



Long Island Power Authority

Internal Controls Over Fiscal Operations

2008-S-93



Thomas P. DiNapoli

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State of New York

Office of the State Comptroller

Division of State Government Accountability

June 1, 2009

Dear Mr. Law:

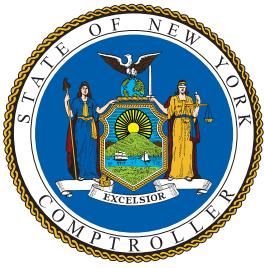
The Office of the State Comptroller is committed to helping State agencies, public authorities and local government agencies manage government resources efficiently and effectively and, by so doing, providing accountability for tax dollars spent to support government operations. The Comptroller oversees the fiscal affairs of State agencies, public authorities and local government agencies, as well as their compliance with relevant statutes and their observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving operations. Audits can also identify strategies for reducing costs and strengthening controls that are intended to safeguard assets.

Following is a report of our audit of Long Island Power Authority's Internal Controls Over Core Fiscal Operations. This audit was performed pursuant to the State Comptroller's authority under Article X, Section 5 of the State Constitution and Section 2803 of the Public Authorities Law.

This audit's results and recommendations are resources for you to use in effectively managing your operations and in meeting the expectations of taxpayers. If you have any questions about this report, please feel free to contact us.

Respectfully submitted,

*Office of the State Comptroller
Division of State Government Accountability*



State of New York

Office of the State Comptroller

EXECUTIVE SUMMARY

Audit Objective

The objective of our performance audit was to determine if the Long Island Power Authority (LIPA) has established an adequate system of internal controls over its core fiscal operations. These functions provide critical support for LIPA's operational activities and help to ensure that LIPA's Board, the public and State policymakers have accurate, reliable information upon which to base decisions and evaluate performance. When considering the accountability and transparency of government operations, these functions are particularly important in light of LIPA's unique position as a largely unregulated public utility service provider. As such, our baseline analysis of internal controls in these core fiscal areas serves as the foundation for our reliance on financial related information as we move forward with future evaluations of LIPA's operational endeavors.

Audit Results - Summary

LIPA was created by the State Legislature in 1986 and is responsible for supplying electricity to approximately 1.1 million customers. LIPA contracts with National Grid PLC to manage its electric transmission and distribution services, as well as customer billing and collections.

We determined that LIPA has many appropriate internal controls in place for its core fiscal operations. However, we identified some areas where improvements could be made to internal controls. For example, we found that several Board trustees do not always attend Board meetings and others have not received training as required by the Public Authorities Accountability Act. Routine attendance by a fully staffed Board composed of appropriately trained individuals is essential to ensuring that all constituencies are represented by individuals who understand and properly execute their role as Board members.

We also found that LIPA's annual procurement report for 2007, which listed 105 contracts totaling more than \$6.6 billion, was not complete and was not formally approved by the Board as required. We found the report listed only firms that LIPA had contracted with directly and did not include all contracts relating to bond activity or those contracts that National Grid had entered into on behalf of LIPA, even though the contracts were all subject to State approval. When all contracting activities are not disclosed, the public and policymakers can be deprived of the level of transparency and accountability necessary to properly evaluate and participate in LIPA operations.

We also found LIPA does not have procedures for following up on outstanding payments, regardless of how long checks remain outstanding. LIPA's May 2008 bank reconciliation listed 209 outstanding checks totaling \$485,000, including \$300,000 outstanding for more than one year.

Among the outstanding checks were four totaling \$143,324 written to three New York State agencies. We determined that this situation occurred because LIPA does not have a policy and does not follow up on outstanding checks identified during the bank reconciliation. By not taking timely action and allowing outstanding checks to accumulate, officials miss an opportunity to identify situations where controls are not functioning as intended and may in fact be reserving funds for items that will never be presented for payment.

Each year, LIPA is required to assess and certify its system of internal control pursuant to both the Public Authorities Accountability Act and the New York State Governmental Accountability, Audit and Internal Control Act (Internal Control Act). While both certifications were completed timely, the underlying assessments were completed by LIPA's internal control officer. State guidelines require that risk assessments supporting the Internal Control Act certification be performed by staff involved in the actual operations. Staff-level participation is important in promoting a culture that recognizes the importance of appropriate internal control systems.

We examined the internal equipment and asset management practices within LIPA's corporate office and found LIPA needs a more comprehensive policy to ensure its computer equipment inventory is accurate. Further, we found that LIPA has vested complete control over the inventory and disposal of computer equipment in one person, instead of segregating these responsibilities to ensure accountability. Improper disposal of computer equipment poses risks to the organization, not only in terms of control over its assets, but also in terms of the potential for disclosure of personal or proprietary information that may be included on the devices.

Finally, we found that LIPA has standard steps that staff follow when issuing debt, but these procedures are not formalized or documented. As a result, management can not always be assured that all required procedures are followed.

Our report includes 12 recommendations to strengthen LIPA's internal controls over its core financial operations. LIPA officials agreed with most of our recommendations and, in responding to our draft report, indicated they have already taken action to implement several of them.

This report, dated June 1, 2009, is available on our website at: <http://www.osc.state.ny.us>. Add or update your mailing list address by contacting us at: (518) 474-3271 or

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Division of State Government Accountability
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Introduction

Background

The Long Island Power Authority (LIPA) was created by the State Legislature in 1986 and is responsible for supplying electricity to approximately 1.1 million customers. In May 1998, LIPA acquired the electrical transmission and distribution system of the Long Island Lighting Company (LILCO), as well as certain other assets, and became the primary supplier of electricity on Long Island. LILCO's remaining assets, including its electrical generating facilities, were merged with Brooklyn Union Gas, creating a new utility called KeySpan Energy Corporation (KeySpan). LIPA entered into three key agreements with KeySpan:

- Management Service Agreement - To provide day-to-day operation and maintenance of the transmission and distribution system, as well as facility operation, customer service, billings and collection, meter reading, financial and operations reporting, planning, engineering, and construction in accordance with LIPA's adopted policies and procedures.
- Power Supply Agreement - To provide capacity and energy from the oil- and gas-fired generating plants of KeySpan formerly owned by LILCO.
- Energy Management Agreement - To provide for the management of LIPA's power supply resources and fuel procurement.

On August 24, 2007, National Grid PLC acquired KeySpan and, pursuant to a merger agreement, is now responsible for providing these services to LIPA. In 2006 and 2007, LIPA expended approximately \$2 billion each year under the three agreements including reimbursement for various taxes, certain fuel and purchased power costs, capital projects, conservation services, research and development, and various other expenditures.

LIPA is governed by a Board of Trustees (Board) comprised of 15 trustees appointed for four-year terms by the Governor, and the leaders of the State Senate and Assembly. LIPA's trustees do not receive monetary compensation other than reimbursement for necessary and reasonable expenses. The Board has established four committees: Personnel & Compensation; Energy, Efficiency and Environmental; Governance; and Finance & Audit. Each of the committees consists of a minimum of three trustees and meets various times throughout the year.

Audit Scope and Methodology

We audited LIPA's internal controls for the period January 1, 2006 through September 23, 2008 to determine if LIPA has established an adequate system of internal controls over its fiscal operations. To accomplish our objectives, we met with LIPA officials to confirm and enhance our understanding of the internal control system. We reviewed related documentation supporting the internal controls in place in the following core fiscal areas: Board governance; procurement and contracting; computer equipment inventory; internal control certification; cash receipts and disbursements; debt issuance; billing and collections; investments; budgeting and expenditure control; accounting and information systems; and payroll.

In each area, we interviewed staff and reviewed relevant procedures to assess risk, and then conducted tests to determine whether procedures were actually in place and being complied with. For example, to determine whether LIPA followed appropriate procedures for awarding contracts, we judgmentally selected ten contracts and reviewed related documentation. We also conducted physical checks of equipment at LIPA's corporate office and selected a judgmental sample of 12 items purchased to verify that they were properly inventoried. To verify disbursements were adequately supported, we judgmentally selected 35 vouchers totaling \$14.7 million that were paid between January and June 2008. Additional sampling information is discussed throughout the report.

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

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. 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 functions do not affect our ability to conduct independent audits of program performance.

Authority	The audit was performed pursuant to the State Comptroller's authority as set forth in Article X, Section 5 of the State Constitution and Section 2803 of the Public Authorities Law.
Reporting Requirements	A draft copy of this report was provided to LIPA officials for their review and comment. Their comments were considered in preparing this report and are included as Appendix A.
Contributors to the Report	Within 90 days of the final release of this report, as required by Section 170 of the Executive Law, the Chairman of the Long Island Power Authority 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 therefor.

Audit Findings and Recommendations

Internal Control Components

Internal control is the integration of the activities, plans, attitudes, policies, and efforts of the people of an organization working together to provide reasonable assurance that the organization will achieve its objectives and mission. An effective system of internal controls has five basic components:

- Control Environment - 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. 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.
- Communication - 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.
- Risk Assessment - Risks are events that threaten the accomplishment of objectives and can ultimately impact an organization's ability to accomplish its mission. A risk assessment is the process of identifying, evaluating and determining how to manage these events.
- Control Activities - Tools, both manual and automated, that help prevent or reduce the risks that can impede accomplishment of the organization's objectives and mission. One commonly used control activity is the requirement that documentation be maintained to substantiate decisions, events, and transactions. Another good control is approval and/or authorization for certain employee decisions, events or transactions.
- Monitoring - The review of an organization's activities and transactions to assess the quality of performance over time and to determine whether controls are effective. Management should focus monitoring efforts on internal control and achievement of

organization objectives. For monitoring to be most effective, all employees need to understand the organization's mission, objectives, responsibilities, and risk tolerance levels.

To determine whether LIPA's internal controls were adequate, we examined 11 core fiscal operations. We interviewed staff, reviewed documentation and processes, and tested transactions and records in each area. We determined that LIPA has many appropriate internal controls in place for these core fiscal operations. However, we identified some improvements that could be made relating to internal controls. For example:

- Control Environment - LIPA holds routine Board meetings, but several trustees often do not attend. Some trustees also have not received appropriate training in their fiduciary responsibility, as required by the Public Authorities Accountability Act. Routine attendance by a fully staffed Board composed of appropriately trained individuals is essential to ensuring that all constituencies are represented and considered by individuals who understand and properly execute their role as Board members.
- Communication - LIPA's annual procurement report is submitted timely, but is not complete. The report does not disclose all contracts, including those which National Grid enters into on behalf of LIPA, and is not routinely approved by the Board prior to submission. When all contracting activities are not disclosed, the public and policymakers can be deprived of the level of transparency and accountability necessary to properly evaluate and participate in LIPA operations.
- Risk Assessment - LIPA's internal control officer conducts reviews in support of annual internal control certifications. However, State guidelines require that this process also involve self-assessments by program staff directly responsible for the operations.
- Control Activities - Specific control procedures can be improved in several areas, including strengthening procurement guidelines to specify procedures for obtaining competitive bids and evaluating contracts, maintaining office equipment inventories, following up on outstanding checks, and formalizing debt issuance procedures.

The following section details our review of key internal controls in each of the core fiscal operations and includes recommendations for specific improvements.

Fiscal Operations

Board Governance

The Public Authorities Accountability Act requires that within one year of appointment, all individuals appointed to the board of a public authority participate in approved training regarding their legal, fiduciary, financial and ethical responsibilities as directors. We reviewed records related to each trustee and found that, as of July 29, 2008, five trustees, three of whom had been trustees for more than one year, had not received the required training. We also noted that one Board position has been vacant since October 2007.

Trustees are expected to attend Board meetings and participate in Board decisions. We reviewed minutes and found that the Board appeared to be active and involved, often questioning proposed projects and action items presented before them. However, we also noted poor attendance by two trustees for the period January 2007 through April 2008. During this time, one trustee did not attend nine of ten Board meetings, while another did not attend six.

Routine attendance by a fully staffed Board composed of appropriately trained individuals is essential to ensuring that all constituencies are appropriately represented by individuals who understand and properly execute their role as Board members. LIPA officials indicated they were aware of the poor attendance record for these trustees and noted difficulties in obtaining full trustee participation. LIPA has since amended its By-Laws (on October 23, 2008), to specify an attendance requirement for all trustees.

Recommendations

1. Ensure that all trustees receive the required training.
2. Monitor trustees' attendance at Board meetings and take action, as necessary, to ensure appropriate participation.

(LIPA officials agreed with our recommendations and reported they have taken steps to inform Board members of training opportunities and to encourage their participation. They also amended LIPA's By-Laws to include an attendance requirement for Board members.)

The Public Authorities Law requires comprehensive procurement guidelines be adopted and included in an annual report on procurement contracts. LIPA's procurement guidelines state that procurement contracts are to be awarded to persons or firms on a competitive basis to the maximum extent possible. All contracts must be approved by the President/Chief Executive Officer. Contracts over \$250,000, and/or extending for over one year, must also be approved by the Board. In addition, the State Comptroller must approve all contracts exceeding \$50,000.

We found that the Board has adopted and approved procurement guidelines. However, LIPA has not operationalized these guidelines into more specific procedures that could help ensure consistent compliance when dealing with competitive bids, contract evaluations, or requests for proposals. We also found that LIPA filed the required procurement report for 2007, indicating that it had entered into 105 contracts totaling more than \$6.6 billion. However, we found no evidence that this report was approved by the Board prior to submission. (In responding to our draft report, LIPA officials stated that the Public Authorities Law does not specifically require the Board to approve the annual procurement report and that such approval would be inconsistent with LIPA's procurement guidelines, which state that some contracts included in the report are not subject to Board approval. However, the Law does specifically require that the report be "approved by the corporation" prior to submission. Approval and ratification of actions and documents on behalf of the organization is a common function of a Board and exercising this responsibility would help ensure that Board members are informed and aware of the full scope and details of contracts to which LIPA is a party.)

More importantly, when we examined the report, we found it was incomplete and listed only firms that LIPA had contracted with directly. The report failed to disclose any contracts that National Grid had entered into on behalf of LIPA, even though these contracts were subject to State approval. As of September 23, 2008, we determined National Grid was involved in 73 contracts totaling \$107 million for Research and Development, Clean Energy, and Retail Services. None of these contracts would be disclosed as part of an annual procurement report under LIPA's current system, despite the fact that each is subject to State approval. We also determined that LIPA's procurement reports generally do not disclose contracts with firms relating to bond activity. While there was no bond activity in 2007, LIPA did issue bonds in 2006. We reviewed bond activity for 2006 and found 19 contracts relating to services for bond issuance, including rating agencies and underwriters; only 5 of these contracts had been disclosed in LIPA's 2006 procurement report. By failing to disclose all contracts, including those associated with bond issuance and those contracted by National Grid on LIPA's behalf, LIPA deprives the public and State policymakers of the most accurate and comprehensive view of its procurement activities that is necessary for both transparency and accountability.

Further, LIPA is also responsible for reporting contract information using the State's Public Authority Reporting Information System (PARIS). We reviewed the information in PARIS and found a number of data errors. For example, several contracts appeared to be operating beyond their expiration dates. By failing to renew contracts timely, an organization risks losing the

protections it may otherwise be afforded by the contract terms. However, our review of these contracts showed that most were actually current and LIPA had instead failed to ensure the accuracy of the data it had entered into the system.

Finally, we also noted that LIPA has three legal contracts with an open duration and contract amount. While there may be valid reasons for the continued use of these firms, these reasons should be documented and justified after a specified period of time or when payments exceed a certain threshold. To ensure appropriate competition, periodic re-bidding or formal evaluation and approval are necessary.

Recommendations

3. Develop and communicate specific procedures that will help staff comply consistently with procurement guidelines when dealing with competitive bids, contract evaluations, and requests for proposals.
4. Improve the completeness and accuracy of contract information included in required annual procurement reports and PARIS filings.

(LIPA officials agreed with Recommendations 3 and 4 and indicated that the most recent procurement report has been expended to include all contracts.)

5. Ensure that annual procurement reports are approved by the Board of Trustees prior to filing.

(LIPA officials disagreed with our recommendation because, in their opinion, Board approval is not specifically mandated by the Public Authorities Law.)

6. Periodically re-evaluate open-ended consultant contracts to assess the need for re-bidding and/or to continue contracting.

(LIPA officials agreed to continue monitoring and re-evaluating open-ended contracts to identify instances when re-bidding may be in the best interest of ratepayers.)

Cash Disbursements

For the year ended December 31, 2007, LIPA reported operating expenses totaling \$3.2 billion, the majority of which represented fuel and power (\$1.8 billion) along with general operating and maintenance costs (\$848 million). We tested LIPA's disbursements and did not find any discrepancies between the disbursement journal, voucher documentation, and check information.

However, we did find that LIPA does not follow up on outstanding payments regardless of how long checks remain outstanding. As a result, LIPA is carrying at least \$300,000 in dated checks on its books.

As part of LIPA's disbursement process, wire transfers and checks for amounts up to \$25,000 are authorized by one person (usually the Controller), while payments over \$25,000 require two signatories. Authorized signatories may not sign checks payable to themselves (expense reimbursements) or to pay for invoices that they themselves approve.

We tested a judgmental sample of 35 vouchers totaling \$14.7 million out of 2,523 vouchers paid during the first six months of 2008. We verified that each disbursement was supported by a vendor invoice for work-related expenses, that there was evidence that the goods and services were provided, that appropriate management approved each disbursement, and that checks were signed by authorized officials. Based upon our sample review, we did not find any significant weaknesses.

We also reviewed the May 2008 bank reconciliation and noted 209 outstanding checks totaling \$485,000, including \$300,000 outstanding for more than one year. The oldest check was dated in 2000. While the circumstances regarding each outstanding check may be unique, old checks can be an indicator that something is potentially amiss in the payment processes, including duplicate payments or invalid addresses. We determined that this situation occurred because LIPA officials do not follow up on outstanding checks identified during the bank reconciliation. Among the outstanding checks were four checks totaling \$143,324 written to three New York State agencies:

- Department of Public Service (DPS) - A check for \$122,274 was written in 2000 for an application to construct an underground electric transmission line. DPS records indicate that the check was received, but it was not cashed.
- Department of Environmental Conservation (DEC) - One outstanding check for \$15,520 from 2005, which represented a partial payment to DEC, had not cleared the bank. We found LIPA subsequently paid a bill, reissued by DEC, that included the original amount along with \$5,187 in interest and penalties applied due to lateness. Nevertheless, LIPA failed to cancel the original check. We also found another outstanding payment to DEC in the amount of \$1,575 from 2007 for a charge that was subsequently reduced to \$475 and paid by KeySpan.

- Department of Motor Vehicles (DMV) - A \$3,955 payment that was issued in 2006 for renewal of unspecified vehicle registrations was not cashed. We found that, although this payment did not clear the bank, DMV officials were unable to identify any outstanding obligations from LIPA.

LIPA officials need to monitor and routinely follow up on checks that remain outstanding for a specified period of time. By not taking timely action and allowing outstanding checks to accumulate, officials miss an opportunity to identify situations where controls are not functioning as intended and may in fact be reserving funds for items that will never be presented for payment. If the payments are found to be appropriate, LIPA can then take further action with its business partners to resolve the situations.

- Recommendations**
7. Reissue payment to the Department of Public Service in the amount of \$122,274.
 8. Monitor and routinely follow up on outstanding checks to identify situations where internal controls are not functioning as intended and ensure proper disposition of funds.

(LIPA officials agreed with Recommendations 7 and 8).

Internal Control Certifications

Each year, LIPA is required to complete two reports covering various aspects of its internal control system: an Assessment of Internal Control Structure required by the Public Authority Accountability Act and an annual internal control certification required by the New York State Governmental Accountability, Audit and Internal Control Act (Internal Control Act). Specific requirements for the Internal Control Act certification are included in the New York State Division of the Budget's Budget Policy and Reporting Manual Item), which requires agencies and authorities to disclose major internal control activities undertaken during the year and to address six elements specified in the Internal Control Act.

We found that LIPA completed both reports timely and addressed each of the required elements of compliance. However, we also noted that the internal control reviews and assessments used to support the reports were all conducted by LIPA's internal control officer and not by program staff involved in the specific operations under review. B-350 requires that line managers in operating units perform self-assessments of risks and controls. This line-level participation is important, both to ensure adherence to controls and to promote line-level buy-in to the process of routinely analyzing and

improving control systems. LIPA officials indicated that they are hoping to get each operating group to conduct its own annual assessment by the end of 2009.

Recommendation

9. Require that all operating groups conduct periodic self-assessments of risks and associated internal controls.

(LIPA officials agreed with this recommendation and reported that steps are underway to begin the self-assessment process.)

Computer Equipment Inventory

We examined the internal equipment and asset management practices within LIPA's corporate office regarding computers. We found LIPA needs a more comprehensive policy to ensure its computer equipment inventory is accurate. State operating procedures generally require that an individual who is not responsible for custody of equipment take an annual inventory of all equipment assigned to each location. To facilitate and ensure accountability, it is important that all equipment transfers, additions and disposals are documented. A complete and accurate inventory reduces the risk that items may be lost, stolen or misplaced. However, we found that no periodic inventory counts are performed and computer equipment is not tagged with a LIPA symbol or control number, as required by LIPA's fixed asset policy. Further, we found that LIPA has granted its Information Technology (IT) Manager complete control over the inventory and disposal of computer equipment, instead of separating these responsibilities to ensure accountability.

According to LIPA records, between January 2007 and July 2008, LIPA purchased computers and related items valued at almost \$540,000. We found that, while the IT Manager maintains an inventory of these computers, it reflects only equipment that has been assigned to staff. We found three laptops and four desktop computers were not yet assigned and therefore were not reflected on the inventory list. We selected a judgmental sample of 12 items purchased during this period valued at more than \$77,000 and were able to locate each item. However, only eight of the items were on the inventory list; the remaining four items (a tape drive, two hard drives and software for the server) were not. We also selected five computer equipment items that we physically observed around LIPA's offices and were able to trace all five to the inventory list.

We also found that the disposal of broken and outdated computer equipment is left up to the discretion of the IT Manager. According to LIPA records, 30 computer related items were recycled in 2007. We found there are no

supporting documents regarding the reasons for the disposal of these 30 items and there is no process in place requiring the IT Manager to obtain authorization to dispose of equipment. Since the same person is responsible for the inventory and disposal of computer equipment, there is less assurance that equipment is actually disposed of or that disposal records are complete. Improper disposal of computer equipment poses risks to the organization, not only in terms of control over its assets, but also in terms of the potential for disclosure of personal or proprietary information that may be included on the devices.

Recommendations

10. Develop a more comprehensive inventory policy that includes: identifying all items to be inventoried; independent periodic inventory checks; and procedures for disposing of equipment.
11. Provide for independent verification or authorization for disposal of computer equipment.

(LIPA officials agreed with Recommendations 10 and 11 and reported that new directives were put in place during March 2009 to correct the reported deficiencies.)

Debt Issuance

LIPA issues debt when necessary to raise capital to support its programs and operations. As of December 31, 2007, LIPA had an outstanding debt portfolio exceeding \$6.8 billion. There was no bond activity in 2007, but there were two new bond issues and four bond refundings in 2006.

Debt is initiated and monitored by the Chief Financial Officer in conjunction with other appropriate staff. The controls over the debt issuance process include the participation, review, opinions and oversight by various parties, including: LIPA officials, bond underwriters, bond counsel, financial advisors, bank trustees, and rating agencies. Further, all debt issuances are subject to approval by the Office of the State Comptroller, LIPA's Board of Trustees, and the Public Authorities Control Board.

We found that LIPA has standard steps that staff follow when issuing debt, but these procedures are not formalized or documented. We reviewed debt activity for 2006 and found that all appropriate approvals were obtained for bond issuances. However, without formal procedures to guide staff, management has less assurance that procedures are consistently followed.

12. Codify procedures for the debt management process to assist staff in ensuring compliance.

Recommendation

(LIPA officials agreed with the recommendation.)

Additional Financial Operations

We reviewed several other aspects of LIPA's financial operations, including revenue and cash receipts, investments, the budget process, and payroll practices. We determined that internal controls over these operations were adequate. Following is a description of these areas.

Revenues

Allocation of receipts to revenue accounts, including receivables, is performed by the Director of Accounting based on information received monthly from National Grid. Each month, LIPA's Accounting Department conducts various analyses of reported revenue to ensure reasonableness. We selected ten deposit transactions from the May 2008 bank statement, along with the May 2008 reconciliation report, and verified that ledger activity agreed with the reported amounts and sources of revenue.

Billings

Billings and collections are outsourced to National Grid. According to LIPA officials, the Customer Accounting Department of National Grid tests the accuracy of the billing that it prepares by recalculating one random bill daily from each of the approximately 40 rate classes. We reviewed the monthly operations report prepared by National Grid for the period ending June 30, 2008. The operations report showed that National Grid exceeded the target accuracy rate of 99.54 percent and has accurately billed 99.6 percent of the year-to-date bills.

Cash Receipts

LIPA contracts with National Grid to bill customers and collect and deposit payments to LIPA's customer remittance account. National Grid has 11 service centers that receive cash and check payments from customers. We found the controls over cash receipts include: customer receipts from the service centers are taken and delivered to a lockbox bank daily by armored security service; the lockbox bank prepares a deposit report, which is reconciled to customer payments daily by National Grid; large, commercial payments are deposited directly to the bank account rather than the lockbox; and online payments are deposited to a separate customer remittance account.

Collections

National Grid's monthly operations report for LIPA includes outstanding

account information and trend analysis. The LIPA arrears report is an active receivable report that details collection actions taken by National Grid for outstanding accounts. The arrears report presents outstanding balance information for residential and commercial customers that are unpaid after 30, 60, and over 90 days. We found that 16 percent of outstanding accounts (approximately \$50 million) were uncollected for more than 90 days, as of May 30, 2008. In addition, almost \$8 million (0.63 percent) of the year-to-date revenue was written off as uncollectible. We reviewed ten outstanding accounts and found that appropriate action was taken to attempt to collect payment in all cases.

Investments

LIPA's investment guidelines provide for investments to be made by either the Director of Treasury or an outside Investment Manager with whom LIPA contracts to handle its investment portfolio. Investments are monitored and reviewed daily by LIPA's Manager of Treasury Operations by accessing the activity on the Investment Manager's system. The guidelines prohibit certain investments, such as reverse repurchase agreements, short sales and complex derivatives. We did not identify any investments in these prohibited categories.

We judgmentally selected six investments from each of the investment reports dated December 31, 2007 and March 31, 2008 and compared the information (issuer, par, rate, maturity, and value) with investment summaries provided by the Investment Manager. All information agreed and was in compliance with the guidelines. We calculated the percentage allocation among the investment types for both reports and found funds were invested in compliance with LIPA's established diversification criteria.

Budgeting and Expenditure Control

The Budget Department is responsible for overseeing LIPA's budget and monitors revenues and expenses throughout the year. After the budget is adopted, the Budget Department prepares monthly reports of expenses by account number for department managers, who must explain variances that exceed 5 percent and \$10,000. Variance explanation reports are presented to the Finance and Audit Committee monthly. The Budget Department also reviews monthly sales forecasts to monitor revenues. We found that the Budget Department adopted written procedures to provide an overview of the budget process and adheres to the procedures.

Payroll

LIPA budgeted \$16.1 million for payroll in 2008 for a staffing level of 103 employees who manage its retail electric operations. Each employee must complete a time sheet, recording the time they started work and the number of hours worked each day. Time sheets are then sent to supervisors for approval. To account for time worked, LIPA maintains an electronic timekeeping system that will automatically calculate the employee leave accruals. The Human Resources Department independently reviews accrual balances each pay period and submits a quarterly report to the Controller. We compared the bi-weekly time sheets for five employees with their bi-weekly annual and sick leave accrual records for a three-month period and did not note any discrepancies.

IT Controls

We examined LIPA's information technology and computer controls. Due to the sensitivity of this information, we have reported our findings in this area to LIPA officials separately.

Appendix A - Auditee Response



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Kevin S. Law
President & Chief Executive Officer

April 15, 2009

Mr. Frank J. Houston
Audit Director
Office of the State Comptroller
Division of State Government Accountability
123 William Street – 21st Floor
New York, NY 10038

Dear Mr. Houston:

Thank you for your report relating to your audit on the Long Island Power Authority's Internal Controls Over Core Fiscal Operations. I am pleased that you have reported that the Authority has many appropriate internal controls in place for its core fiscal operations.

The attached document details our response to your recommendations. As I continually strive to improve the operations of the Authority many recent steps have been taken; such as the issuance of Executive Orders and modifications to our existing By-Laws, which further strengthen our internal controls. Your review, coupled with our own internal measures, serve to benefit the ratepayers of Long Island.

I want to personally thank you and the members of the audit team that worked here at LIPA for the professionalism and courtesy that was extended to the staff here at LIPA.

Sincerely,

A handwritten signature in black ink, appearing to read "K.S. Law".

Kevin S. Law

cc: Elizabeth M. McCarthy, Senior Vice President and Chief Financial Officer
Timothy P. Sullivan, Director of Financial Planning

Long Island Power Authority Response to Office of the New York State Comptroller's Draft Report on Internal Controls over Fiscal Operations

Board Governance

1. Ensure that all trustees receive the required training.

The Long Island Power Authority continually monitors and informs Board members about training sessions and strongly encourages them to fulfill this requirement. This is done through memorandums, e-mail notifications and follow-up phone calls. Due to the limited number of training sessions offered, with none currently being offered on Long Island, LIPA tries to advise the Trustees well in advance of scheduled sessions to maximize their potential attendance and in order to help coordinate travel plans. Recently an option for Trustees to satisfy this requirement by receiving webinar training sessions from the CUNY School of Professional Studies was introduced. LIPA is hopeful that this new option will maximize the ability for those Trustees who have not been able to participate to satisfy the training requirement and has informed all Trustees of this option. To date, two Trustees have already participated in the webinar training and satisfied their training requirement.

2. Monitor trustees' attendance at Board meetings and take action, as necessary, to ensure appropriate participation.

The Long Island Power Authority has always monitored and kept a log of the attendance of Trustees at its Board meetings. In addition, Trustees are notified via e-mail and follow-up telephone calls of Board meetings, which are scheduled a year in advance, to ensure participation.

As noted in your report, to further ensure appropriate participation, on October 23, 2008 the Authority amended its existing By-Laws at Article II, Section 1, to include an attendance requirement for the Trustees, whereby failing to attend six consecutive meetings, or fifty percent or more of the meetings held in a consecutive twelve month period, results in a constructive resignation by the Trustee.

Procurement and Contracting

3. Develop and communicate specific procedures that will help staff comply consistently with procurement guidelines when dealing with competitive bids, contract evaluations, and requests for proposals.

As noted in your report, the Long Island Power Authority does have procurement guidelines that were previously communicated to employees in a training seminar. The Authority intends to develop operational procurement procedures and communicate them to employees.

4. Improve the completeness and accuracy of contract information included in required annual procurement reports and PARIS filings.

The Long Island Power Authority has historically reported all contracts that it enters into directly. It acknowledges that there were difficulties experienced with entering information into the new PARIS system for the 2007 reporting year, some of which were system glitches. LIPA strives to ensure the completeness and accuracy of the annual procurement report and will continue these efforts. In addition, in response to your recommendation, in the recently filed 2008 annual procurement report LIPA has reported information on a larger number of contracts, including LIPA contracts related to bond financing and non-core energy efficiency contracts that are procured by National Grid on LIPA's behalf.

5. Ensure that annual procurement reports are approved by the Board of Trustees prior to filing.

There is no stated requirement in the Public Authorities Law that requires approval of the annual procurement report by the Board of Trustees. Nonetheless, the report is provided to the Board of Trustees as part of LIPA's Annual Report for informational purposes. LIPA does not believe Trustee approval of the report is appropriate, as it contains contracts that, pursuant to LIPA's Trustee approved procurement guidelines, are not subject to Trustee approval. Therefore, seeking Trustee approval of all procurement contracts entered into by LIPA would be incorrect with and counterproductive to its guidelines.

6. Periodically re-evaluate open-ended consultant contracts to assess the need for re-bidding and/or to continue contracting.

The Long Island Power Authority notes that there are currently only two "open-ended," long-term contracts for specialized legal services that have not been re-solicited recently. However, these contracts have repeatedly been evaluated and measured against the market for pricing and quality of service in order to determine whether or not it is in LIPA's customers' interest to re-procure for those services. LIPA believes that based on this review, it is not prudent to re-procure for these services at this time. LIPA has communicated this position to OSC both verbally and in writing over the years, and will continue to re-evaluate this situation in the future.

Cash Disbursements

7. **Reissue payment to the Department of Public Service in the amount of \$122,274.**

The Long Island Power Authority acknowledges that the initial check issued to the Department of Public Service was not cashed and agrees to reissue.

8. **Monitor and routinely follow up on outstanding checks to identify situations where internal controls are not functioning as intended and ensure proper disposition of funds.**

LIPA's system of internal controls was not designed to address the risk of a vendor not cashing a check, but to insure that only properly authorized expenditures were paid. However, given the above recommendation, LIPA will create a policy to follow up and address long outstanding checks based upon the States rules for Unclaimed Property subject to Section 1315 of the Abandoned Property Law.

Internal Control Certifications

9. **Require that all operating groups conduct periodic self-assessments of risks and associated internal controls.**

On February 19, 2009, LIPA President & Chief Executive Officer, Kevin Law, issued a memorandum to all Authority employees on Internal Controls. The memorandum contained a "Message on Internal Control" that applies to all employees and announced required internal control training sessions for all staff. The Authority's Controller, Kenneth Kane, presented this training session and informed managers of their responsibility to perform assessments of risks and controls for their respective areas. Mr. Kane is presently in the process of sitting down individually with each of the managers that will be performing the assessments and instructing them as to what specifically will be required.

Computer Equipment Inventory

10. **Develop a more comprehensive inventory policy that includes: identifying all items to be inventoried; independent periodic inventory checks; and procedures for disposing of equipment.**

On March 6, 2009, LIPA President & Chief Executive Officer, Kevin Law, issued Executive Directive No. 4 which directed the Information Systems & Technology Department to implement and follow a formal, comprehensive inventory policy that includes: identifying all items to be inventoried; conducting independent periodic inventory checks; following established procedures for disposing of equipment; outlining the reasons for any disposal; and obtaining independent verification or authorization for disposal of each item of computer equipment.

IT staff is currently working to develop and implement policies and procedures for IT computer equipment inventory. The policy will provide a single unified view of the physical assets that IT is responsible for, including mapping them to relevant locations. It will serve as best practices for physical inventory controls. The policy will encompass full life cycle asset management, beginning with request, procurement, warranty, install (add, move, change), records providing detailed information about each piece of equipment, end of life threshold, replenishment rules and disposal management. Procedures will be implemented for a control system to ensure adequate safeguards to prevent loss, damage or theft of the equipment.

11. Provide for independent verification or authorization for disposal of computer equipment.

As noted in the response to recommendation # 10, LIPA's inventory policy will provide for independent verification or authorization for disposal of computer equipment. The policy will include thresholds for equipment replacement and end of life, equipment disposal procedures, data security procedures, authority for approval to dispose of equipment, vendor qualifications for disposal and approved vendors for disposal.

Debt Issuance

12. Codify procedures for the debt management process to assist staff in ensuring compliance.

As noted in the State Comptroller's report, LIPA has extensive controls over the debt issuance process. This includes the participation, review, opinions and oversight by various parties, including: LIPA officials, bond underwriters, bond counsel, financial advisors, bank trustees, and rating agencies. Furthermore authorization to issue debt is required from LIPA's Board of Trustees and the Public Authorities Control Board, and all debt issuances are approved by the Office of the State Comptroller.

To codify this process, on March 6, 2009, LIPA President & Chief Executive Officer, Kevin Law, issued Executive Directive No. 5 which directs that LIPA staff codify the relevant procedures relating to debt management. Staff is currently working on this task.