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STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

November 22, 2004

Ms. Anne B. McDonald
Chairwoman
Hudson River - Black River Regulating District
350 Northern Boulevard
Albany, NY 12204

Re: Internal Controls Over Financial Operations
Report 2004-S-58

Dear Ms. McDonald:

Pursuant to Article X, Section 5 of the State Constitution and Section 2803 of the Public Authorities Law, we have audited the Hudson River - Black River Regulating District's system of internal controls over its financial operations for the period April 1, 2002 through March 31, 2004.

A. Background

The Hudson River - Black River Regulating District (District) was created by legislation in 1959 and charged with regulating the flow of waters of two neighboring watersheds: the Hudson River and the Black River. The District's responsibilities involve reducing floods caused by excess run-off and augmenting river flow at times of drought or other periods when normal river flows are low. Organized as a public benefit corporation, the Legislature combined two pre-existing districts into a single entity with a broad spectrum of legal powers to accomplish its mission, including the authority to build and operate reservoirs, issue bonds, and apportion costs to its beneficiaries to finance construction, maintenance, and operations.

A five-member Board of Directors (Board) appointed by the Governor oversees the District's operation. In January 2004, the Board elected a new President and hired a new Executive Director. One of the seats on the Board is vacant and has been since October 2003. The Executive Director is responsible for the day-to-day operations at the District's three offices in the Hudson River Area Office in Albany, the Sacandaga Field Office in Mayfield, and the Black River Area Office in Watertown. In addition, the District operates five water-regulating facilities (Conklingville Dam, Stillwater Reservoir, Sixth Lake Dam, Indian Lake, and the Old Forge Dam). The District employs 27 people and has a budget of \$6.8 million for the 2003-2004 fiscal year. The District funds its operations primarily through assessments levied on beneficiaries along the two watersheds. In addition, the District collects permit fees from property owners for access rights to the Great Sacandaga Lake and assesses fees to power companies for water usage to generate electricity. The

District's costs to operate and maintain the permit system should be paid by permit holders; the power company contracts and beneficiary assessments should pay for the District's remaining operating costs. However, the District has not identified and separated its permit system cost from its normal operating costs. Therefore, there is a risk either permit holders or beneficiaries pay too much or too little. In 2004, the District issued a Request for Proposal (RFP) for a private company to analyze the permit system, including identifying all applicable costs. However, no firms responded to the RFP and the District is considering its alternatives for accomplishing this goal.

B. Audit Scope, Objectives and Methodology

Pursuant to the New York State Governmental Accountability, Audit and Internal Control Act of 1987 (Internal Control Act), as revised in 1999, the District's management is responsible for establishing and maintaining an effective system of internal control and a program of internal control review. In addition, in accordance with New York State Division of the Budget Policy and Reporting Manual Item B-350, State agencies and public authorities must annually certify their compliance with important provisions of the Internal Control Act, and submit this certification of compliance to the Division of the Budget. We audited the District's system of internal control over its financial operations for the period April 1, 2002 through March 31, 2004. The objectives of our performance audit were to assess the adequacy of the District's system of internal control over its financial operations and to express an opinion on the certifications based upon our audit.

To accomplish these objectives, we interviewed District officials and reviewed applicable policies and procedures governing the following significant financial operations: Board oversight and governance, revenue and collections, cash and investments, payroll, procurement and contracting, equipment and asset management, budgeting and expenditure control, and accounting and information systems. We interviewed District staff responsible for these financial operations and performed limited compliance testing to provide assurance that District employees follow established policies and procedures.

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

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State, several of which are performed by the Division of State Services. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members to certain boards, commissions and public authorities, some of whom have minority voting rights. These duties may be considered

management functions for purposes of evaluating organizational independence under Generally Accepted Government Auditing Standards. In our opinion, these management functions do not affect our ability to conduct independent audits of program performance.

C. Results of Audit

In our opinion, because of the material weaknesses described below, management's certifications of compliance for the two years ended March 31, 2003 and March 31, 2004 are not fairly stated based on the criteria set forth in the Internal Control Act and the Division of the Budget Policy and Reporting Manual Item B-350. Our audit identified material internal control weaknesses that were not identified in the certifications of compliance submitted to the Division of the Budget for the years ended March 31, 2003 and March 31, 2004. A material weakness is a condition that precludes the entity's internal controls from providing reasonable assurance that material errors or irregularities will be prevented or detected on a timely basis. These certifications do not list results of internal control assessments; instead they just state that the District is a small authority and its processes and functions are reviewed on a regular basis and that the high risk areas are: receiving and processing of payments, payment of bills, and the permit process. There is no documentation to explain why certain activities are viewed as high risk, how the District plans to eliminate them, or what internal control improvements are planned. In addition, there are no documented methods and procedures for assessing the effectiveness of the District's internal controls objectives. The District also lacks adequate internal control training for its Internal Control Officer or other employees and a well-documented internal control system. Although the District has developed Internal Control guidelines and issued them to each employee, none of the guidelines have been revised since 2000. Additionally, none of the District's past three independent audit reports (2001-2003) include a required report on compliance with the Internal Control Act.

For many of the areas we examined the District did not have written policies for employees to follow. In addition, we noted several material weaknesses the District must address. District officials indicated that they are currently reviewing their overall operations and will seek to formalize, establish, improve or update policies and procedures over several areas. Additional information about these matters and about other aspects of the District's internal controls, including areas in which the controls are strong, is contained in Table I at the end of this report. The following describes the material weaknesses.

1. The District's enabling legislation states that Board members shall not receive a salary or other compensation, but shall receive all necessary expenses incurred in the performance of their duties. We found that the District routinely pays each Board member's full health care benefits, as well as vision and dental benefit costs. In our opinion, these benefits do not constitute a necessary expense in the performance of Board duties.
2. The District's Board authorized the hiring of a Secretary/Treasurer in 1997 and a Legal Counsel in 2002, each at a designated salary. They report directly to the Board. Neither of these individuals submits time records to the District's Administrative Assistant in charge of payroll. Furthermore, the Board resolution provides for an annual salary plus benefits, and the District reports full-time service credits to the New York State Retirement System, however, these individuals actually work part-time. The Secretary/Treasurer, who is paid

nearly \$62,000 a year plus full retirement, health, vision and dental benefits, told us, and his personal time records confirmed, that he works an average of about 4 hours per week. The Legal Counsel, who is paid \$75,000 a year plus full retirement, health, vision and dental benefits, showed us a copy of the time records he keeps at his private law office documenting the time he spends on District work; it averaged only 18 hours per week.

3. We identified a number of opportunities for the District's Board to improve how they operate. The Board has not established a code of ethics for themselves or District officials and staff. The Board authorized permit fee increases without providing sufficient public notice as to the nature of the subject matter to be discussed. The timing of the public notice is described in New York Codes, Rules and Regulations (NYCRRs) Title 6, Part 606.68 and Environmental Conservation Law 15-2109. Furthermore, there was no documentation to show that the Board reviews and asks questions pertaining to the operating budgets they approve for the District. In addition, they have not established a committee structure to help improve their effectiveness.
4. There were no formal policies related to cash disbursements, billing and collection activities, accounts receivable, processing and safeguarding checks and cash receipts, payroll, time and attendance, and budgeting.
5. The District needs to improve security over some of its funds. For example, the District did not have appropriate security over petty cash funds at the Sacandaga Field Office and at the Conklingville Dam. At Sacandaga, all 12 employees had access to the funds and could disburse money. At Conklingville, the petty cash was not properly secured. These situations could lead to misuse or abuse of petty cash. The District also needs to improve security over unprocessed permit checks. More than 4,000 permit checks are sent to the Sacandaga Field Office between January and March. Sometimes not all checks received in a day can be processed the same day due to the volume of checks received. We observed unprocessed checks still in the envelopes that were not kept in a secure location overnight.
6. The District's Board is required by Public Authorities Law (Article 9, Title 7, Section 2925.1) to review and approve investment guidelines annually, but it has not done so since 1985. The District is required to have an annual audit of its investment practices, but it has not done so since 2000. Although the District is authorized to invest funds in U.S. Treasury Bills, it has been using a private broker to invest in a mutual fund made up of U.S. Treasury Bills. The District's funds would be better safeguarded if it purchased the investments directly because under this arrangement there is a risk that the broker could go out of business.
7. A good internal control system separates major functions among different employees so that no one employee handles an entire transaction and that the work of one employee compliments and acts as a check on the work of others; it also helps to timely identify errors and irregularities. There are internal control weaknesses over cash disbursements at the District. One individual in the Albany office determines which expenses are to be paid, generates payment checks, has access to signature stamps, records payments, and reconciles the accounts. There are also internal control weaknesses over purchasing goods at the

Hudson River Area Office and the Black River Area Office. One employee in each of these offices can create a purchase order, verify delivery, generate a payment check and record and maintain the accounting records.

8. In conjunction with the Independent Auditor's Report on Financial Statements, a "Report on Compliance, including Compliance with Investment Guidelines and on Internal Controls over Financial Reporting Based on an Audit of Financial Statement Performed in Accordance with Government Auditing Standards" is required. However, none of the District's past three independent audits for 2001-2003 included this report.
9. The District requires two signatures on its disbursement checks. This control is designed to have more than one official review the appropriateness of payments. The signatories stated that when they personally review the expenses they do not use a signature stamp. We found that many District checks had one signature stamp and some checks had two stamped signatures, suggesting that the disbursements were not properly reviewed before payment was made.
10. To pay vendors, District procedures require certain purchasing documentation, including but not limited to, authorized purchase orders, a form citing the justification for the expenditure, documentation of competitive vendor selection, and purchase receipts. All purchases over \$250 need a justification form and approval by the Executive Director. However, we found that approvals for credit card purchases over \$250 are often obtained after the purchases are made. Additionally, we reviewed a sample of ten purchases over \$250 and found that there was inadequate documentation for three purchases. There was no form citing the justification for a \$21,303 vehicle purchase, just a faxed copy of the vendor's invoice. (District officials explained that the purchase may have been requested and approved by the prior Executive Director.) In another example, the District bought numerous items that cost a total of \$1,059 from a particular vendor, but documentation had only one proposal and no justification as to why the required three proposals were not obtained. There was also no approved justification form or vendor receipt for the purchase of \$564 in supplies, only a typed authorization memo from a District Supervisor; and there was no receiving report for this purchase to ensure that the items paid for were actually received.
11. Proper controls over equipment call for a comprehensive inventory list with equipment acquisitions and disposals promptly recorded. Each of the District's offices and facilities has an inventory list which is sent to the District Office annually. We selected 10 items at five locations and found that equipment items, e.g. electronic vest pocket secretary, had been disposed of and not recorded as such on the inventory records.
12. The Sacandaga Field Office allows employees to borrow equipment for personal use. However, the Board has not authorized this practice.
13. The District's annual budgeting process needs improvement for it to be an effective management tool. We noted several expense items in the budget that should not have been budgeted as expected expenses. For example, in 1998 and 1999, the State of New York assessed the District a \$100,000 service fee from the State Inspector General's Office. The

District's three-year budget for 2003 - 2006 included \$100,000 each year as an expected expense, but the State Inspector General's Office had not billed the District for the service fee since 1999 and District staff did not inquire whether such fees would be charged in the future. In another example, the District carried forward a one-time expense for security at the Conklingville Dam to the next budget cycle. Overstatements such as these result in overcharging beneficiaries.

14. The District's timekeeping policy requires every employee to complete time sheets that are later reviewed and signed by supervisors and submitted for payroll processing. Three of the District's 27 employees do not submit time cards. Two of these employees are executive officers.
15. The District does not require staff to have computer access passwords and it has no disaster recovery plan for data on the District's accounting and information systems.

Recommendations

1. *Discontinue the practice of providing employee health care, vision and dental benefits to Board members.*
2. *Immediately re-evaluate the salaries and benefits for a Secretary/Treasurer and Legal Counsel and determine the extent the salaries for these positions should be reduced considering the limited number of hours required for services performed. Work with the New York State Retirement System to determine if employment credits in the Retirement System for the Secretary/Treasurer and Legal Counsel have been overstated.*
3. *Establish a code of ethics for Board members, District officials and staff.*
4. *Document Board review of the District's operating budgets.*
5. *Establish committees within the Governing Board.*
6. *Develop formal policies and procedures of the various District business processes.*
7. *Secure all petty cash funds.*
8. *Keep unprocessed permit checks in a secure location.*
9. *Review and approve investment guidelines annually, as required.*
10. *Arrange for annual independent audits of District investment practices.*
11. *Discontinue using a private firm for investments.*
12. *Separate duties related to cash disbursements and purchasing.*

13. *Ensure that the independent auditor provides the Report on Compliance in conjunction with the Independent Auditor's Report on Financial Statements.*
14. *Discontinue using a signature stamp on District checks.*
15. *Authorize purchases in advance and retain complete documentation to support the appropriateness of each purchase transaction.*
16. *Promptly record equipment disposals on the inventory list.*
17. *Evaluate the process of lending equipment to employees at the Sacandaga Field Office.*
18. *Take more care when preparing District operating budgets to better ensure that large expenses are reasonable.*
19. *Require all employees to properly complete time records.*
20. *Establish and require computer access passwords.*
21. *Establish a disaster recovery plan for accounting and information system data.*

A draft copy of this report was provided to Hudson River - Black River Regulating District officials for their review and comment. Their comments have been considered in preparing this final audit report and, are included as Appendix A.

District officials agreed with our audit observations, conclusions and recommendations. However, they opted to defer providing a detailed response to each recommendation until they file the required 90-day response. District officials stated that the Board started a restructuring process in late 2003 with the hiring of a new Executive Director in January 2004, and they were beginning to concentrate on administrative, personnel and fiscal issues when we did our audit. We trust that District officials will be able to use our audit results to help focus these efforts.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the Chairman of the Hudson River - Black River Regulating District shall report to the Governor, the State Comptroller, and the leaders of the Legislature and its 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 Gerald Tysiak, Roger C. Mazula, Brandon Ogden, Nadiuska Piedra, and Gayle Clas.

We wish to thank the management and staff of Hudson River - Black River Regulating District for the courtesies and cooperation extended to our auditors during this audit.

Very truly yours,

Carmen Maldonado
Audit Director

cc: Robert Barnes, Division of Budget

TABLE I

**HUDSON RIVER - BLACK RIVER REGULATING DISTRICT
INTERNAL CONTROLS OVER FINANCIAL OPERATIONS**

A colored “traffic light” legend is included in the table below to assist management in focusing an appropriate level of attention on the issues summarized in the table. As part of our audit, we sought answers to a series of questions and reviewed selected District records related to certain basic financial operations. Our questions in each area, along with a summary of the District’s activities and our comments concerning these activities, are included in the table.

Legend:

	Activities/Comments contain matters that should be of immediate concern to management.		Activities/Comments do not contain issues that require management’s immediate consideration.
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	QUESTION	AGENCY ACTIVITIES	COMPTROLLER’S COMMENT
	Board Oversight & Governance:		
	Does the Agency’s Board of Directors function in a manner that promotes an ethical business climate within the organization and encourages and supports full compliance with all applicable laws, rules, and regulations?	<p>The Governor appoints Board members for five-year terms. There are five Board members.</p> <p>It is the Board’s responsibility to establish and adhere to a code of ethics.</p> <p>The New York State Code of Rules and Regulations Title 6, Part 606.68, related to the District states that the Board must make public notification and hold public hearing prior to any changes in fees.</p>	<p>The District’s enabling legislation states that the Governor is to fill all Board vacancies within 30 days after it occurs. One Board seat has been vacant since October 2003.</p> <p>The Board has not developed a code of ethics for themselves or for District staff.</p> <p>The Board approved a budget with \$1.6 million increase in permit fees per year before providing sufficient information to the public about the nature of the matters to be discussed at the public hearings as required.</p>

TABLE I (Cont'd)

	QUESTION	AGENCY ACTIVITIES	COMPTROLLER'S COMMENT
	<p>Has the Agency's Board of Directors established appropriate controls that promote the economic, efficient, and effective operation of the Agency consistent with its statutory public benefit mission and that provide for transparency and accountability in pursuing its strategic business objectives?</p>	<p>The law states that Board members should serve without salary or compensation, but are entitled to payment of all necessary expenses incurred in performance of their duties. All current Board members are offered full health care, vision, and dental benefits for themselves and their family at the District's expense. Also, such benefits are continued after a Board member leaves if he served on the Board for more than four years.</p> <p>The Board authorized the hiring of a Secretary/Treasurer and Legal Counsel. The District pays full-time salaries and benefits to these two individuals, but they actually work part-time.</p> <p>Monthly Board meetings are open to the public. Dates and locations of Board meetings, Board meeting minutes and agendas, concerns of the District, and other information pertaining to the operation of the District are posted on their Internet website.</p>	<p>The Board does not always promote an economical and efficient approach to District operations. For example, the health care, vision and dental benefits provided to current and former Board members are, in our opinion, not allowable because it is a form of compensation and is not a necessary expense. Also, there is no documentation supporting the fact that the Board reviews and asks questions pertaining to the budget they approve for the District. Further, there is no committee structure within the Board to efficiently research and resolve issues.</p> <p>It is also our opinion that hiring part-time officials at full-time salaries and benefits does not show prudent Board direction.</p> <p>Recently, the District has provided for public transparency in pursuing its strategic business objectives.</p>
	<p>Revenue & Collections:</p>		
	<p>Do the Agency's internal controls provide assurance that revenues are billed timely and accurately and are recorded properly in the accounting records?</p>	<p>The District receives revenue from three sources: assessments, permits, and lease agreements. The assessment and permit fees are billed annually. Assessment fees are paid by parties who benefit from the regulated flow of water whether it is protection from flooding or being ensured a minimum flow of water. Permit fees are paid by individuals for the exclusive right to access The Great Sacandaga Lake through a specified segment of land. The lease agreements are paid monthly per contract with hydropower plants for water usage; the lease amount varies monthly depending on the electricity produced. These hydropower plants</p>	<p>We found that all assessment billings for 2004 were timely and accurate.</p> <p>The deadline for payment of permit fees for 2004 was extended one month due to the public protest concerning the substantial increase in permit fees.</p> <p>The District tracks accounts receivable for the Hudson River assessments manually; it tracks all other accounts receivable on a computer system. Revenue from power plants is only recorded upon receipt. No receivable is established for these water usage revenue contracts (one contract was for a fixed annual fee of about \$850,000 paid monthly, and the other contract is based on a percentage of net income</p>

TABLE I (Cont'd)

	QUESTION	AGENCY ACTIVITIES	COMPTROLLER'S COMMENT
		are not billed but instead just send payment to the District monthly.	and is about \$30,000 a year paid monthly). The District does not validate the accuracy of the revenue.
	Do the Agency's internal controls provide assurance that revenues are being collected timely?	District procedures require the assessment bills be paid by October 31 st of each year and, if not paid by then, the bill is referred to the local county, where the assessment fee is added to the individual or business property tax bill. If a permit holder does not pay by April 15 th , the District sends a reminder letter and gives the permit holder one month to pay or the District will rescind the permit and make the lake access available to the next applicant. Revenues from lease agreements are sent by the hydropower companies monthly to the District. There is no formal tracking system to record these payments. However, they are the only source of revenues deposited directly by Albany and Black River District staff.	There are policies and procedures in place to ensure that revenue is collected timely. Our examination indicated that the assessment fees for the Hudson River District were current. The Black River District has approximately \$53,000 of assessment fees in arrears including a beneficiary that has not paid in seven years. District management was tracking these assessments and attempting to collect them. Internal controls are adequate to assure that permit and lease revenues are collected timely.
Cash & Investments:			
	Do the Agency's internal controls provide assurance that cash and investments are properly safeguarded, accounted for, and deposited into the appropriate accounts?	Petty cash drawers are kept at four locations (\$50 in both the Hudson River and Black River Area Offices and \$100 in both the Sacandaga Field Office and at the Conklingville Dam). In addition, there are petty cash checking accounts in the Hudson River and Black River Area Offices. All employees at the Sacandaga Field Office have authority to disburse petty cash. District procedures require assessment revenue receipts to be recorded and forwarded by the District to the Office of the State Comptroller for deposit into Short-Term Investment Pool (STIP) funds the day they are received. All other receipts, such as permit revenues, are held in the office until the day of deposit when they are recorded, restrictively endorsed, and sent to the local bank for deposit.	The petty cash drawer at the Sacandaga Field Office does not have a custodian; all employees are allowed to access the cash at any time and disburse money. However, our testing did not discover any inappropriate expenditure. The practice of allowing all 12 employees to disburse funds could lead to misuse or abuse of the petty cash account. Petty cash at the Conklingville Dam is not properly secured. Our examination found that internal controls are adequate to assure assessment revenues are properly accounted for and deposited into the appropriate accounts. More than 4,000 permit checks are sent to the Sacandaga Field Office between January and March. Sometimes not all checks received in a day can be processed the same day due to the volume of checks received. We observed unprocessed checks still in the envelopes that were not kept in a secure

TABLE I (Cont'd)

	QUESTION	AGENCY ACTIVITIES	COMPTROLLER'S COMMENT
		<p>The Board passed a resolution to invest restricted and unrestricted funds. As of March 31, 2004, the District had nearly \$3.2 million invested with a private investment firm's US Treasury note mutual fund, instead of purchasing the government securities directly.</p> <p>The District has a money market account which is considered an asset of the State and, as such, the Office of the State Comptroller has a process to ensure this account (and all other State bank accounts) has appropriate collateral.</p>	<p>location overnight.</p> <p>The District has not revised its investment guidelines since 1985. Although required annually, the Board has not reviewed and approved the investment guidelines since 1985. The District's investments with the outside investment firm may not be allowable under the District's enabling legislation, and they may not be sufficiently protected if the investment firm goes bankrupt. Also, the District has not had the required independent investment audit since 2000; that audit noted that there was a decrease in the value of the government funds and recommended the District purchase government bonds themselves instead of using a private broker. This recommendation was not implemented and we noted the District's investment value per share was still decreasing.</p> <p>The District's investments in the money market account are properly safeguarded and accounted for.</p>
	<p>Do the Agency's internal controls provide assurance that cash disbursements are properly authorized and recorded?</p>	<p>District procedures and by-laws require dual signatures on all disbursement checks from the general checking account, one of which shall be the Treasurer after reviewing the expense for appropriateness. There are three signatories for the general checking account.</p> <p>The District has two petty cash checking accounts - one each for the Hudson River Area Office and the Black River Area Office. These checks require only one signature and do not have to be audited and countersigned by the Comptroller.</p>	<p>There are no comprehensive formal policies for cash disbursements. One individual in the District office determines which expenses are to be paid, generates checks, has access to signature stamps, records payments, and reconciles the accounts.</p> <p>Some checks had two stamped signatures on them. The signatories stated that when they personally review the expenses they do not use the signature stamps. We conclude that these disbursements were not properly reviewed before payment was approved.</p>
<p>Payroll:</p>			

TABLE I (Cont'd)

	QUESTION	AGENCY ACTIVITIES	COMPTROLLER'S COMMENT
	Do the Agency's internal controls provide assurance that employee time and attendance records are accurate and that leave time is accounted for and recorded properly?	<p>District policies require that all employees complete time sheets. Time sheets are reviewed and signed by the employee's immediate supervisor and are then sent to the District office where they are reviewed and signed by the Executive Director.</p> <p>Leave time is kept by the individual employees and is verified each pay period by District office staff.</p>	<p>Our examination showed that three employees do not submit time sheets and still receive paychecks. Two of these individuals are District executive officers. Without time sheets, the employees work time is not available to accurately report for retirement and other benefit purposes.</p> <p>District internal controls ensure leave time is accurately accounted for and recorded.</p>
	Do the Agency's internal controls provide assurance that payroll changes (e.g., additions, deletions, and overtime) are processed accurately and timely?	District procedures require that all new hires be approved by the Board and that supervisory/Employee Retirement System notification occur for all terminations and retirements. The District has very little overtime and compensatory time off.	We found that the District follows its procedures and they are adequate to provide assurance that payroll changes are processed timely and accurately. However, the District has not established formal policies related to payroll processing.
Procurement & Contracting:			
	Do the Agency's internal controls provide assurance that purchases are authorized, received, and recorded properly?	District policies require the Executive Director to approve all purchases over \$250. The office supervisors in the Hudson River Area Office, Sacandaga Field Office and Black River Area Office, can approve purchases up to \$250.	<p>Our examination found that one employee in the Hudson River Area Office and one employee in the Black River Area Office have the authority to create a purchase order, verify delivery, generate a payment check, and record and maintain the accounting records. The former Executive Director did not consistently review purchase orders over \$250.</p> <p>We found three instances in our sample of purchases over \$250, including the purchase of a \$21,000 vehicle, which lacked required supporting documentation (purchase receipts, purchase justification, and/or expenditure justification forms).</p>
	Do the Agency's internal controls provide assurance that purchases are reasonable and necessary and made in an economical and efficient manner?	<p>The District uses General Municipal Law and State Finance Law for setting its limits for bids and the bidding procedures it follows. All purchases over \$250 need a justification form as well as approval by the Executive Director.</p> <p>All purchases under \$250 are approved by the office supervisors. The District also has credit cards</p>	<p>Our examination found that all credit cards have a maximum credit line but do not have a per purchase limit. The maximum limits per credit card ranged from \$1,000 to \$10,000.</p> <p>In the Sacandaga Field Office, employees use the credit cards for purchases under \$250 prior to obtaining approval. The purchases are authorized afterwards.</p>

TABLE I (Cont'd)

	QUESTION	AGENCY ACTIVITIES	COMPTROLLER'S COMMENT
		that are used for purchases. Authority to use the credit cards is generally limited to a few employees at most sites. However, Sacandaga Field Office issued several store credit cards to all employees.	
<u>Equipment & Asset Management:</u>			
	Do the Agency's internal controls provide assurance that equipment acquisitions and dispositions are authorized and recorded properly, and that a comprehensive inventory of equipment is maintained?	The Hudson River Area Office, Black River Area Office, Sacandaga Field Office, Conklingville Dam, and Stillwater Reservoir all maintain their own equipment inventories. Each office sends their inventory list to the District office annually. District procedures require that items added to or deleted from the inventory be done at the time of purchase or disposition. District policy also requires items purchased to be marked by tags identifying the equipment as property of the District.	Our examination found that the District's internal controls are adequate to provide assurance that acquisitions and dispositions are properly authorized and that a comprehensive inventory is maintained. However, we found items on the inventory that had been disposed of and were not recorded as such in the inventory records.
	Do the Agency's internal controls provide assurance that equipment is secured properly and used as intended?	District procedures require that each vehicle has a log that records mileage and the reason for use. Offices are locked when employees are not there to secure office equipment. District boats are tied to docks at specific dams. The Sacandaga Field Office has a practice of allowing employees to use District equipment and tools for personal use as long as they sign it out and return it the next business day.	Vehicle logs are maintained for each vehicle. District policies generally ensure office equipment is secure. However, the District should consider chaining and using a lock to secure their boats to their docks to help prevent theft. The practice in the Sacandaga Field Office of allowing employees to use equipment and tools for personal use was not approved by the Board.
<u>Budgeting & Expenditure Control:</u>			
	Do the Agency's internal controls provide assurance that the Agency's annual budget is prepared accurately and timely?	The District prepares a three-year budget every third year. The budget includes reserves which are set aside for emergency costs such as legal expenses and unexpected tax increases. The District issued a Request For Proposal (RFP) for an accounting firm to analyze and segregate their operating costs associated with permits and assessments. No firms	Our examination indicates that District internal controls are adequate to provide assurance that the three-year budget is prepared timely. The District's budget is not prepared accurately. We found items in the budget that were not expenses to the District. One example of this is a New York State Service Fee. This \$100,000

TABLE I (Cont'd)

	QUESTION	AGENCY ACTIVITIES	COMPTROLLER'S COMMENT
		<p>responded to this RFP.</p>	<p>fee was charged to the District by the Inspector General's Office in 1998 and 1999. Other items were also carried on the Budget even though they were not expenses for the District. These inflated costs were used to calculate the assessment fees for the current three-year budget. Therefore, the beneficiaries will be overcharged until June 2006 when the new budget beginning July 2006 comes into effect. This occurred because the District staff preparing the budget did not verify that these expenses would be incurred.</p> <p>The District needs to develop a new strategy to address issues pertaining to the segregation of permit and assessment costs.</p>
	<p>Do the Agency's internal controls provide assurance that actual operating results are monitored against budgeted estimates and that appropriate revisions to current and future budgets are made as warranted by these operating results?</p>	<p>District officials prepare monthly comparisons of actual and budgeted expenses and provide them to the Board.</p> <p>There is no policy or procedure in place to provide assurance that an analysis of the prior budget is considered when preparing the new budget.</p>	<p>Our examination of the budget process found that the District does not adequately monitor operating results against budgeted estimates. The District places money charged to the beneficiaries through assessments into the unreserved investment pool for projects not completed during the budget cycle and then charges the beneficiaries again in the next budget for those same projects. We determined that approximately \$147,000 in expenses should not have been included in the next budget. This clearly could result in an overcharge to the beneficiaries.</p> <p>We also found that items are carried over from one budget to the next. This is demonstrated by the fact that they carried a \$100,000 service charge for 5 years after they last paid it. Another example is a budgeted expense for security at the Conklingville Dam that was a one time expense for last year, but was carried over as an expense for this year. The budgets are used to calculate the assessment fees for the beneficiaries. These items unnecessarily increased the fees paid by the beneficiaries. This is then exacerbated by the fact that the assessments are based on the three-year</p>

TABLE I (Cont'd)

	QUESTION	AGENCY ACTIVITIES	COMPTROLLER'S COMMENT
			budget.
Accounting & Information Systems:			
	Do the Agency's accounting and information systems provide assurance that management has access to timely, accurate and relevant information?	Each District office has an accounting software system which prepares accounting results for the Board of Directors to review monthly. There is a separate information system that pertains to permits.	Our examination indicates that the District's internal controls are adequate to assure management has access to timely, accurate, and relevant information.
	Do the Agency's internal controls provide assurance that the accounting and information systems are secure and that the information is recoverable in case of system failure?	The District does not require passwords to gain access to their accounting and information systems. Further, the District does not have disaster recovery or contingency plans for the accounting and information systems. The only disaster recovery plans the District has is in the case of a dam failure. There is an informal practice of office staff taking home back-ups of the system.	Our examination found that information security is weak. Passwords are not used to access the accounting and information system. There are no plans in place in case of accounting and information system failures. District internal controls do not provide assurance that data on the accounting and information system would be recoverable in case of a disaster or other emergency.

STATE OF NEW YORK



Board of Hudson River-Black River Regulating District
350 Northern Boulevard, Albany, New York 12204 Phone (518) 465-3491
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October 6, 2004

Office of the State Comptroller
Division of State Services
123 William Street - 21st Floor
New York, NY 10038

Re: Internal Controls Over Financial Operations Report 2004-S-58

The Board and Management of the Hudson River-Black River Regulating District wish to thank the Office of the State Comptroller for engaging its resources to help the Board and Management of the Hudson River – Black River Regulating District identify areas in which improvement efforts can achieve the best results. We commend OSC staff for its conscientious, expert, and cooperative approach while performing the audit. The Board and Management agree with the goals of OSC's guidance and recommendations and are confident that the District's recent actions with regard to hiring of new staff and implementation of new policies mirror these recommendations.

The Board and Executive Director strive to apply best practices to all of the District's operational, administrative, and fiscal functions. Not unlike other small governmental units, however, limited resources result in their prioritized use. The District's core mission is to reduce floods caused by excess spring run-off and to augment river flow at times of drought or other periods when normal river flows are low. As a public benefit corporation, the district functions without financial support from state and local tax dollars; rather, our income is primarily derived from beneficiaries of the District's river regulation.

In performing our core mission, the District also controls access to ancillary services and benefits to the public and industry. Most recognizable is the District's custody and management of the Sacandaga Reservoir. Created by the Conklingville Dam, the Sacandaga Reservoir offers tremendous recreational opportunities to area residents and the public at large. The District owns the land under the reservoir as well as the shoreline that borders it. By licensing access to the reservoir via the Access Permit System, the District enables Great Sacandaga Lake's multi-recreational qualities for use by area residents and the public. The District's rules and regulations allow it to charge fees for access permits equal to the cost of operating the Access Permit System. An additional revenue generating asset is the controlled release of waters from District-operated reservoirs that enable the generation of reliable and environmentally friendly hydro-power.

Hydroelectric plants and municipalities that benefit from the Regulating District's operations compensate the District for the use of our controlled river flows. Formulae for allocating expenses and revenue assessment among the beneficiaries and access permittees have

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been in place for many years. As District operations evolved and grew, the allocation and assessment calculations, as well as some of its administrative procedures, remained stable.

Late in 2003, the District Board began to formulate plans to modernize several of the District's key administrative functions. By virtue of its mission to prevent flooding, the District historically focused on engineering and the technical aspects of its operations. Not coincidentally, the District continuously receives favorable reviews from oversight regulators at the state and federal levels. With that aspect of District operations under exemplary control, the Board sought new executive leadership who would concentrate on administrative, personnel, and fiscal issues.

The current Executive Director joined the District in January 2004, and with the Board, began to pursue a number of immediate goals, including: implement internal controls for regulatory compliance, assure fiscal professionalism, appoint internal legal counsel and full time chief fiscal officer, review all expense allocation and revenue assessments, and improve public relations. There are many and varied individual tasks associated with these broad and energetic undertakings, all of which require extensive effort from both management and staff. It is important to note, however, that the Board's plan to implement these long-term goals were well underway at the time of the Comptroller's audit and far in advance of the Working Draft.

In addition to leadership of the new Executive Director, the Board recognized the need to employ full-time legal counsel to concentrate solely on the various legal matters affecting the District. Accordingly, the District employed a full-time General Counsel beginning July 2004. General Counsel's responsibilities include regulatory compliance and reform, corporate governance, contract negotiation and management and management of outside counsel in dispute resolution.

The District's \$6 million annual budget ranks among the smallest in the State in relation to other public benefit corporations, however the District faces the same degree of accountability as any other agency, authority or department of the state. Accordingly, the Board recognized the need to employ an experienced and credentialed finance specialist resulting in the appointment of a full-time Chief Fiscal Officer in July 2004.

This major restructuring of the management team at the District, initiated by the Board late in 2003 introduces new levels of professional expertise and sophistication comparable to the engineering and operational expertise long characteristic of District operations. Employing experienced professionals to fill these positions will aid the District in accomplishing many of the goals sought by the Board in January 2004 and recommended by OSC in September.

Among the first results of this restructuring is the Board's pending independent audit of the District's Sacandaga Lake Access Permit System, and the adoption of a revised and comprehensive Procurement Policy. These and other actions by the Board and Management render some Working Draft Recommendations as "in-progress" or "no longer applicable". The District believes that the structural reorganization discussed in preceding paragraphs resolve

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several OSC concerns. The professional skills introduced by this restructuring will lead to natural implementation of policies and procedures in line with OSC's internal control recommendations. We trust that the final report will acknowledge where Working Draft Recommendations can be assuaged or discharged. Additional recommendations will be implemented in conjunction with ongoing pursuit of the Board and Executive Director's initiatives.

The purpose of this letter is not to respond to each of the Working Draft's Recommendations independently. Rather, this response is intended to provide insight into the Board's continuing pursuit of management excellence. As required by Section 170 of the Executive Law, a detailed response to each recommendation will be filed with regulatory offices within ninety (90) days after release of the final report.

Sincerely,

A handwritten signature in cursive script that reads "Anne B. McDonald".

Anne B. McDonald
Chairwoman
Hudson River-Black River
Regulating District