

MINUTES OF THE ONE HUNDRED SIXTH MEETING OF THE  
AUDIT AND FINANCE COMMITTEE  
HELD ON APRIL 12, 2010

Pursuant to notice dated April 2, 2010, the one hundred sixth (106<sup>th</sup>) meeting of the Audit and Finance Committee ("Committee") of the New York State Energy Research and Development Authority ("Authority") was commenced in the Authority's New York City Office at 485 Seventh Avenue, 10<sup>th</sup> floor, New York, New York, and by video conference in the Authority's Albany Office at 17 Columbia Circle, Albany, New York, and by video conference in the Authority's Buffalo Office at 726 Exchange Street, Suite 821, Buffalo, New York, on Monday, April 12, 2010, at 10:00 a.m.

The following members of the Committee were present in New York City, unless otherwise indicated:

Robert B. Catell, Chair

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

Jay L. Gottlieb, Vice-Chair

George F. Akel, Jr. (*by video conference from Albany*)

David D. Elliman

Also present in either New York City or Albany were Authority Member Elizabeth W. Thorndike, Ph.D.; Francis J. Murray, Jr., President and CEO; Robert G. Callender, Vice President for Operations and Energy Services; Janet Joseph, Vice President for Technology and Strategic Planning; Jeffrey J. Pitkin, Treasurer; Hal Brodie, Esq., General Counsel; Jacquelyn L. Jerry, Esq., Deputy Counsel and Secretary to the Audit and Finance Committee; Mark B. Mitchell, Director of Internal Audit; John V. Connorton, Jr., Esq., and Nicole Stallworth, Esq., from Hawkins Delafield & Wood, LLP; Carlos Desmasa and Dominick Setari, from Duncan Williams; and various other staff of the Authority. Present in Buffalo were Donna Gonser and Mary Young, from Lumsden and McCormick, and staff from the Authority.

Mr. Catell called the meeting to order and noted the presence of a quorum. The first item on the agenda concerned the approval of the minutes of the one hundred fifth (105<sup>th</sup>) meeting of the Committee held on January 25, 2010.

Whereafter, upon motion duly made and seconded, and by unanimous voice vote of the Committee members, the minutes of the one hundred fifth (105<sup>th</sup>) meeting of the Committee held on January 25, 2010, were approved.

Mr. Catell said that the next item on the agenda concerned a resolution authorizing amendments to bond documents with respect to rating requirements. Jeffrey J. Pitkin, the Authority's Treasurer, explained that historically, the Authority has required that bonds achieve an "A" rating both at the time of issuance and at any time they are converted to a different interest rate mode and remarketed. A letter of credit or comparable liquidity facility from a bank rated at least "A" was also required with respect to bonds having a "put" feature.

Generally, the purpose of these requirements was to reduce the investment risk to bondholders, and by having a liquidity facility (e.g., letter of credit) in place, ensure that funds would be available to purchase bonds from bondholders at the time of any "put".

When the requirements were imposed, letters of credit and highly-rated insurance policies were widely available at reasonable costs, and obtaining a support facility resulted in a higher rating, and a generally lower interest rate and interest cost savings to ratepayers.

Currently, there are few highly-rated municipal bond insurance companies offering insurance and few banks offering letters of credit and, when they are available, the costs have increased substantially.

In 2002, the Members approved the conversion of bonds bearing a Term Rate in excess of 13 months, without requiring a liquidity facility, and since then the Authority has been making this change in bond documents when requested by a utility. The Public Authorities Control Board ("PACB") has also approved this change in the past. New York State Electric & Gas Corporation ("NYSEG") has requested the change with respect to three series of bonds issued in

1994 ("Bonds"). Even with this change, however, conversion to a term rate or a fixed rate may not be possible without also waiving the requirement that the Bonds achieve an "A" rating at the time of conversion.

NYSEG believes that interest rates may increase over the next few years as the economy recovers. NYSEG is considering converting the Bonds from a weekly interest rate to a term rate or a fixed rate. Without insurance or a letter of credit, the Bonds will likely be rated based on NYSEG's BBB+ rating by Standard and Poor's Financial Services, LLC. By removing the requirement that an "A" rating be achieved at conversion, NYSEG would be able to lock in current, low interest rates for a longer period of time, and remarket the Bonds at the term rate or fixed rate, based upon the best financial interests of the company at the time of conversion. NYSEG's expectation is that locking in rates now will result in lower overall interest costs to ratepayers over the next three years and possibly longer if it converts to a fixed rate.

One series of the Bonds is currently insured by an Ambac Assurance Corporation insurance policy and NYSEG advised that the insurance policy will be cancelled, as authorized by the Members in 2008, and based upon the advice of its remarketing agents.

NYSEG also advises that, though a firm commitment has not been made, it is currently in negotiations with one insurance company that may agree to provide credit support. NYSEG indicates that, at the time the decision is made, if insurance is projected to result in overall lower interest costs, it will proceed with insurance. Staff is recommending approval of the change in rating requirements for conversions completed in the next one-year period, after which a reassessment of market conditions would be required.

The proposed changes have also been discussed with the staff at the Department of Public Service ("DPS") and DPS staff has indicated their concurrence.

In response to an inquiry from Mr. Gottlieb, Mr. Pitkin indicated that allowing the conversion of bonds with a lower rating may increase the pool of investors interested in acquiring the bonds. Mr. Elliman added that the bondholder would receive a slightly higher interest rate.

In response to an inquiry from Mr. Catell, the Authority's Bond Counsel John V. Connorton, Jr., Esq., from Hawkins Delafield & Wood, LLP, explained that there is a risk, but that the Bonds will remain investment grade and this would be disclosed in the offering documents.

The Chair reminded the Committee that the resolution included a sunset provision, and the Committee will be given an opportunity to review this change in one year.

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

#### Resolution No. 356

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), authorizing amendments to bond documents relating to rating requirements.

Mr. Catell said that the next item on the agenda concerned the independent audit of the Authority's financial statements for fiscal year 2009-10. Mr. Pitkin stated that, pursuant to Section 2802 of the Public Authorities Law, the Authority's independent auditor is required to report to the Committee on a timely basis: all critical accounting policies and practices to be used in conducting the independent audit; all alternative treatments of financial information within generally accepted accounting principles that have been discussed with management; and other material written communications between the auditors and management. Consistent with these requirements, Donna Gonser, Audit Engagement Partner, and Mary Young, also from Lumsden & McCormick, addressed the Committee.

Ms. Gonser discussed the timeline and the focus of the audit, and gave a detailed description of the accounting standards to be used. The independent audit will begin at the end of April 2010 and will be completed by the middle of May 2010. The audit will follow both Generally Accepted Auditing Standards, and Governmental Auditing Standards, which are promulgated by the Comptroller General of the United States. The audit will assess and test

controls over investments, payroll procedures, procurement procedures, and disbursements relating to contracts; review revenues, receivables, and expenditures allocation by program; assess accrued liabilities; review cash and investments; and review financial reporting.

Mr. Catell then called upon Mark B. Mitchell, Director of Internal Audit, to provide the Committee with a report on his recent activities. Mr. Mitchell reported on the Multifamily Building Performance Program ("Multifamily Program"). Mr. Mitchell reminded the Committee members that at the January 2010 Committee meeting it was stated that the audit was complete and that management had requested that they be allowed an opportunity to first discuss the results with DPS, prior to the report being finalized.

The Multifamily Program has a budget of \$140.7 million in system benefits charge ("SBC") funding, which was intended to fund the Multifamily Program through June 2011. In October 2009, Mr. Mitchell was asked to review the financial records of the Multifamily Program to determine how much funding the Authority had committed and to determine whether the Authority had exceeded the budget for the Multifamily Program. As of November 2009, the Multifamily Program was found to be overcommitted by \$7.4 million, and an additional \$13.8 million was in the process of being encumbered through the execution of agreements. Subsequently, Multifamily Program staff and Authority management have worked together to reassign projects, disencumber monies, and terminate projects whose funding had not yet been encumbered.

Robert G. Callender, the Authority's Vice President for Operations and Energy Services, explained that the Multifamily Program historically has had a high attrition rate. However, staff will be closely monitoring projects to determine their progress and whether projects are meeting the Multifamily Program deadlines.

Mr. Pitkin added that the Multifamily Program is an open enrollment program, thus participation varies based upon housing market trends.

In response to an inquiry from Mr. Elliman, Mr. Pitkin explained that the Multifamily Program issues incentives in two phases. The first incentive covers the cost of the energy audit

that is completed to determine which eligible measures are appropriate for the structure. The second incentive is used to defray the costs identified in the initial energy audit. In order to better manage funds, staff will issue the first incentive and include an estimate of the second incentive. This will provide staff with a more accurate accounting of available Multifamily Program funds.

Francis J. Murray, Jr., the Authority's President and CEO, added that staff will also be including specific project deadlines. If a deadline is not met, the project may be terminated and the funds would be returned to the available incentive pool.

Mr. Elliman suggested that the Committee receive a regular report on the status of the Authority's open enrollment programs.

In response to an inquiry from Mr. Gottlieb, Mr. Callendar indicated that the Multifamily Program typically experiences a 40% drop-out rate. Mr. Pitkin added that the Authority overcommitted funds after taking into consideration the high rate of attrition, fully expecting that many of the projects would not be completed.

In response to an inquiry from Chair DeLorio, Mr. Pitkin explained that, in the event the Multifamily Program receives applications for funds that are not available in the future, staff will place the applications on a waiting list.

In response to an inquiry from Mr. Elliman, Mr. Pitkin concluded discussions on this topic by stating that if the Multifamily Program does not have the funding to fulfill all of its current contractual obligations, the Authority would seek to use uncommitted SBC funds from other Authority programs to fund any remaining projects, in consultation with DPS staff.

Mr. Mitchell continued his report and recommended four sets of corrective measures to prevent future funds from being overcommitted. First, the Authority should document budgetary control policies in order to reinforce the expectation that program management is accountable for adhering to their budgets. The Authority's Operations and Procedures Manual should be updated to provide additional guidance on when and how pre-encumbrances are entered into

NYSERDA's Enterprise Information System ("NEIS"). It should also provide a description of when encumbrances are recorded and disencumbered.

The second recommendation is that the Authority should ensure that complete, reliable financial pre-encumbrance and encumbrance information is captured in NEIS in a timely manner. This can be achieved by developing at the program level clear, written practices and procedures that describe when and how pre-encumbrances should be entered into NEIS by program staff.

Third, the audit recommended that the Authority ensure contractual obligations are being effectively managed at the program level. This could be accomplished by having Program Managers review the project management operating structure for their individual programs to ensure that all outstanding contractual obligations are being effectively managed.

Fourth, the audit recommended that each Program Manager should be provided with a monthly report that details whether or not the program is meeting its financial obligations. This could be accomplished by amending the monthly Program Financial Status Reports that are issued monthly by the Authority's Finance Department. Mr. Mitchell concluded this discussion by stating that management is in agreement with the recommendations provided in the audit report.

Next, Mr. Mitchell provided the Committee with an update on his ongoing audit activities. At management's request, Internal Audit conducted some testing of the "Great American Appliance Swap Out" Program ("Appliance Program") that was funded under the American Recovery and Reinvestment Act ("ARRA"). The Appliance Program provides the public with rebates for replacing certain old appliances with new, energy efficient appliances. The scope of the audit was limited to testing a sample of initial rebate payments processed by the Authority's program implementer in order to confirm that the Appliance Program's eligibility requirements were being met and to evaluate internal controls over the expenditures. The fieldwork on this audit is complete and the audit report is being written. The Committee will be provided with the final audit report at the June 2010 Committee meeting.

Another audit, which was not on the Internal Audit Plan for Fiscal Year 2009-10 ("2009-10 Audit Plan"), was started by the Authority's Contract Auditor just before being merged with Internal Audit. It is a contract audit of the Authority's agreement with Conservation Services Group ("CSG") to assist in the implementation of the Home Performance with Energy Star® Program ("Home Performance Program"). The purpose of the audit is to assess CSG's compliance with the terms and conditions of the agreement, specifically whether CSG is invoicing the Authority appropriately for its direct-labor costs, indirect rates, and travel expenses. The fieldwork is just about complete, but certain issues need to be addressed with CSG before the report can be written. The Committee will be provided with the final audit report at the September 2010 Committee meeting.

Next, Mr. Mitchell reported that he is in the process of completing the audit of the Flex Tech Program. He has provided the Authority's Vice President for Operations and Energy Services with oral reports and is in the process of completing the written report. The results of the audit will be shared with the Committee at the June 2010 Committee meeting.

In addition, Internal Audit is in the process of completing two risk assessments. The first is an assessment of the Authority's information technology ("IT") risks. The second is a business risk assessment. As part of that latter process, Mr. Mitchell has met with the Committee Members and other Board Members in order to obtain their input about the Authority's business risks. Mr. Mitchell is still meeting with Authority management and staff, and will be able to report on the results of the risk assessments at the June 2010 Committee meeting.

Mr. Mitchell then provided the Committee with an overview of upcoming Internal Audit activities. The IT and business risk assessments will provide input into the development of the Internal Audit Plan for Fiscal Year 2010-11 ("2010-11 Audit Plan"), which will be brought to the Committee for review and approval at the June 2010 .

Mr. Mitchell concluded his report by stating that a quality assurance review ("QAR") of Internal Audit will also be conducted. The QAR will be started once the IT and business risk assessments are completed. Based upon guidance from the Institute of Internal Auditors, it

should take approximately six or seven weeks to adequately prepare for the QAR. The time needed for the preparation and completion of the QAR will be reflected in the 2010-11 Audit Plan.

Next, Mr. Catell asked Mr. Mitchell to discuss the 2009-10 Annual Internal Audit Report ("2009-10 IA Report"). Mr. Mitchell explained that the 2009-10 Audit Plan was reviewed and approved by the Committee at its April 27, 2009 meeting. During 2009-10, the Authority's management was provided with twelve Internal Audit reports, which included nine IT audits and three audits of program activities. Additionally, the fieldwork on two additional audits is complete and the reports are being written; and one other audit and two risk assessments are in the process of being completed.

There was a high level of activity this year because there was a planned carryover of audit activity from the previous year, which accounts for the nine IT audits that were delivered in 2009-10 and performed by KPMG, LLC. The results of those audits were communicated orally as the fieldwork was being conducted, and the written reports that followed were provided during the 2009-10 fiscal year.

In addition, other unanticipated requests were made by management and others, which resulted in adding several different audits to the approved 2009-10 Audit Plan. These changes were discussed with the Committee, and a summary of the changes was included in the Annual Internal Audit Report provided to the Committee. These changes included an IT risk assessment, an audit of the implementation of the reporting requirements for funding received under ARRA that was requested by the Governor's Economic Recovery Cabinet, and the audit of the Appliance Program that was discussed earlier.

Mr. Mitchell completed his report by stating that there were no significant issues to report to the Committee as a result of the completed audits.

Nonetheless, during the audit of NEIS application security, a potential software architectural design issue in one NEIS component was detected. Management recognized its importance and has not implemented this component yet. A plan has been developed that will

successfully manage the issue. Management has had KPMG, LLC and Internal Audit participate in planning discussions, and also has kept Internal Audit fully informed of its plans.

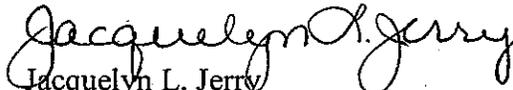
In response to an inquiry from Chair DeLorio, Mr. Pitkin indicated that the Authority has added resources to the Internal Audit Department. Last year, the Contract Auditor was transitioned from Finance to Internal Audit, and the Authority recently hired an additional Internal Auditor. Management will continue to work with Internal Audit to determine what additional resources may be needed in the future.

With respect to the Authority's overall administrative needs, Mr. Pitkin explained that DPS has increased the Authority's reporting requirements, which has strained the Authority's administrative resources. The administrative budget has not been increased to meet these demands. Mr. Murray explained that the Authority's administrative cap is 7% of the total budget compared to the administrative allowances of utilities which are running similar programs with an administrative budget that varies, but can equal 20% or more of their total budget.

Mr. Murray indicated that the Authority has been reluctant to approach DPS to request increasing the administrative budget in these tough economic times, but the Authority may seek to have the fee increased in the near future.

Mr. Catell indicated that the last agenda item concerned other business. There being no further business, 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**

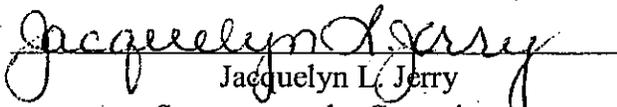
April 2, 2010

**TO THE MEMBERS OF THE AUDIT AND FINANCE COMMITTEE:**

PLEASE TAKE NOTICE that the one-hundred sixth (106<sup>th</sup>) meeting of the AUDIT AND FINANCE COMMITTEE of the New York State Energy Research and Development Authority ("Authority") will be held in the Authority's New York City Office at 485 Seventh Avenue, 10<sup>th</sup> floor, New York, New York, and by video conference in the Authority's Albany Office at 17 Columbia Circle, Albany, New York, and by video conference in the Authority's Buffalo Office at 726 Exchange Street, Suite 821, Buffalo, New York, on Monday, April 12, 2010, commencing at 10:00 a.m. for the following purposes:

1. To consider the Minutes of the 105<sup>th</sup> meeting held on January 25, 2010.
2. To consider and act upon amendments to the rating requirements on three series of bonds previously issued on behalf of New York State Electric & Gas Corporation.
3. To discuss the independent audit of the Authority's financial statements for fiscal year 2009-10.
4. To receive a report on the recent activities of the Director of Internal Audit.
5. To receive an Annual Internal Audit Report from the Director of Internal Audit.
6. 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. In accordance with guidance from the Office of Taxpayer Accountability, the Authority will be posting a video of its Board and Committee meetings to the web within 2 business days of the meeting. The video will be posted at <http://www.nyserda.org/governancemeetings2.asp>.

  
Jacquelyn L. Jerry  
Secretary to the Committee

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Exhibit A

Resolution No. \_\_\_\_

RESOLVED, that the Members of the Authority authorize the amendment of the Trust Indenture, the Participation Agreement, and other documents relating to Pollution Control Refunding Revenue Bonds (New York State Electric & Gas Project) 1994 Series B; Pollution Control Refunding Revenue Bonds (New York State Electric & Gas Project) 1994 Series C; and Pollution Control Refunding Revenue Bonds (New York State Electric & Gas Project) 1994 Series D-1 and D-2 (collectively, the "Bonds"), to waive the minimum rating requirement of "A" with respect to the conversion of such series of the Bonds to a Term Rate (as defined by the related Trust Indenture, by and between the Authority and Deutsche Bank Trust Company Americas, and the related Participation Agreement, by and between the Authority and New York State Electric & Gas Corporation) or a Fixed Rate (as defined by the related Trust Indenture, by and between the Authority and Deutsche Bank Trust Company Americas, and the related Participation Agreement, by and between the Authority and New York State Electric & Gas Corporation), and to allow the remarketing of such series of Bonds at a rating of no lower than BBB/Baa2; and

BE IT RESOLVED, that the Authorized Officers of the Authority are each hereby authorized and directed to execute and deliver any such other agreements, documents, or certificates (including, but not limited to, any agreements, documents, or certificates deemed necessary or proper to evidence or establish compliance with applicable provisions of the Internal Revenue Code of 1986, as amended), to do and cause to be done any such other acts and things and to make such other changes, omissions, insertions, revisions, or amendments to the Bond documents as they may determine necessary or proper for carrying out, giving effect to, and consummating the transactions contemplated by this resolution; and

BE IT FURTHER RESOLVED, that this resolution shall be in effect for one year, unless extended by the Members pursuant to resolution.