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Commission of Investigation*

New Jersey Transit's

BUS SUBSIDY PROGRAM

MARCH 1993

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March 1993

Governor James J. Florio
The President and Members of the Senate
The Speaker and Members of the General Assembly

The State Commission of Investigation herewith formally submits, pursuant to N.J.S.A. 52:9M, a report and recommendations on its investigation into New Jersey Transit's Bus Subsidy Program.

Respectfully,



James R. Zazzali
Chairman



Barry H. Evenchick



Kenneth D. Merin



William T. Cahill, Jr.

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INTRODUCTION

In October, 1991, the State Commission of Investigation received an anonymous letter containing allegations concerning New Jersey Transit Corporation's Bus Subsidy Program. A nine-month investigation by this Commission uncovered evidence of several million dollars worth of fraud in the relatively small \$5 million program.

Opening two days of public hearings on July 22, 1992, Commission Chairman James R. Zazzali said:

We have found ... that the family that controlled two of these [subsidized] bus companies—Monmouth Bus Lines of Asbury Park and Middlesex Metro of East Brunswick—padded the payrolls of both with family members and others who did not work. Some of these people didn't even know their names were on the payrolls, and checks issued in their names were endorsed and cashed by others.

Various personal or household expenses were bought for family members, yet charged to the bus companies. These included home additions, garage door openers, decks, appliances and many other such items. Vendors were instructed to bill the bus companies for the purchases. The family maid was also paid with public funds.

Used NJT vehicles such as buses and cars were sold by one bus company as the agent for NJT, which kept inadequate records of how many or which vehicles were sold. Vehicles intended to be resold were appraised as salvage, some vehicles were stripped for parts before sale and the parts

sold separately, some relatively new vehicles in good condition were sold as junkers. And there is a litany of other irregularities that took place....

And at the conclusion of the public hearings, Chairman Zazzali said, "The scheme was not all that complicated. Take one greedy family, add some gullible, inattentive managers, and it was pretty easy pickings."

* * *

New Jersey Transit Corporation was created in 1979 in response to a widespread recognition that the state needed a coordinated system of mass transportation in order to keep from becoming strangled by vehicular traffic. It was, after all, infinitely cheaper to move groups of people by bus or train than to build enough highways so that each commuter could drive his own vehicle to the centers of commerce.

Initially, NJT was involved only in bus transportation by acquiring some of the state's largest bus companies. Over the years, it acquired more of the smaller firms as they began to have financial difficulty, and it began to subsidize others, especially in areas of the state where it was clearly unprofitable to operate commercial bus service. In the early 1980s, facing the loss of federally funded railroads in the state, NJT expanded in that direction as well. The agency now has an annual budget of nearly \$800 million.

By most accounts, the agency has been reasonably successful in providing moderately priced trans-

portation, acquiring and maintaining modern equipment and expanding to meet the changing needs of commuters. And aside from the ethical problems of a former executive director, the agency has been free from scandal since its creation.

With this background, it was all the more remarkable that NJT failed for years to uncover a major abuse of funds in the Bus Subsidy Program, a small part of its total operation. Not only did the agency fail to detect the abuse on its own, but when it received unsolicited information from outsiders it failed to follow up and, even worse, endangered the safety of one of those sources.

The Bus Subsidy Program is the remnant of a program begun in the 1970s which at one time subsidized as many as 25 carriers. At the time of the investigation, it provided a total of \$5 million to just five bus companies; Middlesex Metro and Monmouth Bus together were receiving approximately 80 percent of these funds. Because the five companies were subsidized to the extent of their losses, NJT's audits were important because they were used to determine the amount and validity of subsidies to these carriers. During the public hearing, Commissioner William T. Cahill, Jr. repeatedly questioned the wisdom of such subsidies, saying the system seems to "reward mismanagement."

In 1986, NJT began its Contracting Out Program, another program under which other carriers bid to provide bus service on certain routes in various areas of the state. These carriers also receive aid but are not subsidized to the extent of their losses as those in the Bus Subsidy Program. Under all the aid programs, many bus companies in New Jersey, including those in the Bus Subsidy Program and the Contracting Out Program, get assistance in the form of buses, support vehicles, computers and other equipment. These various forms of assistance are financed by both the federal and state governments.

All the bus assistance programs are administered by NJT's Department of Private Carrier Affairs,

headed during the period under investigation by Deputy Assistant Executive Director Ronald L. Reisner. Reisner reported to Albert R. Hasbrouck, III, Assistant Executive Director in charge of Corporate Affairs. Both men are attorneys. Lisa DeGrace, the bus contract administrator, worked directly under Reisner and was the day-to-day contact with the bus companies.

* * *

On October 9, 1991, this Commission received a copy of an anonymous, handwritten letter containing allegations of financial misconduct involving state subsidy monies on the part of Monmouth Bus and Middlesex Metro, two companies controlled by 73-year-old Howard P. Farrelly of Dover Township, Ocean County. The letter had been addressed to the State Department of Transportation, as well as to other parties. The Commission does not know whether NJT ever received a copy of this letter although the investigation revealed that the agency did receive several other communications containing similar information. It was this document that prompted the Commission's investigation.

The allegations in the letter included: Payroll padding by putting Farrelly family relatives on the payroll as no-show employees; personal expenses of the Farrellys, including the cost of a housekeeper, being paid by the companies under the guise of business expenses; limousine trips to Atlantic City casinos on weekends, and high living generally. Since inflated business expenses were reflected as increased losses and, because the two Farrelly companies were subsidized by NJT to the extent of their losses, the taxpayers of New Jersey were paying the cost of the financial misconduct.

In its investigation, the Commission went beyond the allegations in the anonymous letter. It subpoenaed 33 witnesses to testify in executive session, 23 of whom testified in the public hearing. It issued 97 subpoenas for documents from NJT, Middlesex Metro and Monmouth Bus Lines and the

three other subsidized companies, as well as from dozens of vendors and others with whom the two Farrelly companies did business.

The investigation was hampered because the bus companies routinely destroyed records older than three years, with the knowledge and approval

of NJT officials. Despite this handicap, the investigation verified the accuracy of most of the allegations and also developed additional information impugning some of NJT's operating procedures. The Commission also determined that some of the misconduct had been going on since 1979.

I

FAMILY BENEFITS

Payroll Padding

To the extent that subsidized bus companies pad their payrolls, their expenses (and subsequent losses) are inflated and their subsidies from NJT increased accordingly.

Several witnesses, including some employees at the Farrelly companies and other carriers, told this Commission that running a bus company requires little in the way of a management staff. All that is needed, according to these witnesses, is a dispatcher to get the buses where they should be and a maintenance shop to keep them running.

Lisa DeGrace said, however, that NJT had no guidelines as to how many officers a bus company should have on its payroll. She testified:

Typically these officers [from bus companies] have been on the payroll since the beginning, which would be around 1979, so it has been set up since the beginning.... It is historical....

She conceded there was no model that NJT could use to compare one carrier with another. But she said that officers are expected to work for their salaries.

Commission Investigative Accountant Michael R. Czyzyk testified that relatives of the Farrelly family and ghost employees at Monmouth Bus and Middlesex Metro collected salaries totalling more than \$800,000 in the 51 months from January 1, 1988 and March 31, 1992. (Exhibit C-98.) This amount does not include the cost of various fringe benefits.

The ghost, or no-show, employees were identified by Commission Senior Special Agent Richard S. Hutchinson in his opening overview of the investigation during the public hearing. Most were relatives of the Farrelly family, some of whom testified under grants of immunity from prosecution.

Regardless of what the corporate documents may indicate pertaining to ownership of Monmouth Bus Lines and Middlesex Metro, there is no question that it was Howard Farrelly who ran them both. It was he that NJT officials dealt with, and all employees acknowledged that he was the boss and the dominant presence in the businesses.

Although Howard's wife, Pauline Virginia Farrelly, is listed in corporate papers as the president and sole director of Monmouth Bus, she had not worked there for years. Lisa DeGrace had never met her, and the Commission established that the signatures on the subsidy contracts were not hers, even though Howard certified that she signed the contracts. Nevertheless, between January 1, 1988 and March 31, 1992, she received a total of \$206,390 in salary and expenses.

Keith Farrelly, the older son of Howard and Virginia, was an officer of Monmouth Bus Lines but rarely came to work. Most of his time when he was there was spent repairing and restoring cars and trucks he bought and sold. Eventually his father rented a separate garage to get Keith's work out of the company garage. Between January 1, 1988 and March 31, 1992, he collected \$197,099 in salary from Monmouth Bus. Keith's first wife Helen was carried on the books as a bus company employee until their divorce. Keith's second wife, listed on

MONMOUTH BUS LINES, INC./MIDDLESEX METRO, INC. PAYROLL ANALYSIS

	JOB "TITLE"	TOTAL WAGES 1/1/88 - 3/31/92	OTHER SUBSIDIZED COMPENSATION 7/1/88 - 6/30/92	ASSIGNED NJT VEHICLE	RECEIVED EMPLOYEE BENEFITS
Howard Farrelly	Officer	\$210,672	\$97,055	X	X
P. Virginia Farrelly	Officer	\$206,390	\$16,600		X
Kerry Farrelly*	Supervisor of Transportation	\$194,184		X	X
Keith Farrelly	Supervisor of Transportation	\$197,099		X	X
Kelly Farrelly Casiero*	Driver/Dispatcher/Supervisor	\$153,795			X
Margaret Farrelly	Driver/Cleaner	\$ 48,320			X
Elizabeth D. Silk/Farrelly	Driver/Cleaner	\$ 37,180			X
Rinaldo Suppa	Dispatcher	\$ 27,610	\$20,505		X
Helen Suppa	Dispatcher/Cleaner/Supervisor	\$ 64,290			
Florence Saldutti	Dispatcher/Cleaner/Supervisor	\$114,100		X	X
Charles C. Mucci	Supervisor	\$ 37,310			X
Zina Owens	Cleaner	\$ 2,385			
Latresa Y. Works	Cleaner/Driver	\$ 19,680			
Gail Hodgkinson	Cleaner	\$ 520			

*Simultaneously on the payroll of both bus companies



the books of Monmouth Bus as a bus driver under her maiden name, Elizabeth Silk, was issued checks totalling \$37,180. Some of those checks were endorsed by her, some by Howard Farrelly and some by others. The proceeds went to Howard.

Kerry Farrelly, the younger son of Howard and Virginia, is listed as vice president of Middlesex Metro and used to work there about half time. Between January 1, 1988 and March 31, 1992, he collected \$194,184 in salary. His former wife Margaret told the Commission that she learned after their divorce that she had been listed as a bus driver for Middlesex Metro and, later, as a spotter. She testified that she never worked for the company and never collected any money. The investigation determined that Kerry had her checks endorsed by others, then deposited them in his own account. They amounted to \$48,320 over four years. After his divorce from Margaret, Kerry used the checks to pay his alimony.

In a certification filed in the divorce proceedings between Kerry and Margaret Farrelly, he had to explain the scheme for making the payments to his wife:

Since I am only allowed by the State to earn a certain salary each year, [Margaret] and I have, for many years, added [her] as an "employee" so that our income is a little bit higher. This is the only way that we could make ends meet This little bit of extra money has always gone right back into the household to pay for the two mortgages, utility bills, etc.... In any event, since the plaintiff is divorcing me, we may no longer be able to continue this practice

Kelly Farrelly Casiero, daughter and youngest child of Howard and Virginia Farrelly, was on the payroll of both bus companies at the same time, under her maiden name at Monmouth and her married name at Middlesex, although she never worked at either company. At Monmouth, she was listed as

a supervisor; at Middlesex, she was listed as a driver and sometimes as a dispatcher. Between January 1, 1988, and March 31, 1992, she was paid \$153,795. In a certification filed in the divorce between Kelly and her husband Thomas Casiero, she stated:

The income which was being paid to me from Middlesex Bus Lines was put into a savings account by my father in order to provide us with a protected fund beyond our reach. Thus, when we put a deck and jacuzzi on the back of the house, the work was paid from that fund. If need be, my father can account for every penny that went into the account and that was taken from the account. Upon our separation, however, my father and I felt it best to terminate that payroll account because we expected the defendant [Thomas Casiero] to be foolish enough to make an issue of income that was actually benefitting him. Rather than have the bus line be subjected to criticism, the best thing to do was simply to discontinue that income. As a result, I do not, and never will in the future, receive that income.

Helen Suppa, a sister of Virginia Farrelly, was listed as an employee and was paid \$64,290 but no one at either company had ever heard of her. Her husband Rinaldo is the owner of record of Middlesex Metro although his duties amounted to little more than part-time dispatcher, spotter and "gofer" for Howard. He received \$27,610. NJT had never heard of Rinaldo Suppa.

Florence Saldutti, another sister of Virginia Farrelly, worked in the office of Monmouth Bus but her exact duties are unclear. She was listed as a dispatcher, bus cleaner and supervisor and was paid \$64,290. The investigation indicated that she kept a second set of books for Howard Farrelly.

Sources at both bus companies have told the Commission staff that Farrelly family members padded the company payrolls with the names of

others and that there were even dead persons listed on the payroll over the years. Kerry, in fact, listed the wife of a bus company employee on the books and cashed her paychecks for himself, unbeknownst to the employee or his wife. Virginia Farrelly's elderly mother was listed as an employee in order to qualify for health benefits and life insurance.

Other Benefits

NJT not only subsidized the two bus companies but also the life-style of the Farrellys. Aside from many family members being no-show employees, the extended Farrelly family received other material benefits from the bus companies. The investigation revealed that historically Howard Farrelly was the person primarily responsible for the schemes by which he, his children and their spouses were able to live lavishly. Witnesses told the Commission that typically what one family got at its home, all or most of the other Farrelly families received as well.

Elizabeth Silk Farrelly, Keith's second wife, testified at the public hearing under a grant of immunity from prosecution that bills for items at her home such as a burglar alarm system were paid by Monmouth Bus. She also said that company employees during their work day did chores at her home such as cleaning the dog pen, mowing the lawn and raking leaves. Her automobile insurance was also paid by the company, she said.

Margaret Farrelly testified, also with immunity, that an individual retirement account paid with bus company funds was established in her name. Bus company employees, also on company time, performed services at her home, including refinishing the basement and building a large outdoor shed. Company funds were used to pay for household supplies, paint, wallpaper, lights, electric garage door openers, furniture, new sidewalks, a lawn sprinkler system and other such items. She also testified that she had gasoline credit cards from Middlesex Metro for her personal use, that her personally owned automobiles were repaired at the

bus company garage, that her personal auto insurance was paid by the bus company and that she had NJT vehicles available to her for her personal use.

In the certification filed in connection with her divorce from Kerry, she stated:

...[H]e [Kerry] also has a company gas card and has, for many years, embezzled money from the bus company. He sells bus parts on the side for cash, sells gasoline from the bus company and pockets the money, and always has thousands of dollars of cash available to him each month I ask that I ... be allowed to continued [sic] to use the company gasoline card I further ask that the checks made out to me from Monmouth and Middlesex Bus Companies be turned over to me each week by the defendant Even though I am never seeing the money, at the end of the year I will receive a W-2 and I will have to pay income tax on these monies.

... I never worked during our marriage, yet we always had the luxury of having a cleaning lady come to our house Kerry ... now claims that he no longer can use the company car, which has all of its expenses paid by the bus company, for personal use. This is an outright lie, since we have been using that car for our personal use for the last 11 years Our car insurance has been paid for by the bus company for the past 11 years. [Howard Farrelly] has never had any problem with us using the company credit card for gas I have had a company gas credit card for the past 10 years The defendant, on the other hand, sets his own hours, comes and goes as he pleases at the bus company, and whether he is there or not, he gets paid.

Christine F. Klagholz, Commission Systems Analyst and a former investigative accountant, testified that members of the Farrelly family received other goods and services that were paid for by the

two bus companies. For instance, Kerry's Video Shoppe, an Ocean County business then owned by Kerry Farrelly, received a \$600 security system in 1989. Kerry also received dining room furniture costing nearly \$1,800, and wallpapering and painting that cost \$1,200. Kelly Casiero received a central vacuum system installed in her home at a cost of \$1,145, as well as a pressure-treated wood deck and a cedar closet, which were built with materials which cost \$1,568.

Keith, who was restoring cars at the Monmouth Bus garage, billed the purchase of many auto parts to the bus company. The manager of an Asbury Park auto parts store which was the principal supplier for Monmouth Bus testified that he sold parts to the company for, among other vehicles, a Corvette, a Cadillac El Dorado, a Cadillac Seville, a Datsun sports car, a Camaro, a Thunderbird and a Lincoln Continental. The witness said Keith purchased about \$2,500 worth of parts from his store each month.

Zina Owens, in testimony confirming that of others, told the Commission that she had worked as a housekeeper, baby sitter and cook for Howard and Virginia Farrelly three days a week. She testified that she also worked one day a week each for Kelly Farrelly Casiero and Kerry Farrelly. She acknowledged that she knew she had been listed as a bus cleaner for Monmouth Bus and received payroll checks from the company although she said she never worked for the company and did not even know where it was located. Owens testified that she also received checks, issued in her sister's name, from the bus company to pay for her personal services to the Farrellys.

While the Farrelly family profited from abuse of the state subsidies, some employees of the two bus companies benefitted as well. These employees would buy appliances, tires and other goods at discount through selected vendors who then billed the bus companies, sometimes by phony invoice to conceal the true nature of the purchase. The goods were usually paid for in installments by the employees paying Keith or Kerry in cash on payday.

II

VEHICLE SALES

Federal regulations regarding subsidized mass transit companies establish standards for removing from service vehicles which have been purchased with subsidies. Buses must be sold when they are 12 years old. Other vehicles may be disposed of if they are at least five years old and have been driven 60,000 miles. The regulations also require that the sale of any used equipment or vehicle for \$5,000 or more must be reported to the Federal Transit Administration so that that agency may recover a portion of its aid.

The 32 private carriers that had vehicles from NJT informed the agency whenever any of their vehicles needed to be replaced, either because of age, mileage or excessive wear. When that happened, NJT simply sent the titles to the carriers for disposition as they saw fit. No one from NJT verified the mileage or condition of any of the vehicles. Although NJT was to be notified of the disposal method used and the proceeds derived therefrom, the policy was never enforced.

In 1988, Assistant Executive Director Albert Hasbrouck changed the procedure and designated Howard Farrelly as NJT's agent to sell used equipment including buses, automobiles and pickup trucks. Since that time a company notifying NJT that any of its vehicles needed to be replaced was directed to take the vehicles to Farrelly at Middlesex Metro to be sold. Occasionally, Hasbrouck's staff at the Department of Private Carrier Affairs would notify a carrier that one or more of its vehicles should be turned in regardless of its mileage or age and, again, direct the carrier to transport the vehicle to Farrelly.

Although Private Carrier Affairs recognized

Middlesex Metro as the agent for these sales, there was never any written contract, formal agreement or internal document memorializing the arrangement. Incredibly, senior Private Carrier Affairs officials testified that, although they knew Farrelly sold aged buses for them, they were unaware until the Commission's investigation that he was selling other equipment as well.

When a vehicle was to be disposed of, either NJT Deputy Assistant Executive Director Ronald L. Reisner, head of the Department of Private Carrier Affairs, or Hasbrouck simply signed the certificate of ownership on behalf of NJT without checking the condition of the vehicle, then forwarded the certificate to Farrelly.

In fact, Private Carrier Affairs kept no records of the mileage on the vehicles it gave to the private carriers and had no idea who had them. Nor did the agency have its own records of how many vehicles Farrelly sold for them or how they were disposed of. The only records available were handwritten lists maintained by Farrelly himself and submitted periodically to Private Carrier Affairs, which had no method by which to verify Farrelly's data. This lack of records enabled Farrelly and his sons to sell some vehicles to family members and others at a fraction of their fair market value.

Exhibit C-85 depicts selected transactions involving 10 vehicles sold by Farrelly to brothers-in-law, a niece, several employees of his bus company, business associates and the brother-in-law of a now-retired NJT official, Jack Rossiter, the former Director of Private Carrier Affairs. The chart reveals the total wholesale value of these 10 vehicles at time of disposal was \$45,050. However, the Commis-

SAMPLE OF NJT VEHICLES SOLD BY HOWARD FARRELLY

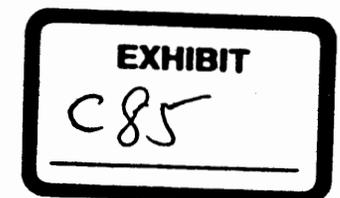
RELATIONSHIP	VEHICLE	NADA AVG. WHOLESALE	ACTUAL SALE PRICE	PRICE REPORTED TO NJT
*Brother-in-law	1984 Chevrolet S.W.	\$1,500	\$ 0	\$ 0
Niece	1984 Ford LTD	\$1,600	\$ 200	Scrapped
**Brother-in-law	1984 Dodge P.U.	\$5,350	\$6,000	\$1,000
Employee	1981 Dodge P.U.	\$2,550	\$ 500	\$ 100
***Employee	1984 Dodge P.U.	\$5,350	\$2,500	\$ 300
10 Employee	1984 Dodge P.U.	\$5,350	\$2,200	\$ 500
Employee	1986 Ford P.U.	\$7,550	\$4,000	\$3,000
****Indirect	1982 Dodge P.U.	\$2,900	\$ 500	\$ 200
Business Associate	1984 Dodge P.U.	\$5,350	\$2,980	\$2,000
Brother-in-law of NJT Official	1986 Ford P.U.	\$7,550	\$ 0	Scrapped

*Given to brother-in-law

**Resold to third party for \$6,000 by Kerry Farrelly

***First sold to Farrelly employee for \$1,000

****Sold to third party by Keith Farrelly



sion was able to establish that the actual sale price of the 10 vehicles was \$18,880. The price Farrelly reported to NJT was only \$7,100, about 16% of their wholesale value and less than half of what he actually collected. Farrelly even went so far as to report that two of the vehicles had been scrapped. One of those vehicles was the pick-up truck, worth \$7,550 wholesale, that was simply given to Rossiter's brother-in-law. Commission Agent Dennis McGuigan, who saw and photographed the truck, characterized it as being in "mint condition."

Farrelly's practice was to keep the proceeds from these sales until after the end of the fiscal year rather than remit the funds to NJT immediately. It was only then that Private Carrier Affairs actually had any information at all about how many vehicles Farrelly had sold and at what price. But since Private Carrier Affairs had no records of its own, the Department knew only what Farrelly chose to tell it. The sums that he accumulated often amounted to several hundred thousand dollars at any one time.

The records of Private Carrier Affairs, which rely exclusively on Farrelly's submissions, reflect that Farrelly reported having sold 200 vehicles for NJT but the Commission determined that there were many more. The Commission further determined, through the appraisal service used by Farrelly, that only 131 of those 200 vehicles he reported had been appraised as required by NJT. However, one bus had been appraised three different times. The investigation also revealed that Farrelly substantially underreported to NJT the appraised value of some vehicles, sometimes by as much as 50 percent, reporting them sold at this reduced value while pocketing the difference.

On May 29, 1991, five months before the Commission began its investigation, NJT's own internal auditors criticized the system of monitoring used by Private Carrier Affairs. However, it was not until January 27, 1992, after the Commission had asked NJT for records and documents and the investigation was nearly complete, that the system was

changed. (Exhibit C-77.)

A 1991 NJT audit report criticized the procedures, saying that "immediate action is required to strengthen internal controls over the monitoring, recordkeeping and disposal of vehicles assigned by the carriers." The report noted that the Department of Private Carrier Affairs did not inspect the vehicles to verify carriers' claims of high mileage or excessive wear. The carriers were not notifying NJT of the ultimate disposal process and the Department was not following up on the matter. The auditors could not verify whether the certificates of ownership had been transferred to the bus carriers because the Department did not maintain that information. Curiously, the audit report contained no mention of the arrangement with Farrelly to sell vehicles for NJT because no one above Hasbrouck knew of it.

According to all witnesses, making this arrangement even more unusual was the fact that Farrelly was not paid for the service. Deputy Assistant Executive Director Reisner, who supervised the Bus Subsidy Program, was asked about this at the public hearing by Commission Counsel Charlotte K. Gaal:

Q. Was there anything put in writing, any type of written agreement or contract with Farrelly?

A. I don't believe there was a contract.

Q. Was there any remuneration for Mr. Farrelly?

A. Not that I'm aware of.

Q. Just so we are clear, Mr. Farrelly was to sell up to hundreds of vehicles without receiving any form of compensation?

A. That's as I understand.

Q. Doesn't that seem unusual?

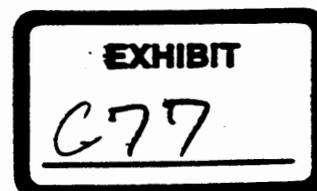
A. Not particularly.

DEPARTMENT OF PRIVATE CARRIER AFFAIRS

Procedures Relating To The Retirement of Leased Vehicles

1. Minimum Criteria
1991 Policy: No vehicle will be retired unless it meets the following criteria:
5 years and 60,000 miles and less than \$5,000 in value.
2. Physical Inspection
Prior to authorizing the retirement of any vehicle, a physical inspection will be performed to verify mileage and years of service.
3. Recordkeeping
Complete records should be kept, including the following: letter amendments to the lease, photocopy of the title, as signed by both NJ TRANSIT and the carrier including the recorded mileage, and the present value assessment. The value assessment should be based upon values set forth in commonly accepted insurance industry valuation books (e.g. Maclean Hunter Market Report (Red Bank) or N.A.D.A. (Blue Book)). A copy of the memo should be kept in the carrier's file as well as a separate Retired Vehicle file.
4. Semi-Annual Mileage Reports
Twice a year, each carrier will submit a report setting forth the odometer reading for each vehicle. These should be reconciled with the information that Performance Standards gathers as part of its bi-annual inspection of vehicles.
5. License Plates
When physical inspection is made, the license plates (or a DMV receipt for them), should be received from the carrier. The title should be fully signed and filled out (mileage), and a copy of both sides retained for NJ TRANSIT's file.
6. Logo Removal
The Department of Private Carrier Affairs will insure that carriers who have purchased retired vehicles, remove NJ TRANSIT's name and logo from the vehicles.

Department of Private Carrier Affairs
January 27, 1992



Q. Why not?

A. I just don't think it is.

Q. I am just wondering, why Farrelly?

A. Again, you have to direct those questions to others. I really don't know.

Q. Since you have been aware of it, have you raised those questions?

A. From what I know of Mr. Farrelly since my assuming of this direct oversight in 1991, he is a person who has been in the bus business a long time and who has, apparently, a great involvement in it and enjoyed coming to work every day and doing things.

Q. Are you suggesting that he was sort of a Good Samaritan?

A. Pardon? I wouldn't characterize that—

CHAIRMAN ZAZZALI: And you are certainly an intelligent public employee. Is it a fair assumption he was doing this, selling the buses free of charge, because he recognized that he had a darn good deal going for himself and for his family? Isn't that a fair impression to be drawn?

A. That is a fair conclusion that others must draw. And in fairness to him, if, in fact, such inferences may be drawn, he will have to

answer to that.

CHAIRMAN ZAZZALI: Don't worry about that. What inferences do you draw?

A. I can't specifically reach any specifics.

CHAIRMAN ZAZZALI: You have no idea, Mr. Reisner?

A. I do not.

In his testimony, Assistant Executive Director Hasbrouck said it was his decision in 1988 to have Farrelly sell vehicles for NJT. He said that with the anticipated glut of used buses coming on the market, the agency was trying to get top dollar when the buses became 12 years old. He said he and others at NJT felt that sales outright by Farrelly would bring more than sales at auction. Hasbrouck said he assumed that Jack Rossiter, who worked for him under Reisner, would have taken care of drawing up a written agreement with Farrelly. Rossiter, who is not an attorney and has a limited education, testified that he received no such instruction.

III

INTER-COUNTY TRANSIT

In March, 1980, Howard Farrelly created an entity called Inter-County Transit, Inc. It was formed five months after Monmouth Bus Lines and in the same year as New Jersey Transit. The Commission questioned the purpose of this company early in the investigation.

Thomas Casiero, the estranged husband of Kelly Farrelly Casiero, testified that when he worked at Monmouth Bus, he was aware that Howard Farrelly kept a second set of books. Based on that testimony as well as information from other sources, this Commission has concluded that the records of Inter-County are Monmouth Bus's "second set of books" — books never audited by NJT. The corporation is a shell or paper entity Farrelly used to divert monies due to NJT. It is simply a checking account into which Farrelly deposited the proceeds from various questionable activities and from which he took funds, largely for the personal use of himself and his family.

Investigative Accountant Michael Czyzyk summarized the Commission's findings in his testimony:

... Inter-County Transit, Inc. was used to re-classify receipts that were obtained from the subsidized companies or [revenue] due to subsidized companies and they were diverted for his personal use. It was basically to divert and launder money.

In his written statement, Czyzyk noted that Farrelly used Inter-County "to siphon monies from the two subsidized bus companies ... by creating invoices for the sale of parts and supplies to the two

companies...."

Inter-County, which listed the same address as Monmouth Bus, had no physical assets, no employees, no inventory, no purchase invoices and no sales invoices. Yet when Farrelly needed to generate cash, records of his two bus companies reflected that parts and supplies were purchased from Inter-County. Such transactions, however, were totally fictitious.

As an example, Commission Special Agent Robert Diszler testified that invoices and billings of Middlesex Metro and Monmouth Bus showed that these companies bought transmissions or transmission parts from Inter-County on 25 occasions over a three-year period. However, Diszler compared these purchase records with daily defect cards filled out by the bus drivers after each shift and with quarterly maintenance reports filled out by mechanics and submitted to NJT. The defect cards indicated that during the three-year period Middlesex Metro replaced only three transmissions and one engine; Monmouth replaced but one transmission. The Commission concludes that the invoices and billings of 25 transmission repairs are among those fraudulent transactions billed by Inter-County to the Middlesex and Monmouth bus companies and reimbursed through subsidies from NJT. Proceeds from such "transactions" as well as from sales of various vehicles or parts were deposited into the accounts of Inter-County.

Another method by which Farrelly bilked NJT was to take vehicles which should have been sold for the agency, declare them worthless by falsifying an appraisal or not having an appraisal done, stripping them of useful parts and selling those parts to other bus companies or to private parties, including some

of his own employees. Farrelly even sold hulks of stripped buses to scrap dealers. These sales were not always reported to NJT but the proceeds were received either in cash or in checks made out to Inter-County or to other accounts controlled by Farrelly. Moreover, the cannibalizing of the vehicles was done at the Farrelly garages, the rent of which was paid by NJT, using bus company employees whose salaries were also subsidized by NJT. Senior Special Agent Hutchinson testified that Farrelly "ran what I would call a bus chop shop at the two subsidized facilities, using subsidized employees of that company." And the proceeds of that "chop shop" went to Howard Farrelly, frequently through Inter-County, Hutchinson testified.

James Keelen, owner of a small private bus company, testified at the public hearing that he had bought 20 or more used NJT buses from Howard Farrelly over the past three to five years. He said he learned through the grapevine that Farrelly had buses and parts for sale. Keelen said that before he heard of Farrelly he had tried to get information from NJT about sales of their used buses but received little help.

Keelen testified that he paid Farrelly an average of \$2,500 per bus but that the buses were actually worth between \$5,000 and \$10,000. He said whenever he bought buses, Farrelly instructed him to make checks payable to as many as three different entities in one day — Middlesex Metro, Monmouth Bus and Inter-County. Keelen said he was also instructed to make some checks payable to cash. Keelen testified that he also bought many new and used bus parts from Farrelly at prices well below what they would have commanded on a legitimate market.

Accountant Czyzyk testified that between January, 1987, and March, 1992, Inter-County records reflected receipts of \$179,890 from Monmouth Bus and Middlesex Metro for the purchase of parts, supplies and rent. Non-affiliated entities paid Inter-County \$396,866 for used buses and parts, all of

which were really the property of NJT; another \$33,660 came from several unidentified sources. A total of \$610,416 in various transactions went into the books of Inter-County Transit. Exhibit C-96 shows that between May, 1988, and March, 1992, Inter-County paid Middlesex Metro \$205,000 for the sale of buses, of which only \$201,862 was remitted to NJT. The remaining \$408,554 was funneled to Howard and Kerry Farrelly and their families and for other purposes.

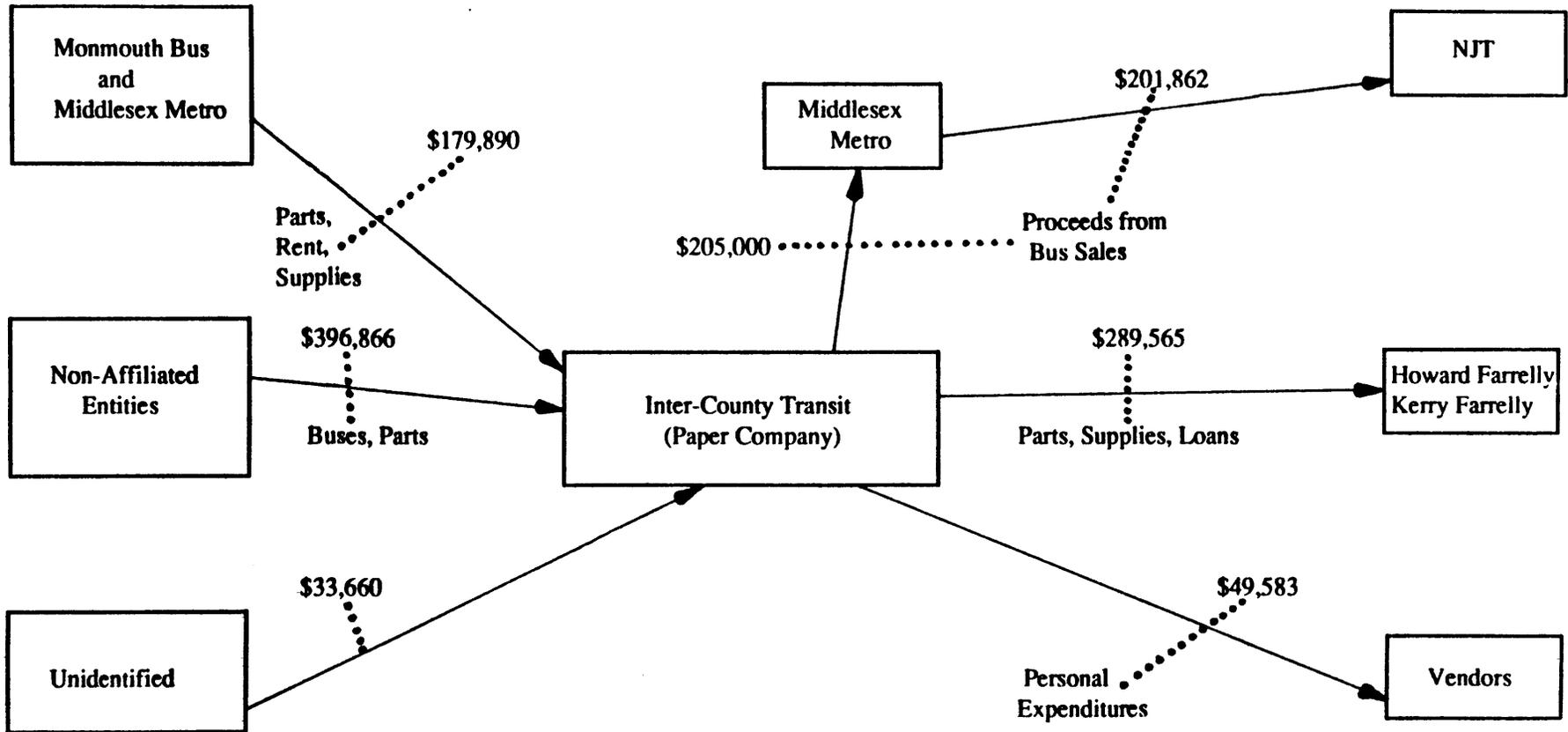
Although Farrelly invoked his Fifth Amendment privilege not to testify at the Commission's public hearing, his accountant represented to the Commission that NJT had instructed him to use Inter-County as a depository for the proceeds of all bus sales. However, all correspondence between Farrelly and NJT indicates that Middlesex Metro, not Inter-County, is the representative entity in the unwritten agreement.

Bus Contract Administrator Lisa DeGrace, a former NJT auditor, said that she was aware of Inter-County. She testified, "It is one of Howard's companies. It is the part or repair business, to my understanding." She said she did not know Inter-County was selling used NJT vehicles and also did not know where it got the engines, transmissions and other parts it was selling.

Farrelly even billed the rental of part of the garage at Monmouth Bus to NJT, claiming he leased it from Inter-County. Farrelly was therefore leasing to himself the same property already paid for once by NJT. The garage used by Middlesex Metro was co-owned by Farrelly and Sidney Kuchin, owner of Plainfield Transit, another subsidized bus company. All rent and capital improvements at both garages were paid for by NJT.

In May, 1990, a Middlesex Metro bus was involved in a major accident. The insurance carrier appraised the damage at \$21,143 and issued a check to Middlesex Metro to cover the damage, less the deductible amount from the insurance policy. After

INTER-COUNTY TRANSIT, INC. SOURCES AND APPLICATION OF FUNDS



16

Receipts
January 1987 to March 1992

Disbursements
May 1988 to March 1992



the check had been deposited, Middlesex Metro contracted with S & W Auto Body Inc., of South River to repair the bus. In August, 1990, Middlesex Metro paid S & W \$21,408. S & W then paid Inter-County \$15,000 that it claimed was the cost of parts needed to repair the bus. The \$15,000, however, was not recorded in Inter-County books as a sale of parts but rather as a repayment of loans to Kerry and Howard Farrelly. The Commission has concluded, based on documents, testimony and source informa-

tion, that the bus was actually repaired at Middlesex Metro by state subsidized employees, notwithstanding S & W owner Louis Wisniewski's insistence that his company did the work. The Commission has found other instances in which Middlesex Metro contracted with S & W Auto Body to perform repairs to vehicles, with parts from the bus company inventory being similarly "purchased" from Inter-County.

IV THE AUDITORS

One of NJT's greatest breakdowns was the failure of its auditing staff to perform certain basic fundamental procedures that should have found some of the fraud alleged in several anonymous communications. Indeed, Commission Assistant Director Helen K. Gardiner, a Certified Public Accountant and former investigative accountant, testified that the NJT auditors "failed to meet at least six generally accepted auditing standards."

Generally accepted auditing standards are recognized by all professional auditors. They are measures of quality, and concern judgment in the way an auditor conducts the audit and performs auditing procedures. These standards include such things as obtaining enough evidence to support the audit conclusions, and appropriate planning and supervision of the audit.

Gardiner said that she reviewed the NJT audits for the fiscal years which ended in 1989, 1990 and 1991 as well as the workpapers for those audits. She testified:

In my opinion, the audits were all deficient. The audit deficiencies led the auditors to draw conclusions which are not valid. The most serious deficiency was in the 1991 audit. That year the auditors had received an anonymous letter which described irregularities and management fraud at the bus companies. Even after receiving this letter full of such allegations, the auditors failed to take logical audit steps to address the allegations.

In addressing the issue of ghost employees, for instance, NJT auditors conducted a controlled pay-

out whereby each employee was required to produce a driver license or other form of identification and sign for his paycheck. Under this procedure, all those listed on the payroll would have to appear and identify themselves properly before they could be paid. However, at the end of the workday on which the payout was conducted, when the NJT auditors left for the day, they left behind the signature sheets and paychecks with bus company officials, the very people under investigation for payroll padding. As a result, the auditors were unable to verify the identities or the signatures of those "employees" who signed for their checks after the auditors had left. In fact, Elizabeth Silk Farrelly and Margaret Farrelly testified that what purported to be their signatures on the payout sheets were forgeries.

Gardiner testified that the 1991 payroll audit was "the worst example of audit deficiency."

The idea here is for the auditor to get all the paychecks and distribute them to the payees, seeing and documenting the identification of the worker who is getting the check. Since the anonymous letter said that some people, including family members, were paid but didn't work, this was an especially important audit procedure that year....

The audit work papers for the Monmouth Bus audit didn't even list the names of the employees. Literally, all they did was to get some 23 employees to sign their names on a piece of paper. There was no control over this procedure.... The whole purpose of the payout was defeated.

The audit of Middlesex Metro listed 57 names,

but includes only 24 signatures. There is no explanation for the lack of signatures for the rest of the names..... In the audits I examined, at the very point where they should have tightened procedures because of the allegations, the NJT auditors, in fact, relaxed them.

Gardiner noted that payout audits conducted in the early 1980s properly listed the names of employees, signatures and driver license information.

NJT auditors admitted that in attempting to investigate 18 specific allegations in an anonymous letter of May, 1991, they compared checks and invoices but did not check with any vendors, even those companies that were specifically named in the letter, to verify invoices that could have reflected improper expenditures.

NJT Audit Director Michael Fucilli defended his staff's failure to substantiate the anonymous allegations:

This letter insinuates [that] within the company fraud is hidden. It is not documented on the company books. It is hidden there is a point where an auditor has a limitation. We are not policemen. We do not have subpoena rights. I cannot grant a person immunity. As an auditor walking into a vendor, and I was going to vendors of other fraud cases questioning vendors, the vendor would talk to me in my face and lie to me. And I have seen where an officer has questioned the same vendor and that person has admitted something different than they told me. A person is not going to incriminate themselves to the auditor....

However, Special Agent Diszler, discussing the "repairs" of transmissions, engines and other parts of buses, said, "Based on the invoices and billings, it appeared that Middlesex and Monmouth Bus were using a tremendous amount of transmissions and

engines. However, an examination of the defect cards and other evidence did not support any of these repairs." In other words, Diszler said, a simple paper check of the bus company records would have revealed many questionable transactions and purchases without even the need for interviews, a reasonable step given the allegations in the anonymous letter.

Commission Systems Analyst Klagholz testified about another scam devised by the Farrellys:

In some instances, [the Farrellys] generated invoices which appeared to be for goods or services provided to the bus company when, in fact, they were for home projects for the Farrellys. In other instances, invoices were generated for work that was never performed, and then in other instances, invoices represented personal items which were billed directly to the bus company.

In yet another scheme, a fuel supplier who supplied more than a half million dollars worth of fuel to both bus companies generated inflated invoices and kicked back part of the amount to Farrelly.

Commenting on NJT's review of some such invoices, Assistant Director Gardiner testified:

The auditors did not review enough invoices. Although they did statistical sampling, they used the wrong table and did not select enough disbursements. In 1991, they only reviewed 77 disbursements for one bus company and 78 disbursements for the other out of a total ... of about 1,000 disbursements for each company.

In a different audit, the auditors examined invoices which looked phony. They should have questioned them. The auditors also reviewed checks issued in payment of these invoices. These checks were deposited in the

bus company bank accounts.... They include deposits of checks payable to a construction company, to Inter-County Transit and to Howard Farrelly himself. They were clearly an indication that the expenses were not valid. This should have raised a red flag to the auditors. The auditors failed to maintain an attitude of professional skepticism. There were many other examples where the auditors should have recognized that something was wrong

For instance, not only did Howard Farrelly order his records destroyed after three years, he also destroyed bank deposit slips monthly for his two bus companies as well as for Inter-County. The deposit slips are especially important for auditors of a cash business like a bus company because they would have reflected the elements of each deposit, which would have included the amount of cash as well as a listing of individual checks with identifiers. But no NJT audit even mentioned the lack of deposit slips.

The Commission established that, with the audit trail thus destroyed, Farrelly used the bus companies' daily receipts to cash various checks, including some he received from the sale of parts or other items. Thus, the state's daily receipts were used to launder the ill-gotten gains of the Farrellys.

Systems Analyst Klagholz testified that checks totalling \$8,830 made payable to a construction company purported to be in Manahawkin were redeposited into bus company accounts. When Commission staff attempted to serve a subpoena on that construction company they found that it had left New Jersey approximately 10 years ago and moved to Florida. The owner of the company told Commission investigators in an interview that he had built a house for Howard Farrelly in 1979 and had done some construction work on one of his son's homes in early 1980 but had done no work in the state since 1980 or 1981. When shown the invoices on which the checks were based, he said his com-

pany had not used that letterhead in about 10 years. The invoices date from 1986 to the present. The invoices were obviously phony and the checks were simply another scheme to take cash out of the daily bus receipts.

Gardiner was also asked about a lack of follow-up by NJT auditors in subsequent years. She responded:

In the 1989 audit of Monmouth Bus, some concern had been raised about the lack of maintenance records for support service vehicles. An audit finding that year required Howard Farrelly to maintain records in subsequent years. Not only were no records maintained after that audit, but the subsequent auditor did not follow up on that finding.

Counsel Gaal asked NJT audit chief Fucilli about the allegations in the anonymous letter:

Q. These allegations, if they are true, are of a criminal nature, are they not?

A. Definitely.

Q. Is there any mechanism at NJT to refer such allegations if it was beyond your ability to investigate it—refer them, let's say, to the office of the Attorney General or the prosecutor's office?

A. Yes, I could have referred—I would have to. I did not because [those offices] were copied on [the anonymous] letter and I thought I would be contacted in the future if there was any interest

Fucilli also testified that NJT receives many anonymous letters and tips. "We chase down as many as we can. Again, we are not in the police department business. We do audits." Several days after the conclusion of the public hearing, Fucilli was dismissed by the NJT Board of Directors.

V

THE WHISTLEBLOWERS

This Commission learned that New Jersey Transit had received at least three anonymous warnings that there were problems with the Farrelly bus companies, but all the warnings were mishandled.

The first warning was a telephone call from an *Asbury Park Press* reporter asking about reports of financial misconduct at Monmouth Bus. The second warning was contained in a letter, found in NJT files by Commission agents, detailing at least 18 separate allegations of mismanagement or misapplication of state funds at the bus companies. The third warning came in a telephone call from a bus mechanic at Middlesex Metro who told the Commission that he spoke directly with Deputy Assistant Executive Director Reisner.

Another possible warning was an anonymous letter addressed to the State Department of Transportation dated September 27, 1991 (Exhibit C-78) from a person who signed the document "a concerned bystander." This correspondent wrote that he overheard conversations in the Ocean County Court House regarding misapplication of state subsidy monies at both bus companies. The conversations were apparently related to a divorce proceeding between Kelly Farrelly Casiero and her husband Thomas, which was referred to earlier in this report. A copy of that letter was sent to the Commission, resulting in this investigation. Whether the original was received by the Department and, if so, forwarded to NJT, could not be established.

The telephone call from the *Asbury Park Press* reporter, the first warning, came sometime in 1990. Notes found in NJT files (Exhibit C-38) showed that the reporter had received an anonymous telephone call alleging employee thefts, drug use by employ-

ees, padding of payroll and cannibalizing of buses on company time at Monmouth Bus. Assistant Executive Director Albert Hasbrouck, Reisner's supervisor, directed two members of his staff to gather information so NJT's public information officer could respond to the reporter. But the staff members were also directed to check with Howard Farrelly himself as to the accuracy of the allegations. In public hearing testimony before this Commission, Hasbrouck said he did not believe he forwarded the information to NJT's internal audit staff for investigation. In executive session two weeks earlier, Hasbrouck had no memory of the incident at all.

During the Commission's investigation, the staff found in NJT's files the second warning, a detailed letter (Exhibit C-37) received on May 15, 1991, alleging 18 separate instances of misapplication of subsidy money at both Monmouth Bus and Middlesex Metro. This letter was referred by NJT Executive Director Shirley DeLibero to Hasbrouck and to Reisner, who referred it immediately to Internal Audit Director Michael Fucilli. But Reisner also sent a copy to Howard Farrelly. Asked by Counsel Charlotte Gaal why he sent the letter to Farrelly, Reisner responded:

It was an automatic response. It was a complaint about the company. I was extremely concerned and I wanted to get his reaction.

Q. Well, this is more than just a complaint as I read it. [It contains] allegations of a criminal nature.

A. That is true. It is also an anonymous letter. It [was] the first such letter I ever received about his company. His company

NOTE: ORIGINAL LETTER IS HANDWRITTEN
RECEIVED BY THE SCI ON OCTOBER 9, 1991

Sept. 27, 1991

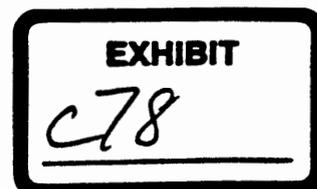
To N.J.D.O.T.,

Sitting in the Ocean County Courts this past week of 9/23/91 I overheard a very interesting statement made. I have investigated some and can supply some information to you.

A young lady had stated "A gift from my father from the bus companies." She was referring to \$20,000 as a gift. We are referring to Monmouth Bus Lines, Asbury Park and Middlesex Bus, East Brunswick. Both STATE subsidized companies. Owned by Howard Farrelly. I am referring to his daughter's statement. How can state money be a gift? Do you know she gets paid a salary by both companies, under KELLY FARRELLY and KELLY CASIERO? She doesn't work either one. From my investigating there are many people (family) on both payrolls that don't work there. Mr. Farrelly pays his housekeeper from the companies. All personal bills are paid by these companies. I ask you "IS THIS RIGHT? STATE MONEY?" His daughter received a total of \$45,000 from these companies, both of which are subsidized. This is the peoples money what gives them this right? They go to Atlantic City by limo almost every weekend, the TROP, TRUMP and Showboat are frequently visited. Brand new cars, diamonds, furs, big houses all are owned by them. Too extravagant alot of people feel.

The State is being stolen from. Are you going to do any thing? I will keep posted to it and I hope to see you do some investigating, because I will go further.

a concerned by-stander



N TRANSIT

Date _____

From the desk of

ALBERT R. HASBROUCK III

To LISA/SACK

Some reporter for the
Asbury Park Press called
and said they got a
call from "someone"
alleging the following at
Mount Pleasant bus

- ① employee thefts
- ② drug use by employees
- ③ padding of payroll
- ④ cannibalizing NY Buses
on company.

I want to tell sandy
check (7489) that

- ① ridership is up ↑
- ② revenue is up ↑
- ③ no complaints about service
- ④ Mount Pleasant has a random
drug testing program

EXHIBIT
C38a

N TRANSIT

Date _____

From the desk of
ALBERT R. HASBROUCK III

To _____

AND RESULTS DO NOT SHOW
WIDESPREAD USE OF DRUGS
④ THE LATEST AUDIT DID NOT
REVEAL ANY IRREGULARITIES
AT MUMMOUTH.

⑤ MY WORK THEY DO ON
MUMS IS DONE AT THE
REQUEST OF NTRANSIT
AND REVENUES RAISED
HELP TO REDUCE SUBSIDY
PAID TO MUMMOUTH.

ASCERTAIN IF ALL TRUE
FROM HOWARD + IF SO
TELL SANDY.

EXHIBIT
C386

An audit and an investigation by people other than state auditors, auditors that know how to see and realize a cover up, of the mis-use of Federal and State funds, should be initiated against Monmouth Bus Co, Asbury Park, N.J. and it's affiliate co. Middlesex Bus inc. E. Brunswick, N.J.

These subsidized operators are there to run these bus lines, not realize personal fortune from them. What is in it for us is their first concern, what monies can I get out, or spend through the Co's. Here is a partial list of how money is misused, for personal use, and is hidden in the books as used for Co. operations.

- 1-use of co. funds to buy house hold goods, soap power, window cleaner spray starch, toilet paper, paper towel and cups, top job, bleach etc, Shop Rite E. Brunswick N.J. and Neptune City N.J. \$1000's per yr for
- 2-bought tires from Monmouth Petroleum and had them killed as fuel 100's per year. Sold them to friends, employees, etc. pocket money paid.
- 3-sell co. fuel to employee's and friends. pocket money received, for fuel.
- 4-use of Exxon credit cards for family's personal use, plus vacation trips, paid through co's. expenses.
- 5-use of telephone credit cards for family's personal matters.
- 6-repair of personal cars and friends cars by S.T.S tire service E. Brunswick N.J. and billed to Bus co. cash to cover bill kept.
- 7-D'Amico Lincoln Mercury same thing.
- 8-Ford diagnostic center Asbury Park same thing.
- 9- Rt. 12 lumber, deck wood over \$1000. delivered to Toms River, N.J. for family members addition, to house. More than once
- 10-Bermans Paint E. Brunswick, N.J. paint bought for house addition,
- 11-paying of family members credit card bills, personal car ins. telephone and utility bills through the co's.

R. C. E. I. V. E. D

MAY 15 1990

OFFICE OF THE
EXECUTIVE DIRECTORSAD
ARH. BREIS

- 12- family members on two co. payrolls, and they do not work.
- 13- family members enrolled in IHA accounts even though they do not work but are on the payroll.
- 14- house maid paid through the co's.
- 15- parts bought from GMC, Flexible Corp. and Prevost sold to other bus co in the state, billed to their co's account, money for parts paid to them or their other co. Inter County Parts
- 16- repairs to other bus co. buses, American Jincusine, South River Bus Co., KIC Coach. Mills paid to owners, parts paid and labor paid out of bus co. accounts.
- 17- oil, anti freeze, transmission fluids co. stock sold to other bus co. 55gal drums at a time cash received fluids sold.
- 18- repair of 84 truck \$2000- , N.J.T was told it had to be junked sold to owners son, who intur. sold it for \$7000-

Multiply this over the years, these CO's have been in operation must be in the millions of dollars taken and misused, why is there a need to increase the transit budget? Just imagine this could be happening in over the other 20 or more sub sized BusCo. in the State of N.J.

c/c N.J.T.

- State Attorney General
- House Public Works & Transportation Washington, D.C.
- Newark Star Ledger
- Asbury Park Press



[had] run quality service and I was concerned and I took those two steps immediately.

Q. Did it occur [to you that] by discussing the matter and communicating the contents of the letter to Farrelly, who in essence would be the object of the investigation, you ran the risk of destruction of records, tampering with witnesses and so forth?

A. It did not occur.

Audit Director Fucilli testified that he was disturbed when he learned that Reisner had sent a copy of the letter to Farrelly. Fucilli said he expressed his strong concern to Reisner. But Reisner testified that he did not recall such a discussion.

Assistant Executive Director Hasbrouck, in his executive session testimony, conceded that he too might have sent a copy of the letter to Farrelly although he did not remember specifically. Hasbrouck also said he did not follow up with anyone regarding the allegations in the letter.

The third warning also came in May, 1991, when Middlesex Metro bus mechanic John Baumlin, who was the union shop steward, phoned Reisner with allegations about thefts at the company, employees' buying tools, parts and fuel from company stock, the sale of NJT subsidized bus parts to other garages, no-show employees on the payroll, work being done in the Middlesex garage on other companies' buses using Middlesex stock and Middlesex employees, and the Farrellys' pocketing payments for repairs. Baumlin testified that he went so far as to give Reisner the names of some of the ghost employees.

Baumlin testified that he did not identify himself by name initially nor did he wish to do so. But he said that Reisner pressed him, insisting that he could not act unless Baumlin was willing to come forward with evidence or information and that he could not act on a mere anonymous telephone call.

Although reluctant and fearing recrimination, Baumlin said he eventually gave Reisner his name. Baumlin also said that Reisner told him that he had had numerous such calls before and that none of those callers would give their name. Baumlin said that once he gave his name, Reisner promised him that his identity would be kept confidential.

When he went to work at Middlesex Metro the next day, however, someone "from the state" was already there meeting with Kerry Farrelly. After the meeting, which lasted the better part of the day, Baumlin said, Kerry confronted him, angrily asked him if he was "wired" and demanded to know what he had told "the state." Baumlin said Kerry knew he had spoken with Reisner because Kerry used Reisner's name.

Immediately following the confrontation, the shop supervisor demoted Baumlin from mechanic to head bus cleaner and threatened that if he stepped out of line he would be fired. And from that point on, Baumlin said, Kerry Farrelly and his other bosses harassed him and made his life miserable.

Baumlin also testified about a second call he made to Reisner, in May, 1992, in which he expressed concern about job security for employees at Middlesex Metro in light of this Commission's investigation. He said that in that call Reisner told him he remembered his call of a year earlier.

In the public hearing, Reisner was asked about these calls by Counsel Gaal:

Q. Do you remember his calling last year?

A. I have no specific recollection of that call.

Q. Do you recall the second call?

A. I do recall having recollection of that second call.

Q. You have no recollection of the first call?

A. I didn't say I have no recollection. I have no specific recollection.

COMMISSIONER KENNETH D. MERIN: What is the difference between "no recollection" and "no specific recollection"?

A. It is not unusual that such a call may have been received, but I have no specific recollection of a conversation with him.

Chairman Zazzali asked Reisner about the wisdom of his alerting Farrelly to the fact that Baumlin had called:

Q. Is it your understanding at this point in time, based on everything that you heard in two days [of public hearing testimony], that you or someone at New Jersey Transit blew the whistle on the whistleblower?

A. I wouldn't characterize it as that. To the contrary, on receipt of this May '91 letter, the first thing I did was to refer it and I took all steps that I thought I could. I didn't consider [the May 1992] call [as coming from a] whistleblower. The letter came a year before. There was an ongoing investigation which I was fully aware of and cooperating with and this was a call largely about job security.

CHAIRMAN ZAZZALI: Let's go back. Baumlin had two telephone calls with you. Pursuant to that, immediately he was threatened with his job the next day. I repeat the question. Isn't it fair to assume that someone, let's forget Reisner, that someone at New Jersey Transit blew the whistle on the whistleblower? Can't you agree to that?

A. I can't respond to that specific question. That was not the intent of my call that I made in May of '92, and if such a thing occurred, it was wrong.

CHAIRMAN ZAZZALI: Of course it was.

In response to questioning by Commissioner Barry H. Evenchick, Reisner conceded that, despite what he told Baumlin about needing to know his identity before he could investigate the allegations, he did nothing with the information except to pass it on to Farrelly.

Shortly after the July public hearing, Reisner took a paid leave of absence, which NJT characterized as voluntary, and subsequently resigned. Lisa DeGrace resigned in December, 1992.

VI BUREAUCRATIC FAILURES

Although this Commission found no instances of corruption or venality on the part of any New Jersey Transit executive or employee, the investigation of NJT's Bus Subsidy Program did reveal a situation symptomatic of the worse kind of bureaucratic inertia. It found managers who were not alert. It found auditors who, either because of their own incompetence or because they were discouraged from doing so, failed to ask the most basic questions in searching out fraud. It found docile administrators who received communications regarding potential fraud on the part of one carrier but, instead of exerting increased oversight, conducted business as usual and, even worse, alerted the carrier. Seemingly everyone ignored warning flags that were raised on several occasions. The Commission must ask the obvious question: Was anyone minding the store?

Albert Hasbrouck, Ronald Reisner and Lisa DeGrace all testified that for four years they were unaware Howard Farrelly was selling support vehicles such as automobiles and trucks. Yet Jack Rossiter, the retired NJT official who reported to Hasbrouck through Reisner, testified that at least DeGrace and Reisner *had* to have known Farrelly was selling such vehicles because they received the annual submissions and checks from Farrelly, unless they were not even reading the reports.

One exchange between Rossiter and Counsel Gaal at the public hearing is illuminating:

GAAL: Did [Reisner] know that cars were being sold by Howard [Farrelly]?

ROSSITER: Of course he did.

GAAL: Why do you say "of course?"

ROSSITER: Because he was there.

GAAL: Every day?

ROSSITER: Every day.

GAAL: Any question in your mind about that?

ROSSITER: Unless he slept, he couldn't have slept all them years.

Rossiter also testified that when he worked for Reisner, the two had specific discussions about some of the vehicles Farrelly was selling. Moreover, Reisner or Hasbrouck actually signed the titles and turned them over to Farrelly whenever he sold a vehicle.

The Commission finds it curious that Reisner denied any recollection of a conversation between himself and Michael Fucilli, the agency's chief auditor, in which Fucilli said he chastised Reisner for sending Farrelly a copy of the anonymous letter alleging improprieties at his bus companies. Reisner said he also had no recollection of the first telephone call from John Baumlin, the bus mechanic from Middlesex Metro, who alerted Reisner in 1990 to the same kinds of conduct. Either Reisner's memory or his candor is suspect.

Rossiter testified that when his brother-in-law wanted a new truck, Rossiter called Farrelly and told him he was sending someone over for this purpose; in testimony, he denied that he told Farrelly the person was his brother-in-law. Yet Farrelly simply

gave a vehicle, worth \$7,550 wholesale, to the brother-in-law. If Rossiter's testimony is truthful, Farrelly gave a vehicle to a mere acquaintance of Rossiter. If Rossiter lied, Farrelly gave a thing of value to the relative of a state official responsible for regulating his business. The question of Rossiter's truthfulness aside, the Commission believes that this one act by Farrelly is a significant indication that something was seriously amiss in the regulatory atmosphere at the Department of Private Carrier Affairs.

* * *

Although Ronald Reisner, as the direct supervisor of the Department, had day-to-day responsibility for oversight of the Bus Subsidy Program and other assistance to private bus carriers, his immediate supervisor, Assistant Executive Director Albert Hasbrouck, must share the responsibility for not minding that store.

Hasbrouck testified that it was he who designated Farrelly in 1988 as the agent to sell used NJT buses in order to, as he put it, "maximize the revenues" for NJT. And he said he insisted that each vehicle be appraised before sale so that the agency would get a fair price. Yet Hasbrouck, an attorney who had been an assistant county prosecutor and a deputy attorney general, admitted that:

- *There was no written contract with Farrelly regarding the sale of more than 200 used NJT vehicles.* Hasbrouck testified that he "assumed" that Jack Rossiter would have taken care of such details including the preparation of a contract. But Rossiter, who retired in December, 1990, denied receiving any such instruction.

- *The issue of payment for Farrelly's services "never came up."* Hasbrouck said if the issue had arisen, "I would have agreed to pay him something, just like we pay auctioneers." Later, he said Farrelly "didn't ask [for payment] so I anticipated that he wouldn't be [paid.]" At best, Hasbrouck had to be

terribly naive to believe that Farrelly was performing this service free of charge.

- *NJT did not have its own records of which vehicles Farrelly sold but had only those documents sent in by Farrelly himself.* Hasbrouck conceded there should have been such records, but offered no reason why it never occurred to him to address the issue before the Commission raised it.

- *Hasbrouck did not know that Farrelly was selling vehicles other than buses.* And he could not identify who at NJT had authorized this or give a reason why Reisner and Lisa DeGrace knew nothing about it.

- *Hasbrouck did not follow up with the agency's auditors or anyone else to determine the validity of accusations contained in anonymous communications alleging diversion of subsidy monies at the Farrelly companies.* In another profession of almost incredible naivete, he said he assumed that if there was anything of substance to the allegations, the auditors would have picked it up in the normal course of their work.

- *Although he "might have" sent Farrelly a copy of one anonymous letter, Hasbrouck did not specifically remember doing so.* Further displaying a lack of sophistication inconsistent with his training, experience and level of responsibility, Hasbrouck testified that he had been dealing with Farrelly for years, saying, "...before all of this, our relationship ... could only be characterized as a good one. He provided quality service, and whenever we needed his help, he was always there for us...." Hasbrouck also said:

I'll tell you why I did it, if I did. I had done business with Mr. Farrelly for a number of years. I did trust him. I thought he was sharp enough to know that this kind of stuff would endanger our relationship and that couldn't possibly be in his best interest or his family's best interest, and that he couldn't

have been involved, and that if it was going on, he could have stopped it.

- *Hasbrouck knew that Farrelly was retaining the proceeds of vehicle sales for months before remitting them to NJT but claimed he believed that Farrelly paid interest on the funds.* Hasbrouck did not articulate the basis for his “belief,” and the Commission’s investigation determined that Farrelly was depositing the proceeds of vehicle sales into interest bearing accounts of Inter-County Transit, keeping the interest for himself. The only interest he paid NJT was for the short period of a month or two when he transferred funds from Inter-County to Middlesex Metro preparatory to remit-

ting them to NJT. Moreover, Hasbrouck testified that it was a fairly deliberate decision not to collect these funds from Farrelly until after the end of each fiscal year in order to conceal them from NJT fiscal staff. He did this, he said, to avoid his department’s losing the funds to another department within the agency.

- *Although Hasbrouck claimed to have insisted that Farrelly obtain appraisals on vehicles before selling them, of more than 200 vehicles sold, appraisals were obtained for only 131.* Farrelly was able to substantially ignore the asserted appraisal requirement because Hasbrouck neither followed-up on the matter personally nor directed anyone else to do so.

RECOMMENDATIONS

Shortly before this report was completed, New Jersey Transit, at the request of this Commission, provided a summary of action it has taken since the public hearing to remedy the problems found during the investigation. The agency's response is reprinted here verbatim.

NJ TRANSIT SUMMARY OF MAJOR PRIVATE CARRIER ACTIVITIES

August, 1992 through February, 1993

- Terminated all contractual relationships with:
— Monmouth Bus Lines, Inc.
— Middlesex Metro, Inc.
- Entered into two short term operating agreements (90 days) for the operation of Monmouth County service (Jersey Shore Transportation) and Middlesex County service (Suburban Management Corp.) to facilitate the termination of contractual relations with Monmouth Bus Lines, Inc. and Middlesex Metro, Inc.
- Terminated employment of the Director of Internal Audit [Michael Fucilli].
- As directed by the Audit Committee of the Board, Coopers and Lybrand (a major independent accounting firm) conducted a review of the Internal Audit Department's procedures, organizational structure and staff skill levels and a new Auditor General was hired to head the Internal Audit Department.
- As directed by Executive Director and led by

the Chief Financial Officer, an internal investigation of the Private Carrier Affairs group was completed and reported to the Board of Directors.

- Accepted resignation of Senior Director of Private Carrier Affairs [Ronald Reisner].
- Reduced the responsibilities of the AED - Corporate Affairs [Albert Hasbrouck*].
- The Private Carrier Affairs group was placed under the direction of the Deputy Chief Financial Officer with reporting responsibility directly to the Executive Director. Weekly status reporting was instituted by the Executive Director.
- Revised the Request for Proposal (RFP) documentation and RFP evaluation process to ensure that the only carriers considered for award of competitively bid contracts are the carriers meeting minimum technical qualification requirements.
- Implemented an RFP evaluation process that utilizes staff expertise in Scheduling and Planning, Maintenance and Quality Assurance, Finance, Operations and MBE/WBE [Minority Business Enterprise/Women Business Enterprise].
- Developed maintenance standards and NJ TRANSIT quality control program, including periodic site reviews by NJ TRANSIT Quality Assurance inspectors.

*Hasbrouck is no longer an Assistant Executive Director and has been removed as a member of NJT's executive management team; he is now Senior Director of Corporate Affairs. Additionally, a quality control unit which formerly reported to Hasbrouck has been disbanded and its functions redistributed within the agency.

- *Revised the revenue collection process to assure tighter control over NJ TRANSIT revenue and timely deposit of funds.*

- *Revised contract terms to clarify contractors' responsibilities and NJ TRANSIT compliance oversight.*

- *Identified incomplete compliance documentation (i.e., evidence of insurance, vehicle registration, etc.) and obtained sufficient documentation or reclaimed the vehicle.*

- *As of January 2, 1993, the Bus Subsidy Program has been eliminated. Entered into contractual relationship based on fixed price competitive proposals for the following service areas:*

- *Monmouth County (TCT Transit Services)*
- *Plainfield & Middlesex County (Central Jersey Transit)*
- *Warren County (Delaware River Coaches)*
- *Salem County (Salem County Community Transit)*

- *Instituted regular Private Carrier Advisory Committee meetings between the Executive Director, NJ TRANSIT staff and private carriers.*

- *Implemented a Bus retirement program which requires the return of all buses to NJ TRANSIT for auction.*

- *Implemented PCCIP equipment retirement program which requires the return of all non-revenue vehicles and/or equipment to NJ TRANSIT for auction.*

- *Initiated an annual bus, non-revenue vehicle and equipment certification process which requires an executive of the carrier to certify to the continued use and existence of all assets provided through NJ TRANSIT programs and provides a basis for site examinations.*

- *After applying the new NJ TRANSIT maintenance and quality standards and providing a reasonable period for correction, terminated the contract for service with County Bus Lines, Inc. in Bergen County.*

- *Instituted a review of the PCCIP for the purpose of combining the PCCIP with the Bus Allocation Program to simplify both programs and to closely tie the federal funds received for the private carrier Section 15 statistics to the benefits they get from NJ TRANSIT.*

- *Began an investigation into the Elderly & Handicapped (E&H) program for the purpose of verifying amounts paid to private carriers and relating this figure to the current number of E&H passengers they are carrying.*

- *Assumed responsibility for the continued operations of certain Hudson County local and interstate routes operated by Hudson Bus Company and/or affiliates due to their petition to the DOT to discontinue service. Conducted an RFP process and will select a carrier to operate service under a three year contract.*

In the opinion of the Commission, NJT has moved aggressively to correct its problems and even anticipated most of the Commission's potential recommendations.

Several other problems remain to be addressed. The most significant is the manner in which NJT's Department of Private Carrier Affairs dealt with the three anonymous warnings of irregularities at the Farrelly bus companies. In his testimony, Assistant Executive Director Hasbrouck admitted that there was no established procedure for dealing with allegations of misconduct, anonymous or otherwise, that might be received by the agency. The Commission believes that, in the absence of such procedures, simply forwarding complaining letters to internal auditors, whether competent or not, is clearly insufficient. And forwarding or reporting the allegations

to their subject is absolutely intolerable.

Moreover, as noted earlier in this report, the letter that prompted this Commission's investigation was a copy of one purported to have been sent to the Department of Transportation, the Attorney General and elsewhere. While the Commission could not establish whether those other copies were in fact sent or received, it is important to emphasize that any agency of government receiving allegations of criminality has an obligation to bring them to the attention of law enforcement officials. Key officials in all state agencies must be made aware of these obligations.

Such notification would not necessarily preclude internal audits or other investigative steps, especially in a department such as Transportation, which is the only agency of state government having an inspector general at this time. The point is that serious allegations must be pursued seriously. Contrary to the professed belief of at least some NJT officials, anonymous allegations are not necessarily less worthy of attention than those made by someone who signs his name.

In this connection, the Commission repeats the recommendation made in its 1992 report on Local Government Corruption regarding creation of inspectors general in certain departments of state government:

Offices of Inspector General (IG) should be created by statute in departments responsible for the distribution and oversight of large amounts of public funds which are expended at the local level. The Commission agrees with Attorney General Robert Del Tufo's call for the statutory creation of such offices in six departments: Education, Human Services, Transportation, Community Affairs, Treasury and Health. Presently, the Department of Transportation has

an Inspector General appointed by and responsible solely to the Commissioner of Transportation.

Each IG should have a measure of independence and report to the Attorney General, as well as the relevant department head. This would facilitate the referral of criminal matters for prosecution. The implementing legislation should mandate the selection of IGs without regard for political affiliation. They should also be qualified by education, experience and professional certification in the fields of accounting, auditing, financial analysis, law, management, analysis, public administration, investigation or criminal justice administration.

Implementation of this recommendation would be a major step in preventing the kind of fraud that occurred in this case.

On another matter, this Commission believes that NJT and other state agencies that finance capital assistance as part of a government contract should recoup some of their investment in the event of cancellation of such contracts. In this case, NJT has a beneficial interest in all of the equipment at Farrelly's two bus companies and has also paid for improvements to the two garages used by the companies. In addition to obtaining title to all its equipment NJT should also attempt to recover the value of those improvements.

* * *

Before its public hearing, the Commission referred the information gathered during its investigation to the Attorney General for consideration of possible criminal charges.

CONCLUSION

The Commission believes that its investigation of NJT's Bus Subsidy Program has revealed an aberration in what is an otherwise well-run organization. That such an aberration could exist there, however, should serve as a warning to executives in

all public and quasi-public entities. The warning is that bureaucratic complacency can invite fraud and abuse. Managers at all levels of government should take careful heed.

* * *

This investigation was directed by Commission Counsel Charlotte K. Gaal and was conducted by Senior Special Agent Richard J. Hutchinson, Investigative Accountant Michael R. Czyzyk, Special Agents Robert Diszler, Dennis McGuigan and William P. Rooney, Assistant Director Helen K. Gardiner and Systems Analyst Christine F. Klagholz.

