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**OFFICE OF THE
NEW YORK STATE COMPTROLLER**

DIVISION OF STATE SERVICES

**DEVELOPMENT
AUTHORITY OF THE
NORTH COUNTRY**

**BOARD GOVERNANCE,
PROCUREMENT, AND
DISBURSEMENT
PRACTICES**

Report 2005-S-34

AUDIT OBJECTIVES

The objectives of our performance audit were to determine whether the Authority Board of Directors is fulfilling its governance responsibility, and whether the Authority established an adequate system of internal controls over procurements and disbursements.

AUDIT RESULTS - SUMMARY

The Development Authority of the North Country (Authority) is a public benefit corporation, overseen by a 13-member Board of Directors. The Authority operates a solid waste management facility, a fiber-optic network, and a water/sewer facility. Authority operations provide services to customers at the United States Army base at Fort Drum and in surrounding counties. Authority operations are decentralized. Each Authority facility procures its own goods and services. For the period January 1, 2003 through June 30, 2005, the Authority disbursed \$50.2 million.

We identified several procurement and disbursement control weaknesses that need to be corrected. For example, written support for purchases was sometimes missing, review and approval to authorize purchases was not always documented, contracts were not always used when required, sole source and emergency procurements were not justified in writing in certain cases, and credit card records were incomplete.

We also identified weaknesses in contract award and monitoring practices. For example, the Authority significantly changed the scope of a multi-million dollar construction project after most of the 24 firms expressing interest in the project had either declined to bid or had their bids rejected. To

foster competition and ensure all qualified vendors had a chance to obtain Authority business, the Authority should have offered all 24 firms an opportunity to bid on the revised project. However, the Authority simply awarded the contract for the revised project to one of the three remaining bidders. We also determined that a contractor was paid \$12,500 for lawn care services that were not properly provided, as grass was as high as 16 inches in some places and brush was so high (about 10 feet) that it completely obscured the fencing in many locations.

These control weaknesses existed because the Authority did not establish a formal procurement and disbursement policy until 2005. In addition, comprehensive procedures for managers and staff to follow to implement the policy were lacking and the policy needs to be expanded. While we did not find instances of fraud or abuse, we conclude that the Board needs to improve its governance with respect to internal controls over procurements and disbursements.

Our report contains 12 recommendations to improve Authority governance and to strengthen internal controls. While Authority officials did not concur with several of our conclusions, they did indicate that they plan to implement our recommendations and have already begun to take actions to address them.

This report, dated September 19, 2006, is available on our website at: <http://www.osc.state.ny.us>. Add or update your mailing list address by contacting us at: (518) 474-3271 or
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BACKGROUND

The Development Authority of the North Country (Authority) was established in 1985 as a public benefit corporation to institute a comprehensive, coordinated program of economic development activities in the counties surrounding the United States Army base at Fort Drum (Jefferson, Lewis and St. Lawrence counties). Further, the Authority was intended to help effectively plan and develop the infrastructure needs required by an expected population increase due to the expansion of the Fort Drum facility. The Authority is overseen by a 13-member Board of Directors (Board). Of this number, 6 voting members are appointed by the 3 counties (2 members from each county) served by the Authority, and 2 voting members are appointed by the City of Watertown; the remaining 5 non-voting members are appointed by the Governor. As of June 8, 2005, the Authority employed 20 salaried staff and 24 hourly staff.

The Authority operates a solid waste management facility, a water/sewer facility and a fiber-optic network management facility, referred to as the Open Access Telecom Network (Network). The solid waste management facility provides non-hazardous solid waste disposal services for the North Country (Jefferson, Lewis, St. Lawrence, and Hamilton counties). The Network became operational in September 2004, and supports educational, governmental, institutional and other users throughout Jefferson, Lewis, and St. Lawrence counties. The Network's 400 miles of fiber and related bandwidth and facilities are leased to telecommunications service providers so that end-user customers can obtain services such as dial tone and internet

access. The water/sewer facility owns, operates, and maintains approximately 45 miles of water and sewer pipelines and associated pumping stations. The facility also includes a two-mile nature trail located along a pipeline section. The facility serves Fort Drum and Western Watertown's water and sewer treatment facilities. The water/sewer facility also provides a variety of services for water and sewer infrastructure in 20 municipalities in Jefferson, Lewis and St. Lawrence counties.

These operations are decentralized and have independent management. For example, each operation is responsible for procuring and contracting for its own goods and services. These goods and services are obtained through contracts, non-competitive purchase agreements, payment on accounts and through credit cards. In addition, certain procurements are handled by a third-party under a miscellaneous engineering services agreement.

For the period January 1, 2003 through June 30, 2005, the Authority disbursed \$50.2 million. Between February 2004 and July 2005, the Authority purchased almost \$1 million in goods and services using credit cards. The Authority's Annual Report for the fiscal year ended March 31, 2005 identified revenues of \$9.8 million, \$5.4 million and \$4.5 million for solid waste, Network and water/sewer services, respectively.

This report addresses Board governance and Authority internal controls and practices related to procurements and disbursements. A separate report will address Authority internal controls for revenue, payroll, investments, vehicles, and travel and entertainment costs.

AUDIT FINDINGS AND RECOMMENDATIONS

Board Governance

Control environment is a product of management's governance including its philosophy, style and supportive attitude, as well as the competence, ethical values, integrity and morale of the people of the organization. The control environment has a pervasive influence on the decisions and activities of an organization, and provides the foundation for the overall system of internal control. If this foundation is not strong, if the control environment is not positive, the overall system of internal control will not be as effective as it should be.

We found that the Authority's Board has taken a number of steps indicative of a strong control environment including:

- Requiring the Board Governance Committee to promote honest and ethical conduct, to enhance public confidence, and to review regularly and update policies regarding procurements;
- Requiring the Board Audit Committee to oversee internal controls and compliance systems;
- Adopting the 1987 Ethics in Government Act;
- Electing in May 2004 to follow relevant provisions of the Sarbanes-Oxley Act, including its provisions requiring that annual reports include an internal control assessment and requiring that the public accounting firm that prepares or issues an audit report must also attest to and report on

the internal control assessment made by management; and

- Meeting regularly to discuss and address Authority business.

However, we also identified some control environment weaknesses including the following:

- In the past, the Board had not required management to assess its internal control systems to identify internal control weaknesses. (During the audit, the Authority advised us that they have contracted to assess internal controls.)
- The Board had not historically required its external auditors to include an internal control review along with the annual audited financial statements.
- The Authority has not established an Internal Audit function.
- The term for one voting Board member expired in September 2001 and the term for another voting member expired in October 2003.
- One non-voting Board member's term expired in October 1999. The term for another such member expired in October 2001, and the term for a third expired in October 2003.
- According to Authority officials, management dedicated significant resources to meeting the Authority mission and to maintaining facility operations, but has not placed a similar emphasis on internal

control policies, procedures, awareness and training.

In the following sections of this report we identify several significant internal control improvement opportunities related to Authority procurements and disbursements. Providing a strong control environment will help the Authority to make the most of these opportunities.

Recommendation

To the Authority's Board:

1. Work in conjunction with Authority executive management to improve the control environment at the Authority by taking the following actions:
 - provide internal control training to Board members, management and staff to enhance the organization's control awareness;
 - annually assess internal controls to verify that systems of internal control continue to operate as intended;
 - require the public accounting firm selected to perform the Authority's annual financial statement audit to attest to and report on management's internal control assessment; and
 - work with State, county, and local officials to ensure all Board members' terms/appointments are current.

Procurement Practices

The Authority's internal controls should provide adequate assurances that procurements are at a reasonable price, are with qualified vendors and are free of favoritism and fraud. The necessary internal controls should be stated in formal policy and

should be supported with comprehensive, written procedures. Authority officials advised us that the Authority did not have a formal policy for procurements until the Board adopted such a policy (Policy) in February 2005. In addition, the Authority lacks comprehensive procedures for management and staff to follow to implement the Policy and to make sure the Policy was supported with specific control requirements.

Our audit covered the period April 1, 2003 through August 31, 2005. While the Policy was not in place for most of this audit period, the Policy generally includes the same criteria that we would have applied to assess the effectiveness of controls over the procurement process in the absence of such overarching guidance from the Authority. Therefore, we used the Policy as the benchmark for our evaluation throughout our audit period. Similarly, in the absence of comprehensive supporting procedures we applied reasonable concepts of internal control to evaluate procurement transactions.

Our findings showed that written support for purchases was sometimes missing, review and approval to authorize purchases was not always documented, contracts were not always used when required, sole source and emergency procurements were not justified in writing in certain cases, and records for use of the credit cards were incomplete. We informed Authority officials of audit exceptions as we detected them and officials acted promptly to take corrective actions.

We examined 19 contracts that each had a value exceeding \$10,000 with some exceeding \$100,000. These contracts pertained to 16 vendors and resulted in approximately \$11 million in payments. These contracts should have been awarded through a formal, competitive bid process (as the Policy requires); any non-competitive

awards should have been supported by written justifications. Seven of the 19 contracts were awarded through a formal, competitive process. For the remaining 12, we identified the following exceptions:

- 4 contracts were awarded on a sole source basis without written justification;
- 3 contracts were awarded based on informal quotes (since each exceeded \$10,000, they should have been competitively bid);
- 2 contracts were awarded on an emergency basis without written justification;
- 1 contract was awarded without bidding and the Authority did not document that the price was reasonable;
- 1 contract was negotiated without competition on behalf of water/sewer clients; and
- 1 vendor was selected without competition because it had a contract with a local municipality.

We also examined non-contract procurements for 30 items each costing \$10,000 or more. These procurements should have been made using formal competition or should have been supported with documentation for not using such competition. Six of the items were procured with appropriate competition, but we found the following exceptions with the procurement of the remaining 24:

- 16 items were purchased on a sole source basis without written justification;

- 1 item was purchased on an emergency basis without written justification;
- 5 items were purchased on the basis of quotes; and
- 2 items were purchased without competition.

We believe the exceptions noted above resulted from the absence of a procurement policy and procedures, insufficient procurement controls, and Policy limitations. For example, we found that the Policy requires bid tabs (the formalized results of the bid opening), but does not require that an Authority official witness and attest to the accuracy of the bid tabs. Further, while advertising bids encourages participation by as many vendors as possible, the Policy is silent about advertisement.

The Authority also lacks procurement procedures that provide management and staff with detailed instructions about how the Policy should be implemented on a day-to-day basis. For example, there are no detailed instructions about the steps to follow in making purchases over \$10,000 (formal bid process) or under \$10,000; the kinds of support needed to document which process was used and why; and steps in an adequate review and approval process to ensure purchases are authorized and appropriate.

During our examination we noted unique problems with certain procurements. However, the Policy did not contain provisions that would have addressed these problems. Therefore, there is a need to amend the Policy to cover these problems. The problems are discussed in the paragraphs that follow.

Third-party administration For about eight years, the Authority has consistently used one

firm for project management and miscellaneous engineering services. This firm also manages the Authority's procurement process for selected projects. However, the Authority's Policy contains no provisions for the use of third-party administrators. Thus, the Authority has no written procedures for monitoring the firm's compliance with its procurement Policy.

Modification of project scope In June 2002 the Authority issued an RFP for designing and building a fiber optic network, with proposals due by July 31, 2002. Although 24 construction firms expressed interest in the project, only 7 firms submitted bids (1 bid was incomplete so it was not considered). The remaining six bids received at the bid opening (August 7, 2002) were evaluated by a consultant, and three proposals were eliminated. However, in October 2002, the Authority asked the three remaining bidders to submit revised proposals for this project, whose scope had been revised by Authority officials. The revisions involved a project modification (building a network using an established route, rather than the contractor's choice of route). The \$10.3 million contract was awarded in January 2003 to 1 of the 3 vendors. The contract was later reduced by about \$2 million when the project scope was again modified. Given the impact of project scope modifications, the Authority should have offered all 24 construction firms an opportunity to bid on the revised project to foster competition and to ensure all qualified vendors had a chance to obtain Authority business. The Authority should revise its Policy to address changes made to a project during the award process, including procedures detailing what management should do to ensure fair and open competition when material changes occur.

Promotion of open competition Another of our sampled vendors was a local company

that, since 1987, was the primary supplier of chemicals used by the Authority's water/sewer facility. During our audit period, the Authority purchased more than \$112,000 in chemicals from this company. In August 2005, after our audit fieldwork had begun, the Authority awarded the firm a contract for the same commodities it had historically purchased without competitive bidding or a formal contract. The RFP specified that one vendor had to deliver a variety of chemicals to multiple locations. As a result, only one vendor - the traditional supplier - submitted a proposal and won the award.

To ensure fair and open competition, and to demonstrate that favoritism is not a factor in such purchases, the Authority should revise its Policy to address RFPs where only one vendor responds. Authority officials said they are considering issuing multiple RFPs for these chemicals to encourage more competition when the contract ends in February 2006.

Authority Purchase Cards

The Authority's purchase card program is intended to facilitate the purchase of selected goods and materials costing less than \$10,000. The Authority has a purchase card policy and procedures related to controlling the use of purchase cards by individual employees. We found that Authority employees generally did not document vendor quotes or sole source justification; further, we determined that controls over purchase cards, at the time of the audit, would not effectively prevent or detect inappropriate purchases.

Less formal competitive bidding

Authority Policy states that purchases costing less than \$10,000 must be procured through a less formal competitive process than for purchases over \$10,000, to help ensure the

Authority obtains these goods or services at a fair and reasonable price. Such less formal processes can include the use of written RFPs; written or verbal quotations; or any method that is cost-effective and fulfills the purpose of the Policy. The Policy also requires that each purchase be documented, and that purchases made at other than the lowest price be justified.

Of the 2,538 credit card transactions, totaling about \$1 million, which were processed between February 2004 and July 2005, we identified 31 transactions that individually cost more than \$4,999 but less than \$10,001. Authority officials were able to provide receipts for each of the 31 transactions, which collectively totaled about \$218,000. However, for 28 of these 31 transactions, officials could not provide evidence of written or verbal quotes from vendors, or provide written support to justify purchases from vendors identified as sole source suppliers.

Controls Over Purchase Cards

According to Authority officials, the purchase card program initiated in 1998, was intended to enhance ordering efficiency and increase self-sufficiency for Authority facilities. Authority managers determine which employees receive purchase cards. As of July 2005, the Authority had issued purchase cards to 19 of its 44 employees.

The Authority developed a purchase card policy in 1998 to control the use of the cards by individual employees. The policy describes physical controls over the cards and necessary authorization; requires distribution of the policy to card users; and forbids the use of purchase cards for inappropriate purchases (e.g., alcohol, personal expenses). The policy also states that Merchant Category Code (Code), a five-digit number that identifies vendors by merchandise type, be used to

block card purchases of non-business goods, such as golf clubs. Each employee issued a card is required to maintain a daily log of card purchases, and to reconcile the purchase card statement to the log every month. However, the policy did not require management to review purchase card transactions to confirm that card purchases are appropriate and accurately recorded, or require that managers periodically assess purchase card activity to determine whether the program or controls over it need to be changed.

We reviewed the 2,538 credit card transactions totaling about \$1 million to assess both employees' compliance with policy requirements and the overall effectiveness of controls. Our tests found that with few exceptions charges were recorded in employee logs and purchases were supported with documentation. However, because controls over the use of purchase cards were weak, misuse of the cards, including purchases of items for personal use, would not likely have been detected. The control weaknesses are identified below.

- Most employees and none of the Authority managers reconciled statements to logs. Without reconciliation, managers cannot verify that employees report all purchases.
- Authority managers do not review vouchers entered into the accounting system to confirm that items are legitimate Authority purchases.
- Five employees with purchase cards also have access to the accounting system. Employees with such access could enter card charges for inappropriate purchases on the accounting system without detection.
- Authority managers do not review purchase card activity to determine

which employees need cards, and what their spending limits should be. (Limits range from \$5,000 to \$75,000.)

- In March 2000, the Authority did away with Code control completely because employees reported they could not make necessary purchases. The Code is a valuable control that should be adjusted rather than eliminated.
- Employees with purchase cards told us that managers and other employees have used their purchase cards without their knowledge or consent. We confirmed this practice is occurring. Such practices violate the Authority's card policy and limit accountability.

When we discussed these control weaknesses with Authority officials, they indicated that their operations grew faster than the necessary control framework. Officials have since instituted a new purchase card policy and related procedures to address the deficiencies we identified. For example, in reviewing the new policy, we found it includes a requirement for: monthly reconciliation of the credit card statement to the log by someone other than the card holder; managerial review and approval of the log and the reconciliation that was performed; reinstatement of the use of Code Restrictions; and prohibition of the use of purchase cards by other than authorized users.

Fuel Cards

Since April 2003, a number of Authority employees have been able to use Authority-issued fuel cards to purchase gasoline for Authority vehicles. The Authority entered into an agreement for the use of fuel cards with two different vendors: Vendor A and

Vendor B. As of August 2005, 10 Authority employees were using fuel cards.

According to Authority managers, there are no written policies and procedures related to the use of fuel cards. Authority officials told us they verbally inform employees about the proper use of fuel cards. Officials reported that employees are told they must purchase only gasoline with the fuel cards, and must submit receipts to their respective facilities so purchases can be reconciled to the vendor's monthly statement.

We reviewed all 758 fuel transactions, totaling more than \$33,000, charged on fuel cards during the period July 2003 through June 2005. The 758 transactions comprised 232 charges from Vendor A and 526 charges from Vendor B. Our review revealed that a total of 272 transactions (36 percent), totaling more than \$11,000, lacked receipts. We found that virtually all the charges (231 of 232) from Vendor A lacked receipts. Authority officials told us this vendor provided receipts only in the station rather than at the pump, and that Authority employees did not obtain them. However, since officials paid the vendor's bills, totaling more than \$9,500, without attempting to obtain any documentation for these purchases, the Authority may have paid for fuel it did not use.

When we compared Vendor B's billing statements to Authority payments for the period July 2004 to July 2005, we identified 41 transactions, totaling more than \$1,750, that were not supported by receipts. We also found that Vendor B's monthly bills were difficult to reconcile with available documentation because the bills did not contain enough detail (e.g., the card number charged for the fuel purchase) to be useful. To completely reconcile all the gasoline charges on fuel cards, the Authority should

remind employees to turn in receipts. In addition, Authority Management must monitor employee compliance with this requirement, and must require fuel vendors to provide specific transaction information on monthly bills. It is essential that the Authority reconcile fuel bills and confirm that transactions are legitimate, to avoid overpaying vendors. We identified one instance in which the Authority may have been billed three times for a single fuel purchase.

Authority officials informed us that they have revised their Policy to address fuel cards, and strengthened controls over the card's use. Improved controls include a requirement that employees submit receipts. In addition, the Authority now uses a fleet management account for fuel purchases. This account provides the Authority with detailed transaction reports that management can use to monitor fuel transactions.

Minority and Women Owned Business Enterprises

The New York Division of Minority and Women's Business Development (Division) administers a statewide program to assist the development of Minority and Women Owned Business Enterprises (MWBE) and to promote equal employment opportunities. The Division defines MWBEs as entities in which minorities and/or women own at least a 51 percent interest and exercise the authority to control day-to-day business decisions. Such firms must be independently owned and operated and authorized to do business in State.

Section 2722 of Article 8, Title 29 of the Public Authorities Law (Law) makes personal service contracts entered into by the authority subject to the provisions of Section 2879 of Article 9 of the Law. Section 2879, which

applies to procurement contracts, defines a procurement contract as any written agreement for the acquisition of goods or services in the actual or estimated amount of \$5,000 or more. The Law also requires public authorities to identify the areas or types of contracts for which MWBEs may best bid. Public authorities are also required to promote MWBE participation in contracts, and to facilitate a fair share of the awards to such enterprises.

We found that Authority officials were not aware that the Law applied to them and, as such, their Policy only required a contract be awarded to an MWBE when the MWBE bid matched the lowest bidder. The Authority Policy needs to be revised to include provisions of the Law. While Title 29 requires the Authority to comply with this provision for only personal service contracts, Authority officials advised us that they will apply this provision to all contracts.

Officials gave us a copy of proposed amendments to the Policy, which states that the Authority desires to maximize its business with State MWBEs, as defined by the Law. To promote participation by MWBEs, the Authority will identify those contracts or areas of contracts for which such businesses may best bid. The proposed amendment also notes the Authority will review listings of area MWBEs, transmit invitations to bid on suitable projects, and facilitate the awarding of a fair share of contracts to such enterprises.

Recommendations

2. Develop and communicate detailed procedures for implementing the procurement Policy.
3. Establish effective controls over procurement to confirm that managers and staff comply with the Policy and

procedures in obtaining goods and services.

4. Modify the procurement Policy to ensure the Authority obtains goods and services at reasonable prices from qualified vendors through an open and competitive process. Ensure that the modified Policy includes provisions that address:

- procurement opportunities that should be advertised;
- the need for an Authority official to witness and attest to the accuracy of bid tabs;
- the Authority's oversight of a contractor that administers any part of the Authority's procurement process;
- protocols that the Authority will follow to promote fair and open competition if a project's scope is changed after bids are opened;
- RFPs that result in limited competition; and
- the need to enhance opportunities for MWBEs to participate in Authority contracts.

5. Train employees who make purchases, on the Authority's procurement Policy and procedures.

6. Improve controls over the use of purchase cards by individual employees by:

- revising the purchase card reconciliation process to ensure all transactions are properly reported, valid and recorded in the accounting system, and only approved charges are billed by the vendor;

- separating critical duties so that one employee cannot access all parts of the reconciliation process, or creating compensating controls to ensure transactions are appropriate;

- confirming that each employee with a purchase card still needs the card, and that card spending limits are reasonable for the employee's use;

- reinstating Merchant Category Code restrictions on the purchase cards; and

- forbidding the use of purchase cards by other than the authorized user.

7. Revise the procurement Policy to address the proper use of fuel cards, including employee accountability for receipts, management's review and approval of gas charges and reconciliation of fuel purchases to vendor charges. Convey this information to employees.

8. Investigate instances of potential duplicate billing for fuel, and confirm that other unsupported gas charges are valid Authority expenses.

Contract Monitoring

An entity that awards contracts for goods or services should monitor contractor performance to verify the contractor is providing the required deliverables and the entity is receiving the goods or services paid for. However, we determined that the Authority did not adequately monitor the performance of a lawn services contractor who, based on our observations, had provided few, if any, mowing or weed removal services at a contract-specified site at the time of our visit. As a result, the Authority contracted for a combined cost of \$11,000 for lawn care services in 2004 and 2005 - plus another \$1,500 to cover an insurance rider the

contractor needed to do the work - without evidence the contractor met contract specifications or paid \$1,500 for the additional insurance.

During this audit, we received a complaint from a contractor who bid on an Authority RFP for lawn care services. The complainant alleged that the low bidder who was awarded the contract could not perform the services required at the low bid price; the complainant also questioned whether the contractor had any liability insurance. To determine whether these allegations had merit, we reviewed the Authority's RFP, the award process and the contract, and we visited one of the sites the contractor was required to maintain.

The contract in question required the contractor to maintain lawns and planted areas at three sites (two pump station areas and a nature trail adjacent to the Authority's water and sewer lines). The contract stated that grass should be maintained at specific heights at these sites; that weeds should be removed every two weeks; and that brush along trailside fencing should be removed once a season. The Authority awarded the contract on May 7, 2004 for a one-year period at a cost of \$5,500, and then extended the contract for 2005.

However, we found this contractor has not performed the contracted services. When we visited the nature trail, we discovered that grass was as high as 16 inches in some places, and that brush was so high (about 10 feet) that it completely obscured the fencing in many locations. We concluded that the contractor had not properly mowed the grass or removed brush at this site for the entire two-year period under contract. Had Authority officials properly monitored this contractor, they could

have demanded lawn maintenance be done per contract terms or cancel the contract for nonperformance and recover the payments made. Instead, the Authority extended the contract. Authority officials said they extended the contract because they were satisfied with the contractor's services in 2004. Authority officials told us they had noted a decline in the contractor's performance in 2005 and had already asked the contractor to improve. Based on our observations no such improvements had occurred. After bringing this matter to the Authority's attention, officials advised us that they are currently holding payments due the vendor.

In comparing the RFP for lawn services to the actual contract, we also found that the scope of work in the contract contained fewer and less detailed specifications than the scope detailed in the RFP. Authority officials were unaware of these differences, which were likely the result of error. However, when the scope of work in the contract is reduced from that stated in the RFP, unsuccessful bidders could claim that their bids would have been different, given different specifications.

We also noted that the Authority paid the contractor an additional \$1,500 so the contractor could purchase a liability insurance rider. Insurance requirements were not stated in either the RFP or the contract. Authority officials said they believed they should compensate the contractor for this additional overhead expense to satisfy changed insurance requirements to do the work. The Authority paid this additional compensation without evidence of the cost of the insurance rider. The Authority should be more diligent in drafting its contracts to preserve the legitimacy of its award process.

Recommendations

9. Develop procedures to ensure that awarded contracts include clear contract specifications.
10. Verify contractors perform the work as contracted and if not, consult with legal counsel to recover money paid for services not provided.

Disbursements

The Authority uses two checking accounts to pay Authority expenses (one account for fiber-optic expenses and the other account for all other expenses) and uses its automated accounting system to create the checks. To produce a check, an employee writes the voucher number on the approved invoice and enters the payment in the accounts payable application. Using this payment data, another employee uses a check-writing application to create checks on press-numbered check stock. Once the check and related advice is printed, the check is forwarded to the fiscal officer or director for review and manual signature. During the period January 1, 2003 through June 30, 2005, the Authority created 4,513 checks totaling \$50.2 million.

Disbursements have a high risk for misuse. Therefore, system controls must help ensure payments are accurate, approved, and are for appropriate purposes. For example, disbursements should be reconciled to supporting documentation and bank statements, and blank checks should be safeguarded. We found the Authority does not have a disbursements policy or detailed procedures for meeting disbursement control objectives. Thus, we audited cash disbursements against general control criteria.

We interviewed Authority officials and staff who are involved in disbursement functions

and reviewed documentation supporting 163 payments (comprising 449 vouchers) totaling \$2.9 million that were included on the November 2004 bank statements. Of the 449 vouchers, 73 vouchers totaling \$209,092 were not authorized in writing. In addition to the previously identified control weaknesses, we attribute these unauthorized and unsupported transactions to the following:

- Duties are not adequately segregated. All administrative employees have access to the accounting system and could input data to produce a check. The fiscal officer can enter data, write checks and sign checks;
- Check signers do not review supporting documentation before signing. They assume payables entered into the system are valid; and
- The system does not require supervisory level approval to issue a check.

In September 2005, the Authority's Executive Director issued a memorandum requiring managers to approve, in writing, all invoices and invoice payments that have been entered into the accounting system for payment. Only invoices that managers have approved are to be paid.

In addition, we found all cancelled checks and voided checks were accounted for, but observed that the check stock was maintained in an unsecured location.

Recommendations

11. Develop an accounting system control requiring supervisory approval to issue a check.
12. Establish disbursement policy and related procedures and communicate them to

managers and staff involved in the disbursement process. The procedures, at a minimum, should address:

- Separation of disbursement duties, to the extent feasible, that ensure no one person has access to the entire accounts payable system;
- Designation of staff authorized to sign checks to obtain and review documentation;
- Safeguarding of check stock;
- Documentation be maintained to support all disbursements; and
- Designation of staff authorized to approve vouchers.

AUDIT SCOPE AND METHODOLOGY

Our performance audit was conducted in accordance with generally accepted government auditing standards, and included Board governance practices and Authority internal controls over procurements and disbursements for the period April 1, 2003 through August 31, 2005.

To determine whether Authority controls over procurements were sufficient to provide management with reasonable assurance that the Authority receives needed commodities and services at reasonable prices, does business with qualified vendors, and avoids favoritism and fraud, we reviewed Authority Policy to identify variances with best practices, interviewed Authority staff responsible for procurement, and performed compliance testing to provide reasonable assurance that Authority employees are following prescribed policies and procedures. To test the Authority's procurement and contracting controls we judgmentally sampled 16 vendors that the Authority reported as having a contractual relationship. We

selected our judgmental sample by stratifying the vendor payments and selecting the three vendors with the greatest total payments, six vendors that had payments exceeding \$100,000 and nine vendors with total payments less than \$100,000. We found that these vendors were awarded 19 contracts. For each of these contracts we reviewed the bid and award process and available documentation to determine how each vendor was selected and compared the methods used to Authority Policy.

We selected another sample of 18 vendors who the Authority reported did not have a contractual relationship. We selected these vendors because their individual payments exceeded the Authority's established \$10,000 limit and required formal competition. These 18 vendors received a total of 29 payments. For each payment we reviewed available records and interviewed management to determine whether the vendor was selected in accordance with Authority Policy.

In addition, we examined 2,538 credit card transactions processed between February 2004 and July 2005. For each transaction we reviewed the Authority's documentation to determine if management and staff properly reported each transaction and provided appropriate supporting documentation. We reviewed 31 of the transactions that exceeded \$4,999 but were less than \$10,001 to determine if the commodity or service had been competitively sought to ensure a fair and reasonable price was obtained. We also reviewed 758 fuel transactions charged on credit cards to determine if the Authority's management and staff properly reported and submitted appropriate documentation to support each transaction.

We tested a sample of disbursement transactions to identify unauthorized and inaccurate payments.

We audited canceled checks and supporting documentation for all checks listed on the November 2004 bank statements for Authority accounts. We also verified that all cancelled checks appeared in accounting records.

While conducting this audit, our office received a complaint regarding the performance of a contractor to whom the Authority awarded a lawn care contract. To determine the merit of this complaint and determine if the contractor is complying with contract terms, we reviewed the contract file and toured an area that the contractor was required to maintain.

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

AUTHORITY

The audit was performed according to the State Comptroller's authority as set forth in Article X, Section V of the State Constitution; and Section 2714 of the Public Authorities Law.

REPORTING REQUIREMENTS

A draft copy of this report was provided to Authority officials for their review and comment. Their comments were considered in preparing this report, and are included as Appendix A. While Authority officials did not concur with several of our conclusions, they did indicate that they plan to implement our recommendations and have already begun to take actions to address them. Appendix B contains State Comptroller's Comments which address the Authority's response.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the Executive Director of the Authority shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising of the steps that were taken to implement the recommendations it contained, and/or the reasons certain recommendations were not implemented.

CONTRIBUTORS TO THE REPORT

Major contributors to this report include William Challice, Richard Sturm, Donald Geary, Randy Partridge, Jackie Keays-Holston, Theresa Lawrence, Theresa Nellis, Mark Radley, and Nancy Varley.

APPENDIX A - AUDITEE RESPONSE



February 15, 2006

Mr. William P. Challice
Audit Director
State of New York
Office of the State Comptroller
110 State Street
Albany, New York 12236

Dear Mr. Challice:

Summary Response

The Authority welcomes the guidance provided by the Comptroller to improve its operations and assure its North Country customers that services provided are well managed and cost effective.

The Comptroller's examination has taken place during a time of transition for the Authority. In the past 18 months the Authority adopted a model governance action plan, awarded its first internal controls audit contract, hired a Finance Director with strong internal controls background, and implemented accounting software upgrades. Internal controls have been improved by changes to procurement policy, investment and ethics policies, purchase card and vehicle use policies, accounts payable procedures, employee expense reporting, computer usage and password policy, minorities and women in business enterprises policies, and vendor consolidation. The full effect of these changes will be seen in years to come.

The Authority is committed to continuous improvement to better fulfill its expanding public mission.

Board Governance Response (Recommendation # 1)

Our Board of Directors has taken a number of steps over the past 18 months to educate both itself and staff on Sarbanes-Oxley and New York State Model Governance Action Plan compliance requirements. At a July 22, 2004, training session, the full Board was briefed on Sarbanes-Oxley compliance by outside counsel. Board and staff participated in both governance and finance training sessions conducted by the New York State Commission on Public Authority Reform.

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The Authority complied with its 2004 Model Governance Action Plan by creating audit and governance committees, adopting a board member's governance manual and contracting for an independent assessment of internal controls. We will authorize this work to proceed upon completion of the OSC's examination and will focus on implementation of controls recommended by the Comptroller.

The strength of the Development Authority lies in the nature of its board member appointments: all are made by North Country or Albany appointing entities independent of the Authority. This assures that the Authority remains accountable to its constituents. Subsequent to the Comptroller's examination, two voting members have been appointed to board terms, giving the Authority a full complement of voting members.

Procurement Practices Response (Recommendations # 2-8)

The Procurement Practices analysis judges the Authority against standards that in many cases either do not apply or were not in effect at the time of procurement. The Authority is committed to implementing procurement policies which adhere to best practice standards for New York State Public Authorities. We have rewritten the Authority's February 2005 procurement policy to even better reflect the Comptroller's guidance as a first deliverable on this commitment.

* Comment 1

The 2006 policy (transmitted electronically) provides detailed implementation procedures (see, for example, Procurement Code of Conduct section) and controls (Section 2.2.0. establishes a random quarterly audit procedure to test compliance). Each of the policy features recommended by OSC has been incorporated. The policy has been developed by our entire management team and it now includes stronger senior management controls to ensure consistency across all Authority functions.

As to questioned procurements made after adoption of the February 2005 policy, these were generally cases where an on-going professional services or supply relationship was being continued. Our policy did not address this situation; the 2006 policy does.

Contracts Over \$10,000 - We believe that each of the sole source, competitive quote, emergency and MWBE procurements cited were appropriately made. Our revised procurement policy will require more explicit written justification and procurement checklists for each contract.

See State Comptroller's Comments, page 22

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Water/sewer clients were given the opportunity to procure services at substantial cost savings from an existing Authority provider, and the Authority was simply a pass through. The growth of water/sewer operations resulted in larger than expected vendor purchases, which the Authority addressed through a subsequent bid process. A commodity vendor was selected because a County bid price was made available to the Authority.

Procurements Without Contracts - The sole source procurements cited involved nine vendors. Each of these was either proprietary or replacement parts and equipment, or professional services. We believe that the cited emergency and competitive quote purchases were also properly made. The revised procurement policy will require more explicit documentation of each procurement decision.

Three Problematic Procurement Practices:

- Third Party Administration - While the Authority does occasionally use an engineering firm to assist procurements (four projects at a total procurement cost of about \$80,000 during the audit period), it does maintain day-to-day involvement in the process, and makes all procurement decisions.
- Modification of Project Scope - The Comptroller contends the Authority made "significant" and "material" changes to the scope of its fiber optic project during the course of evaluating RFP responses and that those changes limited the competitive nature of the process. However, the requirements of the RFP allowed for submission of cost estimates in a manner that ensured a fair assessment of the proposals, while fully disclosing the Authority's right to make adjustments that would improve both the efficiency and effectiveness of the project.

The Authority made two minor changes to the project scope - one regarding the number of spur routes that would be constructed and one regarding route selection. The RFP described the spur routes, and included the statement "Bidders should estimate and itemize costs for building fiber to each of these locations separately. They should be included in the price but the Authority may choose to delete any or all of them at its sole discretion" (emphasis added). In fact, the Authority did ultimately delete several of spur routes from the final contract; however, the change in scope didn't change the unit prices for the construction.

*
Comment
1

* See State Comptroller's Comments, page 22

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The other minor change was regarding route selection. In that instance, the Authority suggested route changes to optimize community benefit of the network. Each of the three finalists was given the opportunity to submit revised costs reflecting the route changes. Again, the RFP clearly gave the Authority the right to make route changes, stating "The Authority reserves the right to negotiate route and scope details with the bidder prior to completion of the Pathway Selection and Permitting phase." The fiber optic design/build RFP met the requirements of the law, and clearly gave the Authority the right to make scope changes.

*
Comment
2

The contention that we limited competition by working with three finalists, and not the entire group of 24 who originally attended the pre-proposal conference fails to take into account the qualifications of the prospective contractors. Sixteen of the attendees disqualified themselves from the competition of their own accord by not submitting a proposal. Offering them a second chance to make a proposal after we made minor scope changes would be unfair to the eight firms that expended the effort and expense to submit a proposal on time and would therefore have compromised the RFP process. Of those eight, four companies were disqualified due to their lack of financial capacity to complete the job. Again, the minor scope changes did not alter the fundamental requirements of the RFP. Finally, the fact that our three finalists were each in the top 10 of telecommunications construction firms in the country and that our final construction costs were 72% of industry averages indicates that we did, indeed, have a competitive process.

- Promotion of Open Competition - Recognizing that the substantial growth of water/sewer operations was creating larger treatment chemical costs, the Authority publicly bid chemicals in May 2005. Since we manage multiple facilities and do not have chemical storage capabilities, only five known vendors were identified, and they were solicited directly by the Authority. Only one of the vendors is local and it is not surprising that it was the sole bidder given the need for frequent deliveries to multiple locations. The Authority structured the contract to expire in February 2006 and a new bid process is now underway.

* See State Comptroller's Comments, page 22

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Authority Purchase Cards - OSC cites transactions for which the Authority provided receipts but not evidence of vendor quotes. These transactions involved 15 vendors, each of which were either sole source or lowest cost suppliers. Each procurement was consistent with law and policy in effect. As noted, the Authority has subsequently implemented an updated purchase card policy which addresses each of the Comptroller's recommendations, and employee training to assure compliance.

Fuel Cards - We recognized that our former vendor was providing inadequate documentation of fuel purchases and have switched to a fleet management account which provides employee and odometer-specific documentation for each refueling. We are pleased that the Comptroller has ratified this decision. Upon review, we believe we were double-billed for a single, \$58.00 transaction, and are seeking reimbursement.

Contract Monitoring Response (Recommendations # 9, 10)

Lawn maintenance contractor performance was in fact acceptable in 2004, and payments were appropriately withheld in 2005 when performance became unacceptable. We have provided contractor insurance certificates which verify that appropriate insurance coverages were secured.

While OSC did correctly conclude that contract performance was unacceptable when auditors toured the nature trail in 2005, it is important to clarify the limits on the Authority's ability to maintain certain portions of the nature trail. Significant portions of the nature trail are within DEC-regulated wetland areas, and mowing has never been performed in those areas because it would violate NYS laws. In fact, the nature trail was constructed as a wetlands mitigation measure as part of the Authority's Watertown-to-Fort Drum sewerline project.

*
Comment
3

The 2006 Procurement Policy includes detailed contract administration guidance as recommended by OSC.

Disbursement Response (Recommendations # 11, 12)

The cited payments are the most ordinary and routine expenses of the Authority (rent, utilities, etc.), delegated to support staff to pay on a management-by-exception basis. All payments were documented to an extent satisfactory to the Authority, and appropriately made.

*
Comment
4

* See State Comptroller's Comments, page 22

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As to OSC's specific disbursement recommendations:

Re: Supervisory Approval. The referenced Executive Director's memorandum added an additional step to the invoice approval process at the suggestion of OSC. It required management approval of all accounts payable batch reports after they have been entered in the accounting system, and before payment. The Finance Director conducts a random monthly batch audit to assure compliance.

Re: Disbursements Policies and Procedure. The A/P batch approval process described above ensures separation of function appropriate to our staffing; the Finance Director audits about 50% of A/P batches monthly to assure proper documentation is in place; we have secured check stock in a locked cabinet; the comprehensive procurement policy now in place will greatly enhance both disbursements documentation and approval processes.

Conclusion

Since the Comptroller's examination began in June 2005, the Authority has made considerable progress in ensuring Sarbanes-Oxley and Model Governance Action Plan compliance. Wide-ranging policies and procedures have been put in place, the full effect of which will be seen in years to come. A Finance Director with a strong background and personal commitment to internal controls has significantly enhanced our operation.

The Comptroller's examination offers a snapshot in time, and the Authority is committed to fully implementing federal and state compliance requirements in the months ahead.

Very truly yours,



Douglas Murray
Chairman

Very truly yours,



Robert S. Suravich
Executive Director

cc: DANC Board of Directors
DANC Management Team
Leslie H. Deming
George Mead

APPENDIX B - STATE COMPTROLLER COMMENTS ON AUDITEE RESPONSE

1. Although the Authority has been operating for more than 20 years, management had not developed a comprehensive written procurement policy until February 2005. While the Policy was not in place for most of this period (April 1, 2003 through August 31, 2005), it generally included the same criteria that we would have applied to assess the effectiveness of controls over the procurement process in the absence of any such written guidance from the Authority. Therefore, we used the Policy as the benchmark for our assessment. Similarly, in the absence of comprehensive supporting procedures on the part of the Authority, we applied reasonable concepts of internal control and sound business practices to evaluate procurement transactions.
2. We do not agree that the RFP allowed the Authority to change the project scope prior to the selection of the contractor. In fact, the RFP states "...it is the intent of the Authority to build the highest quality system possible at the lowest reasonable price. The Authority expects bidders to submit lump sum price proposals. However, during the term of the project it is likely that the network will need to be expanded or revised to accommodate the changing needs of the Authority." Therefore, any negotiation of project scope should have occurred after selection of the contractor. Further, the RFP language the Authority cites to support its right to make route modifications ("The Authority reserves the right to negotiate route and scope details with the Bidder prior to completion of the Pathway Selection and Permitting phase."), applies to changes in pathway selection which the RFP defines as part of project implementation, not contractor selection.
- Providing for minor or immaterial changes during the bidding process is good business practice, but, when those adjustments are material, all contractors that expressed an interest during the RFP process should be given the opportunity to submit a revised bid. We believe building a fiber optic network along a defined route rather than requiring each contractor to develop their own route constitutes more than just a minor project scope change. As the Authority noted, 16 of the contractors did not submit a proposal. However, several of these contractors expressed concerns regarding their ability to develop a fiber optic route and to submit a proposal within the original RFP timeframes. Considering that the original time restrictions limited the number of contractors that submitted bids and the project scope modifications, the Authority should have offered all 24 construction firms the opportunity to bid on the revised project. Doing so, would have fostered competition and given all qualified vendors a chance to obtain Authority business.
3. While the Authority contends that significant portions of the trail are within DEC wetlands, it is important to note that the maintenance contract does not mention any related DEC limitations or identify what portions of the trail are protected wetlands. In fact, we did not observe any designated wetland postings. It is also important to note that we found the entire trail was not adequately maintained, including both entrances and picnic areas, which are clearly not protected wetlands. Based on the Authority's actions cited in the response, they agree with our assessment and have withheld the contractor's payments until performance improves.

-
4. We disagree that the cited payments are the most ordinary and routine expenses.

In fact, the cited payments include Sam's Club, and Top Market, a grocery store,

both of which offer goods that can be used for personal as well as business use. As such, to ensure that Authority expenses are for legitimate business purposes only, invoices should be reviewed and approved before they are paid.