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STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

April 27, 2005

Mr. Charles A. Gargano
Chairman
New York State Urban Development Corporation
633 Third Avenue
New York, NY 10017

Re: Urban Development Corporation
Internal Controls Over Financial
Operations
Report: 2004-S-30

Dear Mr. Gargano:

Pursuant to the State Comptroller's authority as set forth in Article X, Section 5 of the State Constitution and Section 6278 (3) of the New York State Unconsolidated Laws, we audited the Urban Development Corporation's system of internal controls over its financial operations for the period January 1, 2002 through June 25, 2004.

A. Background

The New York State Urban Development Corporation (UDC) is a corporate governmental agency of the State of New York, constituting a political subdivision and a public benefit corporation. UDC was created by Chapter 174, Section 1 of the Laws of 1968. UDC is authorized by law to issue bonds to provide or obtain the capital resources necessary to acquire, construct, rehabilitate or improve the following types of facilities: industrial facilities, manufacturing facilities, commercial facilities, educational facilities, recreational and cultural facilities, and housing for low-income persons. UDC is also authorized by law to create subsidiary corporations, and reported it had 68 active subsidiaries as of March 31, 2004. UDC does business under the trade name Empire State Development Corporation.

Chapter 174 calls for UDC to be governed by a nine-member Board of Directors (Board), comprising two ex officio members (the Superintendent of Banks, and the Chairman of the New York State Science and Technology Foundation (Foundation)) and seven members appointed by the Governor with the advice and consent of the Senate. One of the seven appointed members is designated by the Governor to be Chairman. Board members (other than the Chairman) serve without compensation, and all Board members serve for a term of four years. The Foundation was abolished in January 2000, but the legislation has not been changed to reflect the impact on UDC's Board.

According to UDC's audited financial statements for the fiscal year ended March 31, 2004, UDC's operating revenues in that year totaled \$1.3 billion, its operating expenditures totaled \$1.3 billion, and its net operating income totaled about \$2 million. As of May 3, 2004, UDC had a staff of 372.

B. Audit Scope, Objectives and Methodology

The New York State Governmental Accountability, Audit and Internal Control Act of 1987, as revised in 1999, requires UDC management to be responsible for establishing and maintaining an effective system of internal controls and a program of internal control review. The objectives of our performance audit, which covered the period January 1, 2002 through June 25, 2004, was to assess the adequacy of UDC's system of internal controls over its financial operations and to express an opinion of this system based upon our audit.

To accomplish these objectives, we interviewed UDC staff and management, and reviewed policies and procedures governing the following financial operations: cash receipts and disbursements; investments; payroll; Board governance; and procurement and contracting. In addition, we examined, on a test basis, evidence supporting management's assertions to us about its system of internal controls over the following financial areas: revenue collection; equipment and asset management; and budgeting and expenditure control. We also obtained information about selected activities related to UDC's accounting and information systems. UDC started replacing its accounting system during our fieldwork and, as a result, we limited our testing to focus on the controls over access to the system (e.g., the use of passwords). The objectives of our audit tests were to determine whether UDC management has established policies and procedures that provide an appropriate level of internal control over basic financial operations, and whether UDC employees follow those policies and procedures. We believe our audit provides a reasonable basis for our opinion on UDC's system of internal controls.

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 of UDC that are within our audit scope. Further, these standards require that we understand UDC'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 supporting transactions recorded in the accounting and operating records and applying such other auditing procedures as we consider necessary in the circumstances. An audit also includes assessing the estimates, judgments and decisions made by management. We believe our audit provides a reasonable basis for our findings, conclusions and recommendations.

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

C. Results of Audit

In our opinion, UDC's system of internal controls over its financial operations is adequate in all material respects. However, we noted some areas in which UDC could either improve its system of internal controls or strengthen its adherence to existing policies and procedures. Improvements are particularly needed in the areas of payroll, cash disbursements and Board governance.

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 the organization will achieve its objectives and mission. More specifically, the four purposes of internal control are to:

- promote orderly, economical, efficient and effective operations and to produce quality products and services consistent with the organization's mission;
- safeguard resources against loss due to waste, abuse, mismanagement, errors and fraud;
- ensure adherence to laws, regulations, contracts and management directives; and
- develop and maintain reliable financial and management data, and accurately present that data in timely reports.

An effective system of internal controls has five major components: control environment, communication, risk assessment, control activities, and monitoring. Following is our assessment of UDC's system of internal controls as it relates to each of these major components.

1. Control Environment

Control environment is the attitude toward internal control and control consciousness established and maintained by the management and employees of an organization. It is a product of management's philosophy, style and supportive attitude, as well as the competence, ethical values, integrity, and morale of the organization's people. Organization structure and accountability relationships are key factors in the control environment.

We determined that UDC has established and maintained a satisfactory control environment. However, the control environment would be strengthened if improvements were made in certain aspects of Board governance.

State agencies and public authorities are required by New York State Division of the Budget Policy and Reporting Manual Item B-350 to certify annually their compliance with important provisions of the New York State Governmental Accountability, Audit and Internal Control Act, and to submit this certification to the Division of the Budget. We found that UDC filed its certifications for fiscal years 2002-03 and 2003-04 in a timely manner.

One of the major purposes of internal control is to promote compliance with laws, rules, regulations and management directives. We found that UDC has developed various written policies and procedures to promote such compliance. For example, UDC has developed its own by-laws and has developed a Code of Ethics that goes beyond the financial disclosure requirements and other provisions of the New York State Ethics in Government Act.

State employees in policymaking positions are required to file an annual financial disclosure

form with the New York State Ethics Commission. We selected a sample of UDC employees and determined whether the required financial disclosure form had been filed for calendar years 2002 and 2003. Our sample contained a total of 25 employees in policymaking positions. Information provided by the Ethics Commission indicated that the required forms had been filed by all 25 employees for calendar years 2002 and 2003.

According to UDC procedures, a guidebook containing the "Corporation's Ethics and Conflict of Interest Guidelines" and a "Code of Conduct for Directors" is to be given to each new employee and each new Board member. The individuals receiving the guidebook are to sign a form (the Employee Statement of Interest and Activities form) to acknowledge their receipt of the guidebook and their willingness to comply with the requirements contained therein.

To determine whether this guidebook was distributed as required, we selected a sample of employees and Board members, and determined whether a signed copy of the Employee Statement of Interest and Activities form was on file for the sampled individuals. Our sample consisted of 41 of the 368 UDC employees as of December 2003 (including the Chairman, who is an employee) and all four of the remaining Board members who were in office at that time.

We found signed copies of the form on file for all 41 employees (including the Chairman). However, no form was on file for the four Board members. We were informed by a UDC official that Board members other than the Chairman are not required to sign the form, because they are not employees of UDC. According to this official, it is sufficient to provide the guidebook to the Board members when they are appointed; no additional action is needed to provide assurance the members will comply with the code of conduct contained in the guidebook. We believe the additional assurance provided by the signed form is no less appropriate for new Board members than it is for new employees. At the very least, UDC should keep records documenting when the guidebook is provided to new Board members.

UDC by-laws require the Board to meet at least once a year in October. Additional meetings are not required, but regular Board of Director meetings are indicative of a strong control environment. We reviewed the Board minutes for the two years ended March 31, 2004, and found that the Board met regularly during that time. We also found that a majority of Board members participated in all the meetings. Both the frequency of the meetings and the participation of the Board members contributed to UDC's satisfactory control environment.

New York State's Committee on Open Government, which is based in the Department of State, is responsible for promoting adherence to the State's Open Meeting Law and related legislation. The Committee issues advisory opinions on the meeting practices of public entities. According to these opinions, Board members attending Board of Director meetings by telephone should not be allowed to vote on the matters that are decided at the meetings.

However, when we reviewed the minutes of the UDC Board meetings held between January 2002 and February 2004, we found that, in 4 of the 31 meetings held during that period, Board members (or their representatives) voted while attending by telephone. In these four meetings, between two and four of the voting Board members were attending by telephone. We recommend that the Committee on Open Government's guidance be followed, and Board members be allowed to vote only when they are in actual physical attendance. (In response to our draft report, UDC officials indicated they do not have to follow the Committee on Open Government opinions, and as

such will continue to conduct Board meetings as they have in the past. They added that they follow the Business Corporation Law. We were provided a copy of a section of the law, but it does not provide any support for allowing Board members to vote when they attend by phone.)

We also note that four of the Board's nine positions have been vacant since December 2002. Three of these vacant positions are appointive, while the fourth position is ex officio (the Chairman of the New York State Science and Technology Foundation which was abolished on January 31, 2000). To enhance the Board's public accountability and strengthen the oversight provided by the Board, we recommend UDC request that its Board vacancies be filled.

2. 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 employees who need it in a form and within a time frame that helps them to carry out their responsibilities. Communication also involves outside parties such as customers, suppliers and regulators.

In our examination of the internal controls over UDC's financial operations, we found that communication practices were generally effective. For example, there are written job descriptions for most positions, employees receive annual performance evaluations from their supervisors, and UDC officials have developed an employee handbook, human resources procedure manual, procurement guidelines and travel guidelines. UDC also makes effective use of its intranet and the Internet. It uses its intranet to disseminate guidelines, policies and procedures, staff updates, and interdepartmental reports to employees, and uses the Internet to instruct vendors in how to do business with UDC.

However, we found improvements could be made in certain communication practices involving the Board. According to UDC officials, a week before each Board meeting, Board members receive an informational package on the topics to be discussed at the meeting. The informational package is sent from the UDC mail room, and the only documentation of these deliveries is maintained by mail room staff.

We attempted to review this documentation for our 30-month audit period, but were informed that the documentation was maintained only for the most recent three-month period. At the time of our review, the most recent three-month period was June, July and August of 2004. A total of three monthly meetings were held during this period, and the three meetings were attended by a total of 13 Board members. Therefore, a total of 13 informational packages should have been delivered during this three-month period.

We reviewed the documentation of these 13 deliveries to determine whether the informational packages were mailed to the Board members in a timely manner (i.e., in time to arrive at least one week before the meeting). We found that all 13 informational packages were mailed, but only four of the packages were mailed in a timely manner. We recommend that the documentation of these deliveries be maintained by the Secretary to the Board, and the Secretary monitor the deliveries to ensure that they are timely. We also recommend that the documentation be maintained for at least a full year. (Responding to our draft report, UDC officials claim that the packages should be delivered 5 days before the Board meetings and not a week as was stated to us during our field

work. However, they could not provide any written support for the new timing of information to the Board members. To preclude future misunderstandings, UDC officials need to formalize their policy regarding the delivery of informational packages.)

UDC posts a public notice of its Board meetings on the door of its executive office suite on the 37th floor of its office building located on Third Avenue in New York City. However, access to the building is restricted to employees and official visitors, so members of the public at large do not have access to this notice. UDC officials stated that meeting notices are also posted on UDC's Internet site, but when we reviewed the site, we found no indication that the notices were posted there. We also noted that neither the agenda for upcoming meetings nor the minutes of past meetings were posted on the website. We recommend that this information be posted on the website along with advance notice of upcoming meetings.

3. Risk Assessment

Risks are events that threaten the accomplishment of objectives, ultimately affecting an organization's ability to accomplish its mission. Risk assessment is the process of identifying, evaluating and determining how to manage these events. To have reasonable assurance the organization will achieve its objectives, management should ensure each risk is assessed and handled properly.

We found that UDC has a process for identifying risks in financial operations. In this process, an internal control questionnaire is completed annually by each UDC department, and the completed questionnaires are evaluated by UDC's Internal Control Officer. The Internal Control Officer then prepares an internal control status report on the basis of these evaluations. Included in this status report is a summary of the potential risks identified by each department and the corrective actions suggested by the departments.

We reviewed the internal control status report for 2003 and found that, while potential risks were identified and corrective actions were suggested, the information in the report was not sufficiently detailed and not sufficiently developed to provide reasonable assurance that all risks and corrective actions had been identified. To provide such assurance, UDC should initiate a formal risk assessment process.

4. Control Activities

Control activities are tools - both manual and automated - that help prevent or reduce the risks that can impede accomplishment of an organization's objectives and mission. We audited UDC's control activities in the areas of cash receipts and disbursements; investments; payroll; and procurement and contracting. We found that improvements could be made in each of these areas. We also performed a more limited review of UDC's control activities in the areas of revenue collection, equipment and asset management, budgeting and expenditure control, and accounting and information systems. In these areas, we found UDC's control activities to be reasonable and appropriate.

• Cash Receipts and Disbursements

We found that the controls established by UDC provide reasonable assurance cash receipts are properly safeguarded, accounted for, and deposited into the appropriate accounts. However,

improvements are needed in UDC's controls over cash disbursements.

During the two years ended March 31, 2004, UDC processed a total of 22,397 cash receipt and disbursement transactions. We randomly selected 50 of these transactions (46 disbursements and 4 receipts) for verification. We were unable to verify 11 of the 50 transactions (all 11 were disbursements), because UDC officials could not provide us with any of the documentation that was required for the disbursements (such as the formal purchase request, the purchase order, the invoice, or the record of receipt). In the absence of such documentation, management has no assurance disbursements are authorized, necessary or valid. Ten of the disbursements, totaling \$7,712, were made for such purposes as obtaining services from a credit check agency or obtaining services from a temporary personal services agency. The eleventh disbursement, a wire transfer of \$1.1 million, was a payment from a Federal block grant in one of UDC's programs (we sought, but were not provided with, documentation indicating that the payment was in fact received by the intended recipient). We recommend that significant improvements be made in UDC's documentation of disbursements and maintenance of disbursement documentation.

In addition, according to UDC procedures, the authorization for a cash disbursement is to be documented on a certain designated form (the payment authorization form). However, in 15 of the 35 disbursements in our sample for which supporting documentation was provided, the payment authorization form either was not properly approved (six disbursements) and/or was not completely filled out (for example, required information about the invoice was not provided on the form for 11 disbursements). As a result, there is less assurance these 15 disbursements were properly authorized. The remaining 20 disbursements in our sample and all four receipts in our sample were appropriately documented, and the documentation indicated that these transactions were processed in accordance with UDC requirements.

UDC employees may be reimbursed for travel expenses, parking expenses, and certain other work-related expenses. This type of cash disbursement is subject to various UDC requirements. For example, the expenses should not be reimbursed unless they are supported by certain specified documentation, and employees working in New York City are not eligible for the reimbursement of parking expenses.

To determine whether employee reimbursement transactions were processed in accordance with these requirements, we randomly selected for review 50 of the 829 employee reimbursement transactions that were processed during March 2004. We found that 8 of the 50 transactions in our sample were not processed in accordance with requirements, as follows:

- Four of the ten parking reimbursements in our sample were not supported by the required documentation (original receipts or cancelled checks).
- Another parking reimbursement was supported by documentation that was questionable, because the dollar amount on the original parking receipt (a credit of \$2) was not consistent with either the amount claimed by the employee (\$110) or the amount paid to the employee (\$80). According to this documentation, the employee was incorrectly reimbursed \$80 for the month.

- Another parking reimbursement was inappropriate because the employee was working in New York City and therefore was not eligible for the reimbursement. The employee submitted a receipt for \$375, and was reimbursed \$240.
- Two employees in travel status received higher than the maximum allowable meal reimbursement without obtaining the pre-approval that is required for such reimbursements.

We recommend employee reimbursement transactions be monitored more closely to ensure that they comply with UDC requirements.

We also determined that one of the employee reimbursements in our sample was costlier than necessary, as an employee who rented a car for a week (five days) was reimbursed at the daily rate, rather than at the lower weekly rate. We recommend that the employee reimbursement guidelines be modified to limit such reimbursements to the lowest available rates.

- **Investments**

We found that the controls established by UDC provide reasonable assurance its investments are properly authorized, are accurately accounted for, and are in compliance with UDC's investment policies. However, improvements are needed in certain controls relating to investments.

To determine whether UDC's investments were properly authorized, accurately accounted for, and in compliance with UDC's investment policies, we selected a sample of 65 investments for review. We selected 13 weeks from the 130 weeks between January 1, 2002 and June 25, 2004, and selected five investments at random per week, for a total of 65 investments. We found that 64 of the 65 investments were properly authorized, accurately accounted for and otherwise in compliance with the UDC investment policies that we tested. We were unable to evaluate one of the investments (a U.S. Treasury Bill with a value of \$2.7 million), because UDC officials were unable to provide us with the documentation and related records for this investment. We recommend that steps be taken to ensure that all investment documentation is maintained on file.

UDC investment guidelines state that UDC should invest its funds with banks or trust companies that are authorized to do business in New York State. However, when we asked UDC officials for a list of such banks and trust companies, they were unable to provide such a list. We obtained a list from the Internet site of the New York State Banking Department, and determined that one of the banks used by UDC for investments was not included on this list. We advised UDC officials of this matter, and recommend they maintain an up-to-date list of authorized financial institutions and ensure that UDC funds are invested only with such institutions.

UDC investment guidelines state that "the placement of Repurchase Agreements shall be distributed among several authorized firms: to reduce the level of risk." At the time of our audit, UDC had a total of 26 active repurchase agreements. We reviewed the 26 agreements to determine whether they were adequately distributed among different firms. We found that 13 of the agreements were made with Firm A, 12 of the agreements were made with Firm B, and one agreement was made with Firm C. Since all but one of the agreements were made with only two firms, we conclude that the repurchase agreements were not adequately distributed among different firms. As a result, UDC's risk of financial loss was greater than necessary.

In some instances, the UDC funds deposited with banks are fully protected against loss by Federal Deposit Insurance Corporation (FDIC), and no additional collateral is required to protect the funds. However, in other instances, the deposits are not fully protected by the FDIC, and additional collateral is required. To determine whether additional collateral is required to fully protect its deposits, UDC monitors bank collaterals on a bi-weekly basis. However, we found that improvements are needed in this monitoring process, because according to our analysis, UDC deposits were insufficiently collateralized on the three following occasions:

- For the two-week period ended March 26, 2004, the funds deposited at one bank were insufficiently collateralized by a total of \$19.3 million.
- For the two-week period ended April 23, 2004, the funds deposited at another bank were insufficiently collateralized by \$45,556, and for the two-week period ended April 30, 2004, the funds deposited at this same bank were insufficiently collateralized by \$78,193.

- **Procurement and Contracting**

We found that the controls established by UDC provide reasonable assurance purchases are properly authorized, purchased goods and services are actually received, and procurement transactions are accurately recorded. However, we also determined that, in some instances, services that should be acquired through a contract are not acquired through a contract.

Specifically, according to UDC procurement guidelines, if more than \$15,000 in services is acquired from a vendor over the course of a year, the services should be acquired through a formal contract with the vendor. Despite this requirement, UDC had no contract with three vendors that provided more than \$15,000 a year in temporary personal services, as follows:

	2002 - 2003	2003 - 2004
Vendor A	98,604	68,494
Vendor B	194,348	105,045
Vendor C	1,221,363	535,242

We also note that, according to UDC procurement guidelines, contracts of more than \$50,000 must be formally approved by the Board. As is shown by the preceding table, if the temporary personal services obtained from these three vendors had been covered by contracts, the contracts would have required the Board's approval. Since the services were not covered by contracts, Board approval was not obtained. We recommend that the acquisition of temporary personal services be monitored more closely, and contracts for such services be established as required. (UDC officials replied to our draft report that the use of temporary services increased due to 9/11, that such use was not representative and the reason for not entering into a contract. We recognize the impact of the events of 9/11, but the increase was clear in 2002-03 which does not justify continuing in 2003-04 without a contract, as required by UDC's own procurement guidelines.)

We also determined that, as a result of recommendations made in UDC's 2003 annual review of its internal controls, UDC officials were in the process of reviewing the contracting practices of UDC subsidiaries to determine whether changes needed to be made in contract review procedures to provide for greater standardization among the subsidiaries and better oversight of the subsidiaries' design and construction contracts. We recommend that this review be completed, and contract

review procedures be changed as necessary to address the concerns raised in the internal control review.

- **Payroll**

As of May 2004, the annual salaries for UDC's 372 employees totaled \$26 million. We found that a number of improvements are needed in UDC's controls over payroll. In particular, we identified weaknesses in controls over time and attendance practices, overtime payments, leave accruals, and deletions from the payroll.

UDC employees are required to complete an automated bi-weekly timesheet to record their work hours and their leave time. This timesheet should be approved by the employee's supervisor and submitted to the Payroll Department for processing. To determine whether timesheets were completed, approved and submitted for processing in accordance with UDC requirements, we randomly selected 35 employees and reviewed their timesheets for the seven payroll periods beginning in September 2003 and ending in December 2003. We found that the timesheets were completed, approved and submitted for processing in accordance with UDC requirements.

To determine whether names listed on UDC's payroll register represented bona fide UDC employees, we selected all 21 names listed as working at UDC's Buffalo/Niagara offices and verified that these individuals were working for UDC. We located 20 of these individuals at UDC offices. We were told that the remaining individual works from home through an arrangement established by the individual's former supervisor. While such arrangements may be appropriate when they are properly controlled, we question whether this particular arrangement was properly controlled, for the following reasons:

- UDC could not provide us with any written approval of the arrangement, and neither UDC's Human Resources Department nor its Payroll Department was aware of the arrangement.
- When we asked for the employee's work schedule, we were informed that the employee had no regular work schedule (the other 20 employees in our sample all had regular work schedules).
- When we asked to see evidence of the employee's completed work assignments, we were informed that this information was not yet available because the individual submits only a year-end summary of certain information and it was not yet the end of the year.
- We reviewed the employee's electronic timesheet (which is completed from home) for the two-week payroll period ended September 29, 2004. The employee is supposed to indicate his actual work hours for each day of the payroll period. When we reviewed the timesheet on September 28, 2004, the timesheet was blank: no work hours or leave time had been entered for the first eight days of the payroll period. However, when this timesheet was submitted to the Payroll Department for processing, work hours had been entered for all ten days in the payroll period, and a total of 97.5 work hours were claimed for the two-week period. The employee was paid for only 75 work hours because, in accordance with regulations applicable to this class of employee, he is not eligible for

overtime or compensatory time-off until he works more than 85 hours in a payroll period. In this instance, the employee claimed the 12.5 additional hours as compensatory time-off (these hours can be taken off at a later time). However, we found no evidence that the employee's supervisor had given prior approval for the 12.5 hours of compensatory time, as is required by UDC procedures.

We recommend that the special work-at-home arrangement with this employee be terminated immediately, unless written approval for the arrangement is obtained. If such approval is obtained, we recommend that this arrangement (as well as any other similar arrangements) be monitored appropriately. (In reply to our draft audit report, UDC officials indicated that the special work arrangement was not documented. They added that since then the employee's supervisor has documented the need to have such an arrangement. However, there is no evidence the need has been approved.)

At the time of our audit, 61 of UDC's 372 employees were eligible to earn overtime, and 43 of these 61 employees were paid overtime in 2003. According to UDC procedures, employees working overtime must receive prior approval from their department head to be paid for the overtime hours. They also must sign in and out on a special log that is to be maintained by each department.

However, we found that the special overtime log is not maintained by at least one of UDC's 36 departments (the Administrative Services Department). As a result, there is less assurance the overtime hours claimed by employees in that department were actually worked. We note that four employees in that department were among the top ten UDC overtime recipients in 2003. The overtime paid to these four employees accounted for 10.3 percent, 17.9 percent, 24.4 percent, and 30 percent of their total annual salaries for the year. To verify the overtime hours of employees in the Administrative Services Department, the Payroll Department had to rely on the work hours recorded on the employees' timesheets. We recommend that overtime hours be approved for payment only when they are supported by entries recorded in the special overtime log.

State agencies do not allow their employees to accumulate more than 1,500 hours of sick leave or to donate sick leave accruals to other employees (annual leave accruals may be donated). However, UDC allows its employees to accumulate an unlimited amount of sick leave, and to donate both sick leave and annual leave accruals to employees who do not have enough leave accruals to cover their absences and are on medical or disability leave or leave due to an extended illness of an immediate family member. We question whether it is advisable for UDC to grant sick leave benefits not granted by State agencies, and note that these additional benefits (unlimited sick leave and sick leave donation) could lead to situations in which sick leave is not adequately controlled. For example, we identified a UDC employee who had accumulated more than 2,375 hours of sick leave and had donated more than 1,220 hours of sick leave to other employees. In situations such as this, the amount of sick leave effectively available to UDC's employees may be unlimited. We recommend that UDC modify its policies on sick leave accumulation and donation to make them more consistent with the policies of State agencies.

We also note that, in an effort to reward and compensate employees for exemplary work performed subsequent to the World Trade Center attacks of September 11, 2001, in January 2003 UDC added five days of annual leave to the accruals of 140 employees and 10 days of annual leave to the accruals of 113 employees (the 113 employees reportedly worked a significant amount of uncompensated overtime and weekend hours in the months following the attacks). The value of the annual leave added to the 253 employees' accruals was \$504,417. While such an action on the part

of UDC may have been justified, the action was not submitted for the approval of UDC's Board of Directors. We recommend that actions involving significant costs be submitted for the approval of the Board.

According to UDC procedures, a paycheck should not be issued for a new employee unless certain authorizations are documented and on file with the Payroll Department and the Human Resources Department. To determine whether these procedures were followed, we examined whether the appropriate authorization documentation was on file for three employees who were hired during our audit period. We found that the documentation was on file for all three employees.

According to UDC procedures, when an employee leaves UDC, the Payroll Department should not issue the employee's final paycheck until it receives authorization to do so. This authorization is to be documented on a certain designated form (the clearance checklist form). To determine whether these procedures were followed, we examined whether a completed clearance checklist form was on file for seven employees who left UDC during our audit period. We found that the form was on file for four of the employees, but was not on file for the other three employees. In the absence of this documentation, there is less assurance that these individuals returned all items belonging to UDC such as their identification cards, or access cards. We recommend that action be taken to ensure that final paychecks are not issued unless the appropriate authorization is documented and on file.

We also determined that the names of 12 former UDC employees were included on the list of employees who were authorized to enter UDC's office building in New York City. This list is used by the building's security staff to determine whether individuals are in fact authorized to enter the building. We recommend that improvements be made in UDC's process for updating this list.

According to UDC procedures, each job position should be covered by a formal job description that defines the duties and tasks necessary and integral to the performance of the particular position. The job description should also describe the education and/or equivalent work experience required for the position. We selected 29 filled positions and asked UDC officials for the related job descriptions. We received formal job descriptions for 24 of the positions, but received no job descriptions for the following five positions: Intern, Executive Director, Site Supervisor, Senior Writer, and Director. We recommend that formal job descriptions be developed for these positions.

We also examined whether the current employees were qualified for the 24 positions having formal job descriptions. To make this determination, we compared the job descriptions to the information on each employee's formal job application and/or resume. We found that 23 of the 24 employees were qualified for their positions. We were unable to determine whether the remaining employee was qualified, because there was no job application or resume on file for that employee. We recommend that a formal job application or resume be kept on file for each employee.

- **Other Financial Areas**

We performed a more limited review of UDC's control activities in the areas of revenue collection, equipment and asset management, budgeting and expenditure control, and accounting and information systems. We found that UDC's control activities in these areas were reasonable and appropriate. For example, policies were in place prohibiting unauthorized access to the data

maintained on UDC's accounting and information systems, and Internet access to inappropriate sites was automatically blocked.

However, we did identify one area in which controls needed to be improved. Specifically, access to automated information systems should be restricted to authorized users only. Access can be restricted through various means, including user passwords. To provide optimal protection against unauthorized access, such passwords should be changed fairly frequently.

We also found that UDC employees are not required to change their passwords. This is a control weakness that should be addressed by UDC management to prevent unauthorized access to the individual electronic accounts. We recommend that employees be required to change their passwords regularly.

5. Monitoring

Monitoring is the review of an organization's activities and transactions to assess the quality of performance over time and to determine whether controls are effective. To monitor the continued effectiveness of an internal control system, management should undertake both ongoing monitoring activities and separate evaluations. We concluded that UDC officials have implemented satisfactory monitoring activities in all financial areas.

For example, UDC monitors its investments through weekly reports of investment activities. Investments are also monitored through annual reviews conducted by UDC's certified public accountant. In addition, UDC monitors procurement and contracting activities through quarterly and annual reports that are submitted to UDC management and the Board of Directors. These reports contain such information as the dollar amounts of new contracts, the reasons for the awards, the initial scope of services to be provided through the contracts, and the selection process used in awarding the contracts. The annual procurement and contracting report is provided to outside parties, such as the Division of the Budget, the Senate Finance Committee, and the Assembly Ways and Means Committee.

Recommendations

Control Environment:

1. *Ask new Board members to sign the Employee Statement of Interest and Activities form when they receive the guidebook containing information about ethics and conflict of interest. If a signed form is not obtained, keep records documenting when the guidebook is provided to new Board members.*

(UDC officials agree with this recommendation.)

2. *Allow Board members to vote at Board meetings only when they are in actual physical attendance at the meetings.*

(UDC officials replied to our draft report that they disagree with the opinions of the Committee on Open Government with regard to this issue and do not have to follow such opinions. They added that the Board members are uncompensated and attendance by phone

is done to ensure maximum participation. UDC officials gave us a copy of Business Corporation Law section used to support their response.)

Auditor's Comments: Based on the response from UDC officials, we recommend that UDC refrain from the practice of allowing Board members who attend by telephone to vote until either the Courts have clarified this issue or the statutes applicable to public notices have been amended to specifically authorize voting by telephone.

3. *Request that the vacancies on the Board be filled.*

(UDC officials agree with this recommendation.)

Communication:

4. *Instruct the Secretary to the Board to maintain documentation showing when informational packages are mailed to Board members before Board meetings, and require that the documentation be maintained for at least one full year. Also instruct the Secretary to the Board to monitor the timeliness of the deliveries, and to take corrective action when deliveries are not timely.*

(In their response, UDC officials said "...maintaining records of this nature for three months is sufficient..." adding that the materials are delivered to board members at least five days before the scheduled board meetings.)

Auditor's Comments: We recommend that UDC formally document the procedures to avoid future misunderstandings.

5. *Regularly post on the UDC Internet site advance notice and the agenda of upcoming Board meetings, and the minutes of prior Board meetings.*

(UDC officials agree to consider implementing a policy of posting notices of their meetings and meeting minutes on ESDC's website but, will not post the agenda because "typically" it is not finalized until immediately prior to a meeting. They also add that posting public notices of Board meetings on the door of executive offices fulfills notice requirements.)

Auditor's Comments: We disagree that posting board meetings on the door of executive offices fulfills the intent of the public notice requirement set forth in State law because access to that location is restricted and not available to the public. Also, we urge UDC to post the agenda for UDC meetings on the Internet and handle the revisions, if any, as part of the minutes.

Risk Assessment:

6. *Conduct formal risk assessments of UDC's financial operations and audit the areas of highest risk.*

(UDC officials agree to review its current process to determine whether it needs further strengthening.)

Cash Receipts and Disbursements:

7. *Ensure that disbursements are fully documented and all disbursement documentation is maintained on file.*

8. *Monitor employee reimbursement transactions more closely to ensure that they comply with UDC requirements.*

(UDC officials referred to the audit exceptions as "minor" and supported with sufficient documentation that they were paid under the discretion of UDC's Controllers' Department.)

Auditor's Comments: While we agree that the amounts were relatively minor, we do not agree that sufficient documentation was provided. UDC officials should use the audit exceptions as indicators of where they need to improve controls over cash receipts and disbursements.

9. *Modify the employee reimbursement guidelines to limit reimbursements to the lowest available rates when both daily rates and less costly longer-term rates are available.*

(UDC officials agree with this recommendation.)

Investments:

10. *Ensure that all investment documentation is maintained on file.*

(UDC officials replied to our draft report that they were in the midst of testing a new financial system and that "...one missing file out of 65 is statistically insignificant.")

Auditor's Comments: We disagree because UDC official had sufficient time to locate the missing file. In addition, the missing file was for an investment with a value of \$2.7 million.

11. *Ensure that funds are invested only with institutions that are authorized to do business in New York State.*

(UDC officials replied to our draft report that they disagree with this recommendation because the institution was an authorized participating lender.)

Auditor's Comments: We note that UDC officials were unable to provide a list of the banks or trust companies authorized to do business in New York State. When asked about the Excelsior Linked Deposit Programs, they claimed that they were instructed to make the

investment and did not check whether the banks were authorized to do business in New York State. Therefore, UDC should formally document and maintain its own up-to-date list of banks and trust companies authorized to do business in New York to avoid future misunderstandings.

12. *Ensure that repurchase agreements are adequately distributed among different firms.*

(UDC officials disagree with this recommendation. They said the Repurchase Agreements were transacted with the "...Repo Dealer who offered the highest bid.")

Auditor's Comments: We disagree. UDC investment guidelines say "...the placement of Repurchase Agreements shall be distributed among several authorized firms; to reduce the level of risk." Therefore, UDC should change its guidelines to specify "highest bid" instead of "...shall be distributed among several authorized firms; to reduce the level of risk."

13. *Monitor bank collateral more closely to ensure that deposits are fully protected at all times.*

(UDC officials disagree with this recommendation, claiming that bank deposits are monitored on a weekly basis because it is infeasible to do so daily due to the volume of transactions. In addition, they indicate that bank deposits were sufficiently collateralized for the period ending March 26, 2004.)

Auditor's Comments: We question the practice of reviewing bank collateral on a weekly basis because UDC is exposed to the risk of insufficient collateral each day it places public funds on deposit. UDC did not provide documentation supporting their position that all deposits cited in our audit had sufficient collateral.

Procurement and Contracting:

14. *Monitor the acquisition of temporary personal services to ensure that contracts are established for such services when required.*

(UDC officials agree with this recommendation.)

15. *Complete the ongoing review of contracting practices at UDC subsidiaries, and make all changes necessary to address the concerns raised in the internal control review.*

(UDC officials agree with this recommendation.)

Payroll:

16. *Terminate the work-at-home arrangement identified by our audit unless written approval for the arrangement is obtained.*

17. *Ensure that all work-at-home arrangements with employees are approved by the Human Resources Department and the Payroll Department, and are appropriately monitored and controlled.*

(UDC officials agree with Recommendations 16 and 17. They gave us documentation to support the working arrangement, including a request for approval. However, there is no indication this arrangement was approved.)

18. *Instruct the Payroll Department to approve overtime hours for payment only when they are supported by entries recorded in the departmental overtime log.*

(UDC officials agree with this recommendation.)

19. *Modify the policies on sick leave accumulation and donation to make them more consistent with the policies of State agencies.*

(UDC officials agree to review their current policy to determine if modification is warranted.)

20. *Obtain Board approval before awarding significant amounts of additional leave accruals or paid compensation to employees.*

21. *Ensure that final paychecks for former employees are not issued unless the appropriate authorization is documented and on file in the Payroll Department.*

22. *Improve the process for updating the list of employees who are authorized to enter UDC's office building in New York City.*

23. *Develop formal job descriptions for the five positions identified in our report.*

24. *Keep a formal job application or resume on file for each employee.*

Other Financial Areas:

25. *Require that employee account passwords be changed regularly.*

(UDC officials agree to implement Recommendations 20 through 25.)

A draft copy of this report was provided to UDC officials for their review and comment. Their comments have been considered in preparing this final report, and are included as Appendix A.

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

Major contributors to this report were Robert Mehrhoff, Santo Rendon, William Lichtenberg, Marianne Boyer, James Pugliese, Claude Volcy, Nancy Calabrese, Daniel Raczynski, and Maple Dong.

We wish to thank the management and staff of the Urban Development Corporation for the courtesies and cooperation extended to our auditors during this audit.

Very truly yours,

Carmen Maldonado
Audit Director

cc: Anita Laremont
Gary Ryan
Robert Barnes, Division of the Budget



Anita W. Laremont
Senior Vice President - Legal
and General Counsel

January 26, 2005

Carmen Maldonado
Audit Director
Office of the State Comptroller
Division State Services
123 William Street – 21st Floor
New York, NY 10038

Re: Internal Controls Over Procurement
And Contracting Activities and Report
2004-S-30

Dear Carmen:

Attached is ESDC's response to the recommendations contained in the above-referenced report. Please feel free to contact me if you have any questions.

Sincerely yours,

A handwritten signature in cursive script that reads "Anita W. Laremont".

Enclosure

cc: Eileen Mildenberger
Garry Ryan
Susanna Stein
Frances Walton

Empire State Development Corporation

633 Third Avenue New York, New York 10017-6754 Tel 212 803 3750 Fax 212 803 3775

Appendix A

**EMPIRE STATE DEVELOPMENT RESPONSE TO DRAFT AUDIT REPORT
REGARDING URBAN DEVELOPMENT CORPORATION INTERNAL
CONTROLS OVER FINANCIAL OPERATIONS (2004-S-30)**

The following constitutes ESDC's response to the Office of the State Comptroller's (OSC) draft audit of New York State Urban Development Corporation Internal Controls Over Financial Operations Report (2004-S-30) (the "Report").

ESDC is proud of its extensive system of internal controls over financial operations. Indeed, the draft audit characterizes our system of internal controls as "adequate", while noting some areas for possible improvement. ESDC agrees that improvement is always possible (and, in fact, constantly seeks ways to better perform its functions), but must point out that the areas identified for improvement represent mainly either minor non-conformity with existing policies and procedures, or a difference of opinion about what is required either by law or as a best practice. Following are our responses to the recommendations contained in the draft audit, as well as other comments to clarify or address additional points.

Background, Page 1, Paragraph 1

UDC is governed by an eight-member board of directors. The UDC Act (Chap. 174, Sec.1 Laws of 1968) indicates nine directors, but one position, that of the Chairman of the Science & Technology Foundation, has been eliminated by operation of law, with that entity's dissolution in 2000.

Control Environment

Recommendation 1:

The OSC recommends that we require Board members to sign copies of a Statement of Interest and Activities form to acknowledge their receipt of the Directors Code of Conduct when they begin their board service, pointing out that we require employees to execute an Employee Statement of Interest and Activities form when they begin their employ. ESDC has distinguished between directors and employees with respect to this requirement due to the small number of directors (8) compared to the large number of employees (approx. 370). The General Counsel and Corporate Secretary meet with each director when he or she is appointed to UDC's board, and personally provide them with these materials as part of a board member's briefing book, along with a verbal summary of the material contained therein. Heretofore, we have felt this sufficient to ensure each director's awareness of his or her ethical requirements. We do not believe that executing an acknowledgement provides any "additional assurance" that directors will comply with UDC's Code of Conduct beyond the verbal commitment received when the materials are provided. However, for the sake of record keeping, we will endeavor to secure such an acknowledgement from new directors in the future.

Recommendation 2:

UDC does not believe state law requires board members to be physically present to vote at Board meetings. We disagree with the opinions of the Committee on Open Government with respect to this issue, can find no case law to support them, and are not bound to follow such opinions. In the current era of vastly improved communication technology, it is standard practice among corporate boards throughout the world to permit participation at board meetings telephonically – in fact, the state’s Business Corporation Law permits such provisions in by-laws. In recognition of the many demands placed upon the availability of UDC’s directors – all uncompensated, and all of whom have full time employment, UDC determined that in order to ensure maximum participation in meetings, it was advisable to permit telephonic participation at our publicly held meetings.

Recommendation 3:

The draft audit recommends that UDC request that its board vacancies be filled. UDC’s Chairman and staff work very closely with the Governor’s office in seeking candidates to fill vacant board positions, and will continue to do so.

Communication

Recommendation 4:

The draft audit recommends that the Corporate Secretary monitor the delivery of board materials to directors to ensure that they are timely, and keep records of these deliveries. The Corporate Secretary prepares the packages and delivers them to the Administrative Services department for delivery to individual board members. Administrative Services notifies the Corporate Secretary when all packages are delivered, and in keeping with ESDC practice, maintains records of all deliveries for three months. ESDC believes the practice of maintaining records of this nature for three months is sufficient. With respect to timeliness, the Corporate Secretary endeavors to deliver materials to board members at least five (5) days prior to a board meeting, and sets a schedule at the outset of each month to ensure the achievement of this goal. However, because of the fluid nature of our business, with new items sometimes needing to be added to board agendas close to the meeting date, and other changes beyond staff’s control, it is on occasion not possible to meet this goal. Our board members have expressed appreciation for the fact that we regularly provide them with materials in a timely fashion, which is not always their experience with other boards on which they sit.

Recommendation 5:

The draft audit indicates that UDC routinely posts public notices of its board meetings on the door of its executive office. You fail, however, to point out that this is in complete fulfillment of the notice requirement set forth in state law. UDC will attempt to ensure that notice of its meetings is routinely posted on its Internet site. However, we will not commence the practice of posting meeting agendas on the Internet, because agendas are

not typically finalized until immediately prior to a meeting. ESDC will consider implementing a policy of posting meeting minutes on ESDC's website.

Risk Assessment

Recommendation 6:

The draft audit indicates that UDC already has a formal process for identifying risks in financial operations. As pointed out, an annual survey is conducted, which requires the summary of potential risks and suggested corrective actions. UDC will review this process, to determine whether it requires strengthening.

Cash Receipts and Disbursements

Recommendations 7 and 8:

ESDC staff works very hard to make sure that all disbursements are documented and within our guidelines. We believe the findings in the draft audit are minor exceptions to the overall strong policies and procedures that are in place. In fact, most of the exceptions cited in the report were supported with sufficient documentation that the discretion of UDC's Controller's Department allowed the expenses to be properly paid.

Recommendation 9:

ESDC agrees to amend the Travel Guidelines to limit reimbursement to the lowest available rates when both daily rates and less costly longer-term rates are available.

Investments

Recommendation 10:

It is the Treasury Department's intention to maintain files that are current and complete. During this audit time period, Treasury was simultaneously implementing a new financial system that we were in the midst of testing. As mentioned to the auditor, the one missing investment file could have been pulled as an example for testing for the new financial system. Nonetheless, we feel that one missing file out of 65 is statistically insignificant.

Recommendation 11:

The draft audit recommends that ESDC ensure that funds are invested only with institutions that are authorized to do business in New York State. The investment that is referred to as an investment with an unauthorized institution is an investment under the Excelsior Linked Deposit Program. The institution holding this investment is NBT Bank, N.A. located in Norwich, New York. NBT Bank, N.A. is one of the 65 authorized participating lenders under this program. Hence, this should not be listed as an exception.

Recommendation 12:

Repurchase Agreements are bid out among three or more authorized 'Repo' Dealers in accordance with our guidelines. The trade is then transacted with the authorized Repo Dealer who offered the highest bid. The Repos are fully collateralized, in conformance with our investment guidelines. As a result, we feel that the risk involved is minimal.

Recommendation 13:

ESDC monitors bank balances and supporting collateral on a weekly basis, because it is infeasible to do so on a daily basis, given the volume and nature of cash management transactions. We generate weekly collateral reports for the specific purpose of determining whether deposits are fully collateralized. In the very rare circumstance where the collateral report shows that a bank's balance is under-collateralized, we immediately either contact the bank requesting additional collateral or reduce the bank balance accordingly.

Your audit report cites three instances of under-collateralization. Two instances involved one bank where funds deposited were insufficiently collateralized in two separate weeks by \$45,556 and \$78,193, respectively. Those situations, although *de minimus* in nature, were addressed as discussed above. With respect to the third cited instance, there is no record of a bank's balance being insufficiently collateralized by \$19.3 million for the period ending March 26, 2004. Banks balances were reviewed for this time and all balances were sufficiently collateralized.

Procurement and Contracting

Recommendation 14:

ESDC agrees to monitor the acquisition of temporary personal services to ensure that contracts are established for such services when required. In the two year period referenced in the draft audit, ESDC for the first time in its history utilized temporary personnel in large numbers. Previously, the Corporation's use of temporary personnel was limited to very occasional use, and did not approach or exceed a dollar threshold necessitating a written contract. However, following the September 11, 2001 terrorist attack, ESDC employed, and continues to employ, temporary personnel in much larger numbers, to assist in the processing of applications for assistance through the temporary 9/11-related programs we created.

Recommendation 15:

ESDC has completed the review of subsidiary contracting practices, and determined to make changes necessary to address the concerns raised in the internal control review.

Payroll

Recommendation 16 and 17:

ESDC agrees with the fact that the work situation of the individual discussed in this section, who is characterized as working at home, was not adequately documented. The

individual's supervisor has documented the reasons for the arrangement, which permits the subject individual to serve as a liaison to the various economic development agencies and entities in the three counties in the Southern Tier of the State (Chautauqua, Cattaraugus and Alleghany), as well as to provide outreach to companies in the region. Due to the large size of the region, and distance from the regional office, it is appropriate to have the individual responsible for it reside within it and work from home. Given the unique nature of this arrangement, ESDC recognizes that it must be closely monitored, and agrees to more closely oversee and document the arrangement. The Regional Director will review and approve each upcoming weekly schedule with the employee, and will file a copy of the schedule in the employee's personnel file in the Regional Office. To the extent feasible, the Regional Director will review and approve in advance whether compensatory time will be required.

Recommendation 18:

ESDC has instructed the Payroll Department to approve overtime hours for payment only when supported by entries recorded in a departmental overtime log. All Departments are now required to use the overtime log to be eligible for overtime pay.

Recommendation 19:

ESDC will review its policies on sick leave accumulation and sick leave donation to determine whether policy modification is warranted.

Recommendations 20 through 24:

ESDC agrees with each of these recommendations and will implement them.

Other Financial Areas

Recommendation 25:

ESDC will implement this recommendation.