OFFICE OF THE NEW YORK STATE COMPTROLLER

DIVISION OF LOCAL GOVERNMENT & SCHOOL ACCOUNTABILITY

Monroe County

Use of a Local Development Corporation to Contract for the County's Information Technology System

Report of Examination

Period Covered:

January 1, 2009 — August 6, 2010

2010M-237

Thomas P. DiNapoli

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State of New York
Office of the State Comptroller

Division of Local Government
and School Accountability

September 2011

Dear County Officials:

A top priority of the Office of the State Comptroller is to help local government officials manage government resources efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support government operations. The Comptroller oversees the fiscal affairs of local governments statewide, as well as compliance with relevant statutes and observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving operations and County governance. Audits also can identify strategies to reduce costs and to strengthen controls intended to safeguard local government assets.

Following is a report of our audit of Monroe County, entitled Use of a Local Development Corporation to Contract for the County's Information Technology System. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's Authority as set forth in Article 3 of the General Municipal Law.

This audit's results and recommendations are resources for local government officials to use in effectively managing operations and in meeting the expectations of their constituents. If you have questions about this report, please feel free to contact the local regional office for your county, as listed at the end of this report.

Respectfully submitted,

Office of the State Comptroller
Division of Local Government
and School Accountability

State of New York
Office of the State Comptroller

EXECUTIVE SUMMARY

The Monroe County (County) Executive and 29-member County Legislature (Legislature) govern County operations. The Legislature adopted a County operating budget of $914 million for the 2010 fiscal year. The County's Information Services (IS) Department is headed by the Chief Information Officer (CIO) and operates under the general direction of the County Executive. The IS Department provides all County agencies with support for information management and technology requirements. The IS Department's budget for 2010 was $15.1 million.

In March 2004, the County established a local development corporation[1] (LDC) named Upstate Telecommunications Corporation (UTC). On May 25, 2004, UTC was incorporated for the purpose of issuing bonds to support the County's information systems needs. On December 14, 2004, the Legislature adopted a resolution authorizing the County Executive to contract with UTC to lease new information technology (IT), telecommunications, and local- and wide-area network systems; to provide the services required to support, maintain and upgrade the systems over time; and to provide the systems and services necessary to design and develop the County's enterprise resource planning system, website and e-commerce initiatives. The average annual cost of this contract was not to exceed $6.2 million per year, for a term not to exceed 16 years. On February 7, 2005, the County Executive entered into a contract with UTC for the maximum allowable cost and duration, with a value of $99.2 million over the life of the contract.

Scope and Objective

The objective of our audit was to determine if the County has designed appropriate controls over the procurement of IT systems and services for our review of the period January 1, 2009 to August 6, 2010. We expanded our scope for the procurement of IT systems and services back to March 2004. Our audit addressed the following related questions:

- Was the County's use of an LDC to procure IT systems and services in the best interests of County taxpayers?

- Did County officials properly manage the IT contract with UTC?

Audit Results

We found that County officials did not manage operations as economically as possible in compliance with statutory requirements when entering into a contract with UTC to procure and finance IT systems and services. Specifically, we found that:

[1] Local development corporations are private, not-for-profit corporations often created by, or for the benefit of, local governments for economic development or other public purposes.

- County officials had no legitimate evidence to state that the UTC contract would save $5 million when the Legislature made its decision to approve the UTC contract.

- The County sold $2.5 million in County-owned IT assets to UTC; the County then leased these same assets back from UTC, which will result in County taxpayers paying for equipment that they already owned.

- The County paid UTC $8 million more than UTC expended to provide IT systems and services to the County from February 2005 through December 2009.

The County's request for proposals (RFP) process used to select a vendor for the County's IT needs was just a perfunctory one. Potential vendors were not informed of the existence of the LDC or the intent to use the LDC as a conduit for the contract as part of the RFP. Consequently, only one vendor, with significant connections to current and former County officials, provided a proposal that included the use of the LDC.

Furthermore, County officials were unable to demonstrate how the establishment and use of the LDC to perform a County function would lessen the burdens of government. County payments are paying for the LDC's debt, and the County is now paying principal and interest costs on computers it previously owned. As a result, County taxpayers are likely overpaying for IT systems and services, and will continue to do so over the life of this more than $99 million contract.

We also found that County officials have failed to properly manage the UTC contract. The contract lacks a detailed schedule for IT refreshes (the periodic replacement of equipment) that are supposed to occur over the life of the contract, which could result in the County paying for refreshes it does not receive. Further, over the first five years of this contract, the CIO had no evidence to show that he verified that contract deliverables were of acceptable quality, or that UTC satisfactorily met the terms and conditions of the contract. As a result, the County is at high risk of paying for goods and services that were not provided or that did not conform to contract terms.

Comments of County Officials

The results of our audit and recommendations have been discussed with County officials and their comments have been considered in preparing this report. County officials generally disagreed with our findings, and stated that County practices already conform with our recommendations. Appendix B contains OSC comments on the issues raised in the County's response.

Introduction

Background

The Monroe County (County) Executive and 29-member County Legislature (Legislature) govern County operations. The County has a total population of approximately 733,700, and a workforce of about 4,800 employees. The Legislature adopted a County operating budget of $914 million for the 2010 fiscal year.

The County's organizational structure includes the Information Services (IS) Department, which falls under the general direction of the County Executive. The IS Department is headed by the Chief Information Officer (CIO). The IS Department provides all County agencies with support for their information management and technology requirements. The IS Department also maintains the County's website, and writes and maintains centralized system software. In addition, the County also provides its town and village governments with support, connectivity, and access to centralized applications. The IS Department's budget for 2010 was $15.1 million.

The County had 37 contracts for information technology (IT) hardware, software, and services with average annual expenditures totaling about $8 million. These contracts included 29 New York State Office of General Services (OGS) contracts totaling $891,733 and eight contracts procured using the County's procurement guidelines with estimated annual expenditures totaling $7,158,060.

In March of 2004, the County established a local development corporation (LDC) named Upstate Telecommunications Corporation (UTC). LDCs are private, not-for-profit corporations often created by local governments for economic development or other public purposes. In many instances, these entities are used to avoid statutory provisions that would apply to projects undertaken directly by a local government. LDCs may be created pursuant to Not-For-Profit Law for the following purposes:

- Relieving and reducing unemployment
- Promoting and enhancing employment opportunities
- Instructing or training individuals to improve or develop skills
- Conducting scientific research to attract or retain industry
- Lessening the burdens of government and acting in the public interest.

On May 25, 2004, UTC was incorporated "to lessen the burdens of government," which it claimed it would do by, among other things, issuing bonds to support the County's information systems needs. On December 14, 2004 the Legislature unanimously adopted a resolution authorizing the County Executive to contract with UTC to lease new IT, telecommunications, and local- and wide-area network systems; to provide the services required to support, maintain and upgrade the systems over time; and to provide the systems and services necessary to design and develop the County's enterprise resource planning system, website and e-commerce initiatives. UTC contracted with Siemens Building Technologies (Siemens), and then Siemens assigned the contract, with County permission, to Navitech Corporation (Navitech). Navitech was a newly formed corporation with the former County Chief Financial Officer (CFO) as Chief Operating Officer (COO). The average annual cost of this contract was not to exceed \$6.2 million per year, for a term not to exceed 16 years. On February 7, 2005, the County Executive entered into a contract with UTC for IT systems and services, with average annual payments of \$6.2 million for the life of the 16-year contract, totaling approximately \$99.2 million.

Objective

The objective of our audit was to determine if the County has designed appropriate internal controls over the procurement of IT systems and services. Our audit addressed the following related questions:

- Was the County's use of an LDC to procure IT systems and services in the best interests of County taxpayers?
- Did County officials properly manage the IT contract with UTC?

Scope and Methodology

We examined the County's controls over the procurement of IT systems and services for the period January 1, 2009 to August 6, 2010. We expanded our scope for our review of the procurement of IT systems and services back to March 2004.

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such standards and the methodology used in performing this audit are included in Appendix C of this report.

Comments of Local Officials and Corrective Action

The results of our audit and recommendations have been discussed with County officials and their comments, which appear in Appendix A, have been considered in preparing this report. County officials generally disagreed with our findings, and stated that County practices already conform with our recommendations. Appendix B contains OSC comments on the issues raised in the County's response.

The County Executive and Legislature have the responsibility to initiate corrective action. A written corrective action plan (CAP) that addresses the findings and recommendations in this report should be prepared and forwarded to our office within 90 days, pursuant to Section 35 of the General Municipal Law. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. We encourage the County Executive and Legislature make this plan available for public review in the Clerk of the Legislature's office.

Questionable Use of an LDC to Perform a County Function

County officials have a duty to manage County operations as economically as possible in compliance with statutory requirements. However, County officials did not meet this standard in obtaining IT systems and services, which they are procuring from UTC over the course of UTC's 16-year, $99.2 million contract with the County. We found that:

- County officials had no legitimate evidence to state that the UTC contract would save $5 million when the Legislature made its decision to approve the UTC contract.

- The County sold $2.5 million in County-owned IT assets to UTC; the County then leased these same assets back from UTC, which will result in County taxpayers paying for equipment that they already owned.

- The County paid UTC $8 million more than UTC expended to provide IT systems and services to the County from February 2005 through December 2009.

The County overspent on this contract with UTC because the request for proposals (RFP) process it used to select a vendor for the County's IT needs was just a perfunctory one. The County created the UTC for the purpose of issuing bonds to support the County's information systems needs prior to even starting the RFP process. Potential vendors were not informed of the existence of the LDC or the intent to use the LDC as a conduit for the contract as part of the RFP. Consequently, only one vendor, Siemens, one with significant connections to current and former County officials, provided a proposal that included the use of the LDC.

Furthermore, County officials were unable to demonstrate how establishment and use of the LDC to perform a County function would lessen the burdens of government. County payments are paying for the LDC's debt, and the County is now paying principal and interest costs on computers it previously owned. As a result, County taxpayers are likely overpaying for IT services, and will continue to do so over the life of this more than $99 million contract.

Contract Award Process

Because County officials did not inform all potential vendors that they planned to use the already-established LDC to obtain and finance the contract for IT systems and services, the County's RFP process did not ensure a level playing field for vendors. Furthermore, there is no evidence that establishing and using an LDC in this manner saves money: rather, based on our review of the County's RFP evaluation and selection process and our analysis of UTC's winning proposal, we conclude that the County's use of an LDC to procure IT systems and services was not in the best interests of County taxpayers.

RFP Evaluation and Selection – An RFP is a document used to solicit competition in certain cases when bidding is not required by law, or when authorized by statute as an alternative to bidding. In general, an RFP would specify the minimum acceptable functional, technical, contractual requirements, and the evaluation criteria that will govern the contract award. An RFP serves to inform vendors that a contract is being let and solicits from them a proposal, alerts vendors that the selection process is competitive, sets forth for vendors what information must be provided in order to be responsive to the identified requirements, and sets forth the criteria pursuant to which vendors will be evaluated. The appropriate use of a competitive process can ensure that goods and services are procured in the most prudent and economical manner on the most favorable terms and conditions, and that the procurement is not influenced by favoritism, extravagance, fraud or corruption.

On June 18, 2004, the County issued an RFP seeking a multi-faceted IT solution to address the IT needs of the County and provide for efficiencies. The RFP consisted of four components: A – a County-wide integrated telephone system; B – computing systems, including computers and servers; C – local and wide area network hardware; and D – website redesign, including more on-line services. The County required all vendor proposals to be received by July 22, 2004, with selected vendor proposal presentations to occur in the following weeks. The County received nine proposals for Component A, six proposals for Component B, three proposals for Component C, and nine proposals for Component D. Only one vendor (Siemens) responded to all four components.

According to the RFP, selected County personnel would form a review committee to evaluate[2] all properly prepared and submitted proposals and make a recommendation to the County Executive. The review committee was responsible for evaluating all proposals based on specific criteria. The CIO told us that the review committee consisted of himself, the County Purchasing Manager, and the Deputy County Executive. He further stated that the review committee used "subject matter experts as necessary to participate in the review of technical information in the various proposals." These subject

[2] For purposes of this portion of the report, we assume that the agreement constitutes a professional services contract and/or true leases, and that competitive bidding was not required for the agreement.

matter experts were employees from various County departments, such as IS, Communications and Environmental Services. We made multiple requests for information from various County departments, officials and employees, but the County was unable to provide any documentation for the evaluation process performed by the review committee. The CIO eventually provided us with an informal rating sheet that he compiled from his notes. However, without formal evaluation documentation, there is no clear record of the review committee's selection process. As a result of this serious deficiency in the RFP process, the County cannot show that the winning proposal/vendor was in the best interest of the County.

According to the CIO, the winning proposal was chosen because it suggested the creation of a local development corporation as a financing option. However, the timing of events shows that UTC had already been established before the County issued the RFP. UTC was established in March 2004 and was incorporated on May 25, 2004 for the purpose of issuing bonds to support the County's information systems needs, the same scope presented in the County's RFP dated June 18, 2004. The County established UTC with the express purpose of financing the County's IT system prior to issuing an RFP for IT systems and services that made no reference to such a financing arrangement. Only one vendor met the RFP's unstated criterion. Thus, it appears that one competitor had information not available to others, potentially tainting the RFP process.

This is especially troublesome, given that the initial Directors of UTC (the certifying attorney, a partner of UTC's future accounting firm, and the County Clerk's husband) were in a position to benefit from, or have knowledge about, the County's award of this contract to UTC. Furthermore, the Deputy County Executive who signed the letter recommending that the County contract with UTC (which contracted with Siemens and then Navitech) left County employment and shortly thereafter became a consultant for UTC. The County's CFO left County employment to become COO of the newly-formed Navitech. In addition, one of the subcontractors for the contract with UTC was ECC Technologies, the employer of the County Executive's stepson. The County's award of this contract to UTC following this timeline of events and given the connections to County officials, at a minimum, gives the impression that the RFP process was not a fair and open process, free from the influence of favoritism. If it was the County's intent to finance the project using the already-established LDC, the County should have made this clear in the RFP, enabling all vendors to compete equally.

Analysis of the UTC Proposal – When we analyzed UTC's winning proposal, we identified two problems: County officials have no evidence for the projected $5 million savings to the County from UTC's contract, and the sale/lease back of $2.5 million in County-owned IT assets was neither economical nor in compliance with statute.

The County Executive's referral to the Legislature to approve the UTC contract included $5 million in potential cost savings that the County could achieve over the contract life. Although the CIO stated that he worked with the County Finance and Budget Departments to come up with these savings, County officials could not provide us with any documentation of these cost savings, even after repeated requests. Because County officials had no support for the savings figure that was presented in their recommendation to the Legislature to approve the contract with UTC, the Legislature may have made its decision to approve the UTC contract with expectations of cost savings that was not legitimate.

The winning proposal also provided that UTC buy County-owned IT assets for $2.5 million; UTC then leased the same assets back to the County for the same purpose so UTC could fulfill its contract. When selling or disposing of County assets, County Law states that municipal property may not be sold or otherwise disposed of unless it is no longer needed or necessary for public use. One reason for this requirement – that property must be unneeded for public purposes before it is conveyed – is to prevent an entity from selling assets currently in use and then immediately leasing them back in essentially the same form and for the same use so it can raise money.[3] In essence, the County issued debt through the LDC to generate funds for operating expenses, which is prohibited by law.

County officials could not justify why the sale of $2.5 million in County-owned IT assets to UTC benefitted County taxpayers in any way, or explain why they pursued the sale/lease back transaction in violation of County Law. Because the UTC contract states the County will pay an amount equal to UTC's debt service costs on the bonds, the County will end up paying $2.5 million plus interest for IT assets that the County already owned and continued to use after UTC purchased them from the County.

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[3] Note there are several situations when local governments have been given express statutory authority to convey and leaseback property notwithstanding that it is still needed for use by the local government (see e.g. Energy Law Section 9-103[5]; General Municipal Law Sections 99-n, 99-o).

The County should have required that UTC contract costs be reduced by $2.5 million for the value of the IT assets that the County was contributing to the process, instead of having UTC bond for their purchase and give the cash to the County. The sale/leaseback transaction did not comply with statute and is a waste of taxpayer monies.

Payments in Excess of UTC Expenses

The UTC contract provides for the County to pay an average of $6.2 million annually to fund UTC's project expenditures and debt service payments. The contract states that the County will make payments based on UTC's submission of properly executed County claim vouchers that are supported with necessary documentation, approved by the CIO or his designee, and audited by the County Controller.

We reviewed the last three claims UTC had submitted[4] (at the time of our audit) totaling $12.7 million and found that they were not on County vouchers or sufficiently itemized as required by the contract with UTC. The County Controller stated that UTC claims were not presented on County vouchers or audited prior to payment; rather, the County paid UTC claims according to an approved payment schedule with virtually no review. The CIO told us that he reviews and signs off on individual invoices from UTC, but he does not maintain copies of the invoices or even a list or schedule of these invoices. Furthermore, he does not analyze or compare the total of these UTC expenditures against the County's payments. Therefore, even though the County paid UTC according to the payment schedule, there was no documentation to show that the County paid for only legitimate expenses, and that it paid for only the goods and services it actually received from UTC.

Because County officials failed to maintain this information, we reviewed all UTC expenditures from the beginning of the contract in February 2005 through December 31, 2009 at UTC's accounting firm. We found that UTC expended $50.2 million[5] to provide the County with IT systems and services during this period, but received $58.2 million[6] in payments from the County and debt proceeds, resulting in County overpayments totaling $8 million as of December 31, 2009. According to UTC's financial statements, the majority of these excess funds, approximately $6 million, are invested and designated for the future operating and capital costs of the County's IT project, such as funding future IT refreshes.[7] The remaining $2

[4] These UTC invoices were dated January 2, 2009, August 11, 2009, and January 6, 2010.
[5] Expenditures included $38.4 million to vendors, $1.9 million in management fees, and $9.9 million in bond principal and interest payments.
[6] Receipts consisted of $30.6 million in net bond proceeds plus $27.1 million from the County and $0.5 million in interest revenues.
[7] An IT refresh is the periodic replacement of equipment to ensure its continuing reliability and/or improved speed and capacity.

million resides in current assets. Therefore, the County has essentially created what appears to be an off-the-books reserve of money with UTC. The County does not have direct control of this money and is limited to monitoring these County funds by reviewing reports and financial statements provided by UTC.

The County's use of UTC to build cash reserves avoids statutory requirements that would apply were the County to follow sound budgeting practices by directly establishing a capital reserve fund for the purchase of new equipment.[8] Furthermore, because there have been no formal negotiations or contract amendments regarding what will happen to any excess funds held in this reserve by UTC at the termination of the contract, there is risk that moneys intended to refresh the County's IT assets will be lost and wasted. The failure to effectively audit payments and ensure that contractual payments are in line with actual and necessary expenditures has resulted in the County's overpayment of $8 million for goods and services it may never receive.

Recommendations

1. County officials should adhere to the requirements of GML and County policy when procuring goods and services to help ensure goods and services are procured in the most prudent and economical manner, that goods and services of desired quality are being acquired at the lowest possible price or, in the case of procurements that are exempt from bidding requirements, upon the most favorable terms and conditions, and that the procurement is not influenced by favoritism, extravagance, fraud or corruption.

2. When an RFP process is authorized, County officials should thoroughly review and analyze all proposals using formal evaluation/rating criteria and document their recommendation prior to awarding contracts.

3. County officials should ensure that assets are no longer useful prior to their disposal and that they are getting an appropriate value for the assets upon disposal.

4. The County Controller should only authorize payments for sufficiently itemized and supported vouchers or invoices for goods received and services rendered after a proper audit of the claim. The County Controller should also analyze UTC's total annual expenses and compare that amount to the contract payment to monitor the value of the goods and services received from UTC.

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[8] Reserve funds are created under various laws and are used to finance the cost of a variety of expenditures. The statutes under which reserve funds are established (or sometimes mandated) determine the procedures for establishment, the sources of funding and the procedures and purposes for expenditure.

Contract Management

Best practices for managing contracts include negotiating the terms and conditions in contracts, ensuring compliance with the terms and conditions, and documenting and agreeing on any changes that may arise during its implementation or execution. Written contracts specify the mutually agreed upon terms and conditions of the parties involved, such as the duration, description of goods and services to be provided and compensation to be paid/received. Moreover, it is a general rule that, absent express statutory authority, local governments may not enter into contracts for terms that bind successor governing boards. It is also important that County officials effectively monitor contracts to ensure that vendors are providing the County with the goods and services agreed upon in the terms of the contract.

We found that County officials failed to properly manage the UTC contract. County officials negotiated a contract with an excessive duration that may bind future governing boards without their input on the contract's terms and conditions. Further, the contract lacks a detailed schedule for IT refreshes that are supposed to occur over the life of the 16-year contract. Specifically, we found the duration of the contract was excessive, contract amendments were not formally approved or justified, and service performance was not monitored. As a result, there is no assurance that County funds are being used for optimal benefits.

Duration – The State Constitution, in effect, prohibits the County from issuing bonds or notes for an object or purpose unless the State Legislature has established a "period of probable usefulness" (PPU) for the object or purpose. Local Finance Law (LFL) contains several PPUs which appear to encompass the issuance of bonds or notes by a county to finance the acquisition of computer hardware, software, or both, for specific applications. Because the longest of these PPUs for specific applications is 10 years, a county has authority to issue its own bonds to purchase computer equipment for no more than 10 years.

The UTC contract states the County will pay an amount equal to UTC's debt service costs (principle plus interest) in its average annual $6.2 million payment over the 16-year contract term. According to the CIO, over the first two years of the contract, UTC's bond proceeds were spent primarily for the initial refresh of the County's IT infrastructure. If indeed the majority of the bond proceeds were actually used to purchase IT assets for the initial refresh,[9] then the

[9] Because UTC's various vendor invoices were not detailed, we were unable to verify that the majority of the bond proceeds were used for this purpose.

County will in effect be paying for these assets over 16 years, which is much longer than the PPU established by law had the County issued its own obligations to fund the purchases. Because the County specifically selected UTC as a means of financing the County's IT project, it appears the County may have chosen this method of acquisition in order to effectively finance this acquisition over a longer term than it would have been allowed by law.[10]

Further, because the duration of the UTC contract is for a period of 16 years, it may bind successor governing boards, whose members will not have had any input on the terms and conditions of the contract.[11] County officials did not provide any documentation to justify the length of UTC contract term.

<u>IT Refreshes</u> **–** The IT Solution RFP outlined the various upgrade and implementation (refresh) schedules for each of the four components. For example, the County requested vendors to refer to the County's current product replacement schedules when submitting their proposals. The County's replacement schedule in June 2004 was a three-year refresh for computers and a five-year refresh for networks.

The UTC contract and supporting documentation did not adequately specify what the refresh schedule would be during the life of the 16-year contract. Although there was no formal written refresh schedule, it appears that there was an agreed upon schedule. For example, the CIO provided us with a letter, dated September 10, 2009, in which he requested a delay of the scheduled IT refresh for Components B and C (i.e., computers and networks) that was to occur prior to 2008, the fourth year of the contract. This letter also stated that the County would work with UTC to develop the schedule for the refresh once all the individual County initiatives were completed. These initiatives related to the fourth quarter 2009 release of a new operating system and a specific brand of computers and laptops. Although the County's reasoning for the delay of the IT refresh appears to be justified, it was a material change in the scope of the contract and should have been reflected in an amendment. Because no formal amendment was made and the IT refreshes have already

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[10] Note also that if the "lease" here were determined to constitute an installment purchase agreement, GML limits the term of an installment purchase contract to the PPU prescribed in the Local Finance Law for the equipment being purchased. Accordingly, the County lacks authority to finance the acquisition of computer hardware and software by an installment purchase contract over more than 10 years.

[11] The agreement contains an executory or so-called "non-appropriation" clause which provides that the County may terminate the agreement if "sufficient funds" are not appropriated for the Total Annual Payment during the next fiscal period. It is not clear, however, based on judicial interpretations of such clauses, that the County will be able to unilaterally terminate the contract with impunity for any and all reasons, by not appropriating monies to fund the agreement.

been delayed, the County risks paying for additional IT refreshes that it may not receive prior to the end of the contract.

Even though UTC holds $6 million in County payments that are reportedly earmarked for refreshing IT assets, the County has no detailed schedule to indicate when the refreshes will occur. The absence of clear and unambiguous contract language regarding the replacement of IT equipment increases the likelihood that taxpayers have paid for goods and services that have not been received.

Service Performance – The process of monitoring a contract first involves understanding the contract, including the specific contract obligations and performance indicators by which performance will be monitored. It then requires monitoring the contractor's activities through a variety of means to ensure quality service delivery and satisfactory performance. The UTC contract requires County officials to evaluate the quality of the services provided and determine if they were in accordance with the contract specifications prior to making scheduled payments.[12]

The CIO was the County representative responsible for actively monitoring the UTC contract. He reviewed and signed off on invoices payable by UTC and was responsible for providing UTC with written acceptance letters upon UTC's satisfactory completion of the acceptance testing period for each service provided. However, neither the CIO nor any other County official retained any of this documentation. Therefore, for the first five years of this contract, the County had no means of verifying that UTC provided contract deliverables that were of acceptable quality, and no means of monitoring the extent to which UTC satisfactorily met the terms and conditions of the contract. Without a record of a contractor's performance, the County is at high risk of paying for goods and services it did not receive, or were not delivered in accordance with contract terms.

Recommendations

5. County officials should properly negotiate future contracts and ensure that contracts contain clear contract language that thoroughly details all parties' rights and responsibilities and schedules that set timeframes for contract deliverables. Material changes to contracts should be supported by contract addendums that have been properly authorized.

6. The CIO and County officials should monitor the service performance of the existing UTC contract.

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[12] According to the UTC contract, designated County representatives shall have the right to monitor the provision of services under the agreement, which includes having access, at reasonable times and places, to UTC's employees, subcontractors, reports, books, records, audits and any other material relating to the delivery of such services.

APPENDIX A

RESPONSE FROM COUNTY OFFICIALS

The County officials' response to this audit can be found on the following pages.

Department of **Information Services**

Monroe County, New York

Maggie Brooks
County Executive

Nelson M. Rivera
Chief Information Officer

August 10, 2011

Mr. Edward V. Grant Jr., Chief Examiner
Office of the State Comptroller
The Powers Building
16 West Main Street – Suite 522
Rochester, New York 14614-1608

Re: Use of a Local Development Corporation to Contract for a County's Information Technology System

Dear Mr. Grant,

I would like to thank you and your staff for attempting to assist Monroe County in reviewing the County's use of a Local Development Corporation (LDC) to contract for information technology (IT) systems. The audit process reaffirmed the fact that the County's use of an LDC was an excellent business decision which saved taxpayer dollars and improved the effectiveness of Monroe County's IT operations. Furthermore, the audit recommendations do not find fault with any of the County's actions or recommend a change in policy or practice.

See Note 1 Page 21

Your audit set out to address the following questions about the County's controls over the procurement of IT systems and services:

- Was the County's use of an LDC to procure IT systems in the best interests of County taxpayers?
- Did County officials properly manage the IT contract with UTC (i.e. Upstate Telecommunications Corporation, the LDC)

Monroe County and its administration strongly believe that the County's use of an LDC to procure IT systems was in the best interests of County taxpayers, and that County officials have properly managed the IT contracts with UTC.

The draft report asserts that County officials did not have enough evidence to support the $5 million UTC contract savings when the Legislature made its unanimous, bi-partisan decision to approve the UTC contract. However, the County administration is confident that these savings projections were not only accurate, but were also conservative estimates. The County's Department of Information Services, Department of Finance, and Office of Management and Budget worked collaboratively to analyze the financial impact of this contract prior to execution. This team of County officials projected that if the County did not enter this contract and continued business as usual, the County would spend approximately $133.7 million to acquire and operate similar IT systems during the life of the project. This team estimated that by entering into a contract with the LDC, the County would only spend $128.7 million to acquire and operate similar IT systems, which included the LDC payment of $99.2 million and other recurring operating expenses. This equates to a $5 million savings over the term of the contract as a result of using the LDC model. Furthermore, upon final negotiations, the LDC delivered additional IT systems valued at $8.6 million not included in the original $5 million savings. Thus, the County's actual savings from using the LDC model is over $13 million, a significant savings that ultimately benefits the County's taxpayers. When this is considered, the County believes that the actual

See Note 2 Page 21

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projected savings from using the LDC model of $5 million was, in fact, a conservative estimate. The County's use of an LDC to procure IT systems was in the best interests of County taxpayers because it saved the taxpayers millions of dollars.

Another false assertion made in the draft report is that the County paid "for equipment that they already owned." This statement is simply not true. The sale of surplus IT assets generated a one-time $2.5 million revenue source for the County, and neither the County nor its taxpayers paid any additional dollars to continue using these assets until they were replaced as part of the LDC's computer modernization project. In essence, the LDC paid for these surplus assets, and then allowed the County to continue use of them at no charge as part of its lease agreement until they were replaced within months of the execution of the contract. It is not correct to state that this "will result in County taxpayers paying more for equipment they already owned," because the County did no such thing.

See Note 3 Page 21

It is also alleged in the draft report that "the County paid UTC $8 million more than UTC expended to provide IT systems and services to the County from February 2005 through December 2009," and this is later described as "County overpayments." This statement is also factually incorrect. The contract between Monroe County and the LDC is a fixed price agreement, which will deliver IT systems and services to the County over a long-term period. The County has received all goods and services as delineated in the terms of the contract, has made each annual payment to the LDC as required by the contract, and has not made any "overpayments." The LDC's strategy of long range planning keeps County IT systems up-to-date. Its business model is to acquire assets that it will lease to the County as required in the contract by setting aside part of the payment it receives from the County to fund future IT replacements without needing to borrow funds. This is an intended consequence of a well-conceived business plan which results in the County of Monroe saving taxpayer money by contracting with the LDC for IT systems.

See Note 4 Page 21

Furthermore, the draft report reaches an inaccurate assumption "that County officials failed to properly manage the UTC contract" in three categories: Duration, IT Refreshes, and Service Performance. The report's misconceived assumption is simply untrue and not supported by the facts. The County has demonstrated that it has properly managed the UTC contract. Regarding the duration, the County's governing board, the Monroe County Legislature, unanimously approved the term of this contract. The choice to award a long term contract with the LDC has stabilized IT expenses for the foreseeable future, saved taxpayer dollars, and has proven itself to be a good business decision. Regarding IT Refreshes, the report misstates that "The UTC contract and supporting documentation did not specify what the refresh schedule would be during the life of the 16-year contract." This assertion is clearly false, and it appears that your agency did not adequately review the contract before making this statement. The contract clearly calls out the replacement schedule for the leased equipment in Articles 2.7.1, 3.7.1, 4.7.1, 8.2, 8.13, and 8.14. For example, Article 3.7.1, specifically identifies the fourth, eighth, and twelfth year of the contract as the scheduled timeframe to remove old computers and replace them with new computers. The UTC contract does specify the refresh schedule. If helpful, we would be happy to provide another copy of the contract for your review.

See Note 5 Page 21

Lastly, the draft report discusses a third category, Service Performance, and erroneously states that "neither the CIO nor any other County official retained any of this [acceptance] documentation." Again, this is simply untrue. The County does have this documentation and it is unclear as to why the draft report misstates that it does not exist when the County worked diligently throughout this seventeen-month process to deliver all documents that were requested. The County did in fact verify that UTC provided contract deliverables and has records of signed-off acceptance documentation for the UTC contract deliverables. The draft report then alleges that "the County is at high risk of paying for goods and services it did not receive, or were not delivered in accordance with contract terms." Based on the fact that the County does have the documentation in question, clearly this is a fallacious accusation. To allege that documentation does not exist when clearly it does, undermines the credibility of the entire draft report and calls into question the basic due diligence done to ensure that it is accurate and fair.

See Note 6 Page 22

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In reviewing this report we noted a prejudicial undertone that seemed to stray from your original stated purpose. Generally, previous reports issued by the State Comptroller's Office have been independent third-party reviews with verified facts, including recommendations for improving government operations, and were conducted in accordance with accepted auditing standards. Instead, this report contains numerous rumors and innuendos that are not supported by facts. Even worse, when County officials questioned these spurious statements in the exit conference, your staff admitted to an intentional failure to independently verify their legitimacy.

See Note 7 Page 22

Despite the deficiencies contained in the narrative portion of the draft report, the County agrees with the report's recommendations because they substantiate the correctness of existing County policy and practice.

See Note 8 Page 22

In conclusion, the County's contract with UTC has been properly managed and has saved taxpayers millions of dollars. Although the County disagrees with the specious allegations in the report, the County recognizes the suggested recommendations as listed in the draft report to be consistent with its ongoing management practices and is encouraged that the draft report found no wrongdoing or included any material findings.

See Note 9 Page 22

Sincerely,

Nelson M. Rivera
Director

Cc: Maggie Brooks, Monroe County Executive
Daniel Delaus, Monroe County Deputy Executive
Scott Adair, Monroe County Director of Finance

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APPENDIX B

OSC COMMENTS ON THE COUNTY OFFICIALS' RESPONSE

Note 1

The County's response does not accurately portray the results of our audit. Our audit found that the County's use of an LDC to procure IT systems was not in the best interest of the County or its taxpayers. As a result, we provided six recommendations to County officials to improve operations.

Note 2

Throughout the audit process, examiners repeatedly requested supporting documentation for the $5 million cost savings. However, County officials failed to provide any documentation of the $5 million cost savings from the UTC contract, much less $13 million in cost savings.

Note 3

Our report does not make any false assertions. The County sold County-owned IT assets to UTC for $2.5 million and then immediately leased them back. Therefore, these assets apparently were not surplus or no longer needed for public use, as required by County Law. One reason the Law requires that property must be unneeded for public purposes before it is conveyed is to prevent an entity from selling assets currently in use and then immediately leasing them back in essentially the same form and for the same use for the purpose of raising money. Proceeds from UTC's bond sale were used to pay the County for the IT assets. Because UTC's contract provides for the County to pay an amount equal to UTC's debt service on the bonds issued by UTC, the County will end up repaying $2.5 million plus interest for assets the County already owned and continued to use after UTC purchased them.

Clearly, the result of this transaction was to provide the County with one-time revenues of $2.5 million funded by debt that the County will pay through its contract payments to UTC.

Note 4

Although the County's response initially states that the $8 million overpayment is factually incorrect, County officials acknowledge later in this same paragraph that the $8 million overpayment was an intended consequence of the LDC's business plan to avoid having to borrow funds for future IT refresh. Thus, the County avoided statutory requirements and essentially created what appears to be an off-the-books reserve of money with the UTC.

Note 5

Our report accurately conveys our audit findings, which are based on facts, not assumptions. Further, County officials have not demonstrated that they properly managed the UTC contract. County officials negotiated a contract with an excessive duration that will bind future governing boards without their input on the contract's terms and conditions. Further, the contract lacks a detailed schedule for IT refreshes that are supposed to occur over the life of the 16-year contract. Our careful review of the contract found that the Articles referred to provide only approximations of scheduled refresh dates, such as "at such time on or after" and "prior to beginning of the fourth, eighth, and twelfth years or at such later time as the County and the UTC shall mutually agree in writing." The absence of clear and unambiguous contract language about these significant deliverables raises questions about the legitimacy of the amount the County paid and the amount scheduled to be paid.

Note 6

Throughout the audit process, we repeatedly requested supporting documentation, such as delivery receipts and UTC invoices. County officials did not have this documentation. Therefore, we viewed the documentation at UTC's accounting firm. Without a record of a contractor's performance and detailed vendor invoices, the County cannot be sure it was paying for legitimate expenses and that the County received both goods and services commensurate with the amounts paid or in accordance with contract terms.

Note 7

County officials objected to our reporting about the relationships between County officials, UTC, and Navitech. When relationships could affect the environment in which a contract award process takes place, the public has a right to know about them. We obtained information about these relationships during the course of our audit; we also verified any information we received from other sources to ensure its accuracy. At the exit conference, County officials did not provide any additional documentation that would disprove the accuracy of our reporting about these relationships, or about the timing of County officials' departure from County employment to work for UTC or Navitech.

Note 8

Our recommendations do not substantiate the correctness of the County's existing policy and practice, but suggest areas that need to be improved. We do not believe that the County currently has correct policies and procedures in place.

Note 9

Our audit found that the County's creation and use of an LDC to perform a County function was problematic and not in the best interest of the County. Furthermore, County officials' failure to properly manage the contract has resulted in the overpayment of $8 million to the UTC.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

Our overall goal was to assess the adequacy of the internal controls put in place by County officials to safeguard County IT assets. To accomplish this, we performed an initial assessment of the internal controls so that we could design our audit to focus on those areas most at risk.

During the initial assessment, we interviewed appropriate County officials, performed limited tests of controls and reviewed pertinent documents, such as County policies and procedures, and financial records and reports.

After reviewing the information gathered during our initial assessment, we determined where weaknesses existed, and evaluated those weaknesses for the risk of potential fraud, theft and/or professional misconduct. We then decided upon the reported objective and scope by selecting for audit those areas most at risk. We selected the internal controls over the procurement of IT systems and services for the period January 1, 2009 to August 6, 2010. We expanded our scope for our review of the procurement of IT systems and services back to March 2004 to review the project expenditures related to the UTC contract. To accomplish the objective of this audit and obtain relevant audit evidence, our procedures included the following:

- We reviewed County procurement policies and procedures to gain an understanding of the guidelines applicable when procuring IT assets and services.

- We reviewed 37 IT contracts totaling $8 million, and specifically examined the main contract for IT systems and services between the County and the LDC. In addition, we reviewed claims paid to the UTC totaling $14.1 million (IT systems and services, and copier contracts) and contracts between the LDC and third party vendors that were made available.

- We reviewed invoices totaling $40.3 million, financial reports, audits, and pertinent documentation provided by the LDC for the IT contract from its inception in 2005 through December 31, 2009.

- We reviewed available documentation for the selection of vendors through the RFP process along with vendor responses to the RFP.

- We interviewed key personnel to determine the process by which the County determined the savings estimate related to the IT contract.

- We reviewed the transaction for the sale of information technology assets for $2.5 million and supporting documentation, where available.

- We reviewed policies and procedures for the audit of payments. We examined County vouchers for evidence of audit and approval for payment for the IT contract with UTC.

- We compared UTC's contract to County vouchers and payments to the invoices and documentation provided by the LDC through December 31, 2009.

We conducted this performance audit in accordance with generally accepted government auditing standards (GAGAS). 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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

APPENDIX D

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