelled checks and invoices for materials greater than $2,000. The Project Manager checks the file for duplicates, reviews the cancelled checks to verify vendor payment, and examines invoices to validate the appropriate item costs. The Department should use this revised process to reevaluate Payment Requests 87 and 88, and then recover any overpayments.

2. Proposed Close-Out Costs

Proposed changes to SSSI’s contract reduced the scope of the Project from seven trainsets to five trainsets, plus two coach cars. The proposed changes reduced the contract cost from $74.4 million to $71.8 million. SSSI provided the Department and the Office of the State Comptroller with a binder of pricing documents, dated September 23, 2003, that lists the amount SSSI needs to complete the remaining work (the five trainsets and two coach cars), plus certain costs SSSI had incurred to date (e.g., excess materials, vendor cancellations) for work related to the eight cars that would not be completed. Schedule A of these documents is a summary page that lists individual charges for close-out costs totaling $15.4 million; the remaining documents in the binder support the charges in Schedule A.

The proposed close-out costs of $15.4 million and the results of our audit work are shown in Exhibit A. Of the $15.4 million in total close-out costs included in SSSI’s Schedule A, $6,774,277 were costs that could be audited. We found that SSSI had incurred and paid vendors for costs of $3,639,710. We also found that SSSI had incurred, but not yet paid vendors for, another $1,736,716 in costs, so SSSI could not yet be reimbursed for these amounts. We found that costs totaling $1,397,851 were not substantiated and should be disallowed. As detailed later in this section, we did not audit the remaining $8,697,996 because they included items such as estimated costs (about $3.75 million), labor costs we could not verify (about $.14 million) and costs audited by the Department (about $3.97 million).

We recommend disallowing $1,397,851 in costs, as shown in Exhibit A, because our audit detected errors in the statement of these costs. For example, the Excess Material category (Schedule A, Line 22), with a total of $267,873 in disallowances, included several instances in which SSSI had overstated or understated its unit costs. Most of these items were related to data entry errors, the use of planned unit costs instead of actual unit costs, or a failure to understand how the inventory system tracks certain costs. For example, component parts are normally not given a part number, but are tracked with their assembly. However, we found that both the component and its related assembly were included on the Excess Material listing. In other instances, SSSI double-counted certain Excess Material items because the items were included in two locations on its inventory system. This error occurred because SSSI had not updated its inventory system to remove a second location when its operations were consolidated in one building.
In the Quality Assurance Excess Material category (Line 24), with disallowances totaling $24,045, we found several instances in which the unit costs were over or understated, or the items listed could not be located. In other instances, the items listed were not excess material because they would be used in producing the remaining trainsets.

Vendor Cancellations costs (Line 25), the category with the greatest total disallowance at $796,218, included instances in which there was no supporting documentation for the amount of the cancellation; the order was not actually cancelled; or the order had been shipped prior to cancellation. For example, Schedule A included cancellation charges of $250,000 for one vendor. However, the $250,000 amount was based on an estimate, and SSSI had no documentation to support its calculation of the estimate. SSSI also included $234,660 in cancellation charges for a vendor order it had not cancelled.

Constructed Inventory (Line 27) costs were overstated by $7,595 because they included the cost of a battery box assembly that had not yet been constructed. SSSI also overstated its Storage Costs related to cancellation (Line 30) by $310,232. SSSI originally claimed shop storage costs would be $428,000 for a year. SSSI subsequently recalculated the square footage in its shop storage space and reduced the monthly charge, which decreased SSSI’s storage costs to $117,768 a year. However, SSSI included $428,000 for storage costs on Schedule A, an amount that is $310,232 more than actual storage costs. SSSI also understated its management travel costs by $8,100.

We did not audit $8,697,996 of the $15.4 million in proposed close-out costs. (See Amounts Not Audited in Exhibit A). Listed below are the reasons we did not audit these costs, and their respective locations (Schedule A Line Number) in Exhibit A.

- Approximately $3.9 million in change order costs were audited by the Department’s Contract Audit Bureau. (Line 33)
- Internal Cancellation costs, totaling $3,397,000, were based on undocumented estimates for the following: damage to SSSI’s supply chain; loss of production efficiency; use of management time; and the loss of unrecoverable fixed costs. (Line 30)
- Inventory Disposition costs of $190,000 (Line 26) and Assembly Work in Process costs of $166,000 (Line 29) were based on estimates of the time needed to dispose of excess materials and estimates of completion of components in process.
- Constructed Inventory costs of $25,829 (Line 27) included labor charges from SSSI’s Enterprise Management System (EMS), a system we previously concluded (Report 2002-S-15) produced data of undeterminable reliability.
- Excess Material costs of $117,411 for Purchased Material (Line 22) and $607 for the Quality Review Area (Line 24) included unverifiable labor costs for manufactured material.
- Excess Materials totaling $827,815 (Line 22) were excluded because the cost of the individual items (e.g., screws, bolts) was immaterial.

**Recommendations**

1. Evaluate the $1,580,412 in questioned costs on Payment Requests 87 and 88 and recover any overpayments.
2. **Improve the processing of future material payments by including at a minimum the following:**
   a. **Require SSSI to submit electronic files for the material items requested along with the cancelled checks and supporting invoices.**
   b. **Use computerized data analysis tools, such as those contained in Microsoft Excel, Microsoft Access, or Audit Command Language (ACL) software, to compare for duplicate charges and to avoid mathematical inaccuracies in approving items for payment.**
   c. **Include the dollar amount of disallowances for individual items on disallowance memoranda to SSSI.**

3. **Verify that SSSI has paid its vendors for the $1,736,716 before any payments are made.**

4. **Reduce any contract amendments by the $1,397,851 disallowance for the proposed close-out costs.**

   *(In response to the draft report, Department officials indicated that the $1,397,851 disallowance included estimated amounts.)*

   **Auditor’s Comment** - The amounts included in our $1,397,851 are not estimated amounts. As indicated in the report, we did not audit estimates. The $1,397,851 was disallowed as discussed in the report section *Proposed Close-Out Costs* and should be handled as such by the Department.

5. **Audit the $4.72 million in costs that neither we nor the Department have audited and document the audit’s results before paying these costs.**

   A draft copy of this report was provided to Department of Transportation officials for their review and comment. Their comments have been considered in preparing this final report, and are included as Appendix A. Department officials indicated that, based on the previous concerns raised by our Office, they have implemented several changes, all of which were intended to improve the oversight and management of the Program. These changes include replacing the project management team as well as process-oriented improvements that will help ensure that only reasonable and supportable costs are approved and paid for in the Project. Department officials also state that there will be a final accounting at the completion of the work and they will audit SSSI’s remaining costs to ensure that the costs are reasonable and supportable.

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

   Major contributors to this report were Gerald Tysiak, Roger C. Mazula, Deb Spaulding, Eric Swanson, Jennifer Paperman, Gayle Clas, Kathleen Hotaling, Sharon Salembier and Nancy Varley.
We wish to thank the management and staff of the Department of Transportation for the courtesies and cooperation extended to our auditors during this audit.

Very truly yours,

Carmen Maldonado
Audit Director

cc: Robert Barnes, DOB
    John Samaniuk, DOT
Mr. Joseph H. Boardman  
Commissioner  
Department of Transportation  
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B. Audit Scope, Objectives and Methodology

We audited the Department’s payments to SSSI for work on the Project for the period July 1, 2002 through January 31, 2004 (Payment Requests 58 through 92), excluding costs related to Trainsets 1 and 2, and we also audited the close-out costs submitted by SSSI on September 23, 2003. The Department did not receive or approve SSSI payment requests between September 2003 and December 2003, but it did approve Payment Requests 91 and 92 in January 2004. The objectives of our financial-related audit were to determine whether the payment requests submitted by SSSI and the payments authorized by the Department were accurate and in compliance with the contract, and whether the close-out costs claimed by SSSI were verified by supporting documentation.

To accomplish our objectives, we compared 33 payment requests submitted by SSSI for the period July 1, 2002 through January 31, 2004 to the payments that were approved and paid and examined this data in detail. In addition, we determined the amount of the close-out costs proposed by SSSI that could be audited; the appropriate value of items audited; and items that were unauditable (these items related to estimates provided by SSSI as part of its close-out costs). In the course of this examination, we reviewed and analyzed records maintained by the Department, SSSI and TLE, and interviewed managers and staff of the Department, SSSI and TLE. We also visited SSSI’s remanufacturing plant and physically verified much of SSSI’s inventory.

We conducted our audit in accordance with Generally Accepted Government Auditing Standards. Such standards require that we plan and do our audit to adequately assess those procedures and operations included within the audit scope. Further, these standards require that we understand the Department’s internal control systems and compliance with those laws, rules and regulations that are relevant to the Department’s procedures and operations that 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 our audit provides a reasonable basis for our findings, conclusions and recommendations.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State, several of which are performed by the Division of State Services. These include operating the State’s accounting system; preparing the State’s financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members to certain boards, commissions and public authorities, some of whom have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under Generally Accepted Government Auditing Standards. In our opinion, these management functions do not affect our ability to conduct independent audits of program performance.
C. Internal Control and Compliance Summary

Our consideration of the Department’s internal control structure focused on the controls over payments made to SSSI. We identified certain weaknesses in these controls, which are discussed in detail in the section of this report entitled Verification of Payments.

D. Results of Audit

We audited 33 SSSI payment requests approved by the Department for a total of $11.89 million. For the most part, the 31 payment requests paid under Supplementals 1, 2, 4 and 5, totaling $10.31 million, were properly approved and accurately paid. We identified just two instances of overpayment, totaling $6,958, which the Department recovered in Payment Requests 91 and 92. However, our review of the two payment requests paid under Supplemental 3 (Payment Requests 87 and 88) revealed numerous instances in which SSSI billings for minor materials were unsupported or incorrect. Although the Department reviewed these two payment requests before approving a total payment of $1.58 million, the Department was unable to reconcile billed amounts to approved amounts, and did not completely document its disallowances. Since SSSI may have been overpaid for materials, we recommend the Department reevaluate Payment Requests 87 and 88 and recover any overpayments.

We also audited $6.77 million of the $15.4 million in proposed close-out costs related to SSSI’s scope reduction for the Project. We did not audit the remaining $8.69 million in close-out costs because they were audited by the Department ($3.97 million); were based on undocumented estimates ($3.75 million); contained unverifiable labor charges ($14 million); or were for individually immaterial items ($83 million). Of the total audited amount, we determined that $3.64 million in costs were substantiated and paid; $1.74 million were substantiated costs for which vendors were not yet paid; and $1.39 million were costs that could not be substantiated, and should be disallowed. Disallowances were the result of our identification of data entry errors, incorrect calculations, unsupported costs or misclassification, such as identifying a valid vendor contract for almost $235,000 as a cancellation cost. We recommend that the Department reduce any future contract amendment by the $1.39 million in disallowed costs, and that it verify vendors were paid the $1.74 million in costs before reimbursing SSSI. We also recommend the Department audit and document the $4.72 million in costs that neither we nor the Department have audited.

1. Verification of Payments

The Department approved 35 SSSI payment requests, totaling $13,212,270, for charges relating to Trainsets 3-7 from July 1, 2002, through January 31, 2004. (See Table 1) We did not audit 2 of these 35 payment requests, totaling $1,312,455, because they represent retainage paid on Trainsets 1 and 2, both of which were completed and in service at the time of our fieldwork. We audited the remaining 33 payment requests, which totaled $11,899,815.
Table 1: Department-Approved Payment Requests: 7/1/02 – 1/31/04

<table>
<thead>
<tr>
<th>Contract or Supplemental Agreement</th>
<th>Number of Payment Requests Submitted</th>
<th>Work Covered in Payment Requests</th>
<th>Value of Payment Requests Submitted</th>
</tr>
</thead>
<tbody>
<tr>
<td>Original Contract</td>
<td>2</td>
<td>Payment of retainage on Trainsets 1 and 2</td>
<td>$1,312,455</td>
</tr>
<tr>
<td>Supplemental #1</td>
<td>20</td>
<td>Progress payments and high-cost materials</td>
<td>9,047,446</td>
</tr>
<tr>
<td>Supplemental #2</td>
<td>7</td>
<td>Completed change order work</td>
<td>135,801</td>
</tr>
<tr>
<td>Supplemental #3</td>
<td>2</td>
<td>Minor materials payments</td>
<td>1,580,412</td>
</tr>
<tr>
<td>Supplemental #4</td>
<td>2</td>
<td>Progress payments under Supplemental # 1 and change order work under Supplemental # 2</td>
<td>389,478</td>
</tr>
<tr>
<td>Supplemental #5</td>
<td>2</td>
<td>Progress payments under Supplemental # 1; change orders under Supplemental #2; and materials under Supplemental #3</td>
<td>746,678</td>
</tr>
<tr>
<td>Total</td>
<td>35</td>
<td></td>
<td>$13,212,270</td>
</tr>
<tr>
<td>Original Contract</td>
<td>(2)</td>
<td>Less: Payments excluded from audit scope</td>
<td>1,312,455</td>
</tr>
<tr>
<td>Total Audited</td>
<td>33</td>
<td>Supplementals #1 - #5</td>
<td>$11,899,815</td>
</tr>
</tbody>
</table>

All SSSI payment requests submitted through September 2003 (Payment Request 90) were reviewed by TLE, the technical consultant, by a Department on-site inspector and by the Department’s Project Manager before Department payment was approved. No payment requests were submitted between September and December 2003. As of December 2003, payment requests for materials were reviewed only by the Department’s Project Manager. Under a new process, begun in December 2003, the Project Manager reviews an electronic file containing SSSI billing information to verify that amounts billed for minor materials have been incurred and paid by SSSI, and to determine the Department’s approved payment amount.

a. Payments Under Supplemental Agreements 1, 2, 4 and 5

The Department’s first supplemental stated that SSSI would be paid for completing specific remanufacturing activities (milestones) and reimbursed for the purchase of high-cost materials and equipment. The second supplemental stated SSSI will receive an agreed-upon amount when change orders are satisfactorily completed. The fourth supplemental extended the contract for Trainset 3 charges until September 1, 2003, and the fifth supplemental extended the entire contract term until January 31, 2004.

We reviewed 31 Department-approved payment requests that included payment for milestones, change order work and major materials reimbursement. These 31 payment requests, totaling $10,319,403, were made under supplemental 1 ($9,047,446), supplemental 2 ($135,801), supplemental 4 ($389,478) and supplemental 5 ($746,678). Altogether, we audited 123 progress payments, 35 change order payments and payments for 486 items of major materials contained on 261 invoices. Our review did not include two progress payments (totaling $374,933) and two change orders (totaling $3,423) that related to Trainset 2. We found most payments were supportable and appropriate.

We identified just two exceptions, with a total value of $6,958. In the first instance, the Department overpaid SSSI $4,330 for change order work related to frame repairs on two power cars. SSSI billed the Department twice for the same power cars, both as components of Trainset 7 in
Payment Request 51, and as components of Trainset 6 in Payment Request 62. As a result of our identification of this overpayment, the Department’s Project Manager informed SSSI of the $4,330 overpayment and SSSI made the related reduction on Payment Request 91. In the second instance, the Department overpaid SSSI by $2,628 for an invoice for major materials that was billed twice on the same payment request. The Department recovered this overpayment from SSSI on Payment Request 92.

b. Payments for Minor Materials Under Supplemental Agreement 3

Supplemental 3 was intended to help alleviate SSSI cash flow problems by allowing SSSI to bill for minor materials (including materials previously included in milestones) before milestones were completed, provided the Department’s on-site inspector could verify the materials were received and paid for. Supplemental 3 increased the total amount of materials allowed under the contract by $1,853,264 to $23,378,904 and reduced the milestones and change orders by an equivalent amount, leaving the total contract value at $74.4 million. SSSI submitted Payment Requests 87 and 88, totaling $2,418,878, under supplemental 3, along with printouts of supporting vouchers and copies of cancelled checks. After TLE and the Department’s Project Manager had reviewed the payment requests, the Department approved payment of $1,580,412, as noted in Table 1, and paid SSSI $1,501,391 (the approved amount less 5 percent retainage) in July 2003.

Our review of Payment Requests 87 and 88, as submitted and approved by the Department, revealed numerous instances in which billed, disallowed and approved amounts were unsupported or contradicted by available data. The Department did not document, and was unable to reconcile, amounts SSSI billed to amounts the Department approved, and did not document amounts the Department disallowed. We concluded the Department may have overpaid SSSI for materials costs.

Listed below are examples of the exceptions we identified in Payment Requests 87 and 88.

- SSSI billed, and was paid for, more than the costs allowed for minor materials.

SSSI calculated that minor materials costs included in all progress payments totaled $1,853,264. According to detailed exhibits in Supplemental 3, SSSI had already been paid $840,892 of the $1,853,264 for materials in milestone progress payments paid prior to March 31, 2003. Thus, SSSI was eligible to receive only the remaining $1,012,372 for materials costs. However, in Payment Request 87, SSSI’s gross bill for materials was $2,417,959, from which it deducted the $840,892 already paid to arrive at a net bill of $1,577,067. This amount is $564,695 more than the $1,012,372 available. Further, the Department’s approved payment for Payment Requests 87 and 88, at $1,580,412, is $568,040 more than the amount allowed for minor materials.
TLE recommended making across the board reductions for Payment Request 87.

To verify that SSSI had paid vendors for billed materials, the Department and TLE selected a sample, comprising 214 larger dollar-value line items, from SSSI’s 143-page voucher printout containing 7,149 line items. In reporting review results, TLE stated that payment checks for 144 of these items agreed with supporting vouchers. However, payment checks for 70 of the 214 items (almost 33 percent) were greater or less than the amounts on supporting vouchers. Given the number of exceptions found, TLE concluded the entire bill was suspect, and recommended reducing the amount requested for both the sampled exceptions and for all non-sampled line items in Payment Request 87.

There is no audit trail for disallowed amounts for Payment Request 87.

Based on the Department’s review and TLE’s recommendations for Payment Request 87, the Department disallowed $806,590 before retainage. However, rather than approving $770,477 ($1,577,067 less $806,590), the Department approved only $738,601 before retainage. When we attempted to verify disallowed amounts using Department and SSSI records, we could not identify $288,360 of the Department’s total disallowance. Further, the Department’s disallowance memorandum to SSSI does not relate disallowed amounts to specific items.

The approved amount for Payment Request 87 is not computed accurately.

Using Department and SSSI records, we calculated a total approved amount of $779,992, which is $41,391 more than the Department’s approved amount of $738,601. In reviewing the first 27 pages of the Department’s sample of approved items, we found mathematical errors that produced an overpayment of $1,834, and 14 different items, totaling $3,779, that were both approved and disallowed.

The approved amount for Payment Request 88 is not supported by documentation.

SSSI billed the Department $841,811 in Payment Request 88. The Department approved this amount for payment, even though the SSSI voucher printout totaled only $674,988 for SSSI payments to vendors. We were unable to reconcile the amount billed to supporting documentation, and the Department could not provide an audit trail for this payment request.

Disallowed amounts may have been rebilled on Payment Request 88.

TLE’s letter for Payment Request 88 recommended that the Department reconcile the difference between the total payment requested in Payment Request 87, the sum of approved payments and deductions for this request, and the amount SSSI subsequently requested in Payment Request 88.

As a result of the numerous errors we found in reviewing Payment Requests 87 and 88, as well as the absence of documentation and reconciliation needed to support approved and disallowed amounts, we question the accuracy of the Department’s $1,580,412 approved amount for Payment
Requests 87 and 88. We believe the Department may have paid SSSI more than it should have paid for minor materials costs.

In response to our audits of the Project, Department officials are obtaining a new technical consultant. Officials report that they have also changed their review process in response to our audits by assigning a Project management team in September 2003. This team includes a new Project Manager and team members with financial experience. The Project team modified the process for reviewing and approving materials payment requests effective December 2003. Under the revised process, SSSI provides an electronic file of all items billed on the payment request and all cancelled checks and invoices for materials greater than $2,000. The Project Manager checks the file for duplicates, reviews the cancelled checks to verify vendor payment, and examines invoices to validate the appropriate item costs. The Department should use this revised process to reevaluate Payment Requests 87 and 88, and then recover any overpayments.

2. **Proposed Close-Out Costs**

Proposed changes to SSSI’s contract reduced the scope of the Project from seven trainsets to five trainsets, plus two coach cars. The proposed changes reduced the contract cost from $74.4 million to $71.8 million. SSSI provided the Department and the Office of the State Comptroller with a binder of pricing documents, dated September 23, 2003, that lists the amount SSSI needs to complete the remaining work (the five trainsets and two coach cars), plus certain costs SSSI had incurred to date (e.g., excess materials, vendor cancellations) for work related to the eight cars that would not be completed. *Schedule A* of these documents is a summary page that lists individual charges for close-out costs totaling $15.4 million; the remaining documents in the binder support the charges in *Schedule A*.

The proposed close-out costs of $15.4 million and the results of our audit work are shown in *Exhibit A*. Of the $15.4 million in total close-out costs included in SSSI’s Schedule A, $6,774,277 were costs that could be audited. We found that SSSI had incurred and paid vendors for costs of $3,639,710. We also found that SSSI had incurred, but not yet paid vendors for, another $1,736,716 in costs, so SSSI could not yet be reimbursed for these amounts. We found that costs totaling $1,397,851 were not substantiated and should be disallowed. As detailed later in this section, we did not audit the remaining $8,697,996 because they included items such as estimated costs (about $3.75 million), labor costs we could not verify (about $1.14 million) and costs audited by the Department (about $3.97 million).

We recommend disallowing $1,397,851 in costs, as shown in *Exhibit A*, because our audit detected errors in the statement of these costs. For example, the Excess Material category (Schedule A, Line 22), with a total of $267,873 in disallowances, included several instances in which SSSI had overstated or understated its unit costs. Most of these items were related to data entry errors, the use of planned unit costs instead of actual unit costs, or a failure to understand how the inventory system tracks certain costs. For example, component parts are normally not given a part number, but are tracked with their assembly. However, we found that both the component and its related assembly were included on the Excess Material listing. In other instances, SSSI double-counted certain Excess Material items because the items were included in two locations on its inventory system. This error occurred because SSSI had not updated its inventory system to remove a second location when its operations were consolidated in one building.
In the Quality Assurance Excess Material category (Line 24), with disallowances totaling $24,045, we found several instances in which the unit costs were over or understated, or the items listed could not be located. In other instances, the items listed were not excess material because they would be used in producing the remaining trainsets.

Vendor Cancellations costs (Line 25), the category with the greatest total disallowance at $796,218, included instances in which there was no supporting documentation for the amount of the cancellation; the order was not actually cancelled; or the order had been shipped prior to cancellation. For example, Schedule A included cancellation charges of $250,000 for one vendor. However, the $250,000 amount was based on an estimate, and SSSI had no documentation to support its calculation of the estimate. SSSI also included $234,660 in cancellation charges for a vendor order it had not cancelled.

Constructed Inventory (Line 27) costs were overstated by $7,595 because they included the cost of a battery box assembly that had not yet been constructed. SSSI also overstated its Storage Costs related to cancellation (Line 30) by $310,232. SSSI originally claimed shop storage costs would be $428,000 for a year. SSSI subsequently recalculated the square footage in its shop storage space and reduced the monthly charge, which decreased SSSI’s storage costs to $117,768 a year. However, SSSI included $428,000 for storage costs on Schedule A, an amount that is $310,232 more than actual storage costs. SSSI also understated its management travel costs by $8,100.

We did not audit $8,697,996 of the $15.4 million in proposed close-out costs. (See Amounts Not Audited in Exhibit A). Listed below are the reasons we did not audit these costs, and their respective locations (Schedule A Line Number) in Exhibit A.

- Approximately $3.9 million in change order costs were audited by the Department’s Contract Audit Bureau. (Line 33)
- Internal Cancellation costs, totaling $3,397,000, were based on undocumented estimates for the following: damage to SSSI’s supply chain; loss of production efficiency; use of management time; and the loss of unrecoverable fixed costs. (Line 30)
- Inventory Disposition costs of $190,000 (Line 26) and Assembly Work in Process costs of $166,000 (Line 29) were based on estimates of the time needed to dispose of excess materials and estimates of completion of components in process.
- Constructed Inventory costs of $25,829 (Line 27) included labor charges from SSSI’s Enterprise Management System (EMS), a system we previously concluded (Report 2002-S-15) produced data of undeterminable reliability.
- Excess Material costs of $117,411 for Purchased Material (Line 22) and $607 for the Quality Review Area (Line 24) included unverifiable labor costs for manufactured material.
- Excess Materials totaling $827,815 (Line 22) were excluded because the cost of the individual items (e.g., screws, bolts) was immaterial.

**Recommendations**

1. Evaluate the $1,580,412 in questioned costs on Payment Requests 87 and 88 and recover any overpayments.
2. **Improve the processing of future material payments by including at a minimum the following:**
   a. Require SSSI to submit electronic files for the material items requested along with the cancelled checks and supporting invoices.
   b. Use computerized data analysis tools, such as those contained in Microsoft Excel, Microsoft Access, or Audit Command Language (ACL) software, to compare for duplicate charges and to avoid mathematical inaccuracies in approving items for payment.
   c. Include the dollar amount of disallowances for individual items on disallowance memoranda to SSSI.

3. **Verify that SSSI has paid its vendors for the $1,736,716 before any payments are made.**

4. **Reduce any contract amendments by the $1,397,851 disallowance for the proposed close-out costs.**

   (In response to the draft report, Department officials indicated that the $1,397,851 disallowance included estimated amounts.)

   **Auditor’s Comment** - The amounts included in our $1,397,851 are not estimated amounts. As indicated in the report, we did not audit estimates. The $1,397,851 was disallowed as discussed in the report section *Proposed Close-Out Costs* and should be handled as such by the Department.

5. **Audit the $4.72 million in costs that neither we nor the Department have audited and document the audit’s results before paying these costs.**

   A draft copy of this report was provided to Department of Transportation officials for their review and comment. Their comments have been considered in preparing this final report, and are included as Appendix A. Department officials indicated that, based on the previous concerns raised by our Office, they have implemented several changes, all of which were intended to improve the oversight and management of the Program. These changes include replacing the project management team as well as process-oriented improvements that will help ensure that only reasonable and supportable costs are approved and paid for in the Project. Department officials also state that there will be a final accounting at the completion of the work and they will audit SSSI’s remaining costs to ensure that the costs are reasonable and supportable.

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

   Major contributors to this report were Gerald Tysiak, Roger C. Mazula, Deb Spaulding, Eric Swanson, Jennifer Paperman, Gayle Clas, Kathleen Hotaling, Sharon Salembier and Nancy Varley.
We wish to thank the management and staff of the Department of Transportation for the courtesies and cooperation extended to our auditors during this audit.

Very truly yours,

Carmen Maldonado
Audit Director

cc: Robert Barnes, DOB
    John Samaniuk, DOT
## Exhibit A

### Summary of SSSI Proposed Close-Out Costs Results

<table>
<thead>
<tr>
<th>Schedule A Line Number</th>
<th>Description</th>
<th>Sub-Amounts Included in Total – Schedule A</th>
<th>Amount per Schedule A-9/23/03</th>
<th>Amount Not Audited (1)</th>
<th>Amount Audited</th>
<th>Amount Allowed (Now)</th>
<th>Amount Allowed (Pending)</th>
<th>Amount Disallowed</th>
</tr>
</thead>
<tbody>
<tr>
<td>8-14</td>
<td>TS 6 work completed, invoiced and billed</td>
<td>$0</td>
<td>$1,107,000</td>
<td>$0</td>
<td>$1,145,666</td>
<td>$1,145,666</td>
<td>$0</td>
<td>$0</td>
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<tr>
<td>22</td>
<td>Purchased Material Inventory (Excess Material)</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Purchased Materials</td>
<td>3,930,989</td>
<td>827,815</td>
<td>3,140,058</td>
<td>2,050,621</td>
<td>846,497</td>
<td>242,940</td>
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<tr>
<td></td>
<td>Manufactured Materials</td>
<td>342,799</td>
<td>117,411</td>
<td>188,504</td>
<td>161,298</td>
<td>2,273</td>
<td>24,933</td>
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<tr>
<td></td>
<td>Total Per Sub-Schedule</td>
<td>4,273,788</td>
<td>4,274,000</td>
<td>945,226</td>
<td>3,328,562</td>
<td>2,211,919</td>
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<td>24</td>
<td>Quality Review Area Inventory (Excess)</td>
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<td></td>
<td></td>
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<td></td>
<td></td>
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<tr>
<td></td>
<td>Purchased Materials</td>
<td>304,172</td>
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<td>279,948</td>
<td>179</td>
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<td>607</td>
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<td>19</td>
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<td>Total Per Sub-Schedule</td>
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<td>305,000</td>
<td>607</td>
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<td>279,967</td>
<td>179</td>
<td>24,045</td>
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<td>25</td>
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<td>TS 6 &amp; 7 Inventory Disposition</td>
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<td>27</td>
<td>Constructed Inventory</td>
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<td>Inventory (excluding fuel tanks)</td>
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<td>57,687</td>
<td>0</td>
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<td>Fuel Tanks</td>
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<tr>
<td></td>
<td>Storage costs</td>
<td>428,000</td>
<td>0</td>
<td>428,000</td>
<td>0</td>
<td>117,768</td>
<td>310,232</td>
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<td>Mgmt costs for cancellation &amp; re-pricing</td>
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<td>80,000</td>
<td>0</td>
<td>0</td>
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<td>Mgmt costs travel</td>
<td>8,000</td>
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<td>16,100</td>
<td>(8,100)</td>
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<td></td>
<td>Loss of hourly employee efficiency</td>
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<td>0</td>
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<td>0</td>
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<td></td>
<td>Damage to supply chain</td>
<td>258,000</td>
<td>0</td>
<td>258,000</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Fixed costs not recovered Trainsets 6 &amp; 7</td>
<td>2,514,000</td>
<td>0</td>
<td>2,514,000</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total Per Sub-Schedule</td>
<td>3,833,000</td>
<td>3,833,000</td>
<td>3,397,000</td>
<td>436,000</td>
<td>0</td>
<td>133,868</td>
<td>302,132</td>
</tr>
<tr>
<td>33</td>
<td>Change Orders (2)</td>
<td>0</td>
<td>3,973,334</td>
<td>0</td>
<td>3,973,334</td>
<td>0</td>
<td>0</td>
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<td>Totals (3)</td>
<td></td>
<td>3,833,000</td>
<td>3,833,000</td>
<td>3,397,000</td>
<td>436,000</td>
<td>0</td>
<td>133,868</td>
<td>302,132</td>
</tr>
</tbody>
</table>

### Notes:

1. Amount Not Audited includes amounts excluded from our samples and amounts that were not auditable, such as costs based on estimates.
2. Change orders were audited by the Department’s Contract Audit Bureau.
3. Schedule A’s summary numbers are rounded to the nearest thousand. Since we did our calculations using actual dollar amounts of purchases, etc., the totals for Amount Audited and Amount Not Audited will not equal the total amount shown for Schedule A.
December 20, 2004

Ms. Carmen Maldonado
Office of the State Comptroller
Division of State Services
123 William Street, 21st Floor
New York, New York 10038


Dear Ms. Maldonado:

The Department of Transportation (Department) has reviewed your draft audit report dated November 23, 2004 and we offer the following comments.

In response to previous concerns raised by your office, the Department implemented several changes all of which were intended to improve the management and oversight of the RTL Remanufacture Program. These changes included replacing the project management team; establishing an executive oversight committee; improving coordination among the Department’s project management, budget and finance, and contract management staff; as well as a number of other process-oriented improvements all designed to help assure that only reasonable and supportable costs are approved and ultimately paid for this project. We have also been working jointly with the Office of the State Comptroller’s (OSC) financial services staff to ensure that all transactions meet appropriate State financial requirements.

In addition, it should be noted that the observations made in your draft report were based on estimates of certain costs that SSSI believed at that point in time it would incur to complete the project. Enclosed is a copy of the September 23, 2003 version of Schedule A which illustrates that at the time of your audit, the full cost for the proposed scope reduction was estimated at $74.5 million but, as agreed by all parties this amount was capped at $71.8 million. Schedule A shows that because of the acknowledged uncertainty of some of the budget items, supportable internal cancellation costs would be used to maintain this total as agreed to by OSC’s Division of State Services.

Appendix A
Ms. Carmen Maldonado  
December 20, 2004  
Page 2 of 3

Recommendation #1

Evaluate the $1,580,412 in questioned costs on Payment Requests 87 and 88 and recover any overpayments.

**DOT Response:** The Department reviewed Payment Requests 87 and 88 and determined that $197,537 of the $1,580,412 in costs should be disallowed. The Department will recover this amount through deductions from future SSSI payments. It should be noted that the Department has improved its process for reviewing and approving payment requests in order to help avoid any future overpayments.

Recommendation #2

Improve the processing of future material payments by including at a minimum the following:

a) Require SSSI to submit electronic files for the material items requested along with the cancelled checks and supporting invoices.

b) Use computerized data analysis tools, such as those contained in Microsoft Excel, Microsoft Access or Audit Command Language (ACL) software, to compare for duplicate charges and to avoid mathematical inaccuracies in approving items for payment.

c) Include the dollar amount of disallowances for individual items on disallowance memoranda to SSSI.

**DOT Response:** The Department implemented an improved review process which is consistent with this recommendation. As part of this improved process, the Department required SSSI to submit electronic files together with cancelled checks and supporting invoices to support its payment requests. The Department’s project manager personally checks for duplicate charges and mathematical errors using this electronic data as appropriate. Also, a complete materials database by vendor and by estimate has been instituted. Progress payment request 92 and subsequent payments have been processed in this manner. For any amounts disallowed, specific items are included in the disallowance memoranda to SSSI.

Recommendation #3

Verify that SSSI has paid its vendors for the $1,736,716 before any payments are made.

**DOT Response:** The Department has worked closely with OSC to ensure that only appropriate payments are made. Since progress payment request 92, no reimbursement to SSSI has been made without first obtaining documentation to verify that vendors have been paid for materials purchased by SSSI.
Recommendation #4

Reduce any contract amendments by the $1,397,851 disallowance for the proposed close-out costs.

DOT Response: The Department did not and will not pay for any of the items disallowed by your audit. The amounts included in your $1,397,851 disallowance were part of the cost estimates submitted by SSSI which were proposed to close-out the project at the time of your audit. Since many of these amounts were estimates, it is reasonable to expect that they may change. As noted in Schedule A, other verifiable costs exist to maintain the OSC mandated cap of $71.8 million. No payments have been or would be made without sufficient evidence to support such payment.

Recommendation #5

Audit the $4.72 million in costs that neither we nor the Department have audited and document the audit’s results before paying these costs.

DOT Response: Many of the unaudited costs of this project to date include internal cancellation items such as supply chain impacts, production efficiency, management involvement, fixed costs, inventory disposition, assembly work and small item materials such as bolts, screws, electric wire, fasteners, etc. As SSSI was directed back to work in April of 2004 the Department, working jointly with OSC, interacted with SSSI to negotiate agreed costs and/or calculated analysis in support of these items. At the end of this project there will be a final accounting of costs and the Department’s Contract Audit Bureau intends to review the remaining unaudited costs to ensure that these costs are reasonable and supportable.

In summary, we believe that the Department has fully addressed all of your audit recommendations. We thank you for the opportunity to comment on the draft audit report.

Sincerely,

[Signature]
Paul T. Wells
Chief Engineer

Enclosure

cc: Robert Barnes, Division of the Budget
# Schedule A
## Five Trains plus Two Coaches

<table>
<thead>
<tr>
<th>SSSI</th>
<th>Original</th>
<th>Revision</th>
<th>Full Cost</th>
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<tbody>
<tr>
<td>RTL Program Price Information ($000s)</td>
<td>9-12-03</td>
<td>9-23-03</td>
<td>9-23-03</td>
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<tr>
<td>1 Total Contract</td>
<td>74,385</td>
<td>74,385</td>
<td>74,385</td>
</tr>
<tr>
<td>2 Less TS 6 &amp; 7</td>
<td>9,520</td>
<td>(19,040)</td>
<td>(19,040)</td>
</tr>
<tr>
<td>3 Per Trainset</td>
<td>9,520</td>
<td>9,520</td>
<td>9,520</td>
</tr>
<tr>
<td>4 Plus 2 coaches</td>
<td>9,520</td>
<td>9,520</td>
<td>9,520</td>
</tr>
<tr>
<td>5 Per Trainset</td>
<td>1,904</td>
<td>3,808</td>
<td>3,284</td>
</tr>
<tr>
<td>6 Per Coach</td>
<td>1,642</td>
<td>3,284</td>
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<tr>
<td>7 Subtotal</td>
<td>59,153</td>
<td>58,629</td>
<td>58,629</td>
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<tr>
<td>8 TS 6 work completed, invoiced, and paid</td>
<td>122</td>
<td>122</td>
<td>122</td>
</tr>
<tr>
<td>9 Receipt of TS 6</td>
<td>131</td>
<td>131</td>
<td>131</td>
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<tr>
<td>10 Paypoints invoiced</td>
<td>1,511</td>
<td>1,511</td>
<td>1,511</td>
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<tr>
<td>11 Subtotal</td>
<td>1,764</td>
<td>1,764</td>
<td>1,764</td>
</tr>
<tr>
<td>12 Less two coaches - CCAs &amp; Paypoints</td>
<td>(552)</td>
<td>(657)</td>
<td>(657)</td>
</tr>
<tr>
<td>13 Net</td>
<td>1,212</td>
<td>1,107</td>
<td>1,107</td>
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<tr>
<td>14 Backshop work (subassembly manufacturing)</td>
<td>258</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>15 - completed on TS 6 &amp; 7 - not paid</td>
<td>129</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>16 TS 6 - 50% complete</td>
<td>430</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>17 Less two coaches</td>
<td>(172)</td>
<td>-</td>
<td>-</td>
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<tr>
<td>18 Purchased Mat'l Inventory on hand for units 6 &amp; 7 (excess material)</td>
<td>3,956</td>
<td>4,274</td>
<td>4,274</td>
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<tr>
<td>19 ($2.68MM for TS6 Excess Mat'l)</td>
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<td>-</td>
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<tr>
<td>20 Quality Review Area Inventory (excess material held in QA disposition)</td>
<td>305</td>
<td>305</td>
<td>305</td>
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<tr>
<td>21 Vendor cancellations - Advance funding required</td>
<td>1,000</td>
<td>1,500</td>
<td>1,500</td>
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<td>22 ($1,726 in full Purchase Orders, $359 in partial Purchase Orders)</td>
<td>190</td>
<td>190</td>
<td>190</td>
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<tr>
<td>23 TS 6 &amp; 7 inventory disposition</td>
<td>750</td>
<td>86</td>
<td>86</td>
</tr>
<tr>
<td>24 Constructed inventory - Major Fabrications Made &amp; Installed previously in major materials list but not invoiced</td>
<td>-</td>
<td>166</td>
<td>166</td>
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<tr>
<td>25 Assembly Work in Progress - recognized in future milestones</td>
<td>1,182</td>
<td>1,570</td>
<td>3,833</td>
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<tr>
<td>26 Internal cancellation costs, partial *</td>
<td>67,830</td>
<td>67,827</td>
<td>70,090</td>
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<td>27 Additional Change Orders</td>
<td>3,973</td>
<td>3,973</td>
<td>4,412</td>
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<td>28 Total</td>
<td>71,803</td>
<td>71,800</td>
<td>74,502</td>
</tr>
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</table>

* Change orders in process / Disruption
  Not Included

* partial costs shown to maintain agreed Total. See support documentation for add'l Internal Cancellation Cost.
## Summary of SSSI Proposed Close-Out Costs Results

<table>
<thead>
<tr>
<th>Schedule A Line Number</th>
<th>Description</th>
<th>Sub-Amounts Included in Total – Schedule A</th>
<th>Amount per Schedule A-9/23/03</th>
<th>Amount Not Audited (1)</th>
<th>Amount Audited</th>
<th>Amount Allowed (Now)</th>
<th>Amount Allowed (Pending)</th>
<th>Amount Disallowed</th>
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<tbody>
<tr>
<td>8-14</td>
<td>TS 6 work completed, invoiced and billed</td>
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<td>$1,107,000</td>
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<td>$1,145,666</td>
<td>$1,145,666</td>
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<td>Purchased Material Inventory (Excess Material)</td>
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<td>4,274,000</td>
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<tr>
<td></td>
<td>Purchased Materials</td>
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<td>827,815</td>
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<td>2,050,621</td>
<td>846,497</td>
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<tr>
<td></td>
<td>Manufactured Materials</td>
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<td>117,411</td>
<td>188,504</td>
<td>161,298</td>
<td>2,273</td>
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<td>Total Per Sub-Schedule</td>
<td>4,273,788</td>
<td>4,274,000</td>
<td>945,226</td>
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<td>2,211,919</td>
<td>848,770</td>
<td>267,873</td>
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<td>Quality Review Area Inventory (Excess)</td>
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<td>305,000</td>
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<tr>
<td></td>
<td>Purchased Materials</td>
<td>304,172</td>
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<td>Manufactured Materials</td>
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<tr>
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<td>Total Per Sub-Schedule</td>
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<td>607</td>
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<td>279,967</td>
<td>179</td>
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<tr>
<td>25</td>
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<td>703,782</td>
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<tr>
<td>26</td>
<td>TS 6 &amp; 7 Inventory Disposition</td>
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<td>190,000</td>
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<td>190,000</td>
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<tr>
<td>27</td>
<td>Constructed Inventory</td>
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<td>86,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td></td>
<td>Inventory (excluding fuel tanks)</td>
<td>57,687</td>
<td>57,687</td>
<td>0</td>
<td>50,092</td>
<td>7,595</td>
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<td>Fuel Tanks</td>
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<td>25,829</td>
<td>2,171</td>
<td>2,158</td>
<td>25</td>
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<td>Total Per Sub-Schedule</td>
<td>85,687</td>
<td>86,000</td>
<td>25,829</td>
<td>59,858</td>
<td>2,158</td>
<td>50,117</td>
<td>7,583</td>
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<td>29</td>
<td>Assembly Work in Process</td>
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<td>166,000</td>
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<td>166,000</td>
<td>0</td>
<td>0</td>
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<td>30</td>
<td>Internal Cancellation Costs</td>
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<td></td>
<td></td>
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<td></td>
<td>Storage costs</td>
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<td>117,768</td>
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<td>Mgmt costs for cancellation &amp; re-pricing</td>
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<td>80,000</td>
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<td>0</td>
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<td>Mgmt costs travel</td>
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<td>16,100</td>
<td>(8,100)</td>
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<td>Loss of hourly employee efficiency</td>
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<td>0</td>
<td>0</td>
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<td>0</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Damage to supply chain</td>
<td>258,000</td>
<td>258,000</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Fixed costs not recovered Trainsets 6 &amp; 7</td>
<td>2,514,000</td>
<td>2,514,000</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
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<td></td>
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<td>436,000</td>
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<tr>
<td>33</td>
<td>Change Orders (2)</td>
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<td>3,973,334</td>
<td>0</td>
<td>3,973,334</td>
<td>0</td>
<td>0</td>
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<td>$3,639,710</td>
<td>$1,736,716</td>
<td>$1,397,851</td>
<td></td>
</tr>
</tbody>
</table>

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