

MINUTES OF THE NINETY-FIRST MEETING OF THE
AUDIT AND FINANCE COMMITTEE
HELD ON APRIL 3, 2006

Pursuant to notice dated March 23, 2006, a copy of which is annexed hereto, the ninety-first (91st) meeting of the Audit and Finance Committee of the NEW YORK STATE ENERGY RESEARCH AND DEVELOPMENT AUTHORITY ("Authority") was convened at 11:00 a. m. on Monday, April 3, 2006, in the Authority's Albany office at 17 Columbia Circle, Albany, New York, and by video conference in the Authority's New York City office at 485 Seventh Avenue, 10th Floor, New York, New York, and by video conference in the Authority's Buffalo Office at 617 Main Street, Suite 105, Buffalo, New York.

The following members of the Committee were present:

Robert B. Catell (by video conference from New York)

Vincent A. Delorio, Esq., *ex officio*

George F. Akel, Jr.

Jay L. Gottlieb (by video conference from New York)

Committee member Thomas Marusak did not attend. Also present were Authority Member Parker D. Mathusa; Peter R. Smith, President; Robert G. Callender, Vice President for Programs; Wendy M. Shave, Vice President for Administration and Secretary; Jeffrey J. Pitkin, Treasurer; Roger D. Avent, Esq., General Counsel; Sara L. LeCain, Esq., Assistant Counsel and Acting Secretary to the Committee; Mark B. Mitchell, Director of Internal Audit; John Osinski, New York Power Authority; and various staff of the Authority.

Mr. Catell, Chair of the Committee, noted the presence of a quorum and indicated that the first item on the agenda concerned the approval of the minutes of the ninetieth meeting of the Committee held on January 23, 2006. (Mr. Gottlieb had been unavoidably delayed and had not yet

arrived.)

Whereafter, upon motion duly made and seconded, and by unanimous voice vote, the minutes of the ninetieth meeting of the Committee, held on January 23, 2006, were approved.

Mr. Catell said that the next item on the agenda was a report on principles of governance. Mr. Pitkin, the Authority's Treasurer, explained that the Committee members were being asked to recommend adoption of four resolutions to enact new policies and modify existing policies in response to the enactment of the Public Authorities Accountability Act of 2005, changes to the State Finance Law ("Lobbying Laws") concerning procurement, and promulgations of new regulations for reporting and budgeting issued by the State Comptroller.

The first resolution would amend the Bylaws, the Internal Control Manual, the Procurement Contracts Guidelines, Operative Policy, and Instructions ("Procurement Guidelines"), and the Financial Services Firms Guidelines.

The changes to the Bylaws include: separating the roles of the Chair and the Chief Executive Officer by naming the President as the Chief Executive Officer and clarifying the roles of the Chair and the other Officers; naming the Treasurer as the Chief Financial Officer; clarifying the roles of the Audit and Finance Committee; establishing a new Governance Committee and describing its role; and changing the notice provisions for meetings to include electronic notices.

The changes to the Internal Control Manual include: listing the Members internal control responsibilities such as overseeing the Officers and executive management; adding additional reporting requirements for the annual report submitted pursuant to Section 2800 of the Public Authorities Law; adding requirements for the Members' communication with the independent auditors; adding requirements for the preparation and approval of the annual budget; adding provisions relating to the requirements of the Lobbying Laws and Executive Order No. 127 regarding contacts by outside parties which could be reasonably considered an attempt to influence procurement; and replacing Appendix A of the Internal Control Manual to include revised Internal

Control Standards for New York State Government revised by the State Comptroller in December 2005.

The changes to the Procurement Guidelines address requirements of the Lobbying Laws to prohibit any contact with Authority Staff or Members, other than those individuals designated during the restricted period, when the contact could be reasonably considered an attempt to influence procurement.

The changes to the Financial Services Firms Guidelines provide changes to the annual bond sale report to include certain additional information required to be included in the Public Authorities Law Section 2800 annual report about the Authority's financings.

The second resolution approves policies for the payment of salary, compensation and reimbursements to, and rules for time and attendance of "the chief executive and senior management", as required under the Public Authorities Accountability Act of 2005. All employees are required to follow the same time and attendance rules, and excerpts from the Personnel Handbook describing these benefits are attached. The resolution notes the current compensation for the Officers and executive management and scheduled increases in salary applicable to State Management/Confidential employees.

The third resolution adopts a Defense and Indemnification Policy. The policy summarizes the provisions of Public Officers Law Section 17, which provides for indemnification of Authority Members.

The fourth resolution adopts new Guidelines, Operative Policy, and Instructions for the Disposal of Real and Personal Property ("Property Guidelines"), consistent with the new Title 5-A of the Public Authorities Law. The Property Guidelines provide for accountability of property; generally require competitive bidding for the disposal of real property and personal property with a value in excess of \$5,000; designate the Treasurer as the person responsible for implementing the Guidelines; require the annual approval of the Guidelines by the Members; and require the

submission of the Guidelines and an annual report on real property and personal property disposition to the Members for approval, annually.

Mr. Pitkin reported that the Authority's website has been modified to include a new Governance webpage to include information required to be provided to the public by the Public Authorities Accountability Act of 2005. The webpage also includes information required by the State Comptroller's regulations to demonstrate how the Authority carries out its responsibilities in a transparent and accountable manner. A copy of the webpage was provided as a handout for the Members' reference and information.

Mr. Catell then noted the arrival of Mr. Gottlieb. Mr. Gottlieb indicated that he had read the materials and had no questions with respect to the amendments to existing policies and implementation of the new policies.

Whereafter, upon motion duly made and seconded, and by unanimous voice vote of the Committee members present, the following resolution was adopted.

Resolution No. 308

RESOLVED, that the Audit and Finance Committee recommends that the Members of the Authority adopt a resolution in substantially the same form as the resolution submitted to the Committee (attached as Exhibit A), approving and adopting amendments to the Authority's By-laws, Internal Control Manual (April 2006), Financial Services Firms Guidelines, Operative Policy, and Instructions (April 2006), and Procurement Contract Guidelines, Operative Policy, and Instructions (April 2006), as presented at this meeting, substantially in the form submitted to the Committee (attached as Exhibit B).

Whereafter, upon motion duly made and seconded, and by unanimous voice vote of the Committee members present, the following resolution was adopted.

Resolution No. 309

RESOLVED, that the Audit and Finance Committee recommends that the Members of the Authority adopt a resolution in substantially the same form as the resolution submitted to the Committee (attached as Exhibit C), approving the salary of the President, Vice President for Programs, Vice President for Administration and Secretary, Treasurer, and General Counsel for fiscal year 2005-06 and thereafter; and

BE IT FURTHER RESOLVED, that the Audit and Finance Committee recommends that the Members of the Authority approve the policies regarding the payment of salary, compensation, and reimbursements, and the rules for time and attendance as described in the excerpts from the Personnel Handbook and the Accounting Manual, as presented at this meeting, substantially in the form submitted to the Committee (attached as Exhibit D).

Whereafter, upon motion duly made and seconded, and by unanimous voice vote of the Committee members present, the following resolution was adopted.

Resolution No. 310

RESOLVED, that the Audit and Finance Committee recommends that the Members of the Authority adopt a resolution in substantially the same form as the resolution submitted to the Committee (attached as Exhibit E), approving and adopting the Defense and Indemnification Policy, as presented at this meeting, substantially in the form submitted to the Committee (attached as Exhibit F).

Whereafter, upon motion duly made and seconded, and by unanimous voice vote of the Committee members present, the following resolution was adopted.

Resolution No. 311

RESOLVED, that the Audit and Finance Committee recommends that the Members of the Authority adopt a resolution in substantially the same form as the resolution submitted to the Committee (attached as Exhibit G), approving and adopting the Guidelines, Operative Policy, and Instructions for the Disposal of Real and Personal Property (April 2006), as presented at this meeting, substantially in the form submitted to the Committee (attached as Exhibit H).

Mr. Catell said that the next item on the agenda concerned a report on the recent activities of the State Comptroller. Mr. Pitkin explained that staff is awaiting receipt of the final audit report for the systems benefit charge audit completed in January 2006. Staff was recently notified by the State Comptroller's Office that it will be conducting two additional audits. The first is a follow up to the internal controls audit completed in November 2004 (Report 2005-S-55). The State Comptroller's follow up review will determine whether the Authority fully implemented recommendations contained in the final audit report, which contained five recommendations: revise procedures for Board approval of multi-year contracts; improve the timeliness of collections and billings; improve cash receipts controls by logging cash receipts daily, restrictedly endorsing checks, and segregating duties for custody of checks for deposit from the recording function; improve controls over administrative purchasing by segregating duties for payment authorization from receiving; and improve computer system access controls by restricting access to only functions needed to conduct business, utilizing a more complex password policy, and formalizing and testing a disaster recovery plan.

The second audit concerns the implementation of Executive Order No. 111 ("EO 111"), concerning the purchase of energy efficient equipment. EO 111 requires State agencies and public authorities to purchase ENERGY STAR® labeled equipment. Under EO 111 the Authority must adopt guidelines for the purchase of equipment for which ENERGY STAR® ratings were not available. The State Comptroller expects to review the guidelines developed by the Authority under the EO 111 to determine whether the guidelines were clear and effective. The State Comptroller will also review Office of General Services ("OGS") contracts for equipment for compliance with EO 111, as well as a sample of State agency equipment purchases for compliance with the EO 111 and the Authority's guidelines.

Staff had an opening conference meeting with the State Comptroller's staff on March 16, 2006, and will continue to provide the Committee Members with reports in the future on the status of these two new audits.

Mr. Pitkin also informed the Committee Members of a report issued by the State Comptroller in February 2006 regarding procurements by State public authorities and legislation the State Comptroller has introduced which would provide for additional oversight of State public authority procurements by his office. The report noted that the State Comptroller had conducted a number of audits of public authorities through which procurement “abuses” were identified. Unfortunately, the Authority is included in a listing of findings for audits “demonstrating poor quality procurements resulting in waste or inefficiency.” Two findings from the 2004 internal control audit report are used as support for this finding: one finding noted an isolated instance where a payment had been made under a research contract with inadequate supporting documentation for labor and materials costs in accordance with the contract; the other finding concerned inadequate segregation within the Authority between procurement authorization to approve an equipment purchase from the verification of receipt of the equipment.

Finally, Mr. Pitkin provided an update on the State Comptroller’s proposed legislation which would require establishing a procurement policy committee of the Board comprised of independent Members. This committee would be responsible for issuing rules and guidelines for oversight of procurements. The proposed legislation would further require that the Authority’s Procurement Contracts Guidelines, Operative Policy, and Instructions be at least equal to the statutory requirements applicable to State contracts. Under the proposed legislation, the Authority could issue contracts on any non-competitive basis only upon approval of a two-thirds majority of the Members. Finally, the proposed legislation would require the State Comptroller’s approval of any contract for the sale of property, and gives the State Comptroller the discretion to require his review and approval of any Authority contract prior to execution.

In response to an inquiry from Mr. Gottlieb, Mr. Pitkin reported that the SBC audit covered a three-year period involving more than 9000 contracts for an estimated \$400 million. The State Comptroller’s audit lasted 11 months and reviewed 74 contracts, which were selected by the Comptroller on a non-random basis. The majority of the contracts reviewed encumbered funds close to \$1 million. Overall, the State Comptroller has indicated that the Authority has sufficient controls in place. Mr. Gottlieb highlighted the fact that of the contracts reviewed only a small percentage

revealed problems. Mr. Gottlieb suggested that Authority Staff prepare a memorandum for the Members to use to explain the significance of the findings of the audit, using a benefit/cost analysis. The members present agreed with this approach.

Mr. Catell stated that the next item on the agenda was a discussion of the independent audit of the Authority's financial statements for fiscal year 2005-06 by the Authority's independent auditors. Mr. Pitkin reported that the Public Authorities Accountability Act of 2005 requires that the independent auditors report on a timely basis to the Audit and Finance Committee: (1) all critical accounting policies and practices to be used; (2) all alternative treatments of financial information discussed with management, the ramifications of the use of such alternative disclosures or treatment, and the treatment preferred by the independent auditors; and (3) material written communications between the independent auditor and the authority, such as the management letter and management's response or plan of corrective action, material corrections identified, or schedule of unadjusted differences.

At the June 2005 meetings, the Committee Members recommended approval of, and the Members approved a resolution appointing, Lumsden & McCormick as independent auditors of the Authority for the fiscal year ending March 31, 2006, and reviewed the engagement letter setting forth the services to be performed as part of the audit. The auditors expect to start the planning and field work for the audit later this month and will report to the Committee on the results of the audit at the June 2007 meeting. Consistent with the requirements of the Public Authorities Accountability Act of 2005 for timely communication, John Schiavone, the lead audit partner with Lumsden & McCormick, addressed the Committee by videoconference from the Authority's Buffalo office.

Mr. Schiavone explained that the Authority's financial statements are prepared in accordance with U.S. auditing standards and generally accepted accounting principles for government, which require a summary of significant accounting policies to be included in the footnotes to the financial statements. Mr. Schiavone mentioned that during the year, Staff had raised a question regarding its accounting treatment of certain funds received by the Authority in 2004. Both funds had been recorded as deferred revenue by management in a conservative effort to match revenues with

expenditures. Management and the independent auditors concluded that this treatment was not consistent with relevant governmental accounting standards which require that funds received should be recorded as revenue when received, unless there are any unmet eligibility requirements. The standards also require that unexpended funds be reported as restricted net asset funds. As a result, the comparative financial statement amounts for the year ending March 31, 2005, included in the March 31, 2006 financial statements, will be restated to reflect this change.

Staff also consulted with the independent auditors on its accounting treatment of certain infrastructure costs being incurred at the Saratoga Technology + Energy Park (“STEP”) that are expected to be funded in part from grant funds. It was agreed that these assets and revenues will be recorded and reported in the financial statements in accordance with generally accepted accounting principles for government.

The independent audit will begin at the end of April 2006 and will be complete by the middle of May 2006. The auditors plan to issue drafts of the report by the June 2006 Audit and Finance Committee and Board meetings and will issue a final report following the meetings. The audit will follow U.S. auditing standards. Mr. Schiavone reminded the Committee that an audit is not a tool to detect fraud or illegal acts, instead it is a review of the Authority’s controls. The audit will assess and test controls over payroll procedures, procurement procedures and disbursements relating to contracts; review revenues and receivables; review expenditures allocation by program; assess accrued liabilities; review cash and investments; and review financial reporting.

Finally, Mr. Schiavone reviewed the recent enactment of the Public Authorities Accountability Act of 2005. He noted that the amendments merely bring New York State public authorities in line with current auditing standards. The changes mirror practices already in place in the private sector.

Mr. Catell stated that the next agenda item is a report from the Internal Control Officer. Mr. Pitkin, the Authority’s Internal Control Officer, began by updating the Committee on the status of a matter discussed at the January 2006 meeting. It was reported at that meeting that staff had

uncovered some billing irregularities regarding a research and development (“R&D”) program contract for the development and demonstration of kinetic hydro-turbine technology. Staff had recovered \$54,625 for an overhead billing error from the contractor, a joint venture of two companies. Staff was negotiating with the two separate companies and their counsels for recovery of approximately \$132,000 in additional costs billed to and paid by the Authority for which staff had not received appropriate supporting documentation.

Staff negotiated a dispute resolution agreement with the one company that was primarily responsible for overseeing the joint venture. Under the agreement, the joint venture returned \$48,010 to the Authority and it agreed to an offset of \$34,454 which was payable under two other Authority R&D contracts. In addition, the one company withdrew a separate project proposal that had been submitted to the Authority. Staff believes that this resolution satisfies its dispute with this one company and provides for the accountability of program expenditures attributed to its participation in the joint venture. To date, no evidence indicates that the second company was directly involved in over-billing under the joint venture.

With respect to the approximately \$50,000 that is left in dispute, staff believes the funds were used in constructing the hydro-turbine technology and will address this as part of the analysis of determining whether to proceed with the project, whether the cost-sharing requirements should be amended prospectively, whether to terminate the project, or whether to seek other repayment.

Mr. Pitkin then advised the Committee of a new matter. In February 2006, Director of Internal Audit Mark Mitchell received a phone call from an anonymous caller alleging certain improprieties against a R&D program electronics recycler contractor, which is to be developing and commercializing two machines that could be used to reclaim materials from discarded computer equipment. The caller alleged that the contractor may have submitted fictitious invoices, may have inflated test results from the project, and may have inflated its in-kind contributions to the project, among other allegations. Upon receipt of the allegation, Mr. Pitkin met with Mr. Mitchell, involved Program Staff and Staff from Counsel’s Office, the Finance Unit, and Contract Management. This team recommended that the Authority proceed with an audit of the contract. The Authority’s

Associate Contract Auditor has contacted the contractor, requested certain information, and will schedule an on-site review of this information.

Mr. Catell stated the next agenda item concerned a report from the Director of Internal Audit. Mr. Mitchell explained that the audit of the Authority's projects database system is once again underway after being temporarily suspended so that work could be performed on the Authority-wide risk assessment. The risk assessment activities were consistent with the Internal Controls Manual, which requires the use of a risk-based methodology when developing the audit plan. A report of the results will be provided at the June 2006 meeting. No audit reports were issued since the last Audit and Finance Committee meeting.

The Authority is still in the process of developing a formally documented risk assessment. The process used to document the risk assessment required an identification of business functions for each program and department. Each Program Manager was then asked to complete a risk register for each business process. The risk register shows potential or actual threats to the achievement of objectives; impact the Authority and mitigation of the risks. Based upon these risk registers an opinion can be formed as to how much residual amount of risk remains with the existing controls in place.

In order to assist managers with preparing their input, a number of general meetings with the Officers, Program Directors, and Program Managers were conducted by Mr. Mitchell to explain various approaches to completing their risk assessments. In all, more than 130 completed forms have been received by Internal Audit. Currently, the Officers are actively reviewing the completed risk registers to ensure that the assessments were clear, and consistent. The risk profile will then be evaluated by Internal Audit in order to provide independent concurrence, and issue the results in the form of a report in time for the June 2006 meeting.

The risk assessment process being employed should enhance the Authority's ongoing assessment of its business risks. Because it is a more structured and documented approach, it requires a more rigorous analysis and validation at all levels – by the Officers, the Program

Directors, and, independently, by Internal Audit. Once the risk assessment is complete and a commonly accepted view of risks is achieved, then the real work begins – because management at all levels should be better able to compare their risk profiles to their appetite for risks, and make management decisions accordingly.

Included in the Committee packet is an Annual Activities Report that summarizes the nine various reports, reviews, and review activities conducted during the course of the last year. The results of these audit activities were previously discussed with the Members.

Also included is the proposed internal audit plan that was developed consistent with the information obtained from the most recent risk assessment activities. This year's plan places an emphasis on auditing areas of high interest to the Officers – procedures and controls over program operations. After completing the projects database system audit and the audit of Staff's monitoring of contractor overhead rates, a significant amount of time will be devoted to evaluating the Assisted Multifamily Program. This audit will be aimed at obtaining an indication of how well the Authority's program controls are working. Similar reviews are planned for the New Construction Program, and the Photovoltaic Incentives for Eligible Installers Program. Additionally, the plan calls for audits of the Communications unit and an audit of information technology controls, as well as a review of the solicitation process.

Approval of the attached internal audit plan will result in a series of internal audits being conducted during the coming fiscal year. Results will be reported to the Audit and Finance Committee as they are completed.

Whereafter, upon motion duly made and seconded, and by unanimous voice vote of the Committee members present, the following resolution was adopted.

Resolution No. 312

RESOLVED, that the Audit and Finance Committee approves the Internal

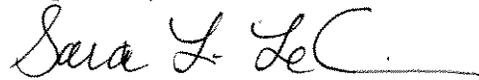
Audit Plan for the Fiscal Year 2006-07, as presented at this meeting, in the form submitted to the Committee (attached as Exhibit I).

Mr. Catell indicated that the last agenda item concerned other business and he called on Vincent DeIorio, the Authority's Chair, to address the Committee. Mr. DeIorio stated that appointing Jay Gottlieb as the Vice-Chair of the Committee is one of the items on the Board meeting agenda. Mr. Gottlieb has been an active member of the Committee, and his insight and advice has been invaluable to the Committee. Mr. DeIorio indicated that Mr. Gottlieb is willing and eager to take on this role. Mr. DeIorio thanked Mr. Gottlieb on behalf of the Committee members for agreeing to serve in this position.

Whereafter upon motion duly made and seconded, and by unanimous voice of the Committee members present, the Audit and Finance Committee recommends that the Members of Authority appoint Mr. Gottlieb as Vice-Chair of the Audit and Finance Committee.

There being no further business, upon motion duly made and seconded, and by unanimous voice vote, the meeting was adjourned.

Respectfully submitted,

A handwritten signature in cursive script that reads "Sara L. LeCain". The signature is written in black ink and is positioned above the printed name.

Sara L. LeCain

Acting Secretary to the Committee