

***HUDSON RIVER-BLACK RIVER  
REGULATING DISTRICT***

***FINANCIAL STATEMENTS***

***JUNE 30, 2006 AND 2005***

**HUDSON RIVER-BLACK RIVER REGULATING DISTRICT**

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**JUNE 30, 2006 AND 2005**

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This Management Discussion and Analysis (MD&A) of Hudson River-Black River Regulating District provides an introduction to the major activities and operations of the Regulating District and an introduction and overview to the Regulating District's financial performance and statements for the fiscal years ended June 30, 2006 and 2005. The MD&A is a requirement of Governmental Accounting Standards Board Statement No. 34.

Following this MD&A are the basic financial statements of the Regulating District together with the notes thereto which are essential to a full understanding of the data contained in the financial statements. The information contained in the MD&A should be considered in conjunction with the information contained in the Financial Statements and the Notes to Financial Statements.

## **REGULATING DISTRICT ACTIVITIES**

The Hudson River-Black River Regulating District was created in 1959 when the New York State Legislature passed legislation combining the Hudson River Regulating District, founded in 1922, and the Black River Regulating District, founded in 1919. Both were created to regulate the flow of the waters of New York State's two great neighboring watersheds.

The legislation charged the Regulating District with regulating the flow of the two rivers as required by the public welfare including health and safety. Specifically, the Regulating District's responsibilities involve reducing floods caused by excess run-off, and augmenting river flow at times of drought or other periods when normal river flows are low. Organized as a public benefit corporation, the Regulating District was given a broad spectrum of legal powers to accomplish this mission, including the authority to build and operate reservoirs, issue bonds, and apportion costs on its beneficiaries to finance construction, maintenance, and operation of its reservoirs.

Regulating District operations are conducted under two regional operating units - one for the Black River area and another for the Hudson River area - with segregated budgets. The management of both regions is vested in a seven-member Board appointed by the governor made up of three residents of the Black River area, three from the Hudson River area, and a seventh at-large member from anywhere in the State. The Board's obligations are to formulate policy for watershed management, operate and maintain reservoir facilities, regulate flow from reservoirs to minimize flooding and maintain a minimum flow to ensure water quality, operate a data-gathering system for precipitation, stream flow, snow depth and flood conditions; maintain certain specific reservoir levels in accordance with the Offer of Settlement; pay property taxes; maintain a sound financial status for maintenance of facilities and infrastructure; and promulgate rules and regulations necessary to fulfill the Regulating District's mission.

The Regulating District receives its primary funding from statutory beneficiaries, comprised of hydroelectric power generators, industrial operations and municipalities that directly benefit from augmented river flow and flood protection. These beneficiaries are annually assessed their proportional share of Regulating District operating expenses. A secondary revenue source comes from hydropower agreements that provide annual revenue in exchange for the ability to utilize headwater on Regulating District-administered state land for hydroelectric generating purposes. A third source of revenue, in the Hudson River area only, is the Sacandaga Lake Access Permit System, which generates revenue equal to the cost to operate the Great Sacandaga Lake Permit System.

**HUDSON RIVER-BLACK RIVER REGULATING DISTRICT**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)**  
 JUNE 30, 2006 AND 2005

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**FACILITIES**

Hudson River Area Facilities: The Regulating District administers the lands of the State of New York that constitute the Great Sacandaga Lake (Sacandaga Reservoir) as well as its shoreline, and issues annual revokable permits to eligible property owners for access to the lake across State land. The lake, impounded behind the Conklingville Dam, is the heart of Regulating District operations in the 8,300 square mile Hudson-Sacandaga area. The Regulating District also owns and operates Indian Lake Reservoir and Dam.

Black River Area Facilities: In the Black River drainage area of 1,916 square miles, the Regulating District operates reservoirs and dams at Stillwater, Old Forge, and Sixth Lake.

Administrative Offices: The Regulating District's main office occupies leased space in Albany. A Regulating District owned building in Mayfield houses the branch office for the Hudson-Sacandaga area. A branch office for the Black River area occupies rented space in Watertown.

**OPERATIONS SUMMARY**

The Regulating District's scope of operations and concomitant costs tend to be relatively stable from year to year:

	<b>Black River Area</b>		<b>Hudson River Area</b>		<b>District Totals</b>	
	<u>2005-2006</u>	<u>2004-2005</u>	<u>2005-2006</u>	<u>2004-2005</u>	<u>2005-2006</u>	<u>2004-2005</u>
Total Operating Revenue	\$ 880	\$ 928	\$ 5,452	\$ 4,698	\$ 6,332	\$ 5,626
Total Operating Expenses	<u>657</u>	<u>764</u>	<u>5,247</u>	<u>5,155</u>	<u>5,904</u>	<u>5,919</u>
Operating Income (loss)	223	164	205	(457)	428	(293)
Net Non-Operating						
Revenue	<u>(87)</u>	<u>68</u>	<u>(458)</u>	<u>61</u>	<u>(545)</u>	<u>129</u>
Net Income (loss)	<u>\$ 136</u>	<u>\$ 232</u>	<u>\$ (253)</u>	<u>\$ (396)</u>	<u>\$ (117)</u>	<u>\$ (164)</u>

The consolidated Regulating District revenues are derived from three primary sources. The financing of the two areas is accomplished independently because operating costs of each are recovered from two different sets of statutory beneficiaries, hydropower (or water usage) agreements and, in the Hudson River area only, the Great Sacandaga Lake Permit System. Statutory beneficiaries in both watersheds are assessed proportional shares of all other budgeted operating and overhead costs, after deducting the estimated revenue from the hydropower agreements, permit system revenue, and estimated interest income. The Sacandaga Lake Access Permit System generates revenue equal to the cost to operate the permitting system. Revenue from statutory beneficiaries, hydropower agreements, and permit holders is reliably adequate to balance the Regulating District's annual budget.

**HUDSON RIVER-BLACK RIVER REGULATING DISTRICT**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)**  
 JUNE 30, 2006 AND 2005

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**OPERATIONS SUMMARY (CONTINUED)**

Operating expenses fall in to four major categories: property taxes, personnel expenses, engineering and maintenance, and administrative overhead. While other expenses remain fairly stable, engineering and maintenance costs vary from year to year depending on a number of factors that affect our reservoirs, dams, and shoreline. These factors include, but are not necessarily limited to, weather, recreational use of facilities, environmental protection and remediation, and regulatory requirements. Since it is the dams that make possible the Regulating District's regulating of reservoir levels and river flows, and which restrain water to prevent flooding, maintenance of these dams is the Regulating District's primary activity.

The Regulating District maintains restricted reserve funds to minimize the effect that budget fluctuations would have on the statutory beneficiaries that provide its primary funding. These reserve funds absorb operating surpluses in lower expense years, and provide a means of funding operating deficits in high expense years - an effective means of assessment stabilization. Current restricted reserves represent 30% of total Regulating District reserves.

Contributing somewhat to annual imbalances between revenues and expenses has been the Regulating District's legislative mandate to adopt three-year budgets. While multi-year budgets, with revenues assessed equally for three years, serve to stabilize assessments during the budget cycle, they also tend toward surplus early in the multi-year cycle, and deficit in the final year.

**BALANCE SHEET SUMMARY**

	<u>2006</u>	<u>2005</u>	<u>Change</u>
Buildings	\$ 980	\$ 980	\$ -
Leasehold improvements, furniture, equipment	607	593	14
Vehicles	<u>657</u>	<u>674</u>	<u>(17)</u>
Cost of depreciable assets	2,244	2,247	(3)
Less accumulated depreciation	<u>(1,155)</u>	<u>(1,077)</u>	<u>(78)</u>
Book value of depreciable assets	1,089	1,170	(81)
Land & improvements	<u>14,118</u>	<u>14,118</u>	<u>-</u>
Book value of fixed assets	15,207	15,288	(81)
Current assets	<u>6,162</u>	<u>5,575</u>	<u>587</u>
Total assets	21,369	20,863	506
Less liabilities	<u>(1,125)</u>	<u>(501)</u>	<u>(624)</u>
Net assets	<u>\$ 20,244</u>	<u>\$ 20,362</u>	<u>\$ (118)</u>

This analysis reflects the Regulating District's stable financial position. Asset growth generally occurs in governmental units when 1) cash assets are accumulated, and/or 2) debt is used to finance acquisition or construction of fixed (durable) assets such as equipment, furniture, land, buildings, major improvements that extend the life of a fixed asset, or leasehold improvements.

## **BALANCE SHEET SUMMARY (CONTINUED)**

Asset shrinkage occurs when 1) accumulated cash assets are used for expenses that exceed revenues, and/or 2) assets acquired during the year cost less than “depreciation.”

The Regulating District’s reserve funds for repairs and assessment stabilization are presently considered adequate, so the Regulating District is managing its financial position by currently appropriating accumulated surpluses to minimize assessment increases to statutory beneficiaries. The effect on the balance sheet is to reduce cash assets.

During the past year, the cost of assets acquired totaled less than depreciation expense, further reducing the book value of assets. Growth of fixed assets in a governmental unit is not necessarily an indicator of financial condition, nor is negative fixed asset growth necessarily an indicator of financial deterioration.

Liabilities increased during the year, resulting in a \$623,585 decrease in Net Assets, primarily as the result of recording a \$682,000 settlement with a statutory beneficiary.

For the Hudson River- Black River Regulating District, the stability in its balance sheet reflects the current adequacy of its fixed assets, and the conservative management of its cash assets to minimize increases in assessments and fees.

## **DEBT**

The Board contemplates incurring debt in the foreseeable future in connection with a proposed office consolidation project estimated at a cost of \$500,000.

## **FINANCIAL CONDITION**

The financial position of the Regulating District remains stable and healthy. Likewise, operating results remain predictable and within an acceptable range of budget variance. Several issues currently exist, however, that will influence future operating results and financial statements.

During the fiscal year that will end on June 30, 2007, the Regulating District will implement new infrastructure accounting requirements imposed by Governmental Accounting Standards Board Statement No. 34 (GASB No. 34). This implementation requires historical research and evaluation of the Regulating District’s infrastructure assets, which is likely to affect values that are reported in future financial reports. Because GASB No. 34 requires that the Regulating District adopt an accounting method that will annually expense a portion of infrastructure costs, it is likely that GASB No. 34 implementation will increase future expenses, and may materially affect future operating statements.

## **FINANCIAL CONDITION (CONTINUED)**

Despite the stability of its operations, the Regulating District is functioning in a dynamic fiscal environment. The statutory beneficiaries have remained largely unchanged since the creation of the Regulating District. However, since 2000 and every year thereafter to date, a statutory beneficiary has commenced proceedings against the Regulating District challenging the Regulating District's apportionment of cost. The statutory beneficiary argues that there are other entities benefitting from the Regulating District that are not apportioned a share of its costs. The suit seeks changes in future assessments as well as refund of allegedly over-charged assessments for previous years. As described in Note 9 in the notes to Financial Statements, this litigation may impact future operating statements, but the affect cannot now be estimated.

## **CONCLUSION**

The accompanying Financial Statements are designed to provide detailed information on the Regulating District's operations to all those with an interest in the Regulating District's financial affairs. Questions concerning any of the information provided in this report, or any request for additional information, should be addressed to the Chief Fiscal Officer, Hudson River- Black River Regulating District, 350 Northern Boulevard, Albany, NY 12204.

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## **INDEPENDENT AUDITOR'S REPORT**

To the Board of Directors  
Hudson River-Black River Regulating District  
Albany, New York

We have audited the accompanying financial statements of Hudson River-Black River Regulating District (the "Regulating District"), a New York State public benefit corporation, as of June 30, 2006 and 2005 as listed in the table of contents. These financial statements are the responsibility of the Regulating District's management. Our responsibility is to express an opinion on these financial statements based on our audits.

Except as stated in the following paragraph, we conducted our audits in accordance with auditing standards generally accepted in the United States of America and standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The financial statements referred to above do not include the capitalization of fixed assets prior to July 1, 1992, which should be included in order to conform to accounting principles generally accepted in the United States of America. The additional amounts that should be recorded as fixed assets are not known.

In our opinion, except for the effects, if any, of the matter discussed in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of Hudson River-Black River Regulating District as of June 30, 2006 and 2005, and the changes in its net assets for the years then ended, in conformity with accounting principles generally accepted in the United States of America.



Management's discussion and analysis on pages 1 through 5 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. The Schedule of Revenues, Expenses and Changes in Net Assets by Area included on page 18 is presented for purposes of additional analysis and is not a required part of the basic financial statements. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated August September 1, 2006 on our consideration of Hudson River-Black River Regulating District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting and compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

A handwritten signature in black ink that reads "Cusack & Company, CPA's LLC". The signature is written in a cursive, flowing style.

**CUSACK & COMPANY, CPA'S LLC**

Latham, New York  
September 1, 2006

**HUDSON RIVER-BLACK RIVER REGULATING DISTRICT**  
**STATEMENTS OF NET ASSETS**  
**JUNE 30, 2006 AND 2005**

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**ASSETS**

	<b><u>2006</u></b>	<b><u>2005</u></b>
Current Assets:		
Cash	\$ 2,006,130	\$ 1,306,454
Investments	3,640,758	3,602,767
Accounts Receivable	3,353	129,332
Prepaid Expenses	<u>511,471</u>	<u>536,257</u>
Total Current Assets	6,161,712	5,574,810
Capital Assets, Net	<u>15,207,138</u>	<u>15,287,731</u>
	<b><u>\$ 21,368,850</u></b>	<b><u>\$ 20,862,541</u></b>

**LIABILITIES AND NET ASSETS**

Liabilities:		
Accounts Payable	\$ 85,318	\$ 140,472
Compensated Absences	266,910	241,965
Current Portion of Settlement Payable	227,333	-
Current Portion Due to NYS Retirement System	<u>39,756</u>	<u>64,171</u>
Total Current Liabilities	619,317	446,608
Settlement Payable, Net of Current Portion Due to New York State Retirement System, Net of Current Portion	454,667	-
	<u>50,386</u>	<u>54,177</u>
Total Liabilities	<u>1,124,370</u>	<u>500,785</u>
Net Assets:		
Investment in Capital Assets Net of Related Debt	<u>15,207,138</u>	<u>15,287,731</u>
Designated Net Assets:		
Assessment Stabilization	550,000	550,000
Capital Projects	1,470,000	1,470,000
Other	<u>195,000</u>	<u>195,000</u>
Total Designated Net Assets	<u>2,215,000</u>	<u>2,215,000</u>
Unrestricted Net Assets	<u>2,822,342</u>	<u>2,859,025</u>
Total Net Assets	<u>20,244,480</u>	<u>20,361,756</u>
	<b><u>\$ 21,368,850</u></b>	<b><u>\$ 20,862,541</u></b>

**HUDSON RIVER-BLACK RIVER REGULATING DISTRICT**  
**STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS**  
**FOR THE YEARS ENDED JUNE 30, 2006 AND 2005**

	<u>2006</u>	<u>2005</u>
Operating Revenue:		
Assessments	\$ 4,984,466	\$ 4,256,925
Water Power Service	920,765	926,500
Permit Fees	<u>426,801</u>	<u>443,176</u>
Total Operating Revenue	<u>6,332,032</u>	<u>5,626,601</u>
Operating Expenses:		
Salaries	1,424,906	1,464,780
Payroll Taxes	105,673	105,122
Pension Expense	136,210	163,341
Other Employee Benefits	365,357	352,362
Post Retirement Health Insurance	243,312	319,318
Real Estate Taxes	2,357,399	2,309,444
Depreciation	113,542	164,874
Insurance	189,922	170,604
Engineering Fees	29,520	43,799
U.S. Geological Survey Contract	102,949	110,569
Rent	52,530	52,530
Utilities	31,846	28,637
Telephone	31,412	29,071
Travel	62,703	77,592
Repairs and Maintenance	20,682	20,217
Professional Fees	466,844	318,527
Postage	10,889	8,513
Office Expense	56,079	67,831
Minor Equipment, Material and Supplies	31,872	33,565
Miscellaneous	30,666	4,535
Erosion Control/Maintenance	<u>36,390</u>	<u>74,624</u>
Total Operating Expenses	<u>5,900,703</u>	<u>5,919,855</u>
Operating Income (Loss)	<u>431,329</u>	<u>(293,254)</u>
Non-Operating Revenue (Expenses):		
Interest and Dividend Income	256,808	184,061
Miscellaneous Income	4,011	11,159
Realized and Unrealized Loss on Investments	(127,424)	(66,367)
Settlement Expense	<u>(682,000)</u>	<u>-</u>
Total Non-Operating Revenue (Expense)	<u>(548,605)</u>	<u>128,853</u>
Decrease in Net Assets	(117,276)	(164,401)
Net Assets at Beginning of Year	<u>20,361,756</u>	<u>20,526,157</u>
Net Assets at End of Year	<u>\$ 20,244,480</u>	<u>\$ 20,361,756</u>

**HUDSON RIVER-BLACK RIVER REGULATING DISTRICT**

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

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	<u>2006</u>	<u>2005</u>
Cash Flows from Operating Activities:		
Cash Received from Providing Services	\$ 6,458,011	\$ 5,626,248
Interest Collected	256,808	184,061
Cash Paid to Employees	(1,399,961)	(1,370,468)
Cash Paid for Employee Related Costs	(878,758)	(912,785)
Cash Paid for Real Estate Taxes	(2,332,613)	(2,353,939)
Cash Paid for Supplies and Other	<u>(1,209,107)</u>	<u>(926,468)</u>
Net Cash Provided by Operating Activities	<u>894,380</u>	<u>246,649</u>
Cash Flows from Investing Activities:		
Purchase of Investments	(165,414)	(150,803)
Purchase of Property and Equipment	(32,950)	(38,463)
Proceeds from Sale of Equipment	<u>3,660</u>	<u>8,300</u>
Net Cash Used in Investing Activities	<u>(194,704)</u>	<u>(180,966)</u>
Cash Flows from Financing Activities:		
Repayment of Bonds Payable	<u>-</u>	<u>(45,000)</u>
Net Increase in Cash	699,676	20,683
Cash at Beginning of Year	<u>1,306,454</u>	<u>1,285,771</u>
Cash at End of Year	<u>\$ 2,006,130</u>	<u>\$ 1,306,454</u>
Reconciliation of Net Loss to Net Cash Provided by Operating Activities:		
Change in Net Assets	\$ (117,276)	\$ (164,401)
Adjustments to Reconcile Net Loss to Net Cash Provided by Operating Activities:		
Depreciation	113,542	164,874
Realized and Unrealized Loss on Investments	127,424	66,367
Gain on Sale of Equipment	(3,660)	(8,300)
Changes in:		
(Increase) Decrease in Accounts Receivable	125,979	(353)
(Increase) Decrease in Prepaid Expenses	24,786	(44,495)
Increase (Decrease) in Accounts Payable	(55,154)	111,287
Increase in Settlement Payable	682,000	-
Increase in Compensated Absences	24,945	94,312
Increase (Decrease) Due to NYS Retirement System	<u>(28,206)</u>	<u>27,358</u>
Net Cash Provided by Operating Activities	<u>\$ 894,380</u>	<u>\$ 246,649</u>

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### *Nature of Activities*

Hudson River-Black River Regulating District (the "Regulating District") was created in 1959 under Article 15, Title 21 of the Environmental Conservation Law, which combined two organizations, the Black River Regulating District (formed in 1919) and the Hudson River Regulating District (formed in 1922). The Regulating District is a New York State public benefit corporation that is mandated to regulate stream flows as required by public welfare, including health and safety. The regulation of stream flows into the two watershed areas is the mission of the consolidated organization. The day-to-day operation of the two areas is conducted independently, because they are not physically related or connected in any way. Accordingly, the financing of the two areas is accomplished independently, because operating costs of each are recovered from two different sets of statutory beneficiaries, hydropower (or water power) agreements and, in the Hudson River area, the Great Sacandaga Lake Permit System. Each watershed area has its own operating personnel; however, a common professional staff serves both. Overall direction is supplied by a board appointed by the Governor of New York State.

### *Reporting Entity*

The Regulating District is a component unit of the State of New York and, as such, is included in the State's general purpose financial statements. The Regulating District's financial statements include all operations for which the Regulating District has financial accountability.

### *Basis of Presentation*

On July 1, 2003, the Regulating District adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 34 "Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments" and GASB Statement No. 37 "Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus." Statement 34, as amended by Statement 37, established standards for external reporting for all state and local government entities. It requires the classification of net assets equity into three components - invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

- *Invested in capital assets, net of related debt* - The component of net assets consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.
- *Restricted* - This component of net assets consists of constraints placed on net assets use through external constraints imposed by creditors (such as through debt covenants), contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation. The Regulating District had no restricted net assets at June 30, 2006 and 2005.
- *Unrestricted fund equity* - The component of net assets consists of net assets that does not meet the definition of "restricted" or "invested in capital assets, net of related debt."

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

*Basis of Accounting*

The accompanying financial statements have been prepared in conformity with generally accepted accounting principles for governmental entities, as prescribed by GASB. In accordance with provisions promulgated by GASB, the Regulating District elected not to apply Financial Accounting Standards Board (FASB) pronouncements and interpretations issued after November 30, 1989.

The operations of the Regulating District are reported as a proprietary fund and, as such, are accounted for on a flow of economic resources measurement focus and the accrual basis of accounting. Within this measurement focus, all assets and liabilities associated with operations are included on the balance sheet with revenues recorded when earned and expenses recorded at the time liabilities are incurred.

*Investments*

The Regulating District's investment policies comply with the New York State Comptroller's guidelines for such policies. Those policies permit investments in, among other things, obligations of the U.S. Treasury and its agencies and instrumentalities, certificates of deposit and obligations of the State of New York. Investments are recorded at amortized cost, which approximates market value and investment income is recorded in the statement of revenues, expenses and changes in fund equity.

*Capitalization and Depreciation*

Property and equipment are recorded at cost. With the exception of reservoirs, depreciation is provided for in amounts sufficient to relate the cost of depreciable assets to operations over their estimated service lives using the straight-line method. Improvements of \$5,000 or more are capitalized, while expenses for maintenance and repairs are charged to expense as incurred. Upon disposal of depreciable property, the appropriate property accounts are reduced by the related costs and accumulated depreciation. The resulting gains and losses are reflected in the combined statement of revenue, expenses and changes in net assets. Prior to the fiscal year ended June 30, 1993, the Regulating District did not capitalize fixed assets. Fixed assets were recorded as expenses and these assets are not recorded on the books of the Regulating District. It is impracticable to determine the cost and accumulated depreciation of fixed assets acquired prior to July 1, 1992.

*Accrued Employee Benefits*

It is the Regulating District's policy to record employee benefits, including accumulated vacation and sick leave, as a liability. Regulating District employees are granted vacation in varying amounts. Upon retirement from the Regulating District, employees are reimbursed for accumulated vacation days up to a stated maximum. In addition, upon retirement, union employees are reimbursed for fifty percent of all accumulated sick days, up to a stated maximum, as specified in the bargaining agreement.

**HUDSON RIVER-BLACK RIVER REGULATING DISTRICT**

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2006 AND 2005

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**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

*Budgets*

By legislation, the Regulating District operates on a three-year cycle. Separate budgets are developed for the Hudson River area and Black River area since the cost of their respective operations are borne by a group of designated beneficiaries in each watershed. General administration costs, including Board expenses, are allocated on a proportionate basis to the two areas. The cost of operating the Permit System at the Great Sacandaga Lake is estimated for a three-year period. This involves allocating personnel salaries and benefits, as well as portions of facility and equipment costs to permit system operations.

*Assessments*

Resolutions are passed by the Regulating District's Board for both the Hudson River area and Black River area annual assessments at the June Board meeting. On July 1<sup>st</sup> of each year, assessments are billed, and on November 1<sup>st</sup>, a transmittal letter is sent to each town, city, or village informing them of each statutory beneficiary in their respective community who did not pay their assessment. Also on November 1<sup>st</sup>, a letter is sent to each county where a statutory beneficiary is located requesting them to charge unpaid assessments on the County's property tax levy for the subsequent year.

*Estimates*

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

**2. CASH**

Cash consists of the following at June 30, 2006:

	<b><u>Carrying Value</u></b>	<b><u>Bank Balance</u></b>
Deposit Accounts	\$ 266,308	\$ 280,706
Deposits held by New York State	<u>1,739,822</u>	<u>-</u>
	<u>\$ 2,006,130</u>	<u>\$ 280,706</u>

The Regulating District's cash deposits at June 30, 2006 were secured by the Federal Depository Insurance Corporation and uncollateralized, as follows:

FDIC Insurance	\$ 161,351
Uncollateralized	<u>119,355</u>
	<u>\$ 280,706</u>

**HUDSON RIVER-BLACK RIVER REGULATING DISTRICT**

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2006 AND 2005

**3. INVESTMENTS**

New York State statutes and guidelines, and the Regulating District's own investment policies, limit the investment of funds to obligations of the U.S. Government and its agencies, certificates of deposit and obligations of the State of New York. At June 30, 2006, investments include \$3,640,758 of Government mutual funds with short-term maturities, under a managed investment arrangement with Sentinel Funds. The Regulating District's investments are carried at amortized cost, which approximates market value. At June 30, 2005, investments included \$3,602,767 under a similar investment management arrangement.

The Regulating District's investments are categorized in accordance with criteria established by GASB to give an indication of the level of risk assumed by the entity at year-end. Category 1 includes investments that are insured or registered or for which the securities are held by the Regulating District or its agent in the Regulating District's name. Category 2 includes uninsured and unregistered investments for which the securities are held by the counter parties trust department or agent in the Regulating District's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the counter parties, or by its trust department or agent but not in the Regulating District's name. All of the Regulating District's investments are classified in Category 1.

**4. CAPITAL ASSETS AND DEPRECIATION**

Capital assets at June 30, 2006 and 2005 is summarized as follows:

	<u>2006</u>	<u>2005</u>
Hudson River Area:		
Reservoir	\$ 12,104,830	\$ 12,104,830
Building	936,787	936,787
Building Improvements	43,300	43,300
Office Equipment	109,927	95,374
Other Equipment	31,208	31,208
Vehicles	<u>560,349</u>	<u>571,692</u>
	13,786,401	13,783,191
Less Accumulated Depreciation	<u>(972,558)</u>	<u>(919,372)</u>
Total Hudson River Area	<u>12,813,843</u>	<u>12,863,819</u>
Black River Area:		
Reservoir	2,000,000	2,000,000
Leasehold improvements	406,442	406,442
Equipment	52,819	52,819
Vehicles	96,906	102,756
Office Equipment	6,318	6,318
Old Forge Rehab - Engineering Costs	<u>13,195</u>	<u>13,195</u>
	2,575,680	2,581,530
Less Accumulated Depreciation	<u>(182,385)</u>	<u>(157,618)</u>
Total Black River Area	<u>2,393,295</u>	<u>2,423,912</u>
Total Capital Assets	<u>\$ 15,207,138</u>	<u>\$ 15,287,731</u>



**HUDSON RIVER-BLACK RIVER REGULATING DISTRICT**

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

JUNE 30, 2006 AND 2005

Depreciation expense charged to operations for the year ended June 30, 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Hudson River Area:	\$ 82,926	\$ 119,007
Black River Area:	<u>30,616</u>	<u>45,867</u>
	<u>\$ 113,542</u>	<u>\$ 164,874</u>

**5. RETIREMENT SYSTEM**

*Plan Description*

The Regulating District participates in the New York State and Local Employees' Retirement System (the System.) This is a cost-sharing, multiple-employer retirement system. The System provides retirement benefits, as well as death and disability benefits. Obligations of employers and employees to contribute and benefits to employees are governed by the New York State Retirement and Social Security law (NYSRSSL.) As set forth in the NYSRSSL, the Comptroller of the State of New York (Comptroller) serves as sole trustee and administrative head of the System. The Comptroller shall adopt and may amend rules and regulations for the administration and transaction of the business of the System and for the custody and control of their funds. The System issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to the New York State and Local Employees' Retirement Systems, 110 State Street, Albany, New York 12244.

*Funding Policy*

The System is non-contributory except for employees who joined the New York State and Local Employees' Retirement System after July 27, 1976, who contribute 3% of their salary for the first ten years of employment and nothing thereafter. Under the authority of the NYSRSSL, the Comptroller shall certify annually the rates expressed as proportions of payroll of members, which shall be used in computing the contributions required to be made by employers to the Pension Accumulation Fund.

The Regulating District is required to contribute at an actuarially determined rate. The required contributions for the current year and two preceding years were:

2006	\$ 167,426
2005	195,180
2004	89,590

The Regulating District's contributions made to the System were equal to 100% of the contributions required for 2004 and 2006. For 2005, a \$134,983 contribution was made and \$60,197 was bonded to be repaid over 10 years in accordance with Chapter 260 of the Laws of the State of New York as discussed below.

On May 14, 2003, Chapter 49 of the Laws of 2003 of the State of New York was enacted which made the following changes in the Systems:

- Requires minimum contributions by employers of 4.5% of payroll every year, including years in which the investment performance would make a lower contribution possible.

**5. RETIREMENT SYSTEM (CONTINUED)**

- Changes the cycle of annual billing such that the contribution for a given fiscal year will be based on the value of the pension fund on the prior April 1<sup>st</sup>.

On July 30, 2004, Chapter 260 of the Laws of 2004 of the State of New York was enacted that allows local employers to bond or amortize a portion of their retirement bill for up to 10 years in accordance with the following schedule:

- For State fiscal year (SFY) 2004-05, the amounts in excess of 7 percent of employees' covered salaries, with the first payment of those pension costs not due until the fiscal year succeeding that fiscal year in which the bonding/amortization was instituted.
- For SFY 2005-06, the amount in excess of 9.5 percent of employees' covered salaries.
- For SFY 2006-07, the amount in excess of 10.5 percent of employees' covered salaries.

The law requires participating employers to make payments on a current basis, while bonding or amortizing existing unpaid amounts relating to the System's fiscal years ending March 31, 2005 through 2007.

Chapter 260 of the Laws of New York State changed the annual payment due date for employers who participate in the New York State and Local Employees' Retirement System. The December 15 payment due date changed to February 1, however, employers were allowed to prepay their payment by December 15. The covered salary period (April 15-March 31) will not change for the calculation.

**6. DESIGNATED NET ASSETS**

The following is a description of designated net assets:

- Assessment Stabilization - \$550,000 (\$550,000 at June 30, 2005) has been designated for the purpose of stabilizing future assessments.
- Capital Projects - \$1,470,000 (\$1,470,000 at June 30, 2005) has been designated for future capital projects.
- Other - \$195,000 (\$195,000 at June 30, 2005) has been designated for legal, engineering and tax purposes.

**7. POST-RETIREMENT HEALTH CARE BENEFITS**

The Regulating District provides post-employment health insurance coverage to retired employees in accordance with various employment contracts and union agreements. Currently 27 retirees met those eligibility requirements. Health care benefits are provided through an insurance company. The Regulating District recognizes the cost of providing these benefits as an expense in the year paid. Post-employment health care benefits were approximately \$243,000 and \$319,000 for the years ended June 30, 2006 and 2005, respectively.

**HUDSON RIVER-BLACK RIVER REGULATING DISTRICT**

*NOTES TO FINANCIAL STATEMENTS (CONTINUED)*

*JUNE 30, 2006 AND 2005*

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**8. HYDROPOWER (OR WATER USAGE) AGREEMENTS**

In the Hudson River area, the Regulating District has a Hydropower Agreement with a hydroelectric company effective July 1, 2003 and expiring June 30, 2015, requiring an annual payment of \$850,000 increasing 3% each year.

In the Black River area, the Regulating District has a Hydropower Agreement with a hydroelectric company effective January 1, 1986 and expiring December 31, 2016, requiring an annual payment of approximately \$30,000 increasing 3% each year.

**9. CONTINGENCIES**

Prior to 2006, the Regulating District was involved in litigation with two statutory beneficiaries. During 2006, a settlement was agreed to with one of the statutory beneficiaries requiring credits totaling \$682,000 to be applied to the beneficiaries' future assessments in equal installments of \$227,333 for the fiscal years ended June 30, 2007, 2008 and 2009. Additionally, the settlement requires that the District will apply \$380,000 of the existing Hudson River Stabilization Fund to reduce future budgets in equal installments of \$126,667 for the fiscal years ended June 30, 2007, 2008 and 2009. A liability and settlement expense of \$682,000 has been reflected in the June 30, 2006 financial statements. As of June 30, 2006, the Regulating District continues to be sued by one major statutory beneficiaries for assessment abatement that could materially affect the financial position of the Regulating District. The case has been in litigation since 2001, and accordingly, the litigant has filed challenges to their assessment for the last five fiscal years. Although the outcome is uncertain the Regulating District's Special Counsel considers the possibility of a negative outcome to be remote.

**10. CONCENTRATION**

Approximately 66% of assessment revenues are provided by two statutory beneficiaries.

**SUPPLEMENTAL INFORMATION**

**HUDSON RIVER-BLACK RIVER REGULATING DISTRICT**  
 STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS BY AREA  
 FOR THE YEAR ENDED JUNE 30, 2006

	<u>Hudson River Area</u>	<u>Black River Area</u>	<u>Total Regulating District</u>
Operating Revenue:			
Assessments	\$ 4,122,959	\$ 861,507	\$ 4,984,466
Water Power Service	901,765	19,000	920,765
Permit Fees	<u>426,801</u>	<u>-</u>	<u>426,801</u>
 Total Operating Revenue	 <u>5,451,525</u>	 <u>880,507</u>	 <u>6,332,032</u>
Operating Expenses			
Personnel Services and Employee Benefits	1,953,124	322,335	2,275,459
Capital Expenditures	28,981	13,014	41,995
Materials and Supplies	361,186	19,970	381,156
Real Estate Taxes	2,321,733	35,666	2,357,399
Contractual Services	643,164	91,000	734,164
Allocated General Board Expenses	(144,399)	144,399	-
Depreciation	<u>82,926</u>	<u>30,616</u>	<u>113,542</u>
 Total Operating Expenses	 <u>5,246,715</u>	 <u>657,000</u>	 <u>5,903,715</u>
 Operating Income (Loss)	 <u>204,810</u>	 <u>223,507</u>	 <u>428,317</u>
Non-Operating Revenue (Expenses):			
Interest and Dividend Income	112,439	144,369	256,808
Miscellaneous Income	1,326	5,697	7,023
Realized and Unrealized Loss on Investments	(50,026)	(77,398)	(127,424)
Settlement Expense	<u>(522,000)</u>	<u>(160,000)</u>	<u>(682,000)</u>
 Total Non-Operating Revenue (Expense)	 <u>(458,261)</u>	 <u>(87,332)</u>	 <u>(545,593)</u>
 Increase (Decrease) in Net Assets	 (253,451)	 136,175	 (117,276)
Net Assets at Beginning of Year	<u>14,938,644</u>	<u>5,423,112</u>	<u>20,361,756</u>
Net Assets at End of Year	<u>\$ 14,685,193</u>	<u>\$ 5,559,287</u>	<u>\$ 20,244,480</u>

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CERTIFIED PUBLIC ACCOUNTANTS  
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NEW YORK STATE SOCIETY OF  
CERTIFIED PUBLIC ACCOUNTANTS

**INDEPENDENT AUDITOR'S REPORT ON  
INTERNAL CONTROL OVER FINANCIAL REPORTING AND  
COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF THE  
BASIC FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH  
GOVERNMENT AUDITING STANDARDS**

To the Board of Directors  
Hudson River-Black River Regulating District  
Albany, New York

We have audited the financial statements of Hudson River - Black River Regulating District (the "Regulating District") as of and for the year ended June 30, 2006, and have issued our report thereon dated September 1, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**INTERNAL CONTROL OVER FINANCIAL REPORTING**

In planning and performing our audit, we considered the Regulating District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Hudson River-Black River Regulating District's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and recommendations as item 1.

**COMPLIANCE AND OTHER MATTERS**

As part of obtaining reasonable assurance about whether the Regulating District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instance of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Directors, management, and is not intended to be, and should not be, used by anyone other than these specified parties.

A handwritten signature in black ink that reads "Cusack & Company, CPA's LLC". The signature is written in a cursive, flowing style.

**CUSACK & COMPANY, CPA'S LLC**

Latham, New York  
September 1, 2006

1. Prior Year Findings and Recommendations

Several of the prior year findings and recommendations have not been fully addressed by management.

We recommend that management development and implement procedures to formally address all findings and recommendations.



**HUDSON RIVER-BLACK RIVER REGULATING DISTRICT**

STATUS OF PRIOR YEAR FINDINGS AND RECOMMENDATIONS

JUNE 30, 2005

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1. Audit Adjustments

We made audit adjustments resulting in a net expense of approximately \$202,000, including adjustments for:

• Depreciation Expense	\$ (164,874)
• Investment Activity	(27,614)
• Unrecorded Assessments Receivable	37,158
• Unrecorded Water Power Service	51,000
• Change in Prepaid Real Estate Taxes	44,495
• Capitalization of a Truck	38,463
• Addition to Compensated Absences	(94,312)
• Unrecorded Accounts Payable	(56,388)
• Unrecorded Retirement System Liability	(28,358)

Management and the Board of Directors must be provided accurate and timely financial statements in order to effectively manage the operations of the Regulating District.

We recommend that procedures be developed and implemented to ensure all accounts are reconciled on a monthly basis and that the appropriate entries are reflected in the books and records on a timely basis.

Status: Although management did provide some analysis and proposed adjustments to us, we proposed seventeen audit adjustments with a \$(890,000) net effect, primarily as a result of recording the legal settlement (\$682,000), unrealized loss on investments (\$127,000) and correction of a receivable (\$51,000).

2. Accounting Systems

During 2005, two separate general ledgers maintained on two different software systems were utilized to record the activities of the Hudson River District and Black River District, respectively. As several expenditures of the Black River District (*e.g.*, payroll and related costs) are paid for by the Hudson River District, this results in duplication of expenses which are offset by an inter-district revenue charge. If one general ledger system were utilized, this complex and confusing system would be eliminated.

We recommend that management consider consolidating the general ledger reporting for the Regulating Districts.

Status: During 2006, initial steps were taken to bring both Districts to a common processing platform.

3. Cost Allocation

There is no formal system to allocate all costs applicable to Regulating District assessments and permit fees.

We recommend that management develop and implement a formal cost allocation system.

Status: During 2006, the Regulating District engaged a consultant to recommend accounting methodologies regarding allocation of permit system costs. Additionally, direct labor tracking procedures were implemented effective July 1, 2006.

4. Inventory of Equipment

To provide effective accountability over equipment owned and assure reliability of records maintained, a physical inventory of equipment should be taken annually. The inventory of equipment should be compared to the fixed asset ledger and appropriate disposition made of account balances representing lost or abandoned equipment.

We recommend that an annual equipment inventory be taken and be reconciled to the general ledger.

Status: Although no equipment inventory was taken in Fiscal year 2006, management indicates that an equipment inventory will be performed in December 2006.

5. Qualified Audit Opinion

The June 30, 2005 audit opinion, consistent with prior years has been qualified as fixed assets acquired prior to July 1, 1992 have not been reflected in the accounts. Generally accepted accounting principles allow for the values of such assets to be estimated, which if properly performed, could result in future unqualified opinions.

We recommend management consider the costs and benefits of valuing fixed assets acquired prior to July 1, 1992.

Status: No actions were taken in 2006.

6. Governmental Accounting Standards Board Statement No. 45 "Accounting and Financial Reporting by Employers for Post-employment Benefits Other than Pensions" (GASB 45")

The current acceptable practice is to expense health care costs for retired employees on a pay-as-you-go basis. For the Regulating District, effective for its fiscal year, ending June 30, 2009, (earlier application is not only acceptable but is encouraged), GASB 45 will require the accrual basis of accounting for this liability which will report the previously unrecognized liability over a period of years, and will require the services of an actuary. This liability will be material to the Regulating District's financial statement.

We recommend that management develop and implement a plan to implement GASB 45 and consider early implementation.

Status: Management plans to implement GASB 45 at June 30, 2007.

7. Uncollectible Assessments

During the June 30, 2005 audit we noted that there is no formal written policy for the collection of past due assessments. Additionally, no procedures exist to determine an appropriate allowance for uncollectible assessments.

We recommend that management develop and implement procedures for the collection of past due assessments and for the provisions of an adequate allowance for uncollectible assessments.

Status: The comment was satisfactorily addressed by management.

8. Develop an Accounting Procedures Manual

We noted that the Regulating District does not have an accounting procedures manual. There may be an assumption that because the Regulating District's accounting system is relatively simple and accounting personnel have direct and easy access to the Chief Financial Officer when questions arise, there is no need for a manual. However, written procedures, instructions, and assignments of duties will prevent or reduce misunderstandings, errors, inefficient or wasted effort, duplicated or omitted procedures, and other situations that can result in inaccurate or untimely accounting records. A well-devised accounting manual can also help to ensure that all similar transactions are treated consistently, that accounting principles used are proper, and that records are produced in the form desired by management. A good accounting manual should aid in the training of new employees and possibly allow for delegation to other employees of some accounting functions management performs. It will take some time and effort for management to develop a manual; however, we believe this time will be more than offset by time saved later in training and supervising accounting personnel. Also, in the process of the comprehensive review of existing accounting procedures for the purpose of developing the manual, management might discover procedures that can be eliminated or improved to make the system more efficient and effective.

We recommend that management consider the development of an accounting procedures manual.

Status: Management is currently in phase two of a three phase plan to address this issue.

9. Personnel Files

During our audit we noted that personnel files contained three sections: a) personal, b) insurance, and c) payroll related. As the personal section of the files are subject to privacy laws, we were not able to complete an audit testing procedure of reviewing personnel files (We satisfied the test through alternative procedures).

We recommend that management consider keeping separate personnel files for personal information subject to privacy laws versus information generally requested for review by auditors and others.

Status: The comment was satisfactorily addressed by management.

**HUDSON RIVER-BLACK RIVER REGULATING DISTRICT**

*STATUS OF PRIOR YEAR FINDINGS AND RECOMMENDATIONS*

*JUNE 30, 2005*

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10. Improvement Segregation of Accounting Department Duties

Although the small size of the Regulating District's office staff limits the extent of separation of duties, we believe certain steps could be taken to separate incompatible duties. The basic premise is that no one employee should have access to both physical assets and the related accounting records or to all phases of a transaction.

One of the most critical areas of separation is cash, where we noted that the bookkeeper handles incoming checks, posts receipts to accounts, processes vouchers, generates payable checks, and receives and reconciles the monthly bank statement. The result is the danger that intentional or unintentional errors could be made and not detected.

As a compensating control, we recommend that the Chief Financial Officer should receive and review the bank statements and canceled checks before turning them over to the bookkeeper to prepare the bank reconciliations. The Chief Financial Officer might also review the reconciliations after they are prepared. These simple steps would not require the addition of any new employees or add significant time to the Chief Financial Officer.

Status: The comment was satisfactorily addressed by management.