

MINUTES OF THE NINETY-FOURTH MEETING OF THE
AUDIT AND FINANCE COMMITTEE
HELD ON SEPTEMBER 25, 2006

Pursuant to notice and an agenda dated September 15, 2006, a copy of which is annexed hereto, the ninety-fourth (94th) meeting of the Audit and Finance Committee of the NEW YORK STATE ENERGY RESEARCH AND DEVELOPMENT AUTHORITY ("Authority") was convened at 10:30 a.m. on Monday, September 25, 2006, in the Authority's Albany Office at 17 Columbia Circle, Albany, New York, by video conference in the Authority's New York 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:

Jay L. Gottlieb, Vice-Chair (by video conference from New York)

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

George F. Akel

Committee members Catell and Marusak were not present. Also present was Authority Member Parker D. Mathusa.

In addition, Peter R. Smith, President and Chief Executive Officer; Robert G. Callender, Vice President for Programs; Jeffrey J. Pitkin, Treasurer; Roger D. Avent, Esq., General Counsel; Mark B. Mitchell, Director of Internal Audit; Jacquelyn L. Jerry, Esq., Associate Counsel and Secretary to the Audit and Finance Committee; and various staff of the Authority were present.

Since Mr. Catell, Chair of the Audit and Finance Committee, was unable to attend, Mr. Gottlieb, the Committee's Vice-Chair called the meeting to order. Mr. Gottlieb noted the presence of a quorum and indicated that the first item on the agenda concerned the approval of the minutes of the ninety-third meeting of the Committee held on June 26, 2006.

Whereafter, upon motion duly made and seconded, and by unanimous voice vote of the Committee members present, the minutes of the ninety-third meeting of the Committee, held on June 26, 2006, were approved.

Mr. Gottlieb stated that the next item on the agenda was a report on the implementation of Governmental Accounting Standards Board Statement No. 45 ("GASB45"), concerning the accounting and reporting of the employer's share of retiree health insurance. Jeffrey J. Pitkin, the Authority's Treasurer, reported on the implementation of GASB45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, and the actuarial valuation report included in the Committee meeting packet. Mr. Pitkin explained that GASB45 changes the reporting for an employer's share of health insurance benefits provided to retirees by recognizing these costs in the period when the related employment services are rendered, on an accrual basis, rather than on a pay-as-you-go basis when the benefits are paid.

GASB45, which must be implemented for the Authority's fiscal year beginning April 1, 2007, requires that an actuarial valuation be performed every two years. The Authority retained Milliman, Inc. ("Milliman"), an actuary and consulting firm, to perform the first actuarial valuation of health benefit costs.

Health insurance benefits are provided to current employees and retirees through the New York State Health Insurance Program, administered by the New York State Department of Civil Service. For both active employees and retirees, the Authority pays 90% of the health insurance premium costs for single coverage and 75% of the additional premium costs for family coverage, consistent with New York State ("State").

As part of its actuarial valuation for determining future costs, Milliman reviewed census information concerning the Authority's current employees and its retirees and projected the future cost of these benefits, factoring in various assumptions, such as inflation, employee turnover, retirement, and mortality. These projected future costs were then discounted to current dollars using a discount rate reflecting the time value of money. Since the liability is to be recognized over an

employee's total expected employment with the Authority, an Accrued Liability related to past service first had to be calculated for retired and current employees, as of the valuation date (April 1, 2006). This Accrued Liability is to be recognized as an annual expense on a catch-up basis over an amortization period not to exceed 30 years. An additional annual expense is to be recorded for the costs associated with benefits earned in that year by current employees.

The actuarial valuation is dependent on two key assumptions: the inflationary rate assumed for health insurance costs and the discount rate. Authority staff compared Milliman's assumptions with the assumptions being used by the State. Milliman's assumptions were also reviewed with the Authority's independent auditors, who agreed that they were reasonable.

GASB45 does not require that the retiree health insurance costs be pre-funded in a separate trust account, which would segregate the funds from other Authority funds, but it is a possible option. If this option were implemented, a modification to the Authority's Investment Guidelines would be necessary to permit these funds to be invested in longer-term, higher-yield investments to reduce the amount the Authority would have to contribute in the future. At this time, however, staff recommends following the State's lead by not establishing a separate account. This position will be reviewed periodically.

In recording the liabilities, staff recommends the maximum allowed 30-year amortization period permitted and also recommends using a level amortization. This would reduce the impact of the accounting change on the Authority's budget in the first year and reduce fluctuations in the following years.

Based upon all these factors, the Authority's Accrued Liability for health insurance benefits as of April 1, 2006, was calculated at \$23,638,800. Implementation of GASB45 in the fiscal year beginning April 1, 2007, will result in the recording of an accrued expense in the amount of \$3,154,300 in each of the next two fiscal years to account for current employee's and retired employee's past service costs and current employees cost for this fiscal year. The actuarial valuation to be conducted two years from now will be used to determine the amounts to be included in future

years.

Implementation of GASB45 will have a significant impact on the Authority's annual budget. The Authority's Preliminary Spending Plan for FY 2007-08 estimates an increase in annual expenses of about \$2.9 million due to this accounting change. The increase of \$2.9 million is the difference between the Accrued Liability and annual expense determined by the actuarial report and the \$250,000 which was previously recorded on the pay-as-you-go principle.

The cost is to be allocated across all programs as a fringe benefit cost. Approximately \$1.6 million of the \$2.9 million increase will be allocated to the system benefits charge ("SBC") funded programs. The overall SBC program funding approved by the Public Service Commission ("PSC") provided administrative funds in the amount of 7% of total funding; the \$1.6 million allocation of health benefits costs will increase the Authority's administrative costs, as a percent of total funding, in this program by nearly 1%. Staff will work with the Department of Public Service to address this and report back to the Members.

Lastly, approximately \$700,000 of the \$2.9 million increase in expenses will be allocated to programs funded by unrestricted revenues; this will reduce the Authority's balance of unrestricted net assets to less than the Authority's historically maintained \$2 million in working capital. Staff is working with the Division of the Budget to address this issue.

Mr. Pitkin concluded his presentation by stating that the proposed FY 2007-08 Budget, incorporating these proposed changes, will be presented to the Members for their approval at the January 2007 meeting.

In response to an inquiry from Mr. Akel, Mr. Pitkin indicated that, since the State's and most other government entities accounting system is cash based rather than accrual based, these entities are not likely to establish separate accounts for funding health benefit costs.

In response to an inquiry from Mr. Gottlieb, Mr. Pitkin indicated that the level amortization is more conservative, because it records the same budgetary costs each year for health insurance,

while other amortization options would have the costs increase over time as the payroll for then current employees increases. Level payments also minimize budgetary fluctuations.

The Committee members indicated their concurrence with the proposed methodology and assumptions and that the Committee would recommend to the Authority Members that staff implement the changes in the fiscal year beginning April 1, 2007.

Mr. Gottlieb indicated that the next agenda item concerns performance-based, lump sum payments to the Officers and General Counsel and asked Mr. DeIorio, the Authority's Chair, to discuss the item. Mr. DeIorio explained that, historically, in accordance with the Authority's compensation policy, the Chair determined merit increases for the Officers and General Counsel. Recent changes to the Public Authorities Law require that the Members now approve these merit increases. Therefore, Mr. DeIorio recommended that the Committee members adopt a resolution recommending approval of performance-based, lump-sum payments to the Officers and General Counsel in an aggregate amount not to exceed \$36,843. This amount equals 5.75% of the total aggregate salaries for these employees and is consistent with the aggregate percentage payment paid to these individuals last year. The performance-based, lump sum payments are in recognition of the performance of these individuals. These funds have already been included in the 2006-2007 Budget.

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

Resolution No. 319

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 performance-based, lump sum payments to the Authority's President and CEO, Vice President for Programs, Vice President for Administration and Secretary, Treasurer, and General Counsel in an aggregate amount not to exceed \$36,843, as allocated by the Chair in consultation with the President and CEO, payable on or about December 13, 2006.

Mr. Gottlieb then indicated that the next agenda item concerned a report on a recent audit by

the Office of the State Comptroller (“OSC”) concerning implementation of Executive Order No. 111 (“EO 111”). Mr. Pitkin explained that, included in the meeting packet for the Committee member’s review and comment, is a draft response letter to the draft audit report issued by OSC. The draft audit report covered OSC’s audit of a portion of EO 111 pertaining to procurement of energy efficient products. The draft audit report states that the Authority had properly completed its responsibilities under EO 111, and contained no exceptions or recommendations. The draft response letter agrees with, and accepts the results of, the report.

The Committee members indicated their concurrence with the proposed draft response letter. Mr. Gottlieb also commended staff for a job well done.

Mr. Gottlieb then indicated that the next agenda item concerned a report from the Director of Internal Audit, Mark B. Mitchell. Mr. Mitchell reported that, after he had begun to audit the Assisted Multifamily Program, the Authority awarded the implementation contract to a new contractor. Internal discussions concluded that continuing the audit would result in a report of a program that had changed its operating approach and structure and that some of the audit findings might not be applicable to the new approach. Internal Audit will instead review the new program design before it is implemented, in order to analyze the design and provide input. After allowing some time for program implementation, an internal audit of the new program will then be conducted.

An audit of the Authority’s public relations information used by the Communications Division and the Legislative Affairs function for providing information to stakeholders and the press is underway. The results of this audit will be reported at the next Committee meeting.

Also, before the Committee’s next meeting, an audit of the New Construction Program, managed by Energy Efficiency Services, should have begun.

Lastly, Mr. Mitchell mentioned that he and Mr. Pitkin had been serving for more than a year as members of an internal control task force comprised of representatives from the New York State Division of the Budget, OSC, and other State agencies. The Task Force has developed an Internal

Control Act Implementation Guide that describes good practices for internal control officer's and internal audit functions. The guide will be sent to approximately 175 State commissioners, internal control officers, and internal audit directors at more than seventy-five State agencies.

Mr. Gottlieb said that the last item was other business and he asked if there were any other matters the Members wished to discuss. There being none, upon motion duly made and seconded, and by unanimous voice vote, the meeting was adjourned.

Respectfully submitted,



Jacquelyn L. Jerry
Secretary to the Committee