

MINUTES OF THE ONE HUNDRED ELEVENTH MEETING OF THE
AUDIT AND FINANCE COMMITTEE
HELD ON JANUARY 30, 2012

Pursuant to notice dated January 17, 2012, a copy of which is annexed hereto, the one hundred eleventh (111th) meeting of the Audit and Finance Committee (“Committee”) of the NEW YORK STATE ENERGY RESEARCH AND DEVELOPMENT AUTHORITY (“Authority”) was convened at 11:00 a.m. on Monday, January 30, 2012, 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.

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

Robert B. Catell, *Chair*

George F. Akel, Jr.

Member Elliman did not attend.

In addition, 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., Secretary and General Counsel; Sara L. LeCain, Esq., Senior Counsel and Secretary to the Audit and Finance Committee; Mark B. Mitchell, Director of Internal Audit; John V. Connorton, Jr., Esq., from Hawkins Delafield & Wood, LLP; Michael T. Bailey from the Village of Malverne; and various other members of the staff of the Authority were present.

Mr. Catell called the meeting to order and noted the presence of a quorum. He stated that the meeting notice and agenda were mailed to the Committee members and press on January 17, 2012.

Mr. Catell indicated that the first item on the agenda concerned the approval of the minutes of the one hundred tenth (110th) meeting of the Committee held on June 20, 2011.

Whereafter, upon motion duly made and seconded, and by unanimous voice vote, the minutes of the one hundred tenth meeting of the Committee held on June 20, 2011, were approved.

Mr. Catell indicated that the next item on the agenda was a report on the status of the Green Jobs-Green New York (“GJGNY”) energy efficiency financing program from the Authority’s Treasurer, Jeffrey J. Pitkin.

Mr. Pitkin stated that the Authority launched the GJGNY residential financing program in November 2010, offering unsecured loans for up to \$25,000 for loan terms of 5, 10, or 15 years at an interest rate of 3.99% (3.49% if consumer repays through automated payment).

As of December 31, 2011, the Authority had received 2,747 applications for financing. 1,658 (60%) have been approved, 862 (31%) have been denied for failure to meet the Authority’s loan underwriting standards, and 227 (8%) did not provide sufficient information to fully qualify them. Of the 1,658 approved applications, 94% of the applications have been approved under the conventional Tier 1 standards for loans expected to be financed through the capital markets, and 102 applications have been approved through Tier 2 standards, which will be funded from the revolving loan fund until they have a demonstrated performance that would allow them to be financed through the capital markets.

The Authority has purchased 908 loans that have been closed totaling approximately \$7.9 million. An additional 316 loans were approved and are pending closing for an additional \$3.0 million in loans.

As of December 31, 2011, the Authority had 903 outstanding loans for a total of \$7.6 million. There are 9 accounts which are past due, representing .9% of the portfolio. The average

loan is \$8,686, with a weighted average term of 12 years, a weighted average interest rate of 3.57%. The weighted average FICO score of borrowers is 748.

Mr. Pitkin explained that the Authority has begun accepting applications for On-Bill Recovery Loans for residential homeowners. The Power NY Act of 2011 required on-bill recovery financing to be implemented by May 31, 2012. However, in the State of the State message, Governor Cuomo announced that the implementation was being accelerated. Working with the New York State Department of Public Service (“DPS”) and staff from each of the investor owned utilities; the Authority has launched the residential on-bill recovery loan program. The Authority will address providing on-bill recovery loans for small businesses, not-for-profit organizations, and multifamily buildings in the months ahead.

Consumers will now have the option of electing whether they prefer to undertake an on-bill recovery loan or an unsecured loan. The terms of the on-bill recovery loan are the same as the unsecured loan, with two exceptions. The interest rate will be 2.99%, and the annual loan payments cannot exceed the estimated annual energy savings of the measures to be implemented.

The loan underwriting standards for residential on-bill recovery loans are the same as for the current unsecured loans, except that the borrower or co-borrower must own the property and must be named on the utility account of one of the six investor-owned utilities or the Long Island Power Authority. In addition, the borrower must provide a mortgage to the Authority, which will be recorded by the Authority’s mortgage servicer who will record mortgages and mortgage satisfactions on a statewide basis.

The loan will be repaid through a “NYSERDA Loan Installment” charge on the borrower’s utility bill. However, if the borrower’s service is terminated or suspended the Authority’s loan servicer, Concord Servicing Corporation (“Concord”) will bill the borrower or property owner directly until utility service is established or re-established. Concord will be exchanging a series of data files on a weekly and monthly basis with the utilities to track and maintain loans, loan remittances, and fees payable to the utilities pursuant to the statute. In an

effort to provide for the accelerated implementation of the residential on-bill recovery loan program, while still providing sufficient time for utilities to make modifications to billing and other systems, the on-bill recovery loans will provide that the “NYSERDA Loan Installment” charge will not appear on the borrower’s utility bill prior to June 1, 2012.

In response to an inquiry from Mr. Catell, Mr. Murray indicated that the Authority would like to increase participation in GJGNY. However, the current fiscal climate has hampered greater participation. Mr. Murray indicated that initially, there had been an additional work load for staff, but this burden is expected with the implementation of any new program. Mr. Pitkin added that the increased work load is a result of the time and effort to design and plan the standards and processes necessary to run the loan programs. This effort will decrease as the Authority transitions to full program implementation.

In response to an inquiry from Mr. Catell, Mr. Pitkin indicated that the Authority is subject to interest rate risk. However, the interest rates have been set to recover any administrative costs. If the market changes, the interest rates may need to be addressed in order to cover any additional costs.

Mr. Murray stated that the Authority is at the forefront of the on-bill effort, and as a result the model is being monitored across the nation.

Next, Mr. Pitkin stated that the original approach for GJGNY was initially to fund loans from the revolving loan fund, aggregate the loans to a sufficient scale, and then issue bonds secured by the loan portfolio and reserve funds provided through a U.S. Department of Energy (“DOE”) grant, to leverage the GJGNY funding and support additional loan activity. The bonds are expected to be issued as Qualified Energy Conservation Bonds (“QECCBs”), which provide a federal subsidy of approximately 70% of the interest cost on the bonds. Issuance of the bonds requires the use of QECCB bond volume cap, and the State provided the Authority with the ability to use approximately \$20.1 million of the State’s QECCB allocation. In addition, the Authority may use any amounts reallocated to the State from any of the State’s large local governments,

which received QECB allocations totaling approximately \$182.1 million. To date, the Authority has received reallocations from 3 local governments and has a total of about \$24.3 million in QECB allocation currently available. A few other local governments have indicated their intention to reallocate their allocations to the Authority.

Mr. Pitkin explained that there is growing concern that the limited use of QECB bonding authority to date may present a risk that the federal government will revert the authority for QECB allocations not used. A total of \$3.2 billion of QECB bonding authority was provided nationally, and to date only about 17% of the bonding authority has been used. New York State has had only two QECB issuances totaling \$3.6 million and ranks 22nd among all states in terms of the percentage of its QECB authority used. Mr. Pitkin stated that the QECB authority was granted under the American Recovery and Reinvestment Act. Therefore, the federal government might revert the authority due to lack of activity and in an effort to address federal budgetary concerns.

The interest rate set on loans issued for unsecured loans, as well as the interest rate proposed for on-bill recovery loans, were predicated on the substantially lower financing costs that would be realized through a QECB bond issuance. Reversion of the bonding authority would present a problem because loan repayments could be insufficient to cover financing costs. As a result, staff believe it may be prudent to proceed with a QECB issuance before having the loan portfolio fully issued. Mr. Pitkin indicated that a financing will be presented to the Committee and the Board for their approval at the April 2012 meetings for the issuance of \$25 million in bonds. Following approval by the Members, the bonds would also require approval by the Public Authorities Control Board. Therefore, the bonds will not be issued until April 2012 or May 2012.

Internal Revenue Service regulations require that any QECB issuance proceeds be loaned within three years of the bond issuance. Given the amount of loans issued to date, staff does not anticipate a problem with meeting this requirement. However, a special redemption clause would be included in the underlying terms of the bonds to allow a portion of the bonds to be

redeemed if the Authority was not able to meet this requirement.

If the Authority were to issue bonds prior to fully issuing the loan portfolio, it would not be able to use the loan portfolio to reduce the interest rate payments on the bonds. However, Mr. Pitkin explained that the cost of not having the full loan portfolio is far outweighed by the benefit of receiving the 70% QECB federal subsidy to reduce interest rate costs overall.

Mr. Pitkin stated that the first step in the QECB issuance will be to work with the Authority's financial advisor and bond underwriters to structure the terms of the bonds. He indicated that the next agenda item would discuss recommendations for a team of bond underwriters.

In response to an inquiry from Mr. Catell, John V. Connorton, Jr., Esq. from Hawkins Delafield & Wood, LLP, the Authority's bond counsel, indicated that the bond documents would explain how the bonds were issued and how the bonds would be redeemed.

Mr. Catell concurred that there is a risk that the authority to issue QECBs could be reverted prior to the April 2012 meeting, but that the Authority faced an even greater risk if it took no action at all.

Mr. Catell then stated that the next agenda item concerned the appointment of bond underwriters. Mr. Pitkin explained that pursuant to the Authority's Financial Services Guidelines the Committee members are asked to approve a resolution recommending the selection of Citigroup Global Markets, Inc. ("Citigroup"), Jefferies & Company, Inc. ("Jefferies"), and Samuel A. Ramirez & Co., Inc. ("Ramirez") as bond underwriters for bonds issued by the Authority to fund GJGNY. The firms were competitively selected and will provide investment banking and bond underwriting services for a period of up to five years.

In December 2011, the Authority issued a Request for Proposals ("RFP") seeking proposals from firms interested in providing investment banking and underwriting services

related to the negotiated sale or private placement of bonds to be issued by the Authority in connection with the GJGNY energy efficiency financing program. The RFP indicated the Authority's intention to select up to three firms, with one award to a firm with a national underwriting practice serving large issuers, one award to a firm whose experience has been focused on small programs and issuers in the Northeast region, and one award to a certified minority- or woman-owned business enterprise ("M/WBE"). The three firms selected would be assigned responsibilities to serve as senior manager on a rotational basis for program bonds issued over time with the other two firms serving as co-managers.

The Authority received 20 proposals in response to the RFP – 5 proposals from national firms, 8 proposals from regional firms, and 7 proposals from M/WBE firms.

A Technical Evaluation Panel ("TEP") comprised of Authority staff and outside reviewers reviewed, scored, and ranked the proposals. In accordance with the RFP, the proposals were evaluated and scored based on each proposer's demonstrated experience; understanding of and ability to perform the scope of services; assigned personnel; underwriting ability; and fees.

Based on the TEP's recommendations, staff recommend appointing Citigroup, Jefferies, and Ramirez to serve as co-managers for bonds issued for the GJGNY program.

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

Resolution No. 381

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 the selection of the firms of Citigroup Global Markets, Inc., Jefferies & Company, Inc., and Samuel A. Ramirez & Co., Inc to serve as bond underwriters for the Authority related to its financings for the Green Jobs-Green New York Program.

Mr. Catell indicated that the next item on the agenda was a report from Mark Mitchell, the Director of Internal Audit, on a Quality Assurance Review of the Authority's Internal Audit function. The Quality Assurance Review is an independent assessment of the Authority's internal audit activities, and is required in order to meet internal auditing standards. It assessed internal audit activities and determined that they "generally conform" to internal auditing standards promulgated by the Institute of Internal Auditors ("IIA"), which is the highest rating.

The review also commends Internal Audit for being well-structured, progressive, and conforming to IIA standards given the small staff size of the department.

The Authority's Internal Audit function was found generally to comply with 44 of the 45 individual IIA standards and partially complies with the one remaining standard. Two opportunities for improvement were identified, and Mr. Mitchell indicated his intention to implement both recommendations.

The first recommendation is to better determine and communicate internal audit resource requirements to the Officers and the Members of the Audit and Finance Committee when preparing the annual internal audit plan. Although the internal audit plan was found to have been developed using a process that evaluates the Authority's risks, the report recommends that the Director of Internal Audit should consider revising the annual planning process so it more clearly provides a description of the actual amount of resources that are required to provide an appropriate level of audit services in support of the Authority's plans, goals and objectives. This recommendation will be implemented during the development of the Annual Audit Plan for Fiscal Year 2012-13 to be submitted to the Committee for review and approval at the April 2012 meeting.

The second recommendation is for the Internal Audit function to continue to develop a more interactive relationship with the Officers. This will allow Internal Audit to be viewed and relied upon more by the Officers as a management tool for assuring that the Authority's risks are being appropriately managed and that internal controls are working as intended. Implementing

this recommendation is intended to increase the value of the service that Internal Audit provides to management. Several other management techniques were offered that are intended to enhance the operation of the Internal Audit function. To implement this recommendation, Mr. Mitchell will schedule a conference call with the Audit Committee Chair and the Officers to discuss organizational risks, and how these risks may be addressed through the development of Internal Audit activities to be included in the Annual Audit Plan for Fiscal Year 2012-13 to be presented for review and approval at the April 2012 meeting.

Mr. Murray added that the Quality Assurance Review indicated that the Authority needs to view Internal Audit in the same manner as Information Technology. It should be a service that is used to support the Authority's operations.

Mr. Catell indicated that the next item on the agenda was a report from Mr. Mitchell on his recent activities. Mr. Mitchell indicated that he has completed three audits since the last Committee meeting.

In September 2011, the audit of Agreement 9802, Program Implementation Services for the Authority's Home Performance Programs was completed. There were no significant findings with regard to the internal controls that are in place. However, the Contractor was asked to reimburse the Authority for costs that were questioned during the audit. In addition, a few recommendations were made to management to make minor improvements to the overall contract management and project management processes.

The Authority made payments to the Contractor of more than \$11 million during the period audited. The audit found that during that period the Contractor had overbilled the Authority a total of approximately \$48,700, or 0.42% of the amount the Authority was invoiced. In 2010, there was an additional \$15,500 in overbillings that occurred while the audit was being conducted. The Contractor reimbursed the Authority for the full \$64,295.

The audit found that \$29,964 was a result of inaccurate billing practices. An additional \$34,331 was disallowed because the Contractor added a profit to travel expenses which is not consistent with general practices and is not permitted under federal contracting cost standards. In the future, the Contractor's travel will be reimbursed at federal travel per diem rates.

The audit also made several recommendations that, if adopted, would improve internal operations. The first two recommendations suggested finding a way for operations to better assure that actual direct labor rates and indirect overhead costs were reflected on invoices. Management indicated they anticipate making a change to contract requirements so that contractors will be required to provide with each invoice a certification indicating the contractor's compliance with contract billing requirements.

A number of suggestions that would improve the Authority's boilerplate contract language were developed by Internal Audit and communicated to management in a memorandum, dated March 9, 2011. Management concurred with the recommendations to clarify boilerplate contract language regarding contractor requirements when billing direct labor costs and indirect overhead costs. Additionally, the Authority will develop guidelines and standards for when different fee arrangements, such as fixed billable rates, fixed price with milestone payments, and cost reimbursable, should be used. This approach will be used as the Authority enters into new contracts.

The audit also recommended that the Authority discontinue the practice of allowing contractors to charge a fee based on travel expenses. Management indicated that although there are no clear State standards for applying a contractually negotiated mark-up or profit percentage to travel costs, and fees associated with travel costs are generally a small part of the total contract amount, it concurs with the recommendation and will change contracting costs so as to be consistent with general practices. The Authority will change future contracts as they are entered into or modified to clarify that no profit will be allowed on travel.

Lastly, although the audit found that working meetings involving meals were a commendable program management practice, it recommended that the Authority assure that strong safeguards would be in place so that contractors and Authority staff are familiar with meal reimbursement requirements so that all reimbursements would be consistent with NYS Public Officers Law §73(5)(a) as well as the Authority's expense reimbursement policy.

Next, Mr. Mitchell indicated that Internal Audit completed an audit of a contractor's compliance with Agreement 10402, which requires specific tasks to be performed in support of the New York ENERGY STAR Homes Program. This audit was conducted at the request of the Program Director.

During the period September 1, 2007 through December 31, 2010, the Authority made contract payments of approximately \$1,485,000. The audit found that although the Contractor billed most direct expenses in an appropriate and supportable manner, because certain financial management and accounting controls were not in place, the Contractor's hourly rate billings were higher than its actual labor costs. As a result, the Contractor overbilled the Authority a total of \$115,568, or 7.78% of its total billings. Labor rates, which included an allocation for fringe and payroll taxes, were not based on actual labor costs, as required by the Agreement. Most of the difference resulted from earlier billing practices, and after the Agreement was modified, subsequent billed labor rates more closely resembled actual labor expenses.

The audit also found that the Contractor could not provide an acceptable cost allocation methodology to recover its fringe benefits and payroll taxes associated with direct labor charges, as well as its general and administrative expenses. Although these indirect costs were not disallowed, the audit recommended that the Contractor develop an acceptable cost allocation methodology to support future billings. The Contractor indicated that it would improve its financial management controls, and its accounting and billing practices.

The Authority was reimbursed for the full amount of \$115,568.

Lastly, Mr. Mitchell discussed an audit of the Main Tier Renewable Portfolio Standard (“RPS”) that was completed in December 2011. RPS has processes and activities in place that provide reasonable assurance that it will comply with the New York State Public Service Commission (“PSC”) Orders establishing the RPS. The audit found that out of the approximately \$696 million expended or encumbered, every expenditure and encumbrance examined was properly accounted for. The audit concluded that the design of the RPS is effective and provides assurance that it will meet the requirements of the PSC’s Orders. Furthermore, the audit found that the first three solicitations under the RPS had an 80.5% project completion rate.

The audit concluded that the effectiveness of the RPS’s internal control activities is adequate. Generally, controls evaluated were adequate, appropriate, and effective to provide reasonable assurance that risks are being managed and objectives should be met. For example, all paid invoices that were tested were supported by a New York State Independent System Operators report that showed RPS-eligible attributes created during the month matched those which the Authority paid for, and no invoices tested were paid prior to the facility achieving operational certification.

However, the audit identified a few specific opportunities to improve controls. Some opportunities were identified that would improve recordkeeping associated with the solicitation process and would better safeguard the physical custody of letters of credit even though the Authority was able to account for the physical custody of all letters of credit.

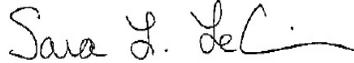
Mr. Mitchell indicated that several of the recommendations identified during the audit were adopted and were in place and operational during the solicitation that took place in January 2011.

In response to an inquiry from Mr. Catell, Mr. Murray stated that the Authority issues an Annual Report that includes the RPS metrics. Mr. Murray indicated that there may be a challenge going forward since the RPS competes with natural gas prices. The price the

Authority pays for projects may increase as a result of this. However, the RPS has controls in place that allow the Authority to cancel a project if the costs go above a certain amount.

Mr. Catell indicated that the last item on the agenda was other business and asked if there were any other matters the Committee members wished to discuss. There being none, upon motion duly made and seconded, and by unanimous voice vote, the meeting was adjourned.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Sara L. LeCain". The signature is fluid and cursive, with a long horizontal flourish extending to the right.

Sara L. LeCain
Secretary to the Committee

NOTICE OF MEETING AND AGENDA

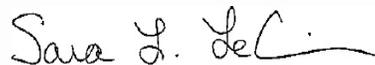
January 17, 2012

TO THE MEMBERS OF THE AUDIT AND FINANCE COMMITTEE:

PLEASE TAKE NOTICE that the one hundred eleventh (111th) 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, 10th Floor, New York, New York, and by webcast, on Monday, January 30, 2012, commencing at 11:00 a.m., for the following purposes:

1. To consider the Minutes of the 110th meeting held on June 20, 2011.
2. To receive a report on the Green Jobs-Green New York program.
3. To consider and act upon a resolution recommending the appointment of Bond Underwriters to the Authority.
4. To receive a report from the Director of Internal Audit on the results of the Quality Assurance Review.
5. To receive a report from the Director of Internal Audit on recent internal audit activities.
6. To transact such other business as may properly come before the meeting.

Members of the public may attend the meeting at either of the above locations. In accordance with guidance from the Office of Taxpayer Accountability, the Authority will be posting a video of the meeting to the web within two business days of the meeting. The video will be posted at <http://www.nysesda.ny.gov/en/About/Board-Governance/Board-and-Committee-Meetings.aspx>.



Sara L. LeCain
Secretary to the Audit and Finance Committee

New York State Energy Research and Development Authority

Albany
17 Columbia Circle, Albany, NY 12203-6399
(P) 1 (866) NYSERDA | (F) (518) 862-1091
nysesda.ny.gov | info@nysesda.org

Francis J. Murray, Jr., President and CEO

Buffalo
726 Exchange Street
Suite 821
Buffalo, NY
14210-1484
(P) (716) 842-1522
(F) (716) 842-0156

New York City
485 Seventh Avenue
Suite 1006
New York, NY
10018-6815
(P) (212) 971-5342
(F) (518) 862-1091

**West Valley Site
Management Program**
9030-B Route 219
West Valley, NY
14171-9500
(P) (716) 942-9960
(F) (716) 942-9961

Exhibit A

Resolution No. ____

RESOLVED, that the Members approve the selection of the firms of Citigroup Global Markets, Inc., Jefferies & Company, Inc., and Samuel A. Ramirez & Co., Inc to serve as bond underwriters for the Authority related to its financings for the Green Jobs-Green New York Program.