

MINUTES OF THE ONE HUNDRED FOURTH MEETING OF THE  
AUDIT AND FINANCE COMMITTEE  
HELD ON SEPTEMBER 21, 2009

Pursuant to notice and an agenda dated September 14, 2009, a copy of which is annexed hereto, the one hundred fourth (104th) meeting of the Audit and Finance Committee ("Committee") of the NEW YORK STATE ENERGY RESEARCH AND DEVELOPMENT AUTHORITY ("Authority") was convened at 12:30 p.m. on Monday, September 21, 2009, 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, 10<sup>th</sup> floor, New York, New York; by video conference in the Authority's Buffalo Office at 726 Exchange Street, Suite 821, Buffalo, New York; and by webcast.

The following members of the Committee were present in Albany unless otherwise indicated:

Robert B. Catell, Chair

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

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

George F. Akel

David Elliman

In addition, Jeffrey J. Pitkin, Treasurer; Hal Brodie, Esq., General Counsel; Mark B. Mitchell, Director of Internal Audit; Jacquelyn L. Jerry, Esq., Deputy Counsel and Secretary to the Audit and Finance Committee; and various other staff of the Authority were present.

Mr. Catell, Chair of the Committee, called the meeting to order and noted the presence of a quorum. He stated that the meeting notice and agenda were mailed to the Audit and Finance Committee members and press on September 14, 2009.

Mr. Catell then stated that the first item on the agenda concerned the approval of the

minutes of the one hundred third meeting of the Committee held on June 22, 2009.

Whereafter, upon motion duly made and seconded, and by unanimous voice vote of the Committee members present, the minutes of the one hundred third meeting of the Committee, held on June 22, 2009, were approved. Mr. Elliman said that he would abstain from voting since he was not a Member of the Committee on June 22, 2009.

Mr. Catell stated that the next item on the agenda concerned a proposed amendment to Resolution No. 819 and asked Hal Brodie, the Authority's General Counsel to discuss the item. Mr. Brodie reported that previously, the Chair who then served as the chief executive officer of the Authority was authorized under Resolution No. 819 to make Declarations of Intent on behalf of the Authority. A Declaration of Intent preserves the qualification of expenditures for future tax-exempt financing.

The Public Authority Accountability Act ("Act") amended the Authority's enabling statute to redefine the duties of the Chair and the President. Under the Act, the President was designated as the chief executive officer of the Authority. Thus, the proposed amendment to Resolution No. 819 would designate the President and CEO as the person authorized to execute Declarations of Intent, consistent with this statutory change.

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

#### Resolution No. 347

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), amending Resolution No. 819 to name the President and CEO, the chief executive officer, as the person designated and authorized to make declarations of intent on behalf of the Authority.

Mr. Catell stated that the next agenda item concerned two Declarations of Intent. Jeffrey J. Pitkin, the Authority's Treasurer, explained that the Committee is requested to recommend approval of the issuance of a Declaration of Intent on behalf of National Grid Generation LLC of up to \$200 million in tax-exempt debt for an Electric Project; and a Declaration of Intent on behalf of National Grid NY of up to \$500 million in tax-exempt debt for a Gas Project.

Official action, such as a Declaration of Intent, generally must take place no later than 60 days following the incurrence of an expenditure in order to preserve eligibility for later tax-exempt financing. While adoption of the Declaration of Intent represents a current intent to finance the Projects for Internal Revenue Code purposes, it does not constitute a commitment to finance. An allocation of Private Activity Bond Ceiling ("State Cap") would be needed for any subsequent financing under the Declarations of Intent, and financing documents would have to be prepared and approved by the Members before any bonds could be issued.

The Electric Project would consist of facilities for the local furnishing of electric energy constructed during National Grid Generation LLC's fiscal years 2011-13 and located within Suffolk and Nassau Counties as part of the company's electric production system.

The Gas Project would consist of facilities for the local furnishing of gas constructed during National Grid NY's fiscal years 2010-12 and located within The City of New York as part of the company's gas distribution system.

Interest cost savings would accrue to the respective companies' ratepayers.

Whereafter, upon motion duly made and seconded, and by voice vote of the Members present, except Mr. Catell, the following resolution was adopted. Mr. Catell recused himself.

#### Resolution No. 348

RESOLVED, that the Audit and Finance Committee recommends that the Members of the Authority adopt a resolution approving execution of a Declaration of

Intent on behalf of National Grid Generation LLC, substantially in the form submitted to the Committee (attached as Exhibit B).

Whereafter, upon motion duly made and seconded, and by voice vote of the Members present, except Mr. Catell, the following resolution was adopted. Mr. Catell recused himself.

Resolution No. 349

RESOLVED, that the Audit and Finance Committee recommends that the Members of the Authority adopt a resolution approving execution of a Declaration of Intent on behalf of National Grid NY, substantially in the form submitted to the Committee (attached as Exhibit C).

Mr. Catell said that the next agenda item concerned the appointment of Bond Counsel to the Authority. Mr. Brodie reported that the Members are requested to approve the appointment of Hawkins Delafield & Wood LLP (“Hawkins”) as Bond Counsel to the Authority. Under the Authority’s Financial Services Guidelines (“Guidelines”), the Authority is required to issue a request for proposals (“RFP”) for bond counsel services every 5 years. In accordance with the Guidelines, the Authority issued a solicitation for bond counsel services in June 2009. A Technical Evaluation Panel, comprised of staff from the legal department and the finance unit, met to review the 12 proposals received in response to the RFP and recommended that Hawkins be appointed as the Authority’s Bond Counsel.

Bond Counsel is responsible for advising and assisting in the implementation of the Authority’s financing program. In addition, Bond Counsel provides guidance and support with respect to general financial matters relating to the Authority.

In accordance with past practice, the Authority does not pay for Bond Counsel services performed in connection with conduit issues. Instead, the utility or other entity on whose behalf the bonds are issued will be responsible for the costs of issuing the bonds. Therefore, no funds are currently budgeted for these services.

If approved, staff will enter into a letter agreement with Hawkins to serve as Bond Counsel for the period January 1, 2010, through December 31, 2014.

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

Resolution No. 350

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 D) appointing Hawkins Delafield & Wood LLP as Bond Counsel.

Mr. Catell stated that the next agenda item was a report on the implementation of Governmental Accounting Standards Board Statement No. 45 (“GASB 45”). Mr. Pitkin reported that GASB 45 requires the Authority to recognize retiree health insurance costs in the period when the related employment services are rendered, on an accrual basis, rather than when the costs are paid. At the June 2009 meeting, the Committee discussed establishing a segregated trust account to hold assets and then to use the earnings from those assets to reduce the Authority’s annual contribution necessary to meet its obligations. The Committee directed staff to look into establishing a trust account.

The Authority has engaged a consultant, Milliman, Inc. (“Milliman”), to assist in establishing a trust account, developing an investment strategy for trust assets, and implementing ongoing investment monitoring processes. Milliman has provided initial draft documents for accomplishing these objectives, which staff is currently reviewing. Milliman has also prepared investment return projections using a simulation of different asset allocation scenarios.

In addition, Authority staff have had discussions with staff from the New York State Department of Taxation and Finance (“Tax and Finance”), the Authority’s statutory fiscal agent, on serving as trustee, as well as in a depository capacity.

Staff expects to complete the investment policy analysis, review of draft documents, and discussions with Tax and Finance over the next few weeks. Staff anticipates recommending a complete implementation strategy to the Committee at the January 2010 meeting.

In response to an inquiry from Mr. Elliman, Mr. Pitkin explained that the Authority's contributions to the trust account would be made in proportion to the Authority's salary costs. The Authority has already accounted for these costs. However, the costs amount to .8 of 1% of the total administrative costs for SBC, making it more difficult for the Authority to meet the cap of 7% of the total SBC funding for administrative costs. The Authority has thus far not approached the New York State Public Service Commission to discuss increasing the administrative set aside and has been able to absorb the GASB 45 costs.

The Authority has reported these funds with respect to its accrual accounts but has not detailed the funds with respect to the cash accounts. Mr. Pitkin explained that staff recommends transferring all GASB 45 funds to the trust account, once it is established.

The Chair stated that the objective of the trust account is to protect the funds. In establishing the account, the Authority will need to review its Investment Guidelines to ensure that the account meets the Authority's established requirements. If Tax and Finance concludes that it is precluded from serving as the trustee for the trust account, the Authority will need to obtain the services of a trustee, an account custodian, and an investment manager to provide assistance. Mr. Brodie concluded by adding that the Authority's enabling statute provides authority for Tax and Finance to invest funds upon the direction of the Authority, and staff has pointed this out to Tax and Finance.

Mr. Catell stated that the next item on the agenda was a report on an audit of System Benefits Charge ("SBC") achievements by the Office of the State Comptroller ("OSC"). Mr. Pitkin reported that OSC issued an audit report regarding the Authority's achievement of results in SBC-funded programs and the Authority's response. The audit found that achievements and

performance measures in SBC programs are well-documented and based upon data verified by independent program evaluators. The audit also found that the reporting of SBC program goals and achievements had improved over time to enable users to assess program results, and that Authority management is actively monitoring SBC program progress.

Mr. Pitkin concluded this presentation by explaining that the audit report includes minor recommendations for improving the accuracy of reported achievements, which management has agreed to implement.

Mr. Catell said that next on the agenda was an update on the Authority's financing program. Mr. Pitkin explained that, in April 2009, at the request of Energy East Corporation ("Energy East"), the Members adopted a resolution authorizing the issuance of Authority bonds in a term interest rate for a period in excess of 13 months, without also requiring that a liquidity facility be in place. Due to the limited availability of, and current high costs associated with, obtaining credit and liquidity support, the resolution adopted by the Members authorized all utilities to convert to this term interest rate mode.

Thereafter, consistent with the resolution and as requested by Energy East, amendments were made to the underlying documents with respect to a \$10.5 million series of bonds issued on behalf of Rochester Gas and Electric Corporation ("RG&E"). On August 5, 2009, RG&E converted these bonds to a term interest rate for a period in excess of 13 months for the period August 5, 2009, through July 1, 2016.

With respect to a series of bonds issued on behalf of RG&E in 1997, it was necessary that approval from the Public Authorities Control Board ("PACB") also be obtained. In May 2009, the PACB authorized the changes and, thereafter, amendments were made to the underlying documents consistent with the Authority's resolution and the PACB's approval. Thereafter, on August 5, 2009, RG&E converted an additional \$33.9 million in bonds to a term interest rate for a period in excess of 13 months for the period August 5, 2009, through July 31, 2016.

With respect to both series of bonds, at the end of the term rate period, a new term interest rate may be set or RG&E may convert the bonds to bear interest at a different interest rate, based on then current market conditions.

In response to an inquiry from Mr. Elliman, Mr. Pitkin indicated that at the time of conversion of the bonds, the auction interest rate was lower than the term interest rate. However, RG&E was participating in the auctions and therefore the bonds were not being marketed to investors and RG&E was not benefiting from their tax-exempt status. Thus, the conversion of the bonds allowed the bonds to be remarketed in the tax-exempt market.

Next, Mr. Catell asked Mark Mitchell, the Authority's Director of Internal Audit, to provide the Committee with a report on his recent activities. Mr. Mitchell explained that in July 2009, he performed a benchmark comparison of the Authority's internal audit resources to those of similar-sized organizations both in State government and in the private sector. The results of the benchmarking were discussed with management and, as a result of those discussions, Internal Audit resources were increased. Margaret Elvin, the Authority's Contract Auditor, has recently been reassigned to Internal Audit. Additionally, a staff person who supports the Authority's executive staff has been assigned to provide Internal Audit with administrative support on a part-time basis. The revised 2009-2010 budget includes funds for one additional internal auditor position. Moreover, Internal Audit resources were increased in the two previous years when KPMG LLP ("KPMG") was selected to conduct a series of information technology ("IT") internal audits, coinciding with the implementation of the NYSERDA Enterprise Information System ("NEIS"). Now that NEIS has been implemented and the Authority is operating in a more complex and challenging IT environment, it is appropriate, and required by internal auditing standards, that the Authority conduct an evaluation of the adequacy and effectiveness of controls dealing with information systems' risks. There are two approaches that are common for this type of review. The first approach is to hire an Internal Audit staff member that has IT knowledge and skills. The other approach is to hire outside resources possessing those attributes. Either approach is consistent with internal auditing guidance and standards.

In addition, this year's internal audit plan calls for a post implementation review of the network, operating system, database, and application security policies, procedures, and associated security design, and in some cases, specific system configurations. In order to conduct these and similar reviews that are IT-related, Mr. Mitchell said that he will need additional resources. Furthermore, until NEIS has been operational for a period of time, Mr. Mitchell suggested that the Authority continue to conduct one or two audits a year at specific points in time, using an external auditing firm. Once staff has become more comfortable with NEIS, Mr. Mitchell will update the Committee on the need for additional Internal Audit resources.

Mr. Mitchell proposed implementing this approach by issuing a request for proposals for post implementation and other internal auditing services, and then to assign specific responsibilities on a task work order basis. The term of the contract would be for a five-year period. The budget for this approach will be developed at the end of this fiscal year, when a formal IT risk assessment and IT audit plan will be developed.

Mr. Elliman commented that the Committee should have the opportunity to review the cost of external auditing services. Mr. Catell concurred with this suggestion and stated that this was a prudent method for obtaining additional auditing resources. Mr. Akel suggested that the Committee review this approach in a couple of years and weigh the benefits of procuring outside assistance versus hiring additional staff.

In response to an inquiry from Mr. Elliman, Mr. Mitchell stated that there are a number of audit firms with specialized IT audit credentials and that the solicitation would be marketed to those firms.

The Committee concurred with Mr. Mitchell's proposal.

Next, Mr. Mitchell explained that, at the June 2009 Committee Meeting, he reported that a number of draft audit reports relating to various aspects of IT had been provided to management for their initial review and comment. Since then, management has reviewed all nine reports and

raised a number of questions and requests for clarification, which resulted in further editing before the reports were recently finalized. Management now has the final reports and is in the process of writing a formal response to the audits.

Then, Mr. Mitchell provided the Committee with an update on the audit of the Home Performance with ENERGY STAR<sup>®</sup> Program (“Home Performance Program”) performed by Margaret Elvin. During the twelve-month period covered by the audit, the Authority paid more than \$5 million in SBC incentives. Payments were made to homeowners for eligible energy-efficiency home improvements and to approximately 160 participating contractors. Each payment went through a review and approval process, and that payment process was the subject of the audit.

The audit found that Conservation Services Group (“CSG”), the program implementer, and two other program partners, HVCC and BPI, appear to be fulfilling their payment processing responsibilities. Their verification processes appear to be working as intended to ensure claimants meet the Home Performance Program eligibility guidelines; to ensure incentive claims are substantiated by appropriate documentation and accurately calculated; and, except for a small number of incentives relating to certification tests, to ensure that claims are properly coordinated with the Authority. Overall, the processing systems were found to be effective. The audit report provided seven recommendations for minor improvements to communications that, if implemented, would further improve the Home Performance Program.

Next, Mr. Mitchell reported that he was asked to co-chair a sub-committee designated to develop and publish a risk assessment tool that would be made available to State agencies and public authorities. The sub-committee is a subgroup of New York’s Recovery Act Internal Controls and Fraud Working Group, whose activities are performed on behalf of Governor Paterson’s New York State Economic Recovery and Reinvestment Cabinet.

Working in collaboration with representatives from the New York State Department of Transportation and OSC, a risk assessment template and guidance was developed and posted on

the internet in early September 2009. The guidance is to assist State agencies and public authorities to identify, document, and prioritize risks associated with program activities required in order to achieve the objectives associated with American Recovery and Reinvestment Act of 2009 (“ARRA”) funding.

Although the sub-committee work interrupted Mr. Mitchell’s internal audit activity as originally scheduled, he said that it should not interfere with his completion of the audits contained in this year’s internal audit plan.

With respect to the internal audit plan, Mr. Mitchell reported that he is continuing to conduct work on the audits of the Flexible Technical Assistance Program in Energy Efficiency Services and the Multifamily Performance Program in the Residential Energy Affordability Program. The Authority’s Vice President for Programs, Robert Callender, has been provided with an interim report regarding the design of each program. The fieldwork for both audits is expected to be completed in the next several weeks, and Mr. Mitchell plans to issue audit reports in October 2009 and mid-November 2009, respectively. Once the audits are complete, Mr. Mitchell said he will begin an audit of the Main Tier Renewable Portfolio Standard Program, which he plans to complete by the end of the year.

Mr. Mitchell then reported that management has requested that the benefits administration review be postponed until next year, when the benefits administrator returns from maternity leave. Instead, Mr. Mitchell will conduct an audit of the travel and purchase expenditures processed in the Authority’s expense reimbursement system. The audit will assess whether expenditures are properly supported, and in compliance with the Authority’s policies and procedures. The audit work is planned to begin in mid-November 2009 and will be completed by the end of the year.

Next, Mr. Pitkin provided the Committee with an update on the implementation of NEIS, the Authority’s new financial management system. Implementation of NEIS had led to a delay in contracting and payment processes. However, payment processes have returned to more normal

processing timeframes and management is reviewing reports on the status of contracting activities. Overall, staff is working diligently to adapt to the new system.

The NEIS implementation team continues to meet weekly to identify and prioritize issues for resolution. To assist in this effort, the Authority has also retained staff from the NEIS implementation contractor for post implementation support, as well as a minority-owned service provider with system integration expertise. Staff is continuing efforts to fill a functional system analyst position, which is critical to effectively assist system users. This person will also serve as a liaison between functional users and the IT department.

Staff is still experiencing difficulties with a component of NEIS that permits the electronic submission of proposals and applications by program participants. Due to potential security vulnerabilities, the Authority has not been able to implement this function. Staff has been working with the Authority's IT security consultant, the NEIS implementation contractor, the New York State Information Security Office ("CSCIC"), and the NEIS software vendor in an effort to eliminate these vulnerabilities.

Mr. Pitkin also reported that staff is conducting backups of the system on a daily basis and storing this information off-site to provide for disaster recovery. However, installation of computer servers at an off-site disaster recovery location has not yet been completed.

Lastly, Mr. Pitkin explained that it is not unusual for an organization to take up to a year to attain full functionality for a system of this magnitude. Staff and management are focused on managing the transition.

In response to an inquiry from Mr. Catell, Mr. Pitkin indicated that the Authority is still receiving support from the NEIS implementation contractor. The contract was a fixed price contract, and final payment has not yet been made, pending resolution of the identified vulnerabilities. It is still unclear whether the vulnerabilities are related to the Authority's system as implemented or to the underlying system's software.

In response to an inquiry from Mr. Akel, Mr. Pitkin explained that the potential vulnerabilities were identified initially by KPMG and later were confirmed by CSCIC when they tested the security of the system at the Authority's request.

Mr. Mitchell explained that he would be conducting a post implementation review to confirm that appropriate application controls and security, as well as IT general controls, have been established in NEIS. The review is intended to serve as a follow-up audit to the recent round of IT audits, but it will also be the first time that the controls in the NEIS operating environment are assessed. Since staff is still in the process of working out performance issues in NEIS, Mr. Mitchell suggested postponing the review of IT controls described in this year's audit plan, until NEIS has been in operation for a full year.

The internal audit plan also calls for a comprehensive business risk assessment of the Authority, including an IT risk assessment. Internal auditing standards state that the Authority's ethics-related objectives, programs, and activities, as well as its IT governance must be evaluated by Internal Audit. Therefore, Mr. Mitchell will assess these items during the comprehensive business risk assessment.

However, in order to conduct the IT risk assessment and evaluate IT governance, Mr. Mitchell said he will need to solicit the assistance of an IT audit expert. Mr. Mitchell estimates this expenditure will total approximately \$24,000.

Lastly, Mr. Mitchell indicated that he will also need to procure the services of an individual to conduct a quality assurance review of the Authority's Internal Audit activities as required by internal auditing standards. The cost for these services is not anticipated to exceed \$20,000.

In response to an inquiry from Mr. Elliman, Mr. Mitchell responded that the hiring of the quality assurance auditor would not be a conflict and is similar to management procuring the

services of an independent auditor to review the Authority's financial statements. Mr. Pitkin stated that the Members would be provided with a copy of the final audit report.

Mr. Catell said that the last item was other business and he asked Mr. Pitkin to discuss unrestricted net assets. Mr. Pitkin reported that, at the September 2009, Program Planning Committee ("PPC") meeting, the PPC asked that staff provide an analysis to support its rationale for suggesting that a \$2 million balance of unrestricted net assets would provide a minimally acceptable reserve balance. In accordance with this request, staff reviewed financial reports for several other public authorities.

In general, the level of unrestricted funds maintained by other public authorities was considerably larger, as a percentage of annual expenditures, than the Authority's Fiscal Year 2009-10 budget and the proposed Fiscal Year 2010-11 budget, which is approximately .2%. However, staff has not yet obtained information on the rationale used by other public authorities in determining their unrestricted fund balances. Some of these public authorities have significantly larger assets than the Authority, which could require higher levels of reserves.

Historically, the Authority's level of unrestricted funds has been based on amounts necessary to meet obligations at the Western New York Nuclear Service Center ("West Valley") and to provide general working capital. In the past, issues at West Valley have required immediate response by the Authority. Each of these issues resulted in expenditures of several hundreds of thousands of dollars.

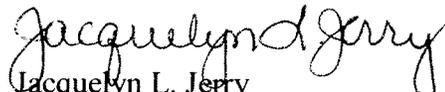
In addition to West Valley, the Authority also requires working capital to meet obligations at the Saratoga Technology + Energy Park, as well as costs related to the Columbia Circle building and equipment. It is reasonable to assume that in any given year, these costs could require several hundred thousands of dollars to meet unanticipated needs.

Mr. Pitkin concluded the discussion by explaining that in 2008, like many public authorities, the Authority's assessment for the New York State Cost Recovery fee was increased

by approximately \$2 million. This unanticipated increase resulted in approximately \$400,000 of additional unrestricted funds having to be used to pay this increased cost. Therefore, volatility in the annual assessment could adversely affect working capital needs. Stall will continue to discuss this matter with the New York State Division of the Budget.

Mr. Catell 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

**NOTICE OF MEETING AND AGENDA**

September 14, 2009

TO THE MEMBERS OF THE AUDIT AND FINANCE COMMITTEE:

PLEASE TAKE NOTICE that the one hundred fourth (104<sup>th</sup>) meeting of the AUDIT AND FINANCE COMMITTEE of the New York State Energy Research and Development Authority will be held 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, 10<sup>th</sup> Floor, New York, New York, by video conference in the Authority's Buffalo Office at 726 Exchange Street, Suite 821, Buffalo, New York, and by webcast, on Monday, September 21, 2009, commencing at 12:30 p.m., for the following purposes:

1. To consider the Minutes of the 103<sup>rd</sup> meeting held on June 12, 2009.
2. To consider and act upon a resolution amending Resolution No. 819, to substitute the title of President and CEO, as the person authorized to make Declarations of Intent on behalf of the Authority.
3. To consider and act upon Declarations of Intent on behalf of National Grid Generation LLC and National Grid NY to finance facilities for the local furnishing of electric energy and gas, respectively.
4. To consider and act upon the appointment of Bond Counsel to the Authority.
5. To receive a status report on implementation of Governmental Accounting Standards Board ("GASB") Statement No. 45, Accounting for Post-Employment Health Insurance Benefits.
6. To receive a report on an audit of System Benefits Charge achievements by the Office of the State Comptroller.
7. To receive a report on the Authority's financing program.
8. To receive a status report from the Director of Internal Audit.

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**Main Office**  
**Albany**  
17 Columbia Circle  
Albany, NY 12203-6399  
Toll Free: 1 (866) NYSERDA  
Phone: (518) 862-1090  
Fax: (518) 862-1091

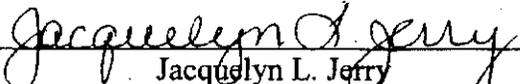
**West Valley Site**  
**Management Program**  
10282 Rock Springs Road  
West Valley, NY 14171-9799  
Phone: (716) 942-9960  
Fax: (716) 942-9961

**New York City**  
485 Seventh Ave., Suite 1006  
New York, NY 10018  
Phone: (212) 971-5342  
Fax: (212) 971-5349

**Buffalo**  
Larkin at Exchange Building  
726 Exchange Street, Suite 821  
Buffalo, New York 14210  
Phone: (716) 842-1522  
Fax: (716) 842-0156

9. To transact such other business as may properly come before the meeting.

Members of the public may attend the meeting at any of the above locations. The meeting is also available through webcast at <http://www.nyserda.org/governancemeetings.asp>.

  
Jacquelyn L. Jeffry  
Secretary to the Audit and Finance Committee