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COMPTROLLER

OFFICE OF THE
NEW YORK STATE COMPTROLLER

DIVISION OF STATE SERVICES

DEVELOPMENT AUTHORITY OF THE NORTH COUNTRY

REVENUE, SELECTED EXPENSES AND ACCOUNTING SYSTEM

Report 2005-S-62

AUDIT OBJECTIVE

The objective of our performance audit was to determine whether the Development Authority of the North Country (Authority) established an adequate system of internal controls over revenue, payroll, investments, vehicle use, meal and lodging costs, and accounting systems.

The Authority is a public benefit corporation, overseen by a 13-member Board of Directors. The Authority operates three major infrastructure facilities (water and sewer, solid waste management and a fiber-optic network) that provide services to customers at the United States Army base at Fort Drum and in surrounding counties. Authority operations are decentralized, so each facility's revenue sources and expenditures are independent of those of the other Authority facilities.

AUDIT RESULTS - SUMMARY

We found the Authority had billed and collected the user fees due for the sample of transactions we reviewed. However, Authority controls over solid waste services operations should be improved to confirm hauler bills are accurate. Further, while the Authority could account for all the checks we reviewed, controls over the check receipt process could be improved. [Pages 4-6]

The Authority holds a significant amount of funds in investments. We found that Authority investment transactions reviewed complied with Authority policies. However, we identified potential risks to Authority investments in several instances. For example, one Authority disbursement for $155,000 from an investment account was authorized by an Authority official with Board approved check signing authority of only $15,000. The Board and Authority management, respectively, need to review the investment policy and strengthen investment controls to improve accountability for invested funds. [Pages 5-6]

Our review of payroll found that, while controls in this area should be strengthened, Authority payroll expenses were generally accurate, authorized and properly recorded. However, our review of meals and lodging expenses determined that some Authority payments for these expenses were unsupported and, in our opinion, inappropriate or excessive. For example, during the audit period the Authority spent more than $1,300 on employee lunches and a birthday party. In addition, Authority spending on meals and lodging for a conference were more than triple the cost guidelines of the U.S. General Services Administration, which specify government employee reimbursement rates and are also used as a reasonable standard by the private sector. We attribute these problems to the Authority's vague guidelines for meals and lodging, and to management's position that such expenses were appropriate and necessary. [Pages 6-11]

We also found the Authority acquired 11 vehicles for employees' business use without analyzing whether the acquisitions were cost effective, and without adequately tracking vehicle usage. Although commuting accounted for a significant amount of total mileage on these vehicles, the Authority did not report vehicle usage or other taxable fringe benefits (e.g., paid membership dues for professional organizations) for the employees who received these benefits. Lastly, we found the Authority should improve controls over its accounting systems. [Pages 9-11]

Our report contains 16 recommendations to improve controls over the above cited

financial operations. Authority officials did not agree with our conclusions regarding certain expenses that we considered inappropriate. Generally, however, officials did agree with our recommendations and have taken steps to implement changes.

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
Office of the State Comptroller
Division of State Services
State Audit Bureau
110 State Street, 11th Floor
Albany, NY 12236

BACKGROUND

The 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, six voting members are appointed by the three counties (two members from each county) served by the Authority, and two voting members are appointed by the City of Watertown; the remaining five non-voting members, of which one is recommended by the Senate and one is recommended by the Assembly, are appointed by the Governor. As of December 17, 2005, the Authority employed 46 staff (22 salaried staff and 24 hourly staff).

The Authority operates a solid waste management facility, a water/sewer facility and a fiber-optic network, 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 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 serves Fort Drum and western Jefferson County'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.

The Authority's annual report for the fiscal year ended March 31, 2005 identified revenues of $9.9 million, $5.4 million (including grants) and $4.5 million for solid waste, Network and water/sewer services, respectively. As of September 2005, the Authority had $63 million invested in short and long term accounts. As of June 2005, the Authority also owned or operated 17 licensed vehicles.

This report addresses Authority internal controls over revenues, payroll, investments, vehicles, meals and lodging costs and its accounting system. A separate report entitled *Internal Controls Over Procurement* (Report

2005-S-34), that addressed the Board's governance and the Authority's controls over procurements and disbursements, found the Authority's control environment and other control components needed improvement. We recommended the Board improve its governance, and Authority management develop a sound internal control framework.

AUDIT FINDINGS AND RECOMMENDATIONS

Controls over Revenue

We found the Authority billed and collected the user fees due for the sample of transactions we reviewed. However, Authority controls over solid waste services operations should be improved to confirm hauler bills are accurate. Further, while the Authority could account for all the checks we reviewed, controls over the check receipt process could be improved. Finally, while our tests of Authority investment transactions did not identify any instances of noncompliance with Authority policies, we found the Board and Authority management need to annually review the investment policy and strengthen investment controls to improve accountability for invested funds.

User Fees

Authority operations collect user fees that are generally based on contracts for specified services. The Authority bills:

- network service providers according to established contract terms;
- water/sewer customers at a fixed annual rate per 1,000 gallons, based on meter readings of water flowing out of the system and sewage flowing into the system; and
- solid waste customers, based on tonnage and waste category.

We found the Authority has policies and procedures for billing and collecting user fees for each of the above operations. Our review of contracts, meter readings and tonnage slips determined the Authority had properly billed, reported and collected the correct amounts for the transactions we audited. However, we also concluded the Authority needed to improve its monitoring of solid waste scale house operations and segregate scale house functions to verify that haulers pay user fees due.

The Authority requires trucks entering the solid waste facility to be weighed. Early in the audit, we found that Authority control procedures did not confirm trucks were weighed on entry, so haulers may not have been invoiced for the tonnage they dumped. When we told Authority officials about this problem, they developed a monitoring policy requiring an Authority manager to observe and document dumping activities for several trucks each billing period, and to subsequently confirm each of these haulers was properly invoiced.

We also found the scale house supervisor, who oversees daily scale house activities and produces hauler invoices also weighs the trucks. As a result, the supervisor is reviewing her own work. We encourage the Authority to segregate daily scale house operations from the supervisor's responsibilities or to develop a compensating control to verify all haulers are properly weighed and invoiced.

Check Receipt Process

The Authority should have controls in place to confirm the checks it receives from users

are timely recorded, processed and deposited in Authority accounts. In the Authority's check receipt process, checks are logged into a check log on a daily basis, and then forwarded for processing and deposit. On a monthly basis, a supervisor reconciles the check log to the accounting system and bank statements and signs the check log. We assessed this process as adequate to provide control over checks received. To confirm the Authority's compliance with this process, we tested a sample of 29 transactions, which were recorded in 14 different check logs, to verify payments were properly processed. Since 4 of the 14 logs were not signed by the supervisor, there was no evidence the required reconciliation was done. We also noted that checks are not restrictively endorsed to safeguard checks from unauthorized use. We encourage the Authority to verify that reconciliations are done, and to require that checks be restrictively endorsed immediately upon receipt.

Investments

As of September 30, 2005, the Authority maintained portions of its revenue in 30 investment accounts, which totaled $63 million. The Public Authorities Law (Law) requires the Authority to adopt comprehensive investment guidelines, detailing how Authority investments will be made, monitored and reported, and to distribute the guidelines to officers and staff. The Authority must also prepare and approve annual and quarterly investment reports, which detail investment procedures, the results of an annual independent audit, the Authority's investment income record, and brokerage fees. Further, the Law requires the Board to annually review and approve the guidelines and to review the annual and quarterly investment reports.

While we found the Authority does have an investment policy (Policy), it has not produced annual and quarterly investment reports. Further, the Authority's Policy lacks the detailed investment guidelines and monitoring procedures required by the Law. In addition, the Board had not done an annual review of the Policy as the Law requires. Authority officials stated they are in the process of developing guidelines and monitoring procedures. In January 2006, Board officials, prompted by this audit, reviewed and approved the Authority's Policy and prepared and reviewed the Authority's current investment report.

Our review of 29 long-term investments for November 2004 totaling $4.2 million and 40 money market withdrawals totaling $8.2 million determined that investments complied with the Policy and withdrawals were supported by documentation. However, we identified potential risks to Authority investments in several instances, as stated below.

- One individual is responsible for making and recording investment transactions, as well as reconciling investment statements. These duties should be segregated, or compensating controls developed, to protect investments from misuse.

- The Authority made seven disbursements from investment accounts, totaling $485,000, directly to third-party payees. One disbursement for $155,000 was authorized by an Authority official whose check signing authority was limited by the Board or $15,000. Although the seven disbursements were for valid business purposes, such payments circumvent Authority cash disbursement controls and are not

recorded in the accounting records. Officials report they no longer make disbursements to third parties from investment accounts.

- In October 2004, a broker misallocated a $309,000 bond deposit. With regular review of investment reports and activity, officials could have identified and promptly corrected this mistake. The Authority has since sent a letter dated January 24, 2006 to request a correction.

To safeguard Authority investments, the Authority should correct the control weaknesses noted above, and promptly complete its development of investment guidelines and related monitoring procedures.

Recommendations

1. Review and realign the duties of the scale house supervisor to separate truck weighing and billing duties or implement appropriate compensating controls.

2. Verify that the supervisor reconciles checks received, require documentation of reconciliations be maintained and restrictively endorse checks upon receipt.

3. Develop and implement detailed guidelines and monitoring procedures to support the Policy. The procedures should, at a minimum, assign responsibility for monitoring transactions and following up on unusual or incorrect transactions.

4. Segregate investment responsibilities so one individual is not responsible for making and recording investment transactions, and for reconciling investment statements. If this is not possible, implement appropriate compensating controls.

5. Prohibit third-party disbursements from Authority investment accounts. Examine prior third-party disbursement transactions to confirm that no inappropriate transactions occurred.

6. Correct the misallocations to the Authority's accounts.

7. Make sure the Board annually reviews and updates the Policy and obtains and reviews quarterly investment reports.

Selected Expenses

Our review of payroll found that, while controls in this area should be strengthened, Authority payroll expenses were generally accurate, authorized and properly recorded. However, our review of meals and lodging expenses determined that some Authority payments for these expenses were often unsupported and, in our opinion, some were inappropriate or excessive. Finally, we found the Authority owned or leased 17 vehicles for employees' business use without analyzing whether the acquisition methods were cost effective, and without adequately tracking vehicle usage. Although commuting accounted for a significant amount of total mileage on these vehicles, the Authority did not report vehicle usage or other taxable fringe benefits (e.g., paid memberships to professional organizations) for the employees who received these benefits.

Payroll

The Authority should verify employees are paid only for time worked and payroll disbursements are accurate, authorized and properly recorded. Primary payroll functions should be segregated, or compensating

controls developed, to prevent or detect inaccurate or inappropriate transactions. Payroll controls include supervisory approval of timesheets and standardized forms to authorize and document payroll changes.

We found that Authority payroll responsibilities were not adequately segregated. One individual adds and deletes employees to the payroll; modifies payroll data (e.g., pay rate); generates paychecks and initiates direct deposits; and maintains timekeeping and accounting records and has the ability to approve and modify timesheets. The accounting supervisor reviews the payroll before processing but does not confirm that the payroll was processed correctly. The inherent risk in assigning all the primary payroll functions to one person is that inappropriate payments could occur without detection. Authority officials told us they will develop compensating controls for payroll responsibilities that cannot be segregated.

According to Authority officials, the Authority requires supervisors to sign employee timesheets and approve payroll changes (additions to or deletions from the payroll) before they are processed. We examined 168 employee timesheets for 4 pay periods to verify supervisory review, and 10 of the 39 payroll changes that occurred between January 2003 and June 2005. We found that virtually all timesheets were signed. However, officials had no documentation to support 2 of the 10 payroll changes (1 termination and 1 addition) to confirm the changes were authorized. We attribute these exceptions to the Authority's use of ad hoc measures (verbal communication, e-mails, Post-it notes) to request payroll changes resulting in inconsistent documentation and limited accountability for the changes. Officials are now developing a standardized payroll processing form.

Authority Meals and Lodging Expenses

The Authority incurred meals, lodging, and other employee reimbursable business expenses totaling $118,000 over a 31-month period ending July 31, 2005. Our audit focused on meals and lodging expenses. To maintain proper control over these costs, the Authority should develop a written comprehensive meals and lodging policy that establishes expenditure limits in compliance with relevant laws and guidelines and promotes consistent travel practices. Management should distribute the policy so employees know which costs are allowable. Management must then confirm that employees who process these expenses understand the policy and follow procedures designed to implement the policy.

However, we found the Authority's Personnel Policies Manual (Manual), updated on November 24, 2004, provides only limited guidance for payment of employee travel and miscellaneous expense. For example, the Manual states that employees must maintain receipts or written records to document their business expenses to be reimbursed for meals and lodging expenses that are reasonable and customary. The Manual does not define what constitutes proper documentation or reasonable and customary business expenses. Expense documentation, according to sound business practices and the Internal Revenue Code, should include at least the employee's name, the event involved and evidence of a business reason for the expense. Since the Authority is a public entity that derives its revenue from user fees which include federal and local government customers, reasonable and customary business expense should be limited to expenses those customers would view as appropriate and prudent.

We examined samples of Authority meals and lodging expenses to determine whether

Authority reimbursements and direct payments for meals and lodging were properly documented, appropriate and prudent expenses. Our samples included Board and Executive staff expenses totaling $12,227 and employee expenses totaling $5,350. We found the Authority incurred unsupported and, in our opinion, inappropriate and excessive meals and lodging expenses. For purposes of this audit, we defined unsupported, inappropriate and excessive costs as noted below.

- Unsupported expenses include disbursements for which adequate documentation was not provided.
- Inappropriate expenses were those that, in our opinion, were not a prudent use of public money because they were not necessary.
- Excessive costs were expenses that, in our opinion, although supported and appropriate in nature, appeared too high.

Unsupported or Inappropriate Expenses

We found certain meals and lodging expenses we reviewed were either unsupported, inappropriate or both. For example:

- $1,069 was spent to express "gratitude" to about 100 contractor employees who worked on the Authority's Network. We believe this expense was an inappropriate use of public funds.
- $1,325 was spent for employee lunches and a birthday party. Generally these expenses were simply noted as "staff lunch," without documentation to show there was a business purpose and need for these expenses.
- $805 was spent on 10 meal reimbursements. These receipts did not document who attended the dinner, what was discussed during dinner, and why these expenses were incurred.
- $758 was paid for lodging; the 12 lodging expenses we selected were incurred by 1 employee who was reimbursed for lodging in Watertown, his official workstation. Authority officials stated these expenses were incurred during the construction of the Network when this employee had worked late.
- $214 was paid to a Board member for refreshments he purchased for a Board picnic even though the member did not provide documentation to support this expense.

Authority Officials conveyed that because they are a public benefit corporation of the State, they, at times, operate like a private enterprise. However, the Authority is a public benefit corporation of the State and practices such as paying for contractor meals generally would not be considered an efficient use of public money.

Excessive Expenses

The Authority has not established dollar limits on meals or lodging. To gauge the reasonableness of lodging and meal costs, we compared Authority costs to U.S. General Services Administration (GSA) guidelines, which specify government employee reimbursement rates for lodging and meal expenses. Because GSA rates are considered a reasonable standard, private sector businesses also consult them in setting limits for their employees' expenses.

Our sample included two payments for an Authority strategic planning conference. When we reviewed the documentation associated with the conference, we found that the rates the Authority paid for meals, alcohol and lodging for 11 Board members and executive staff, as well as 2 guest speakers, significantly exceeded published GSA rates. Officials conveyed that while the cost of the conference exceeded GSA rates, they did not incur additional costs for conference room space. The following table compares the GSA allowances to the actual expenses incurred.

Comparison of Total Conference Costs to GSA Rates			
	GSA Allowance	Actual *	Percent Variance
Meals	$1,032	$4,813	366%
Lodging	1,416	3,216	127%
Total	$2,448	$8,029	228%

* Net of guest reimbursements

The Authority is justified in paying for its Board and executive management to attend a strategic planning session for business purposes, but conference expenditures for meals and lodging should not be excessive.

The Authority is not specifically bound by GSA guidelines. However, the Authority is a public benefit corporation of New York State, and as such, should limit its expenditures for meals and lodging. We encourage officials to establish a comprehensive meals and lodging policy that ensures public money is used in an effective and economical manner.

Vehicles

As of June 2005, the Authority owned or leased 17 licensed vehicles, including pickup trucks, sedans and SUVs. We found the Authority does not adequately track the mileage on its vehicles. Such information could be used to determine total miles traveled, commuting miles, fuel used, etc. However, on August 30, 2005, as a result of our inquiries, the Authority developed a Vehicle Use Policy (Policy) to establish control over Authority vehicles and their use. The Policy now requires each driver to record certain basic usage information (mileage, fuel usage, etc.) in a vehicle log.

Using available records for the 11 vehicles issued to water/sewer employees for the 2005 calendar year, we determined that a significant amount of the mileage on these vehicles - 30 percent on average, was incurred to commute to work rather than to perform water/sewer duties. In doing this test, we used mapping software to determine the distance drivers traveled from their residence to their first work location (i.e., personal commute). As shown in *Exhibit A*, commuting mileage for the drivers of these 11 vehicles ranged from 10 percent to 64 percent of the total mileage on their vehicles.

The Authority also needs to develop a policy to manage its fleet of vehicles. Such a policy would typically include:

- requiring a cost/benefit analysis before acquisition to compare costs (acquisition vs. reimbursement) and acquisition methods (lease vs. purchase);
- detailing why and when an employee can be assigned a vehicle, as well as the most appropriate vehicle type;
- establishing, in terms of annual mileage, when a vehicle is underused and should be reassigned or removed from the fleet;

- establishing a specific maintenance schedule for each class of vehicles operated; and
- reminding drivers to comply with relevant State laws in operating Authority vehicles.

Unreported Fringe Benefits

We also found the Authority does not report certain fringe benefits that employees receive as compensation on their annual wage statements (W-2s). According to the Internal Revenue Code, an employee receives compensation when an employer pays for an employee's lodging expense, and related meal costs, which are incurred in the general vicinity of the employee's main work location, regardless of the employee's family home location. Therefore, each of the 12 sampled lodging expenses reported earlier in this report should be considered a fringe benefit and must be reported as employee compensation.

The Authority negotiates compensation packages with a number of its top employees. These packages include memberships in professional organizations. However, the Authority does not report these benefits as compensation on the employees' W-2's. Because such memberships are negotiated as a condition of the official's employment, the value of the membership is compensation, and is therefore subject to applicable State and federal income tax. Authority officials said they did not report these fringe benefits as compensation because they believe the above expenditures primarily benefited the Authority. We encourage the Authority to identify the fringe benefits its employees receive and report them as employee compensation.

The value of an employee's use of an Authority vehicle for commuting is also a fringe benefit that should be reported as income on the employee's W-2. However, we found the Authority has not identified the extent to which its vehicles are used by employees to commute to work. The Authority also has not reported this fringe benefit for any of its employees, or instructed employees to report their personal use of Authority vehicles on their tax returns. Officials told us they had not considered the tax implications of Authority vehicle use by employees. Authority policy now requires employees to report their commuting mileage so their fringe benefit can be calculated.

Recommendations

8. Segregate primary payroll functions so one individual is not responsible for major payroll components. If the primary payroll functions cannot be segregated, develop compensating controls.

9. Develop payroll processing procedures and consider using standardized payroll forms. The procedures should include but not limited to:

- defining payroll processing responsibilities;
- prohibiting the processing of timesheets without proper supervisory approval; and
- requiring all payroll changes be authorized in writing.

10. Develop and distribute a comprehensive written Meal and Lodging Policy whose provisions include but are not limited to:

- identifying meals and lodging expenses that are reimbursable, as

well as the documentation employees must submit to obtain reimbursement;

- identifying practices/costs the Authority does not reimburse (e.g., parking tickets); and
- defining amounts and types of expenses the Authority does not pay because they are excessive.

11. Ensure that employees that process travel costs consistently review submitted expenses for conformance to the Policy before reimbursing travelers by confirming that all vouchers for meals and lodging expenses, including credit card charges, have sufficient back-up documentation. Documentation should at a minimum include: the business reason or nature of the business discussions and a list of attendees. Expenditures should also comply with the Authority's expenditure limits.

12. Develop a cost benefit analysis to determine which automobile acquisition method is the most cost-effective.

13. Develop a written fleet management policy that incorporates the components and requirements discussed in this report.

14. Identify and report all taxable fringe benefits employees receive as employee compensation.

Accounting System

Authority management is responsible for safeguarding its computer system from unauthorized access, and for limiting authorized access to sensitive information or critical systems. An authentication process (user ids and passwords) should be established to verify users' identification before system access is granted. Logical access controls should also be implemented to restrict user access to the data and files they need to perform their jobs. We found the Authority needs to strengthen its controls over access to more effectively protect its information resources.

- The Authority's password policy needs improvement. The Authority instituted a password policy on September 1, 2005, which details password structure and the importance of keeping passwords confidential. Employees must use a password to gain access to the Authority's network and accounting system. However, this policy requires passwords to be changed annually, rather than every 30 to 90 days, as accepted information technology standards require.

- Logical access controls should be strengthened. The Authority's Finance Director and two support staff have unlimited access to all aspects of the accounting system (billing; collecting and accounting for Authority revenue; recording and paying Authority payables; reconciling accounts). Since these users have administrative rights, they can also delete customer histories, payment applications, general ledger transactions, etc. The Authority should determine the specific access needs of these and other users and assign rights accordingly.

To reduce the risk that sensitive Authority data could be inappropriately accessed, altered or misused, management should periodically review access authorizations and access rights to determine whether they remain appropriate. The Authority stated that

its prior Finance Director reviewed access controls in October 2005, but could not document this review. We encourage Authority officials to review user access authorizations to confirm users have only the authorizations needed to perform their job.

Recommendations

15. Require passwords to be changed in accordance with industry standards (i.e., every 30 to 90 days).

16. Establish policies and procedures for accessing the Accounting Information System, including:

- logical access control (e.g., user Ids, passwords);
- separation of duties;
- a determination of user access need and the assignment of access rights in accordance with identified need;
- periodic review to determine if assigned rights are consistent with user needs and responsibilities; and
- limited authorization to delete and modify historical records.

AUDIT SCOPE AND METHODOLOGY

Our performance audit was conducted in accordance with generally accepted government auditing standards, and included Authority internal controls over its financial operations including revenue, selected expenses and the Authority's accounting system for the period April 1, 2003 through December 31, 2005.

To test the Authority's revenue process for each of the three primary operations, we reviewed the following Authority records:

- Network - For the period April 1, 2003 through September 30, 2005, Fiber Optics revenue totaled $3.3 million (contractual revenue). From the 14 entities that contract for Network services, we judgmentally selected the four largest contracts. These contracts account for $2.57 million, or 78 percent of the total Fiber Optic revenue. For each contract, we compared contract terms to revenues billed, collected and reported.

- Water/Sewer Operations - For the period April 1, 2003 through March 31, 2005, Water/Sewer revenue totaled $13,128,429. More than 90 percent of the operations revenues are derived from a Federal contract. For this contract, we compared the contract billing terms to one quarter of transactions for the fiscal year ended March 31, 2005. We reviewed meter readings, bills for purchasing water and sewer services and the billing statements the Authority sent to its Army Line users during the quarter.

- Solid Waste - For the fiscal years ended 2004 and 2005, the Authority respectively collected tipping fees of $8.7 and $9.6 million. Between April 1, 2003, and September 30, 2005, the scale house issued 57,742 scale tickets, from which we randomly selected 50 tickets to test. For each ticket, we calculated the amount that should have been invoiced and compared our calculation to the actual billings. We also reviewed accounting records to confirm the contractor paid

the invoice and that each transaction was recorded properly.

To test the Authority's investment controls, we reviewed the 40 investment withdrawals made between October 1, 2004 and December 31, 2004, totaling $8.2 million to determine if they were adequately documented. We also reviewed the 29 long-term investment transaction made by a broker in November 2004 totaling $4.2 million to determine if the investments complied with the Authority's Policy.

To determine if additions to the payroll system and deletions from it are properly authorized, we randomly sampled 5 of the 16 employees terminated from the payroll system and 5 of the 23 employees added to the payroll system between January 2003 and June 2005. To determine if other payroll changes (e.g., pay raises, direct deposit, tax exemption status, and stipends) are properly authorized and documented, we judgmentally selected 20 of the 458 payroll changes recorded in a payroll change log between November 2004 and July 2005. We judgmentally selected a sample so our review would include different types of payroll changes.

To determine if Authority reimbursements and direct payments for meals and lodging are appropriate, sufficiently documented, and reasonable, we selected the following samples: of the $17,715 paid for Board member expense. We reviewed two payments totaling $10,186 that were associated with a strategic planning conference. We also reviewed 5 payments (totaling $2,041) of the 30 payments totaling $7,390 to the Black River Valley Club for board meetings during the period January 1, 2003 through June 30, 2005.

We also judgmentally reviewed 28 of the 128 Authority credit card transactions that appeared to be employee meal and lodging expenses. These transactions, which totaled $3,787 and $8,587, respectively, were processed over a 17-month period (March 1, 2004 through July 31, 2005). Also, between January 1, 2003 and June 20, 2005 the Authority issued 378 checks to its employees for expenses they paid totaling $84,059. Two employees were reimbursed a total of $24,047 of which we judgmentally reviewed 10 meal reimbursements for $805 and 12 lodging reimbursements for $758.

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.

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. Authority officials did not agree with our conclusions regarding certain expenses we considered inappropriate. Generally, however, officials did agree with our recommendations and have taken steps to implement them.

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 contained herein, and where recommendations were not implemented, the reasons therefor.

CONTRIBUTORS TO THE REPORT

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

Exhibit A

Comparison of Reported Mileage
To Projected Commute Mileage
For the period January 2005 through December 2005

Driver	Annual Mileage [1]	Projected Annual Commute Mileage [2]	Projected Commute Mileage (%)
Driver 1	26,447	16,936	64%
Driver 2	26,102	9,739	37%
Driver 3	25,490	10,746	42%
Driver 4	21,277	8,069	38%
Driver 5	19,212	4,513	23%
Driver 6	17,190	2,075	12%
Driver 7	17,018	2,588	15%
Driver 8	16,231	5,771	36%
Driver 9	16,095	3,548	22%
Driver 10	14,902	1,546	10%
Driver 11	12,053	3,592	30%
Average	19,274	6,284	30%

1 Based on Authority records

2 Projected Annual Commute Mileage was calculated by determining the mileage from the employee's home to his or her reported first work location. Because the Authority does not track an employee's ending work location, we generally used the Water/Sewer's Warneck Pump Station as the employee's last work location and projected his or her evening commute from this location. The Authority reported that drivers 5 and 9 do not report to Warneck Pump Station therefore we used their first reporting location as their ending location too.

APPENDIX A - AUDITEE RESPONSE

DEVELOPMENT AUTHORITY
OF THE
NORTH COUNTRY

June 29, 2006

FEDERAL EXPRESS

Mr. William P. Challice
Audit Director
State of New York
Office of the State Comptroller
Division of State Services
State Audit Bureau
123 William Street, 21st Floor
New York, New York 10038

Re: *Revised Response to Draft Audit Report (2005-5-62)*

Dear Mr. Challice:

Summary Response

We once again welcome the guidance provided by the Comptroller in this second audit report on Authority operations focusing on revenue, selected expenses and accounting system. As we said in our response to your first audit report (2005-5-34), the Authority is committed to continuous improvement to ensure that our services are well managed and cost effective.

We again note that the Comptroller's examination has taken place during a time of transition for the Authority. In the past two years, 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, and those that will result from the subject report, will be seen in years to come.

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Controls Over Revenue (Recommendation #1-7)

- User Fees:

  The Authority has supplemented its recently-adopted landfill scale inspection procedure to include a billing inspection. Inspections are being performed for each billing period, and include a reconciliation of scale and billing data by appropriate supervisory personnel so as to segregate weighing and billing functions (Recommendation #1).

- Check Receipt Process:

  The Accounting Supervisor reconciles the check log to the accounting system and bank statements, and signs and dates the log. The Finance Director has begun to review the reconciliation and sign and date the log to ensure compliance. All checks are being restrictively endorsed upon receipt (Recommendation #2).

- Investments:

  Our January 2006 Investment Policy separates duties as follows: the Executive Director approves all investment transactions; the Accounting Supervisor makes all investment transactions and reconciles the accounts; the Finance Director reviews and approves all investment reconciliations. We believe this properly segregates investment responsibilities and ensures that problems are identified and promptly corrected. As you note, we have prohibited third-party disbursements from investment accounts. Our board is actively participating in administration of the revised Investment Policy (Recommendations #3-7).

Selected Expenses (Recommendation #8-14)

- Payroll:

  The Accounting Supervisor currently reviews payroll prior to processing, and is now checking it after processing to ensure that process controls are in place. We have already improved controls by creation of a Payroll Change Form to ensure consistent documentation (Recommendations #8, 9).

- Meals and Lodging:

  OSC reports that the Authority spent $118,000 over a 31 month period on meals, lodging and other reimbursable expenses. We note that about $84,000 of this total was in fact employee expense reimbursement related to day-to-day work activities in our three county region, only 21% of which were for meal and lodging expenses in the most recent fiscal year (25% was for mileage, 21% for training and education, and the remainder for other work-related items). Thus, a substantial portion of the cited spending total was for non-meals and lodging expense.

  Clarification aside, we do commit to putting a comprehensive Travel, Meal and Lodging Policy and followup procedures in place, as you recommend (Recommendations #10, 11).

  We generally do not agree with your findings as to "unsupported or inappropriate expenses":

  ◊ Management approved in advance expenditure of $1,069 to pay for one of the weekly safety meetings held by our fiber network general contractor, subcontractors and other project team members to, in the words of our Telecom Services Manager in his written approval request, ". . . show our appreciation for adhering to the safety practices as well as demonstrating to the utilities that we are aware of our safety responsibilities relative to the fiber optic pole construction." These business meetings were held before the start of the scheduled workday and, in the judgment of management, were an appropriate project expense which should not be dismissed as a mere expression of "gratitude".

  ◊ We concur that employee expenses, including lunches, should be more consistently documented, and our new Travel, Meals and Lodging Policy will further develop this procedure. We do note that $1,325 spent over the audit period equates to about $12 per employee annually, and that these are working meals primarily furnished on our premises for the convenience of the Authority. The fact that one of these meals coincided with an employee's birthday does not take it out of the category of de minimus meals, we believe.

- ◊ The cited inadequate documentation of ten meal reimbursements were all related to construction of the fiber optics network, a period during which salaried staff worked extraordinary hours to bring a state of the art network on line in a period of months, at costs well below industry average. We have subsequently furnished OSC with details as to the business purposes of these expenses, and believe all to be justified. We acknowledge that our documentation was not consistent, and will address this in our Travel, Meals and Lodging Policy.

- ◊ As to 12 lodging expenses incurred in Watertown, management not only approved, but urged, that the fiber network employee in question avoid traveling home after a series of extremely long work days, when he served as the single point of contact with the contractor on all issues related to route selection, fiber design, make ready, scheduling, field conditions, and construction. During the construction period, this salaried employee averaged 120 hours of work per pay period, which went as high as 160 hours in one period. We acknowledge that there may have been an income tax issue relative to these reimbursements (Unreported Fringe Benefits section) and will seek legal advice to ensure we properly address these issues in the future.

Finally, as to board strategic planning expenditures, we appreciate OSC's concurrence that there is justification for planning activities. Given the regional nature of our membership, rapid expansion of Authority operations, and significance of what we do, it is important that we allow time for identifying opportunities and risks, evaluating strategies, and setting corporate goals and operational benchmarks. The board is committed to planned governance, and, at the session in question, spent three intensive days in discussion which set course for the Authority in the months ahead. A substantial record of proceedings documented this, a copy of which was provided to OSC.

We are certainly sensitive to the issue raised by OSC, and will ask our Strategic Planning Committee to evaluate cost options consistent with our Travel, Meals and Lodging Policy, and develop a budget for the full board's approval should any similar session be considered in the future.

We recognize that there has been little guidance in law or regulation on these matters before now, and although we are not in full agreement with OSC's assessment of meals and lodging expenditures, it is our intent to be fully compliant with best practice standards for New York State Public Authorities moving forward.

- Vehicles:

We have routinely monitored vehicle mileage for two purposes. First, all Authority vehicles are tracked through maintenance management software. Second, each of the cited vehicles used by water/sewer employees are OGS lease vehicles which are tracked to avoid excess mileage charges, and rotated as appropriate. We acknowledge that enhancements in monitoring vehicle use are needed, and our new fleet management policy will address this.

As to the commuting mileage issue raised, it must be understood that our ten licensed water/sewer operators have 24/7 on-call responsibilities for 2 major water transmission lines, 1 major sewer conveyance system, 18 municipal water districts, 14 municipal sewer districts, 4 sewage treatment plants and 6 water treatment plants. We serve nearly 70,000 customers in a service area ranging over 2,989 square miles, and must meet or exceed Department of Defense standards in serving Fort Drum, as well as regulatory agency requirements. In short, these are service vehicles performing mission-critical work, and management has determined that this vehicle management method is in the best interest of the Authority and its customers. Since the Authority leases low-cost OGS vehicles with a 20,000 miles/year limit, cost-efficiency is facilitated.

We also acknowledge that documentation of an explicit cost/benefit analysis to compare vehicle costs, acquisition methods, selection of vehicle type, etc., is lacking, but do monitor these issues as part of our annual budget process. During the most recent year reviewed by the auditors, 2005-06, for example, we determined that total vehicle expense was $84,155, which compares favorably with the estimated cost of IRS rate mileage reimbursements, estimated to be $94,348 (although we note that this is not a practical alternative given the necessity for operator service vehicles).

In addition to our existing vehicle use policy, we are developing a comprehensive fleet management policy, which will assign all vehicle decisions to a fleet manager and address vehicle acquisition, documentation, maintenance/repair, fuel, disposition, lease management, standardization, reporting and coordination (Recommendations #12, 13).

- Unreported Fringe Benefits:

  We will seek legal advice in revising our travel and personnel policies to report, as appropriate, cited meals, lodging and professional membership expenses as income. We have already instituted W-2 reporting of commuting mileage as part of our revised vehicle use policy (Recommendation #14).

Accounting System (Recommendation #15-16)

- Passwords:

  While the New York State Cyber Security Policy does not appear to be applicable to the Authority, we have adopted a Computer Password Policy which requires that passwords be changed at regular intervals (Recommendation #15).

- Access:

  An annual review of logical access controls will be conducted and documented to ensure that access rights are consistent with user needs and responsibilities (Recommendation #16).

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.

During this same period, enactment of the Public Authorities Accountability Act, and additional regulations and reporting requirements issued by the State Comptroller will undoubtedly lead to further improvement of Authority administration.

We again note that the Comptroller's examination offers a snapshot in time, and that the Authority is committed to fully implementing compliance requirements in the months ahead.

Very truly yours,

Douglas Murray
Chairman

Very truly yours,

Robert S. Juravich
Executive Director

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