



Chautauqua, Cattaraugus, Allegany & Steuben Counties

Southern Tier Extension Railroad Authority

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"This institution is an equal opportunity organization"
John Margeson, Chairman

STERA ASSESSMENT OF EFFECTIVENESS OF INTERNAL CONTROLS

Prepared for the Year Ending December 31, 2011

March 5, 2012

This assessment is prepared in conformity to the NYS ABO Policy Guidance, "Assessment of the Effectiveness of Internal Controls."

A. Definition of the Authority's Major Business Functions

Mission of the Authority - The mission of the Southern Tier Extension Railroad Authority is to fulfill the intent of the New York State Legislature in creating it, which was "to preserve and enhance the system of railroads serving Chautauqua, Cattaraugus, Allegany and Steuben counties in New York state and Warren and Erie counties in the Commonwealth of Pennsylvania, so as to insure a healthy economy for these counties."

The goals of the Southern Tier Extension Railroad Authority are (a) to encourage an operating railroad that provides adequate rail service, (b) to catalyze increased rail shipping carload volumes, (c) to create and seize opportunities for additional business expansion and development based on rail service, (d) to undertake and catalyze rehabilitation efforts and improved functional performance of the rail lines, and (e) to achieve a clean audit report and NYS ABO compliance report

Authority's Primary Operating Responsibilities – The Authority is responsible for:

- operating in conformity with all applicable laws and regulations,
- the ownership of certain railroad assets for the benefit of the public good,
- operating consistently with the public trust and best interests of Chautauqua, Cattaraugus, Allegany and Steuben counties in New York state and Warren and Erie counties in the Commonwealth of Pennsylvania, and the municipalities and school districts therein,
- the proper and appropriate use of public funds
- the maintenance of good operating relationships with affected railroad operating companies, the business community, and certain public entities including but not limited to NYS DOT
- undertaking certain capital projects, including rehabilitation of railroad assets and construction of assets that will further the mission of the Authority

Indication of responsibilities of various business units, operations and functions that have been put in place to achieve the goals of the Authority – There are no other business units, operations and functions that have been put in place to achieve the goals of the Authority.

Definition of the Objectives of the Authority – The Authority’s objectives include:

- the promotion of the ongoing and permanent commercial viability of the railroad system operating in southwestern New York State and northwestern Pennsylvania
- the increased utilization of railroad shipping by companies operating in southwestern New York State and northwestern Pennsylvania
- growth in real property and sales tax bases of the affected counties in New York state and the Commonwealth of Pennsylvania, and the municipalities and school districts therein

Policies, procedures and guidelines in place to guide staff in the operations of each specific business function, communicate the objectives, and provide the methods and procedures used to assess the effectiveness of those functions – STERA has in place the following policies:

- Bylaws
- Audit Committee Charter
- Governance Committee Charter

- Code of Ethics
- Compensation, Reimbursement and Attendance Policy
- Competencies and Personal Attributes Required of Board Members
- Defense and Indemnification Policy
- Equal Opportunity and Affirmative Action Policy
- Internal Control Procedures
- Investment Policy
- Lobbying Policy
- Management Performance Evaluation Standards
- Measurement Standards for Performance Evaluation
- Mission Statement
- New Member Orientation Process
- New Member Orientation Process Reference Document
- Procurement Guidelines
- Property Disposition Guidelines
- Public Access to Records Policy
- Public Access to Records - Subject Matter List
- Records Management Program
- Travel Policy
- Uniform Tax Exemption Policy
- Whistleblower Policy

STERA is in the process of revising the following policies:

- Bylaws
- Audit Committee Charter
- Internal Control Procedures
- Procurement Guidelines

STERA also has the following policy in a state of preparation:

- Personnel Policy

This is not a priority inasmuch as STERA does not have and does not foresee having, any personnel / employees.

STERA also has in place the following three committees to help guide staff, implement business operations, and provide the methods and procedures used to assess the effectiveness of business functions:

- Executive Committee
- Audit Committee
- Governance Committee

The Authority has not created a Finance Committee inasmuch as it never has issued any debt.

B. Determination of the Risks Associated with Authority Operations

<u>Risks</u>	<u>Risk Level</u>
Financial insolvency – external causes	Low
Financial insolvency – internal causes	Low
Liability for event occurring from railroad operations	Low
Liability for event occurring from real estate ownership	Low
Liability for event occurring during construction	Low

Methods for Minimizing or Avoiding Risks

- Risk: Financial insolvency – external causes
 - Method: Avoiding activities that are not self-liquidating from external funding
- Risk: Financial insolvency – internal causes
 - Method: Involvement of Board in preparation and presentation of internal financial statements, review of financial statements by full Authority Board, double signature requirement for all checks (CEO/Treasurer does not have signature authority), annual audits in which all financial transactions are reviewed, ethics filings by Board and contract staff; additionally, revisions to the internal control procedures have been proposed relating to creating a CFO position separate from the CEO, and relating to oversight of bank balances and internally prepared interim financial statements by some combination of the CFO, Audit Committee and an outside accountant
- Liability for event occurring from railroad operations

- Method: Indemnification agreement with operating railroads, directors and officers insurance
- Liability for event occurring from real estate ownership
 - Method: Indemnification agreement with operating railroads, directors and officers insurance
- Liability for event occurring during construction
 - Method: Indemnification agreement with construction agents and engineering consultants, requiring construction agents and engineering consultants to have adequate insurance, directors and officers insurance

Frequency of Review of Risk Controls

- Risk: Financial insolvency – external causes
 - This is an ongoing procedure. It is reviewed annually.
- Risk: Financial insolvency – internal causes
 - This is an ongoing procedure. It is reviewed annually.
- Liability for event occurring from railroad operations
 - This is an ongoing procedure, with the indemnification agreement in place and insurance in place. It is reviewed annually.
- Liability for event occurring from real estate ownership
 - This is an ongoing procedure, with the indemnification agreement in place and insurance in place. It is reviewed annually.
- Liability for event occurring during construction
 - This is an ongoing procedure, with the indemnification agreements and insurance requirements for construction agents and engineering consultants required of all such contracts. Insurance is in place on an ongoing basis. This policy is reviewed annually.

C. Identification of the Internal Control Systems in Place

The Authority has adopted a number of internal controls (policies, practices, attitudes, guidelines and other actions) that, when followed, provide reasonable assurance that the Board and staff understand and properly carry out their responsibilities, that appropriate professional and ethical conduct is observed, and that the Authority will honor its purpose and mission. All Board members, management, and staff are aware of and understand the policies and practices that the Authority has adopted to ensure that the Authority is effective and to address the risks that are relevant to the Authority's operation. The Authority's policies and guidelines are posted on the Authority's web site for review by all Board members, management, and staff, and all Board members, management, and staff are given a copy of these policies and guidelines when they first become associated with the Authority.

D. Assessment of the Extent to Which the Internal Control System is Effective

The assessment of internal controls is an annual process involving a review by the Authority's Governance Committee and Audit Committee, which identify and report any weaknesses of the

internal control structure to the Authority Board of Directors and Management. During this process, the Governance Committee and Audit Committee evaluate the effectiveness of the existing control structure and determine whether current procedures are adequate with respect to mitigating risk, minimizing ineffectiveness and deterring opportunities that could lead to the abuse of corporate assets. The Governance Committee and Audit Committee also evaluate whether the authority's policies and operating practices are understood and executed properly and whether these policies and practices are adequate to protect the organization from waste, abuse, misconduct, or inefficiency. This assessment also is reported to the Authority Board of Directors and Management. The primary vehicle for these assessments is inquiry and observation, supplemented by a review of documents and records as needed.

In March 2011, the independent auditor recommended that all members of the Audit Committee would review the bank statements and internally prepared financial statements, and the Audit Committee Chairman would sign off on the financial statements. The review and comment on the financial statements could be accommodated through email. At the June 2011 Board meeting, the Board proposed to modify this new internal control protocol as follows: STERA would engage an external accountant to review bank statements and internally prepared financial statements before they are presented to the Audit Committee for review. This began a process of re-thinking the internal control process, and in November 2011, the Audit Committee proposed that (a) the Bylaws be revised to require that the Treasurer / CFO be a Board member, (b) that all checks be reviewed by the Audit Firm and recommended for approval by the Audit Committee, (c) that the Audit Firm review would monthly bank statements and draft internally prepared financial statements, and (d) the CFO would sign off on internally prepared financial statements and then report to the Audit Committee. As of December 31, 2011, the Board has not yet reviewed this proposal.

E. Process for Corrective Action

When a weakness is identified, the Governance Committee and/or Audit Committee recommend to the Authority Board of Directors and Management a corrective action plan. The Board reviews any such recommendation, modifies the proposed plan if necessary, and then adopts the corrective action plan, which is then monitored by Management, the Governance Committee, the Audit Committee, and the Authority Board of Directors.

F. Internal Control Certification

As a local public authority, in order to satisfy the requirement of Section 2800 (2)(a)(8) of Public Authorities Law, STERA incorporates, either within its annual report or as a separate document, a statement explaining that the Authority has conducted a formal, documented process to assess the effectiveness of their internal control structure and procedures, and indicating whether or not the internal controls are adequate. This statement is posted to the Authority's website.

Additionally, the Authority retains any documentation available to support the assessment of its internal controls. If the Authority has found any deficiencies with the internal controls over its functions or operations, it retains additional documentation to demonstrate that it has adopted corrective action plans to address these weaknesses. This documentation is available upon request to the Authority's independent auditor or to the NYS ABO compliance review staff.

As part of the Public Authorities Reporting Information System (PARIS) Annual Report process, STERA reports whether or not it has prepared this assessment and provides the URL link to the Authority's website where STERA has posted the Annual Report, which includes the assessment and the required statement explaining that the Authority has conducted a formal, documented process to assess the effectiveness of their internal control structure and procedures, and indicating that the internal controls are adequate.