MINUTES OF THE ONE HUNDRED NINTH MEETING OF THE
AUDIT AND FINANCE COMMITTEE
HELD ON APRIL 18, 2011

Pursuant to notice dated April 8, 2011, the one hundred ninth (109th) 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 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, on Monday, April 18, 2011, at 10:30 a.m.

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

Robert B. Catell, Chair (by video conference from New York City)
Vincent A. DeIorio, Esq., *ex officio*
George F. Akel, Jr.
David D. Elliman (by video conference from New York City)

Also present in either New York City or Albany were 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; Sara L. LeCain, Esq., Senior Counsel and Secretary to the Audit and Finance Committee; Mark B. Mitchell, Director of Internal Audit; and various other staff of the Authority. Present by telephone were Donna Gonser and Mary Young from Lumsden and McCormick.

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 eighth (108th) meeting of the Committee held on September 27, 2010.

Whereafter, upon motion duly made and seconded, and by unanimous voice vote of the Committee members, the minutes of the one hundred eighth (108th) meeting of the Committee held on September 27, 2010, were approved.

Mr. Catell said that the next item on the agenda concerned the independent audit of the Authority's financial statements for fiscal year 2010-11. 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 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 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. This will be the first year that the independent auditors will perform a review of the Authority's post-employment health insurance benefit trust.

In response to an inquiry from Mr. Elliman, Ms. Gonser explained that Governmental Accounting Standards Board Statement 54 will change the presentation of restricted and unrestricted fund balances on the fund balance sheet, breaking them out into new categories. The new standard becomes effective for the fiscal year ending March 31, 2012.

In response to an inquiry from Mr. Catell, Mr. Pitkin indicated that the Committee would be provided the results of the independent audit at the June 2011 meeting. As part of the

independent audit process, the Committee Members and other Board Members may be called on an individual basis.

Mr. Catell said that the next item on the agenda concerned a resolution authorizing amendments to the Internal Control Manual. Jeffrey J. Pitkin, the Authority's Treasurer, explained that the Members are requested to adopt a resolution approving amendments to the Internal Control Manual. The purpose of the Internal Control Manual is to set forth the Authority's policies and procedures for ensuring an effective system of internal controls that also promotes accountability and transparency. The Board is responsible for approving all modifications to the Internal Control Manual. The Internal Control Manual summarizes the detailed policies and procedures contained in the Operations and Procedures Manual, Personnel Handbook, Accounting Policies and Procedures Manual, and Information Security Policies and Procedures Manual, which are provided to staff.

In March 2011, a multi-disciplinary group was convened to review the Authority's manuals to ensure that they are clear and that they reflect current practices and policies. The proposed amendments include adding: responsibility and accountability for program performance reporting; controls recently enhanced for information technology governance; further specificity to the duties and controls of certain organizational units; and various updating, editorial, and clarifying changes.

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

Resolution No. 372

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 the Internal Control Manual.

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 that since his last report, internal audit has completed an audit of employee travel and credit card expenditures. The

results showed that expense reporting controls are designed to provide reasonable assurance that the Authority's employees are following travel expenditure and reporting guidelines. With few exceptions, reviews performed by supervisors and Finance staff provided assurance that the Authority's travel and expense policies and directives, as outlined in the Personnel Handbook, were followed. Although a few specific opportunities to improve business controls were identified, no material findings were noted. Generally, the travel and expenditure controls evaluated are adequate, appropriate, and effective to provide reasonable assurance that travel expenditures are being documented and being reviewed and approved by a supervisor and by Finance staff.

Next, Mr. Mitchell provided the Committee with an update on several audits that are close to being completed.

This first concerned an audit of Conservation Services Group ('CSG'), the implementation contractor for the Home Performance with ENERGY STAR® ('Home Performance') Program. As previously reported, before the report could be completed, certain issues identified during the audit had to be resolved. Once those issues were resolved, the reporting has been progressing on track. As a result, the final draft of the audit of CSG was provided to the Program Manager last week, and Mr. Mitchell anticipates receiving the formal response from the Officers no later than May 2011.

The audit of New York's Appliance Swap-Out ('Appliance') Program was postponed in order to work on the CSG audit. The results of the audit were provided orally to the Program Manager and the Officers during the summer of 2010 to allow internal control improvements to be made immediately at the beginning of the Appliance Program. The work has resumed and the preliminary report will soon be given to the Program Manager, and Mr. Mitchell anticipates issuing a final report in May 2011.

Mr. Mitchell reported that the fieldwork for the audit of the Main Tier Renewable Portfolio Standard ('RPS') has been completed. Most of the recommendations that were provided during the audit have already been implemented and were in place for the recently completed solicitation. In order to accommodate staff's need to process the solicitation, Internal Audit has

held off holding a closing conference until the week of April 18, 2011. Mr. Mitchell will provide the Program Manager the preliminary draft after the meeting and will issue a final report sometime in June 2011.

Mr. Mitchell indicated that Internal Audit began fieldwork on the contract audit of a contractor for the New York ENERGY STAR® Homes Program. Staff provided the contractor with an interim oral report and written analysis because the contractor's timekeeping and expense allocation records have not been maintained in a manner that would allow for an audit at this time. Discussions are underway to determine what steps the contractor wishes to take to remedy the situation.

Lastly, Mr. Mitchell reported that the Flexible Technical Assistance Program audit was also placed on hold in order to complete the CSG audit. It has now been rescheduled so that the remaining work can be completed by July 2011.

In response to an inquiry from Mr. Akel, Mr. Mitchell indicated that Internal Audit has recommended that at the time of contract negotiation, staff should discuss with the contractor the Authority's expectations and evaluation the contractor's ability to meet the Authority's record keeping requirements.

Next, Mr. Catell asked Mr. Mitchell to discuss the 2010-11 Annual Internal Audit Report ('2010-11 IA Report'). Mr. Mitchell explained that the Interim Internal Audit Plan was reviewed and approved at the June 2010 Committee meeting and the Internal Audit Plan for fiscal year 2010-11 ('2010-11 Audit Plan') was reviewed and approved by the Committee at its September 27, 2010 meeting. In accordance with the Internal Control Manual, the Members were provided with the 2010-11 IA Report, which summarizes the results of internal audit activities undertaken during fiscal year 2010-11.

Mr. Mitchell indicated that seven reviews were conducted: a comprehensive business risk assessment, an Information Technology ('IT') risk assessment, and five audits. The results of the completed audits were previously discussed with the members. The table accompanying the

memorandum summarizes the audits completed and the status of outstanding audits which were approved in the fiscal year 2010-11 Audit Plan.

The audits did not reveal any significant issues to report to the Members. This means that nothing material and significant came to Internal Audit's attention about a particular objective, such as the effectiveness of the system of internal controls, adequacy of the risk management process, or on any other specific matter. The design of the entity wide controls to assure compliance with applicable laws and regulations are adequate, appropriate, and effective to provide reasonable assurance that risks are being managed and compliance objectives should be met. Generally, program level controls in the Authority that were audited are adequately designed and appropriate.

Mr. Catell indicated that the next item on the agenda was approval of the Internal Audit Plan for fiscal year 2011-12 ("2011-12 Audit Plan"). Mr. Mitchell asked the Members to review and approve the draft 2011-12 Audit Plan, which summarizes Internal Audit activities that will be initiated or completed in the fiscal year April 1, 2011- March 31, 2012. The draft 2011-12 Audit Plan has been reviewed and accepted by the Authority's Officers.

Mr. Mitchell explained that the Internal Control Manual requires the Director of Internal Audit to develop an annual audit plan using a risk-based methodology for review and approval by the Committee, to implement the approved plan, and to provide periodic reports to the Committee on the results of conducting the approved plan.

The draft 2011-12 Audit Plan was developed by using a risk-based methodology. In addition, consideration was given to requests from the Officers and the Members during last year's entity-wide risk assessment and the IT risk assessment, as well as the results of recent audits.

Most of the audits scheduled in the 2011-12 Audit Plan will assess the adequacy of internal controls in place that are intended to mitigate project management and program monitoring risks. The Authority places a high reliance on these controls to manage those risks,

which is to be expected as a result of having a number of transaction-oriented programs with significant volume.

The 2011-12 Audit Plan is comprised of twelve audits. Ten audits will be completed during the current fiscal year. Five of those audits are from the 2010-11 Audit Plan. Five new audits will be started and finished during the current fiscal year. The last two new audits in the proposed 2011-12 Audit Plan will be started toward the end of the current fiscal year and are scheduled to be completed during the following fiscal year. The timetable for this activity is shown in the table at the end of the report previously provided to the Committee.

Mr. Mitchell explained that the 2011-12 Audit Plan provides broad coverage of Authority operations. It includes auditing three separate business processes within the Authority's program areas; auditing one contractor that provides outreach and project consulting services to an Energy Efficiency Services program; and auditing three of the Authority's administrative areas: IT, Contracts Management, and Human Resources.

The first new audit that is proposed is the audit of the NYSERDA's solar photovoltaic program, which is funded through the customer-sited tier of the Renewable Portfolio Standard program. This was listed as the last audit scheduled on last year's plan.

The second audit will review IT change controls by evaluating the design, implementation, and operating effectiveness of current IT change control policies and procedures for making changes to application software. The audit will focus on a sample of changes made during the last year to the integrated financial management system and two primary program database systems. It will be performed by a contractor who will work independently and will be overseen by the Director of Internal Audit at a cost not to exceed $36,000.

Next, Mr. Mitchell explained that the Officers suggested auditing the recently implemented GJGNY financing program. GJGNY financing is available to participants in the Home Performance Program to finance the installation of recommended energy efficiency improvements, which may be repaid through energy savings. The audit will review procedures

for approving and funding loans and procedures for collection and monitoring of outstanding loans.

The fourth audit proposed is a data quality audit. It will evaluate various attributes that affect the quality of the Authority's operational and financial data contained in the Authority's three important data bases.

Mr. Mitchell indicated that a contract audit of a contractor that provides program support to the Energy Efficiency Services New Construction Program is scheduled to begin in September 2011 and will be completed in January 2011.

The sixth proposed audit will evaluate the monitoring of research and development contracts that contain a recoupment clause. The clause provides the Authority with royalties from the sale of products developed through the contract.

The final audit of the fiscal year will be of the Authority's benefits administration activities in Human Resources. Mr. Mitchell explained that benefits administration is an area that has high costs associated with it, and this area has not been audited by Internal Audit yet.

Mr. Mitchell indicated that changes to the 2011-12 Audit Plan may be made on an ad hoc basis by the Officers and the Committee to accommodate unforeseen circumstances. Any changes will be reported to the Committee.

Mr. Mitchell concluded his report by explaining that approval of the 2011-12 Audit Plan will result in a series of internal audits being completed during the fiscal year. Each final report will be sent to the Members once it is completed, and the results of each completed audit will be included in Mr. Mitchell's reports to the Committee at its regularly scheduled meetings. A report is considered to be final after the Officers have had an opportunity to review and comment on the draft report.

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

Resolution No. 373

RESOLVED, that the Audit and Finance Committee approves the Internal Audit Plan for the Fiscal Year 2011-12, as presented at this April 18, 2011 meeting, in the form submitted to the Committee (attached as Exhibit B).

Mr. Catell indicated that the next item on the agenda was the GJGNY financing program. Mr. Pitkin reminded the Committee that the Authority's approach for providing financing for residential energy efficiency improvements as part of GJGNY was presented at the Committee's September 2010 meeting.

Mr. Pitkin reported that the Authority launched the residential financing program in mid-November 2010. Consistent with the authorizing legislation, the terms of the loans being offered are for an unsecured loan, with a maximum loan amount of $13,000 and a term of 5, 10, or 15 years depending on the borrower's request, provided that the life of the loan does not exceed the anticipated life of the energy efficiency measures. The loan is available for owners of one to four family homes to finance approved cost-effective energy efficiency improvements installed by contractors accredited by the Building Performance Institute as part of the Authority's Home Performance Program. The financing allows the cost of the improvements not covered by any other Authority or utility incentive to be financed.

The initial interest being offered on the unsecured loans is either 3.99% or 3.49% if the borrower agrees to automated monthly payment. At the September 2010 Committee meeting, Mr. Pitkin anticipated that the loan interest rate would be offered at a rate of either 5.99% or 5.49%. However, he had indicated that if the Authority were designated to use the State's bond volume cap authorization to issue Qualified Energy Conservation Bonds ('QECBs'), the Authority would be able to lower the interest rate on the loans. QECBs provide for a 70% federal subsidy of the bond interest costs. Based on this information, the Committee approved the issuance of a Declaration of Intent by the Authority requesting bond volume cap authorization.

On November 8, 2010, Governor Paterson allocated approximately $20.1 million of the State's bond volume cap to the Authority to be used to support loans issued through GJGNY. In addition, five local governments (Broome, Rockland and Oswego Counties; and the Towns of Smithtown and Huntington) have reverted their approximately $8.2 million suballocations of the

State's QECB volume cap to the Authority. Therefore, staff expects to have the ability to issue $28.3 million of QECBs. This amount may increase if additional local governments revert their suballocations.

Mr. Pitkin explained that the issuance of QECBs is subject to arbitrage limitations on excess earnings, which includes interest earned on loans in excess of the costs of originating, servicing, and financing the loans. In consultation with the Authority's bond counsel and financial advisor, staff determined that 3.99% and 3.49% would substantially cover the anticipated costs of the loans, without having the potential to trigger arbitrage rebates, which would negate the benefits of the federal QECB interest subsidy.

Mr. Pitkin indicated that the loans are being originated by Wisconsin Energy Conservation Corp, d/b/a Energy Finance Solutions ('EFS'), an experienced-Fannie Mae lender that was competitively selected to offer residential financing. Staff anticipates expanding the financing program to include multiple lenders originating loans during 2011. At this time, EFS is qualifying borrowers for financing using loan underwriting standards established by the Authority, which includes a minimum FICO credit score of 640 or higher and a ratio of debt-to-income of less than 50%, among other criteria. These criteria were established based on loan underwriting standards which would be accepted by rating agencies and investors for a pledge against bonds that would eventually be issued by the Authority to provide additional loan capital. Alternatively, borrowers not meeting these criteria can still qualify for a loan through a revolving loan pool, which allows for utility and mortgage bill payment history to be substituted for the minimum FICO score and allows a slightly higher level of debt-to-income.

Once EFS closes on the loan and disburses the loan proceeds, a loan data file and the loan documents are sent to Concord Servicing Corporation ('Concord'), a 3rd-party loan servicer under contract to the Authority. Concord validates the loan information and performs a review using a 15% sample of loans to confirm that the documentation used to originate the loans meets the loan underwriting criteria. Once approved, Concord will notify the Authority, which will then purchase the loan from EFS. The purchased loan is serviced by Concord on behalf of the Authority.

Mr. Pitkin explained that staff will aggregate loans purchased from EFS, until a sufficient amount has been aggregated to support an initial bond issuance, estimated at $25 million. The bonds would be issued as federally-subsidized QECBs with a limited revenue obligation pledge of the repayments from the loan portfolio and the funds maintained in the revolving loan fund. For the initial issuance, the bond issue would be significantly over-collateralized. This will allow for a minimum "A" rating and allow the securities to establish a track record for future issuances. The proceeds from the issuance will be returned to the revolving loan fund pool to support the issuance of additional loans.

As of March 31, 2011, the financing program has received 6,105 requests for free or subsidized energy audits. 5,071, or 83%, of the applications qualified for free energy audits, and 2,419 energy audits have been completed. The financing program has received 911 applications for financing, and 515 of these, or 59%, have been approved. Of these, 146 have closed and 114 are approved and awaiting closing. The Authority has purchased 143 loans for a total of $1,155,231. As of March 31, 2011, one loan was paid off early and there are 142 loans in the portfolio with an outstanding balance of $1,140,841. All loans are current. The weighted average loan amount is $8,123 with a term of 12.2 years, an interest rate of 3.58%, and a borrower FICO score of 747.

In response to an inquiry from Mr. Catell, Mr. Pitkin explained that 2,419 represents the number of applications that have completed energy audits and moved on to the implementation of measures.

In response to an inquiry from Mr. Elliman, Mr. Pitkin indicated that the Authority's financial advisor has completed a model of the losses that could be realized. However, Mr. Pitkin explained that the Authority received a $40 million ARRA grant from the U.S. Department of Energy for leveraging private capital for statewide energy efficiency financing. Up to $9.3 million of this grant may be used as a loan loss or debt service reserve with DOE's approval, and to date DOE has approved $3.98 million. This funding will be used to fund any loan delinquencies or losses. Once the DOE grant has been expended, the remaining losses will be off-set using the Authority's remaining portfolio.

With respect to cost, Mr. Pitkin indicated that the Authority will pay $175 per loan to the lenders for origination. The servicing costs will be approximately $5 per month ($60 per year) per loan. In addition, the Authority will pay a net interest rate cost of 1.8% on bonds issued. As a result, the 3.99%/3.49% interest rate being charged on loans 3.99%/3.49% will substantially cover the costs of origination, servicing, and financing of the loans, with any balance being subsidized from the Green Jobs-Green New York revolving loan fund available.

In response to an inquiry from Mr. Elliman, Mr. Pitkin indicated that the GJGNY fund would bear the risk if the servicing costs were to increase above $5. Mr. Pitkin explained that the average servicing cost is $2.50 a month initially, but will increase over time as some loans require delinquency collection efforts. Staff estimated the costs at $5 per month per account based on average costs for similar loan portfolios.

In response to an inquiry from Mr. Akel, Mr. Pitkin explained that the financing program will be marketed through several channels. The GJGNY legislation requires that the Authority contract with consumer based organizations to provide community outreach. In addition, the Authority will offer contractors participating in other Authority programs incentives to market the financing program. The New York Energy $mart Coordinators will provide outreach through participation in exhibits and fairs across New York. Lastly, the Authority will market the financing program through various media outlets across New York. Mr. Pitkin indicated that staff is encouraged by the large response the financing program has received with very little marketing effort.

Mr. Pitkin indicated that staff expect to be rolling out the financing program for the small commercial, not-for-profit, and multifamily building sectors in the coming months. The financing approach anticipated is to use RGGI funds as a revolving loan fund to support loans issued by lenders. There is $13 million for small commercial sector and $10 million available for the multifamily sector. The lenders would be responsible for originating and servicing the loans, and they would be underwritten based on their standards. The Authority would provide 50% of the loan to the lender, up to $26,000 for small commercial and $500,000 for multifamily, at no interest, so that the lender would be expected to offer the borrower an interest rate 50%

lower than its normal rate. The lender and the Authority would share pro-rata in any losses on the loans.

In response to an inquiry from Mr. Catell, Mr. Pitkin explained that the Authority partners with a lender who is incentivized to act appropriately because the lender is also at risk by issuing the loan. Mr. Elliman cautioned that the Authority should closely monitor the lenders to ensure that the lenders do not lay off their risk on the loans. Mr. Catell concurred and suggested that the Committee be periodically updated on the status of the financing program.

Mr. Catell stated that the last agenda item concerned other business, of which there were two items to discuss.

Mr. Pitkin explained that in May 2010, the Office of the State Comptroller ('OSC') initiated an audit of the energy audit component of the Authority's Flex Tech Program. The purpose of the audit was to determine if the Flex Tech Program had sufficient resources to meet demand. OSC staff completed the audit in September 2010. In December 2010, staff received a draft report. The draft report notes that the Flex Tech Program had sufficient resources to meet demand; had adequate internal resources to meet customer needs and processes that are well-managed; had sufficient financial resources to meet existing demand; and was reaching the public sector in its promotion of services to help reduce the burden on local government taxpayers. The Authority issued a reply to the draft report. Based upon discussions with OSC staff, it was not clear that OSC will issue a final report. Therefore, a copy of the draft report and the Authority's reply was provided to the Members.

Next, Mr. Pitkin indicated that DOE Inspector General's Office ('IG') recently completed an on-site audit in March 2011 of the $123 million State Energy Program American Reinvestment and Recovery Act ('ARRA') grant. The purpose of the audit was to ensure that recipients of ARRA funds are using the funds in accordance with Federal and DOE requirements. The review included reviewing financial progress of the State Energy Program, as well as the controls and procedures for the awarding of projects and monitoring subgrantee compliance. The DOE IG also completed a number of site visits to meet with subgrantees and monitor projects and compliance procedures. The DOE IG did not issue a formal report, but it

will include the results in a report to be issued later in the year for its review of a number of DOE ARRA grants. Informally, the DOE IG commented that it was pleased with the Authority's monitoring systems and controls.

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

Respectfully submitted,

Sara L. LeCain

Sara L. LeCain
Secretary to the Committee

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NOTICE OF MEETING AND AGENDA

April 8, 2011

TO THE MEMBERS OF THE AUDIT AND FINANCE COMMITTEE:

PLEASE TAKE NOTICE that the one-hundred ninth (109th) 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 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, on Monday, April 18, 2011, commencing at 10:30 a.m. for the following purposes:

1. To consider the Minutes of the 108th meeting held on September 27, 2010.
2. To discuss the independent audit of the Authority's financial statements for fiscal year 2010-11.
3. To receive a report from the Internal Control Officer and to consider and approve modifications to the Authority's Internal Control Manual.
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 consider and act upon a resolution approving an Internal Audit Plan for fiscal year 2011-12.
7. To receive a report on the Green Jobs-Green New York program.
8. 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.nyserda.org/governancemeetings2.asp.

Sara L. LeCain
Secretary to the Committee

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Exhibit A

Resolution No. ____

RESOLVED, that the amendments to the Internal Control Manual, as submitted at this April 18, 2011 meeting, are hereby approved and adopted.

Exhibit B

Resolution No._____

RESOLVED, that the Audit and Finance Committee approves the Internal Audit Plan for the Fiscal Year 2011-12, as presented at this April 18, 2011 meeting, in the form submitted to the Committee.