Long Island Power Authority
Year ended December 31, 2011

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" or "LIPA"). 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 on the Authority and its operations, it should be noted that the Authority determined in 2010 that it would be desirable to create an internal audit function that presently does not exist. Funds were allocated in the 2011 approved budget to create that new function and although it remained unfilled as of December 31, 2011, a suitable candidate has accepted an offer to fill the position shortly. It should also be noted that approximately 90% of the Authority’s operating and capital budgets are managed by 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. The Authority’s efforts to create a fully functional Internal Audit department are under way, and once established that department will utilize as needed additional independent accounting firms or other independent consultants where particular expertise is needed and or desirable.

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 late 2011 and again during the first quarter of 2012, NG Internal Audit met with LIPA’s Internal Control Officer (“ICO”) and Vice President and Chief Financial Officer (“CFO”) to discuss NGIA performance and to discuss LIPA requests for the upcoming year, which is to be incorporated into NG’s audit plan.

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 (ICO) and the Finance and Audit Committee of the Board of Trustees.

Furthermore, the Authority’s Chief Operating Officer (“COO”), Michael Hervey, who has assumed the responsibilities of the Chief Executive Officer under the Authority’s By-laws, has continued his strong support of internal controls as is demonstrated by his request that in addition to supplying general training to all staff, the ICO provide specific training to the senior staff Mr. Hervey has also emphasized that all officers should actively support the structure of internal controls of the Authority.

*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 2011, the Authority’s ICO continued to use the New York State NYWORKS template for assessing risks and identifying mitigation plans to control those risks. As in prior years, each process owner (“Director of…”) was required to identify and assess risks associated with their particular areas of responsibility through submission of the NYWORKS template. The ICO has received all submissions for the upcoming year (2012) and will begin a more thorough review process during the second quarter. Since the Authority has hired a Director of Internal Audit, the plan is to have a joint review of the risk assessments in order to help the new Directorof Internal Audit understand the operations of the Authority and provide a new perspective on the Authority’s risk profile. In order to ensure a thorough understanding and appropriate assessment of each identified risk, and to ensure that all risks are addressed, the ICO and the Director of Internal Audit will meet with each process owner and discuss the respective assessments. As in the past, this process is viewed as an opportunity for the ICO and now the Director of Internal Audit 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 the review with each process owner, the ICO will request sign-off by the appropriate Vice President.

*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 has been raised by the COO, who has instructed each process owner VP to encourage staff to review the policies and procedures manual and update as needed. It is the goal of the Authority to establish 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 to be reviewed by the ICO and Director of Internal Audit, who will engage 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 process owner VP. The ICO also discusses each assessment with the CFO, which this year will include the Directorof Internal Audit. Although not implemented during 2011 as originally planned, LIPA in 2012 has established an internal audit function that will eventually be responsible for reviewing each assessment and provide feedback 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 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 NG, who employs its own internal audit function. LIPA’s ICO meets (either in person or via telephone) regularly with NG internal audit function to review audit plans, suggest or request areas for audit, and to be keep abreast 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 are to be incorporated into the Authority’s 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. When LIPA engages outside independent accounting firms or other consultants who make recommendations for improvements, LIPA management takes such recommendations seriously and tasks the process owners with implementing, or overseeing the implementation of such recommendations. With the addition of an internal audit function, a more robust follow-up process can be implemented at LIPA for such audit recommendations.

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 that require each employee to review and understand the guidelines and requires each employee to retain or dispose of files/documents accordingly. Please note that Authority personnel are currently under order from the New York State Inspector General’s Office to suspend disposal activities until further notice.

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 that was focused more on the Authority’s overall control environment, and the “one at the top.” In addition, during 2011 the ICO offered training to other employees to provide a full review of the Authority’s internal control process. Part of the 2011 message was to increase diligence of individual review activities over NG given the significant staff reductions announced earlier in the year, and the announcement that LIPA has chosen a new service provider to replace national Grid beginning January 1, 2014.

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

During 2011, the ICO continued with two levels of training, senior staff and other staff. 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 all other staff 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 do so. Emphasis is placed on oversight of National Grid who performs most of the day-to-day functions for 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 provides a tool 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 NG 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 expects to have a fully functioning Internal Audit department available in 2012.

Kenneth Kane,
Internal Control Officer