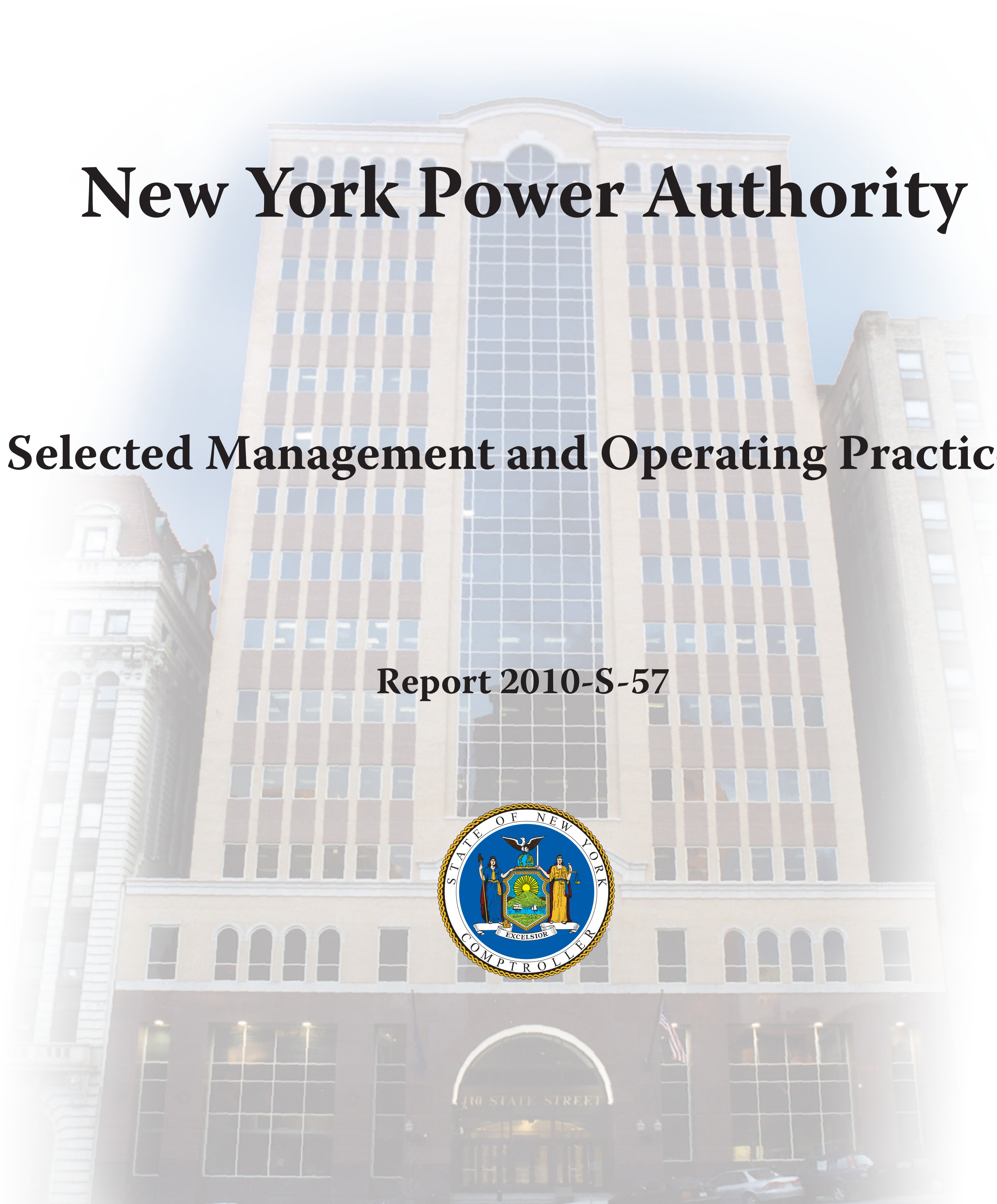
OFFICE OF THE NEW YORK STATE COMPTROLLER

DIVISION OF STATE GOVERNMENT ACCOUNTABILITY



New York Power Authority

Selected Management and Operating Practices

Report 2010-S-57

Thomas P. DiNapoli

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State of New York
Office of the State Comptroller

Division of State Government Accountability

July 28, 2011

Michael J. Townsend
Chairman
New York Power Authority
123 Main Street
White Plains, NY 10601-3170

Dear Chairman Townsend:

The following is a report of our audit of controls over Selected Management and Operating Practices of the New York Power Authority. This audit was performed pursuant to the State Comptroller's authority under Article X, Section V of the State Constitution and Chapter 469 of the Laws of 1989.

Our audit covered the period January 1, 2009 through June 21, 2011 and included an examination of expenditures related to personal service contracts, discretionary spending and the cost of debt issuance. In general, we found these expenditures were appropriate, although we noted certain areas where practices can be improved to provide better accountability.

This audit's results and recommendation are resources for you to use in effectively managing your operations and in meeting the expectations of taxpayers. If you have any questions about this report, please feel free to contact us.

Respectfully submitted,

Office of the State Comptroller
Division of State Government Accountability

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State of New York
Office of the State Comptroller

EXECUTIVE SUMMARY

Audit Objective

Our audit objective was to determine whether the New York Power Authority's (Authority) management and operating practices resulted in reasonable and business-related expenditures, including personal service contracts, discretionary spending and the cost of debt issuance.

Audit Results - Summary

We found the Authority's management and operating practices generally resulted in appropriate expenditures in all areas examined, including consulting and service contracts, discretionary spending and the cost of debt. Expenditures were business-related and generally reasonable and necessary. The Authority also monitored costs to ensure it was obtaining services and items at a reasonable price.

Although discretionary spending generally appeared reasonable and proper, we did identify certain expenditures totaling approximately $340,000 over the two-year audit period where we question if the purpose and/or the amount of such expense represents the best use of public funds particularly during what are difficult fiscal times for New York State. These expenses included amounts the Authority paid to host annual parties and picnics for employees, retirees and their children; for empathetic flowers and other gifts; and for other socially-oriented events. The Authority also spent a significant amount on employee recognition awards and ceremonies. We brought these issues to the attention of Authority officials, who agreed to take steps to minimize these costs in the future.

The Authority reviews its portfolio of consultant and service contracts on a quarterly basis to determine whether each one is still necessary and reasonable. The Authority also prepares quarterly and annual contract reports that are reviewed by its Board of Trustees. We reviewed a sample of 20 contracts and found each of them to be necessary and reasonable.

The Authority's cost of debt is consistent with industry standards. To minimize its costs and limit its exposure, the Authority continually monitors its debt and conducts various cost analyses. Moreover, the Authority routinely issues Requests For Proposals (RFPs) to identify additional underwriters for its bond issuances and commercial paper series. The Board recently approved the selection of new underwriters.

Our report contains one recommendation for improving selected management and operating practices. Authority officials generally agreed with our recommendation, and stated that they have taken steps to reduce these costs.

This report, dated July 28, 2011, is available on our website at: http://www.osc.state.ny.us.
Add or update your mailing list address by contacting us at: (518) 474-3271 or
Office of the State Comptroller
Division of State Government Accountability
110 State Street, 11th Floor
Albany, NY 12236

Introduction

Background

The New York Power Authority (Authority) is America's largest state-operated public power organization, with 17 generating facilities and more than 1,400 circuit-miles of transmission lines. Created in 1931, the Authority is headquartered in White Plains and governed by a Board of Trustees. The Authority sells power to government agencies, community-owned electric systems and rural electric cooperatives, private companies, private utilities for resale and neighboring states. The Authority's mission is to provide clean, low-cost and reliable energy to promote economic and job development, energy efficiency, renewables and innovation for the benefit of both its customers and all residents of New York State. In 2010, the Authority reported a net income of $181 million.

As of December 31, 2010, the Authority had 2,172 open contracts totaling more than $5.3 billion, of which over $3.9 billion had been expended. Contracts for non-personal service or equipment purchases, contracts in excess of $3 million, and personal service contracts in excess of $1 million, are reviewed and approved by the Trustees, as stipulated in the Authority's policies. For the two years ended December 31, 2010, the Authority's expenditures included almost $3.2 billion to pay vendor invoices, $10 million for procurement card purchases, and almost $3 million for travel expenses.

The Authority finances construction of new projects from internally generated cash and /or through sales of bonds and notes to investors, and pays related debt service with revenues from the generation and transmission of electricity. The Authority's Board approves all bond issuances and commercial paper series. Total debt outstanding as of December 31, 2010 was $1.94 billion of which $1.62 billion is long-term debt and $320 million is short-term debt (commercial paper).

Audit Scope and Methodology

Our audit scope covered the period January 1, 2009 to June 21, 2011 and included an examination of expenditures related to personal service contracts, discretionary spending and the cost of debt issuance. During our audit, Authority officials informed us that the Office of the State Inspector General was conducting a concurrent investigation of the Authority's expenditures in the areas of grants, contributions and legal services contracts. After discussions with the Inspector General's representatives, we decided to narrow the scope of our audit. To accomplish our audit objectives, we reviewed source documentation for invoices and procurement card purchases; reviewed contracts;

met with Authority employees; and reviewed Authority and New York State policies, procedures, guidelines, and other applicable laws and regulations.

We conducted our performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained during our audit provides a reasonable basis for our findings and conclusions based on our audit objectives.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members to certain boards, commissions and public authorities, some of whom have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under generally accepted government auditing standards. In our opinion, these functions do not affect our ability to conduct independent audits of program performance.

Authority

The audit was performed pursuant to the State Comptroller's authority as set forth in Article X, Section V of the State Constitution. Additionally, Chapter 469 of the Laws of 1989 requires the State Comptroller to conduct an audit of the Authority's management practices at least once every five years.

Reporting Requirements

A draft copy of this report was provided to Authority officials for their review and comment. Their comments were considered in preparing this report, and are included at the end of the report.

Within 90 days of the final release of this report, as required by Section 170 of the Executive Law, the Chairman of the Authority shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons therefor.

Contributors to the Report

Major contributors to the report were John Buyce, Walter Irving, Joel Biederman, Rick Podagrosi, Don Cosgrove, W Sage Hopmeier, Natalie Sherman, Andre Spar, Arnold Blanck, Anthony Calabrese and Tracy Samuel.

Audit Findings and Recommendation

Discretionary Spending

To determine whether the Authority's discretionary spending was necessary and reasonable, we judgmentally selected initial samples of 39 invoices, 58 procurement card and 15 travel transactions for review based on expense descriptions that presented what we considered higher risks of impropriety (e.g., food, gifts, flowers and entertainment). After identifying certain potentially inappropriate or questionable expenses, we expanded our samples to include 177 procurement card and 52 invoice transactions to determine the total costs associated with these higher-risk expenses. For 2009 and 2010, we identified about $340,000 of questionable discretionary expenditures, including the following:

- $160,000 spent on a total of 21 holiday parties and picnics for employees, retirees, and guests. For example, the White Plains Office had its annual holiday party in-house, but spent between $9,100 and $9,500 each year on the food for this party;
- $46,000 and $39,000, respectively, on gifts for employee service and recognition. In addition, the Authority spent at least $57,000 on service award or recognition ceremony expenses, mostly food and beverages;
- $21,000 for complimentary AARP memberships for all retired employees;
- $10,000 spent for "empathetic" gifts, such as flowers, to employees and relatives; and
- $7,000 in entrance fees and other expenses related to having staff participate in the Corporate Challenge road race.

Authority officials defended their spending practices, stating that the expenses we cited were minor in scope and helped to boost employee morale. However, they stated the Authority, as a result of this audit, will discontinue paying for empathetic gifts and AARP memberships not covered by contractual commitments. In addition, they stated the Authority will continue to cut back on expenses related to service and recognition awards and ceremonies, picnics and holiday parties.

We also reviewed a sample of 15 employee travel events focusing on overseas flights and found each to be necessary and reasonably priced. The Authority has a travel unit that books all flights and hotels. Unit staff look for the most economical route, using government rates when available and negotiating rates whenever possible.

Recommendation

1. Limit or eliminate spending on nonessential items such as parties, ceremonies, gifts and memberships.

Contracts

We also found all 20 personal and miscellaneous service contracts we reviewed were necessary and reasonable. To determine whether the contracts were necessary, we analyzed whether the services provided were essential to the Authority's mission and goals. To evaluate the reasonableness of the contracts, we reviewed the award process (e.g., competitive bid, justified sole or single source) and if the Authority considered the feasibility of alternatives, such as using in-house staff, for these services. We also determined the Authority has a process to periodically review existing contracts to re-assess whether they are still necessary and appropriate.

Employees in the Authority's procurement unit are each responsible for a portfolio of contracts. Every quarter they review their portfolio. If a project is nearing the end of the contract period or there are indications the project is complete, they contact the Authority employee who has responsibilities for overseeing the work performed under the contract. The procurement unit employee determines whether the contract can be closed, needs to be rebid, or needs an extension in accordance with the Authority's Procurement Guidelines. The Authority prepares quarterly and annual contract reports, which are reviewed by the Board.

Cost of Debt

We found the Authority's debt costs and the practices it applies to managing debt are reasonable. To select underwriters for issuing debt, the Authority uses a Request For Proposal (RFP) process to initially identify companies to function as Senior Manager, Co-Managers and selling groups. The most recent RFP was issued in 2010. The Board approved the selection of additional companies, bringing the Authority's total to six Senior Managers, five Co-Managers and 11 selling groups.

The Authority does not have a formal written debt management strategy. However, it continually monitors interest rates and other factors. It also conducts analyses to determine whether refinancing would be beneficial to limit its exposure.

We reviewed the Authority's expenses related to its cost of debt, including management of principal, interest, counsel costs and other fees. We identified the rates associated with these costs and fees, obtained and reviewed bank liquidity and remarketing agents' agreements, and examined interest rate swap policies and procedures. Our review indicated the Authority's costs, rates, policies and procedures, are all consistent with industry standards.

123 Main Street
White Plains, New York 10601
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New York Power Authority
Generating more than electricity

Michael J. Townsend
Chairman

July 22, 2011

Mr. John Buyce
Audit Director
Office of the State Comptroller
Division of State Government Accountability
110 State Street, 11th Floor
Albany, NY 12236

Dear Mr. Buyce:

Please deem this letter as the New York Power Authority's response to the draft final audit report (2010-S-57) entitled: New York Power Authority — Selected Management and Operating Practices (the "2011 Draft Final Report").

The Authority is pleased that the Office of the State Comptroller (OSC) has found that the Authority's management and operating practices generally resulted in appropriate expenditures in all areas examined, including consulting and service contracts, discretionary spending and the cost of debt.

Management reviews the Authority's expenditures on an ongoing basis. Prior to the commencement of the 2011 management audit in March, 2011, significant reductions in the discretionary spending items noted in the 2011 Draft Final Report (holiday events, recognition awards, etc.) had been implemented.

The Authority reduced the annual cost of the service award and employee recognition programs by 62% from $150,000 in 2007 to $57,000 in 2010. Management achieved these savings by decentralizing the events; that is, each facility conducted its own event locally to eliminate travel and lodging costs and, in addition, by reducing the average cost of the awards. The employee recognition program, which provided individual awards for specific achievements during the prior year, was eliminated in 2010.

During this same period, the Authority reduced the annual cost of the annual holiday party and other cultural events by 27% from $109,000 in 2007 to $80,000 in 2010. Management achieved these savings by implementing cost saving measures such as celebrating the events in-house, reducing the number of attendees and eliminating non-essential spending.

The Authority agrees with the recommendation set forth in the 2011 Draft Final Report; however, while reducing costs, management will seek to retain the benefits inherent in such programs including employee retention in the highly skilled and competitive utility industry.

The Authority acknowledges and appreciates the cooperation and courtesies extended by the OSC to the Authority during its audit.

If you have any questions, please do not hesitate to contact me at the above address “Attention: Secretary’s Office.”

Very truly yours,

Michael J. Townsend
Chairman

MJT/tac