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”).

As a means of providing background on the Authority and its operations, it should be noted that the Authority established an internal audit function mid-year 2012. The Authority has also provided budgeted funding levels for an enterprise-wide Risk Management position, and additional staffing for the internal audit department. Furthermore, in 2013 the Authority operated under a unique outsourcing model whereby National Grid performed significant business functions related to the electric transmission and distribution system, including the processing of financial transactions, many of which are treated as pass-through costs to LIPA (e.g., capital and storm restoration). During the first quarter of 2013, National Grid reported to LIPA that their financial statements for their year ending March 31, 2014, would disclose a material weakness in internal control over financial reporting related primarily to the implementation of an ERP system. During 2013, LIPA had suspected (but had not been notified of) transaction processing problems at National Grid and had taken steps to mitigate the risk that National Grid internal control weaknesses would negatively impact LIPA. These steps included requiring more detailed analysis of, as well as supporting documentation for, charges from National Grid.

The Authority also engages various consultants to examine specific areas of National Grid’s operations that impact LIPA. Since its creation, the Authority’s Internal Audit department has utilized independent firms to provide additional resources and expertise as needed.

In addition to the above protections, the Authority is entitled to and has direct input into certain of the activities of the National Grid Internal Audit (NGIA) department. NGIA has not reported any significant internal control issues related to LIPA.

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 Internal Audit function, the Internal Control Officer (ICO) and the Finance and Audit Committee of the Board of Trustees.

*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 2013, the Authority’s internal auditor worked with each department to update and assess risks and identify controls that mitigate those risks. As in prior years, each process owner (“Director of _____”) is responsible to maintain and document a risk assessment.

Also in 2013, a Management and Operations Audit, commissioned by the Department Of Public Service and performed by the NorthStar Consulting Group was completed. The report, issued on September 13, 2013, identified a number of areas where internal controls could be improved upon. LIPA has begun a process to implement all the report recommendations.

As more fully set forth below, during this past year the Authority has been fully engaged in transitioning service providers, and staff has assisted in a full process review of virtually all functions with the new service provider. Since 2013 was a year full of transition activities, many of the existing operating controls will continue to evolve over the next year, including those required of LIPA to fulfill its oversight responsibilities.

The Authority views the process of risk assessment and mitigation controls as an ongoing and constant theme of good management.

*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 encourages 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.

*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 Public Service Enterprise Group (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. As part of the new agreement, PSEG LI is to create an internal audit department. During this past year of transition, PSEG-LI has undertaken steps to create 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 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 during the period covered by this report, relied on the internal audit department of National Grid to identify and track corrective actions of their processes. As we enter the new agreement with PSEG-LI, LIPA will again rely heavily on the establishment of a strong internal control environment at PSEG-LI to include proactive follow-up of any corrective actions necessary. 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 Enterprise Risk Management function, a more robust follow-up process will be 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 has adopted a Record Retention Policy that adequately complies with existing state regulations governing the Authority’s documents.

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

In 2013, the vast majority of the Authority’s staff was primarily engaged in the oversight of various agreements between LIPA and National Grid. Accordingly, the Internal Audit Director provided training for all staff members, the primary message of which was to increase diligence of review activities over National Grid, and to understand and question their roles and responsibilities under the new agreement. The training also covered LIPA specific functions (those not outsourced) which carried a very similar message in that increased diligence is necessary as LIPA is entrusted with public funds. The message stressing the importance of increased diligence was timely in that LIPA will engage a new service provider beginning January 1, 2014. As such, LIPA staff needs to establish a sound oversight regimen for monitoring the new service provider. This is especially important as staffing levels have been reduced by approximately 50%.

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

As noted above, 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 the “norm”. 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 LIPA control environment which it is based on the COSO framework.

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

As training was provided by the Director of Internal Audit, as opposed to the IC officer, a new and different focus was presented, yet reiterating a consistent message—that internal controls are important and remain the responsibility of every employee. As LIPA enters a new stage in its corporate life cycle, many opportunities for strengthening Internal Controls should present themselves, which will in turn lead to more meaningful “real life” examples of mitigation activities to reinforce the importance of a strong control environment.

Based on the above, reliance on the National Grid 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.

Kenneth Kane,
Internal Control Officer