Long Island Power Authority
Year ended December 31, 2010

Assessment of the Internal Control Structure

As required under the Public Authorities Accountability Act, the Internal Control Officer is required to make an annual assessment of the effectiveness of internal controls of the Long Island Power Authority (the “Authority”). To accomplish this, I am using the Compliance Roadmap for Internal Control Officers Directors of Internal Audit and Other Stakeholders included as Appendix A to the New York State Internal Control Act Implementation Guide: Strengthening Compliance With the Act and Standards, issued in September 2006.

As a means of providing background for the Authority and its operations, it should be noted that the Authority has found that it would be desirable to create an internal audit function that presently does not exist. Funds have been allocated in 2011 to create that new function. It should also be noted that approximately 95% of the Authority’s operating and capital budgets are under management to National Grid (formerly KeySpan, who was acquired by National Grid in August of 2007). The agreement with National Grid (NG) provides the Authority with the services of NG Internal Audit department, who reports to the NG audit committee. Also, the Authority engages various public accounting firms, as well as other consultants to examine specific areas of NG’s operations that impact LIPA. In addition to creating of an Internal Audit department, the Authority will continue to engage additional independent accounting firms to perform similar audit functions.

In addition to the above protections, the Authority is entitled to and has direct input into the activities of the NG Internal Audit (NGIA) department. In January 2011, NG Internal Audit met with LIPA’s Internal Control Officer to discuss LIPA it requests for the upcoming year, which is to be incorporated into NG’s risk assessment and audit plan. The Authority can accept, reject or modify this list and submits a listing of additional audit areas for the NG IA department to examine. As situations warrant, LIPA may exercise its rights to request special audits during the course of the year.

Also, all LIPA related activities under contract to NG are to be afforded the same level of scrutiny and internal control review as is afforded to NG’s other business processes.

The italicized questions below come from the New York State Internal Control Act Implementation Guide: Strengthening Compliance with the Act and Standards, issued in September 2006. Below each question is the Authority’s response.

Each Agency/Authority Head should provide a communication to all staff in support of its internal control program, including the importance of assessing internal controls.
Included in the forepart to the *Long Island Power Authority Management Policies and Internal Control Guidelines*, (Guidelines), is a message on internal controls from the former President and Chief Executive Officer which stresses the importance of strong internal controls. The message notes that employees should respect internal controls, as stated in the Guidelines, and as enforced by the Internal Control Officer and the Finance and Audit Committee of the Board of Trustees.

Furthermore, the Authority’s Acting President and Chief Executive Officer, Michael Hervey has continued his strong supports of internal controls as was evidenced in December 2010 when Mr. Hervey requested that the IC officer address senior staff and provide annual training. Mr. Hervey noted that all officers should instruct their staff to support the structure of internal controls of the Authority and review and update the policies and procedures manual as appropriate.

*Internal control programs should include a preliminary risk self-assessment by function.*

*Internal control programs should include an in-depth assessment of each function and should include the identification of inherent risks and internal controls for each function.*

During 2010, the Authority’s Internal Control Officer (“ICO”) continued to use the NY State NYWORKS template for assessing risks and identifying mitigation plans to control those risks. As in 2009, each process owner (“Director of….”) was required to identify and assess risks associated with their particular areas of responsibility through submission or the NYWORKS template. The Internal Control officer is currently in the process of reviewing the submissions for 2010/2011 and will hold meetings with each process owner to ensure a thorough understanding and appropriate assessment of each identified risk, and to ensure that all risks are addressed. As in the past, this process is viewed as an opportunity for the ICO to meet with, discuss and assess each process owner’s understanding of risks and controls they use to mitigate such risks. Please note that the Authority views the process of risk assessment and mitigation controls as an ongoing and constant theme of good management. After review with each Director, the ICO officer will request sign-off by the area VP.

*Internal control programs should establish the frequency of reporting cycles for each risk assessment, internal control review, and other internal control reporting documents.*

Currently the Authority prepares a risk assessment annually, and updates the Guidelines as necessary; however, it has been brought forth during the annual internal control training offered to senior staff that there have been very few updates to the policies and procedures manual. This is an area of concern that is to be addressed through the Authority’s establishment of a routine review cycle of the policies and procedures manual.

*Internal control programs should establish an approval or independent review process of the preliminary risk assessments and the more in-depth internal control reviews.*

As noted above, the risk assessments are currently under review by the ICO, who is in discussions with each process owner to ensure a thorough understanding of the areas addressed, and to ensure that all risks are given the appropriate level of review. Risk assessments are to be approved by each area VP. The ICO also discusses each assessment with the Chief Financial Officer. During 2011, LIPA plans to create an internal audit function that will be responsible for reviewing each assessment and providing another perspective on the control environment at LIPA.

*Internal control programs should establish minimum and maximum timeframes for periodically reviewing its organizational structure and its inventory of functions.*

The Authority reviews each function at least annually and when there has been a significant change to the systems or processes, to ensure that appropriate controls are in place. As noted below, the majority of the Authority’s day-to-day processes are outsourced to vendors responsible for oversight of their employees
and functions under contract. The primary vendor under contract to the Authority is National Grid, who employs its own internal audit function, performs annual risk assessments and establishes review cycles for the work that they perform on behalf of LIPA. LIPA’s ICO meets (either in person or via telephone) regularly with NG internal audit function to review risks, suggest or request areas for audit, and to be advised of audit activities performed on LIPA-related functions.

*Internal control programs should establish a process for identifying improvement areas, corresponding corrective actions, and implementation status of all corrective actions.*

If deficiencies are noted, or improvements need to be made to strengthen controls, the ICO will meet with the responsible process owners and make recommendations for change. Changes to processes are first developed by the ICO along with input from the process owner, and upon approval by the area VP, are to be incorporated into Authority processes. As the majority of day-to-day processes are handled through an outsourcing relationship, LIPA relies on the internal audit department of NG to identify and track corrective actions of NG. It should be noted that during 2010, a control deficiency was identified by LIPA staff related to a National Grid process for estimating unbilled sales. LIPA staff immediately contacted LIPA’s independent accountants to inform them of the issue and then developed a revised methodology to resolve the deficiency. The revised methodology was reviewed and approved by LIPA’s independent accountants as well as independent experts hired by LIPA to review and assess the impact of the deficiency. NG implemented the changes as recommended and LIPA has begun monitoring the change to ensure that compliance with the change occurs. LIPA will also monitor the appropriateness of the unbilled sales data being provided to LIPA by NG.

*Internal control programs should establish and maintain documentation standards (what needs to be kept; by whom; where; and for how long).*

The Authority has reviewed and considered the applicable standards related to document retention and determined that the existing state regulations governing the Authority’s documents are sufficient to serve its purposes and thus an additional policy is not necessary for the Board’s consideration. During 2010 the Authority issued record retention and disposition guidelines and has begun the process of implementation, requiring each employee to review and understand the guidelines and asking each employee to retain or dispose of files/documents accordingly.

*Agency management should assign staff to one of three training levels: Line Staff, Middle Managers, and Executive Management.*

The ICO has developed training for senior staff, including the President and Chief Executive Officer that was focused more on the Authority’s overall control environment, and the “tone at the top.” In addition, during 2010 the ICO met with all new hires and provided a full review of the Authority’s internal control process. Staff level training was not provided to all other employees due to time constraints of the ICO who was heavily involved in the development of new procedures related to unbilled sales as noted above. The ICO does not perceive this as a significant issue as there have been few changes to the risk environment in the past twelve months, (i.e. no new programs with significant risks, very little turnover), and that the majority of new hires were in the area of IT and Conservation, and not widely dispersed throughout the Authority. During 2011, training will be planned for all employees of LIPA to reinforce oversight of NG as NG has announced a reorganization that will result in a significant workforce reduction that may impact LIPA.

*Agency management should identify training objectives and key concepts (see Appendix A) for each level.*

As noted above, the ICO did create different training sessions with differing objectives for the two groups identified above. For senior staff the training focused on tone at the top and the responsibility to implement and support a strong system of Internal Controls. For new hires, the training was designed to introduce the topic to new employees and those unfamiliar with Internal Controls requirements of the
State and this Authority, to reinforce the importance of controls to staff members who are generally familiar with such controls, and to remind all employees of their professional obligation to maintain the public’s trust, and the consequences of failing to so. The new hire training was focused on oversight of National Grid who performs most of the day-to-day functions for LIPA. New hires that were process owners also met individually with the ICO to discuss the process of completing a risk assessment and to reiterate the importance of risk mitigation. Subsequent to the training sessions, National Grid announced a reorganization; as such IC training during 2011 will focus on how this might impact LIPA,

Agency management should identify methods of delivery and frequency following the recommended framework of “quick hitters,” instruction-based learning, and executive meetings.

As noted above, the continued use of the self assessment format introduced in 2009 provides a tool helped to keep the message fresh for the process owners, who are encouraged to discuss and enforce the importance of internal controls with their respective staff.

Based on the above, reliance on the National Grid internal controls processes, and KPMG’s Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Governmental Auditing Standards which did not identify any material weaknesses or significant control deficiencies, I believe that the internal controls of the Long Island Power Authority provide reasonable assurance that the organization will achieve its objectives and mission. However, to strengthen such controls, the Authority has included in its 2011 budget funding for an internal audit department. As of the date of this filing, an audit charter is under review by internal staff and is to be presented to the Finance and Audit committee of the Board at the April meeting. Once approved it is believed that the hiring process will quickly follow.

Kenneth Kane,
Internal Control Officer