



Chautauqua, Cattaraugus, Allegany & Steuben Counties  
**Southern Tier Extension Railroad Authority**  
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"This institution is an equal opportunity organization"

Terry Everetts, Chairman  
Richard Zink, Chief Executive Officer

**AUDIT COMMITTEE SELF-EVALUATION REPORT TO THE STERA BOARD**  
on  
**AUDIT COMMITTEE FUNCTIONS FOR CALENDAR YEAR 2016**

Submitted March 27, 2017

**1. Fulfillment of Audit Committee Purposes**

- **Requirement:** Per the Committee Charter, the Committee's purposes are to assist the Board by (a) assuring that the Board fulfills its responsibilities for the Authority's internal and external audit process, (b) recommending to the Board the hiring of a specific certified independent accounting firm for the Authority and the compensation to be paid to the accounting firm, and providing direct oversight of the performance of the independent audit performed by the accounting firm hired for such purposes in conjunction with the CFO, and (c) providing an avenue of communication between management, the independent auditors, the internal auditors, and the Board.
- **Observations:** During 2016, the Committee fulfilled its purposes per the Committee Charter.
- **Deficiencies:** None.
- **Evaluation:** During 2016, the Committee's fulfilled its purposes per the Committee Charter.
- **Recommendations:** None.

**2. Composition of Audit Committee and Selection of Audit Committee Members**

- **Requirement:** Per the Committee Charter, the Committee shall be composed of at least three independent members of the Board. Committee members and the Committee Chairperson are appointed by the Authority's Board Chairman. Committee members are prohibited from being an employee of the Authority or an immediate family member of an employee of the Authority. In addition, Committee members shall not engage in any private business transactions with the Authority or receive compensation from any private entity that has material business relationships with the Authority, or be an immediate family member of an individual that engages in private business transactions with the Authority or receives compensation from an entity that has material business relationships with the Authority. Committee members should possess or obtain a basic understanding of governmental financial reporting and auditing.
- **Observations:** During 2016, the Committee's composition and selection were consistent with the Committee Charter. There is one vacancy, which will be filled once an Allegany County Board members is appointed. There are no instances of actual or potential conflict.
- **Deficiencies:** None.
- **Evaluation:** During 2016, the Committee's composition and selection were consistent with the Committee Charter.
- **Recommendations:** None.

### 3. Audit Committee Meetings

#### A. Number of Committee Meetings

- **Requirements:** Per the Committee Charter, the Committee must meet a minimum of twice a year, plus any additional meetings as needed to adequately fulfill all the obligations and duties outlined in its Charter. During 2016, the Committee was scheduled to meet four times, but three meetings (March 7, 2016; October 3, 2016; and December 5, 2016) were cancelled because of a lack of a quorum. The Committee thus met once during 2016, on June 6, 2016. On the other dates, the Committee's functions with respect to financial oversight were undertaken by the full Board of Directors.
- **Observations:** In order to reduce the number of meetings cancelled for the lack of a quorum, in June 2014 the Board had increased the size of the Committee and designated Committee members who have fewer time conflicts. This generally has proven successful, although in 2016 this strategy did not prove effective as three scheduled meetings were canceled. However, this was in part because of the Committee being down one member because of Allegany County not appointing a member to fill its three Board member representative positions, and also because one Committee member did not attend because of increased private (i.e., non-Authority) business activity that eventually forced his resignation from the Board at the end of the calendar year. Once these two Board vacancies are filled, the Committee expects that it will not have similar recurring frequent meeting cancellations due to a lack of quorum.
- **Deficiencies:** Failure to meet the required number of times..
- **Evaluation:** The Committee did not meet its responsibilities in this regard during the year ending December 31, 2016.
- **Recommendations:** Allegany and Steuben County must fill the Board vacancies, and new members must be appointed to the Audit Committee once these Board vacancies are filled.

#### B. Committee Meeting Operations

- **Requirements:** Per the Committee Charter, the Committee must meet in person or via videoconference. A quorum must be present to transact Committee business. A majority of the whole number of voting members of the Committee is required to transact any business (take action). Committee meetings are subject to the New York State Open Meetings Law and must be properly noticed per the Open Meetings Law. Committee meeting agendas must be prepared for every meeting and provided to Committee members along with briefing materials a minimum of one week before any scheduled Committee meeting. Minutes of every Committee meeting must be recorded. Committee agendas and meeting minutes must be posted to the Authority's web site.
- **Observations:** During 2016, the Committee's meeting operations were consistent with the Committee Charter.
- **Deficiencies:** None.
- **Evaluation:** The Committee met its responsibilities in this regard during the year ending December 31, 2016.
- **Recommendations:** None.

#### C. Committee Meeting(s) with the Authority's Independent Auditor

- **Requirements:** Per the Committee Charter, the Committee must meet with the Authority's independent auditor at least annually to discuss the financial statements of the Authority.
- **Observations:** During 2016, the Committee was scheduled to meet with the Authority's independent auditor on March 7, 2016. However, this meeting was canceled because of a lack of a quorum, although the Committee members present did meet with the auditor. The Committee did not meet

its responsibilities in this regard during the year ending December 31, 2016.

- **Deficiencies:** Failure to meet with the independent auditor.
- **Evaluation:** The Committee did not meet its responsibilities in this regard during the year ending December 31, 2016.
- **Recommendations:** In future years, the Committee must meet at least once with the independent auditor.

#### 4. Powers and Responsibilities of the Audit Committee

##### A. General Provisions

- **Requirements:** Per the Committee Charter, the Committee has responsibilities related to (a) the independent auditor and annual financial statements, (b) special investigations and whistleblower policies, and (c) miscellaneous issues related to the financial practices of the Authority.
- **Observations:** The Committee met its responsibilities with respect to the independent auditor and annual financial statements during the year ending December 31, 2016. No issues relating to special investigations, whistleblower events, or other miscellaneous issues related to the financial practices of the Authority arose during 2016.
- **Deficiencies:** None.
- **Evaluation:** The Committee met its responsibilities in this regard during the year ending December 31, 2016.
- **Recommendations:** None.

##### B. Independent Auditor(s) and Audited Financial Statements

- **Requirements:** Per the Committee Charter, the Committee's functions related to the independent auditor(s) and audited financial statements include:
  1. Recommending to the Board the hiring of a specific certified independent accounting firm for the Authority and the compensation to be paid to the accounting firm, providing direct oversight of the performance of the independent audit performed by the accounting firm hired for such purposes, and pre-approving any and all audit services provided by the independent auditor.
  2. Establishing procedures for the engagement of the independent auditor to provide permitted audit services. The Authority's independent auditor is prohibited from providing non-audit services unless having received previous written approval from the Committee. Non-audit services include tasks that directly support the Authority's operations, such as bookkeeping or other services related to the accounting records or financial statements of the Authority, financial information systems design and implementation, appraisal or valuation services, actuarial services, investment banking services, and other tasks that may involve performing management functions or making management decisions.
  3. Reviewing, based upon the CFO's recommendation, the Authority's audited financial statements, associated management letter, report on internal controls and all other auditor communications.
  4. Recommending to the Board that it approve the Authority's audited financial statements, associated management letter, report on internal controls and all other auditor communications; and recommending to the Authority Board that it undertake specific appropriate actions to remedy any deficiencies identified in the Authority's audited financial statements, associated management letter, report on internal controls and all other auditor communications.
  5. Reviewing significant accounting and reporting issues, including complex or unusual transactions and management decisions, and recent professional and regulatory pronouncements, and understanding their impact on the financial statements.

6. Meeting with the independent audit firm as needed to discuss any significant issues that may have surfaced during the course of the audit.
  7. Reviewing and discussing any significant risks reported in the independent audit findings and recommendations and assessing the responsiveness and timeliness of management's follow-up activities pertaining to the same.
- **Observations:** The Audit Committee had undertaken the following actions related to its functions related to the independent auditor(s) and audited financial statements:
    1. Upon the recommendation of the Committee, the auditor previously had been engaged at a specific fee structure by the Board in a prior year on a multi-year contract, in a manner consistent with the Committee Charter.
    2. The Authority's independent auditor did not submit any proposals to provide non-audit services over the course of the multi-year contract, including 2016.
    3. The Committee had been scheduled to meet with the auditor on March 7, 2016, at which time the auditor was to present the audit, including the management letter and report on internal controls, all of which the Committee was to review. Instead, the full Board of Directors heard this presentation on that same date.

The auditor had identified a significant deficiency in internal controls, which the full Board discussed with the auditor. The deficiency was that the Authority relied upon and contracted with the auditor to prepare the financial statements and footnote disclosures. This is a material weakness in the Authority's internal control, because the auditor is not a part of the Authority's internal control system and hence the Authority cannot exercise controls over external financial reporting. The auditor recommended that the Authority consider investing in the resources necessary to prepare financial statements that would not require the auditor to propose material adjustments in order that they be in compliance with U.S. generally accepted accounting principles. This could be done either internally or through contracting with a third party accountant. The Board considered the benefits of implementing this recommendation in comparison with the related costs it would incur.

4. On March 7, 2016, the Committee was to recommend to the Board that it approve the Authority's audited financial statements, which included the associated management letter and report on internal controls. The Committee also could have recommended to the Board that the Authority's contract agent Southern Tier West prepare the financial statements and foot note disclosures. However, inasmuch as the Committee did not meet on March 7, 2016, it could not undertake these two actions, as would have been appropriate.
- **Deficiencies:** Failure to meet on March 7, 2016 caused a failure to meet with the independent auditor, and a failure to make appropriate recommendations to the Board of Directors per the Committee Charter.
  - **Evaluation:** The Audit Committee did not meet its responsibilities in this regard during the year ending December 31, 2016.
  - **Recommendations:** Whenever significant issues arise during the audit process, the Committee should meet with the audit firm to discuss these issues, and subsequently report to the Board any recommendations. Whenever such significant risks are reported in the independent audit findings and/or recommendations, the Committee minutes should document a discussion of those issues and recommendations (if any) to the Board on responding to those risks. Whenever significant accounting and reporting issues arise, the Committee minutes should document a discussion of those issues and a recommending (if any) to the Board on responding to those issues. These are current STERA practice.

### C. Internal Controls, Compliance and Risk Assessment

- **Requirements:** Per the Committee Charter, the Committee's functions related to the internal controls, compliance, and risk assessment include:
  1. Reviewing the report on internal controls by the independent auditor as a part of the financial audit engagement.
  2. Recommending to the Board that it approve any internal audit reports and take specific appropriate actions to remedy any deficiencies identified in any internal audit reports and any deficiencies identified in the report on internal controls by the independent auditor as a part of the financial audit engagement.
- **Observations:**
  1. On March 7, 2016, the Committee was scheduled to review management's assessment of the effectiveness of the Authority's internal controls during the year ending December 31, 2015. There were no internal audit activities during 2016. However, this review of management's assessment of the effectiveness of the Authority's internal controls did not occur because the Committee meeting scheduled for March 7, 2016 was canceled due to a lack of a quorum.
  2. The Committee was scheduled to meet with the auditor on March 7, 2016, at which time the auditor was scheduled to present the audit, including the management letter and report on internal controls, all of which the Committee was scheduled to review. Instead, the full Board of Directors heard this presentation on that same date.

The auditor had identified a significant deficiency in internal controls, which the full Board discussed with the auditor. The deficiency was that the Authority relied upon and contracted with the auditor to prepare the financial statements and footnote disclosures. This is a material weakness in the Authority's internal control, because the auditor is not a part of the Authority's internal control system and hence the Authority cannot exercise controls over external financial reporting. The auditor recommended that the Authority consider investing in the resources necessary to prepare financial statements that would not require the auditor to propose material adjustments in order that they be in compliance with U.S. generally accepted accounting principles. This could be done either internally or through contracting with a third party accountant. The Board considered the benefits of implementing this recommendation in comparison with the related costs it would incur.
  3. On March 7, 2016, the Committee was to recommend to the Board that it approve the Authority's audited financial statements, which included the associated management letter and report on internal controls. The Committee also could have recommended to the Board that the Authority's contract agent Southern Tier West prepare the financial statements and foot note disclosures. However, inasmuch as the Committee did not meet on March 7, 2016, it could not undertake these two actions, as would have been appropriate.
- **Deficiencies:** Failure to meet on March 7, 2016 caused a failure to meet with the independent auditor, a failure to consider internal control considerations, and a failure to make appropriate recommendations to the Board of Directors per the Committee Charter..
- **Evaluation:** The Committee did not meet its responsibilities in this regard during the year ending December 31, 2016.
- **Recommendations:** Whenever internal controls, compliance, and risk assessment issues are reported in the independent audit findings and/or recommendations, the Committee minutes should document a discussion of those issues and recommendations (if any) to the Board on responding to those issues. This is current STERA practice.

#### D. Special Investigations

- **Requirements:** Per the Committee Charter, the Committee's functions related to special investigations include:
  1. Ensuring that the Authority has an appropriate confidential mechanism for individuals to report suspected fraudulent activities, allegations of corruption, fraud, criminal activity, conflicts of interest or abuse by the Directors, officers, or employees of the Authority or any persons having business dealings with the Authority or breaches of internal control.
  2. Developing procedures for the receipt, retention, investigation and/or referral of complaints concerning accounting, internal controls and auditing to the appropriate body.
  3. Requesting and overseeing special investigations as needed and/or referring specific issues to the appropriate body for further investigation (for example, issues may be referred to the State Inspector General or, other investigatory organization).
  4. Reviewing all reports delivered to it by the Inspector General and serve as a point of contact with the Inspector General.
  5. Reporting to the Board on any reports or complaints received under this section, and recommending to the Board that it take specific appropriate actions to respond to issues identified in these reports or complaints.
- **Observations:** The Authority has a Whistleblower Policy and a Records Retention Policy in place, both of which are consistent with the Committee Charter and State regulatory requirements. These policies are provided to all Board members, officers, and employees, and are available to the general public on the Authority's web site. Depending on who the suspected perpetrator is, the mechanism for reporting varies. Officers and all Board members are available to receive such reporting, as are the appointing entities and the NYS ABO. The Chairman will direct an investigation of any complaints, or refer them as appropriate. Should a complaint be made to either the NYS ABO or one or more of the appointing entities, the Authority will investigate as appropriate. There were no reports or complaints during the year ending December 31, 2016.
- **Deficiencies:** None.
- **Evaluation:** The Committee met its responsibilities in this regard during the year ending December 31, 2016.
- **Recommendations:** The Committee's minutes should document any reports or complaints received, any discussions regarding special investigations, and any referrals of issues. This is current STERA practice.

#### E. Other Responsibilities of the Audit Committee

- **Requirements:** Per the Committee Charter and the NYS ABO's expectations as expressed in the Model Audit Committee Charter provided by the NYS ABO, the Committee's other responsibilities include:
  1. Obtaining any information and training needed to enhance the Committee members' understanding of the role of audits and the independent auditor, the risk management process, internal controls, and financial reporting standards and processes.
  2. Reviewing the Committee's charter annually, reassessing its adequacy, and recommending any proposed changes to the Board. The Committee charter must be updated as applicable laws, regulations, accounting and auditing standards change.
  3. Conducting an annual self-evaluation of the Committee's performance, including its effectiveness, compliance with its Charter, an assessment of how it has discharged its duties and

met its responsibilities, and any requests for Board approval for proposed changes in Committee operations. The Committee shall present a written self-evaluation report to the Board.

- **Observations:** No information was requested or required to enhance Committee members' understanding of the role of audits and the independent auditor, the risk management process, internal controls, and financial reporting standards and processes. During 2016, new Committee members were provided training in Committee functions and responsibilities, and all Committee members were trained in the evolving interim internal accounting statement formats. The Committee did review and assess the adequacy of its Committee Charter in 2016, and recommended no changes in the Charter to the Board during the year ending December 31, 2016. The Committee did undertake a self-evaluation in 2016, and provided a written self-evaluation report to the Board in 2016, and recommended no changes in Committee operations to the Board during the year ending December 31, 2016.
- **Deficiencies:** None.
- **Evaluation:** The Audit Committee has not seen the need to obtain specific training. The members of the Committee have experience with understanding of the role of internal audits and the independent auditor, the risk management process, and internal controls, and have a certain level of familiarity in financial reporting standards and processes. The Audit Committee met its responsibilities in this regard during the year ending December 31, 2016.
- **Recommendations:** The Committee may wish to obtain training in specific relevant skill sets mentioned herein. The Committee should annually review the Committee's charter annually, reassess its adequacy, and recommend any proposed changes to the Board of the Authority in future years; this is current practice. The Committee should annually conduct a self-evaluation of its performance; this is current practice.

## 5. Summary Self Evaluation of Audit Committee Functions During Calendar Year 2016

- **Successes**
  - The Committee complied with most of its functions as regards fulfillment of purposes, committee composition and selection of members, meetings, and powers and responsibilities.
- **Deficiencies**
  - The issue of the vacancy from Allegany County, plus the issue of the Steuben County Committee member who didn't attend and eventually resigned from the Board, in part caused cancelation of three meetings due to a lack of a quorum. This cascaded into a failure of the Committee to undertake a number of its important required functions, including meeting with the auditor, consideration of internal control functions, policy and report review, and making recommendations to the Board of Directors.
- **Recommendations**
  - The Committee membership should be modified as soon as is practical so as to remedy the issue of cancelation of meetings due to a lack of a quorum.
  - The audit annually should be delivered in a timely fashion so that the Committee and Board can review it, and the Board can approve it, and it can be included in the Annual Report and transmitted to NYS ABO prior to the March 31 submission deadline. This is current STERA practice.
  - The Committee should review management's annual assessment of the effectiveness of the Authority's internal controls, and make recommendations to the STERA Board for its approval and for undertaking any corrective actions implied by the assessment. This is current STERA practice.
  - The Committee should review the Committee's charter annually, reassess its adequacy, and recommend any proposed changes to the Board of the Authority. The Audit Committee charter

should be updated as applicable laws, regulations, accounting and auditing standards change. This is current STERA practice.

- The Committee should annually conduct a self-evaluation of its performance. This is current STERA practice.
- Additionally, the Committee should undertake the other recommended actions noted above, some of which are appropriate only when certain circumstances arise. This is current STERA practice.

**Approved by the Audit Committee  
And  
Submitted to the Board of Directors of the  
Chautauqua, Cattaraugus, Allegany, and Steuben  
Southern Tier Extension Railroad Authority  
On March 27, 2017**

*Thomas M. Barnes*

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**Secretary**

**March 27, 2017**

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**Date**