Long Island Power Authority  
Year ended December 31, 2012  

Assessment of the Internal Control Structure

As required under the Public Authorities Accountability Act, the Internal Control Officer ("ICO") 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. Funds were allocated beginning in the 2011 approved budget to create that new function which remained unfilled until mid-year 2012 when the position of Director of Internal Audit was filled. Furthermore, given the unique outsourcing business model that the Authority operates under, whereby approximately 90% of the operating and capital budgets are managed by National Grid (formerly KeySpan, who was acquired by National Grid in August of 2007), significant reliance is placed upon the internal controls at National Grid (“NG”). The operating agreements with NG provide the Authority with the services of NG Internal Audit department, which reports to the NG audit committee. The processes followed by NG in managing LIPA’s system are subject to the same internal controls as all of NG. 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 Internal Audit department will utilize additional independent accounting firms or other independent consultants where particular expertise is needed and or desirable, and will eventually be responsible for reviewing each assessment and provide feedback on the control environment at LIPA.

In addition to the above protections, the Authority is entitled to and has direct input into certain of the activities of the NG Internal Audit (NGIA) department. Throughout 2012, LIPA’s ICO has requested that the NGIA conduct various audits or reviews, the progress of which are discussed at LIPA’s Finance and Audit Committee meetings.

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

Furthermore, the Authority’s newly appointed Chief Operating Officer (“COO”) who also serves as the Authority’s Chief Financial Officer (“CFO”), Michael Taunton, who assumed the responsibilities of the President and Chief Executive Officer under the Authority’s By-laws, has continued his strong support of internal controls as is demonstrated in part by his request that the Director of Internal Audit provide general internal control training to all staff and that the risk self-assessments be completed as quickly and efficiently as possible.

*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 2012, 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 requested to update prior year assessments. Unfortunately, LIPA’s service territory was devastated by Superstorm Sandy during the last quarter of 2012, the time frame usually dedicated to updating the risk assessments. Given the storm responsibilities required of all LIPA employees during such an event, which lasted from October 29, 2012 through the end of November, many of the assessments were not updated, and are still in progress as of the date of this filing. Since the Authority now has a Director of Internal Audit, the plan is to have the risk assessments reviewed by the ICO and the Director of Internal Audit to help minimize the learning curve relative to the operations of the Authority and provide a new perspective on the Authority’s risk profile. The ICO and the Director of Internal Audit will meet with each process owner and discuss the respective assessments as they become available. 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.

It should be noted that there are two significant issues that impacted the Authority during 2012 and will likely have a long term effect, namely the transition of service providers from NG to Public Service Enterprise Group (“PSEG”), discussed below, and, as mentioned above, Superstorm Sandy. Since Long Island was declared a federal disaster area by the President, LIPA is entitled to FEMA reimbursement for allowable costs incurred as a result the Storm. In order to ensure that LIPA recovers the maximum amount allowable from FEMA, it has engaged a professional services firm with significant experience in assisting clients with such claims. This firm will help review invoices to assess the allowability of costs incurred, assist in the claim process itself, and represent LIPA should costs be challenged that LIPA believes to be allowable. LIPA believes that by engaging this firm the risk of loss will be substantially reduced.

*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 strives to prepare a risk assessment annually, and requires staff to update the IC Guidelines when processes change.
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 Vice President.

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

In December 2011, the Board of Trustees ("Board") approved the selection of PSEG, along with their partner, Lockheed Martin ("Lockheed"), as the new service provider to take over the operation of LIPA’s transmission and distribution system beginning January 1, 2014 under a new Long Island based company (PSEG LI) that will focus exclusively on services to the Authority. In January 2012, the Authority and PSEG LI executed an Operations Services Agreement ("OSA") for a scheduled term of ten years beginning January 1, 2014. As such, each process currently performed by NG will be reviewed in light of the new organization. As part of the new agreement, PSEG LI is to create an internal audit department and prepare internal control process maps to support a Sarbanes Oxley type environment. It is anticipated that all processes will have risk based assessments prepared which will drive a risk based audit approach, and that all processes will be fully inventoried and documented.

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 and or the Director of Internal Audit will meet with the responsible process owners and make recommendations for change. Changes to processes are first developed 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 has been implemented.

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 direction from various State entities, including the State Inspector General’s Office, Attorney General’s Office and Moreland Commission to suspend disposal activities until
further notice related to their reviews of certain LIPA and/or industry specific matters, including response to Superstorm Sandy.

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

The vast majority of the Authority’s staff is primarily engaged in the oversight of various agreements between LIPA and NG. Accordingly, the Director of Internal Audit provided training for all staff members, the primary message of which was to increase diligence of review activities over NG. The training covered LIPA-specific functions (those not outsourced) and carried a very similar message with respect to increasing diligence related to ratepayer funds. This message was timely in that LIPA will engage a new service provider beginning January 1, 2014, and as such LIPA staff needs to establish a sound oversight regimen for monitoring the new service provider.

Agency management should identify training objectives and key concepts for each level.

The Director of Internal Audit had two primary training objectives, the first being focused on tone at the top and the responsibility of management to implement and support a strong system of internal controls. The other primary objective was to increase the diligence of review and to challenge normal operating activities. The training introduced many of the key concepts of a strong internal control environment, such as segregation of duties, matching, review processes, and authorization levels. The training also spoke of the control environment and how at LIPA it is based on the Committee of Sponsoring Organizations ("COSO") framework.

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

For the first time in many years, training was provided by the Director of Internal Audit, as opposed to the ICO. This provided staff with a new and different perspective, yet reiterated the message presented in prior years, thus providing a consistent message—that internal controls are important and remain the responsibility of every employee.

Based on the above, reliance on the NG internal controls processes, the support provided by independent consultants, the establishment of an internal audit department within LIPA, 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.

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Kenneth Kane
Internal Control Officer