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

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LONG ISLAND POWER AUTHORITY

IMPLEMENTATION OF THE NEW YORK STATE GOVERNMENTAL ACCOUNTABILITY, AUDIT AND INTERNAL CONTROL ACT

2000-S-37

DIVISION OF MANAGEMENT AUDIT AND
STATE FINANCIAL SERVICES

H. Carl McCall
STATE COMPTROLLER

Report 2000-S-37

Mr. Richard M. Kessel
Chairman
Long Island Power Authority
333 Earle Ovington Boulevard, Suite 403
Uniondale, NY 11553

Dear Mr. Kessel:

The following is our report addressing the Long Island Power Authority's implementation of the New York State Governmental Accountability, Audit and Internal Control Act.

This audit was done in accordance with 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 Management Audit
and State Financial Services

August 22, 2001

EXECUTIVE SUMMARY

LONG ISLAND POWER AUTHORITY

IMPLEMENTATION OF THE NEW YORK STATE GOVERNMENTAL ACCOUNTABILITY, AUDIT AND INTERNAL CONTROL ACT

SCOPE OF AUDIT

The Long Island Power Authority (LIPA) was created by the State Legislature in 1986 to reduce the high utility rates on Long Island and to acquire and decommission the Shoreham Nuclear Power Plant. The Shoreham Plant was partly responsible for the high rates, as it had been built by the Long Island Lighting Company (LILCO) but was not put in service for commercial use due to public opposition to a nuclear power plant on Long Island. In 1998, LIPA acquired LILCO's electrical transmission and distribution system (distribution), 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 (BUG) creating a new utility called KeySpan. KeySpan entered into a number of long-term contracts with LIPA, under which it supplies electricity to LIPA, operates LIPA's electrical distribution system and collects payments from LIPA's customers.

LIPA has 56 employees and relies on KeySpan and other contractors to operate, maintain and oversee Long Island's electrical distribution system. In the year ended December 31, 2000, LIPA reported revenues of about $2.2 billion and operating expenses of about $2 billion. LIPA's operating expenses include a portion of the $1.6 billion paid to KeySpan for fuel purchased, capital projects, operating expenditures and other expenditures. LIPA is governed by a 15-member Board of Trustees who are appointed by the Governor and the Legislature. Our audit addressed the following questions about LIPA's system of internal control for the period May 28, 1998 (the date LILCO's assets were acquired by LIPA) through February 28, 2001:

- Has LIPA established and maintained an adequate system of internal control?

- Has LIPA complied with the provisions of the State legislation (the Internal Control Act) requiring all State agencies and public authorities to maintain an adequate system of internal control?

AUDIT OBSERVATIONS AND CONCLUSIONS

We found that LIPA needs to develop written procedures for many aspects of its operations, improve the practices used in monitoring KeySpan and other contractors, fully comply with the Internal Control Act, and make other improvements in its internal controls. We also found that a $25 million grant awarded to Nassau County for energy efficiency and conservation projects was not awarded in accordance with established procedures and some of which may not have been used for the purposes authorized by the grant award process.

An internal control system 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. We found that improvements are needed in LIPA's internal control system. For example, written instructions and procedures are dated, often trailing the fast-paced changes in business processes experienced by LIPA. In addition, written procedures do not exist for many aspects of LIPA's operations, including procedures to guide staff monitoring KeySpan and other contractors. As a result, LIPA management must develop a keener awareness of business actions that could compromise or damage LIPA's reputation or result in a loss of LIPA's assets. (See pp. 5-14)

Improvements are especially needed in LIPA's oversight of KeySpan and other contractors. For example, two major consulting firms are paid to perform numerous tasks for LIPA. However, neither the specific nature of the tasks nor the actions taken by the consultants in performing the tasks are documented by the LIPA managers responsible for overseeing the consultants. In addition, the actions taken by LIPA staff in monitoring the performance of KeySpan and other contractors serve as the first line of defense against business improprieties; therefore, we recommend a number of improvements in LIPA's contract management practices. (See pp. 17-22)

In 1999, as part of its efforts to reduce electric bills and foster economic growth on Long Island, LIPA began to award grants for projects that would promote energy efficiency and the use of clean and renewable energy sources on Long Island. Early in 2000, a grant of $25 million was paid to Nassau County. However, contrary to the procedures governing the grant award process, Nassau County was not required to submit descriptions of its projects for approval and had submitted no progress reports on its projects. To indicate how the grant funds had been used and were being used, Nassau County submitted a list of projects that had been, or were being, undertaken by Nassau County to LIPA's Chairman. According to the information on the list, the projects cost more than $139 million and were undertaken between 1992 and 2001. We question whether many of the projects on the list were eligible for grant funding. Since this list does not indicate whether the projects met the criteria for grant funding, we recommend that LIPA officials visit the projects that appear to be eligible, formally evaluate their compliance with funding criteria, and verify their reported

cost. We also note that the amount received by Nassau County in grant funding ($25 million) exceeded the amount authorized by LIPA's Board of Trustees ($20 million). (See pp. 25-27)

COMMENTS OF LIPA OFFICIALS

LIPA officials generally agreed with the findings and recommendations and indicated they have taken action or are in the process of implementing many of the recommendations.

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INTRODUCTION

Background

The Long Island Power Authority (LIPA) was created by the State Legislature in 1986 to reduce utility rates on Long Island, which were among the highest in the nation at the time, and to acquire and decommission the Shoreham Nuclear Power Plant, which was partly responsible for the high rates. The Shoreham Plant had been built and licensed by the Long Island Lighting Company (LILCO) at a reported cost of $5.6 billion, but could not be put in service for commercial use because of public opposition to a nuclear facility on Long Island. LIPA completed the decommissioning process for the Shoreham Plant in 1995, and is seeking non-nuclear uses for the site.

In 1998, part of LILCO was purchased by LIPA and the remaining assets were merged with Brooklyn Union Gas (BUG) to create a new utility called KeySpan. LIPA acquired LILCO's electrical transmission and distribution system (distribution), as well as certain other assets, and became the primary supplier of electricity on Long Island. KeySpan assumed operational responsibility for virtually all the plants, equipment and staff resources previously belonging to LILCO. All the electricity produced by KeySpan on Long Island is from power generating plants that formerly belonged to LILCO. This electricity is purchased by LIPA in accordance with the terms of a fifteen-year power supply management contract between the two entities. In addition, in accordance with other contracts between the two entities, KeySpan operates LIPA's electrical distribution system and provides customer-billing services. The contracts include incentives that increase or decrease payments to KeySpan based on performance goals. One of the primary functions of LIPA's managers is to monitor KeySpan's performance in fulfilling the terms of these contracts.

To finance its acquisition of LILCO assets, which included transmission facilities, distribution lines, the Shoreham facility, and an 18 percent interest in the Nine Mile Two Nuclear Power Plant in Oswego, New York, LIPA issued tax-exempt bonds. LIPA uses the revenue generated by the sale of electricity to

pay the interest on these bonds, to purchase electricity wholesale, to make payments in lieu of taxes to local governments and the State, and to pay other operating expenses. In the year ended December 31, 2000, LIPA reported revenues of about $2.2 billion and operating expenses of about $2 billion. LIPA's operating expenses include a portion of the $1.6 billion paid to KeySpan for fuel purchased, capital projects, operating expenditures and other expenditures. Lower interest costs resulting from the sale of the tax-exempt bonds has helped LIPA reduce electricity rates on Long Island.

LIPA's budget for general and administrative expenses for 2001 totals about $16.3 million. In addition, LIPA budgeted $15.6 million for outside consulting services. LIPA has about 56 employees, and relies on consultants from two vendors in particular: PricewaterhouseCoopers (PwC) and Navigant Consulting, an engineering firm, to help LIPA managers monitor its contracts with KeySpan. A 15-member Board of Trustees whose members must reside on Long Island governs LIPA. The Governor appoints nine of the Trustees, three are appointed by the Senate Majority Leader, and the Assembly Speaker appoints three.

Since 1987, New York State agencies and public authorities have been required by law to establish and maintain a comprehensive system of internal control. The New York State Governmental Accountability, Audit and Internal Control Act of 1987 first established these requirements, and when this legislation expired, the New York State Governmental Accountability, Audit and Internal Control Act renewed the requirements in 1999. (Throughout the remainder of this report, this law is referred to as the Internal Control Act.) To guide State agencies and public authorities in their implementation of the Internal Control Act, the New York State Division of the Budget issued Budget Policy and Reporting Manual Bulletin B-350. Bulletin B-350 requires each agency and public authority to certify compliance with the Internal Control Act by March 31 of each year.

In addition, the State Comptroller is required by Article II, Section 8 of the State Finance Law to publish internal control standards. These standards are intended to guide State agencies and public authorities in their establishment and maintenance of internal control systems. These standards, last revised by the Comptroller in February 1999, provide the basis

for the Comptroller's evaluation of internal controls in audits of State agency and public authority operations.

Audit Scope, Objectives and Methodology

We audited LIPA's system of internal control for the period May 28, 1998 (the date LILCO's assets were acquired by LIPA) through February 28, 2001. The objectives of our financial related audit were to determine whether LIPA established and maintained an adequate system of internal control, and whether LIPA complied with the specific requirements of the Internal Control Act. To accomplish our objectives, we interviewed LIPA officials, reviewed LIPA procedures and examined LIPA records. We also met with KeySpan officials to obtain an understanding of the internal controls that safeguard the LIPA assets operated by KeySpan. In addition, since LIPA depends on computer systems for its financial operations, communications and customer services, and receives financial, performance, operating and expense reports produced on KeySpan computer systems, we evaluated the internal controls in LIPA's computer systems, and obtained an understanding of the automated systems and applications at KeySpan that provide information to LIPA.

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 operations which are included in our audit scope. Further, these standards require that we understand LIPA's internal control structure and its compliance with those laws, rules and regulations that are relevant to the operations included in our audit scope. An audit includes examining, on a test basis, evidence to support 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.

We use a risk-based approach when selecting activities to be audited. This approach focuses our audit efforts on operations that have been identified through a preliminary survey as having the greatest probability for needing improvement. Consequently, by design, finite audit resources are used to

identify where and how improvements can be made. Thus, little audit effort is devoted to reviewing operations that may be relatively efficient or effective. As a result, our audit reports are prepared on an "exception basis." This report, therefore, highlights those areas needing improvement, and does not address activities that may be functioning properly.

Response of LIPA Officials

Draft copies of this report were provided to LIPA officials for their review and comment. We considered their comments in preparing this report and they are included as Appendix B.

LIPA officials replied they generally agree with our findings and recommendations and indicated they have implemented some of them and are in the process of implementing others. However, they added that certain conclusions in the report needed additional comments to place them in the proper context, in particular the delay in formalizing procedures and the Clean Energy Fund.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the Chairman of LIPA shall report to the Governor, the State Comptroller, and leaders of the Legislature and fiscal committees of the State of New York, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons therefor.

SYSTEM OF INTERNAL CONTROLS

An internal control system 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. According to internal control standards, a system of internal control consists of five interrelated components: the control environment, communication, risk management, control activities and monitoring. In our audit of LIPA's internal control system, we identified the need for improvement in all five of these components. Improvements are especially needed in the critical control activity of documentation, as many of LIPA's operating procedures have not been documented and the actions taken by LIPA to monitor the performance of KeySpan and other contractors are not adequately documented. We also found that LIPA has not complied with some of the requirements of the Internal Control Act. As a result of the weaknesses we identified in LIPA's internal controls, LIPA has less assurance that its assets are adequately safeguarded.

LIPA officials told us they are aware of the need for good internal controls and are fully committed to strong internal controls. However, they also told us that due to limited resources their initial priority was to focus their resources on providing safe and reliable energy to Long Island residents. Consequently, control policies and procedures have not been fully documented.

Control Environment

The control environment in an organization is a reflection of the attitude toward internal control and the level of control consciousness established and maintained by the management and employees of an organization. We found that internal controls have not been given a high priority by LIPA officials. Even though LIPA is required by Division of the Budget Bulletin B-350 to certify compliance with the Internal Control Act by March 31 of each year, LIPA did not comply with this requirement during our audit period. Compliance with the Internal Control Act is to be certified on a prescribed certification

form, but LIPA did not submit the form for 1998 and submitted the form for 1999 more than seven months late in 2000. On the certification form for 1999, LIPA officials stated that they had not developed written procedures for all their operating practices (and therefore did not yet comply with the Internal Control Act), because they were still in the process of documenting their policies and procedures, which will not be completed until December 2001. They stated that the policies and procedures were not documented because, since their acquisition of LILCO assets in May 1998, their focus had been on providing safe and reliable energy.

We agree that LIPA officials should focus on providing safe and reliable energy. However, a good system of internal control is an essential component for an organization to meet its mission. Therefore, if LIPA's operating policies and procedures were documented, management would be better able to focus on mission-related activities. In the absence of written policies and procedures, there is less assurance that the routine, day-to-day tasks of an organization are performed as intended.

Current internal control standards also note that the control environment is enhanced when a formal mission statement is developed by executive management and is communicated clearly to the rest of the organization. We found that LIPA has not adopted a mission statement. LIPA has a corporate commitment statement (statement) indicating it is committed to "safe and reliable service, rate stability, customer satisfaction and business growth." LIPA officials told us this statement is accepted as LIPA's "mission" statement. However, the purpose and importance of this corporate commitment statement has not been formally communicated to the rest of the organization. As a result, there is less assurance that the corporate commitment statement will always guide the actions and decisions of LIPA's staff and management. (Responding to our draft report, LIPA officials indicated that the statement will be refined into a formal mission statement. However, we remind LIPA that it needs to formally communicate the purpose and importance of its mission statement to the entire organization.)

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, contractors, suppliers and regulators. A good system of communication is essential for an organization to maintain an effective system of internal control, and ultimately, to achieve its mission.

We found that improvements are needed in the communication between LIPA and KeySpan. LIPA receives a number of reports from KeySpan addressing various aspects of the services provided to LIPA by KeySpan. The reports are supposed to be provided at certain intervals (e.g., daily, weekly, monthly or yearly) however, they are often submitted late. As a result, LIPA does not always have the information it needs on a timely basis. For example, in part, because of the lateness of expense reports submitted by KeySpan, the financial information submitted to LIPA's Board of Trustees is at least two months old.

Improvements are also needed in the communication between LIPA and one of its primary consultants, PwC. While PwC works on several projects for LIPA at any given time, it is not required by LIPA to provide regular standardized reports showing the status of these various projects. As a result, LIPA managers are less able to ensure that the work performed by PwC is performed in accordance with expectations. When we asked LIPA officials for a list of the projects assigned to PwC, the list had to be updated by PwC.

Assessing and Managing Risk

Every organization faces a variety of risks from external and internal sources. Risk assessment is the identification and analysis of the risks relevant to an organization's objectives. Through risk assessment, managers identify and analyze the risks that can jeopardize the achievement of these objectives, and determine how best to manage these risks.

We found that improvements are needed in LIPA's risk assessment practices. While LIPA has assessed the risks associated with some aspects of its operations, it has not performed a risk assessment for a number of important aspects of its operations, such as developing its budget, monitoring actual expenditures against budgeted expenditures, reviewing

KeySpan expenditures, monitoring KeySpan operations, planning and monitoring major capital projects, and processing storm damage claims from KeySpan. In the absence of a complete risk assessment, LIPA managers cannot be adequately assured that their internal controls are sufficient to protect LIPA's assets and ensure that the organization's objectives are met.

LIPA officials told us they have not assessed the risks associated with KeySpan because KeySpan prepares such an assessment annually. However, we were informed this assessment is not provided to LIPA officials. We believe there is a need for LIPA officials to routinely obtain KeySpan's annual risk assessment and review the assessment to determine whether the operations relevant to LIPA are adequately addressed. If they are not adequately addressed by KeySpan's risk assessment, LIPA should perform its own assessment of these operations.

We also found that improvements are needed in LIPA's strategic planning process. In June 2000, LIPA initiated a long-term strategic plan by identifying five major strategic initiatives (such as ensuring a supply of power for Long Island). These initiatives are to form the basis of a long-term strategic plan for LIPA. However, LIPA has not set a time frame to complete this process or to complete its plan, because LIPA officials believe such a time frame would be neither appropriate nor realistic in light of the volatility of the deregulated electric utility business.

We note that any long-term plan developed by LIPA would have to be modified annually, so changes in the utility business could be taken into account. We also note that the volatility of the utility business makes planning more necessary, not less necessary.

Control Activities

Control activities help prevent or reduce the risks that can impede accomplishment of an organization's objectives and mission. Control activities include documentation, approval and authorization, verification, supervision, separation of duties, safeguarding assets, reporting, and controls over computer systems. We found that improvements are needed in a number

of LIPA's control activities, particularly its documentation practices.

For example, LIPA's Standard Operating Procedures Manual, which documents LIPA's basic control activities, has not been revised since 1996, before LIPA purchased LILCO's assets and became a supplier of electricity. LIPA officials are in the process of revising the Manual, and at the time of our audit, they had updated written procedures for the accounts payable, investments, and contract procurement functions. However, LIPA did not have written procedures for the treasury, budgeting, financial reporting, general ledger, purchasing, personnel, payroll, employee expense reimbursement, and customer relation functions, and for controlling computer systems. In addition, LIPA had not developed, and does not plan to develop, written procedures for monitoring the work done by its contractors. These contractors, which include KeySpan, PwC and Navigant Consulting, perform most of the day-to-day activities overseen by LIPA managers.

LIPA officials told us they did not plan to develop written procedures for monitoring the work performed by KeySpan under its contracts with LIPA, because they believe the contracts and their associated written agreements (side letters) provide sufficient written guidelines for monitoring the contracts. The officials also believe the written job description for the position of LIPA's Controller provides written guidelines for monitoring these contracts. We acknowledge the contracts provide a basis for developing guidelines for monitoring KeySpan, because they generally indicate what is expected of KeySpan. However, neither the contracts nor the Controller's job description specifies the actions that need to be taken by LIPA to verify that the expectations are met. For example, according to one of the contracts, KeySpan is expected to maintain LIPA's transmission facilities and distribution lines. However, the contract does not specify the actions that LIPA officials (such as how to review the documentation provided by KeySpan) should take to obtain reasonable assurance that the transmission facilities and distribution lines are being adequately maintained.

In addition, at the end of each contract year, KeySpan is required to submit to LIPA an annual settlement statement in which the total management service fee and performance incentives payable to KeySpan for the year are compared to the

amounts paid by LIPA during the year for management services and performance incentives. Any difference in the two amounts has to be settled by the two parties within a prescribed time period. Even though the settlement statements submitted by KeySpan have been complex documents requiring careful and lengthy review, LIPA has not developed detailed written procedures to guide its staff in their review of the statement and in their settlement of differences with KeySpan. In the absence of such procedures, the settlement process is less likely to be completed in a timely manner, and we note that both of the settlements that were negotiated during our audit period were subject to long delays (for example, the settlement process for 1999 should have been completed by June 1, 2000, but was not completed until February 23, 2001).

We also note that, while LIPA's contracts with PwC and Navigant Consulting provide a basis for developing procedures for monitoring the performance of the consultants, they do not provide specific guidance to the LIPA managers who are responsible for monitoring the consultants and ensuring that their performance is consistent with the requirements of the contracts. In fact, much of the language in the contracts with PwC and Navigant Consulting is deliberately vague so that the consultants can be used to provide assistance in the areas where assistance is most needed at any given time. For example, the contract with Navigant Consulting states that the engineering firm's tasks under the contract "may be revised, added or eliminated from time to time during the year to meet LIPA's needs." Consequently, if LIPA managers are to be assured that the work performed by the consultants during the year is consistent with management's expectations, both the specific expectations for that year and the consultants' fulfillment of the expectations must be documented, and this documentation must be reviewed by the LIPA managers responsible for monitoring the consultants. To provide assurance that this process is followed, written guidelines should be developed to direct the LIPA managers responsible for monitoring the consultants. Moreover, as discussed previously in this report, LIPA managers would be better able to monitor PwC if the consultant provided regular standardized reports showing the status of its various projects.

LIPA officials informed us that, in January 2001, LIPA's Board of Trustees created the position of Chief Administrative Officer

whose priority is to document LIPA's policies and procedures and internal controls.

We note that LIPA's internal controls would be strengthened if its oversight of its contractors was better documented. For example, LIPA officials informed us they communicate weekly, and even daily, with KeySpan officials, and certain LIPA staff, such as customer service managers and engineers, and continually visit operations managed by KeySpan. However, the meetings between LIPA and KeySpan officials are documented only minimally, and the results of visits by LIPA staff generally are not documented. If these meetings and visits were properly documented, LIPA management would have a more reliable basis for assessing the adequacy of the work performed by the contractors and greater assurance that the priorities identified by LIPA management were appropriately addressed.

Improvements are also needed in other control activities. For example, the consultants are required by contract to maintain records showing the amount of time spent on each LIPA project. Because LIPA's payments to its consultants are based on the number of hours worked by the consultants, the hours claimed by the consultants should be verified, at a minimum on a test basis. However, LIPA officials told us they do not ask consultants to submit documentation to support the number of hours claimed on their invoices. Instead, invoices are only reviewed for reasonableness of the hours worked and the assignments as reported by the consultants. Consequently, LIPA officials have limited assurance that the hours claimed by the consultants are appropriate.

In addition, as is described in detail in the section of this report entitled "Areas of Operation," some vouchers may have been paid without all the required authorization, employees were paid without the required supervisors' signatures, the amount collected from LIPA's customers by KeySpan is not verified by LIPA, the uses of a $25 million grant awarded to Nassau County for energy efficiency and conservation projects were not adequately verified by LIPA, and the controls over LIPA's computer systems need to be strengthened.

(Responding to a draft of this report, LIPA officials indicated that our conclusion that some vouchers may have been paid without all the required authorization is not valid based on the fact that

required documentation was missing from files that were up to two years old. They believe the documents were part of the voucher package at the time of approval.

Auditors' Comments: While we acknowledge LIPA's position, we note that documentation serves as evidence that can substantiate decisions, actions, transactions, or systems. It also creates a history that can guide an entity in making subsequent decisions, and can be a very valuable tool in self-evaluation and external or internal audits, allowing management to trace the entire cycle of any transaction. Because documentation was missing or incomplete, we conclude, "that some vouchers may have been paid without all the required authorization." LIPA officials should focus on improving controls over their payment files.)

Monitoring

Monitoring is the review of an organization's activities and transactions to assess the quality of performance over time and to determine whether its controls are effective. Management should focus its monitoring efforts on internal controls and the achievement of the organization's objectives. We found that improvements are needed in LIPA's monitoring practices, as the monitoring performed by its Internal Control Officer could be more effective and the monitoring that could be provided by KeySpan's Internal Audit Department is not taken full advantage of. In addition, LIPA officials have not formally evaluated whether they need their own internal auditor.

LIPA is required by the Internal Control Act to appoint an Internal Control Officer to implement and monitor internal controls. According to the Act, the Officer should report to the head of the agency. LIPA has designated its Director of Financial Reporting as its Internal Control Officer. In making this designation, we believe LIPA does not fully comply with the Internal Control Act, because an individual who is responsible for providing the Board of Trustees with accurate financial data (as Director of Financial Reporting) cannot at the same time independently evaluate the internal controls intended to ensure the accuracy of this data. We also question whether a single individual can devote adequate time and effort to these two responsibilities (financial reporting and internal control implementation and monitoring). Moreover, since the Director of Financial Reporting reports to the Controller, this individual's position in the organization is not consistent with the Internal

Control Act, which requires that the Internal Control Officer report to the head of the organization. LIPA officials told us that the Director of Financial Reporting is the best choice to be Internal Control Officer, because this individual is the most qualified and most independent member of management given LIPA's current staffing levels. Nonetheless, if this arrangement is maintained, we question whether LIPA management can be adequately assured that the internal controls in the Financial Reporting Department are adequate.

According to guidelines provided by the New York State Division of the Budget, when the Internal Control Officer identifies weaknesses that might impede fulfillment of the organization's objectives, a plan must be developed to correct the weaknesses and executive management must approve this plan. LIPA's Internal Control Officer told us he has tested internal controls, identified weaknesses and initiated changes to address these weaknesses. However, the Internal Control Officer did not document the weaknesses, the plans to correct the weaknesses or executive management's approval of these plans. He told us the tests of internal controls are done in the performance of his regular business duties and he takes action to correct any weaknesses that are identified. To fully comply with the requirements of the Internal Control Act and the guidelines developed by the Division of the Budget, LIPA's Internal Control Officer should formalize this process.

LIPA is required to certify its compliance with the Internal Control Act by March 31 of each year. As part of this certification, LIPA must evaluate whether it needs an internal auditor. However, in the certification submitted in November 2000, LIPA officials did not indicate whether they had evaluated the need for an internal auditor. LIPA officials told us they believe they do not need an internal auditor, because the size of their staff is too small. The officials told us they instead rely on PwC and Navigant Consulting to perform reviews of day-to-day transactions, look into problems and help monitor the contracts with KeySpan. The officials also told us they rely on the internal audits performed by KeySpan's Internal Audit Department.

While we acknowledge that the consultants and the KeySpan internal auditors can be helpful to LIPA management, they are employees of other organizations and therefore cannot be expected to serve LIPA's interests as consistently or to the extent that LIPA's own internal auditors could. We also

question whether the size of LIPA's staff is the most relevant factor when considering the need for an internal auditor, because contractors perform most of the activities managed by LIPA. We believe the size of LIPA's budget – about $2 billion – is a more relevant factor when determining the need for an internal auditor.

We further note that LIPA would make even better use of KeySpan's Internal Audit Department if LIPA officials requested copies of the Department's annual audit plan.

Recommendations

1. Develop a plan that affirms the revision of the Standard Operating Procedures Manual will be completed by December 2001. Include estimated completion dates for the sections in process, and monitor progress against these dates.

2. Enhance the practices used to monitor contractors by: developing written procedures for monitoring the work performed by contractors and including these procedures in the Standard Operating Procedures Manual; documenting what is specifically required of the consultants during the year as well as what the contractors do to fulfill these specific requirements; documenting meetings with contractor officials and visits to contractor sites by LIPA staff; and verifying, at least on a test basis, the hours reported on invoices.

3. Develop detailed written procedures for the annual settlement process with KeySpan.

4. Develop a mission statement, formally communicate this statement to the entire organization.

5. Require consultants to periodically submit standardized reports showing the status of their work for LIPA.

Recommendations (Cont'd)

6. When performing risk assessments, include all aspects of LIPA's operations in the assessments. In addition, routinely obtain KeySpan's annual risk assessment and review the assessment to determine whether the operations relevant to LIPA are adequately addressed. If they are not adequately addressed, perform an assessment of these operations.

7. Establish a time frame for initiating a long-term strategic planning process and for developing a long-term strategic plan.

8. Assign the Internal Control Officer no duties that conflict with the duties of implementing and monitoring internal controls in all LIPA operations, and have the Internal Control Officer report to LIPA's Chairman. In addition, require that the Internal Control Officer document the internal control weaknesses identified during the review of controls, the plans to correct the weaknesses, and executive management's approval of these plans.

9. Formally evaluate the need for an internal auditor.

10. Routinely request copies of KeySpan's annual internal audit plan.

    (In response to Recommendation 10, LIPA officials claimed that they have always received copies of KeySpan's annual audit plan but there appears to be some confusion as to whether copies were supplied to the audit staff.

    Auditor's Comments: At the completion of our fieldwork and after the draft of this report was issued, LIPA gave us copies of KeySpan's annual audit plan. We believe this is a step in the right direction. Now, LIPA must take the necessary steps to take full advantage of the monitoring function that could be provided by KeySpan Internal Audit Department.)

AREAS OF OPERATION

We found that internal controls can be strengthened in certain financial processes and in relation to LIPA's computer systems. We also found that a $25 million grant awarded to Nassau County for energy efficiency and conservation projects was not awarded in accordance with established procedures and some of which may not have been used for the purposes authorized by the grant award process.

Financial Operations

We identified a number of weaknesses in LIPA's internal controls over payments made to contractors and vendors, payroll and personnel practices, and payments collected from customers.

Payments to Contractors and Vendors

According to accounts payable procedures approved by LIPA management, the department head that ordered and received the product or service should approve all vendor invoices, and the accounts payable unit should maintain a log of invoices awaiting approval by the appropriate department heads. No invoice should be paid until the appropriate department head has approved it. However, we found that the accounts payable unit does not maintain a log of invoices awaiting approval. Instead, an informal tickler file of invoices is maintained. LIPA officials believe the informal tickler file provides adequate assurance that payments will be made for authorized purposes only. However, in the absence of the required log of invoices awaiting approval, an invoice can be paid without proper confirmation that the goods and services were authorized and were actually received.

To determine whether LIPA payments to contractors were processed in accordance with LIPA's requirements, we selected a judgmental sample of 73 payments totaling $365.2 million out of 478 payments during the two years ended December 31, 2000. A total of 43 of these payments (totaling $357.1 million) were made to KeySpan for services provided under its contracts

with LIPA, and the remaining 30 payments (totaling $8.1 million) were made to Navigant Consulting, PwC or KeySpan (these payments to KeySpan were reimbursements of storm damage claims).

We reviewed LIPA's files for these 73 payments and determined that, for six payments totaling $44.1 million, there was no documentation in the file indicating that the payment had been approved by the appropriate department head. For two of the six and another 11 payments, we also determined that other documentation required by LIPA procedures was not included in the files. (The purpose of documents not in the file would provide some assurance that payments were authorized, processed, recorded and accounted for in the appropriate manner.) We therefore conclude that, if LIPA management is to be reasonably assured that payments are processed in accordance with requirements, improvements are needed in LIPA's payment and documentation practices.

To protect against the loss of documentation, only authorized employees should be allowed access to payment files (referred to as voucher packages at LIPA). However, access to the voucher packages is not controlled or restricted, and any employee has access to the packages. As a result, it is possible that some (or all) of the missing documents we identified were part of the voucher packages when the payments were made, but were subsequently separated from the package.

LIPA officials do not believe their controls are significantly compromised by the missing documentation we identified, because no payment can be made without the approval of either the Controller or the Chief Financial Officer, and invoices exceeding $25,000 (as were all the invoices in our sample) require two signatures for payment. We acknowledge that dual signatures provide some additional control; however, it does not offset the assurance that is lost when a payment is not approved by the appropriate department head, because the department head generally knows much more about the services or goods being paid for and is therefore better able to determine when a payment should not be authorized.

We also identified the following weaknesses in LIPA's controls over payments to contractors and vendors:

- Internal controls are weak when the person who is responsible for approving a payment can also make the payment, because any unauthorized payments made by this person may not be detected in a timely manner. We believe responsibilities are not adequately separated at LIPA, because the head of the department who approves PwC invoices for payment also signs the checks making the payment. LIPA officials stated that the risk is limited because invoices over $25,000 need two signatures for payment. We disagree, because as previously explained, the additional signatures are from individuals who may not know enough about a transaction to identify a payment that should not be authorized. Properly separating responsibilities provides better control than requiring additional signatures.

- To prevent duplicate payments, invoices should be cancelled or clearly stamped as paid. However, LIPA's Accounts Payable Procedures and Controls procedures do not require invoices to be canceled or stamped in a manner that would preclude their reuse.

Payroll and Personnel Practices

LIPA employees are required to maintain bi-weekly worksheets of the hours worked and leave time taken, and to submit these worksheets every two weeks for input into the automated timekeeping system. The automated system produces an official time report that is reviewed and signed by the employee and the employee's supervisor. We judgmentally selected for review 30 (first 30 full-time employees provided) of the 58 employees on LIPA's payroll for the four weeks ended January 4, 2001. For each employee, we requested the two bi-weekly worksheets and the two official time reports for this four-week period. We reviewed these worksheets and time reports, and identified the following internal control weaknesses:

- None of the 60 official time reports were signed by a supervisor.

- For two of the 60 official time reports, there was a discrepancy between the official time report and the supporting worksheet. (In one instance, the worksheet indicated that the employee was absent for 7.5 hours, but the employee was charged only 6.5 hours of leave on the

official time report; in the other instance, the worksheet indicated that the employee earned 4.25 hours of compensatory time, but the employee accrued 6.5 hours on the official time report.)

- Many of the worksheets were not fully completed by the employees (e.g., on 39 of the 55 worksheets provided and reviewed), the employee indicated that a certain number of compensatory hours were worked during the two-week period. However, we found that 32 of the 39 worksheets did not indicate on which days these hours were worked.

- Eight of the 39 worksheets, the employee did not indicate which types of accrued leave should be used to account for the employee's absences during the two-week period.

- Five worksheets of the 60 requested (for four employees) were missing.

LIPA officials told us that the problems we identified should be corrected when LIPA's new automated payroll reporting system is implemented. They also noted that, while the bi-weekly worksheets should have been fully completed by the employees, the official time record is the important document and employees were required to review and sign this document.

In addition, LIPA maintains official job descriptions for its management personnel. However, we found they were not developed for two of the 14 manager titles, (Chief Financial Officer and Internal Control Officer). In the absence of formal job descriptions, there is an increased risk that the performance of the individuals in these titles will not be consistent with management expectations of LIPA.

Payments Collected from Customers

According to one of the contracts between LIPA and KeySpan, KeySpan collect payments from LIPA's customers and deposits the funds into an account maintained by LIPA. If LIPA officials are to be adequately assured that the amounts deposited into LIPA's account include all the payments collected from their customers, they must periodically reconcile the amounts deposited by KeySpan to the amounts billed to and

received from customers. However, LIPA officials perform no such reconciliation.

LIPA officials told us they do not verify KeySpan's cash deposits because they believe work done by PwC has shown that they can rely on the accuracy of the amounts deposited by KeySpan. They told us that, on a test basis, PwC auditors trace the total amount collected by KeySpan to the bank deposit slips and/or bank statement, and also review audits of cash receipts done by KeySpan's internal auditors. LIPA officials further informed us they plan to begin random tests of KeySpan's deposits to verify that all amounts collected are accounted for. However, in the absence of a test that compares the amounts deposited to the amounts billed and received, and one that determines whether the amount billed was correct, LIPA officials have limited assurance that the revenues received are correct.

Some of LIPA's customers receive electricity from LIPA and gas from KeySpan. The payments collected from these customers must be allocated between LIPA and KeySpan. KeySpan initially estimates the portion of these collections that will be allocated to LIPA, and deposits the estimated amount into LIPA's account. The exact amounts to be allocated to LIPA and KeySpan are subsequently calculated by KeySpan in accordance with a methodology approved by KeySpan and LIPA, and differences between the exact allocations and the estimated allocations are to be settled each month.

Each month, KeySpan reports the differences between the exact allocations and the estimated allocations to LIPA. However, we found that KeySpan has not been timely in its submission of these reconciliation reports. For example, no reconciliation reports were submitted for a period of more than six months during the year 2000 (between April and November of 2000) until December of 2000, and no report was submitted in January or February of 2001. These delays are due in part to efforts by KeySpan to revise the allocation methodology. LIPA officials told us they have repeatedly asked KeySpan to provide the reconciliation reports in a timely manner. As a result of the delays in submitting the reconciliation reports, there have also been delays in settling the differences between the actual allocations and the estimated allocations.

Recommendations

11. Maintain a log of invoices awaiting approval by the appropriate department head, and ensure that invoices are not paid unless they have been approved as required.

12. Control and restrict access to voucher packages to authorized employees, and establish records to account for the location of any documents that are removed from the files.

13. Separate incompatible payment-related responsibilities.

14. Cancel or stamp all invoices that are paid.

15. Review employee time records for accuracy, completeness and supervisors' signature.

16. Develop job descriptions for all management positions.

17. Periodically compare the customer payments deposited by KeySpan to the amounts billed to and received from customers.

18. Work with KeySpan to expedite the process of reconciling differences between estimated and actual customer billing allocations.

COMPUTER SYSTEMS

LIPA uses a local area network to operate its computer systems, and uses the computer systems to support its financial processes, communications and customer services. Certain types of internal controls are uniquely applicable to computer systems, they are typically categorized as either general or application controls. General controls relate to all activities in the computer environment, and address such concerns as the safety and security of computer hardware and electronic information; the development, modification and maintenance of computer programs; and the use of and changes to the data maintained in computer files. Application controls relate to the specific tasks performed by a specific computer, and they are intended to provide assurance that data entered into the system is properly recorded, processed and reported.

We interviewed LIPA officials and observed LIPA's computer systems, and determined that LIPA has implemented certain general and application controls for its computer systems (as was previously mentioned in the section of this report entitled "System of Internal Control," these controls have not been documented; LIPA officials told us they were in the process of documenting the controls as part of their revision of the Standard Operating Procedures Manual). For example, employees must use a personal password to gain access to the local area network, and computer system operators regularly backup programs and files on tape.

However, improvements are needed in some of the controls that have been implemented and other controls need to be implemented. For example, employees are not required to regularly change their personal password, the backup tapes are kept on-site in a container that is not fireproof (a fireproof container was purchased at our suggestion), and LIPA does not have a disaster recovery plan that will allow it to recover critical data and continue data processing operations if the current systems were destroyed or disabled.

Improvements are especially needed in the physical and environmental controls for protecting computer hardware. For

example, LIPA's four file servers are kept in an unlocked room to which the door is usually kept open. The room is also used as a storeroom and an office for a consultant, and it is not air-conditioned. The room has a water sprinkler system, but covers are not available to protect the servers from water damage. If there is a power outage, no backup power (such as a generator or batteries) is available. As a result of the weaknesses we identified in LIPA's general and application controls, there is an increased risk that the data produced by LIPA's computer systems will not always be reliable, and critical data and data processing capabilities will not be recovered in a timely manner in the event of a disaster.

LIPA officials told us they plan to move their servers to a more appropriate area. LIPA originally had only one file server, but since it became a supplier of electricity, its operations have grown significantly.

Recommendation

19. Implement computer general and application controls that are consistent with the controls described in the internal control standards published by the State Comptroller, e.g. require employees to periodically change their password, develop a disaster recovery plan, and provide adequate physical and environmental controls over equipment.

CLEAN ENERGY FUND

In May 1999, LIPA's Board of Trustees established a Clean Energy Fund (Fund) to promote energy efficiency and the use of clean and renewable energy sources on Long Island in order to reduce customers' electric bills and foster economic growth. Grants are to be awarded from the Fund to applicants whose planned projects meet certain criteria. Grant recipients are expected to submit progress reports to the Board and allow inspections by LIPA officials. The entire process is to be governed by detailed procedures that have been published by LIPA. At least 10 percent of the Fund is to be targeted to projects benefiting low-income households, and some level is to be targeted to economic development projects that promote clean energy. The Board of Trustees approved a resolution of $160 million for a five-year period for the Clean Energy Fund.

In February 2000, LIPA's Board of Trustees adopted a resolution to award Nassau County a grant of $20 million from the Clean Energy Fund to be used for clean energy and conservation programs. The records show that a $25 million grant was awarded to Nassau County, $5 million more than the resolution authorized. We also determined that, contrary to the published procedures governing the grant award process, Nassau County was not required to submit for approval descriptions of its clean energy and conservation projects. In addition, even though grant recipients are expected to submit progress reports to the Board, Nassau County had submitted no such reports or any other documentation indicating how the $25 million was being spent. We also noted that documents we reviewed indicated that, potentially, the $25 million could be used for items related to fiscal issues, but this would not reduce the amount available for the clean energy and conservation programs.

To indicate how the grant funds had been used and were being used, Nassau County submitted to LIPA's Chairman a list of projects that had been, or were being, undertaken by Nassau County. According to information on the list, the projects cost more than $139 million and were undertaken between 1992 and 2001. In a letter dated February 1, 2001 to the Nassau County Controller, the Chairman of LIPA acknowledged receipt of this

list and stated that it presented sufficient evidence to satisfy the requirements of the grant.

We reviewed the list of projects and based on the information contained on the list, we could not determine whether several of the projects were eligible for grant funding, either because they did not appear to meet the published funding criteria and/or because they were completed before the plans for creating the Clean Energy Fund were announced. (For example, one of the projects was described as "open space land acquisition" and another project was described as various Long Island Rail Road improvements.) On the basis of the information contained on the list, it appears that four of the projects, which together cost more than $7 million, meet both the funding criteria and the time frame for the Clean Energy Fund, while two other projects (which together cost more than $20 million and involved the reconstruction of Long Island Rail Road passenger stations) might possibly meet both the funding criteria and the time frame for the Clean Energy Fund.

When we asked LIPA officials why the grant to Nassau County totaled $25 million, when the Board of Trustees had approved only $20 million, they told us LIPA's Chairman was authorized to exceed the amount approved by the Board. According to the officials, the Chairman was authorized to take this action because the Board resolution awarding the grant to Nassau County authorized the Chairman "to perform such further acts and deeds as may be necessary, convenient or appropriate, in the judgment of the Chairman, to effect the approved Shoreham Settlement Agreement." However, in the absence of any documentation stating that the additional $5 million grant to Nassau County for energy-related projects was formally included in the Board Resolution Approving Shoreham Settlement Agreement, we question whether the Chairman's action in awarding the additional grant funds was in fact authorized by the Board's resolution.

(Responding to the draft report, LIPA officials commented that the statement in our report that we "devote little effort to reviewing operations that may be relatively efficient or effective" applies in our treatment of the clean energy fund. They added that we concentrated on the grant process while overlooking the fact that the $25 million awarded to Nassau County was not a part of the original Clean Energy Fund established by LIPA. They explained the funds were given to obtain Nassau's

agreement to the settlement. As a result, LIPA agreed to provide an additional $25 million to Nassau for clean energy activities not subject to the normal grant award process that is used for the Clean Energy Fund.

Auditors' Comment: While we acknowledge the explanation provided in the response as to the reason for justifying payments to Nassau County, the audit accurately presented the facts. To provide for proper accountability, LIPA officials need to require that their records accurately report all financial transactions.)

Recommendations

20. Ensure that Clean Energy Fund grant awards do not exceed the amounts authorized by the Board of Trustees.

21. Comply with the published procedures for awarding Clean Energy Fund grants and for monitoring the use of the grant funds.

22. Ensure that the Clean Energy Fund grant awarded to Nassau County was used in accordance with Fund requirements by visiting the projects and formally evaluating their compliance with funding criteria, and verifying their reported cost.

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Appendix A

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July 2, 2001

Ms. Carmen Maldonado
Audit Director
Office of the State Comptroller
Division of Management Audit & State Financial Services
123 William Street-21st Floor
New York, NY 10038

Re: New York State Draft Audit Report 2000-S-37

Dear Ms. Maldonado:

This letter is in response to the State's draft audit report (2000-S-37) addressing the Long Island Power Authority's implementation of the New York State Governmental Accountability, Audit and Internal Control Act.

Generally, the Long Island Power Authority (LIPA) concurs with the findings and recommendations included in the draft report. Attachment A provides a synopsis of LIPA's response to each of the 22 recommendations made in the report. A more detailed response to each recommendation, including implementation plans and implementation schedules, will be provided as a part of LIPA's compliance with Section 170 of the Executive Law. This Law requires LIPA to report, within 90 days of the final release of this report, to the Governor, the State Comptroller, and leaders of the Legislature and fiscal committees of the State of New York. This report will advise what steps were taken to implement the recommendations and where recommendations were not implemented the reasons therefor.

However, LIPA does wish to comment on certain sections of this report as follows:

System of Internal Controls

LIPA considers sound and effective Internal Controls to be of the utmost importance and these controls are given the highest priority in the operations of the Authority. The tone of the report (Page 5) could lead the reader to assume that, because all written documentation was not completely up to date, LIPA was not fully committed to strong Internal Controls. This is absolutely not the case. LIPA is, and has been, committed to and is utilizing a strong system of internal controls. However, given the finite amount of resources available, LIPA is still in the process of formally documenting these controls. These existing controls will be updated and documented along with any additional required controls by the end of Calendar Year 2001.

For much the same reason LIPA does not have a "formal mission statement"(Page5). LIPA does have a "corporate commitment statement" which currently serves as its mission statement and which is communicated to all employees in the "Chairman's Budget Letter" which establishes high level organizational goals on an annual basis. As part of its strategic planning process LIPA will refine the "corporate commitment statement" into a more formal "mission statement".

Control Activities

As a summary to this section (Page 11), a paragraph points out certain items in the report section entitled "Areas of Operation" which highlights certain observations made in the report. These observations, and the assumptions and conclusions drawn from them, are inserted here as findings which do not have a basis in fact. As an example, to state that "some vouchers may have been paid without all the required authorization" because certain required documentation was missing from files that were up to two years old is not a valid conclusion. It should be noted that the vouchers in question were not paid in error. Also, the fact that two officers of the Authority signed the vouchers attests to the fact that the documentation in question was part of the voucher package at the time of approval.

Monitoring

An important internal control tool for LIPA is the Internal Audit Department of KeySpan. On page 13 of the audit draft it is noted that LIPA would make better use of this resource if it requested copies of KeySpan's annual audit plan. LIPA has done this since the relationship first began in 1998. There appears to be some confusion on the issue as to whether or not copies were supplied to the audit staff. This confusion may have been caused by the different formats used by KeySpan in supplying this information. Additional copies of the audit plans have been provided to the staff.

Clean Energy Fund

Page 4 of the draft report states that: "little effort is devoted to reviewing operations that may be relatively efficient or effective". This is particularly evident in the observations related to the clean energy funds awarded to Nassau County as part of the Shoreham settlement. The audit draft concentrates on the clean energy fund grant process while passing over the fact that the $25 million awarded to Nassau County was not a part of the original Clean Energy Fund established by LIPA. The settlement would not have been completed without Nassau County's concurrence. Suffolk County had already agreed to a settlement which reduced their liability from $1.4 billion to $620 million.. In order to obtain Nassau's agreement to the settlement, LIPA agreed to provide $25 million to Nassau for clean energy activities. This was in addition to the $160 million LIPA had pledged to clean energy over a 5 year period and was never intended to be subject to the normal grant award process that LIPA uses for the Clean Energy Fund.

Thank you for the opportunity to comment on this draft report. If you have any additional questions please contact Mr. Edward P. Murphy, Jr., Chief Administrative Officer, at (516) 719-9822.

Sincerely,

Richard M. Kessel
Chairman

Attachment

Cc: M Gridley

ATTACHMENT A

Long Island Power Authority
Response to the Recommendations
as made by the
New York State Comptroller's office
Report 2000-S-37

Recommendations	LIPA Response
1. Develop a plan that affirms the revision of the Standard Operating Procedural Manual will be completed by December 2001. Include estimated completion dates for the sections in process, and monitor progress against these dates.	**LIPA concurs with this recommendation and is in the process of preparing a schedule which will be monitored as to actual progress. In addition, components of the manual are already in the process of being prepared.**
2. Enhance the practice used to monitor contractors by: developing written procedures for monitoring the work performed by contractors and including these procedures in the Standard Operating Procedural Manual; documenting what is specifically required of the consultants during the year as well as what the contractors do to fulfill these specific requirements; documenting meetings with contractor officials and visits to contractor sites by LIPA staff; and verifying, at least on a test basis, the hours reported on invoices.	**LIPA will evaluate this recommendation as a potential component of the Standard Operating Procedures Manual.**
3. Develop detailed written procedures for the annual settlement process with KeySpan.	**LIPA will review this recommendation. However LIPA maintains its contention that the contracts with KeySpan are themselves a written procedure for the annual settlement process.**
4. Develop a mission statement, formally communicate this statement to the entire organization.	**LIPA will develop and formally communicate a formal mission statement.**
5. Require consultants to periodically submit standardized reports showing the status of their work for LIPA	**LIPA will evaluate this recommendation.**
6. When performing risk assessments, include all aspects of LIPA's operations in the assessments. In addition, routinely obtain KeySpan's annual risk assessment and review the assessment to determine whether the operations	**LIPA concurs with this recommendation and will implement it.**

ATTACHMENT A

Recommendations	LIPA Response
relevant to LIPA are adequately addressed. If they are not adequately addressed, perform an assessment of these operations.	
7. Establish a time frame for initiating a long-term strategic planning process and for developing a long-term strategic plan.	**LIPA concurs with this recommendation and will implement it.**
8. Assign the Internal Control Officer no duties that conflict with the duties of implementing and monitoring internal controls in all LIPA operations, and have the Internal control Officer report to LIPA's Chairman. In addition, require that the Internal Control Officer document the internal control weaknesses identified during the review of controls, the plans to correct the weaknesses, and executive management's approval of these plans.	**LIPA will reexamine the duties and reporting relationships of the Internal Control Officer. The documentation process used in internal control reviews will also be reviewed and changed as appropriate.**
9. Formally evaluate the need for an internal auditor.	**LIPA will evaluate the need for an internal auditor.**
10. Routinely request copies of KeySpan's annual internal audit plan.	**LIPA already does this and has provided copies to the state.**
11. Maintain a log of invoices awaiting approval by the appropriate department head, and ensure that invoices are not paid unless they have been approved as required.	**LIPA will continue to evaluate this recommendation in comparison with the tickler file that is currently in use and will make changes as appropriate.**
12. Control and restrict access to voucher packages to authorized employees, and establish records to account for the location of any documents that are removed from the files.	**LIPA concurs with this recommendation and will evaluate and implement appropriate processes to protect the voucher packages.**
13. Separate incompatible payment-related responsibilities.	**LIPA concurs with this recommendation and takes all possible steps to segregate responsibilities within the confines of the limited number of LIPA employees.**

Recommendations	LIPA Response
14. Cancel or stamp all invoices that are paid	**LIPA will implement this recommendation**
15. Review employee time records for accuracy, completeness and supervisors' signature.	**LIPA concurs and will utilize its new payroll reporting system to enhance controls in the payroll reporting process.**
16. Develop job descriptions for all management positions.	**LIPA is in the process of completing the descriptions for all jobs.**
17. Periodically compare the customer payments deposited by KeySpan to the amounts billed to and received from customers.	**LIPA will review the control processes over cash receipts and make any changes necessary to provide appropriate levels of assurance.**
18. Work with KeySpan to expedite the process of reconciling differences between estimated and actual customer billing allocations.	**LIPA continues to take steps to expedite this process.**
19. Implement computer general and application controls that are consistent with the controls described in the internal control standards published by the State Comptroller, e.g. require employees to periodically change their password, develop a disaster recovery plan, and provide adequate physical and environmental controls over equipment.	**LIPA concurs with this recommendation and is in the process of implementing these changes.**
20. Ensure that Clean Energy Fund grant awards do not exceed the amounts authorized by the Board of Trustees.	**LIPA concurs with this recommendation and has controls in place to provide this assurance.**
21. Comply with the published procedures for awarding Clean Energy Fund grants and for monitoring the use of the grant funds.	**LIPA is in compliance with the published procedures.**
22. Ensure that the Clean Energy Fund grant awarded to Nassau County was used in accordance with Fund requirements by visiting the projects and formally evaluating their compliance with funding criteria, and verifying their reported cost.	**LIPA has obtained data from Nassau on their application of the Clean Energy Fund money given to Nassau County. LIPA will evaluate the necessity of additional steps to verify the expenditures.**