

**ACTIONS NEEDED TO  
MITIGATE RISKS  
ASSOCIATED WITH THE  
ACCESS TO THE REGION'S  
CORE PROJECT**

*Federal Transit Administration*

*Report Number: MH-2010-066*

*Date Issued: May 17, 2010*



# Memorandum

U.S. Department of Transportation  
Office of the Secretary  
of Transportation  
Office of Inspector General

Subject: ACTION: Actions Needed to Mitigate Risks  
Associated with the Access to the Region's Core  
Project  
Federal Transit Administration  
Report No. MH-2010-066

Date: May 17, 2010

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Assistant Inspector General  
for Surface and Maritime Program Audits

Reply to  
Attn. of: JA-40

To: Federal Transit Administrator

This report presents the results of our assessment of the Federal Transit Administration's (FTA) oversight of the Access to the Region's Core (ARC) project in New York and New Jersey—one of the largest transit infrastructure projects in the United States. Project costs are currently estimated at more than \$9 billion and FTA plans to commit a total of \$3 billion through its New Starts program<sup>1</sup>—the largest amount slated to date for any transit project in that program. In August 2009, FTA approved an early systems work agreement to expedite ARC, allowing the New Jersey Transit (NJT) Corporation, the project's sponsor and manager, to incur costs of \$1.35 billion, prior to meeting all Federal New Starts requirements, and initiate construction activities. FTA also awarded \$130 million in American Recovery and Reinvestment Act (ARRA) funds to NJT for ARC project activities.

Given the considerable investment in ARC and the risks inherent in a project of this magnitude, we evaluated FTA's oversight. Specifically, we (1) determined whether project risks were identified and strategies were implemented to mitigate the risks; (2) identified any challenges faced in ensuring sufficient funding was available for the project; and (3) assessed NJT's controls for combating fraud, waste, and abuse. To conduct our work, we evaluated FTA and NJT project documents related to costs, schedule, financing, fraud, engineering, and other

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<sup>1</sup> The purpose of the New Starts program is to provide Federal financial support for locally planned and operated public transit. Federal support is in the form of competitive, discretionary capital investment grants in local fixed guideway transit projects, such as commuter rail, light rail, heavy rail, bus rapid transit, trolleys, and ferries.

issues; reviewed applicable regulations, law, and guidance; and interviewed key officials. We conducted our work from January 2009 through March 2010 in accordance with generally accepted government auditing standards for performance audits. Additional details of our objective, scope, and methodology are described in exhibit A.

## **RESULTS IN BRIEF**

FTA's ARC oversight activities provide reasonable assurance that significant cost, schedule, and funding risks have been identified, and FTA has taken proactive steps to increase its oversight of ARC—as evidenced by requiring a project execution plan. However, as of January 2010, FTA did not have finalized project documents from NJT—the project management plan, project execution sub-plans, master schedule, and financial plan—that describe strategies for mitigating identified risks. The lack of finalized documents hinders FTA's ability to oversee NJT's mitigation actions. For example, without a completed master schedule and its supporting schedule management plan, FTA lacks a tool for assessing NJT's ability to meet important project benchmarks, such as the issuance of specific construction contracts. Meeting such benchmarks is critical to keeping the project on schedule and within its budget. Delays in developing one key set of documents, the seven sub-plans, were due, in large part, to the lack of agreement between FTA and NJT as to what constitutes compliance with the requirements of the overarching project execution plan. In addition, NJT was inexperienced in dealing with this new process. FTA acknowledged that some of the project execution plan's processes were new to NJT and the industry as a whole, and that developing such plans required thoughtful consideration. Yet, FTA has not issued formal guidance on this process for other sponsors to follow on future major projects, as has been done with other New Starts program requirements, such as for financial plans. In addition, FTA identified several long-term risks that the project faces, which if left unresolved, could lead to schedule delays or cost increases. This underscores the need for FTA to continue its proactive oversight of these risks. For example, one risk relates to obtaining the rights for access to properties not owned by NJT in order to complete geotechnical and environmental investigations. Delays in obtaining these rights would impact NJT's ability to complete ARC's final design in a timely manner.

FTA must also ensure that NJT addresses certain ARC funding resource challenges. ARC depends on several Federal, state, and local funding sources, including \$3 billion from the Port Authority of New York & New Jersey (Port Authority). As of January 2010, full Federal funding had yet to be approved, and the long-term availability of local funding was uncertain. FTA will need to perform a financial capacity assessment on the availability of the local funding to be provided. If one or more of these funding sources is delayed or is not available

in the expected amounts, the project schedule could be delayed because NJT might not be able to cover costs on its own, resulting in NJT postponing certain project activities.

Finally, the project's management controls are insufficient to detect fraud and ensure contractor integrity—in part because FTA did not request NJT to document its fraud prevention program in the project management plan, a practice FTA has used on other Region II major projects. Further, NJT opted not to use an independent private-sector inspector general (IPSIG)<sup>2</sup> on the project—despite evidence that an IPSIG can help identify problems in real time, such as internal control weaknesses, contractor integrity and ethics lapses, and infiltration of organized crime. The Office of Inspector General (OIG) and other agencies have cited using IPSIGs as a best practice on large construction projects in New York and New Jersey, such as the New York Metropolitan Transportation Authority's (MTA) Fulton Street Transit Center.

We are making a series of recommendations to ensure that ARC oversight fully addresses the heightened risks associated with proceeding under an early systems work agreement and meets ARRA requirements. On May 3, 2010, FTA responded to our draft report. FTA concurred with five of our recommendations and partially concurred with the sixth. We consider the actions FTA has taken and plans to take as being fully responsive to our recommendations. A complete discussion of FTA's comments and our response begins on page 16.

## **BACKGROUND**

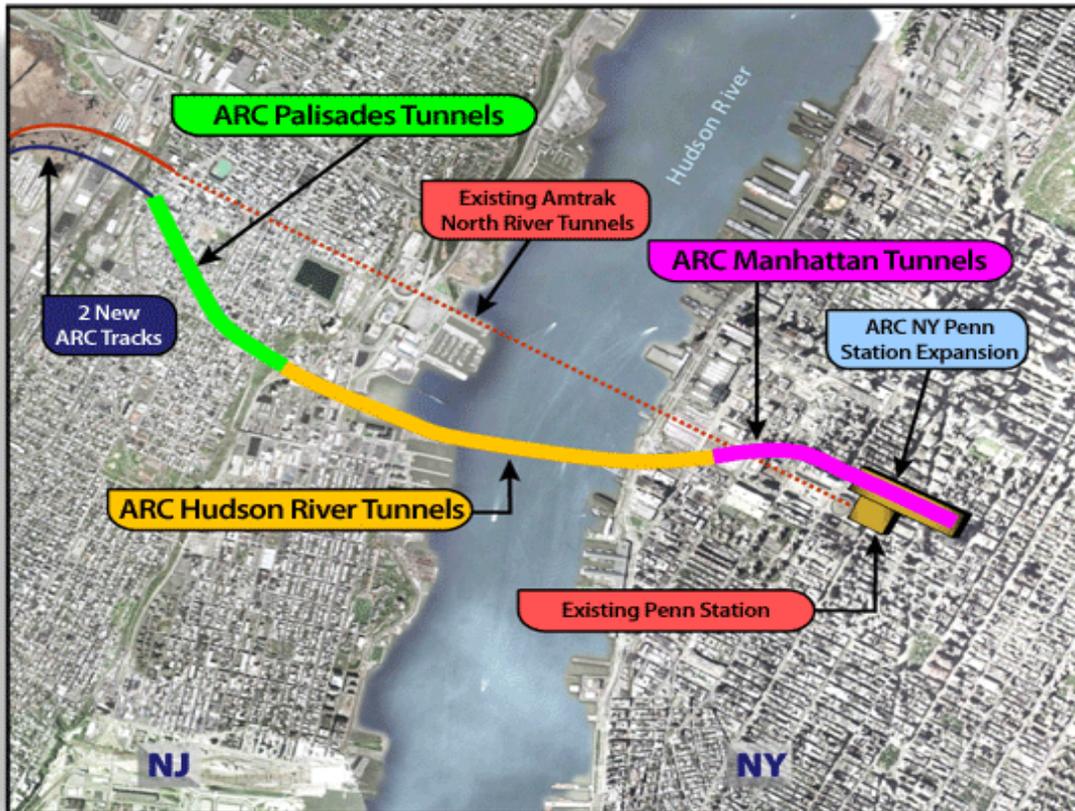
Through ARC, NJT plans to construct a 9-mile commuter rail line between Secaucus, New Jersey, and Manhattan, New York, that runs adjacent to Amtrak's Northeast Rail Corridor (see figure 1). The project includes construction of two new tunnels under the Hudson River, a new underground passenger rail station adjacent to New York's Pennsylvania Station in midtown Manhattan, a storage yard, and the purchase of passenger rail vehicles and specialized dual-powered locomotives. NJT's total estimated cost for the project is \$9.23 billion, which includes the cost of all rail car purchases to provide full-capacity<sup>3</sup> service in 2030. The baseline cost estimate is \$8.7 billion, which reflects the cost of rail car purchases needed for initial service scheduled for December 2017.

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<sup>2</sup> An IPSIG is an independent firm with legal, auditing, and investigative skills, employed by an organization to ensure compliance with relevant laws and regulations and to prevent, uncover, and report unethical and illegal conduct.

<sup>3</sup> The total number of rail cars needed to meet the project's forecasted ridership in 2030. The \$8.7 billion baseline estimate includes the cost of 110 of the total 196 rail cars and locomotives to be purchased.

**Figure 1. Map of the ARC Project**



Source: NJT.

FTA's Region II Office in New York City is responsible for providing oversight of NJT's management of the project. Region II receives support from a project management oversight contractor (PMOC) in evaluating NJT's technical capability and capacity and from a financial management oversight contractor (FMOC) in assessing NJT's financial capability to construct, operate, and maintain the project. FTA's oversight role includes ensuring that potential project risks, such as NJT's inability to access committed funds, are identified up front and that NJT takes action to mitigate these risks. Allowing ARC to proceed with an early systems work agreement without meeting all New Starts full funding grant agreement requirements adds to its inherent cost and schedule risks—heightening the need for FTA to effectively oversee NJT's management of the project. For example, one of the inherent risks is that delays in FTA's awarding a full funding grant agreement<sup>4</sup> for the entire \$3 billion may hinder the project's progress because it could result in NJT postponing the timely award of key construction

<sup>4</sup> Full funding grant agreements are multi-year contractual agreements between FTA and a project's sponsor that formally define scope, cost, and schedule. These agreements also establish the maximum level of Federal financial assistance and outline the terms and conditions of Federal financial participation.

contracts due to the lack of a Federal funding commitment to cover these costs.

To successfully complete tasks necessary to ensure the project is within budget and on schedule and meets full capacity service, NJT must coordinate with the following third parties.

- Port Authority provides ARC staffing and funding resources, and is responsible for acquiring access to property in New York.
- Amtrak works with NJT to address environmental, property acquisition, force account, and traction power issues. Amtrak will also provide a portion of the funding on the Portal Bridge project—a project that is critical for ARC to meet its expected service capacity.
- Con Edison provides NJT with access to its property in order to perform environmental investigations and NJT must acquire property from Con Edison for construction of the Manhattan Tunnels.

In January 2009, FTA approved ARC for entry into final design—the last milestone in FTA’s New Starts evaluation process before approval of a full funding grant agreement. Exhibit B depicts the New Starts planning and development process, and outlines key milestones in the project’s history.

## **FTA LACKS FULLY DEVELOPED PROJECT DOCUMENTS FROM NJT THAT ARE KEY TO IDENTIFYING AND MITIGATING PROJECT RISKS**

FTA’s ARC oversight activities provide reasonable assurance that significant cost and schedule risks have been identified. However, as of January 2010, FTA lacked finalized project documents from NJT—the project management plan, project execution sub-plans, master schedule, and financial plan—that describe strategies for mitigating identified risks. The lack of finalized documents hinders FTA’s ability to hold NJT accountable for taking risk mitigation actions. For example, without a completed master schedule and its supporting schedule management plan, FTA lacks a tool for assessing NJT’s ability to meet important project benchmarks, such as the issuance of specific construction contracts. Meeting such benchmarks is critical to keeping the project on schedule and within its budget. Moreover, ARC faces known long-term "watch list" risks, such as property access rights, that require continued vigilant oversight by FTA because, if these "watch-list" items are left unresolved, they could lead to schedule delays or cost increases over time.

## **FTA Implemented the Use of a Project Execution Plan To Identify Significant Project Risks**

In January 2009, FTA and NJT agreed to the requirements of the project execution plan and its sub-plans, which provide reasonable assurance that processes are in place to identify risks related to costs, schedule, project management, project financing, construction quality, engineering, and other issues. FTA will need to continue to use the project execution plan and its sub-plans to identify risks and monitor NJT's management of the project. In addition to the risks identified in the project execution plan, FTA's PMOC and FMOC also identified technical and financial risks in their ongoing assessments. For example, the PMOC's September 2009 monthly status report identified a risk of delays in obtaining the rights for access to properties in New York and New Jersey in order to complete geotechnical and environmental investigations. Lack of access could impede NJT's progress in completing the project's final design. The FMOC, in its May 2009 draft financial assessment report, highlighted risks to the availability of Federal and local funds that NJT needs to construct the project. NJT is aware of these risks and committed to undertaking a high degree of risk mitigation to keep the project on schedule and within budget.

## **Lack of Fully Developed Project Documents from NJT Impedes FTA's Oversight**

When construction began, NJT was still developing the project management plan, project execution sub-plans, master schedule, and financial plan—key documents FTA needs to oversee NJT's efforts to mitigate project risks. The project execution sub-plans are needed to identify mitigation strategies that will provide a level of assurance that NJT will address identified risks, allowing ARC to proceed through final design and be constructed on-budget and on-schedule. Despite lacking fully developed documents, FTA allowed the Manhattan Tunnels construction contract to proceed in June 2009 and approved an early systems work agreement in August 2009, in part to avoid delays and higher costs.

FTA requires a project management plan for all New Starts projects.<sup>5</sup> However, ARC's project management plan is incomplete. FTA “conditionally” approved NJT's ARC project management plan in May 2009, and notified NJT that many of the project execution sub-plans, which were incorporated by reference in the document, were not acceptable. In June 2009, NJT submitted a revised project management plan to address these deficiencies. In July 2009, FTA notified NJT that the June 2009 project management plan and sub-plans were still not fully

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<sup>5</sup> A sponsor's project management plan explicitly defines all tasks necessary to implement a major capital project. The plan should include organization's staffing, project budget, construction schedule, and quality assurance and quality control programs.

compliant with the project execution plan's requirements. For example, the project management plan still lacked acceptable organizational charts and a discussion of management controls. These plan elements are critical to FTA's oversight of the project. Organizational charts are needed to show the responsibilities and relationships for NJT and Port Authority staffs; identified controls are needed to minimize the risk of not achieving the project execution plan's requirements; and a strategy for NJT staff involvement is needed to better ensure effective systems operations. When FTA approved NJT's early systems work agreement in August 2009,<sup>6</sup> FTA stipulated that before executing the full funding grant agreement NJT must have a fully approved project management plan and provide evidence that it is operating in conformance with the plan.

As of January 2010, NJT's seven project execution sub-plans remained incomplete, despite the project moving forward. Table 1 describes the purpose of the seven sub-plans.

**Table 1. ARC Project Execution Sub-Plans**

<b>Sub-Plan</b>	<b>Purpose</b>
Quality Management	Ensures that all necessary programs are established and closely followed.
Cost Management	Provides reliable cost information and requires cost estimates to be documented and maintained.
Schedule Management	Provides reliable schedule information and requires schedules to be documented and maintained.
Risk Management	Provides a formal, systematic approach for the management of costs and schedule against a baseline by identifying project risks and a framework for mitigating risks to avoid their potential impacts.
Cost and Schedule Contingency Management	Ensures that there are sufficient cost and schedule contingencies available at key milestones for the completion of the project.
Secondary Cost and Schedule Mitigation Capacity	Provides additional cost and schedule plans and assesses NJT's capacity to handle risk events or mitigation activities that are project-phase specific.
Geotechnical Risk Mitigation Capacity	Identifies geotechnical-specific cost and schedule risks and mitigation strategies.

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<sup>6</sup> There are few statutory requirements for awarding an early systems work agreement, and FTA has not issued related regulations or written guidance. The Secretary may legally make such an agreement if a project's Record of Decision has been issued and there is reason to believe that: (1) a full funding grant agreement will eventually be made and (2) the terms of the agreement will promote the project's ultimate completion more rapidly and at less cost.

The continued lack of the risk management sub-plan is of concern, particularly since FTA rejected NJT's earlier risk management sub-plan because it did not meet requirements and omitted a key deliverable, the geotechnical risk allocation plan.<sup>7</sup> When FTA allowed the procurement of the design/build contract for the Manhattan Tunnels work to proceed—just 5 months after approving entry into final design in January 2009—the entire project execution plan processes were not in place to mitigate schedule slippages and cost increases. FTA officials acknowledged that this was an unusual step for a project of this size; but they believed it was the best way to proceed so that the project could be completed on schedule and within budget. In our view, this decision provides little incentive for NJT to address FTA's concerns, and inhibits FTA's ability to hold NJT accountable for completing risk mitigation actions. Ultimately, the full impact of project risks and the effectiveness of NJT's mitigation efforts will not be known until after FTA fully approves all required sub-plans and NJT implements them.

Recognizing NJT's inexperience with the processes involved in developing and implementing a project execution plan, FTA provided guidance to NJT on the development of sub-plans. Region II officials believe they provided NJT with adequate guidance on the principles involved in developing acceptable sub-plans. However, according to NJT, delays in completing the project execution sub-plans are due largely to the lack of clear FTA guidance on documentation requirements.<sup>8</sup> When NJT asked FTA for guidelines to follow in developing its project execution plan, FTA suggested that NJT follow the general criteria found on FTA's web site and contact the New York MTA for guidance because it was one of the first New Starts sponsors to develop a project execution plan. According to NJT officials, neither source provided relevant guidance. In a July 2009 memorandum recommending approval of the early systems work agreement, FTA acknowledged that some of the project execution plan's processes were new to NJT and the industry as a whole, and that developing such plans required thoughtful consideration. However, FTA has not issued a formal guidance document on preparing such plans. The lack of guidance has not only resulted in NJT generating multiple drafts for FTA's review; but FTA staff has had to rely on professional judgment, based on lessons learned from other large projects, to determine what was acceptable.

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<sup>7</sup> The geotechnical risk allocation plan formally documents NJT's approach to risk allocation for the geotechnical scope of work between the contractor and NJT. This geotechnical plan is critical, given the extensive tunnel work involved in the project.

<sup>8</sup> A table in FTA's guidance on the full funding grant agreement process refers to a specific regulation or policy document for each step in the process, except the step related to the project execution plan, which recommends contacting a FTA regional office.

The project's master schedule and financial plan were also incomplete when the early systems work agreement was approved in August 2009. Our engineering team reviewed the latest master schedule and several contract-level schedules that FTA and NJT provided. The team concluded that the project lacked a baseline master schedule with planned activity benchmarks and durations that could be compared against the ongoing activities for the purpose of measuring the project's progress. Additionally, the durations and dates for activities in the master schedule did not correlate with the durations and dates that contract-level schedules reported for the same activities. Without a master schedule that ties together the work of all contracts and its supporting schedule management plan—which is needed to provide reliable schedule information—NJT's ability to identify and track the time and resources used to complete each project task is impaired. Accordingly, FTA does not have an important oversight tool it needs to assess NJT's efforts in managing delays and controlling cost growth.

In August 2009, FTA estimated that potential project delays ranged from 9 months to 22 months—based on the degree of risk assigned to project activities. Yet these estimates are based on schedule data from January 2008—the same data FTA used to approve the early systems work agreement. According to our engineering team, the outdated data would not allow FTA to measure whether critical activities were on schedule or whether estimated delays have increased. According to FTA, NJT will not be required to submit an updated master schedule until 90 days prior to applying for a full funding grant agreement—a date that is unknown at this time.

While FTA concluded that NJT's draft financial plan was sufficient to enter final design and support the early systems work agreement, FTA identified actions and made 10 subsequent recommendations that would need to be finalized before a full funding grant agreement is awarded. FTA also stressed that NJT must update the draft financial plan prior to applying for a full funding grant agreement or as part of the next annual New Starts rating cycle (for the fiscal year 2011 budget process) to reflect any changes in assumptions that occur. The FMOC's recommendations include making the financial plan consistent with the baseline cost estimate that FTA and NJT agreed to; NJT executing agreements with the Port Authority and the New Jersey Turnpike Authority (Turnpike Authority) regarding distribution of responsibilities for cost overruns; and developing a cash flow management plan. Moreover, because FMOC's financial capacity assessment was based on NJT's financial data through June 2008, it may not reflect current economic conditions considering the upheavals in U.S. financial markets and the broader economy that have occurred since that time.

### **Long-Term Cost and Schedule Risks Require Close Monitoring**

FTA has identified “watch list” risks that could have a significant impact on project costs and schedules over the long term and, therefore, require continued

close monitoring. First, NJT will need to complete its financial plan and coordinate with Amtrak to facilitate the timely completion of the Portal Bridge—critical for ARC’s ability to reach full operational capacity in 2030. The current Portal Bridge, owned and operated by Amtrak, is an essential rail crossing for both NJT and Amtrak systems in New Jersey. The purpose of the project is to improve system reliability and provide additional rail capacity for NJT and Amtrak. NJT’s draft financial plan shows a \$728 million commitment from NJT for the Portal Bridge project and assumes Amtrak will provide the remaining funding needed—approximately \$472 million. In August 2009, FTA reiterated to NJT that it will need to identify a complete and reasonable financial plan for the \$1.2 billion replacement of the Portal Bridge in New Jersey prior to executing the full funding grant agreement. In September 2009, NJT and Amtrak reached an agreement on each entity’s obligations for the Portal Bridge’s next phases. However, the agreement notes that these obligations are subject to funding availability.

Second, environmental and geotechnical investigations have to be conducted on the 423 properties NJT needs to acquire by 2012 for ARC to continue to move forward. According to an August 2009 PMOC report, NJT’s consultant engineers stated that if critical environmental and geotechnical data were not available in time to meet the 2012 deadline, the project’s final design would need to be redone when the data are provided. The PMOC further noted in a September 2009 monthly report that delays in obtaining the rights for access to properties in New York and New Jersey to complete geotechnical and environmental investigations would delay design activities, which are on the critical path to project completion.

Finally, ARC’s timely completion relies on procuring and testing 22 dual-powered locomotives, which will be needed to serve projected full capacity ridership in 2030. The first pilot locomotive, scheduled for delivery in July 2011, will be tested at a Federal Railroad Administration (FRA) testing facility in Colorado and on NJT’s rail system. Accordingly, effective coordination with FRA is essential to ensuring needed testing occurs in a timely manner and the locomotives meet all applicable requirements and FRA safety standards.

## **UNCERTAIN FUNDING PRESENTS PROJECT IMPLEMENTATION AND COMPLETION CHALLENGES**

FTA must ensure that NJT addresses several project funding challenges before executing a full funding grant agreement. The ARC’s complex financing structure relies on future funding from various Federal, state, and local agencies. As of January 2010, full Federal funding had yet to be approved, and the long-term availability of local funding was uncertain. If one or more of these funding sources is disapproved or unavailable in the amounts assumed in the draft financial plan, NJT will be challenged to keep the project progressing as scheduled.

Until its estimated completion in 2017, ARC will need substantial funding from various sources, as shown in table 2. The early systems work agreement commits only a portion of the total Federal funding that NJT's draft financial plan assumes. In the past, FTA warned NJT that its assumptions for annual New Starts appropriations were significantly higher than Congress has historically given to any single transit project and exceeded levels FTA previously discussed with NJT. FTA and NJT are still in the process of agreeing on the final funding projections that will be used in the full funding grant agreement, according to FTA. Also, the full funding grant agreement may be significantly delayed. FTA may not have sufficient commitment authority—the overall level of New Starts funding authorized by Congress—to execute a full funding grant agreement until a new surface transportation authorization law is enacted. According to FTA, the fiscal year 2010 appropriations act (Pub. L. No. 111-117) allows the Secretary to issue new full funding grant agreements outside the normal commitment authority calculation during fiscal year 2010 only, which ends on September 30, 2010. Whether this exception to the normal limits on commitment authority may extend into fiscal year 2011 or beyond will depend on the terms of future legislation.

**Table 2. ARC Funding by Source<sup>1</sup>**  
(Dollars in Millions)

Funding Source		Amount
<b>State/Local</b>	Port Authority	\$3,000.00
	New Jersey Turnpike Authority	\$1,250.00
	<b>Subtotal</b>	<b>\$4,250.00</b>
<b>Federal</b>	FTA New Starts (Total) <sup>2</sup>	\$3,000.00
	FHWA CMAQ/NHS Flex <sup>3</sup>	\$1,319.98
	ARRA	\$130.00
	<b>Subtotal</b>	<b>\$4,449.98</b>
<b>Total</b>		<b>\$8,699.98</b>

Source: FTA's Annual Report on New Starts Funding Recommendations, Fiscal Year 2011

<sup>1</sup> The amounts shown in table 2 reflect those included in NJT's financial plan.

<sup>2</sup> Of this amount, the early systems work agreement commits \$395 million as the initial installment towards the \$3 billion FTA intends to provide to ARC under a full funding grant agreement.

<sup>3</sup> New Jersey Transportation Planning Authority proposed to flex \$1 billion in Federal Highway Administration (FHWA) National Highway System (NHS) or Congestion Mitigation and Air Quality (CMAQ) program funds.

The long-term availability of local funding sources is also uncertain. FTA had concerns about the Port Authority's and Turnpike Authority's capacity to provide

promised funding, totaling \$4.25 billion, and delayed the financial capacity assessments for these funding sources. Such assessments are required before a full funding grant agreement can be awarded, but FTA determined that a detailed examination in August 2009 would not have been useful because of volatile credit market conditions, and decided to defer the assessments until closer to the time when ARC will be considered for the full funding agreement.<sup>9</sup> FTA proceeded with an early systems work agreement without fully examining either Authority's ability to provide the promised funds—potentially jeopardizing the timely completion of the project if the Port Authority or the Turnpike Authority cannot provide their share or cover any cost overruns.

In its fiscal year 2010 and 2011 New Starts rating assessments, FTA expressed concerns about the long-term availability of funding from the New Jersey Transportation Trust Fund Authority. Projections provided by the Trust Fund indicate that all of its revenues are fully programmed to cover current and authorized debt service through fiscal year 2028. This leaves no funds for ARC and other capital projects that are dependent on future allocations from the Transportation Trust Fund, including NJT's state-of-good-repair. The FMOC stated that NJT must provide a more precise plan as to how these funds will be made available, as well as its priorities for modifying the capital program should a lesser amount of funds be made available from the Transportation Trust Fund.

Despite these risks, NJT and other project partners had not reached an agreement on who will be responsible for cost overruns. Before executing a full funding grant agreement, FTA must assess NJT's financial capacity to complete the project as designed and cover potential cost overruns. Specifically, FTA needs assurance that the full funding grant agreement will be supported by an amended general project agreement between NJT and the Port Authority that clearly states how they will allocate responsibility for cost overruns and cover the impact of any delays in receiving Federal New Starts funds. The current general project agreement, dated March 2009, states only that NJT and the Port Authority will work together in good faith to secure additional funds in the event of cost overruns. FTA also wants NJT to provide a final agreement with the Turnpike Authority, formalizing its financial commitment to the project and addressing the respective roles and responsibilities of the agencies, including the Turnpike Authority's participation in funding cost overruns.

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<sup>9</sup> In March 2008, FTA performed a brief review of the Port Authority's financial capacity, but this was not a detailed examination that would fulfill FTA's full funding grant agreement requirements.

## **MANAGEMENT CONTROLS ARE INSUFFICIENT TO COMBAT THE RISK OF FRAUD, WASTE, AND ABUSE**

Based on lessons learned from our past projects and fraud prevention work in New York and New Jersey, we concluded that ARC's management controls are insufficient to detect fraud and ensure construction integrity. Our conclusion was based, in part, on the fact that FTA did not request NJT to document its fraud prevention program in the project management plan, as FTA had done on other major projects. Further, NJT opted not to use an independent private-sector inspector general (IPSIG)<sup>10</sup> on the project—despite evidence that an IPSIG can help identify problems, such as internal control weaknesses, contractor integrity and ethics lapses, and infiltration of organized crime, in real time. OIG and other agencies have cited using IPSIGs as a best practice on large construction projects in New York and New Jersey, such as the New York Metropolitan Transportation Authority's (MTA) Fulton Street Transit Center. In October 2009, the Governor of New Jersey, issued an executive order that required the State Comptroller to ensure the adequacy of internal controls and determine whether additional oversight is needed to keep the project within budget. Our assessment of the state executive order concluded that it did not provide sufficient details on the Comptroller's responsibilities for fraud prevention or investigations. Employing additional fraud controls is imperative to protect the significant Federal and local investment in ARC given the magnitude of construction contracts to be awarded, the emphasis ARRA places on fraud prevention, and the history of malfeasance in the construction industry in New York and New Jersey.

### **Fraud and Contractor Integrity Provisions Were Not Included in the Project Management Plan**

FTA did not request NJT to include a chapter in ARC's project management plan that documents its fraud prevention program and clearly assigns responsibility for preventing, detecting, and following up on instances of fraud, waste, or abuse. In contrast, FTA did require Lower Manhattan Recovery Project sponsors, including the MTA and the Port Authority, to include a fraud section in their project management plans. In October 2006, FTA's Lower Manhattan Recovery Office directed its project sponsors to revise their project management plans to describe what actions they were taking to minimize opportunities for contractor fraud; and FTA stated that each sponsor must implement a proactive, structured program to protect the Federal investment from unscrupulous contractors.

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<sup>10</sup> An IPSIG is an independent firm with legal, auditing, and investigative skills, employed by an organization to ensure compliance with relevant laws and regulations and to prevent, uncover, and report unethical and illegal conduct.

When we inquired whether FTA would apply similar fraud and contractor integrity requirements to the ARC's project management plan, FTA Region II staff told us no—that this was not the normal approach, and the Lower Manhattan Recovery Project sponsors were required to have a fraud section because the projects were 100 percent federally funded. In our opinion, ARC should be required to meet the same standards that FTA placed on the Lower Manhattan Recovery Projects because of the similarity in the overall Federal funding provided, project complexity, and the potential fraud environment in New York and New Jersey. In addition, the Office of Management and Budget's (OMB) ARRA implementation guidance directed agencies to be aggressive in mitigating instances of fraud, waste, and abuse on projects receiving ARRA funding, such as ARC. Enhancing the project management plan to include documentation of a robust fraud program would be consistent with OMB's guidance.

### **Use of Integrity Monitors To Help Combat Fraud Was Rejected**

In a July 2006 testimony on lessons learned from large transportation projects,<sup>11</sup> we reported on the value of hiring integrity monitors, also known as IPSIGs, on major projects in geographic areas where the risk of fraud is high—as is the case in New York and New Jersey. Despite the benefits and widespread use of integrity monitors in New York and New Jersey, in September 2009, NJT officials informed us they were not using an IPSIG on ARC. Based on our years of monitoring major construction projects in the region, we believe NJT should reconsider its decision.

IPSIGs can be valuable in serving as the “eyes and ears” of management on the ground by helping to oversee what happens in real time, from procurement through completion of the various stages of construction. Moreover, IPSIGs can provide immediate feedback on corrective actions to address problems related to internal control weaknesses, contractor integrity and ethics, conflicts of interest, infiltration of organized crime, or deviation from standard procedures or regulatory guidelines. IPSIGs can also add value when they report their findings to an independent oversight entity experienced in fraud investigations, such as an agency's inspector general. The impact of the preventive measures employed by IPSIGs cannot be readily quantified, but deterring fraudulent behavior allows a project to be completed with fewer unnecessary and costly distractions.

Other FTA sponsors have used IPSIGs in conjunction with their inspectors general, and stepped up their counter-fraud efforts in recent years. For example, MTA—another large FTA sponsor in New York, with a capital budget of nearly

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<sup>11</sup> OIG Testimony Number CC-2006-056, “Lower Manhattan Reconstruction: Lessons Learned from Large Transportation Projects,” July 13, 2006. OIG reports and testimonies are available on our website: [www.oig.dot.gov](http://www.oig.dot.gov).

\$28 billion—has recognized the serious risks posed by fraud on transportation projects in the region. MTA uses IPSIGs on some of its larger projects, including those receiving ARRA funding, and MTA officials have publicly touted the benefits of this approach to enhancing in-house oversight capabilities.

## **CONCLUSION**

The ultimate success of ARC in meeting cost and schedule targets will depend, to a large degree, on FTA's ability to ensure that NJT takes effective and timely risk mitigation actions for the duration of this complex project. FTA's decision to award an early systems work agreement may keep the project within budget and on schedule but is not without significant risk. The fact that project construction was allowed to begin before NJT satisfactorily addressed the concerns FTA and its oversight contractors previously raised underscores the need for FTA to continue providing an enhanced level of oversight. While FTA has taken proactive steps to increase its oversight of ARC—as evidenced by requiring a project execution plan and developing a roadmap for NJT to follow in order to receive a full funding grant agreement—more action is needed to complete oversight documents and implement fraud controls that are designed to protect the significant Federal investment, including the ARRA funds that ARC received. The President and Congress have called for unprecedented levels of accountability and transparency in the ARRA program. Accordingly, we are making a series of recommendations to advance FTA's efforts to have a full complement of oversight tools to hold NJT accountable for carrying out a high degree of risk mitigation and for exhibiting sound management practices.

## **RECOMMENDATIONS**

We recommend that the Federal Transit Administrator identify FTA's planned actions to:

1. Work with NJT to promptly finalize the project management plan, project execution sub-plans, and financial plan;
2. Ensure that NJT continues to coordinate with other stakeholders to address the watch list risk items in a timely and effective manner;
3. Obtain amended project agreements between NJT and the Port Authority and the Turnpike Authority regarding distribution of responsibilities for any future cost overruns;
4. Work with NJT to update the project's master schedule and ensure it ties together the work of all contracts;

5. In light of new ARRA oversight requirements, include a fraud and contractor integrity chapter in the project management plan and assess whether NJT has adequate management controls in place to prevent fraud, waste, and abuse on ARC; and
6. Issue written guidance on developing a project execution plan for major New Starts projects, including all of the required elements.

## **AGENCY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE**

We provided a draft of this report to FTA for review and comments on March 17, 2010. FTA provided us its formal comments on May 3, 2010, and technical clarifications on April 20, 2010, which we incorporated, as appropriate. FTA's complete comments are included as the appendix to this report.

FTA's comments expressed concern that some of the draft report's conclusions did not clearly recognize risk factors that FTA had previously identified or that FTA has repeatedly advised NJT that fulfillment of project requirements and procedures are necessary before executing an ARC full funding grant agreement. FTA also stated that the award of the early systems work agreement was in accordance with authorized statute and is a legitimate part of project development within the New Starts process. For example, FTA noted that its decision to grant the early systems work agreement to NJT was made in part to avoid delays and higher costs, even though the completed project execution plan and sub-plans were not delivered. In addition, FTA commented that it has provided appropriate guidance and assistance, via meetings, letters and emails, to NJT, and is convinced that any delays in receiving finalized documents are due to a combination of project complexity; grantee inexperience; and, at times, NJT's unwillingness to develop policies and procedures consistent with FTA's programmatic requirements.

We believe that our report presented an accurate assessment of ARC's status. In response to FTA's comments, we revised the report, as appropriate, to further emphasize FTA's efforts to provide proactive oversight of ARC and to note that NJT has not provided acceptable documents to FTA. Further, we do not challenge the legal basis of the early systems work agreement, nor do we question the appropriateness of using this statutory provision to help keep the project within budget and on schedule. However, we continue to believe that the decision to award the early systems work agreement and to allow NJT to incur significant Federal costs—while NJT has not complied with full funding grant agreement requirements—has risks associated with it. Specifically, FTA's oversight toolbox does not contain the fully developed project management plan and finalized project execution sub-plans tools, even though construction is proceeding.

FTA concurred with five of our recommendations and partially concurred with the sixth. FTA stated that it has taken or is planning to take the following actions on specific recommendations.

**Recommendation 1:** Concur. FTA commented that it has emphasized that the ARC project will not be considered for a full funding grant agreement unless all required plans are completed to FTA's satisfaction. FTA will continue to work with NJT to develop the project management plan, project execution sub-plans, and a financial plan. FTA emphasized that development of these plans is the sole responsibility of NJT and the prompt completion of these plans will depend on actions taken by NJT. FTA stated that it would provide a comprehensive and expeditious review of the plans developed by NJT and offer feedback and recommendations for improvements as needed. FTA expects to receive all of the required information from NJT in the 3rd Quarter of fiscal year 2010.

**OIG Response:** We consider the actions planned by FTA to be responsive to the recommendation and acceptable. However, the recommendation will remain open until FTA provides us with the information it receives from NJT so we can review it to ensure FTA's actions were fully responsive to our recommendation.

**Recommendation 2:** Concur. FTA commented that the timely completion of watch list items is critical to ensuring that the ARC project remains within budget and on schedule, and that timeliness is largely contingent on NJT taking prompt, effective, and constructive action. FTA stated that it will continue to monitor NJT's actions and provide oversight to ensure that NJT is adequately accomplishing this coordination.

**OIG Response:** We agree with the actions FTA has taken and plans to take to continue its monitoring of the watch list items. These actions meet the intent of the recommendation and are sufficient to close it.

**Recommendation 3:** Concur. FTA commented that NJT has verbally informed FTA that NJT, not the Port Authority or the Turnpike Authority, will be responsible for cost overruns or delays in the receipt of Federal funds during construction. FTA believes that amended project agreements are not expected to be necessary. According to FTA, NJT has been informed that when it submits a revised financial plan in support of the full funding grant agreement, it must include adequate details on how NJT plans to cover cost overruns and/or delays in the receipt of Federal funds, should they occur, and that if there is any need to rely on funding from other parties, any necessary supporting agreements to that effect must be included with the plan.

**OIG Response:** We agree with the actions FTA is taking and plans to take to address the intent of our recommendation. However, the recommendation will remain open until FTA provides us with NJT's financial plan to ensure that FTA's actions were fully responsive to our recommendation.

**Recommendation 4:** Concur. FTA reiterated that NJT must submit a master schedule, and FTA will use this schedule in its deliberations with NJT as it negotiates a full funding grant agreement. FTA reiterated that NJT is responsible for developing the master schedule.

**OIG Response:** We agree with the actions FTA is taking and plans to take to address the intent of our recommendation. However, the recommendation will remain open until FTA submits NJT's approved master schedule for us to review to ensure the actions taken were fully responsive to our recommendation.

**Recommendation 5:** Concur. FTA agreed that the size and complexity of the ARC project requires additional efforts to prevent fraud, waste, and abuse. FTA will require that the ARC project management plan, and all mega-projects, include provisions to account for fraud and contractor integrity regardless of whether the projects receive ARRA funding. In other comments, FTA agreed that project sponsors of ARC and other mega-projects should consider using IPSIGs. FTA stated that, while it does not have the legal authority to require NJT to utilize an IPSIG, FTA will recommend that NJT use an IPSIG on ARC.

**OIG Response:** We agree with the actions FTA plans to take to address the intent of our recommendation. However, we request that FTA provide us with a revised ARC project management plan that contains fraud and contractor integrity provisions and a copy of its recommendation to NJT to use an IPSIG. Our recommendation will remain open until FTA submits this documentation for us to review to ensure that the actions taken were fully responsive to our recommendation.

**Recommendation 6:** Concur, in part. FTA recognized the importance of its project development requirements, as well as the documentation necessary to fulfill these requirements. According to FTA, there are lessons learned from the ARC project development process that FTA intends to build into proposed project management requirements. FTA also stated that it is proceeding with the development of a Notice of Proposed Rulemaking on Project Management (49 C.F.R. Part 633) that will capture lessons learned from the ARC project and other capital projects. During the course of this effort, FTA will be seeking to identify whether there are tools that could enable it to further enhance both grantee project management and FTA's oversight processes, especially for mega-projects. FTA responded that it is looking at how to best incorporate some of the tools that are in

the ARC project execution plan into standard processes and will subsequently develop any necessary guidance.

**OIG Response:** We recognize that the ARC is unique due to its technical complexity and the amount of funds invested, but we continue to believe that a more formalized guidance document would have assisted NJT in developing acceptable project documents. We agree with the actions FTA plans to take to address the intent of our recommendation. Based on FTA's comments, we consider these actions as meeting the intent of the recommendation and sufficient to close it.

### **ACTION REQUIRED**

In accordance with Department of Transportation Order 8000.1C, we request that FTA provide us with target action dates for submitting supplemental documentation for recommendations 1, 3, 4, and 5 within 30 calendar days of the date of this report.

We appreciate the courtesies and cooperation of FTA representatives during this audit. If you have any questions concerning this report, please call me at (202) 366-5630 or Thomas Yatsco, Program Director, at (202) 366-1302.

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## **EXHIBIT A. OBJECTIVE, SCOPE, AND METHODOLOGY**

Our objective was to evaluate FTA's oversight. Specifically, we (1) determined whether project risks were identified and strategies were implemented to mitigate the risks; (2) identified any challenges faced in ensuring sufficient funding; and (3) assessed NJT's controls for combating fraud, waste, and abuse. We evaluated FTA's oversight of ARC, based on the OIG Framework for Evaluating FTA's Oversight of Major Transit Projects. The key components of this framework evaluated whether:

- baseline cost and schedule estimates are realistic;
- the Federal share of the funding is available and whether reliable local funding source(s) exist to cover the non-Federal share of project costs;
- the project has a clear, transparent, organizational structure and the project sponsor is exhibiting sound project management practices;
- disagreements about project design and alignment have been resolved and any needed third party agreements have been reached or negotiations are progressing in a productive manner;
- the project meets the New Starts evaluation criteria and FTA guidance and requirements for federally funded projects;
- project management oversight contractors and financial management oversight contractors have conducted comprehensive, independent reviews of the project in accordance with FTA's guidance and requirements; and
- FTA and the project sponsor have agreed to mitigation strategies to address key project risks identified by FTA's oversight contractors.

We reviewed FTA documents and New Starts criteria related to ARC's oversight. Also, we reviewed FTA's budgets and staffing levels and a FTA Headquarters workforce assessment. We reviewed the PMOC monthly reports; FMOC assessments; FTA's grant agreements and amendments; NJT's ARRA and early systems work agreement applications; and ARC's project execution plan, project management plan, and Risk Register. These documents highlight the costs, funding, and schedule status of ARC and provide an update on the risks related to the project.

We conducted interviews with officials from FTA's Headquarters and Region II offices, NJT, and key stakeholders, including the Port Authority and Amtrak. Our audit was conducted at FTA Region II in New York, New York, and NJT in

Newark, New Jersey. Team members were continuously alert to current events impacting ARC as reported by local media and for indications of fraud, waste, and abuse.

OIG engineers assisted in the evaluation of FTA's oversight of ARC. They reviewed PMOC products, evaluated the risk mitigation plans developed by NJT, and reviewed the project's cost and schedule estimates.

In addition, within the context of the audit objective, the *Government Accountability Office Government Auditing Standards* for internal controls requires auditors to assess whether internal controls have been properly designed and implemented by the organization for the purpose of protecting its resources against waste, fraud, and inefficiency.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. The audit was conducted between January 2009 and March 2010.

## EXHIBIT B. TIMELINE OF ARC'S PROGRESS IN FTA'S NEW STARTS PROCESS

### *New Starts Planning and Project Development Process*

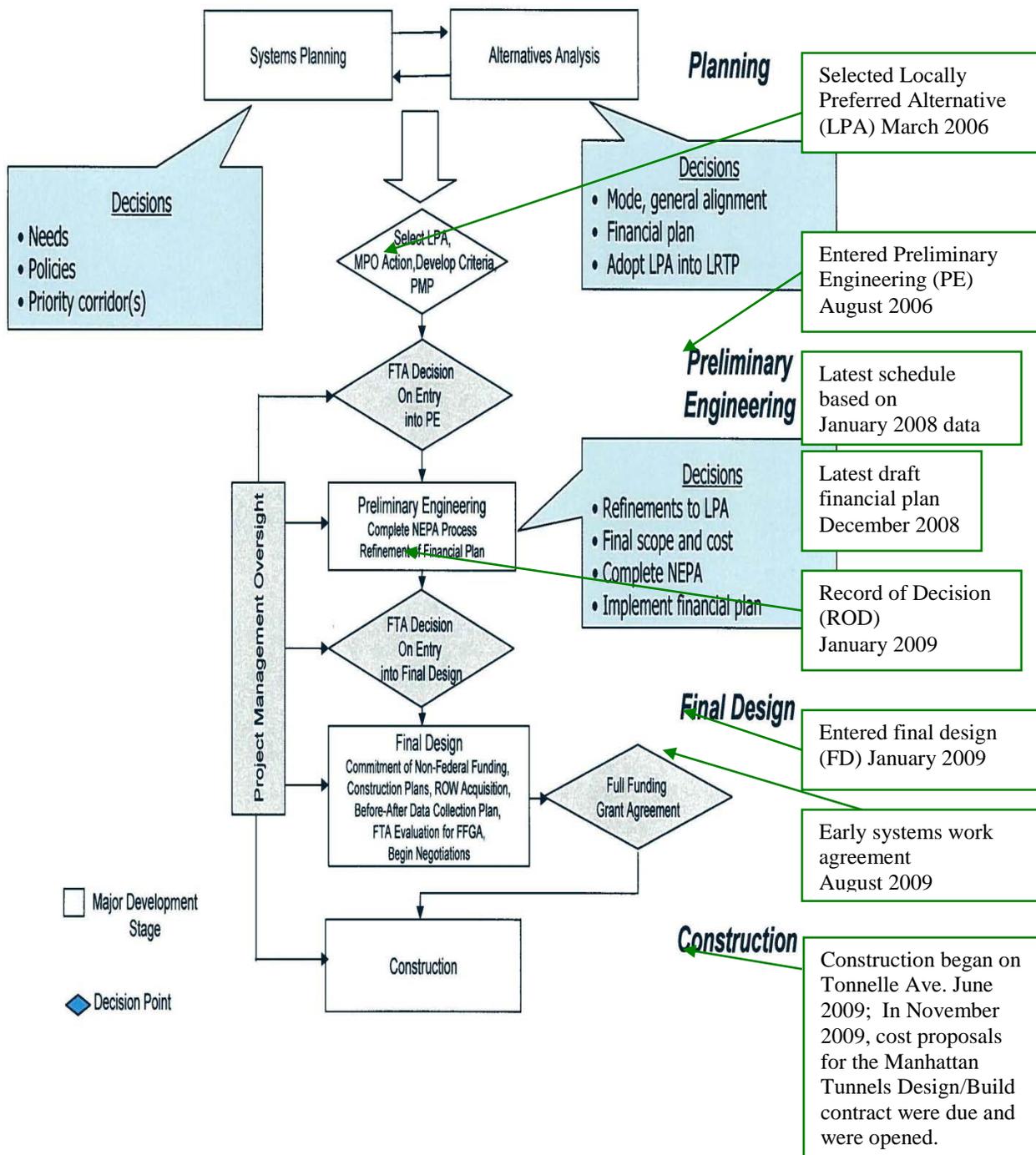


Exhibit B. Timeline of ARC's Progress in FTA's New Starts Process

**EXHIBIT C. CONTRIBUTORS TO THIS REPORT**

<b>Name</b>	<b>Title</b>
Thomas Yatsco	Program Director
George Lavanco	Project Manager
Regan Maund	Senior Analyst
Joseph Tschurilow	Auditor
Rosa Scalice	Auditor
Michael Dzandza	Auditor
Rodolfo Pérez	Engineer Advisor
Anne-Marie Joseph	Senior Engineer
Aron Wedekind	Engineer
Harriet Lambert	Writer-Editor

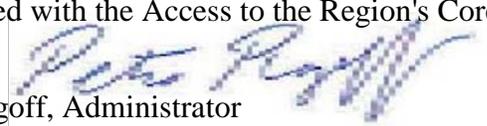
## APPENDIX. AGENCY COMMENTS



U.S. Department  
of Transportation  
**Federal Transit  
Administration**

# Memorandum

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Subject: ACTION: FTA Management Response to Office of Inspector General (OIG) Draft Report, "Actions Needed to Increase FTA's Oversight and Mitigate Risks Associated with the Access to the Region's Core Project." 

Date: **May 03 2010**

From: Peter Rogoff, Administrator  
Federal Transit Administration

Reply to  
Attn. of: Timothy P. Steinitz,  
202-366-3996

To: Joseph W. Comé  
Assistant Inspector General  
for Surface and Maritime Program Audits

Existing Federal Transit Administration (FTA) processes are designed to ensure that all necessary elements are in place before a Full Funding Grant Agreement (FFGA) is approved or funding is provided for the Access to the Region's Core (ARC) Project. Given the size, complexity, and importance of the ARC project to the economy of the New York / New Jersey region and the northeastern United States, FTA continues to work closely with the project sponsor and manager, the New Jersey Transit Corporation (NJT), to monitor the ARC project and to ensure that NJT meets the requirements of FTA's New Starts and Project Management Oversight (PMO) programs.

For accuracy, the OIG report needs to more clearly enumerate and acknowledge FTA's existing procedures, designed to control cost and schedule, which were in place as the ARC project entered the New Starts pipeline. These actions are taken by FTA to ensure that project requirements will be fully and appropriately implemented. As currently drafted, the reader is led to the erroneous conclusion that pending project issues are attributable to FTA's lack of appropriate controls. Rather, the issues are primarily related to how rigorously the procedures are being implemented by the project sponsor. In fact, FTA has repeatedly advised NJT that fulfillment of project requirements and procedures are necessary before a FFGA will be considered for the ARC project. The draft report needs to clarify that core project management and cost control processes are clearly established within the parameters of the New Starts program. Moreover, the OIG should clarify that the issues identified in the report have come to light as a result of FTA applying its procedures and *sharing* that information with the OIG.

FTA's New Starts program is one of the largest discretionary programs in the Federal government and is subject to very strict statutory requirements that are reflected in detailed rules and guidance. In addition, this program receives a high level of oversight by program and subject matter experts. FTA is following clear steps and specific requirements for projects in the New Starts program to progress from stage to stage of the project development process. One of the benefits of the final design stage in the process is to allow the project to finalize appropriate project management documents suitable to the nature and scale of the project. FTA will ensure that such documents are in place by the time the FFGA is executed.

The draft report is also inaccurate in its assessment that granting an Early Systems Work Agreement (ESWA) "removes any incentive for NJT to address FTA's concerns" regarding the lack of a risk management sub-plan, and that this decision "potentially jeopardized" the project's costs and schedules. Moreover, the draft report is also inaccurate in stating that FTA is "fast-tracking the ARC project outside the prescribed New Starts process." First, the use of an ESWA is authorized in statute under the New Starts program, and is a legitimate part of project development within the New Starts process. It is a useful New Starts tool that is deployed only when needed to help projects maintain cost and schedule, including when there is a potential for issuing an FFGA. Second, because NJT is using design/build contracts, not granting an ESWA would *definitely have jeopardized* the ability of NJT to keep the project on schedule and within budget. The OIG says as much on page 6 of the draft report, stating that FTA's decision to award an ESWA was made "in part to avoid project delays and higher costs." FTA's decision to grant an ESWA to NJT was based on that certainty, even though the completed Project Execution Plan (PEP) and sub-plans were not yet delivered. Third, significant incentive remains to develop the necessary project management tools, as an FFGA will only be issued with their satisfactory completion. Before being awarded an FFGA, NJT and FTA will complete an updated risk assessment to help define the cost and schedule for the project. FTA will assure that potential project risks, such as NJT's ability to access committed funds, are identified up front and that NJT takes action to mitigate these risks. In summary, the ESWA was a necessary interim step intended to make long-term management and completion of the ARC project more efficient and less costly.

In accordance with its existing statutory and programmatic requirements and structure, FTA has ensured that appropriate project review and project management oversight, including mechanisms to inform the grantee of potential risks related to fraud, waste and abuse, are in place for this project. FTA can, and does, tailor its oversight processes to fit the type and size of the project, as well as to accommodate the experience and background of the project sponsor. FTA agrees that the size, scope and complexity of the ARC project require a special level of oversight, as reflected in its actions to date. FTA is committed to assisting NJT as it completes all necessary FFGA requirements and will continue to provide comprehensive oversight for the ARC project.

FTA recognizes that the project's success will depend on strong and effective oversight by the FTA, but just as importantly, a positive, proactive, and constructive approach to project management by NJT.

## **FTA Continues to Work Closely with NJT to Ensure Required Documents are Completed**

FTA recognizes the importance of its project development requirements, as well as the documentation necessary to fulfill these requirements, and has been working to ensure that these requirements are fulfilled with regard to the ARC project prior to the award of an FFGA. The OIG draft report lends support to FTA's efforts with regard to the need for NJT to provide FTA with fully developed project documents for the ARC project. Up to this point, NJT has failed to provide fully developed project documents to FTA in their initial and follow-on submittals. While it is useful to have a number of these submittals completed as early as possible, the deadline for completing many of these documents is tied to the award of the FFGA. To aid NJT's efforts and to eliminate potential ambiguity, last October FTA provided NJT with a document checklist (or roadmap) of all the actions that need to be completed prior to the FFGA. This roadmap is updated periodically, with the latest update on March 10, 2010. The FTA Administrator and the Secretary recently used this checklist in discussions with the New Jersey Governor as a means of fully informing the Governor of the actions necessary for the project to proceed. FTA has provided appropriate guidance and assistance, via meetings, letters and email, to the grantee and is convinced that any delays in receiving finalized documents are due to a combination of project complexity, grantee inexperience and sometimes an unwillingness to develop policies and procedures consistent with FTA's programmatic requirements.

It is for these reasons that FTA disagrees with the OIG's conclusion that FTA did not provide NJT adequate guidance in developing PEP sub-plans. FTA believes the issue lies with the grantee's timely response to such guidance. FTA remains committed to providing assistance and guidance to NJT within the "go/no-go" project threshold and that programmatic requirements be fulfilled *prior to awarding* an FFGA to the ARC project. Finally, FTA is working to ensure that NJT completes a detailed baseline project schedule (tied to individual contract schedules) and a schedule management plan prior to awarding the FFGA. These actions are required as part of the roadmap and FTA agrees that completing these documents will be critical to assessing the project's progress. In addition, schedule adherence will remain a key element of each quarterly review meeting as the project progresses.

There are lessons learned from the ARC project development process that FTA intends to build into proposed project management requirements. FTA is proceeding with the development of a Notice of Proposed Rulemaking on Project Management (49 CFR Part 633) that will capture lessons learned from the ARC project and other capital projects. During the course of this effort, FTA will be seeking to identify whether there are tools that could enable it to further enhance both grantee project management *and* FTA's oversight tools and processes, especially for mega-projects (projects with capital costs over \$1 billion) such as ARC. Although not specifically discussed in the Advanced Notice of Proposed Rulemaking, FTA is looking at how to best incorporate some of the tools that are in the ARC project PEP into standard processes and will subsequently develop any necessary guidance supporting these enhanced tools and processes that are included in the final rule.

## **FTA will Conduct a Financial Capacity Assessment of ARC before Awarding an FFGA**

It was FTA that identified the funding issues that are mentioned in the OIG draft report. NJT, through the roadmap, is well aware that it must develop a revised financial plan so that FTA can conduct an updated Financial Capacity Assessment before the ARC project will be considered for an FFGA. The draft report notes that FTA delayed performing reviews of the availability of the Port Authority of New York / New Jersey's (Port Authority) and Turnpike Authority's funding sources due to economic uncertainty in general and the bond markets in particular and admonishes that this review must be done. We agree as to the necessity of this review; however, quickly changing market conditions would render an early examination by FTA of these sources obsolete prior to a decision on the FFGA. FTA will perform this review at the point in the project sequence when it is appropriate and meaningful.

FTA has a strict process for conducting these financial assessments. While FTA awarded an ESWA to NJT without completing a new examination of the availability of Port Authority funds, the financial risk resides with NJT, which would be required to reimburse FTA should an FFGA for the ARC project not be awarded. Furthermore, as mentioned above, in February 2010, the FTA Administrator and the Secretary spoke with New Jersey's new Governor about the Department's concerns regarding funding, the potential for cost overruns on this project, and how any overruns would be funded. These concerns were reinforced in a March 26, 2010 letter to the Governor. The Governor reiterated New Jersey's commitment to the project in a letter dated April 7, 2010. Similar concerns were also expressed in a March 29, 2010 letter to the Port Authority. The Port Authority confirmed its commitment to the project in an attachment to the Governor's April 7, 2010 letter to FTA.

The report also raises a concern about whether the unavailability of contingent commitment authority beyond Fiscal Year (FY) 2010 could delay the project. Whether this exception to the normal limits on commitment authority may extend into FY 2011, or beyond, will depend on the terms of future legislation – both an FY 2011 appropriations bill and the eventual legislation to extend or amend the authorization statute. Since the Federal New Starts share for this project is capped at \$3 billion, halting the project because of the uncertainty with commitment authority could result in cost escalation, which would need to be borne by local taxpayers since any increase in cost must be paid for from higher local contributions.

### **FTA Conducts Extensive Activity to Prevent Fraud, Waste and Abuse**

FTA has strong and comprehensive processes in place to prevent fraud, waste and abuse on all projects receiving FTA funding, including those funded by the Recovery Act. FTA makes constructive use of all opportunities to reinforce its commitment to address these issues, both in writing and verbally. For example, FTA provides training opportunities for contractors and grantees to be aware of potential fraud. This topic is also addressed as a component of all agency grant reviews, Triennial Reviews, Project Management Oversight Contractor (PMOC) reviews and general financial audits.

As the OIG indicated in its recent report on Recovery Act Implementation,<sup>12</sup> FTA is making efforts to combat fraud in Recovery Act funding. FTA is continuing this effort and invites representatives from the OIG to make presentations on ways to recognize and mitigate fraud, waste and abuse at all FTA-sponsored oversight conferences and workshops. These workshops are regularly attended by FTA staff, contractors and grantees.

FTA shares the OIG's concerns about the lack of specific measures in place to monitor the ARC project's efforts to prevent fraud and abuse. However, this concern arises not primarily because the ARC project includes Recovery Act funds, but because of the large Federal investment in this project. In July 2009, following a series of discussions between the FTA Administrator and former New Jersey Governor Jon Corzine, FTA transmitted an email to the Governor and the New Jersey comptroller commenting on a proposed Executive Order (EO) from the Governor which would provide for greater monitoring of the ARC project. FTA shared this draft EO with OIG, which recommended changes to the text of the EO and commented that no role was specifically identified for New Jersey's OIG as part of this process. However, the OIG stated that while this was a matter of concern, it was a "state matter." FTA forwarded recommended changes in the EO language, along with its own comments, which the Governor incorporated into the final EO.

While this draft report identifies utilizing an independent private-sector inspector general (IPSIG) as a best practice for projects receiving large amounts of Federal funding, this approach is not standard practice for New Starts projects. The OIG did note that the Fulton Street Transit Center project in Lower Manhattan did utilize an IPSIG and FTA agrees that this project and other mega-projects do require considerations for IPSIGs. While FTA does not have the legal authority to require NJT to utilize an IPSIG, as this is the State's decision, FTA can, and will, recommend that NJT use an IPSIG for the ARC project.

In addition, while fraud and contractor integrity are covered collectively by FTA's current rule on project management oversight (Part 633.25 (a) through (j)), FTA is currently updating this regulation and will include a specific provision on waste, fraud and abuse for all mega-projects seeking Federal funding. In the meantime, FTA agrees that the size and complexity of the ARC project, and other mega-projects, require that such measures be identified and will require that the project management plan (PMP) for the ARC project and other mega-projects include provisions to account for fraud and contractor integrity.

## **RECOMMENDATIONS AND RESPONSES**

**Recommendation 1:** Work with NJ Transit to promptly finalize the PMP, PEP sub-plans, and financial plan.

**Response:** Concur. FTA emphasizes that the ARC project will not be considered for an FFGA unless all required plans are completed to FTA's satisfaction. FTA will use the roadmap and continue to work with NJT to develop the PMP, PEP sub-plans and financial

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<sup>12</sup> "DOT's Implementation of the American Recovery and Reinvestment Act: Continued Management Attention is needed to Address Oversight Vulnerabilities," MH-2010-024, November 30, 2009.

plan. FTA emphasizes that development of these plans is the sole responsibility of NJT. As a result, the prompt completion of these plans will depend on actions taken by NJT. FTA will provide a comprehensive and expeditious review of the plans developed by NJT and offer feedback and recommendations for improvements as needed. FTA expects to receive all of the required information from NJT in the 3<sup>rd</sup> Quarter of FY 2010.

**Recommendation 2:** Continue coordinating with other stakeholders to ensure timely completion of watch list items.

**FTA Response:** Concur. While timely completion of watch list items is critical to ensuring the ARC project remains within budget and on schedule, FTA again must emphasize that project management is the sole responsibility of the project sponsor (NJT) and that timeliness is largely contingent on NJT taking prompt, effective and constructive action. FTA will continue to monitor NJT's actions and provide oversight and assistance to ensure that NJT is adequately accomplishing this coordination.

**Recommendation 3:** Obtain amended project agreements between NJT and the Port Authority and the Turnpike Authority regarding distribution of responsibilities for any future cost overruns.

**FTA Response:** Concur. NJT has verbally informed FTA that it, not the Port Authority or the Turnpike Authority, will be responsible for cost overruns or delays in the receipt of Federal funds during construction. Hence, amended project agreements are not expected to be necessary. NJT has been informed, however, that when it submits a revised financial plan in support of the FFGA request, it must include adequate details on how NJT plans to cover cost overruns and/or delays in the receipt of Federal funds, should they occur, and that if there is any need to rely on funding from other parties, any necessary supporting agreements to that effect must be included with the plan. This is in keeping with FTA's normal practice for New Starts projects.

**Recommendation 4:** Work with NJT to update the project's master schedule and ensure it ties together the work of all contracts.

**FTA Response:** Concur. FTA reiterates that NJT must submit a master schedule, and FTA will use this schedule in its deliberations with NJT as the proper cost and schedule to be included in the FFGA. As project sponsor, NJT is responsible for developing the master schedule, not FTA. While FTA will provide comprehensive and expeditious review of project planning documents from NJT, the project sponsor is responsible for completing and updating the master schedule.

**Recommendation 5:** In light of new Recovery Act oversight requirements, include a fraud and contractor integrity chapter in the PMP to assess whether NJT has adequate management controls in place to prevent fraud, waste, and abuse on ARC.

**FTA Response:** Concur. While fraud and contractor integrity are covered collectively by FTA's current rule on project management oversight (Part 633.25 (a) through (j)), FTA agrees that the size and complexity of the ARC project requires additional efforts to monitor the

project for potential fraud and abuse. FTA will require that the PMP for the ARC project, and all mega-projects, include provisions to account for fraud and contractor integrity regardless of whether or not the projects receive Recovery Act funding.

**Recommendation 6:** Issue written guidance on developing project execution plans for New Starts projects, including all of the required elements.

**FTA Response:** Concur, in part. As discussed above, FTA is considering the essential elements of PEPs and other project management strategies in its project management rulemaking currently underway (49 CFR Part 633, Project Management Oversight). FTA will pay special attention to specific needs applicable to mega-projects. While FTA will continue to provide technical assistance and guidance to NJT, it does not believe that standard written guidance will adequately address the unique needs and concerns applicable to individual New Starts projects.

\* \* \* \* \*

Thank you for the opportunity to comment on the draft report. In addition to the comments above, FTA is attaching a number of technical edits and specific comments for the OIG's consideration in finalizing its report. Please contact me at (202) 366-4040 with any questions or if we may be of further assistance.