A REPORT BY THE NEW YORK STATE OFFICE OF THE STATE COMPTROLLER

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COMPTROLLER

HOUSING FINANCE AGENCY STATE OF NEW YORK MORTGAGE AGENCY AND AFFILIATED AGENCIES AND CORPORATIONS

INTERNAL CONTROLS OVER FINANCIAL OPERATIONS

2004-S-9

DIVISION OF STATE SERVICES

Alan G. Hevesi
COMPTROLLER

Report 2004-S-9

Mr. Stephen J. Hunt
President and Chief Executive Officer
Housing Finance Agency
State of New York Mortgage Agency
641 Lexington Avenue
New York, NY 10022

Dear Mr. Hunt:

The following is our audit report addressing internal controls over financial operations at the New York State Housing Finance Agency, the State of New York Mortgage Agency, and affiliated agencies and corporations (i.e., the New York State Affordable Housing Corporation, the New York State Project Finance Agency, the State of New York Municipal Bond Bank Agency, and the New York State Tobacco Settlement Financing Corporation).

This audit was performed pursuant to the State Comptroller's authority as set forth in Article X, Section 5 of the State Constitution; and Article II, Section 8 of the State Finance Law. Major contributors to this report are listed in Appendix A.

Office of the State Comptroller
Division of State Services

March 3, 2005

EXECUTIVE SUMMARY

HOUSING FINANCE AGENCY

STATE OF NEW YORK MORTGAGE AGENCY AND AFFILIATED AGENCIES AND CORPORATIONS

INTERNAL CONTROLS OVER FINANCIAL OPERATIONS

SCOPE OF AUDIT

The New York State Housing Finance Agency (HFA) and the State of New York Mortgage Agency (SONYMA) are public benefit corporations created to support housing and homeownership programs. Both HFA and SONYMA issue bonds to finance their operations. HFA and SONYMA also provide staff and administrative support to three other bond-issuing agencies that have no staff of their own: the New York State Project Finance Agency (which provides long-term financing to economic development projects), the State of New York Municipal Bond Bank Agency (which provides financing to municipalities), and the New York State Tobacco Settlement Financing Corporation (which receives and distributes New York State's share of the funds provided through the multi-state settlement with tobacco companies). In addition, a sixth agency, the New York State Affordable Housing Corporation, is a subsidiary of HFA, and often works closely with SONYMA.

While these six agencies sometimes function independently of one another, they are closely interrelated in many ways. For example, all six agencies are overseen by a single President and Chief Executive Officer, and all six agencies share a single Finance Office. The six agencies also share some of the same employees, as the time of these staff may be allocated among the agencies. For the most part, our audit addressed areas of operation that relate to all six agencies; consequently, we generally refer to the Agency (meaning all six agencies). Our audit addressed the following question about the Agency's systems of internal control over financial operations for the period January 1, 2003 through March 31, 2004:

- Have adequate systems of internal control been established over basic financial operations?

AUDIT OBSERVATIONS AND CONCLUSIONS

We found that, on balance, adequate systems of internal control have been established over the Agency's basic financial operations. However, improvements are needed in certain specific controls.

We determined that an appropriate control environment has been established and maintained at the Agency. Each quarter, department heads are required to certify to the adequacy of the internal controls in their departments, and each year they must perform formal risk assessments to determine whether controls need to be strengthened in any way. The Agency has also developed written policies and procedures, and established appropriate control activities, in a number of financial areas. For example, project revenues are reconciled monthly to bank statements, purchases are monitored by an automated tracking system, administrative expenses are regularly compared against approved budget levels, and backup and disaster recovery procedures have been established for the Agency's computer systems.

However, improvements are needed in employee time and attendance controls, certain purchasing controls, documentation of contract award practices, equipment inventory controls, various aspects of corporate governance, certain financial reporting practices, certain controls relating to the debt-issuance process, and revenue collection practices. For example, certain types of contracts are not included in a required annual report that is supposed to list and describe the Agency's contracts, and written policies and procedures have not been developed for the process that is used in setting salaries for more than 30 Agency executives and managers not covered by collective bargaining agreements. In addition, we were unable to determine whether 8 of the 15 contracts we reviewed met the Agency's contractor selection requirements, because the documentation provided by the Agency contained insufficient information.

COMMENTS OF AGENCY OFFICIALS

A draft copy of this report was provided to Agency officials for their review and comment. Their comments have been considered in preparing this report and are included as Appendix B. Agency officials generally agreed with our recommendations, initiated a number of improvements during the course of our audit, and indicated that other improvements are planned.

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INTRODUCTION

Background

The New York State Housing Finance Agency (HFA) and the State of New York Mortgage Agency (SONYMA) are public benefit corporations that were created to support housing and homeownership programs. Both HFA and SONYMA issue bonds to finance their operations. HFA and SONYMA also provide staff and administrative support to three other bond-issuing agencies that have no staff of their own (the New York State Project Finance Agency, and the State of New York Municipal Bond Bank Agency and its subsidiary, the New York State Tobacco Settlement Financing Corporation). In addition, a sixth agency, the New York State Affordable Housing Corporation, is a subsidiary of HFA, and often works closely with SONYMA.

While these six agencies sometimes function independently of one another, they are closely interrelated in many ways. For example, all six agencies are overseen by a single President and Chief Executive Officer, and all six agencies share a single Finance Office. The six agencies also share some of the same employees. A total of 212 individuals are employed by three agencies and the time of some of these staff are allocated among the other three agencies that do not have a payroll. At the same time, the six agencies have six separate Boards of Directors/Members (although the Board directors/members of subsidiary agencies are the same individuals), and separate programs and missions. In our examination of internal controls over financial operations at these six agencies, we sometimes address areas affecting all six agencies (such as procurement, which is processed through the shared Finance Office), and sometimes address areas that are specific to one agency (such as Board oversight). When we address areas affecting all six agencies, we refer to the Agency (meaning all six agencies); when we address areas that are specific to one agency, we refer to that agency by name.

HFA was created in 1960, under Article III of the Private Housing Finance Law, to finance low and moderate-income housing, municipal and not-for-profit health facilities, and community-related facilities; and to provide funds to repay the State for amounts advanced to finance the cost of various housing assistance programs. HFA participates in federal housing assistance programs, and administers the State's Housing Project Repair Program and Infrastructure Trust Fund Program. HFA finances most of its activities through the issuance of bonds. During the fiscal year ended October 31, 2003, HFA reported operating revenues of $227.3 million ($184.4 million from interest on loans) and operating expenses of $271.9 million, resulting in an operating loss of $44.6 million. The operating loss was due to a decline in operating revenues (due to a reduction in mortgage interest rates and a decrease in investment earnings) and to bad debt expense. HFA has 63 employees on its payroll, but some of these employees allocate their work time among all six agencies. HFA is governed by a seven-member Board.

SONYMA was created by statute in 1970 to provide affordable homeownership opportunities for low and moderate-income first-time homebuyers and other qualifying homebuyers, and to provide mortgage insurance for qualifying real property loans. For the fiscal year ended October 31, 2003, SONYMA reported operating income of $265.4 million ($210 million from interest and discounts earned on mortgages) and operating expenses of $302.7 million, resulting in an operating loss of $37.3 million. SONYMA also reported non-operating revenues of $101.6 million for this year. SONYMA has 108 employees on its payroll, but some of these employees allocate their work time among all six agencies. SONYMA is governed by a nine-member Board of Directors.

The New York State Affordable Housing Corporation (AHC), a subsidiary of HFA, was established pursuant to Section 45-b of the Private Housing Finance Law to administer the Affordable Home Ownership Development Program. The purpose of this program is to promote home ownership by persons of low and moderate income, and thereby foster the development, stabilization and preservation of neighborhoods and communities. AHC works with its parent agency, HFA, and SONYMA to increase homeownership opportunities. For the fiscal year ended March 31, 2003, AHC reported operating revenues of $27.9 million ($26.6 million from State appropriations) and operating expenses of $28 million, resulting in an operating loss of $140,720. AHC has 41 employees on its payroll, but some of these employees allocate their work time among all six agencies. AHC is governed by a seven-member Board. Its members consist of the members of the HFA Board.

The New York State Project Finance Agency (PFA) was created in 1975, as a single purpose agency to provide economic development projects with long-term financing that could not be provided by the New York State Urban Development Corporation (which now does business as the Empire State Development Corporation). For the year ended October 31, 2003, PFA reported operating revenues of $11.4 million and operating expenses of $4.2 million, resulting in an operating income of $7.2 million. PFA has no direct employees; staff are assigned to PFA when needed from HFA, SONYMA and AHC. PFA is governed by a seven-member Board.

The State of New York Municipal Bond Bank Agency (MBBA) is a corporate governmental agency, constituting a public benefit corporation created by the New York State Legislature in 1972. MBBA originally was created to provide municipalities with an alternative mechanism for selling general obligation bonds. Subsequently, pursuant to its enabling statute, as amended, funds raised by the issuance and sale of MBBA's revenue bonds have been provided to municipalities for various purposes. For the year ended October 31, 2003, MBBA reported operating revenues of $4.6 million and operating expenses of $5.7 million, resulting in an operating loss of $1.1 million. MBBA has no direct employees; staff are assigned to MBBA when needed from HFA, SONYMA and AHC. MBBA is governed by a seven-member Board of Directors.

The New York State Tobacco Settlement Financing Corporation (TSFC), a subsidiary of the MBBA, is a public benefit corporation created in 2003 by the TSFC Act. TSFC was created for the purposes of issuing bonds backed by the State's share of payments made pursuant to the Master Settlement Agreement (the settlement of all health-related claims with all states) with tobacco manufacturing companies. As of October 31, 2003, TSFC had one bond issuance of $2.3 billion in asset-backed revenue bonds. At that time, its total operating revenue was $15.9 million and its total operating expenses were $2.2 billion (primarily distributions to New York State). In December 2003, TSFC issued another $2.2 billion of bonds. TSFC has no direct employees; staff are assigned to TSFC when needed from HFA, SONYMA and AHC. TSFC is governed by a seven-member Board of Directors. Its members consist of the members of the MBBA Board of Directors.

Audit Scope, Objective and Methodology

We examined the systems of internal control over financial operations at the six agencies for the period January 1, 2003 through March 31, 2004. The objective of our performance audit was to determine whether adequate systems of internal control have been established over the following basic financial operations: revenue collection, cash disbursement, investment activities, payroll, procurement and contracting, equipment and asset management, financial reporting, accounting and information systems, debt issuance, corporate governance, and budgeting practices. To accomplish our objective, we interviewed Agency officials, and reviewed and analyzed Agency records and reports pertaining to the major financial management functions. We also tested the internal controls that have been established for these functions.

We conducted our audit in accordance with Generally Accepted Government Auditing Standards. Such standards require that we plan and perform our audit to adequately assess those procedures and operations included within the audit scope. Further, these standards require that we understand the Agency's internal control structure and compliance with those laws, rules and regulations that are relevant to the Agency's procedures and operations that are included in our audit scope. An audit includes examining, on a test basis, evidence supporting transactions recorded in the accounting and operating records and applying such other auditing procedures as we consider necessary in the circumstances. An audit also includes assessing the estimates, judgments and decisions made by management. We believe our audit provides a reasonable basis for our findings, conclusions and recommendations.

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

Response of Agency Officials to Audit

We provided a draft copy of this report to Agency officials for their review and comment. Agency officials generally agreed with our findings, and their comments have been considered in preparing this report. Where appropriate, we have made changes to our report to address information provided in the Agency's response. The Agency's complete response is included as Appendix B.

Within 90 days after the final release of this report, as required by Section 170 of the Executive Law, the President of the New York State Housing Finance Agency, State of New York Mortgage Agency, New York State Affordable Housing Corporation, New York State Project Finance Agency, State of New York Municipal Bond Bank Agency, and New York State Tobacco Settlement Financing Corporation shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons therefore.

EVALUATION OF INTERNAL CONTROL STRUCTURE

A well developed system of internal control contains the following five basic components: the control environment; communication; risk assessment; control activities; and monitoring systems. We evaluated each of these basic components of internal control structure as they relate to the Agency's financial operations. We determined that, on balance, each component of the structure is adequate.

However, improvements are needed in certain specific control activities, certain specific monitoring activities, certain aspects of the control environment, and certain communication practices. Additional details about these matters and specific recommendations for improvement are included in the subsequent two sections of this report: *Financial Functions with Significant Risks* and *Other Financial Functions*.

Control Environment

Control environment is the attitude toward internal control and control consciousness established and maintained by the management and the employees of an organization. It is a product of management's philosophy, style and supportive attitude, as well as the competence, ethical values, integrity, and morale of the organization's people. The organization structure and accountability relationships are key factors in the control environment. The control environment has a pervasive influence on all the decisions and activities of an organization. A positive control environment is the foundation for each of the other components of internal control, providing discipline and structure for the entire system. Management and employees must therefore establish and maintain an environment throughout the organization that sets a positive and supportive attitude toward internal control.

We found that Agency management has emphasized internal controls by requiring all department heads to perform Functional Vulnerability Assessments and related testing of their operations each year. Agency management ensures internal controls are adhered to by requiring quarterly certifications from the department heads. In addition, State agencies and public authorities must annually certify their compliance with important provisions of internal control to the New York State Division of the Budget in accordance with Budget Policy and Reporting Manual Item B-350. The Agency Internal Control Officer coordinates the Agency's certification efforts, and we determined that the Agency has complied with this requirement.

One of the major purposes of internal control is to promote compliance with laws, rules, regulations and management directives. Such compliance can be promoted through formal written policies and procedures. We determined that the Agency maintains appropriate formal written policies and procedures in the areas of cash and investments; procurement and contracting expenditures; payroll and human resources; budgeting and expenditure control; and accounting and information systems.

We conclude that an adequate control environment has been established and maintained by the Agency. However, as is described in detail later in this report, the Agency either has not adequately established, or has not effectively communicated, policies and procedures for some of its financial operations (e.g., debt issuance, revenue collection, and inventory and asset management). In addition, the control environment would be strengthened if improvements were made in certain aspects of corporate governance. These matters are discussed in detail later in this report.

Communication

Communication is the exchange of useful information between and among people and organizations to support decisions and coordinate activities. Within an organization, information should be communicated to management and other employees who need it in a form and within a time frame that helps them to carry out their responsibilities. Communication also takes place with outside parties such as customers, suppliers and regulators.

We found that adequate systems of communication have been established and maintained by the Agency. For example, the Boards of Directors/Members for the six agencies meet on a regular basis, almost monthly. There are also regularly-scheduled meetings held within the various departments, as well as informal daily interactions between staff and supervisors. In addition, the Agency's Internet site informs the public about the organization's activities and operations. However, as is described later in this report, certain communication practices need to be improved in the area of procurement and contracting, and certain financial reporting practices need to be improved.

Risk Assessment

Risks are events that threaten the accomplishment of objectives and can ultimately affect an organization's ability to accomplish its mission. Risk assessment is the process of identifying, evaluating and determining how to manage these events.

We found that an adequate system of risk assessment has been established and maintained by the Agency. The Agency assesses risk in each of 17 functional departments. The Functional Vulnerability Assessment is completed each year and is forwarded to the Agency's Internal Control Officer. The Functional Vulnerability Assessment is a self assessment by the departments. Each department head is responsible for performing some testing to ensure that the controls are in place and functioning as intended. In addition, the Agency's Internal Audit Unit, as part of its annual activities, reviews the Functional Vulnerability Assessments and related testing of controls.

Agency management also requires all departments to certify to their internal controls quarterly to attest that their departments are operating efficiently and adhering to the established systems of internal control. This quarterly certification is to be submitted to the Agency President, any exceptions are to be noted, and the exceptions are to be explained until they are resolved. We also note that internal controls are evaluated annually by the Agency's external auditors.

Control Activities

Control activities are tools, both manual and automated, that help prevent or reduce the risks that can impede accomplishment of the organization's objectives and mission.

For example, documentation should be maintained to substantiate decisions and transactions, and appropriate authorization should be required for certain kinds of decisions and transactions. There should also be verifications to ensure the completeness, accuracy, authenticity and validity of transactions and information. In addition, assets should be safeguarded to reduce the risk of unauthorized use or loss, and computer systems should have adequate backup and disaster recovery procedures to prevent or reduce the risks related to system failure, power loss or other potential threats to the system or its data.

We found that the Agency has established appropriate control activities in a number of financial areas. For example, each month project revenues are reconciled to bank statements, and all past due accounts are highlighted and reported. We also note that purchases require several authorizing signatures and are monitored by a tracking system; administrative expenses are regularly compared against their approved budget levels; controls have been established to monitor employee activity on computer systems and block inappropriate Internet usage; and adequate backup and disaster recovery procedures have been established for the Agency's computer systems. However, as is described later in this report, improvements are needed in certain control activities in various financial areas.

Monitoring

Monitoring is the review of an organization's activities and transactions to assess the quality of performance over time and to determine whether controls are effective. For example, ongoing monitoring includes regular supervisory activities, comparisons and reconciliations.

We found that, overall, an adequate system of monitoring has been established and maintained by the Agency. However, as is described later in this report, improvements are needed in the monitoring of time sheets and purchases.

FINANCIAL FUNCTIONS WITH SIGNIFICANT RISKS

As part of our evaluation of the Agency's systems of internal control over financial operations, we assessed the Agency's risks in each of its basic financial operations. This assessment indicated that, due to certain control weaknesses, there were significant risks in the following operations: payroll (time and attendance), procurement and contracting, equipment and asset management, corporate governance, and financial reporting. In our audit of these areas, we determined that improvements are needed in the maintenance and monitoring of employee time sheets, certain other time and attendance matters, certain purchasing controls, documentation of contract award practices, equipment inventory controls, various aspects of corporate governance, and certain financial reporting practices.

Time and Attendance

Employee Time Sheets

The Agency has formal policies and procedures regarding the preparation of employee time sheets. These policies and procedures are contained in the HFA employee handbook, the SONYMA personnel manual and employee union contracts. According to these policies and procedures, Agency employees must work a 7½-hour day that includes two paid 15-minute breaks (one in the morning and one in the afternoon) and an unpaid 30-minute lunch period. Agency employees are required to complete a biweekly time sheet, and record all time off work on the time sheet. The employees are to charge all time off work to the appropriate leave credits (i.e., vacation, personal or sick leave). The time sheet must be signed by the employee, approved by the employee's supervisor and forwarded to the Human Resource Department for processing. In signing the time sheet, the employee and the supervisor are attesting that the information on the time sheet is accurate.

Employees who are in Band V and below are required to show, on their time sheets, the hours they actually worked each day (i.e., time started working, time stopped working for lunch or leave, time returned from lunch or leave, and time stopped working). Employees who are in Band VI and above do not have to record these times; they report their time on an exception basis and are thus required only to record the number of hours of leave that are used on days that are not fully worked.

The Human Resource Department is responsible for reviewing each time sheet to ensure that it is complete and correct on the basis of the information included on the time sheet (e.g., if the work hours recorded by a Band V or below employee indicate that only 7 hours were worked on a particular day, the employee's leave credits should be charged for one-half hour on that day). The Human Resource Department is also responsible for calculating each employee's leave balances. Employees with a low leave balance should not receive a paycheck for a biweekly pay period unless a time sheet for that pay period has been processed by the Human Resource Department.

To determine whether employee paychecks were supported by properly completed time sheets that had been processed by the Human Resource Department, we selected a sample of 70 of the Agency's 212 employees and reviewed their time sheets for selected three-month periods. We randomly selected 50 of the 212 employees, and reviewed their time sheets for January through March 2004. We also randomly selected ten other employees and systematically selected ten other employees, and reviewed these 20 employees' time sheets for October through December 2003. Fifty of the 70 sampled employees were Band V and below, while 20 of the employees were Band VI and above.

We found that, for all 70 employees, the paychecks for the three-month periods were supported by time sheets that had been processed by the Human Resource Department. In no instance was a time sheet missing. However, for 17 of the 70 employees, at least one of the time sheets for the three-month period was not properly completed.

Following are some of the time sheet errors that we identified:

- In two instances, the work hours recorded on the time sheets of Band V or below employees indicated that the employees did not work a full day. In both instances, the employees did not charge leave credits for the time that was not worked. One employee did not charge 15 minutes taken off on the morning of January 14, 2004, and another employee did not charge 30 minutes taken off on January 30, 2004.

- The wrong type of leave credit was charged by the Human Resource Department when it updated two employees' leave accrual balances. For example, in one instance, the employee charged 7½ hours to personal leave on his timesheet, but the accrual report in the Human Resource Department indicated that the 7½ hours was charged to sick leave.

- Contrary to requirements, two Band V or below employees reported their time on an exception basis. They did not record their actual work hours each day on their time sheets.

- A Band VI or above employee appropriately charged 7½ hours of leave credits for an absence on January 2, 2004. However, the accrual report in the Human Resource Department indicated that only six hours had been charged to the employee's accruals for this absence. This same employee charged one hour of personal leave on January 14, 2004, but this hour of leave was not charged by the Human Resource Department when it updated the employee's accrual balances.

Agency officials agreed with our findings, and made the appropriate corrections.

We note that these errors should have been identified by the Human Resource Department, as a clerk in the Department is responsible for reviewing the time sheets for completeness and correctness, and the Department's Assistant Director is responsible for verifying the work of the clerk. Such supervisory review should be documented, but we found that the Assistant Director's review of the clerk's work was not documented. In the absence of such documentation, there is less assurance that the supervisory review is as thorough as it should be.

Agency officials stated that they intend to implement additional monitoring and verification procedures for the review of time sheets. They also stated that a permanent Human Resource

Assistant has been hired and will be able to assist in the process.

Work Hours

According to the HFA employee handbook, employees are required to take a meal break. However, on seven different dates in December 2003 and January 2004, a temporary Agency employee worked without taking a meal break. Agency officials discovered that this employee was failing to take a meal break, and took corrective action to stop the practice. However, during our review of purchasing, we determined that another temporary employee was working without taking a meal break.

Agency officials stated that temporary employees are always required to take a lunch break, but sometimes fail to take the break, even when they have been instructed to do so. We recommend that the Agency monitor temporary employees more closely to ensure that this requirement is being met.

In addition, according to Agency officials, certain SONYMA employees are allowed to work special flextime schedules in which they may (1) either start work one-half hour later or leave work one-half hour earlier than normal Agency hours, and (2) apply their two 15-minute breaks towards either the beginning or end of the work day. For example, one of the employees on this schedule works 8:00 a.m. to 3:30 p.m. each day, taking the two 15-minute breaks together at the end of the work day (from 3:30 to 4:00 each day).

According to Agency officials, this special type of work schedule can be used by ten long-term SONYMA employees. No other employees are authorized to work such a schedule. The officials stated that the ten employees are allowed this kind of flexibility because of a pre-existing agreement with the employees' union. However, the officials could not document this agreement, and we note that State employees are not permitted to apply their 15-minute breaks towards the beginning or end of the work day.

Moreover, in our review of time sheets for the 70 selected employees, we determined that two unauthorized employees were using this special flextime schedule. For example, one of the employees was working 9:00 a.m. to 4:30 p.m. each day, taking the two 15-minute breaks together at the end of the work day (from 4:30 to 5:00 each day). Agency officials stated these two employees were in fact authorized to use the schedule, but we note neither employee was included on the list of ten authorized SONYMA employees provided to us by the Agency.

We question the appropriateness of the special flextime schedule, and note that the Agency's Internal Audit Unit has also questioned the use of the schedule. We recommend that the schedule be discontinued if documentation cannot be found for the agreement authorizing the schedule. If such documentation can be found, and the use of 15-minute breaks at the beginning or the end of the work day is determined to be appropriate, we recommend that the Agency take action to ensure that the schedule is used only by those employees who are specifically authorized to do so.

Agency officials state that the elimination of the special flextime work schedule will be included in the upcoming collective bargaining negotiations.

Purchasing Practices

The Agency has general written guidelines (Procurement Guidelines) that govern the procurement of personal services and non-personal service items such as supplies, equipment, repair services and courier services. A purchase order process is to be used for the procurement of non-personal service items. According to Agency officials, written approval must be obtained from authorized individuals before a purchase order can be processed. This written approval must be documented on a formal purchase request. If a purchase request is approved, the Finance Office should ensure that budgeted funds are available for the requested item. If funds are available, an appropriate vendor should be sought through a competitive process.

The Agency's purchase order process, if followed, provides an appropriate system of internal control. However, the process is not described in detailed written procedures that can be provided to the staff who are responsible for following the process. In the absence of such detailed written procedures, there is less assurance the process will be followed. We recommend such procedures be developed and distributed to Agency staff.

To determine whether the Agency's purchase order process was in fact followed, we reviewed a sample of purchases that had been made by the Agency. During the period January 2, 2003 through April 12, 2004, the Agency processed a total of 1,079 purchase orders totaling $2,083,665. We selected 50 of these purchase orders, totaling $124,636, for review. Our selection of purchase orders was random, except for the fact that we excluded from selection any purchase orders relating to advertising services. We then judgmentally selected for review an additional seven high-dollar purchase orders for advertising services and other items. We thus reviewed a total of 57 purchase orders.

We reviewed the documentation (such as purchase request, vendor invoice and Agency voucher) relating to these 57 purchases, and found that three of the seven high-dollar purchases and 28 of the 50 randomly selected purchases did not fully comply with the Agency's purchase order process. In particular, prior approval was not obtained as required for many of the purchases. For example, for two of the high-dollar purchases and 21 of the other purchases, the good or service was received before the purchase request was approved. In addition, in 4 of the 57 sampled purchases, the purchase amount exceeded the amount in the budget of the department making the purchase. We also determined that, in 4 of the 57 purchases, the Agency's payment for the good or service was not timely (i.e., within 30 days of the receipt of the goods or services). We recommend that the Agency take action to improve its compliance with required purchasing procedures and ensure payments are made within 30 days.

To properly control and account for all of the Agency's purchases, all purchase orders are tracked by the Agency's automated Purchase Order System. However, we found purchase orders are not used to buy certain periodicals that are on standing order. Thus, these purchases are not tracked by the Purchase Order System, and as a result, are not subject to the same degree of control as other purchases. We recommend that these purchases be treated the same as other non-personal service purchases, and be tracked by the Purchase Order System.

Agency officials stated that they intend to clarify the procedures that are to be followed in the purchase order process, and more fully document purchase order transactions. The officials stated they believe the existing internal controls over purchases adequately ensure the integrity of the procurement process; however, they agree there is room for improvement and will review our audit findings and recommendations, and implement changes where appropriate.

Contracting Practices

The Agency's Procurement Guidelines describe the procedures that should be followed when contracts are awarded by the Agency. For example, the Guidelines describe the various methods that may be used to select contractors (e.g., competitive bid, request for proposal, competitive negotiations, sole source, emergency, pre-qualified slate). The Guidelines also include advertising requirements for contracts that are to be awarded on a competitive basis and describe the approvals that must be obtained in the contract award process (e.g., all contracts exceeding one year in duration and $50,000 in amount must be approved by the appropriate Board of Directors/Members).

To determine whether Agency contracts met the contractor selection requirements contained in the Procurement Guidelines, we reviewed the documentation relating to 15 of the 121 contracts listed in the Agency's most recent Annual Procurement Report (this report covered the six agency fiscal years ended in 2003). We judgmentally selected the 15 contracts from among the six agencies reviewed. These included various types of contracts as well as those related to debt service. The Annual Procurement Report, which is required by the Agency's Procurement Guidelines, is supposed to list all the Agency's active personal service contracts and all other active Agency contracts of more than $5,000.

On the basis of the contract documentation that was made available to us, we were able to determine that 7 of the 15 contracts met the contractor selection requirements contained in the Procurement Guidelines. While none of the seven contractors was the lowest bidder for its contract, the documentation that we reviewed indicated that all seven contractors were appropriately selected primarily on the basis of their experience and expertise.

We were unable to determine whether the remaining eight contracts met the contractor selection requirements contained in the Procurement Guidelines, because the documentation provided by the Agency was incomplete, irrelevant or contained insufficient information for such a determination. Two of these eight contracts were sole source contracts (i.e., in these two instances there was no competition, because the Agency believed only one vendor was capable of providing the services it required); however, no contemporaneous documentation was provided that justified the sole source method of selection. As of October 31, 2003, the Agency had spent a total of $1.4 million on these eight contracts, which provided legal services, financial services, recovery services, security services, and various types of consulting services.

In the absence of adequate supporting documentation, there is less assurance contracts are awarded in accordance with requirements. We note that contract award documentation is not maintained in a central location; rather, different types of documentation are maintained in different Agency departments.

Agency officials stated that they strive to maintain complete documentation on the selection and awarding of contracts, and were unable to provide complete supporting documentation for some contracts because these contracts were originally awarded prior to 1996. However, no documentation was provided by Agency officials substantiating that any of the contracts were originally awarded prior to 1996. Moreover, based on the information in the Agency's Annual Procurement Reports and the actual contracts themselves, none of the eight contracts was awarded prior to 1996 (according to this information, the oldest contract originated near the end of 1996).

Equipment Inventory Control

Organizations should perform periodic physical inventories of equipment, and reconcile these inventories with existing inventory records. Management can then resolve any discrepancies and the inventory records can be adjusted as necessary. The New York State Accounting System User Procedure Manual describes specific control procedures that can be used to ensure equipment is properly safeguarded and accounted for.

We examined the Agency's controls over equipment and found the Agency has not developed written policies and procedures for equipment control. There are no written guidelines indicating which equipment items should be inventoried (e.g., all items above a minimum value), how transfers of equipment within the Agency should be recorded, what steps should be taken when items are lost or stolen, or what steps should be taken when equipment must be disposed of. Agency officials stated they will use the New York State Accounting System User Procedure Manual as a guideline to establish written policies and procedures governing equipment and asset management.

In addition, while the Agency maintains equipment inventory records, the records do not contain all the information that should be included in such records (such as the value of the items, the date of acquisition, or the serial numbers for items with serial numbers). We also determined that inventory reports are not routinely prepared for management to review. In the absence of such oversight, equipment management practices are less likely to be effective.

To determine whether the Agency's inventory records were accurate and complete, we selected a sample of 45 items for verification. We selected 15 of the items from the inventory records and attempted to locate the items. We also selected 15 items during our physical observations and determined whether the items were recorded in the inventory records. We selected these 30 items judgmentally, focusing our attention on computer-related equipment and seeking items from each floor of the Agency's main office. In addition, we selected 15 recently purchased computers from purchasing records and determined whether the 15 computers were recorded in the inventory records.

We found that all 15 recently purchased computers and all 15 items selected during our observations were recorded in the inventory records. In addition, we were able to locate 14 of the 15 items selected from the inventory records. According to Agency officials, the item that could not be located was obsolete and most likely in storage.

During our observations, we noted that many relatively old, and potentially obsolete, computer-related items were stored in the Agency's computer room. We were told that these items had been in storage for approximately three years and that no equipment (including obsolete items) is deleted from the inventory, unless there is specific authorization to do so. Consequently, the current inventory list contains significant amounts of obsolete equipment items. We recommend Agency officials review these items and dispose of those that are obsolete or no longer needed and delete the items from the inventory records.

Corporate Governance

The six agencies are governed by their six respective Boards of Directors/Members and a single President. We found that improvements are needed in the process used by the Boards and the President in establishing salary levels for senior Agency officials. We also found that improvements are needed in certain other areas of corporate governance.

Compensation of Executives and Management Employees

The salaries of the President and certain other Agency executives (i.e., Senior Vice Presidents) are set by the Chairman of the HFA Board of Directors and the Chairman of the SONYMA Board of Directors, with input from the President. The salaries of approximately 30 management employees are set by the President, after consultation with each employee's supervisor. The salaries of the remaining Agency employees are governed by collective bargaining agreements.

Written policies and procedures govern the process that is used in setting the salaries of employees covered by collective bargaining agreements. However, no written policies and procedures have been developed by the Agency to govern the process that is used in setting the salaries of Agency executives and management employees not covered by collective bargaining agreements. We recommend the Agency develop such policies and procedures.

In addition, we question whether the salaries of Agency executives should be set by just three individuals (the President, the HFA Chairman, and the SONYMA Chairman) and the salaries of management employees set by just the President. We believe the entire Board of Directors/Members, for all six agencies, should be involved in this process. We note that a Board is intended to be a collaborative body, and other Board members have equal standing to the Chairmen. We also note that, during the 2003 fiscal year, 35 Agency executives and discretionary management employees had salaries of at least $100,000.

Agency officials noted that, according to the by-laws of the six agencies (which were last amended in 1993 for five of the six agencies), the President, the HFA Chairman and the SONYMA Chairman are authorized to set the salaries of Agency executives and discretionary management employees. Our review of the bylaws, reveal broad and general duties discussed and does not specifically address compensation. The officials stated that they will take under advisement whether to adopt a more fully documented compensation policy and whether to require the involvement of all Board members in the salary-setting process. The officials also stated that they are considering a number of revisions and refinements to the Agency's by-laws.

Use of Agency Vehicles and Credit Cards

During calendar year 2003, the Agency leased three vehicles. These vehicles were assigned to the President, the HFA Chairman, and the Agency's Chief Financial Officer. According to Agency officials, the vehicle assigned to the Chief Financial Officer was a pool car that was made available to Agency staff for business-related matters. The lease for the pool car was not renewed for 2004. However, the other two leases were renewed, and as of July 30, 2004, the two vehicles continued to be assigned to the President and the HFA Chairman.

According to Article III, Section 43, of the New York State Housing Finance Agency Act, "the [Board] members, including the chairman, shall serve without salary or other compensation, but each member, including the chairman, shall be entitled to reimbursement for actual and necessary expenses incurred in the performance of his or her official duties." Based upon this provision of the law, we question whether the HFA Chairman should be provided with an Agency vehicle. Agency officials stated that they will take this issue under advisement. They indicated that the Chairman has many Agency duties and responsibilities for which an Agency vehicle needs to be made readily available.

The New York State Accounting System User Procedure Manual states that agencies should maintain records of equipment utilization. We note that, during the period covered by our audit, the Agency had no detailed written procedures governing the use of its leased vehicles. In addition, the Agency maintains no usage log or other documentation to account for the use of its leased vehicles. As a result, there is no documentation indicating that the vehicles are used only for business purposes (such documentation is needed for income tax purposes). We recommend such documentation be maintained.

Agency officials stated that, as of June 15, 2004, they had developed a vehicle usage policy that codified and updated previous policy and directives. According to this policy, the vehicles assigned to the President and the HFA Chairman are subject to no restrictions in their use. In view of the language contained in Article III, Section 43, of the New York State Housing Finance Agency Act, which explicitly states that the Chairman "shall serve without salary or other compensation," we question whether the Chairman should be assigned a vehicle that can be used for personal, non-business purposes.

The President, the HFA Chairman and the President's Driver are each assigned a corporate credit card. The three credit cards are billed on one account. For the period January 1, 2003 through March 31, 2004, a total of $21,952 was billed on this account. To determine whether the account's expenses were related to Agency business, we examined the supporting documentation for two billing cycles of expenses, totaling $2,018. We found that the available documentation supported only $601 in expenses; the remaining $1,417 in expenses was not supported by any documentation. As a result, there is less assurance these expenses were related to Agency business.

According to the credit card bills, over half of the undocumented expenses included expenses for food and beverages.

In addition, as of July 2004, gasoline credit cards were assigned to the President's Driver and the Chief Financial Officer (for the pool vehicle). We question why the gasoline credit card for the pool vehicle was still active in July 2004, when the lease for the pool vehicle was terminated in December 2003.

We note that the Agency has not developed written policies and procedures governing the use of its credit cards. In the absence of such policies and procedures, there is less assurance the cards will be used only for business-related purposes. We recommend such policies and procedures be developed. Agency officials stated they will take the need for such policies and procedures into advisement.

Other Matters

The Agency is included among the public authorities that are subject to the New York State Public Authorities Law. Each year, these authorities are required to produce certain financial reports relating to their procurement and investment activities. According to Article 9 of the Public Authorities Law, each of these various financial reports must be approved by the authority's Board. However, we found that, during fiscal year 2003, the HFA and SONYMA Investment Report and Investment Guidelines were not approved by their respective Boards. In addition, the AHC and MBBA Investment Guidelines were not approved by their respective Boards.

We also found that a written Statement of Board Duties has not been developed for any of the agencies' Boards. In the absence of such guidelines, Board members may not always fully understand what is expected of them. We note that, between December 2002 and December 2003, an HFA Board member and an AHC Board member did not attend at least half the Board meetings held during that period.

Agency officials stated that they attempt to meet all requirements for financial reporting and Board approval. They also stated they believe Board members should attend Board meetings, but noted that scheduling conflicts sometimes occur. The officials further stated that they have formulated a series of recommendations aimed at creating a detailed, cogent statement of Board member responsibilities in the areas of corporate governance and financial management.

Financial Reporting

The Agency is required by Section 2879 of the Public Authorities Law to prepare an Annual Procurement Report. The Agency is also required by their Procurement Guidelines to prepare quarterly procurement reports, and to submit both the quarterly and annual reports to the appropriate Board for approval. This report is supposed to list all the Agency's active personal service contracts and all other active Agency contracts of more than $5,000.

We found that, during our audit period, the Agency prepared all the required procurement reports, and appropriately submitted these reports for Board approval. The following table summarizes the information in the procurement reports for the fiscal years ended in 2003 (AHC's fiscal year ends on March 31; the other five agencies' fiscal years end on October 31):

Agency	Number of Contracts	Amount Paid in Current Fiscal Year	Amount Paid Over Life of Contract
HFA	89	$8,385,807	$36,219,982
SONYMA	16	1,345,026	4,668,589
AHC	7	43,229	342,972
PFA	1	15,654	60,810
MBBA	3	65,552	95,126
TSFC	5	713,000	713,000
Total	121	$10,568,268	$42,100,479

As is shown in the above table, 121 contracts with a total cost of $42.1 million were included in the procurement reports. However, additional contracts, with a total cost of $49.9 million, were not included in the Agency's procurement reports for this period. These contracts related to the Agency's issuance of bonds in 2003 and are termed cost-of-issuance (COI) contracts. In these contracts, the Agency contracts with firms that provide underwriting services, legal (bond counsel) services, financial advisory services, rating agency services, printing services, and trustee services (the trustee, usually a bank, handles the proceeds from a bond issuance). The COI contracts were not included in the Agency's procurement reports for 2003, because it is the Agency's practice to exclude COI contracts (except bond counsel fees) from its procurement reports.

We believe COI contracts should be included in the quarterly and annual procurement reports. We note that COI contracts are not specifically excluded from the reports by the Public Authorities Law. We also believe the inclusion of COI contracts would provide better public accountability.

Agency officials note that most of the COI contract costs are reported to Board members and the Office of the State Comptroller through the Bond Sale Report and Procurement Contract Reports. The officials note that only a small portion of the bond issuance costs (relating to trustee and rating agency fees) is not reported. However, we note that neither the Bond Sale Report nor the Procurement Contract Reports contain complete individual COI contract costs. To provide full public accountability, the actual cost of each contract, and the name of each firm, should be reported. Agency officials stated that they would take our recommendation under advisement.

We also determined that improvements can be made in the reporting format of the Agency's procurement reports. The information in the reports is not presented in a portfolio summary of contract activity (i.e., total contracts awarded by year, contract amount, by department, etc.). As a result, the information may not be as useful and informative as it could be.

We further determined that the usefulness of the procurement reports could be enhanced if the Agency's definition of "active" contracts was expanded. At present, the Agency defines active contracts as those involving Agency payments during the year. However, a contract with no payments may still be utilized by the Agency, and it would be informative to include such contracts in the procurement reports.

Agency officials acknowledge that there may be opportunities for enhancing the content of the procurement reports without jeopardizing their statutory compliance, and indicate they will explore and develop such opportunities.

The Agency, like other public authorities, is required by the New York State Comptroller's Regulation on Accounting and Reporting for Public Authorities (2NYCRR, Part 201) to submit various financial reports to the Office of the State Comptroller within 90 days of the end of the Agency's fiscal year. The required financial reports include:

- Annual Report
- Financial Statements
- Annual Investment Report
- Annual Procurement Report and Guidelines
- Prompt Payment Policy and Report
- Auditors' Report on Investment

We found that, in both 2003 and 2004, the Agency was three to four months late in submitting the required financial reports. Agency officials indicated that the reports were submitted late because much of the required information was not available within the required time frames. Agency officials stated that they would try their best to provide the information as soon as it was available.

Recommendations

<u>Time and Attendance</u>

1. Take action to improve the Human Resource Department's review of time sheets and maintenance of employee accrual balances.

   (Agency officials indicate that they have appointed a permanent Human Resource Assistant to replace the temporary employee. They are confident that this employee will serve to reduce the error rate substantially. In addition, they indicated that they have implemented additional monitoring and verification procedures with respect to time sheet review and the maintenance of employee accrual balances.)

2. Monitor temporary employees more closely to ensure that they take meal breaks.

Recommendations (Cont'd)

(Agency officials indicate that the temporary employee cited in our report was instructed on numerous occasions by both her department head and representatives of Human Resources that she must take a lunch break. They added that it is and always has been their policy to require a one-half hour lunch break for all temporary employees.)

3. Discontinue the special flextime work schedule unless the union agreement authorizing the schedule can be documented. If the agreement can be documented, and the use of 15-minute breaks at the beginning or the end of the work day is determined to be appropriate, ensure that the schedule is used only by those employees who are specifically authorized to do so.

   (Agency officials indicate that to avoid a protracted and costly legal contest with the employees' union, the Agency elected to eliminate the practice with respect to the remaining employees in collective bargaining, rather than by unilateral implementation. Accordingly, elimination of the pre-existing flextime schedule has been included as a management demand in the collective bargaining negotiations which commenced on August 25, 2004.)

Purchasing Practices

4. Develop detailed written procedures for the purchase order process.

5. Take action to improve Agency compliance with the requirements of the purchase order process. In particular:

   - ensure that required prior approvals have been obtained and budgeted funds are available before purchase orders are processed, and

Recommendations (Cont'd)

- ensure that payments are made within 30 days of the receipt of the goods or services.

(Regarding Recommendations 4 and 5, the Agency is considering the appointment of a Contract Administrator who would have responsibility for overseeing the procurement process and for ensuring that complete and appropriate procedures are in place. In addition, although the Agency believes that the current purchase order control system adequately ensures the integrity of the goods, they will provide more detailed written procedures that can be utilized by the staff that are responsible for following the process.)

6. Track purchases of periodicals on the Agency Purchase Order System.

   (Agency officials indicate that they will take this recommendation under advisement.)

Contracting Practices

7. Fully document the contract award process for all contracts subject to the requirements contained in the Agency's Procurement Guidelines, and maintain this documentation on file.

   (Agency officials indicate that the required documentation was available when the approvals were sought and given. However, not all material for every contract has been retained over the years. To remedy this, the Agency's goal is to use improving technology and record-keeping programs to provide more ready, ongoing access to older and more voluminous records.)

Recommendations (Cont'd)

Equipment Inventory Control

8. Establish comprehensive written policies and procedures governing equipment and asset management.

9. Add appropriate details to the information in the inventory records, and periodically provide inventory reports to management.

   (Concerning Recommendations 8 and 9, Agency officials indicate that they are in the process of upgrading the inventory system. The specified replacement software will streamline the program and provide expanded detailed periodic reports. In addition, draft written policies and procedures are currently under review by senior management.)

10. Dispose of obsolete and unneeded computer-related equipment, and delete the items from the inventory records.

    (Agency officials indicate that the disposal of obsolete computer equipment is being addressed by the Information Technology Unit.)

Corporate Governance

11. Develop written policies and procedures for the process of setting salaries for Agency executives and other employees not covered by collective bargaining agreements. Require full Board involvement in this process.

    (Agency officials indicate that they are currently revising procedures to address greater Board involvement in this process.)

Recommendations (Cont'd)

12. Maintain a usage log to account for the miles driven with Agency vehicles.

    (Agency officials indicate that in accordance with their current vehicle usage policy, usage logs are not required for vehicles designated for "unrestricted use." During our audit period, both Agency vehicles had been designated for unrestricted use. Therefore, in accordance with the Agency's policy, no vehicle usage log was required to be maintained.)

    <u>Auditors' Comments</u> - The value of the personal use of Agency vehicles by Agency officials is subject to Income and Social Security/Medicare taxes and must be reported to the IRS every year. Although this reporting has been done, there is no supporting documentation to substantiate the personal mileage use reported. Maintenance of usage logs would provide this documentation.

13. Assign a vehicle to the HFA Chairman only if it can be shown that the assignment is not contrary to the language in Article III, Section 43, of the New York State Housing Finance Agency Act.

    (Agency officials believe the assigning of a vehicle to the HFA Chairman is not contrary to the HFA Act; however, they indicate that they are actively considering making the subject vehicle a pool car.)

14. Develop written policies and procedures governing the use of corporate and gasoline credit cards. Include provisions for eligibility, authorization, required documentation (e.g., receipts), personal use, limitations and restrictions.

Recommendations (Cont'd)

(Agency officials indicate that they have instituted written policies and procedures governing the use of corporate and gasoline credit cards.)

15. Ensure that all required reports and guidelines are reviewed and approved by the Agency Boards of Directors/Members.

    (Agency officials indicate that they will follow their adopted guidelines with respect to approval of required reports and guidelines.)

16. Develop a Statement of Board Duties for all the Agency Boards of Directors/Members.

    (Agency officials indicate that they recently formulated a series of recommendations in these areas. Implementation will require substantial reformation of the agencies' by-laws and statutory revisions.)

<u>Financial Reporting</u>

17. Include COI contracts in the Agency's quarterly and annual procurement reports. Report the actual cost of each COI contract and the name of the contracting firm.

    (Agency officials will change the procurement report to include more information.)

18. Revise the format of the procurement reports to make the information easier to understand, and include all contracts with activity, but not necessarily payments, for the reporting period.

    (Agency officials indicate that the current procurement contract reports are statutorily compliant. However, they agree that there are probably opportunities to refine and amplify the content of the reports, and they will endeavor to do so.)

Recommendations (Cont'd)

19. Ensure timely submission of the annual financial information required by the State Comptroller's Regulation on Accounting and Reporting for Public Authorities.

    (Agency officials indicate that some of the information being requested is not available because their external auditors are simultaneously preparing the year-end statements. They will continue to do their best to provide this information to the Comptroller's office as soon as it becomes available to them.)

OTHER FINANCIAL FUNCTIONS

As part of our evaluation of the Agency's systems of internal control over financial operations, we assessed the Agency's risks in each of its basic financial operations. This assessment indicated that there were areas in which the risks were not significant, mainly because the controls in these areas generally appeared to be adequate. Accordingly, in these areas (accounting and information systems, budgeting practices, debt issuance, revenue collection, cash disbursement, and investment activities), we reduced the extent of our audit testing. We interviewed the Agency staff responsible for these areas and performed limited compliance testing to provide assurance established policies and procedures were being followed. We found that certain improvements are needed, especially in the controls over debt issuance and revenue collection.

Accounting and Information Systems

We tested the accuracy and the timeliness of the Agency's data entry process for its accounting system. We selected two cash receipts and four cash disbursement transactions recorded on the accounting system and traced the transactions to their source documents. We found that the transactions were entered accurately, but they were not entered promptly on the accounting system for the two cash receipts (they were entered 3-5 days after the source documents were received). We took no exception to the four cash disbursements.

We also reviewed controls over system security. We tested five computers and found that passwords had been changed within the last 90 days, appropriate kinds of firewalls had been established, and inappropriate Internet sites had been blocked. We also determined that the Agency had developed, and tested, a plan for recovering critical data and re-establishing data processing capabilities in the event of a disaster or loss of data processing capabilities.

We also reviewed Agency compliance with procedures for protecting sensitive and confidential data. We examined routine reports produced by the accounting and information systems to determine whether they included sensitive information, and we observed employee work areas and general office areas to determine whether sensitive data was left unsecured. We found no sensitive information in the reports we reviewed and no sensitive data left unsecured.

Budgeting Practices

We reviewed the accuracy of the Agency budget process for the fiscal year ended October 31, 2003. We determined how the Agency estimated revenues and expenditures for the year, we verified approvals were obtained as required, and we compared budgeted expenses against actual expenses. We found that the budget was generally accurate, as the overall variance between actual and budgeted expenses was less than 10 percent (HFA exceeded its budgeted expenses by 4 percent and SONYMA was under budget by 6 percent).

Debt Issuance

The primary activity performed by the Agency is issuing bonds and other debt instruments. However, we found the Agency has not developed a formal policy and procedures manual to govern its debt-issuing activities. While working procedures are in place, a formal manual is needed to provide guidance and describe the Agency's roles and responsibilities in this complex process. In particular, guidance is needed for the authorization, management, recording and handling of debt issuances.

Agency officials stated that, because each bond issuance is unique, a procedures manual would be too specific and would need to be modified on an ongoing basis to accommodate the details of each issuance. They also noted that existing written materials (such as the HFA Underwriting Manual and the Agency's Bond Sale Guidelines) provide guidance to staff. We agree that each bond issuance is unique, but note that there are general terms, requirements, guidelines and parameters that apply to all bond issuances. A comprehensive manual could consolidate the various existing guidelines and formalize the existing unwritten procedures.

For each bond issuance, the Agency awards COI contracts for underwriting services, legal services (bond counsel), and other financial services. The contractors are to be selected from listings of pre-qualified contractors. Contractors qualify for these listings by meeting certain requirements. According to the Agency's Procurement Contract Guidelines, the qualification and performance data that is used to determine whether a contractor qualifies for a listing should be updated and/or recertified annually.

However, we found that the qualification and performance data is not updated and/or recertified annually. Agency officials stated the current listing of pre-qualified bond counsels and underwriters is about four to five years old, and while some firms have been added to the listing since it was first established, there is no specified time frame indicating how long the listing is to remain in effect. The officials stated they are actively considering updating the pre-qualified listings with greater formality and regularity.

We also identified the following areas in which controls over debt-issuance practices could be strengthened:

- The Agency has not established a policy that requires or encourages the rotation of contracts among the pre-qualified firms. Such a policy helps to avoid an appearance of favoritism in the award of contracts. Agency officials stated that they seek to award the contracts to the most qualified and experienced firms. The officials also believe that existing procedures provide for a rotation of contracts among firms. However, in the absence of a policy explicitly requiring or encouraging such rotation, contracts may not be rotated often enough to promote an appearance of fairness.

- Only SONYMA has established a maximum amount (cap) payable to bond counsels and underwriters. The other four agencies have not established such a cap, which is commonly used to control the cost of such contracts. We note that all the agencies have a negotiated cap for contracts with financial advisors.

- In most cases, full Board approval is not sought by the Agency when contracts are awarded for bond counsel and underwriting services. Instead, the approval of the

President and the appropriate Board Chairman is sought. Full Board approval is sought only at TSFC for underwriting services. We recommend that full Board approval be sought for all COI contracts.

Under generally accepted accounting principles, the costs of debt issuance should generally be capitalized. However, when we reviewed five HFA bond issuances, we found that debt-issuance costs were not capitalized in two of the issuances. In one issuance, the Agency incorrectly expensed a total of $4,680 in debt-issuance costs. In the other issuance, $67,424 in debt-issuance costs were incorrectly charged to an expense account.

Agency officials indicated that these costs were incorrectly coded due to clerical errors. Agency officials stated they plan to prepare a written policy and procedures memorandum for staff about the treatment of such costs. The officials also stated that they intend to perform a reconciliation to ensure debt-issuance costs are properly capitalized for all outstanding issuances.

Revenue Collection

The Agency routinely receives a number of checks each month from various sources. For example, HFA receives commitment and application fees, SONYMA receives Mortgage Insurance Fund checks, and AHC receives repayment checks from grantees. The Agency also receives payments for dental premiums from Agency retirees, loan payments from Agency retirees, and other miscellaneous payments.

To provide reasonable assurance all payments are properly accounted for and properly deposited in bank accounts, the payments should be processed in accordance with detailed written policies and procedures. However, we found the Agency has not developed written policies and procedures for the processing of these payments. While informal procedures are followed, we found these procedures do not provide adequate control over the payments. For example, payments are not recorded in a log immediately on receipt. Instead, checks are passed among a number of individuals before they are recorded as received.

We further determined that separate control log numbers are not used for the different types of revenue received. Each type of revenue shares the same sequential log numbering. In such a system, it is more difficult to maintain proper accountability for the different types of revenue. We also found that the payments received are not reconciled to the payments deposited, and the different cash-handling duties (receiving payments, recording payments, and depositing the checks) are not separated among different employees to provide the maximum degree of accountability and control.

It is Agency policy to record cash deposits on a timely basis. While no time frame is specified, Agency officials indicated a reasonable amount of time would be less than a week. We found that some AHC cash deposits were not recorded timely. The cash was received in December 2003, but was not recorded until February 2004. The unrecorded deposits were not identified, because a bank reconciliation was not performed during the period.

Agency officials noted that we identified no lost, undeposited or unaccounted for checks, but agree that controls should be strengthened. They stated that they have formed a committee of personnel from the cash-handling departments, and this committee is to make recommendations for improvement.

Cash Disbursement

It is Agency policy to cancel any check that has been outstanding for six months. However, during our review of SONYMA's February 2004 bank reconciliation for its checking account, we identified ten checks (totaling $12,790) that had been outstanding for between six and ten months. After we notified SONYMA officials, all ten checks were voided.

The Agency has no written policy stating that outstanding checks should be canceled after six months. We recommend such a policy be established. Agency officials agree with our recommendation, but stated that, in their opinion, only six of the SONYMA checks that we identified had been outstanding for more than six months. In our opinion, this disagreement about the length of time the checks had been outstanding underscores the need for detailed written policy in this area. This policy should clarify the time frame that is to be used in determining when an outstanding check should be canceled.

Investment Activities

The Agency routinely invests the cash it receives from the issuance of bonds. According to the Agency procedures manual for its Treasury Department, such investments should be made on the basis of a written agreement, unless they are short-term investments resulting from a certain type of bond issuance (refunding bonds, which are used to refinance debt).

However, when we reviewed a sample of 18 investments made by the Agency from bond proceeds, we found that three of the investments were not made on the basis of a written agreement. In all three instances, the funds were invested in U.S. Treasury bills (in the amounts of $8.9 million, $26.1 million and $68.5 million) due to their short-term needs.

Agency officials stated that the procedures in the manual should be revised to reflect how short-term investments relating to Bond issues are actually handled. We recommend the procedures be revised, and written agreements be obtained in accordance with the revised manual.

Recommendations

Debt Issuance

20. Develop a comprehensive policy and procedures manual for the Agency's debt-issuance activities.

    (Agency officials indicate that they will work towards consolidating the various existing guidelines and formalize the existing procedures into a comprehensive manual.)

21. Annually update and/or recertify the listings of pre-qualified COI contractors.

Recommendations (Cont'd)

(Agency officials cite that they already periodically update their existing pre-qualified panels. However, they are actively considering whether these should be accomplished with greater formality and frequency.)

22. Develop policies requiring that:
    - COI contracts be rotated among firms,
    - caps be established for all COI contracts, and
    - full Board approval be required for COI contracts.

    (Agency officials indicate that their procedures already provide for the rotation of firms based upon their qualifications and uniqueness of their particular expertise to the bond transaction. In addition, caps have been established for certain COIs, and for others, costs are driven by market conditions and the complexity of the transaction.)

    Auditors' Comments - In the absence of a policy explicitly requiring or encouraging rotation of firms, contracts may not be rotated often enough to promote an appearance of fairness.

23. Ensure that COI costs are appropriately capitalized.

    (Agency officials concur with this recommendation.)

Revenue Collection

24. Establish written policies and procedures for the revenue collection process, and evaluate the feasibility of consolidating the existing decentralized collection process.

Recommendations (Cont'd)

25. Ensure cash deposits are recorded timely.

    (Regarding Recommendations 24 and 25, Agency officials indicate that a committee comprised of personnel from the various departments involved in the receipt of checks has been established and is currently scheduled to make policy and procedure recommendations in early February 2005.)

Cash Disbursement

26. Establish a written policy requiring the cancellation of outstanding checks after a certain time period. Monitor outstanding checks to ensure compliance with the policy.

    (Agency officials concur with this recommendation and indicate that a written policy will be prepared and distributed to the appropriate staff.)

Investment Activities

27. Revise the Agency's investment guidelines to accurately reflect expectations for short-term investments.

    (Agency officials indicate that staff followed the procedures in the Treasury Procedure Manual that applied to the economic refunding bonds. However, to eliminate any future exceptions, the Manual has been revised.)

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December 2, 2004

Mr. Frank J. Houston
Audit Director
Office of the State Comptroller
Division of State Services
State Audit Bureau
123 William Street – 21st Street
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Dear Mr. Houston:

This letter is in response to the Office of the State Comptroller's (OSC) draft audit report which we received on November 9. This report, 2004-S-9, addresses the internal controls over financial operations at the New York State Housing Finance Agency, State of New York Mortgage Agency, and affiliated Agencies.

The draft audit report concluded that the Agencies' internal controls, including the control environment, communication, risk assessment, control activities and monitoring, were adequate. The draft report further details recommendations for improving our current internal control systems. Our response to these recommendations is attached.

Included in the background section of the report, is information indicating that some of the Agencies are operating at a loss. For all Agencies except the Tobacco Settlement Financing Corporation, the "loss" represents an expenditure of surpluses that have accumulated in prior years and are required to be used for program purposes.

We appreciate your time and effort in conducting this audit, as well as the recommendations advanced.

Very truly yours,

Stephen J. Hunt
President / CEO

cc: Jerome M. Becker, Chairman HFA
Joseph Strasburg, Chairman SONYMA
John B. Mannix, Chairman Budget & Audit Committee, HFA
John F. Cape, Chairman Audit & Finance Committee, SONYMA

New York State Housing Finance Agency
State of New York Mortgage Agency
Response to OSC Examination

Time and Attendance

1. Take action to improve the Human Resource Department's review of time sheets and maintenance of employee accrual balances.

Agencies' Response:
As recognized in the OSC examination report (the "Report"), the individual time sheet issues were addressed immediately upon their being communicated to Human Resources ("HR") representatives.

We respectfully point out that errors listed in the Report are primarily clerical in nature and have all been corrected. In addition, we have assigned a permanent employee to replace the temporary employee. As part of her training, the new HR Assistant is receiving formal training and instruction in the Agencies' time sheet administration, time monitoring and attendance verification procedures. We are confident that a permanent employee in this position will serve to reduce the error rate substantially.

In addition to the above, we have implemented additional monitoring and verification procedures with respect to time sheet review and the maintenance of employee accrual balances. Pursuant to the current procedure, the HR Assistant Director will be reviewing 20% of time sheets quarterly; certifying to the Chief Operating Officer that such review was completed; and providing the Chief Operating Officer with the details of any problems and any remedial action taken. This process will include checking time sheets for required signatures and verifying that leave designations entered on time sheets are correctly entered into the system. The HR Assistant Director will also increase periodic spot checking with an emphasis on verifying that the number of hours entered in the system matches the actual hours reflected on the time sheet.

HR is also currently exploring possible modifications to the Human Resources Information System to create additional written instructions and help menus concerning proper processing of time sheets and the accurate maintenance of employee accrual balances. Automation of time sheets will be subject to Union approval through the collective bargaining process that commenced August 25, 2004.

The Agency's Time and Attendance memo dated March 21, 2002 issued by the COO and the HR Director has been reissued to all staff reinforcing HR policies and procedures relating to time and attendance. Managers will be reminded of the importance of their responsibility in certifying time sheets, along with HR policies that relate to time and attendance. The requirements will be further reinforced in meetings scheduled to be held with managers, supervisors and staff by the Agencies' COO and the Human Resources Director.

2. **Monitor temporary employees more closely to ensure that they take meal breaks when they work six or more consecutive hours.**

Agencies' Response:
The temporary employee referred to in the Report was instructed on numerous occasions by both her department head and representatives of Human Resources that she must take at least a ½ hour lunch break. Unfortunately, she did not always comply. This matter was ultimately resolved by her temporary agency, and she has since been replaced by a permanent employee. It is (and has always been) the policy of the Agencies to require a one-half hour lunch for all temporary employees.

3. **Discontinue the special flextime work schedule unless the union agreement authorizing the schedule can be documented. If the agreement can be documented, and the use of 15-minute breaks at the beginning or the end of the work day is determined to be appropriate, ensure that the schedule is used only by those employees who are specifically authorized to do so.**

Agencies' Response:
The following language is set forth in the Memorandum of Understanding between SONYMA and Local 2110 AFL-CIO effective May 1, 1997: "Article 16 - Hours of Work A. The Agency's regular work hours shall be Monday through Friday from 9:00 a.m. to 5:00 p.m. with a total of one hour for lunch breaks, provided, however, **that existing established deviations in starting and ending time may be continued** *(emphasis added).* As reflected in two written responses to the Agency's internal auditors dated 5/14/03 and 10/06/03, employees utilizing special flex-time work schedules do not work ½ hour less than other Agency employees, and their adjusted departure time is the result of a flex-time practice that dates back to when SONYMA had a 35 hour workweek, and the deviation is permissible as stated in the Memorandum of Understanding highlighted above. Only those employees entitled to this contractual benefit are authorized to do so.

The situation involving the subject employees was brought to the attention of Human Resources subsequent to completion of the previous collective bargaining. As set forth in the written explanations to the Agency's internal auditors, in response to being made aware of the pre-existing flex-time issue, SONYMA ceased granting these requests to new employees and restricted the practice to those already receiving it. As a result, the number of employees receiving the pre-existing flex-time schedule has been reduced substantially through attrition.

In order to avoid a protracted and costly legal contest with the Union, the Agency elected to eliminate the practice with respect to the remaining employees in collective bargaining rather than by unilateral implementation. Accordingly, elimination of the pre-existing flex-time has been included as a management demand in the collective bargaining negotiations which commenced on August 25, 2004.

Purchasing Practices

4. Develop detailed written procedures for the purchase order process.

Agencies' Response:
Purchase Orders are covered under the Agencies' Procurement Guidelines and Procedures Manual. The Agencies are currently considering the appointment of a Contract Administrator who would have responsibility for overseeing the procurement process and for ensuring that complete and appropriate procedures are in place.

5. Take action to improve Agency compliance with the requirements of the purchase order process. In particular:
- **ensure that required prior approvals have been obtained and budgeted funds are available before purchase orders are processed, and**
- **ensure that payments are made within 30 days if the receipt of goods or services.**

Agencies' Response:
The Agency respectfully points out that most of the purchase orders identified as not having prior approval were primarily limited to the procuring of temporary help and purchase of kitchen supplies, in particular, water. The hiring of temporary help is done when it is requested by the Human Resource (HR) unit head, has received the express authorization of the Chief Operating Officer (COO) and that authorization has been communicated to the HR department by the COO. The HR department then secures the temporary help. The processing of a written purchase order is initiated when an invoice is received by the Agency for services rendered. We agree that the authorization of the CFO/COO should be reduced to writing, and will consider the most efficient way of doing so. Purchase of kitchen supplies is covered by a formal written contract with a vendor who has

responded to a Request for Proposals. Processing payments through the PO system was an additional layer of control implemented by the Agency.

The Chief Financial Officer authorizes every request for purchase and purchase order, and in his absence the Deputy CFO is his designee. The individual currently administering each Agency's budget is the Deputy Chief Financial Officer. In the absence of the CFO, the Deputy CFO may act in both capacities. Prior to authorizing a purchase, the CFO requires written approval that funds are available in the Agencies' budget for the purchase.

As part of the Agencies' Prompt Payment Policy, we endeavor to make payments in 30 days. However, at times this goal cannot be attained. Reasons for tolling payments include insufficient documentation, incorrect routing of invoices and /or billing disputes.

Although the Agency believes that the current Purchase Order control system adequately insures the integrity of the procurement of goods, we will provide more detailed written procedures that can be utilized by the staff who are responsible for following the process.

6. Track purchases of periodicals on the Purchase Order System.

Agencies' Response:
Management will take under advisement the recommendation that the current arrangement of "standing orders" for Legal subscriptions be discontinued in favor of individual purchase order processing. We note that the current "standing order" arrangement provides adequate control without unnecessary and excessive paperwork.

Contracting Practices

7. Fully document the contract award process for all contracts subject to the requirements contained in the Agency's Procurement Guidelines, and maintain this documentation on file.

Agencies' Response:
The standard the Agencies follow is to fully document the selection and awarding of all contracts in accordance with Agency guidelines and internal controls. We have reviewed the contracts in question, seven of which were approved by the Members or Directors. In connection with these approvals there is, in our minutes together with Directors and Members meeting materials, sufficient documentation respecting the selection and award of the contracts at such time.

Further, underlying documentation was concurrently available for inspection when the approvals were sought and given.

The substantial documentation requested in connection with the competing bids and inquiries with respect to the many contracts into which the Agencies enter becomes voluminous. Storage, and sometimes transport off site, is a necessity. Historically, not all originally available material for every contract has continued as part of the Agencies' actively managed files over the long term. The Agencies' goal, however, is to use improving technology and record-keeping programs to provide more ready, ongoing access to older and more voluminous records. The Agencies envision that responsibility for such improved record keeping access will be an important function of the Contract Administrator it intends to hire.

Equipment Inventory Control

8. Establish comprehensive written policies and procedures governing equipment and asset management.

Agencies' Response:
Though the current inventory software utilized by the Agencies to manage equipment and assets is adequate, as evidenced by the fact that all items except one were located during the various samplings (the item not located was an item removed from service in 1998), we are in the process of upgrading the inventory system. The specified replacement software will streamline the program and provide expanded detailed periodic reports. A vendor has been engaged whose program will provide specific identification (sequential bar-coded serialization), stated value (the Agencies' assets are expensed at purchase) and enhanced transfer, lost, stolen and obsolete equipment categorization capability. The software will provide enhanced security features and reside on the Agencies' network. Additionally, at this time, draft written policies and procedures are currently under review by senior management.

9. Add appropriate details to the information in the inventory records, and periodically provide inventory reports to management.

Agencies' Response:
As described in our previous response, a detailed inventory record will be established and periodic reports distributed to management.

10. Dispose of obsolete and unneeded computer-related equipment, and delete the items from the inventory records.

Agencies' Response:
Currently, the disposal of obsolete computer equipment is being addressed by the Information Technology Unit.

Corporate Governance

11. Develop written policies and procedures for the process of setting salaries for Agency executives and other employees not covered by the collective bargaining agreements. Require full Board involvement in this process.

Agencies' Response:
The Agencies operate in accordance with their by-laws and a long standing history of practices spanning several decades with respect to the process of setting and adjusting salaries.

We are currently revising procedures to address greater Board involvement in compensation matters.

12. Maintain a usage log to account for the miles driven with Agency vehicles.

Agencies' Response:
In accordance with the current vehicle usage policy, dated June 15, 2004 and supplemented July 14, 2004, which codifies and updates previous policy directives concerning the use of automobiles in connection with Agency business, "(e)xcept for vehicle usage designated as "unrestricted use," employees authorized to use automobiles for travel shall maintain a log of destinations and mileage traveled on the form to be provided to the employee by the employee's supervisor at the time authorization is obtained….."

During the period of the audit there were only two Agency vehicles, both of which had been designated for unrestricted use. Therefore, in accordance with the Agencies' policy, no vehicle usage log was required to be maintained.

13. Assign a vehicle to the HFA Chairman only if it can be shown that the assignment is not contrary to the language in Article III, Section 43, of the New York State Housing Finance Agency Act.

Agencies' Response:
The Chairman clearly has many Agency duties and responsibilities for which an Agency vehicle needs to be made readily available for his/her use. Furthermore,

the vehicle is not supplied as "salary or other compensation" within the meaning of the Agency's enabling statute. The fact that a 1099 is submitted for federal tax purposes in connection with an item does not mean that such item constitutes "salary or other compensation" for purposes of the referenced State statue. However, in response to this recommendation, the Agency is actively considering making the subject vehicle a pool car.

14. Develop written policies and procedures governing the use of corporate and gasoline credit cards. Include provisions for eligibility, authorization, required documentation (e.g. receipted), personal use, limitations and restrictions.

Agencies' Response:
The Agencies have already instituted written policies and procedures governing the use of corporate and gasoline credit cards. The two gasoline credit cards and three corporate cards continue to be restricted for business use purposes. For the period examined, almost 90% of the credit card charges related to automobile expenses and pre-approved out-of-town travel, the balance was related to business meetings.

15. Ensure that all required reports and guidelines are reviewed and approved by the Agency Boards of Directors.

Agencies' Response:
We are mindful of the distinction the examiners have made between submitting reports to the Members and Directors for review and having the Members and Directors actually cast a vote to approve what they have received. The Agencies will follow their adopted guidelines with respect to approval of required reports and the submission of current guidelines for review in connection therewith.

16. Develop a Statement of Board Duties for all the Agency Board of Directors.

Agencies' Response:
Recently, as part of an initiative aimed at creating a detailed, cogent statement of Member and Director responsibilities in the crucial areas of corporate governance and financial management, the Members and Directors, assisted by staff and outside counsel, formulated a series of recommendations in these areas. Implementation will require, as part of a continued effort, substantial reformation of the Agencies' by-laws and statutory revisions of a general, as well as an Agency-specific nature.

Financial Reporting

17. Include COI contracts in the Agency's quarterly and annual procurement reports. Report the actual cost of each COI contract and the name of the contracting firm.

Agencies' Response:
All major costs of issuance are reported to our Members and Directors, and to the State Comptroller. Underwriters' discounts are currently reported as part of the Bond Sale Report (this is an annual report to the Members and Directors) for all of the Agencies; bond counsel fees are reported as part of the Procurement Contract Report, as are fees of financial advisors, cash flow consultants and TEFRA hearing expenses. The New York State cost recovery fee is a statutory requirement as to which we have no discretion, and is paid to the State. Only trustee fees and rating agency fees are not reported to the Members and Directors.

We respectfully note that all costs of issuance are reported to the State Comptroller every time we sell bonds. In addition, Members and Directors receive copies of the Official Statements for every financing.

We will change the procurement report to include more information, including that which is already reported, as indicated above.

18. Revise the format of the procurement reports to make the information easier to understand, and include all contracts with activity, but not necessarily payments, for the reporting period.

Agencies' Response:
The current procurement contract reports are statutorily compliant. However, management considers that there are probably options or opportunities to refine and amplify the content of the procurement contract reports that would still be statutorily compliant and will endeavor to do so.

We agree that all "active" contracts should be included in the report. However, we believe that a better definition of active is that there is activity with respect to the utilization of those rights, as evidenced by incurring an obligation to pay.

19. Ensure timely submission of the annual financial information required by the State Comptroller's Regulation of Accounting and Reporting for Public Authorities.

Agencies' Response:
While the recommendation suggests a 90-day reporting period, some of the information being requested within this 90-day period is not available since the Agencies and their external auditors (who are responsible for three of the five reports requested by the Comptroller and listed below) are simultaneously preparing year-end statements and reports for all Agencies (except AHC which has a different fiscal year end). The Agencies' statutory requirements are as follows:

- Annual Reports- HFA: 90 days from the end of the fiscal year – SONYMA: 180 days from the end of the fiscal year
- Financial Statements- HFA: 90 days from the end of the fiscal year – SONYMA: 180 days from the end of the fiscal year
- Annual Investment Reports- All Agencies: 180 days from the end of the fiscal year (PAL §2925)
- Auditors' Report on Investments- All Agencies: 180 days from the end of the fiscal year
- Prompt Payment Report – All Agencies: 90 days from the end of the fiscal year

Accordingly, the Agencies are regretfully unable to provide your office with the subject information within the requested timeframe. We will continue to do our best to provide this information to the Comptroller's office as soon as it becomes available.

Debt Issuance

20. Develop a comprehensive policy and procedures manual for the Agency's debt-issuance activities.

Agencies' Response:
Since each bond issuance is unique, management feels that a fixed procedures manual would be too specific and would need to be modified on an ongoing basis to accommodate the details of each issuance. The HFA Underwriting Manual and Processing chart specifies Debt Issuance's role and responsibilities for each multi-family bond issuance. In addition, there are written materials with respect to procedures for debt issuance, including Bond Sale Guidelines. The Guidelines set forth specific procedures for the selection of underwriters, the use of Requests for Proposals for specific sales, ethical considerations and the establishment of panels.

The Members and Directors have adopted procedures which specify the way the selection of underwriters is to be made. A recommendation memorandum is made by a Senior Vice President to the President as to appointment of underwriters. Per Article IV of the Bond Sale Guidelines adopted by each of the Agencies, the President, with the concurrence of the respective Chairman, selects managing underwriters for specific bond issues to be sold through negotiated sale.

However, we will work towards consolidating the various existing guidelines and formalize the existing procedures into a comprehensive manual.

21. Annually update and/or recertify the listings of pre-qualified COI contractors.

Agencies' Response:
The Agencies already do periodic updates of their existing pre-qualified panels. We are actively considering whether these should be accomplished with greater formality and regularity.

22. Develop policies requiring that:

- **COI contracts be rotated among firms,**
- **Caps be established for all COI contracts, and**
- **Full Board approval be required for COI contracts.**

Agencies' Response:
Our current procedures already provide for the rotation of firms based upon their qualifications and the uniqueness of their particular expertise to the bond transaction. In addition, caps have been established for certain COIs, and for others, costs are driven by market conditions and the complexity of the transaction.

23. Ensure that COI costs are appropriately capitalized.

Agencies' Response:
The Agencies concur with this recommendation. The miscoding of the two COI items in question was due to a clerical error. Accounting management intends to prepare a detailed written policy and procedures memo to the staff concerning COI. This will include:

- Type of debt issuance expenses;
- When to capitalize debt issuance expenses;
- Method of amortization;
- Time period of amortization.

In addition, accounting management intends to perform a detailed reconciliation to ensure costs are properly capitalized.

Revenue Collection

24. Establish written policies and procedures for the revenue collection process, and evaluate the feasibility of consolidating the existing decentralized collection process.

Agencies' Response:
A committee comprised of personnel from the various departments involved in the receipt of checks has been established and is currently scheduled to make policy and procedure recommendations in early February, 2005. These recommendations will incorporate procedures including, but not limited to, the following:

- One unit, specifically, Treasury, will receive and log checks. Such log will have separate control log numbers for the different categories of revenue received;
- Procedures for notifying appropriate unit of revenue received;
- Procedures for tracking the timely depositing of checks;
- Procedures for ensuring that deposits are posted timely;
- Procedures for the reconciliation of check receipt logs;
- Preparation of a written manual for distribution to appropriate staff incorporating the committee's final recommendations.

That being so, we note that no checks were lost, unaccounted for or not deposited.

25. Ensure cash deposits are recorded timely.

Agencies' Response:
The policies and procedures established in response to recommendation #24 will address the timely deposit of checks.

Cash Disbursement

26. Establish written policy requiring the cancellation of outstanding checks after a certain time period. Monitor outstanding checks to ensure compliance with the policy.

Agencies' Response:
The Agencies concur with this recommendation and a written policy will be prepared and distributed to the appropriate staff.

The Agencies respectfully points out that the current policy pertaining to the cancellation of outstanding checks is six months and not 90 days.

27. Revise the Agency's investment guidelines to accurately reflect expectations for short-term investments, and obtain written agreements for investments in accordance with the guidelines.

* See Below

Agencies' Response:
Investments of proceeds of the Agencies' bond financings generally require Investment Agreements to coincide with the anticipated drawdown of funds, and the Agencies' Treasury Procedure Manual was written to ensure that the provisions deemed necessary or appropriate by the Agencies are included in these Agreements and are stipulated in writing. Bond proceeds related to economic refunding bonds are invested in short term instruments (i.e. Treasury Bills). Since there are no drawdown provisions, collateral agreements or other pre-requisite documents associated with Treasury Bills, these investments may be executed verbally.

The three investments noted in your comments related to the Personal Income Tax (PIT) bond issue, a new program that was introduced in 2003, the purpose of which is providing funds to the State. The PIT bond proceeds were not immediately needed by the State following the bond closing and were invested in short term instruments (Treasury Bills) until a determination was made as to when the funds would be used. Staff followed the procedures in the Treasury Procedure Manual that applied to the economic refunding bonds. However, in order to eliminate any future exceptions, the Procedure Manual has been changed to read as follows:

> "Section 4,A, vi - Solicitation of offers relating to proceeds of new bond issues should be made in writing with the Agency's conditions of purchase stipulated. In the case of economic refunding bonds, or if a drawdown schedule is not available, proceeds of bond issues may be verbally invested in Securities (as defined in the Investment Guidelines)."

* Recommendation number 27 has been revised based on the Agency comments.