A REPORT BY THE NEW YORK STATE OFFICE OF THE STATE COMPTROLLER

H. Carl McCall
STATE COMPTROLLER

NEW YORK POWER AUTHORITY

MANAGEMENT AND OPERATIONS

2000-S-61

DIVISION OF MANAGEMENT AUDIT AND STATE FINANCIAL SERVICES

H. Carl McCall
STATE COMPTROLLER

Report 2000-S-61

Mr. Joseph J. Seymour
Chairman
New York Power Authority
30 South Pearl Street
Albany, NY 12207

Dear Mr. Seymour:

The following is our audit report addressing the management and operations of the New York Power Authority.

This audit was performed pursuant to the State Comptroller's authority as set forth in Chapter 469 of the Laws of 1989, as amended. In performing this audit, we were assisted by The Liberty Consulting Group of Quentin, Pennsylvania, a utility management-consulting firm. We list major contributors to this audit report in Appendix A**.**

Office of the State Comptroller
Division of Management Audit
and State Financial Services

July 31, 2001

EXECUTIVE SUMMARY

NEW YORK POWER AUTHORITY
MANAGEMENT AND OPERATIONS

SCOPE OF AUDIT

The New York Power Authority (NYPA) is the largest state-owned utility in the United States, providing about a quarter of the electricity used in New York State. NYPA operates five large power plants, five smaller generating facilities and more than 1,400 circuit miles of transmission lines. NYPA sells its electricity to various non-residential customers, particularly government entities and the investor-owned utilities operating in New York State. While NYPA receives no State appropriations, it was created by State law, and the Legislature and the Governor are ultimately responsible for ensuring that the actions of NYPA are in the public interest.

In 1996, New York State, through its Public Service Commission, began to significantly deregulate its power industry. As a result of this deregulation, the power industry was restructured and competitive wholesale and retail markets were created. The wholesale market was created as New York's regulated utilities were required to sell their generating plants to new owners, who are expected to compete with one another and other power generators in producing electricity. The retail market has been created as the utilities and newly formed energy services companies are expected to compete with one another in selling electricity and providing other services to consumers. NYPA, which is not subject to the regulations of the Public Service Commission, has remained a producer, transmitter and marketer of electricity, and therefore must compete in both the wholesale and retail markets.

Beginning in 1991, the Office of the State Comptroller has been required by State law to perform at five-year intervals a comprehensive audit of NYPA's management and operations. This audit was performed in accordance with that requirement. In performing this audit, we were assisted by a management-consulting firm specializing in utility operations. Our audit focused on the actions taken by NYPA in preparing to operate in a more competitive environment as well as other selected aspects of NYPA's operations.

Audit Observations and Conclusions

We found that certain actions need to be taken by NYPA management if NYPA is to be in a position to compete effectively in the newly deregulated power industry. In particular, NYPA needs to justify its actions as a public sector provider of electricity to develop additional capacity for the New York City area beyond its current customer base. This justification should be based on an independent analysis of such relevant factors as market conditions in the area.

To help meet the demand for power in the New York City area, NYPA is planning to expand its Poletti plant and has installed several small combustion-turbine generators in the New York City area, and may make a commitment to continue purchasing electricity from one of its former nuclear power plants. These three power resources involve about 2,000 megawatts of generating capacity and an estimated financial commitment totaling more than $1 billion of operating costs annually. However, as the New York City area market is deregulated and becomes more competitive, NYPA may not be able to generate enough revenue from electricity sales in the market to cover the costs of these commitments. We were unable to determine whether NYPA's plans to produce and consider purchasing this additional electricity were based on appropriate studies of likely market conditions and available alternatives for providing additional power to the area, because as is explained on pages 12 and 13 in the body of this report and in Appendix C, NYPA officials took actions to delay and limit the scope of this audit. Because of such delaying tactics, we were unable to complete our examination of NYPA's plans for the New York City area. We intend to pursue this issue in addition to others as part of a separate audit and recommend that NYPA limit actions on these plans until it can show that the financial viability of the plans has been justified by appropriate independent studies of market conditions and other relevant factors. (See pp. 7-16)

We were able to determine that, while NYPA's installation of the combustion-turbine generators in the New York City area will provide short-term electric-system benefits, it could create long-term problems by undermining the market competitiveness intended by deregulation and discouraging future private investment in generating capacity in the area. We recommend that NYPA's role in the new competitive power markets be clearly defined in statute. We believe NYPA should seek legislation that would clarify its role in the new competitive power markets. (See pp. 13-16)

We further found that NYPA will have to compete more and more with specialized, multi-state companies and other suppliers to buy and sell electricity at the best available price. However in the opinion of our management-consulting firm, NYPA lacks the demonstrated expertise and administrative infrastructure to compete effectively in this newly created arena. We recommend that NYPA take immediate action to either outsource its energy trading activities or significantly upgrade its in-house energy trading capabilities. (See pp. 16-20)

In June 2000, a consultant hired by NYPA began an organizational assessment to determine how NYPA should be staffed in light of these changes, especially the sale of NYPA's nuclear-power plants. The consultant completed most of the work required for the assessment and was paid in full, but NYPA officials asked that the assessment not be completed. In the absence of such an assessment, NYPA deferred learning exactly what kinds of skills and staff are needed for its new projects and activities (in particular, its energy trading activities). In addition, NYPA may be incurring unnecessary expenses for administrative and support staff who are no longer needed because its nuclear operations were sold. We conservatively estimate that these unnecessary expenses could total at least $10.5 million a year. We conclude that, because of NYPA's delay in completing such an organizational assessment, it is operating with a corporate administrative and support staffing level that was designed for a much larger and very different type of business. We therefore recommend that NYPA immediately complete the organizational assessment and that the results and recommendations be presented to the Board of Trustees as well as the Governor and the Legislature. (See pp. 25-28)

We also examined NYPA's management reporting systems and found that significant improvements are needed if NYPA officials are to have the information they need for crucial business decisions. For example, information about competitors, customer profitability and other aspects of operating in a competitive environment is not provided by NYPA's systems. In our review of other aspects of NYPA's operations, we found that NYPA effectively manages projects helping government customers improve their energy efficiency. However, NYPA does not consider all eligibility criteria in selecting customers for the Power for Jobs Program, in which qualifying businesses receive low-priced electricity in exchange for a commitment to create or retain a certain number of jobs in New York State. In our review of certain practices relating to business travel, we question NYPA's need for an Albany-based corporate airplane purchased in October 2000 at a cost of about $5 million, and we identify a number of ways in which NYPA's travel expenses can be reduced and more effectively controlled. (See pp. 28-46)

Comments of NYPA Officials

NYPA officials disagree with most of our conclusions, many of our recommendations, and believe some recommendations repeat actions that are already in progress. In sum, they believe the report contains many inaccuracies and is not useful. A complete copy of their response is included as Appendix B.

NYPA officials stated that they do not find our audit results useful and attribute this, at least in part, to the consulting firm we hired to assist us in this audit. We disagree with this conclusion. The Liberty Consulting Group is a leading consulting firm in serving utility regulators and others with oversight responsibility. Liberty has performed over 200 projects for more than 40 energy utilities and more than half of the state-regulatory commissions in the United States. In addition to its work for the New York State Comptroller in the immediately-preceding NYPA audit, Liberty has done management audits of: three utilities for the Pennsylvania Public Utility Commission, three utilities for the New York Public Service Commission, three utilities for the Connecticut Department of Public Utility Control, and one utility each for the Arkansas, Maryland, New Hampshire, and Tennessee commissions. Liberty has also worked for municipalities and other government-owned utilities, and for rural electric cooperatives.

We question the willingness of NYPA officials to be held publicly accountable and to receive constructive criticism. We note that NYPA officials were uncooperative and opposed the audit from the start, and delayed the audit process by slow responses to our inquiries.

Despite the comments by NYPA officials that the report contains factual errors, we question why they did not avail themselves of the opportunities to raise their concerns at a meeting on April 19, 2001 when we verbally advised them of our preliminary findings, or subsequently when we provided written preliminary findings to them with a request for formal comments. Instead, they chose to respond in a manner that makes the audit process appear as if the entity being audited was not aware of the audit results until it received the draft report in June 2001.

In addition, when responding to the draft report in July 2001, NYPA officials provided information that was not previously given to us. Where appropriate, changes have been made to the report to recognize relevant factual information conveyed in NYPA's response to our draft report (see Appendix B). Our response as well as the consulting firm's response to the comments by NYPA officials are included as Appendices C and D. The conclusions and recommendations, presented in this report were developed by career OSC auditors and a national utility management-consulting firm with considerable experience evaluating the management and operations of public and private utilities in many states.

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INTRODUCTION

Background

The New York Power Authority (NYPA) is the largest state-owned utility in the United States. NYPA provides about one-quarter of the electricity used in New York State by operating ten generating facilities and more than 1,400 circuit miles of transmission lines. NYPA also administers programs promoting economic development, energy efficiency, and the development of electro-technologies.

NYPA is a public benefit corporation created by the State Legislature in 1931. While NYPA is governed by a Board of Trustees, the State Legislature and the Governor are ultimately responsible for ensuring that the actions of NYPA are in the public interest. NYPA receives no State appropriations, as it obtains revenue from the sale of electricity and issues bonds to finance construction projects.

NYPA was authorized to develop hydroelectric power on the St. Lawrence and Niagara Rivers. NYPA's St. Lawrence and Niagara hydroelectric plants began operation in 1958 and 1961, respectively. The St. Lawrence plant has a generating capacity of 800 megawatts, while the Niagara plant has a generating capacity of 2,400 megawatts. (A megawatt is generally considered to be enough electricity to light 1,000 typical homes.)

To meet New York State's need for additional electricity, in 1968 NYPA was authorized by the State Legislature to build additional generating plants. Since most of New York's hydroelectric potential was already developed, NYPA built a pumped storage hydroelectric plant in the Catskill Mountains (the 1,040-megawatt Blenheim-Gilboa plant, which began operation in 1973) and a nuclear plant near Oswego on the shore of Lake Ontario (the 800-megawatt James A. FitzPatrick plant, which began operation in 1975).

In 1974, in response to financial difficulties encountered by Consolidated Edison, which was the primary source of electricity in the New York City metropolitan area, NYPA was directed by the Governor and the Legislature to buy two partially constructed generating plants from Consolidated Edison, to complete the construction of the plants, and to operate both plants (the 825-megawatt fossil-fueled Charles B. Poletti plant, which is located in Queens, and the 970-megawatt nuclear powered Indian Point 3 plant, which is located on the Hudson River in northern Westchester County). As part of this arrangement, NYPA was expected to sell most of the electricity produced by these two plants to government agencies in New York City and Westchester County, which were formerly customers of Consolidated Edison. The Indian Point 3 plant began operation in 1976, and the Poletti plant began operation in 1977.

In the late 1970's, NYPA began a program to develop small hydroelectric generating facilities throughout the State, and five such facilities, with a combined generating capacity of 30 megawatts, began operation between 1982 and 1986. NYPA added another generating facility when it was awarded a competitively-bid contract to build and operate a power plant in Suffolk County (the 136-megawatt fossil-fueled Richard M. Flynn plant, which began operation in 1994). In November 2000, in order to reduce its operating risks, NYPA sold its two nuclear power plants (the FitzPatrick and Indian Point 3 plants) to Entergy Corporation, a global energy company that also operates nuclear power plants in other states. As part of the sales agreement, NYPA will purchase the plants' output through 2004. To meet the increased demand for electricity in New York City from its customers and others, NYPA has announced plans to add over 1,000 megawatts of new capacity between an expansion of its Poletti plant and the just installed small combustion-turbine electric generators. (The small combustion turbines are intended to meet the area's projected capacity deficit in the summer of 2001.)

NYPA also built, owns and maintains a network of high-voltage transmission lines to carry power from its generating plants and other sources of electricity. These transmission lines include the most powerful line in the State for importing hydroelectric power from Canada and a connection across Long Island Sound, which was needed to supply more power to Long Island. The flow of electricity on NYPA's transmission lines is controlled by its Frederick R. Clark Energy Center in central New York, which also links NYPA to New York's seven investor-owned utilities. The overall flow of electricity in the State is regulated by the New York Independent System Operator, a recently created not-for-profit entity regulated by the Federal Energy

Regulatory Commission, that manages the sale, purchase and transmission of electricity in New York.

NYPA sells its electricity to various non-residential customers including government agencies and public authorities (such as the Metropolitan Transportation Authority), municipal and rural cooperative electric systems, private companies participating in economic development programs, the State's seven investor-owned utilities, and public agencies in neighboring states. Most of NYPA's major governmental customers are located in the New York City area. Since NYPA has never had a franchise like the investor-owned, municipal and cooperative utilities, its sales of electricity have consistently been on a contract basis. In addition, unlike the investor-owned utilities, NYPA is not regulated by the New York State Public Service Commission.

In 1996, New York State, through its Public Service Commission, began to significantly deregulate its power industry. As a result of this deregulation, the power industry was restructured and competitive wholesale and retail markets were created in the industry. The wholesale market was created as New York's regulated utilities were required to sell their generating plants to new owners, who are expected to compete with one another and other power generators in producing electricity. The retail market has been created as the utilities and newly formed energy services companies are expected to compete with one another in selling electricity and providing other services to consumers. NYPA has remained a producer, transmitter and marketer of electricity, and therefore must compete in both the wholesale and retail markets.

Audit Scope, Objectives and Methodology

We audited selected aspects of NYPA's operations for the period August 1, 1996 through May 31, 2001. The objectives of our program, financial and operations audit were to (1) evaluate the processes used by NYPA in deciding to expand the capacity of its Poletti plant and take other actions to meet the projected demand for power in the New York City area; (2) evaluate the actions taken by NYPA in preparing to compete in the new wholesale and retail electricity markets; (3) evaluate the pace of the turbine-generator upgrades that have been undertaken at the St. Lawrence and Niagara hydroelectric plants; (4) evaluate the adequacy of the organizational and staffing changes made by NYPA; (5) evaluate the adequacy of NYPA's management reporting information; (6) evaluate the effectiveness of NYPA in administering selected economic development and energy efficiency programs; (7) evaluate the controls over employee travel-related expenses; and (8) evaluate the adequacy of NYPA's strategic planning and disaster recovery planning for its automated information systems.

To accomplish our objectives, we interviewed NYPA officials and reviewed documents that NYPA provided. For some audit areas, we tested NYPA's records to assess compliance with its own policies and procedures and with adherence to good management practice and controls. We also interviewed selected customers in NYPA's energy efficiency programs.

The Chairman of NYPA's Board of Trustees and NYPA's Chief Financial Officer provided us with a representation letter on this audit. In the representation letters, these officials attest that, to the best of their knowledge, all requested financial and programmatic records and related data have been provided to the auditors. They further affirm that either NYPA has complied with all laws, rules, and regulations applicable to its operations that would have a significant effect on the operating practices being audited, or that any exceptions have been disclosed to the auditors.

However, during the course of our audit, NYPA management did not always provide the audit team with complete and timely access to the information requested, such as information about NYPA's plans to provide additional power to the New York City area, information relating to a consultant's assessment of NYPA's staffing levels and skills in light of the sale of the nuclear plants and development of new plants, and information on financial forecasts past 2001. In reviewing NYPA-supplied documents, that routinely took many weeks to produce, we found references to other documents from time-to-time that NYPA did not deliver, representations of NYPA's management aside. We consider this lack of cooperation on the part of NYPA management to be a scope limitation on our audit. Therefore, readers of this report should consider the potential effect of this scope limitation on the findings and conclusions presented in this report. This matter is further discussed in Appendix C.

In performing this audit, we contracted with The Liberty Consulting Group of Quentin, Pennsylvania, a utility management-consulting firm. We relied on this firm's expertise and considerable experience in evaluating utility operations.

The Liberty Consulting Group along with personnel from Watson Rice LLP provided detailed analysis of all aspects of NYPA's programs, management and operations consistent with the stated scope and overall objectives established for the NYPA audit. OSC nevertheless maintained overall management responsibility for the conduct of the audit and ensured full compliance with government auditing standards. Such standards require that we plan and perform our audit to adequately assess those operations of NYPA which are included within the audit scope. Further, these standards require that we understand NYPA's internal control structures and compliance with those laws, rules and regulations that are relevant to the operations which are included in our audit scope. An audit includes examining, on a test basis, evidence supporting transactions recorded in the accounting and operating records and applying such other auditing procedures as we consider necessary in the circumstances. An audit also includes assessing the estimates, judgments, and decisions made by management. Subject to the above mentioned scope limitations, we believe that our audit provides a reasonable basis for our findings, conclusions and recommendations.

Chapter 469 of the laws of 1989 requires the State Comptroller to do a program, financial and operations audit of NYPA at least once every five years. To fulfill this statutory mandate, prior to the actual audit, we identified a number of specific concerns and issues that, with the assistance of The Liberty Consulting Group, have been pursued during this audit. We fine-tuned and revised the audit areas as circumstances warranted. The audit of NYPA has culminated in this report, which covers but does not necessarily report on all concerns and issues originally identified because the report is prepared on an “exception basis” and, therefore, is focused on areas in need of increased attention and stronger improvement and not on those areas where NYPA is considered to meet minimum industry standards and demonstrate adequate controls and sound management practices.

Response of NYPA Officials to Audit

We provided NYPA officials with drafts of the matters addressed in this report for their review and comments. Their comments have been considered in preparing this report and are included as Appendix B.

This audit is the third under Chapter 469 of the Laws of 1989 and, over the years, we have observed a disturbing trend by NYPA officials to try to manipulate the audit process, oppose our legitimate audit oversight, and attempt to slow our progress.

Despite the comments by NYPA officials that the report contains factual errors, we question why they did not avail themselves of the opportunities to raise their concerns at a meeting on April 19, 2001 when we verbally advised them of our preliminary findings, or subsequently when we provided written preliminary findings to them with a request for formal comments. Instead they chose to respond in a manner that makes the audit process appear as if the entity being audited was not aware of the audit results until it received the draft report in June 2001. In addition, when responding to the draft report in July 2001, NYPA officials provided information that was not previously given to us.

We take exception to the criticism leveled by NYPA in its cover letter, executive summary, audit process commentary, and NYPA's lengthy response document. We stand by the audit team's conclusions and recommendations, which were developed by career OSC auditors and a national utility management-consulting firm with considerable experience evaluating the management and operations of public and private utilities in many states. To help ensure that our consideration of NYPA's comments is clear, we respond to NYPA's commentary in Appendix C. Where appropriate, we have made changes to the report to recognize relevant factual information conveyed in NYPA's response.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the Chairman of the New York Power 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 in this report, and where recommendations were not implemented, the reasons therefor.

GENERATING AND SUPPLYING POWER IN A COMPETITIVE ENVIRONMENT

To help meet the demand for power in the New York City area, NYPA is planning to expand its Poletti plant and is installing several small combustion-turbine generators in the New York City area, and may make a commitment to continue purchasing electricity from one of its former nuclear power plants. These three power resources involve about 2,000 megawatts of generating capacity and an estimated financial commitment totaling more than $1 billion of operating costs annually. However, as the New York City area market is deregulated and becomes more competitive, NYPA may not be able to generate enough revenue from electricity sales to cover the costs of these commitments.

Therefore, before finalizing its commitments to provide additional power to the New York City area, NYPA needs to analyze the likely market conditions in the area and thoroughly evaluate all available alternatives for providing such power. NYPA may have performed such analyses and evaluations, but because NYPA officials were slow to respond to our requests for information, we were unable to verify the relevance and use of the information that was finally provided to us without significantly jeopardizing our ability to issue this mandated audit report by July 31, 2001, as required by State law. While we were unable to complete our examination of this aspect of NYPA's operations as part of this audit, we intend to pursue this issue as part of a separate audit.

We note that, even though we first began requesting information relevant to NYPA's New York City area operations in September 2000, and made repeated requests of this nature throughout the audit, relevant information was not provided to us until mid-May 2001, when our audit field work was about to be completed. We also note that, while NYPA officials eventually provided a considerable number of consultant reports that may include analyses and evaluations relevant to NYPA's New York City area operations, the officials did not provide us with any internal memos, reports or other documentation indicating that the information in these consultant reports was in fact used by

NYPA officials in their decision-making processes. In the course of our audit, senior NYPA officials provided no indication that their decisions to expand the Poletti plant, install the combustion-turbine generators, and consider extending the power-purchase contract had been guided by the kinds of studies and analyses that were contained in the consultant reports, and on a number of occasions, told us they were not aware of any such studies and analyses.

We were able to determine that, while NYPA's installation of the combustion-turbine generators in the New York City area will provide short-term electric-system benefits, it could create long-term problems by undermining the market competitiveness intended by deregulation and discouraging future private investment in generating capacity in the area. We recommend that NYPA's role in the new competitive power markets be clearly defined in statute.

We further found that NYPA, which will have to compete more and more with other utilities and specialized, multi-state companies to buy and sell electricity at the best available price, lacks many of the demonstrated skills and administrative infrastructure to compete effectively in this newly created arena. We recommend that NYPA take immediate action to either outsource its energy trading activities or significantly upgrade its in-house energy trading capabilities. We also note that the upgrading of the turbine-generators at the St. Lawrence plant needs to be monitored closely to ensure that creeping delays do not hinder this modernization effort.

Power Supply and Demand in the New York City Area

Prior to deregulation, most of the electricity supplied to New York City was generated by Consolidated Edison, one of the State's seven investor-owned utilities. In the new competitive environment, consumers in New York City will not have to obtain electricity from any particular source. However, to protect against problems caused by transmission bottlenecks and other disruptions in the supply of electricity to New York City, a Settlement Agreement involving the Public Service Commission has established a local reliability rule. According to this rule, an entity serving load within New York City is required to have at least 80 percent of the installed capacity necessary to service such load located within the City.

While NYPA is not at this time subject to the local reliability rule, it could be made subject to the rule in the future by the New York Independent System Operator. If NYPA were subject to the rule, it would need about 500 megawatts of additional in-City generating capacity if it were to continue to serve its existing government customers in the City. Instead, as NYPA officials state in their response to our draft report, the New York Independent System Operator has adopted a minimum locational generation capacity requirement that is akin to the local reliability rule in that it requires an entity serving load in New York City to have or purchase 80 percent of its capacity from electricity generated within the City. Accordingly, NYPA plans to expand the capacity of its Poletti plant (located in Queens) by 500 megawatts at an estimated cost of $367 million.

In addition, to ensure that it will have enough power to continue supplying its customers in the New York City area, NYPA is exploring the possibility of extending beyond 2004 its contract to purchase the output of the Indian Point 3 nuclear plant that was sold to Entergy Corporation. Further, in response to projected shortfalls in New York City's supply of electricity in the 2001 summer peak usage period, NYPA is installing 11 simple-cycle, 47-megawatt combustion-turbine electric generators in or near New York City at an estimated cost of $500 million (this cost includes special equipment for protecting the environment).

In expanding its Poletti plant, installing the combustion-turbine generators, and possibly extending its purchase contract with Entergy Corporation, NYPA is making or considering financial commitments involving more than $1 billion annually. We examined the process used by NYPA in making or considering these commitments to determine whether NYPA's decisions have been based on appropriate studies and analyses.

The Expansion of the Poletti Plant and the Extension of the Indian Point 3 Power-Purchase Contract

NYPA's customers in the New York City area account for a significant portion of NYPA's business. For example, in 2001, these customers are expected to account for 60 percent of NYPA's approximately $2 billion in total revenue from the sale of electricity. NYPA is planning to expand its Poletti plant and is exploring the possibility of extending its power-purchase contract with Entergy Corporation in order to ensure that it will have enough electricity to continue supplying these customers. However, in the new competitive environment, NYPA officials cannot assume that they will be able to retain all these customers or continue to be the sole supplier of power for the customers that are retained.

According to NYPA officials, their customers in the New York City area have paid 20 to 22 percent less than they would have paid if their electricity had been supplied by Consolidated Edison. During the deregulation transition period, all New York City area electric customers except NYPA customers in the areas formerly served by Consolidated Edison have to absorb a Stranded Cost Recovery Charge. ("Stranded" costs are costs a utility is obliged to pay, such as costs relating to long-term contracts or costs incurred in constructing a plant, but is not expected to recover in a competitive market.) Consequently, NYPA will probably continue to enjoy a significant price advantage until the stranded costs have been fully recovered. Since these costs were originally expected to be recovered by March 31, 2002, NYPA's competitive advantage may begin to disappear during 2002, at which time competitors can declare an "open season" on NYPA's New York City area customers.

These customers are bound to NYPA for the duration of their power-purchase contracts, but most of these contracts can expire beginning in 2005. (According to the termination provision in the contracts, three years notice is required for termination, and for most of the contracts, such notice cannot be given until December 31, 2001.) Moreover, beginning in 2002, these customers are permitted by the contracts to obtain a portion of their electricity from sources other than NYPA, although NYPA still has the right to match or beat any offers from other suppliers.

If NYPA is unable to retain its market share in the New York City area, or has to reduce its prices to match the new competitors in the area, it may not be able to recover the costs that will be incurred from its expansion of the Poletti plant or the costs that would be incurred from an extension of its power-purchase contract with Entergy Corporation, and may in fact incur significant financial losses. Beginning in 2002, NYPA's customers in the New York City area can begin to shop elsewhere for electricity, and may begin to find prices lower than the prices offered by NYPA, especially in 2004 and after. Before committing significant financial resources to new generating sources (the Poletti expansion) or purchasing electricity (from Entergy Corporation) to supply these customers, NYPA should estimate how much electricity it can reasonably be expected to sell, and at what price, in the newly competitive New York City area market. In addition, before committing significant financial resources to expand the Poletti plant in order to comply with the minimum requirement requiring 80 percent in-City generating capacity, NYPA should thoroughly evaluate all available alternatives for adding capacity within New York City.

We asked NYPA officials to provide us with any studies they had performed related to their plans to provide additional power to the New York City area. They provided us with the *Poletti Repowering Report* which had been prepared by NYPA's staff and was the basis for proceeding with the Poletti expansion. We evaluated this report and concluded it was inadequate for the following reasons:

- It assumed that NYPA would continue to serve New York City area customers, which may not in fact be the case.

- It assumed that NYPA would own and operate the Indian Point 3 plant, which is not the case.

- The data in this report is outdated, having been prepared in September 1997.

- The study was based on a very simple market forecast and an economic analysis which assumes a monopoly market in which customers have no choice of generation suppliers.

Because the information NYPA provided was inadequate, we asked if there were any other relevant studies which NYPA may have used as the basis for the decision to expand the Poletti plant. In fact, so we could determine whether NYPA's decisions to expand the Poletti plant and consider extending its power-purchase contract with Entergy Corporation were based on appropriate studies and analyses, we made repeated requests, some of which were written and some of which were verbal. However, we were provided only with the *Poletti Repowering Report*, and were repeatedly told by senior NYPA officials that, as far as they knew, no other such information was available.

In April 2001, when we reviewed our preliminary findings with senior NYPA officials and noted the absence of other studies in support of NYPA's decisions relating to the Poletti expansion and the possible extension of the power-purchase contract, the officials did not indicate that any other studies had been conducted and were used in their decision-making processes.

Finally, on May 9, 2001, as our audit field work was about to be completed, NYPA officials provided us with a large number of reports that had been prepared for NYPA by a consultant in 1999 and 2000. We determined that these reports contained the kinds of information we had repeatedly requested beginning in September 2000: studies and analyses relating to the New York City area market, Poletti expansion feasibility studies, and studies and analyses relating to possible alternatives for adding generating capacity within New York City. However, we could not verify that these studies and analyses were in fact utilized in NYPA's decisions to expand the Poletti plant and consider extending its power-purchase contract with Entergy Corporation, without significantly jeopardizing our ability to comply with the State law authorizing our audit of NYPA. This law requires an audit report to be issued by the Office of the State Comptroller on or before July 31 of every fifth year beginning in 1991. To verify the relevance and use of these various consultant reports would have taken several weeks. If the reports had been provided to us earlier in the audit, when we repeatedly requested such information, we would have had ample time to verify their relevance and use, but at this late stage, the time was not available. (We note that, at no time did NYPA officials provide us with any internal memos, reports or other documentation indicating that the information in these consultant reports was in fact used by NYPA officials in their decision-making processes, and during the course of our audit, the officials provided no indication that their decisions to expand the Poletti plant and consider extending the power-purchase contract had been guided by the kinds of studies and analyses that were contained in the consultant reports.)

We therefore conclude that we cannot, at this time, fulfill our audit objective of determining whether NYPA's decisions to expand the Poletti plant and consider extending its power-purchase contract with Entergy Corporation were based on appropriate studies and analyses. As a result, the following critical questions -- concerning the need, justification and economic viability of these actions -- remain unanswered:

- Were all reasonable alternatives considered?

- Was the proper analysis of market demand completed?

- Was the proper analysis of market supply completed?

- Was the proper integrated, long-term, risk-adjusted, discounted cash flow economic analysis conducted?

- Was the solution selected the most economically prudent?

- How will investments be recovered, and will they be recovered in a reasonable amount of time?

We also believe that NYPA officials, in waiting so late in the audit process to respond to requests for information that were made near the beginning of the audit process, failed to comply with the State law authorizing our audit, as Section 4.2 (C) of this law requires NYPA officials to "supply specific and complete answers to questions upon which information may be needed." Moreover, in our one-day review of the stack of consultant reports provided to us on May 9, 2001, we found an indication that other relevant information may not have been provided to us, as one of the reports examined further expansion of the Poletti plant by an additional 800 megawatts. Even though such a prospect is highly significant and was relevant to many of our requests for information relating to NYPA's plans for serving the New York City area market, NYPA officials made no mention of this possible further expansion and provided no other information relating to such an expansion.

In view of NYPA's obligation to serve the public interest, an obligation that is underscored by the State law requiring our periodic audit of NYPA's management and operations, we are disappointed that NYPA officials chose to vigorously attack the audit process and the audit team, rather than provide full and complete information regarding its business activities. For example, we would have welcomed a timely and complete explanation of NYPA's decisions to expand the Poletti plant and consider extending the power-purchase contract with Entergy Corporation. Unfortunately, we did not and thus were unable to complete our examination of this aspect of NYPA's operations as part of this audit, we intend to pursue this issue as part of a separate audit.

We note that the ground has yet to be broken for the Poletti expansion, and NYPA can still "walk away" from this project during the year 2001, if it should be determined that the project should not be continued. While NYPA has been authorized by its Board of Trustees to spend $197 million toward this project, these funds are to be used primarily to make advance payments to General Electric to schedule the new Poletti facility's turbine generator in the manufacturing process. Because of the high demand for these turbine generators, NYPA could sell its slot in the turbine generator production schedule to another entity.

NYPA is considering actions that could increase its generating capacity in the New York City area to as much as 2,800 megawatts: a Poletti expansion (500 megawatts), PowerNow turbines (500 megawatts), the potential extension of the Indian Point 3 contract (980 megawatts), and to run either the existing Poletti plant (825 megawatts) or its potential replacement. However, the peak demand for NYPA's existing customers in the New York City area is only 1,700 to 1,800 megawatts. These plans entail a substantial investment even for NYPA and associated high degree of speculative risk in a very volatile market. We therefore recommend that prior to making further commitments for the completion of the Poletti expansion or the extension of the Indian Point 3 contract, NYPA demonstrate that the commitments are consistent with an independent analysis of the financial viability of the New York City area market for NYPA.

NYPA officials state in their response to our draft report that they will not proceed with large financial commitments to build or buy electricity without commitments from NYPA's customers. However, in the professional opinion of our management-consulting firm, NYPA has committed to the 500 megawatt Poletti expansion in the Trustee meeting of August 29, 2000; to the PowerNow turbines that have been approved by the Trustees and built (500 megawatts); and the existing Poletti plant (825 megawatts) or its potential replacement. If NYPA were to extend the Indian Point 3 contract, which it is considering, these power-supply commitments could potentially result in NYPA having about 1,000 megawatts of capacity more than its New York City area customers require. Our intent was to alert the appropriate officials that if NYPA were to commit to the Indian Point 3 contract extension, or other firm power-supply sources, such as the recent request for proposals that NYPA issued, NYPA would have a very substantial speculative merchant generator position in the New York City area. As pointed out earlier, because of NYPA's managerial tactics to inhibit the audit process, we did not receive the complete and necessary information from NYPA in sufficient time to analyze what NYPA may or may not have done in this area. We therefore conclude further study and analysis is warranted.

The Installation of Combustion-Turbine Generators in New York City (The PowerNow Program)

The New York Independent System Operator determined that there may be a shortfall in the electrical energy supply for New York City in the summer of 2001. In response, NYPA implemented the PowerNow Program, in which NYPA installed eleven 47-megawatt simple-cycle combustion turbines in the New York City area.

We recognize that NYPA implemented the PowerNow Program in response to a potential crisis. Those responsible for forecasting the region's balance of electrical supply and demand have clearly determined that the New York City area is at risk of electricity supply disruptions. If significant shortages occur, they will very likely be accompanied by substantial increases in electricity prices. California's experience in such a situation demonstrates that, regardless of the reasons for an insufficient supply of power, swift action must be taken to restore the balance between demand and supply. Since there clearly was little time for the implementation of privately initiated supply options, there are advantages to NYPA's intervention.

However, it should also be recognized that public intervention in a market designed to be competitive has consequences; for example, it could chill the development of other private options, which are expected to produce long-run economies. Therefore, if private sector energy companies are to be expected to make rational investment decisions that promote long-term reliability and economy in the region, there needs to be a clear articulation of NYPA's role and authority in the new market. We note that the PowerNow Program has not been explicitly authorized by legislation or executive order, and NYPA's very public response to this expected power shortfall has not been accompanied by a description of its future role. Such a description is needed, and needs to be sufficient to provide private suppliers, on whom the New York State market will largely depend, with the perspective and information they need to make the investment decisions that will have a direct bearing on the mid- and long-range development of energy resources in the State.

We also tried to evaluate the process used by NYPA officials in deciding to install these generators. The objective of our review was to determine whether the decision was based on an appropriate analysis of available alternatives and how NYPA expected it would recover its investment in these units. However, for the same reason we were unable to complete our audit of the decision-making processes for the Poletti expansion and possible extension of the Entergy Corporation power-purchase contract (the delay by NYPA officials in providing us with potentially relevant consultant reports), we were unable to complete our audit of the decision-making process for the combustion turbines. We will address the process in a future audit.

Recommendations

To NYPA's Board of Trustees:

1. Before finalizing commitments to expand the Poletti plant and to extend the Indian Point 3 power-purchase contract, complete an independent analysis that demonstrates whether these actions are financially viable.
2. Obtain an independent analysis to evaluate the appropriateness of NYPA's continued ownership and operation of the PowerNow turbines past the summer of 2001.
3. Seek statutory support for a clear description of NYPA's role in New York State's competitive wholesale and retail power markets.
4. Explain NYPA officials' lack of timely responses to State auditors' requests for information.

Energy Trading Capability

In the past, NYPA routinely sold excess electricity, and routinely purchased some of the electricity needed by its customers when it was not available from internal sources because of unexpected generating unit outages and other reasons. For example, between 1996 and 2000, NYPA's purchases and sales of electricity ranged from $11 million to over $40 million a year. Such energy trading is commonplace in the power industry. However, in New York State's new competitive wholesale and retail power markets, NYPA will face many new challenges in its energy trading activities. In addition, with the sale of its two nuclear power plants (which together had a generating capacity of 1,800 megawatts), NYPA may have to purchase more electricity than it did in the past, and with the expansion of the Poletti plant and the implementation of the PowerNow Program to meet the peak demand needs of New York City, NYPA will face additional energy trading challenges.

If NYPA is to buy and sell power at competitive prices in this new and challenging energy trading environment, it will need to enhance its organization, its risk-management practices, and the skills of the employees responsible for its energy trading activities. Moreover, in this new environment, NYPA will be competing with firms whose only business is to operate in this very different and risky market of power marketing and trading.

In the year 2004, when NYPA's fixed-price contract with the Entergy Corporation for power from the Indian Point 3 plant is scheduled to terminate, the new Poletti facility is scheduled to become operational, and most of NYPA's contracts with its customers in the New York City area face possible termination, NYPA will face a competitive power market that is very different than the current market. No matter how each of these individual issues is resolved, NYPA will be dealing with a highly competitive marketplace for electrical energy, with uncertainties on both the supply side and the demand side of the energy requirements equation. NYPA must take steps now to be prepared to participate in this marketplace.

NYPA officials have stated that they will not engage in energy trading activities on a speculative basis, but rather to take care of basic operating needs. Nevertheless, NYPA will be competing for power supplies on the open market against multi-state energy traders whose main line of business is power transactions. For example, Williams Energy is a dominant player in this market, and operates with about 300 trading personnel and 200 support staff out of a state-of-the-art energy trading floor the size of an ice skating rink. NYPA currently has six power traders, and six support personnel. During 1999, Williams moved 91 million megawatts of electricity, which is more than 100 times the amount of electricity moved in the open market by NYPA in its most active year of energy trading (1997). Enron, another dominant force in this market, typically moves about 400 million megawatts a year, more than 400 times the amount moved by NYPA in its most active year. In addition, NYPA's plans to expand power supply resources in the New York City area show that it will be a merchant generator, which requires sophisticated energy trading skills. A merchant generator buys and sells electricity on the open market without the security of long-term contracts, which by definition is speculative.

In response to the emergence of competitive multi-state power markets, some of the public power authorities in other states have outsourced their energy trading activities. For example, the Nebraska Public Power District has turned its energy trading activities over to The Energy Authority (TEA), a private company specializing in energy trading and risk management with offices in Nebraska and Florida. Most electric utilities in this country, whether public or private, have recognized that they are entering a new energy trading environment and will need expertise in some areas that are new to traditional utility operations. Therefore, these utilities have not only restructured their organizations to accommodate these changes, but they have gone outside of their organizations to obtain personnel skilled in commodity trading activities and risk management strategy, and familiar with the fast pace and high risk embodied in today's energy trading arena.

We examined the actions taken by NYPA officials in response to the emergence of competitive multi-state energy trading markets. We found that NYPA has appropriately restructured its organization to bring focus to energy trading activities, as NYPA has created an Energy Resource Management function under the Vice President of Power Contracts and Energy Resource Management. However, all the positions in this new group have been filled with existing NYPA personnel. We reviewed the resumes of these individuals and, in the expert opinion of our management-consulting firm, found that they do not possess the skills needed to conduct energy trading activities in the new competitive multi-state markets. We note that some of these individuals were transferred from NYPA's nuclear operations.

We also examined NYPA's procedures and processes for conducting energy trading activities. We found that significant improvements are needed in these procedures and processes, as energy trading job descriptions are out-of-date, performance goals are irrelevant or do not exist, operating procedures are incomplete, and management reports are cumbersome and lack meaningful performance measurements. We also found no evidence indicating that the management reports are received by senior management, and insufficient evidence that planning for energy purchasing and bulk power transactions is sufficient. In addition, NYPA has not developed measurable targets for the energy trading activities described in its strategic plan for Energy Resource Management.

We further note that, while NYPA officials recognized the importance of risk management in energy trading activities when they created a unit with the function of controlling and limiting financial risks, the unit is not appropriately located in NYPA's organizational structure. This unit reports to the Director of Marketing Planning in the Marketing and Economic Development organization, which does not provide sufficient visibility, or authority, for a function that is critical in the new competitive multi-state energy trading markets.

However, as our audit field work was nearing completion, we learned that NYPA had transferred responsibility for risk management to the Treasurer, and was in the process of analyzing proposals from outside organizations to manage NYPA's risk management function on a contract basis. As part of its responsibilities, the contractor will be expected to recruit and train two individuals from outside NYPA who will eventually become NYPA employees with full responsibility for risk management. In general, the contractor will be expected to assess the magnitude of NYPA's risk exposure in the areas of energy trading and fuel management, and to help NYPA define its levels of risk tolerance. The contractor will also be expected to enhance NYPA's procedures and guidelines for energy trading and risk management, and to train NYPA's employees in these functions. It is also expected that, once the risk management function is established within NYPA, it will report directly to the President of NYPA.

We believe that the weaknesses we identified in NYPA's risk management function may effectively be addressed by this new approach, and recommend that a similar approach be taken to address the weaknesses in NYPA's energy trading capability.

Recommendations

5. Promptly complete the process for contracting to improve the risk management function.

Recommendations (Cont'd)

6. Either outsource energy trading activities, or recruit from outside NYPA a senior individual with substantial experience in energy or commodity trading to direct NYPA's energy trading activities.
7. Develop an action plan for correcting the weaknesses described in this report in the procedures, practices, job descriptions, management reports, and performance measures relating to NYPA's energy trading activities.

Convertible Static Compensator Project

NYPA's convertible static compensator (CSC) project is a tool for upgrading and reinforcing its transmission system. The CSC system will use high-speed solid-state electronic switches to instantaneously redirect power flows and avoid, or compensate for, bottlenecks on transmission lines. Of particular note is the CSC's ability to control power flow simultaneously on two different lines in the same substation by exchanging power between them and routing power from an overloaded line to an underutilized one.

This new technology can be especially useful in New York State because there is extensive generating capacity in the western and northern parts of the State, but heavy demand in the New York City area. This has led to transmission constraints, and in the eastern part of the State, a major transmission corridor is at the limit of capacity at least 25 percent of the time. NYPA expects that the CSC system will increase the flow of electricity by as much as 240 megawatts, and provide transmission operators the widest choice of management options to relieve bottlenecks at NYPA's most congested power corridor.

NYPA has initiated construction of this CSC system at its Marcy Substation. The CSC will enable NYPA to provide additional voltage control at the Marcy Substation and to directly control power flow on one or two NYPA transmission lines between Utica and Albany. The first elements of the CSC have been completed and, on April 2, 2001, Phase I of the project was turned over to the New York Independent System Operator for its use in operation of the Central-East Transmission corridor. This new CSC system will continue to be owned by NYPA, while its operation will be under the control of the Independent

System Operator. Final installation of all elements of the CSC project (Phase II) is scheduled for July 2002. The estimated cost of the CSC system is $48 million. NYPA will provide $35 million, and the remainder will be financed by others such as the project contractor, and at least 25 other utilities in the United States and Canada.

We reviewed NYPA's records for the CSC projects to determine whether it should have been the dominant investor in this pioneering technology and whether it is being adequately compensated for these transmission line technology improvements that benefit all utilities that wheel electricity through NYPA's transmission grid. In addition, we were interested in evaluating NYPA's risk assessment actions related to the commitment to install new technology on the NYPA transmission system, on a full-scale basis.

We determined that NYPA has appropriately tested the CSC system technology and evaluated the risks associated with introduction of this new technology into their transmission system. In addition, NYPA has shown that its investments in the CSC system should be returned in a reasonable amount of time. NYPA expects cost recovery of their investment in the CSC system through two mechanisms, either the direct sale, or retained ownership, of the Transmission Congestion Contracts (TCC's) awarded to NYPA by the Independent System Operator for the CSC project, and/or through the NYPA Transmission Adjustment Charge (NTAC). However, exact project cost recovery cannot be specified now because the Independent System Operator is a new entity, with many of their policies and procedures continuing to evolve, such that final policies related to TCC's have not yet been determined.

NYPA's reply to our preliminary findings was that the Independent System Operator has awarded it 114 TCCs effective April 13, 2001. However, it did not provide a value for the TCCs and there is no assurance that the number of TCCs will not change when the permanent award methodology is established.

We also note that NYPA will not finish Phase II of the project until next year. Therefore, there must continue to be some accountability for NYPA to demonstrate that the total project functions as intended, and that total project cost recovery mechanisms are continuing to function as currently anticipated.

Recommendation

8. Provide the Governor and State Legislature with quarterly reports on the progress of the CSC project. These reports should include: updates on the on-line monitoring of Phase I of the CSC project, updates on the progress toward completion of Phase II of the CSC project, notification that both Phase I and Phase II of the project are operating satisfactorily, and updates on the actual project cost recovery through operation of the TCCs.

Upgrades at the Two Major Hydroelectric Plants

NYPA is upgrading the turbine-generators at its two major hydroelectric power plants: the Niagara plant and the St. Lawrence plant. The upgrading is intended to improve efficiency and extend the life of the power plants. The Niagara plant has a total of 13 turbine-generators, while NYPA's portion of the St. Lawrence plant (which is shared with Canada) has a total of 16 turbine-generators. At each plant, NYPA is upgrading one turbine-generator a year. At the time of our audit, NYPA had upgraded 7 of the 13 units at the Niagara plant, and was in the process of upgrading the first of the 16 units at the St. Lawrence plant. We examined the pace of the upgrades at the two plants to determine whether it could be accelerated.

At the Niagara plant, we determined it would be possible for NYPA to increase the rate of the upgrade process to two turbine-generators a year. However, because of the additional costs that would be incurred by such an increase, and because such an increase would accelerate the completion of the entire upgrade process by only two years (the remaining six units would be completed in 2004 rather than 2006), we concluded that it would not be cost-effective to accelerate the current pace of the upgrade process at the Niagara plant.

At the St. Lawrence plant, we determined that, because of the configuration of the facility, there is not sufficient room to work on two units at the same time. However, it is possible to upgrade three units in two years. We therefore concluded that NYPA's plan for the pace of upgrading at the St. Lawrence plant is reasonable and can be adjusted on the basis of experience once some of the units are upgraded.

However, we did find indications that the schedule for the upgrades at the St. Lawrence plant is slipping. The upgrade of the first unit had been scheduled to begin in September 2000, but had yet to begin by May 15, 2001. In the Niagara upgrade project, there was an interval of several years between project initiation and the upgrade of the first unit. With significant, nationwide demands on the power plant manufacturing and construction industry, and NYPA's history of not completing projects in a timely fashion, there is a risk of additional schedule slippage at the St. Lawrence plant.

Recommendation

9. Take appropriate actions to prevent further slippage in the upgrade schedule at the St. Lawrence plant.

ORGANIZATIONAL STAFFING AND DECISION-MAKING

When NYPA sold its two nuclear power plants, it reduced the size of its staff by more than half (from 3,412 to 1,697 authorized positions). NYPA will need new skills, and may need additional staff, for such activities as the implementation of the PowerNow Program and the buying and selling of electricity in a competitive environment.

In June 2000, a consultant hired by NYPA began an organizational assessment to determine how NYPA should be staffed in light of these changes. The consultant completed most of the work required for the assessment and was paid in full, but NYPA officials asked that the assessment not be completed. In the absence of such an assessment, NYPA deferred learning exactly what kinds of skills and staff are needed for its new projects and activities (in particular, its energy trading activities, as is discussed earlier in this report). In addition, NYPA may be incurring unnecessary expenses for administrative and support staff who are no longer needed because its nuclear operations were sold. We conservatively estimate that these unnecessary expenses could total at least $10.5 million a year. We recommend that NYPA immediately complete the organizational assessment and that the results and recommendations be presented to the Board of Trustees as well as the Governor and the Legislature.

We also examined the information provided by NYPA's budgeting, planning and management reporting functions. We found that budgeting information is adequate, but significant improvements are needed in the planning and management reporting information if NYPA officials are to have the information they need for crucial business decisions.

Need for an Organizational Assessment

In November 2000, NYPA completed the sale of its two nuclear power plants to Entergy Corporation. Prior to the sale of the plants, NYPA had a total of 3,412 authorized staff positions. After the sale, the number of authorized positions was reduced by 1,715, as follows:

- 619 positions at the FitzPatrick nuclear power plant,
- 613 positions at the Indian Point 3 nuclear power plant,
- 393 positions at NYPA's nuclear headquarters, and
- 90 positions in nuclear appraisal and compliance activities.

Therefore, as a result of the sale of the two nuclear power plants, the size of NYPA's staff was reduced by about one-half to 1,697. Since many of the remaining 1,697 positions are administrative and support positions (such as accountants, attorneys, and human resources staff), and a sizeable portion of the work performed by the NYPA staff in these positions had related to NYPA's nuclear operations, it is likely that NYPA would need fewer administrative and support positions after the nuclear operations had been sold.

NYPA recognized the need to evaluate its administrative and support staffing needs, as it retained a consultant to perform an organizational assessment that was scheduled to begin on June 5, 2000 and be completed by July 21, 2000. According to documents maintained by NYPA, the consultant was expected to produce "a prioritized list of potential restructuring opportunities, with estimated savings, headcount reductions and possible personnel redeployments." Therefore, this organizational assessment could have helped NYPA officials adjust the level of their administrative and support staff in response to the sale of the nuclear plants, and could have helped the officials make other staffing changes in response to other new operational needs, such as the implementation of the PowerNow Program and the emergence of competitive wholesale and retail power markets.

However, according to NYPA officials, the consultant was "pulled off" the organizational assessment prior to its completion, and no final report was produced. In response to our preliminary observations, NYPA officials stated that the project was put on hold while management assessed how the currently staffed work force adapted to changes in assignments after the nuclear divestiture and work force reductions resulting from a retirement incentive, coupled with the beginnings of major projects requiring heavy resource allocations. According to the officials, NYPA's Chief Operating Officer wanted to see how the organization runs with current employees, and may revisit the organizational issues in the future. We were told by NYPA officials that all of the interviews, background work and analysis for the organizational assessment were completed by the consultant, and that the full contract price of $200,000 was paid, but no report was produced that we could review.

NYPA began the process of selling the nuclear power plants to the Entergy Corporation in the fall of 1999, when it was publicly announced that the negotiations for the sale had begun. NYPA's Board of Trustees approved the sale on March 28, 2000, and the sale was closed on November 21, 2000. As of June 1, 2001, NYPA had yet to complete the formal assessment of its need for organizational changes as a result of this sale. We conclude that, because of NYPA's delay in completing such an organizational assessment, it is operating with a corporate administrative and support staffing level that was designed for a much larger and very different type of business.

NYPA officials have repeatedly told us that they have not yet determined how NYPA's organizational structure and staffing levels will change as a result of the sale of the two nuclear power plants. The officials also note that NYPA will need additional staff for new projects and activities, such as the relicensing of its hydroelectric plants, the expansion of the Poletti plant, the implementation of the PowerNow Program, and the buying and selling of electricity in a competitive environment. However, the skills, type, and staffing levels of administrative support required for these projects and activities are not likely to be the same as those required for the nuclear operations. Moreover, the organizational assessment begun by the consultant was intended to help NYPA officials address both of these needs: the need to restructure as a result of the sale of the nuclear operations and the need to obtain staff for new projects and activities.

As a result of NYPA's suspension of this organizational assessment, it deferred learning exactly what skills and staff are needed for its new projects and activities (in particular, its energy trading activities, as is discussed earlier in this report), and may be incurring unnecessary expenses for administrative and support staff who are no longer needed. Considering that NYPA's overall staffing level was reduced by about one-half, and its headquarters-related contract services budget was reduced by 25 percent as a result of the sale of the nuclear operations, we conservatively estimate that NYPA's Corporate Support payroll can also be reduced by at least 25 percent. Given that NYPA's Corporate Support payroll was budgeted for $41.9 million in 2001, we estimate that about $10.5 million of this amount may represent unnecessary expenses that could be eliminated if an organizational assessment were completed and its recommendations implemented.

Recommendations

10. Promptly complete the organizational assessment and present the results, conclusions and recommendations directly to the Board of Trustees as well as the Governor and the Legislature.
11. Provide full documentation to the Governor and the Legislature of actions taken to implement the recommendations contained in the organizational assessment.

Information for Management Decisions

In the dynamic environment of the energy business, it is crucial to have appropriate management and decision-making information. Moreover, the need for management decisions to be based on the best available information will become even more important as the energy business becomes more and more competitive. The budgeting, planning and management reporting functions in particular must provide information that is relevant, timely, reliable and complete. For management information to be relevant in the dynamic and increasingly competitive energy business, it cannot be confined to current and historical periods; it must also address future periods with forecasts and analyses of likely markets, operations and strategies.

We examined the information provided by NYPA's budgeting, planning and management reporting functions. We found that the budgeting information is adequate, but significant improvements are needed in management reporting, analysis, and decision-making information. As a result of some of the weaknesses we identified in NYPA's management reporting systems, NYPA officials have lacked some of the information that was needed for crucial business decisions, such as their decision to expand the Poletti plant and consider an extension of their contract to purchase power from the Indian Point 3 nuclear power plant.

NYPA's processes for budgeting and measuring operating expense performance begin annually with a review by the Budget Director of the previous year's budget and actual performance. The operating expenses for each facility and headquarters department are analyzed for previous year's budget actually spent, work plans for the budget year, recurring and non-recurring activities included in the previous years' budget, and long-range plans for the unit. The Budget Director makes recommendations regarding the budget for each department and facility, and meets with each to discuss the recommendations and arrive at a mutually acceptable target. The budget target recommendations are reviewed and approved by the Comptroller, Senior Vice President of Finance, and President. Budgets are then built to meet the targets from the bottom up by NYPA departments. Approved budgets are later sent to the Board of Trustees. We conclude that NYPA's budget-setting process is well structured and provides reasonable oversight and processes.

NYPA measures its operations and maintenance budget performance with monthly reports that present the annual budget, year-to-date budget, year-to date actual expenditures, year-to-date variance from budget, and year-to-date percentage variance from budgets for each department and facility. We examined the summary and detailed monthly budget reports and found that they provide operating expense information in a clear and relevant form for use by NYPA management.

NYPA uses its Long-Range Financial Plan to forecast ten years of financial information, including the projected performance of each of its business units. Such long-range planning is crucial in the dynamic and increasingly competitive energy business. NYPA officials told us that NYPA's Long-Range Financial Plan was last updated in February 2000. Therefore, a more current Long-Range Financial Plan was not available either for us or NYPA's Board of Trustees to review. However, since the February 2000 Long-Range Financial Plan, NYPA has closed on the sale of its two nuclear power plants, signed contracts to purchase electricity from these plants through 2004, committed to the purchase of turbines for the Poletti expansion, the generators for the New York City area in the PowerNow Program, and is considering an extension to the contract to purchase electricity from the Indian Point 3 nuclear plant. We therefore conclude that NYPA's decision makers have not been provided with all the necessary forward-looking financial information during a critical period of decision-making and change. We recommend that NYPA upgrade its ability to update the Long-Range Financial Plan on-demand, and perform such updates when they are needed.

NYPA hired a consultant to evaluate its system for providing financial reports to top management. In May 2000, the consultant reported its findings to NYPA. According to the report submitted by the consultant, the energy industry and NYPA's environment are changing, driving the need for new and more externally-focused management information. The consultant concluded that NYPA's management reporting had gaps in the management information required in NYPA's business environment. The key findings from the report are summarized as follows:

- NYPA's executive management reports do not support analysis or strategy. They are of limited value for identifying issues and helping make decisions, because the reported information is too detailed, is difficult to read (numbers only), is focused almost exclusively on financial matters, is backward-looking, and is internally focused.

- Relevant information is not available, such as: trading performance, customer margins, current and future market conditions, competition, risk management, and external benchmarks.

- The data capture process across all systems is not standardized.

- Current systems do not support the management reporting process.

We agree with the consultant. For example, information about power markets, energy trading, competitors and customer profitability is crucial in a competitive environment. As is discussed earlier in this report, NYPA officials are making and considering commitments to provide additional power to the New York City area, but lack information about the competitors in the area, the profitability of their customers in the area, and other crucial aspects of the New York City area market. In addition, as is also addressed earlier in this report, if NYPA does not adequately monitor its performance in the increasingly competitive energy trading market, it could incur significant financial losses.

The consultant recommended that a new set of management reports be developed to provide NYPA executive management with the information that it needs to manage and plan for the business, as well as to make major decisions. The consultant emphasized that the reports should be designed before software and hardware were selected to support the management reporting system. The consultant provided samples of the types of reports that would provide NYPA management with the information it needs.

When we asked NYPA officials if they intended to implement the consultant's recommendations, they acknowledged there is a need to design new management reports and stated that they are in the process of designing a few of the reports. However, we found that NYPA has not made substantial progress in the areas recommended by the consultant. Specifically, NYPA has not redesigned the management reporting end-products prior to delving into system projects, such as an upgrade to its financial information system. Considering the importance of good management information in NYPA's current environment and the serious nature of its needs in this area, we conclude that NYPA is likely to require significant consulting help in upgrading its management reporting system.

Recommendations

12. Immediately implement the consultant's recommendations for improving management reports, beginning with a total redesign of the standard reports.
13. Develop the capability to upgrade the Long-Range Financial Plan on demand, and perform such updates at least once a year and whenever major changes in strategy, projects or assumptions are anticipated.

SELECTED ENERGY PROGRAMS

NYPA administers programs that promote economic development, energy efficiency, and the development of electro-technologies. We audited NYPA's effectiveness in administering energy efficiency programs and its primary economic development program. While we identified certain relatively minor weaknesses in NYPA's administration of energy efficiency programs, we concluded that NYPA's project management is generally effective in these programs. However, we identified the need for significant improvement in NYPA's administration of its primary economic development program (the Power for Jobs Program).

The Power for Jobs Program

In NYPA's economic development programs, businesses that qualify for participation in the programs receive electricity from NYPA at a lower price than would otherwise be available. In exchange for this low-priced electricity, the businesses are expected to retain or create jobs in New York State. At the time of our audit, a total of 800 businesses were participating in NYPA's various economic development programs. Because about 80 percent (637) of these businesses participated in the Power for Jobs Program, we focused our review on this program. The objective of our review was to evaluate the effectiveness of NYPA in administering the Power for Jobs Program.

We found that, when NYPA evaluates an applicant's eligibility for the Program, it does not apply most of the eligibility criteria included in the law authorizing the Program. We further found that NYPA has not established an adequate system for evaluating the effectiveness of the Power for Jobs Program. We also found that NYPA has not been timely in its efforts to verify the employment levels reported by Program customers, and does not always take action when it discovers that the employment levels are lower than were agreed to by the customers. We recommend a number of improvements in NYPA's administration of the Power for Jobs Program.

Program Effectiveness

The Power for Jobs Program was created by the State Legislature in July 1997. The businesses participating in the Program receive low-priced electricity from NYPA in exchange for a commitment to create or retain a certain number of jobs. The total amount of power available through the Power for Jobs Program is subject to limits established by the Legislature, and generally, Program customers receive no more than about one-half of their electricity through the Program.

To participate in the Program, a business must submit an application to the Economic Development Power Allocation Board, which is chaired by NYPA's CEO and consists of three other members appointed by the Governor, Senate Majority Leader and Assembly Speaker. The application itself is reviewed by NYPA staff, who evaluate the applicant's eligibility for the Program on the basis of several criteria that are included in the legislation authorizing the Program.

According to NYPA, the Power for Jobs Program has been very successful. For example, according to NYPA, as of May 2001, nearly 270,000 jobs were "linked to" the Program (that is, the businesses participating in the Program had agreed to create or retain a total of nearly 270,000 jobs). We examined how the effectiveness of the Power for Jobs Program is measured by NYPA and found that three types of measurements are used, as follows:

- the total number of jobs to be created or retained by the businesses participating in the Program (e.g., nearly 270,000 jobs as of May 2001),

- increases in employment levels at businesses participating in the Program (e.g., in a review of more than 200 Program contracts that were initiated in 1998 and 1999, NYPA determined that the participating businesses reported about 3,700 more jobs than had been agreed to), and

- the ratio of the number of jobs to be created or retained by a participant to the amount of electricity available through the Program to the participant (e.g., 100 jobs per megawatt).

We question the appropriateness of these measurements, because it is not clear how employment levels at the participating businesses are affected by their electricity bills. These measurements imply that the participating businesses or non-profit organizations created or retained a certain number of jobs *because* they paid less for electricity than they would have paid in the absence of the Power for Jobs Program. However, a company's decision to add or cut jobs, or to stay in the State or relocate elsewhere, is affected by a great many factors, many of which are likely to be more important than variations in the cost of electricity. We do not dispute that reductions in electricity bills are valuable to businesses. However, in the absence of a demonstrated link between such reductions and a company's creation or retention of jobs -- which may well have been created or retained even if a customer was not participating in the Power for Jobs Program -- we question the appropriateness of attributing the jobs to a customer's participation in the Power for Jobs Program.

We also question the appropriateness of other aspects of the "jobs per megawatt" measurement. NYPA uses this measurement both to define success (the more jobs created/retained per megawatt of power provided, the better) and as a basis for evaluating Program applications (the more jobs an applicant promises to create or retain for every megawatt of power it receives from NYPA, the better the applicant's chances of being allowed to participate in the Program). However, this approach favors businesses that use less electricity per employee (such as service providers) at the expense of those that use more electricity per employee (such as manufacturers), even though businesses that use more electricity per employee tend to have a greater need for lower electricity rates and are therefore more likely to base employment levels and relocation decisions on variations in the price of electricity.

In addition, if the number of jobs created or retained per megawatt of electricity provided is to be considered an indicator of program effectiveness, the Power for Jobs Program could, in theory, be made to seem more effective by increasing the number of participating businesses and decreasing the amount of electricity provided to each business, as the total number of jobs created or retained per megawatt of power provided would be higher. However, in reality, if the amount of electricity provided to a participant were reduced, the cost of the electricity would be even less of a factor in the participant's decisions relating to the creation or retention of jobs.

We therefore conclude that the measurements used by NYPA are not valid indicators of the effectiveness of the Power for Jobs Program. According to the law that authorizes the Program, by December 1 of each year, NYPA is to report to the Governor and Legislature on "the need for the continuation of economic development programs, including the Power for Jobs program." In the absence of valid performance indicators, we believe NYPA cannot adequately fulfill this requirement. We therefore recommend that NYPA either develop valid performance indicators for the Power for Jobs Program, or hire an independent consultant to develop such indicators.

Compliance with Program Requirements

Customers in the Power for Jobs Program are required by their contracts to submit annual reports to NYPA about their employment levels, and NYPA is expected to review these reports to ensure that the customers are maintaining their employment at the agreed upon levels. In addition, NYPA is authorized by the contracts to conduct audits at the customers' sites to verify the reported employment levels.

We reviewed the actions taken by NYPA to verify the employment levels reported by Program customers. We found that, until October 2000, NYPA had conducted few audits at the customers' sites, and the audits that were conducted were not timely (e.g., audits of employment reports for 1997 were completed in April 1999). As a result, NYPA was less likely to identify Program customers who were not maintaining employment at the agreed upon levels. Such customers can have their power allocations reduced, and can even be expelled from the Program. Since the total amount of electricity available for the Program is limited by law, and far more businesses have applied to the Program than can be accepted, it is important for NYPA to identify noncompliant customers on a timely basis. Once such customers are identified, they can be replaced, when appropriate, by different customers that may comply with Program requirements.

While NYPA did not perform many on-site audits of Program customers, it did review annual reports submitted by Program customers to compare their reported employment levels against their agreed to employment levels. For example, according to information reported by NYPA's President to the Board of Trustees, in 1999 NYPA reviewed a total of 276 such annual reports. According to Program regulations, if the number of jobs reported by a participant is not a certain percentage (80 percent or 90 percent, depending on when the contract was initiated) of the agreed upon level, the participant's allocation of electricity may be reduced or terminated. However, we found that NYPA often does not reduce or terminate the allocations of such customers.

For example, in 32 of the 276 annual reports reviews conducted in 1999, NYPA found that the reported employment levels were less than 80 or 90 percent (whichever was appropriate) of the agreed upon levels. NYPA reduced or terminated the amount of electricity allocated to 9 of these 32 customers, but continued to allocate the same amount of electricity to the remaining 23 customers because NYPA officials had reason to believe their employment levels would increase in the future. We recognize that NYPA officials want to give Program customers every chance to comply with Program requirements, but action must also be taken to ensure that such customers do indeed comply with the requirements.

The law authorizing the Power for Jobs Program describes at least 12 criteria that should be used when determining whether an applicant should be approved in the Program. For example, these criteria include the types of jobs created, as measured by wage and benefit levels; security and stability of employment; and the extent to which economic development power will affect the overall productivity or competitiveness of the applicant's business and its existing employment within the State. However, NYPA uses only one of these criteria (the ratio of the number of jobs to be created or retained to the amount of economic development power requested by the applicant) when determining whether to admit applicants into the Program. As a result, NYPA does not fully comply with the intent of the law.

Recommendations

14. Either develop valid performance indicators for the Power for Jobs Program or hire an independent consultant to develop such indicators.
15. (Recommendation deleted based on NYPA's response.)

Recommendations (Cont'd)

16. Incorporate all the criteria included in the law into the process for evaluating applications for the Power for Jobs Program.

Energy Efficiency Programs

NYPA's energy efficiency programs are aimed at helping program customers reduce their energy costs by replacing old, less-efficient equipment with new, more efficient equipment. The program customers, most of whom are government agencies, engage NYPA to manage their projects for improving energy efficiency. NYPA conducts a feasibility assessment and manages the construction and/or installation of the energy-conserving devices. NYPA also finances the projects and allows program customers to repay project costs over several years.

NYPA has completed about 1,000 energy efficiency projects since 1990, and has implemented a number of different program initiatives, including the: High Efficiency Lighting Program (HELP), the Energy-Efficient Refrigerator Program, the Clean Air for Schools Program, the Non-Electric End Use Program, and the Electrotechnologies Program. The total cost of the projects through the year 2000 was $504 million. According to NYPA, these projects save program customers a total of $68 million a year in energy costs, and 159,000 kilowatts a year in electricity.

We examined NYPA's records for a sample of all of the energy efficiency projects. The sample consisted of the largest 37 projects from all of the programs and 13 additional projects from different counties costing less than $100,000 each. These projects cost a total of $137 million. We also surveyed selected program customers to determine whether they were satisfied with NYPA's management of their energy efficiency projects. The overall objective of our audit was to evaluate NYPA's effectiveness in administering its energy efficiency programs.

We found that, generally, NYPA was effective in its administration of these programs. All 44 of the completed projects in our sample were completed on schedule and NYPA had either recovered, or was in the process of recovering, the costs of these projects. In addition, the program customers we contacted told us that they were pleased with NYPA's performance in managing their projects. We did identify opportunities for improvement in certain administrative controls relating to estimates of cost savings, customer satisfaction surveys and other practices.

Each energy efficiency project is expected to result in certain energy savings. However, NYPA has no procedures for following-up to verify that the estimated savings are realized. As a result, the estimated savings could be overstated. According to NYPA officials, its method for estimated savings is based on a 1994 consultant study. We do not dispute the appropriateness of the estimation methodology, but note that the value of NYPA energy efficiency programs could be more accurately determined if the actual savings were verified.

NYPA routinely performs telephone customer-satisfaction surveys for the HELP Program customers in Westchester County, New York City and Long Island. However, it does not perform such surveys for customers in other programs and areas of the State. We recommend that such surveys be performed for all programs and in all areas of the State.

To determine whether program customers were satisfied with NYPA's management of their energy efficiency projects, we contacted officials at three of the largest customers: the New York City Transportation Authority, the New York City Housing Authority, and the New York State Office of General Services. The officials we contacted told us they were pleased with NYPA's project management on their projects. They stated that NYPA engaged contractors who moved the projects along at the agreed pace, and that NYPA's engineers were attentive to details.

Program customers are required to approve all project work. However, for 23 of the 50 projects in our sample, there were no records indicating that the participant had approved all project work. In addition, approved change orders were not included in six files. As a result, there is risk that the work on these projects was not completed in accordance with requirements. Absent such documentation in project files, NYPA officials state in their response to our draft report that the work is approved implicitly because their customers paid for the work. However, we believe that complete project documentation of all approvals is a good business practice and necessary to prevent possible disputes.

We also note that, although NYPA has spent more than $500 million on energy-efficiency programs, its internal-audit unit generally audits only one energy service program annually because, according to NYPA officials in their response to our draft report, their risk is minimal and internal audit resources are limited. Nonetheless, considering the dollar size and diversity of these programs, we recommend that NYPA increase its internal audit coverage for energy efficiency programs, and use the internal audits to provide assurance that energy efficiency projects are properly approved by program customers.

Recommendations

17. Develop a process for verifying the actual savings of energy efficiency projects.
18. Perform customer-satisfaction surveys for energy efficiency projects in all areas of the State.
19. Increase the internal audit coverage for energy efficiency programs, and use the internal audits (and other available means) to provide assurance that energy efficiency projects are properly approved by program customers.

SELECTED MANAGEMENT PRACTICES

We examined certain practices of NYPA relating to business travel expenses and planning for information technology functions. We found that some of NYPA's travel expenses could be reduced and could be more effectively controlled. We also found that improvements can be made in NYPA's strategic planning and disaster recovery planning for its information technology functions.

Travel-Related Practices

Between 1996 and 2000, NYPA spent between $6 million and $7 million a year on business travel. Almost one-half of all NYPA employees receive some form of reimbursement for their travel, which ranged from as little as $1 to more than $68,000 annually for some employees. As a public entity, NYPA has an obligation to carefully manage its travel expenditures and ensure that such expenditures are in accordance with established guidelines. We found that NYPA could reduce some of its travel expenses and could improve some of its controls over these expenses.

Corporate Aircraft

NYPA owns two corporate aircraft, a Beechcraft B-200 King Air Turbo Prop placed in service in January 1989, and hangered in White Plains, and a Beechcraft B-350 King Air Turbo Prop placed in service in October 2000, and hangered in Albany. NYPA shares the use of this second aircraft on a 50-50 basis with the New York State Police, which pays to hanger, fuel and maintain the aircraft.

NYPA purchased the Albany-based aircraft at a cost of about $5 million. NYPA officials told us they purchased the plane because using it would cost less than using commercial flights for many of their business travel purposes. According to an analysis prepared by NYPA, the savings resulting from the acquisition of the plane will total about $167,000 over ten years.

We examined NYPA's analysis of the savings to be realized from the purchase of the second plane, and we found that the analysis was seriously flawed for the following reasons:

- NYPA's analysis was not conducted on a net present value basis to account for the differences in timing of cash flows over the ten-year period of the analysis. Using all the cost data from NYPA's analysis, but applying a present value discount rate of 6 percent, we found that NYPA's costs over the ten-year period will be more than $1.9 million higher, rather than $167,000 lower.

- NYPA significantly understated the cost of operating the plane, as the operating costs it used were based on the cumulative average costs of operating its other plane since that plane was placed into operation in 1989. This practice understates the current operating cost of items such as fuel, which has increased significantly in recent years. NYPA also included no depreciation or amortization costs for the plane, which is not appropriate for a comparison to the rates charged for commercial and chartered flights, because such rates are set high enough to recover capital costs as well as operating costs.

- NYPA's analysis compared the plane's operating costs to *standard* commercial airfares, not the lower discounted airfares that are generally obtained by NYPA when its employees use commercial flights. The standard rates may be more than double the rates actually paid by NYPA.

We therefore conclude that, if NYPA officials had properly analyzed the acquisition and operating costs of the second, Albany-based plane, they would have determined that using the plane is far more costly than using commercial flights. As we note, even on the basis of NYPA's understated cost data, a present value analysis shows that purchase of a second aircraft results in a cost to NYPA of $1.9 million instead of a savings of $167,000. The differential would be even larger if the plane's current operating costs were used, if depreciation costs were appropriately taken into account, and if the comparison was made to the prices actually paid by NYPA to use commercial flights.

NYPA officials also told us in their response to our draft report that the second plane was needed to improve flexibility and productivity and because the first plane was often used. They also stated that it would be less costly than the alternatives of commercial airlines or chartered flights. However, the officials did not document that there was an increased demand for use of its corporate aircraft that could not be met by commercial airlines or chartered aircraft at a lower cost. Furthermore, NYPA's cost study did not place a value on increased flexibility and productivity made possible by a second aircraft; we used the same initial cost data provided by NYPA and it did not justify the purchase of the second corporate plane.

Use of Video-Conferencing Facilities

NYPA has video-conferencing equipment at all of its major locations. NYPA purchased the equipment to improve internal communications and to reduce travel costs, as employees can meet in video-conferences instead of traveling long distances for meetings. This equipment cost NYPA a total of $625,500: $57,500 for the terminal equipment at each of nine sites, as well as bridging equipment for $108,000 at White Plains to enable three or more sites to participate in a single conference. It costs about $1,000 a year at each location to maintain the equipment. This equipment uses existing NYPA data lines, so there are no per-minute charges when NYPA uses the equipment. Since one business trip can easily cost more than $1,000, the video-conferencing system has easily paid for itself in just the last two years of its operation, and is an effective way to control and reduce business travel costs.

We examined NYPA's use of its video-conferencing facilities and found indications that the facilities are not used as often as they could be. In particular, while the facilities are used often at some NYPA locations, they are rarely used at other locations. For example, in 2000, the Blenheim-Gilboa power plant and the Clark Energy Center each used their video-conferencing facilities about 125 times, while the Niagara power plant used its facilities only 17 times. Some locations that appear to have similar needs and operations consistently use video conferencing more that others. For example, the St. Lawrence hydroelectric power plant uses video-conferencing two to three times more often than the Niagara hydroelectric power plant. If the video-conferencing facilities at the Niagara plant were used more often, it is possible that the amount of travel expenses incurred for trips to the Niagara plant could be reduced.

We note that NYPA does not maintain logs to indicate the names of the personnel participating in video conferences, or the matters discussed. Such information would be useful not only in identifying who uses the system, but also in identifying organizational units that do not use video-conferencing. This information could be used to promote increased use of the system.

Other Travel-Related Issues

NYPA operates a Travel Desk staffed by four people who provide travel agency services to employees who travel on NYPA business. It is NYPA policy that all employees use the Travel Desk for business travel needs to provide NYPA management with better control over business travel costs. We found that NYPA employees generally use the Travel Desk to make their travel arrangements. However, the Travel Desk does not decide which mode of transportation would be most economical. If an employee has three options for travel – automobile, commercial airline or corporate aircraft – the Travel Desk does not make cost comparisons so it could make the most economical travel decision. Instead, department mangers approve travel requests made by their employees, including their mode of transportation. Since the department managers may not know which mode of travel is most economical and the Travel Desk has expertise on travel costs, NYPA should develop a process for including the Travel Desk experts in such day-to-day business travel decisions.

NYPA officials told us that Travel Desk staff discuss travel alternatives with traveling employees and managers. However, this is not a formal process and is not required. We note that, generally, corporate travel desks are used to minimize all costs of travel, not just to obtain the lowest airfares, as is done at NYPA.

NYPA has a total of 240 vehicles in its corporate fleet for employee business use. We examined the deployment of these vehicles at NYPA's major operating locations and determined that some locations appear to have more vehicles than are needed. For example, the Clark Energy Center has one automobile for every two employees and the Blenheim-Gilboa plant has one automobile for every three employees. In contrast, the other locations have between five and eight employees for every automobile, a ratio more consistent with industry standards. NYPA officials could not explain these widely varying ratios. We recommend that NYPA officials determine whether all the vehicles are needed, and sell all the excess vehicles.

Some NYPA employees are on extensive business travel assignments and as a result, receive a significant amount of travel reimbursements (nearly double their salary in some instances). Generally, these employees routinely travel to facilities far from their official workstation for extended periods of time. NYPA officials state that there are organizational and employee benefits to such long-term travel arrangements. However, it may also be possible for NYPA to reduce its travel costs in some of these instances by using employees at the distant locations to perform the work or by using local contractors to do the work.

NYPA's policy is to have all of its employees use a corporate credit card for all business travel, lodging and automobile rentals. This practice reduces the need for making cash advances for business travel, and is a cost-effective way to pay business expenses. However, we sampled the records of 40 NYPA business travelers and found that 12 of the travelers did not use the corporate card to pay their business travel expenses.

Recommendations

20. Sell one of the NYPA corporate aircraft.

21. Improve controls over travel-related costs by taking the following actions:

- Accumulate information about the use of NYPA's video-conferencing facilities to identify opportunities for increasing the use of the facilities, and develop performance management goals to encourage the use of the facilities.
- Develop a process that enables the Travel Desk to review travel requests to ensure that the cost of the travel is minimized.

Recommendations (Cont'd)

- Analyze the use of the corporate vehicles at the different locations. If the variations in the employee-to-automobile ratios are not justified by business use, sell all the unneeded vehicles.
- (Recommendation deleted based on NYPA's response.)
- Reevaluate the assignments of employees to long-term travel status. Consider either outsourcing such assignments or assigning the work to an employee closer to the work location.
- Enforce the policy of requiring employees to use NYPA's corporate credit card for business travel expenses.

Information Technology Planning

Organizations should develop strategic plans for the achievement of their missions, goals and objectives. As part of this planning, information technology long- and short-range plans should be developed to ensure that the use of information technology is aligned with the mission and business strategies of the organization.

We found, however, that NYPA does not formalize its long and short-range information technology strategic plans. NYPA officials told us that, because of the competitive environment in the electric utility industry, they do not want to put their plans in writing. Although NYPA has information technology plans for individual projects, it does not have a strategic plan that is integrated with NYPA's overall business strategy.

A written strategic plan for information technology would provide a framework for strategic decision-making regarding hardware and software platforms and communications equipment architecture. Such strategic planning is particularly vital for NYPA at this time of change. With the sale of its two nuclear power plants, NYPA needs to rethink its information technology strategies in light of the reduction in the scope of its operations. Additionally, with the changes in the regulatory environment in the electric generation, transmission, and distribution processes, it is imperative that a strategic plan for information technology be in place.

Organizations also need disaster recovery plans to help ensure that critical data processing activities can be resumed promptly in the event of a disaster. We found, however, that NYPA has not developed a complete disaster recovery plan. NYPA has written some procedures for data processing recovery in the event of a disaster at its White Plains Office; however, these procedures address only offsite data storage and restoration of the data. The procedures do not address the steps required to rebuild the network or an individual server in the event of a partial or total network or server failure.

NYPA officials told us that the White Plains data center is housed in a protected environment with adequate backup generators, and they therefore do not expect a total loss of the data center. They believe this is a worse-case scenario for which periodic testing is unnecessary. Consequently, there are no formal plans for dealing with a total loss of the facility. Planning for the loss of facility is a crucial element in any information technology disaster recovery plan; testing for loss of a facility should be an important part of the contingency planning process. NYPA's Information Technology officials told us that if there is a loss of data processing capability, they could purchase a new server to restore the data using their backup tapes. They also indicated that the following options are available for resuming processing in the event of a server failure:

- There is a backup server in the data center. There would be a fifteen-minute recovery period if the primary server fails.

- If the White Plains facility is lost, NYPA would move its processing to the Clark Energy Control Center in Marcy. This would entail a three to seven day period until full recovery.

However, NYPA neither has a formal plan for moving its data processing operations to a backup server on site or at an alternate site, nor do they have a testing plan to provide assurance that such alternate processing can be set up expeditiously and will function as intended. In addition, NYPA has not performed an analysis to examine the impact of having processing at the White Plains office partially or fully interrupted. Without such an analysis, NYPA does not know the effect of such an interruption on its business.

Recommendations

22. Develop a formal strategic plan for Information Technology functions which supports NYPA's overall business strategy.

23. Formally analyze the impact of an interruption in NYPA's data processing functions, and on the basis of this analysis, develop a complete disaster recovery plan. Test the plan periodically to ensure its viability.

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New York State Comptroller

New York Power Authority

Michael H. Urbach
Senior Vice President
and Chief Financial Officer

July 19, 2001

Honorable H. Carl McCall
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Re: 2001 Management and Operations Audit

Dear ~~Comptroller McCall:~~ Carl

Pursuant to Chapter 469 of the laws of 1989, as amended by Chapter 298 of the laws of 1990 enclosed, please find the response of the New York Power Authority to the 2001 Management and Operations Audit conducted by the Office of the State Comptroller. I am sending you these comments in advance of the issuance of your final report with the hope that an effort will be made by your office to present a more accurate and useful document than we have seen to date.

In reviewing the draft final report, it is apparent that the audit has not provided the New York Power Authority, the Governor, the Legislature, our customers, or the people of New York State a benefit remotely commensurate with the substantial costs incurred. Unfortunately, this result is not surprising since your staff insisted on hiring Liberty Consulting Group to perform the audit, the same consulting group which audited us five years ago and whose prior audit report is filled with numerous and erroneous recommendations. These included potentially closing down our two nuclear plants (which were recently sold to Entergy for record prices) and selling our Poletti Power Project (which is crucial to our maintaining the ability to provide the MTA and City of New York with low cost power). Thus, despite NYPA having incurred nearly $2.3 million ($2,300,000) dollars in audit costs, providing over 900 documents in response to audit requests, and dedicating some 11,000 person hours to the audit process, the final report fails to provide either an accurate analysis or depiction of prior events or useful advice to guide future Authority actions.

* Note 1

* Note 2

* Note 3

* Note 1

As you are aware, Chapter 469 of the Laws of 1989, as amended, is intended to provide the Governor and the Legislature with a detailed assessment of the ways in which Authority actions facilitate and conform to policies established by the Governor and the Legislature. Those policies are set forth in the Authority's enabling statute (§1000 *et seq* of the Public Authorities Law). Instead, the report reflects a strong bias towards a discussion of what the policies should be, regardless of the statutory provisions. For

* Note 4

* See State Comptroller's Notes, Appendix C

example, the enabling legislation establishing the Power for Jobs program states that "The legislature finds that the cost of electricity has a significant effect on economic development, employment levels and decisions to retain, attract, or expand businesses in New York". Despite this, the report states "We question the appropriateness of these [jobs] measurement because it is not clear how employment levels at participating businesses are affected." Clearly, this is not a constructive suggestion on how to operate the Power for Jobs program or an evaluation of whether the Authority is operating the program consistent with the statute. This type of gratuitous challenge to state policy is rampant throughout the report and has stained the audit process.

* Note 5

Further, when the report does focus on operations of the Authority, many of the audit findings merely repeat recommendations that have previously been identified by NYPA staff or by consultants hired by NYPA. Obviously, it is of little use to NYPA to pay for the same advice twice or to get a report which merely recommends actions that are currently in progress.

* Note 6

Finally, the draft report is absurd in its lengthy examination and discussion of postulated Authority "actions" which have no basis in fact. Thus, for example, we are criticized for entering into extensions of our power purchase contracts with Entergy Corp. without considering the allegedly adverse consequences of doing so. However, we have made no commitments to extend the contracts and have only had very preliminary discussions with Entergy on this issue. This type of bogus criticism is uncalled for.

* Note 7

I would urge you to consider these comments as your office prepares the final report. I know that you do not condone wastefulness. Thus, I remain hopeful that the final report will be accurate and of some degree of usefulness to the Authority. My staff and I remain available to assist your staff in the effort to improve the final report.

Sincerely,

Michael H. Urbach
Senior Vice President
And Chief Financial Officer

MHU:tmg

* See State Comptroller's Notes, Appendix C

2001 Management Audit

New York Power Authority Response to OSC Management Audit Draft Final Report

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2001 Management Audit

Executive Summary

Introduction

The New York Power Authority (Authority) is the nation's largest state-owned power organization and one of New York's leading electricity suppliers. The Authority provides low-cost power to government agencies; to municipally-owned and rural-cooperative electric systems; to job-producing companies and non-profit groups; to private utilities for resale - without profit - to their customers; and to neighboring states, under federal requirements. The Authority is also a national leader in promoting energy efficiency and the development of clean energy technologies and electric vehicles. A non-profit, public-benefit energy corporation, the Authority does not use tax revenues or state credits. The Authority finances its projects through operations and bond sales to private investors.

According to Chapter 469 of the Laws of 1989, as amended, the Office of State Comptroller is required to perform at five-year intervals an evaluation of NYPA's management and operations. The Legislature intended this process to be a periodic review that would ensure that the Authority's operations were in conformance with New York State energy policy. Unfortunately, this audit too often becomes a policy debate regarding what the auditors believe policy should be rather than a serious review of operations. The last audit was completed in July of 1996, and included a number of recommendations and conclusions that events have shown would have been highly detrimental to the Authority and to New York State. For example, the 1996 audit suggested that NYPA's continued ownership and operation of Poletti was not in the best interests of the State. In the current de-regulated market it is clear that Poletti is a vital piece of New York City's energy picture, both from the standpoint of reliability and with respect to price. New York City's demand for electricity has increased dramatically since 1996. Poletti is vital to meeting that demand and avoiding transmission bottlenecks since it is located in the New York City Zone. NYPA's continued ownership of Poletti has allowed NYPA to provide power to its Southeastern New York (SENY) governmental customers at stable prices while customers of Con Edison saw their electricity prices rise dramatically last year. NYPA has traditionally served its governmental customers at a 20% - 25% discount from Con Edison's prices; however, last year the savings rose to approximately 40%. Maximizing the operation of Poletti is just one of the many actions NYPA has taken since the last Audit which has benefited New York State.

* Note 4

* Note 3

There are a number of other actions NYPA has undertaken since the last audit which have benefited the State. During 1998, NYPA was able to operate IP3 at 91 percent of Maximum Dependable Capability (MDC). The two-plant (IP3 and JAF) output of 12.6 billion kwh surpassed by 10 percent the previous best nuclear generation total of 11.5 billion kwh in 1986. During 1997, JAF operated at about 95 percent of MDC. NYPA recognized that this performance turnaround at our nuclear plants enhanced their market value. This enabled the Authority to complete the largest privatization of assets in State history by selling its nuclear plants to Entergy on November 21, 2000. The Authority sold its Indian Point 3 (IP3) and James A. FitzPatrick (JAF) nuclear plants to Entergy for a record amount of $967 million dollars. This amount represents a price that is many times higher than the Authority would have received in 1996.

* Note 3

The Authority has also engaged in sound and prudent financial practices over the past five years that have been recognized by the financial community and have enhanced its financial security and its ability to undertake projects. For example, since 1995, the Authority's total Debt-to-Equity ratio has been reduced significantly from 2.2 to 1.5. In addition, the total Debt-to-Capitalization has been reduced significantly from 68.8% to 59.7%. Also, during 1998, the Authority completed a $2.6 billion long-term debt-restructuring program. The Authority's new Bond Resolution

* See State Comptroller's Notes, Appendix C

provides the flexibility it needs to function in the deregulated environment. As a result of these and other actions taken by NYPA, the Authority's long-term debt rating was upgraded to Aa2 by Moody's Investors Service and AA by Fitch IBCA, and confirmed as AA- by Standards & Poor's during 2000.

On the operational side, total net generation records were set at Authority facilities in 1998, 1997 and 1996. For 1998, total net generation increased 1 percent to 39.3 billion kilowatt-hours (kwh) from 38.9 billion kwh in 1997, the previous record. NYPA was able to achieve this while boasting one of the best safety records in the industry. As of June 30, 2001, there were no reportable accidents at NYPA's power projects and plants for the past eight months.

On the management of operations front, NYPA has reduced its non-nuclear Operations & Maintenance expenses by $13.0 million since 1995 on a nominal dollar basis. This equates to a $40 million (or 21%) reduction when adjusted for inflation.

This is a particularly important time for the Authority. There are a number of activities being performed by the Authority including planning for and licensing an additional 500 mw power plant at Poletti to serve our SENY customers, putting into operation eleven turbine generators at various sites within New York City and Long Island to insure adequate supplies, the construction of the Convertible Static Compensator Transmission Project to ease transmission congestion, major upgrades to our two Hydroelectric plants, implementing economic development programs such as the Power for Jobs program to make New York State more competitive, and undertaking major energy efficiency projects all of which were examined under the scope of this audit. They will be summarized below and examined closely in the body of this report.

Audit Process

The current audit has been a long, expensive, and labor-intensive process for the Authority. The current audit began in the fall of 1999 with the risk assessment survey meetings attended by the Office of State Comptroller and the Authority. The risk assessment process included field work and information requests including interviews with Authority staff. That process resulted in the issuance of a Request for Proposals (RFP) by the Office of the State Comptroller that required proposals by April 21, 2000. The evaluation of proposals was conducted by the Office of State Comptroller and a contract was issued to Liberty Consulting in September 2000. The opening conference was held November 3, 2000, and the field work commenced in January 2001. The current Audit contains ten (10) topics or areas of review. To date the OSC has been given more than nine hundred (900) documents to review, and conducted over three hundred, forty-four (344) hours of interviews involving seven thousand (7,000) person-hours of New York Power Authority staff time, and in total requiring the Authority to dedicate eleven thousand (11,000) person-hours of staff time to meet the needs of the Comptroller's Office. It is anticipated that the total cost to the Authority will exceed the 1996 level and will be $2.3 million ($2,300,000) in 2001 dollars. This data excludes time and cost information relating to the OSC's 2-month risk assessment review, which took place during the Fall of 1999.

* *Note 1*

In reviewing the draft final report, it is apparent that the audit has not provided the New York Power Authority, the Governor, the Legislature, our customers, or the people of New York State a benefit remotely commensurate with the substantial costs incurred to prepare the report. This is because the final report fails to provide either an accurate analysis or depiction of prior events or useful advice to guide future Authority actions.

* *Note 1*

Chapter 469 of the Laws of 1989, as amended, is intended to provide the Governor and the Legislature with a detailed assessment of the ways in which Authority actions facilitate and conform to policies established by the Governor and the Legislature. Those policies are set forth in the Authority's enabling statute (§1000 *et seq* of the Public Authorities Law). Instead, the report reflects a strong bias towards a discussion of what the policies should be regardless of the statutory provisions. For example, the enabling legislation establishing the Power for Jobs (PfJ) program states that:

* *Note 4*

> "The legislature finds that the cost of electricity has a significant effect on economic development, employment levels and decisions to retain, attract, or expand businesses in New York".

Despite this, the report states "We question the appropriateness of these [jobs] measurements, because it is not clear how employment levels at participating businesses are affected." Clearly, this is not a constructive suggestion on how to operate the PfJ program or an evaluation of whether the Authority is operating the program consistent with the statute. This type of gratuitous challenge to state policy is rampant throughout the report and has negatively affected the audit process.

* *Note 5*

Further, when the report does focus on operations of the Authority, many of the audit recommendations merely repeat recommendations that have previously been identified by NYPA staff or by consultants hired by NYPA. Obviously, it is of little use to NYPA to pay for the same advice twice or to get a report that merely recommends actions that are currently in progress.

* *Note 6*

Finally, the draft report is replete within lengthy examinations and discussions of postulated Authority "actions" which have no basis in fact. Thus, for example, the Authority is criticized for failing to consider the allegedly adverse consequences of extending certain power purchase contracts when we have made no commitment to do so.

* *Note 7*

* See State Comptroller's Notes, Appendix C

Audit Topics

Power Supply and Demand in the New York City Area

The New York State Independent System Operator (ISO), the entity responsible for overseeing the reliability of the bulk power system in New York State, has determined that there may not be enough electricity to meet the needs of New York City in the summer of 2001. The ISO, the New York State Public Service Commission and others have estimated that this shortfall may be as large as 400,000 kilowatts in summer 2001. Other parties, including major utilities, the Mayor of New York City, and the New York State Attorney General, have recognized the vital importance of preventing interruptions in service in New York City. The cost of interruptions to the residents and businesses, both from a public safety and economic development viewpoint, are immeasurable. The enormous "business risk" associated with a loss of service completely outweighs any recommendations by the Office of the State Comptroller to move slowly and cautiously in this matter.

NYPA responded quickly to a very real threat to the wellbeing of NYC residents and businesses. The mitigation of this potential crisis did not allow for the delay and inaction all too typical of government planning. On August 29, 2000, the Authority's trustees took the first step in an effort to assure adequate power supplies during the summer of 2001 by authorizing the emergency purchase of up to 520,000 kilowatts of new electric generating capacity. This was accomplished with the purchase of 11 simple cycle, 44,000 kilowatt natural gas powered generating plants for installation at sites throughout New York City and Long Island. These new units are currently available to meet the needs of NYC electric customers while larger plants, necessary to meet the city's growing need, go through the siting, approval, and construction process.

Despite the extensive effort and cost associated with the audit, and despite the full cooperation of the Authority, and despite being given all of the information required to formulate a reasoned opinion, the Auditors present no opinion on this matter. Instead, the Auditors create a straw man issue out of actions which the Authority has not taken, such as extending certain power purchase contracts, and then "critique" the action which has not been taken. As a result we are left with a "recommendation" to consider future ownership issues regarding the turbine units. * Note 7

The second topic discussed under the heading of "Power Supply and Demand in the New York City area" is the proposed construction of a 500 mw combined cycle facility at Poletti. The New York State ISO has determined that in order to meet New York City's electricity demands and prevent transmission bottlenecks and other disruptions, at least 80% of the generating capacity needed to serve New York City must be located within New York City. In recognition of the sound logic behind this rule, and in recognition of NYPA's role as a load serving entity in New York City, NYPA has proposed to construct a 500 mw facility at Poletti to enable NYPA to continue to provide the benefits of lower cost power to its SENY governmental customers.

Despite the extensive effort and cost associated with the audit, and despite the full cooperation of the Authority, and despite being given all of the information required to formulate a reasoned opinion, the Auditors present an incorrect picture of these events. The Auditors indicate that the Authority is at risk of having considerably more capacity under ownership or contract than it needs to serve the loads of its customers. This situation is presented this way by the Auditors because of their insistence in considering actions which have not happened, such as the extension of the Authority's power purchase contracts with Entergy. * Note 7

The Authority is mindful of the need to have an appropriate balance between its supply portfolio and its contractual obligations. The Authority will logically not proceed with large financial commitments to build or buy electricity without commitments from its customers. It has operated this way in the past and will continue to do so in the future.

* See State Comptroller's Notes, Appendix C

Energy Trading Capability

The New York Power Authority does not function like an energy trading company. NYPA does not purchase power that it does not need for customer requirements and does not sell power that it does not have. This has been the case at NYPA and will continue to be the case in the ISO or RTO market. NYPA's staff engaged in market activities are well trained, knowledgeable, and experienced. They have been actively involved in the creation and evolution of the ISO and possess the required skills to conduct transactions in competitive electric markets. In addition, because of their experience, they have been actively recruited by other entities seeking these qualifications and familiarity with New York. NYPA will seek to hire employees who may bring special expertise that may be needed in the future to complement NYPA's workforce.

Note 8

Note 9

Risk management functions are being performed under the direction of the Treasurer. Statements made by the auditors regarding the reporting structure of this function are inaccurate. In addition, NYPA believes that comparisons to energy trading companies such as Williams or Enron are of no value in this audit because of the above described nature of the activities undertaken by NYPA staff. In fact, the auditor's fear that NYPA will engage in the Williams or Enron type of energy trading functions suggests that the auditors do not accurately comprehend NYPA's activities in the ISO environment.

Note 10

Note 11

Convertible Static Compensator Transmission Project

The Convertible Static Compensator (CSC) redirects electricity from overtaxed lines to underutilized lines and reduces the mid-state bottleneck. The CSC is the first of its kind in the world and the latest generation of Flexible Alternating Current Transmission Systems (FACTS). Phase One of the CSC project was activated in early April, 2001. The CSC's first phase increases transmission capacity by 60 megawatts on the heavily used lines between Utica and Albany and by 114 megawatts statewide. When fully operational by the summer of 2002, the CSC is expected to permit total increases, including those already achieved, of 120 megawatts on the Utica-Albany lines and 240 megawatts (enough to serve more than 200,000 homes) statewide. By using existing transmission lines more efficiently, CSC technology will reduce the need to build new lines, thus avoiding the associated environmental impacts. In addition, it will strengthen system reliability and give customers greater access to lower-cost electricity. In view of the fact that this very technical project has widespread industry involvement, has been put into service and will be subject to ISO control, we see no need for the monitoring and other reports recommended by the auditors.

Note 12

Upgrades at the Two Major Hydroelectric Plants

NYPA is making an investment of $293 million to modernize and upgrade the thirteen turbines at the Robert Moses Power Plant at the Niagara Power Project. This effort is designed to extend the life of the plant by replacing the plant's original 40 year old turbine generators. During 2000, the Authority completed the upgrade of the seventh of 13 turbine-generators at the Niagara Project, and began work on the eighth. The improvements will permit increase power production at times of greatest need but except for limited efficiency gains, will not increase overall power production at the project. The program is planned for completion in 2006.

NYPA is also making an investment of $254 million to modernize and upgrade the sixteen turbines at the St. Lawrence-FDR Project. During 2000, the Authority initiated work on the first of 16 turbines to be replaced at its St. Lawrence-FDR Project. The $254 million project is scheduled to continue through 2013. The first new unit is due to be installed by late-2001.

* See State Comptroller's Notes, Appendix C

Contrary to the auditor's conclusions, there has been no slippage in these projects and they are both on schedule.

*
Note
13

Need for an Organizational Assessment

NYPA has consistently recognized the need to closely monitor the changing needs of the organization over the years. Since 1995, for example, NYPA has reduced its non-nuclear Operations & Maintenance (O&M) expenses by $13.0 million on a nominal dollar basis. This equates to a $40 million (or 21%) reduction when adjusted for inflation.

From 1991 to Forecast 2001, the Authority is forecasting that its non-nuclear O&M expense will decrease by $32 million on a nominal dollar basis. This equates to a $105.3 million (or 36%) reduction when adjusted for inflation.

NYPA has undergone dramatic changes in personnel with the sale of the nuclear assets. The number of staff positions have been reduced by approximately one half. The organization is going through an adjustment and transition period and at the same time engaging in constructing the 11 turbine generators, planning for the Poletti expansion project and adapting to the competitive ISO markets. The headquarter staffing levels will be further adjusted in the future as NYPA adjusts to its new challenges.

*
Note
14

Information for Management Decisions

NYPA management recognizes that it needs relevant, timely, and focused information to address the issues it faces in the changing energy markets. NYPA staff regularly provides this information to management, and to assist them, NYPA retains qualified consultants to advise NYPA on risk and risk mitigation issues, including what new information may be necessary to acquire. The recommendations are being implemented in a planned and prioritized fashion. For example, an integrated Financial, Procurement, and Human Resources system was successfully implemented during 1998 and put into operation at the beginning of 1999. Thus, the auditors' recommendations in this area appear superfluous and unnecessary.

*
Note
15

The Power for Jobs Program

On July 29, 1997, State legislation was enacted that created the Power for Jobs Program. It provided for 400 MW of low-cost electricity over a 3-year period for employers who agree to retain or create jobs in New York State. 100 MW was set aside for small businesses and not-for-profit corporations.

In 1998, the statute was amended and increased the program size to 450 MW; and in 2000, legislation was enacted which authorized another 300 MW of power to be allocated.

Since the inception of the program over 3318 inquiries have been received. 913 completed applications were reviewed, and 717 businesses and not-for-profits all across New York State are receiving low-cost Power for Jobs power. Job commitments resulting from the program far exceed original expectations with more than 4 times the original estimate of jobs committed statewide, approximately 307,398 jobs. The program has been one of the most successful economic development programs in state history with some 294,012 jobs retained and 13,386 jobs created.

The auditors are critical of the Authority for measuring the program's success by the number of jobs created or maintained. The enabling legislation establishing the Power for Jobs program states that "The legislature finds that the cost of electricity has a significant effect on economic

* See State Comptroller's Notes, Appendix C

development, employment levels and decisions to retain, attract, or expand businesses in New York". Despite this, the auditor's report states "We question the appropriateness of these [jobs] measurements, because it is not clear how employment levels at participating businesses are affected." Clearly, this is not a constructive suggestion on how NYPA is to operate the program.

* Note 5

In addition there are a number of factual inaccuracies included as criticisms in the report. For example, the auditors note that the Authority does not apply the statutory criteria when evaluating an applicant's eligibility. The auditors make this statement despite being informed on numerous occasions, including in NYPA's written response to the preliminary findings, that NYPA applies all of the statutory criteria.

* Note 16

Energy Efficiency Programs

NYPA's energy conservation programs have resulted in energy savings equivalent to 166 megawatts (a small combined cycle generating plant). Our customers have also been able to achieve cost savings of $70 million annually from these programs.

NYPA has dramatically increased its investment in energy efficiency in recent years, with spending of $97 million in 2000, more than 2½ times its 1994 total.

In 2000, New York State was ranked number 1 among the states in energy conservation and reduction of harmful emissions into the atmosphere by the American Council for an Energy-Efficient Economy.

The hallmark of NYPA's conservation efforts is its national award-winning High Efficiency Lighting Program, know as HELP. In HELP, NYPA works with facility managers of public buildings to identify, design and install new lighting and motors, as well as upgrades to heating, ventilation and air-conditioning systems. NYPA finances the projects, recovering its costs by sharing in the resulting electric bill savings.

During 1999, the Authority's trustees approved an additional $200 million in funding for energy efficiency projects (at public facilities) producing environmental and economic benefits for New Yorkers. This $200 million increased the total authorized project funding to $740 million. $50 million was added to the Energy Services Program, bringing that program's total funding to $80 million. The program provides the energy improvements and savings for public facilities using electricity provided by utilities other than the Power Authority.

The Authority has installed 100,000 of more than 180,000 new apartment-sized refrigerators pledged to the New York City Housing Authority (NYCHA) under a long-term contract for supply of NYPA electricity. The nine-year installation period began in 1996. When all 180,000 refrigerators are replaced, these refrigerators will save NYCHA about $7 million a year by decreasing its annual energy use by 103 million kilowatt-hours, or enough to meet the needs of about 20,000 apartments.

Pursuant to the Clean Water/Clean Air Bond Act of 1996, the Authority administers a Clean Air for Schools Project program, for which $125 million in Bond Act monies was allocated for effectuation of such program. The Authority launched a full-scale program to replace antiquated coal-fired furnaces with clean oil- and gas-burning boilers at public schools in New York City, Long Island and Buffalo. The funds expanded a coal conversion program that the Authority began in 1994 with the New York City Board of Education.

NYPA's electric transportation program is one of the most ambitious in the country. NYPA in 2000 became the first utility in the Northeast to enter the Electric Vehicle Association of the Americas (EVAA) prestigious "Million-Mile Club", representing more than 1 million miles of travel by electric vehicles operated by NYPA and its customers in New York State. More than 130

* See State Comptroller's Notes, Appendix C

vehicles have been placed in general fleet service at NYPA, the New York City Department of Transportation and Environmental Protection and the City of White Plains. In addition, Various small battery-powered electric vehicles have been placed in service for the New York City Police Department, the City's Housing Authority and Parks Department, business improvement districts and smaller municipalities. Also, based on development work sponsored by NYPA, there are 10 hybrid-electric buses in service in the City.

The auditor's recommendations for verifying energy savings and using customer satisfaction surveys add nothing new as the Authority currently performs these functions. * Note 17

Travel-Related Practices

NYPA operates a centralized travel desk which maintains an on-going dialogue with both individual employees and management regarding various travel alternatives and minimizing costs. The travel desk enables NYPA to achieve cost savings of approximately $1.4 million per year. Thus, we believe the auditor's recommendation to develop a process to minimize travel costs ignores the desk's ongoing efforts in this area. In addition, the auditor's recommendation to analyze corporate auto use merely asks us to perform what is currently a very active ongoing effort in this area. * Note 18

Since the purchase of its first corporate aircraft in 1989, the Authority has benefited from the efficiencies and cost effectiveness of using corporate aircraft rather than commercial or charter flights to complete substantial travel assignments. These travel assignments to the operating sites, construction projects, public hearings, trustees' meetings, regulatory and relicensing meetings, and various litigation sites have shown substantial increases in volume. The Authority and the energy marketplace have undergone a number of business evolutions that have required substantial increases in the usage of its existing corporate aircraft. Experience has shown that the airplane is a significant business and management tool, providing greater flexibility and productivity. In light of this increased usage and the aging of the existing corporate aircraft, the Authority examined the need to upgrade this asset. The result of the subsequent study by the Authority indicated that the purchase price of a second aircraft will be recovered through savings realized due to reduced commercial travel expenditures, and extending the life and value of the current aircraft. The auditors recommendation fails to fully value the increased productivity and flexibility made possible by the corporate aircraft. * Note 19

Information Technology Planning

Contrary to the implication of the auditor's recommendation, the Authority's Information Technology (IT) division has a strategic plan to deal with potential system failures. As part of Y2K readiness plans, the Authority completed a comprehensive inventory to identify components and applications that might be affected by the Y2K problem. On January 1, 2000, the Authority reported a smooth Y2K transition, with no service interruptions. Further, an integrated Financial, Procurement, and Human Resources system was implemented during 1998 and put into operation at the beginning of 1999. As a result of these activities, NYPA has a backup system for every primary component of its IT system. Together with regular testing of its systems, NYPA believes it has in place the plans and processes to deal with potential system failures. * Note 20

* See State Comptroller's Notes, Appendix C

Chapter

1

Generating and Supplying Power in a Competitive Environment

Power Supply and Demand in the New York City Area

OSC Position/Conclusion

The OSC Auditors have stated that NYPA is planning to enter into financial commitments of over $1 billion annually, as well as securing as much as 2,800 mw of new generating resources, They go on to say that prior to making further commitments for capacity expansion or extension of supply contracts, that NYPA contract for an independent analysis of the financial viability of the New York City area market for NYPA.

NYPA's Analysis of/Comments on Auditors' Findings

The initial audit observations and conclusions are based on a misunderstanding of the issues and a misapplication of the facts, and as a result, incorrect conclusions are developed regarding NYPA's plans, particularly in the Southeastern New York (SENY) market area.

NYPA is erroneously characterized as planning to enter into financial commitments of over $1 billion annually (in fact, the potential commitment is only a fraction of that amount), as well as securing 2,800 mw of generating resources, (which is more than 50% greater than the governmental customer load NYPA currently serves in the region). These conclusions are simply wrong and unsupported by any NYPA action. Armed with these errors of fact, the audit report further concludes that NYPA will become a merchant generator and goes on to provide recommendations on this basis. (See also comments on Energy Trading Capability.) *Note 21*

The audit report mixes up three aspects of NYPA's SENY business:

1. To meet the potential power shortages in New York City, NYPA embarked on an emergency program to bring on-line approximately 400MW of new generation for the region by June of this year in order to avoid California-style rolling black-outs in the City.

2. In order to meet the NYISO's 80% in-city capacity requirement for its governmental customers and to supply low cost reliable power to such customers and the NYC market, NYPA has filed an application to build a 500 mw power plant at the existing Poletti site at Queens, NY.

3. NYPA is presently studying its longer term power requirements for its customers in the region, including, among other scenarios, the extension or replacement of the existing Entergy purchase power agreements for either or both IP3 and FitzPatrick generation. (A decision has not yet been made by NYPA and for which studies are on-going.)

* See State Comptroller's Notes, Appendix C

From the outset of the audit, the OSC indicated that NYPA's 500 mw expansion plans at the Poletti site (Item #2 above) were going to be a major focus of the audit's examination. NYPA received and responded to numerous data requests related to the topic. The staff analysis and report, upon which the decision to proceed was based, as well as NYPA's internal financial forecasts incorporating the new 500 mw unit (the 2000 Long Range Financial Plan) were supplied.

Very late in the process, the OSC evidently changed the scope of the audit to NYPA's future plans (post-500 mw plant) for the SENY region (Item #3 above) without informing NYPA. As late as May 30, 2001, the Auditors transmitted to NYPA the preliminary findings on this topic, labeled as "the Need for a New In-City Generating Plant at Poletti." Clearly, as late as May 30th the topic was still the Poletti expansion plans. However, sometime between May 30, 2001 and the release of the draft audit report on June 28, 2001, the scope evolved into a generic analysis of "NYPA's NYC area operations." *Note 22

NYPA's consideration of the longer term SENY power supply issue is presently on-going. On May 31, 2001, NYPA staff (at NYPA's request) met with the auditors and briefed them fully on the content of ongoing studies and two information-only presentations to senior management (senior level decisions have yet to be made in this area) and how this work, when complete, will integrate within NYPA's 2001 Long Range Financial Plan. *Note 23

The remainder of the OSC write-up on this newly expanded topic contains factual errors.

The audit report incorrectly states that the PSC established a **local reliability rule** of 80% and incorrectly states that an entity **cannot serve** electric customers unless 80% of the generation capacity needed to supply these customers is located within New York City. *Note 10

The 80% requirement was originally established by the PSC as part of a Consolidated Edison Company rate case. Later, the requirement was adopted by the NYISO as an LSE (Load Serving Entity) minimum locational generation capacity requirement, not a local reliability rule. A local reliability rule is something different and is established by the New York State Reliability Council. An entity serving load (LSE) in New York City must have or purchase 80% of its capacity from generation located within New York City. If it does not meet this requirement the ISO will purchase the capacity for the LSE and charge them a deficiency penalty. Thus, the words "cannot serve electric customers" included in the audit are incorrect. *Note 10

- NYPA, in several instances, is described as serving Poletti customers on Long Island. This is incorrect as NYPA serves governmental customers only in the New York City and Westchester County areas. *Note 10

- The OSC description of the Poletti Repowering Report is incorrect. The study most certainly did assume that a competitive marketplace would develop; that the market price for electricity would be affected by the highly efficient, newer technology plants; and that this competitive market would drive down the price of electricity. Further, we assumed we would be able to retain our customers only if we could continue to hold a price advantage over other suppliers. In this report, we concluded just that. Subsequent to the release of this report, NYPA sold its IP3 and FitzPatrick nuclear power plants. The effect of the sale and the related purchased power agreements, as well as the construction of the 500 mw expansion at the Poletti site, were incorporated into NYPA's 2000 Long Range Financial Plan (copies of which were provided to the OSC). These analyses confirm that we should be able to maintain a competitive advantage in a competitive market and we should continue to provide the benefits of lower cost electricity to our governmental customers. *Note 24

- The suggestion that NYPA is contemplating increasing its SENY generating capacity to as much as 2800 mw – more than 50% greater than its customer loads – has no support in any NYPA action and is simply incorrect. Of the myriad of power supply alternatives being considered (and discussed at our May 31st meeting), the auditors have mistakenly added the

* See State Comptroller's Notes, Appendix C

options together to get to the 2800 mw (Option A AND Option B) instead of recognizing the options were mutually exclusive (Option A OR Option B).

* Note 25

NYPA's Position on Generating and Supplying Power in a Competitive Environment

Without a franchised service territory, the Authority has always generated power in unregulated electric markets. Thus, it has had long experience with competition and market requirements. Despite this history, the Auditors worry that potential commitments to continue purchasing power from the Entergy plants coupled with the Authority's announced expansion of the Poletti Project along with the Power Now! Combustion Turbine Program will result in the Authority having as much as 2,800 megawatts of generating capacity in the New York City area. Since this amount is much greater than the existing load of the Authority's customers in that area -- about 1,700 to 1,800 megawatts, the auditors are concerned the Authority will acquire too much generation.

* Note 26

Before the Power Authority extends its contracts with Entergy, it will analyze the costs and benefits of various alternatives to supply the needs of its customers in the Southeastern New York area. If, after the construction of the proposed 500 megawatt Poletti expansion, the Authority still has a need for capacity and energy to serve its New York City area customers it may choose to purchase additional supplies from other generators. Thus, it currently cannot be determined where the Authority will extend its power supply agreements with the Entergy Corporation. The report notes that the Authority is at risk of having considerably more capacity under ownership or contract than it needs to serve the loads of its customers suggests that the Authority would proceed to make financial commitments to build or buy electricity without corresponding commitments from its customers to continue to receive electricity service from the Authority. As noted, from our lengthy experience in competitive markets, we are not willing to take such a foolish action.

* Note 25

The Authority is very mindful of the need to have an appropriate balance between its supply portfolio and the contractual obligations of its customers to receive service from the Authority. The Authority will take appropriate steps to ensure that it has sufficient, but not excessive, resources to meet its customers needs after the current Entergy contracts have expired.

The exact manner by which the Authority will address the terms of the contracts with its customers, including such matters as the size and make-up of its supply portfolio is best not debated in the audit review process. In any event, it is important to note that at present, the Authority has entered into no agreements with Entergy or any other supplier with respect to the provision of power and energy upon the termination of the Entergy Purchase Power Agreements. Moreover, the Authority has made no irrevocable commitment to the construction of the Poletti Expansion Project. This will occur only after we have received an Article 10 certificate from the state siting board allowing us to proceed with constructing the plant. To the extent the Authority has made investments in engineering and equipment procurement, prior to receiving such certificate these investments would be easily recouped by selling the valuable rights to other developers seeking to construct generation in the capacity-constrained New York City market.

* See State Comptroller's Notes, Appendix C

OSC Position/Conclusion

The Auditors conclude NYPA will face many new challenges in its energy trading activities and that NYPA employees who are engaged in energy transactions do not possess sophisticated energy trading skills.

NYPA's Analysis of/Comments on Auditors' Findings

The OSC insists on mischaracterizing NYPA's energy trading role and uses inappropriate benchmarks when making comparisons, i.e., Williams and Enron, which operate in markets throughout the country with the majority of their transactions being bi-lateral in a non-ISO environment. Furthermore, neither of these companies is an owner of generating facilities in New York. Thus the auditor's comparisons of NYPA need-based energy transactions to energy trading operations of these entities based on speculative trades are inappropriate analyses. NYPA's staff engaged in the ISO markets are well-trained, knowledgeable and experienced. They not only have skills but also regularly conduct transactions in the ISO environment. It is for this reason that a number of Energy Resource Management (ERM) staff have been sought after by entities whose primary business is trading. If the OSC fully appreciated the skill sets required to be effective in the New York markets, they would have drawn different conclusions. Context missing from the draft final report include:

Note 8 *Note 11* *Note 9*

- Although the market place is evolving, "competition" is not new to the Power Authority. We have been retail wheelers for over two decades. NYPA has always been operating in a "competitive" market – long before utility deregulation occurred. *Note 27*

- NYPA has never had a franchise territory or a monopoly and has had to compete in order to retain its customers.

- NYPA's mandate is to serve customers in the state of New York with low cost power and use its facilities for the benefit of New Yorkers. NYPA is not in the business of trading large volumes of energy for profit, and will not be in this business in the future. *Note 26*

- The Energy Authority (TEA) is a not-for-profit organization, which specializes in physical bi-lateral transactions in non-ISO markets, much like NYPA's position prior to the formation of the NYISO. NYPA was a major market participant in the New York Power Pool environment. It is doubtful that an outside trading entity or personnel, though skilled in commodity trading activities, would be able to handle NYPA's activities in an ISO environment without the knowledge of and experiences in NYISO's operations and NYPA's generating assets and management strategies. *Note 8* *Note 11*

- Energy purchasing and bulk power functions at NYPA are supported by processes and procedures required for effective management of these functions. NYPA has been proactive in addressing the requirements of this area, fully recognizing its increasing importance. The OSC audit ignores the many actions NYPA has taken to lay foundation for "best in class" performance.

- The performance management system for ERM personnel is based on TEAM (The Employee Achievement Measure) contracts, which in accordance with NYPA policy reflect the *Note 9*

* See State Comptroller's Notes, Appendix C

cascading down of the NYPA strategic plan, budget and performance measures in accordance with NYPA's performance planning process.

- The Trustees and Executive Management receive monthly reports on NYPA's performance, incorporating the performance of the ERM functions. In addition, they also receive regular reports on risk management related to energy purchasing and bulk power transactions. These reports included presentation to inform management and the Trustees on the risk management function, provide progress reports on implementation of the functions, and presentations explaining major risks faced by NYPA. Further, in accordance with the Energy Market Risk Management Standards, NYPA Executive Management is informed of, and authorizes, transactions relating to management of NYPA's risks in the energy markets. As part of the risk management reorganization at NYPA, these reports would be improved to more effectively present to the management the necessary information relating to NYPA's energy trading function. * Note 27 * Note 9

- NYPA has established a Supply Planning group with the mission of planning for NYPA's future power supply needs. Responsibility for evaluating and negotiating future supply portfolio is assigned to the Director – Supply Planning reporting to a Senior Vice President. * Note 10

- Risk management functions report to the Treasurer.

* Note 10

NYPA's Position on Energy Trading Capability

NYPA's position on Energy Trading Capability is indicated in its analysis above.

Convertible Static Compensator Transmission Project

Description of Project

NYPA has completed Phase One of its installation of a convertible static compensator (CSC), the world's most advanced device for controlling the flow of electricity on transmission lines, at its Clark Energy Center in Marcy, New York. When Phase Two is completed in mid-2002, the CSC will permit more power to flow on existing lines, strengthening system reliability and giving consumers greater access to lower-cost electricity. It will also benefit the environment by reducing the need for new lines.

NYPA's Position on Convertible Static Compensator Transmission Project

Except for the recommendation, NYPA does not have any significant disagreement with the OSC report on this audit issue.

The OSC recommends that NYPA provide the Governor and Legislature with quarterly reports on the progress of the CSC project. We disagree with this recommendation because the project is well underway, has widespread industry involvement and is subject to ISO control. Further, a legislative reporting process relating to NYPA capital projects is already in place. Periodic reports are filed with the Division of the Budget. In addition, the Governor and the Legislature generally request information from NYPA and NYPA complies. Thus, there is no need for such reports and the Governor and the Legislature do not need to be told what information they should receive. * Note 28

See Chapter 5 for NYPA's Response to Final Report Draft Recommendations for recommendation #8 and NYPA's full reply.

* See State Comptroller's Notes, Appendix C

Upgrades at the Two Major Hydroelectric Plants

Description of Project

NYPA's upgrade of its hydroelectric projects on the St. Lawrence and Niagara rivers is a half-billion dollar plus work-in-progress. NYPA completed the upgrade of the seventh of the 13 turbine-generators at the Robert Moses Niagara Power Plant in 2000. Work has commenced on the first of 16 turbines at St. Lawrence. The upgrades are scheduled for completion in 2006 and 2013 for the Niagara and St. Lawrence projects, respectively.

NYPA's Position on Upgrades at the Two Major Hydroelectric Plants

Except for the recommendation, NYPA does not have any significant disagreement with the OSC report on this audit issue.

The OSC recommended that NYPA take "appropriate actions to prevent further slippage in the upgrade schedule at St. Lawrence." We disagree with this recommendation. The characterization that here is a need to prevent "further slippage" implies that there has been "slippage" prior to this time. The auditor's conclusion is without any support, and accordingly, we disagree with the assessment.

* *Note 29*

See Chapter 5 for NYPA's Response to Final Report Draft Recommendations for recommendation #9 and NYPA's full reply.

* See State Comptroller's Notes, Appendix C

Chapter

2

Organizational Staffing and Decision-Making

Need for an Organizational Assessment

OSC Position/Conclusion

The Auditors have stated that NYPA will need new skills, and may need additional staff, for such activities as the implementation of the Power Now Program and the buying and selling of electricity in a competitive environment. The Auditors have indicated that with the sale of the nuclear plants, NYPA should complete an organizational assessment to determine what restructuring will be needed. The Auditors believe that employee skill sets required at NYPA post-nuclear plants will be different.

NYPA's Analysis of/Comments on Auditors' Findings

NYPA disagrees with the OSC's position on existing employee skill sets. NYPA's position on this matter is indicated below.

NYPA's Position on Need for an Organizational Assessment

NYPA management recognized that headquarter staffing levels should be reviewed and analyzed in light of the nuclear divestiture, but also realized that any decisions made in haste could have significant ramifications throughout the Authority. As previously stated, the organization is going through an adjustment period with major new projects underway as well as adapting to rapid changes in the utility industry.

* Note 30

The audit findings indicate that the skill sets of the employees needed to support the new organization will differ greatly from those required to support the nuclear operations. This statement is misleading as the employees or positions in question are not functional nuclear staff. The nuclear staff has already transferred to Entergy. The remaining support staff in question is administrative, financial, legal, etc., whose skill sets can support any kind of organization. In anticipation of changes in responsibilities many headquarter administrative groups have eliminated positions while others are not filling vacancies until the organizational assessment is complete.

The audit conclusion suggests that NYPA "pulled off" PricewaterhouseCoopers (PwC) from the engagement prior to its completion. As previously stated the assessment was placed on hold pending the outcome of this transitional period. There is no reason to presume that PwC would not complete their assignment and issue a report of useful findings and recommendations.

* Note 31

* See State Comptroller's Notes, Appendix C

Information for Management Decisions

OSC Position/Conclusion

The Auditors have stated that NYPA should develop the capability to update its Long-Range Financial Plan on-demand.

NYPA's Analysis of/Comments on Auditors' Findings

NYPA believes that its management already receives timely financial and other information necessary to make decisions.

NYPA's Position on Information for Management Decisions

NYPA's Long Range Financial Plan (LRFP) has been its central planning tool for a number of years. An LRFP has been produced every year since 1985 – with the month of completion varying anywhere from February to October depending on that year's particular planning cycle requirements. The 2001 LRFP, due for completion later this year, will incorporate the long-term SENY supply analysis discussed in the above section on Power Supply and Demand in the New York City Area. The 2001 LRFP was never "expected" in February, as the OSC report states. NYPA staff met with the auditors on May 31, 2001 to brief them on the status of the LRFP and, in particular, how the on-going SENY analysis was an integral part of its development. * Note 23

NYPA is criticized for not having the 2001 LRFP available for review during the audit. Part of the criticism is that many key events have occurred since the release of the 2000 LRFP. However, of the five items listed as not having been provided to decision-makers, the first three were in fact incorporated in the 2000 LRFP, one (building the Power Now units) is progressing on an expedited basis and the last (extension of the purchase power contracts with Entergy) is presently under review and not anywhere near a decision point.

We simply disagree with the conclusion that NYPA decision makers have not been provided with relevant financial information for their decisions. It is unfortunate that the timing of the LRFP work does not coincide with the due dates for completion of this audit. These analyses are timed for NYPA's business planning process and not for the audit. * Note 23

* See State Comptroller's Notes, Appendix C

Chapter 3

Selected Energy Programs

The Power for Jobs Program

OSC Position/Conclusion

The Auditors have stated that they question the linkage between the cost of electricity and the maintenance and creation of jobs. They have also implied that NYPA does not follow all of the criteria in the Power for Jobs legislation relating to the selection of recipients of the lower cost power.

NYPA's Analysis of/Comments on Auditors' Findings

The Auditors make two fundamental errors in their review of the Power for Jobs Program. The Auditors question the very premise of the Power for Jobs Program.

* Note 5

The Auditors simply refuse to recognize the findings and declarations made by the State Legislature itself when Power for Jobs was enacted by Chapter 316 of the 1997 Laws. The linkage between power and jobs has been determined by the Legislature and it is not for the Power Authority, the Office of the State Comptroller or its Auditors to challenge that statutory premise. The linkage can be seen from the Legislative findings set forth below.

> ϶ 1. Legislative findings and declarations. The legislature finds that the cost of electricity has a significant effect on economic development, employment levels and decisions to retain, attract or expand businesses in New York. The legislature further finds that businesses operating in New York State pay well above the national average for electricity and are compelled to compete in a national and global economy with other enterprises that pay less for electricity.
>
> The legislature further finds that the economic development programs managed by the power authority of the state of New York and the investor-owned utilities in the state have assisted numerous businesses to stay and expand in New York, that the power authority has limited economic development power remaining for allocation under its current programs and that if no economic development power is available in the future, New York State enterprises may not make the investments and commitments necessary to maintain jobs and expand facilities in New York State. The legislature further finds that additional low cost power could provide additional opportunities for economic development.
>
> * * *
>
> Accordingly, the legislature declares that the purpose of this act is to establish the power for jobs program to make available low cost power to large businesses, small businesses and not-for-profit corporations.

* See State Comptroller's Notes, Appendix C

* * *

1997 New York Session Laws. Chapter 316, Laws of 1997

The Auditors also claim that in addition to jobs, the Power for Jobs Act describes at least 12 criteria that should be used when determining whether an applicant is admitted to the program. The Auditors state that these criteria include, for example, the types of jobs created, security and stability of employment in the extent to which low cost power will affect the overall productivity or competitiveness of the applicants' business and its existing employment within the state. The Auditors claim that NYPA uses only one of these criteria, the ratio of jobs to be created or retained to the amount of power requested when determining to admit applicants into the program.

This is simply incorrect and reflects a basic misunderstanding of how the program is administered by the Economic Development Power Allocation Board. The Board considers <u>all</u> twelve statutory criteria prior to making a recommendation for an allocation under the program, including each and every criteria mandated by the Act. As discussed in various interviews, the Auditors have been told several times, NYPA follows the criteria enumerated in Section 184 of the Economic Development law.

The application form required of all applicants requires that they address the 12 criteria and each application is provided to each member of the board for his or her consideration prior to voting on a recommendation. The record of decision with respect to all applications of power under the program includes the completed application and all information provided required under the Act. Consequently, the PfJ evaluation process correctly considers all the statutory criteria.

* Note 16

Energy Efficiency Programs

OSC Position/Conclusion

The Auditors have stated that NYPA should develop a process for verifying the actual savings of energy efficiency projects. They also state that NYPA should perform surveys for energy efficiency projects in all areas of the State. And lastly, they recommend that Internal Audit increase coverage to assure that energy efficiency projects are properly approved by the program participants.

NYPA's Analysis of/Comments on Auditors' Findings

We are not in agreement that 23 of the 50 projects did not indicate that the participant had approved the project work. All of these projects had such approvals (because of the volume of documents in various files, the approvals may have been overlooked by the auditors). Further, customer approvals are demonstrated by their on-going payments for the projects.

* Note 32

NYPA's Position on Energy Efficiency Programs

The Auditors have acknowledged that NYPA indicated that in 1994 RLW Analytics validated NYPA's original savings assumptions and any recommendations to improve our estimates were

* See State Comptroller's Notes, Appendix C

implemented at the time. As to verification of the actual savings of current energy efficiency programs, NYPA has no objections to such verifications.

Customer satisfaction surveys are currently being done in the SENY customer area. A large part of our non-SENY customer work is performed for the Office of General Services (OGS). We meet monthly with OGS and any problems are addressed at these meetings. In addition, all customers are provided with a one-year warranty for all equipment installed. * Note 17

NYPA disagrees with the Auditors' recommendation for increased audit coverage of energy efficiency projects. NYPA is collecting all of its costs. Risk exposure is minimal. Because Internal Audits' resources are limited, increasing coverage of areas where the risk exposure is minimal decreases coverage in other more important areas.

* See State Comptroller's Notes, Appendix C

Chapter 4

Selected Management Practices

Travel-Related Practices

OSC Position/Conclusion

The Auditors have stated that NYPA's Travel Desk just seeks "to obtain the lowest airfares..." Among various recommendations, they suggested that NYPA consider not paying per diems from petty cash, NYPA reevaluate assignments related to long-term travel status to reduce travel costs and NYPA should sell one of its two corporate aircraft.

NYPA's Analysis of/Comments on Auditors' Findings

NYPA's positions on those matters are indicated below.

NYPA's Position on Travel-Related Practices

Travel Desk

We disagree with the statement that the Travel Desk just seeks "to obtain the lowest airfares..."

The Travel Desk maintains an on-going dialogue with both individual employees and management regarding various low cost travel alternatives.

Petty Cash Travel Payments

Per diems and other business travel expenses are currently charged to cost center accounts to provide for budgetary control over costs. Issuing checks to cover small items like per diems would be inefficient and would provide no benefit. * Note 33

Temporary Work Assignments

Relating to reevaluation of the assignment of employees to field assignments, a limited number of employees with specific educational backgrounds and successful work experiences have been selected for strategic assignments. These temporary work assignments are intended to bring special skills to bear on certain tasks and to provide valuable cross training experiences for the employees. This approach will add depth and flexibility to the Authority's individual contributors' capability and will enhance overall operational effectiveness. The business travel expenses incurred with this approach are considered to be reasonable professional development costs that are required to accomplish organizational goals. It is intended that these employees will return to

* See State Comptroller's Notes, Appendix C

their official workstation with enhanced qualifications following completion of such temporary assignments.

Corporate Aircraft

We disagree with the auditors relating to their position that NYPA should sell one of its two aircraft.

Since the purchase of its first corporate aircraft in 1989, the Authority has benefited from the efficiencies and cost effectiveness of using corporate aircraft rather than commercial or charter flights to complete substantial travel assignments. These travel assignments to the operating sites, construction projects, public hearings, trustee's meetings, regulatory and relicensing meetings, and various litigation sites have recently shown substantial increases in volume. The Authority and the energy marketplace have undergone a number of business evolutions that have required substantial increases in the usage of its existing corporate aircraft. Experience has shown that the airplane is a significant business and management tool, providing greater flexibility and productivity. In light of this increased usage and the aging of the existing corporate aircraft, the Authority examined the need to upgrade this asset. The result of the subsequent study by the Authority indicated that the purchase price of a second aircraft will be recovered through savings realized due to reduced commercial travel expenditures, and extending the life and value of the current aircraft. The auditors recommendation fails to fully value the increased productivity and flexibility made possible by the corporate aircraft.

* Note 50

* Note 19

Information Technology Planning

OSC Position/Conclusion

The Auditors have stated that NYPA does not have a formal strategic plan for IT, has not formally analyzed the impact of an interruption in NYPA's data processing functions; and does not have a complete disaster recovery plan.

NYPA's Analysis of/Comments on Auditors' Findings

We disagree with the OSC's position on Information Technology Planning. NYPA's position on this matter is set forth below.

NYPA's Position on Information Technology Planning

Information Technology has an overall key strategy, which covers the following key areas:

Infrastructure
Systems
Application Development & Package Acquisition
Security
Customer Support & Training

Information Technology, working with the Business Units, performed a business impact analysis during the Y2K project. This analysis was driven by a need to determine what impact an interruption to the application would have on the data processing requirements of the business.

* See State Comptroller's Notes, Appendix C

As described to the OSC auditors in answer to their document requests on Disaster Recovery, Information Technology believes that the primary component to NYPA's disaster-recovery plan is a backup process for every system on a regular basis. This backup process is typically to tape and with an off-site backup periodically developed as a copy. The Information Technology department views disaster as a failure of one of the following forms:

- Failure in the software in production
- Failure of the hardware in production
- Loss of Network connectivity
- Loss of Telecomm
- Loss of Facility

Each of the first four forms of failure happens in the real NYPA production environment occasionally. This allows Information Technology to hone its process for minimizing the overall disruption to the business. The last form is the worst-case scenario and seems to be the one that the OSC auditors want to focus on. Periodically planning and testing for this scenario seems to be unnecessary. * Note 20

* See State Comptroller's Notes, Appendix C

Chapter
5

NYPA Response to Recommendations

* See State Comptroller's Notes, Appendix C

	Recommendation	NYPA Response	
	Generating and Supplying Power in a Competitive Environment ***Power Supply and Demand in the New York City Area*** Recommendations		
1.	Before finalizing commitments to expand the Poletti plant and to extend the Indian Point 3 power-purchase contract, complete an independent analysis that demonstrates whether these actions are financially viable.	This recommendation is a restatement of actions that the auditors were informed are currently ongoing at NYPA. The level of importance given to the possible extension of power purchase contracts is misleading and not reflective of the discussions NYPA has had with audit staff. The extension of these contracts was merely one item of many discussed as possible methods of providing for NYPA's SENY customer load. The report creates the impression that NYPA has decided to extend these contracts. This is not accurate. NYPA would obviously conduct appropriate analysis prior to pursuing this course of action. NYPA has made a decision to apply for a permit to build a 500 mw facility at Poletti in order to meet the 80% in-city generation requirement and to serve the needs of its SENY customers. Regarding future decisions which NYPA may make, NYPA met with the members of the auditing staff on May 31, 2001 to brief them on the many options available to NYPA to meet the longer term power supply needs of NYPA's SENY governmental customers. Detailed discussions ensued on the analytical tools developed by NYPA to assess the competitive marketplace. An overview of some of the preliminary results of NYPA's business planning process for the SENY market area were discussed as well as the beginnings of the evaluation of its fuel supply, hedging and pricing strategies in a competitive market given the changed risk profile of NYPA. These analyses are ongoing.	* Note 34 * Note 23

	Recommendation		NYPA Response	
2.	Obtain an independent analysis to evaluate the appropriateness of NYPA's continued ownership and operation of the Power Now turbines past the summer of 2001.		Please refer to NYPA's reply to Recommendation #1 above.	* Note 34
3.	Seek statutory support for a clear description of NYPA's role in New York State's competitive wholesale and retail power markets.		NYPA is governed by the Power Authority Act and related legislation, as amended from time to time by the Governor and the Legislature.	* Note 35
4.	Explain NYPA officials' lack of timely responses to State auditors' requests for information, and the refusal to provide a standard audit representation letter.		We disagree with this recommendation and find it both false and inflammatory. It is NYPA's opinion that it requires no response and has no place in a professional and proper audit.	* Note 36
	Energy Trading Capability Recommendations			
5.	Promptly complete the process for contracting to improve the risk management function.		This is another recommendation that simply states an action that NYPA began on its own initiative and is ongoing. Simply agreeing with NYPA actions and recommending prompt completion of such action does not add value to the management audit process which is costing NYPA $2.3 million.	* Note 37
6.	Either outsource energy trading activities, or recruit from outside NYPA a senior individual with substantial experience in energy or commodity trading to direct NYPA's energy trading activities.		NYPA is not an energy trading company. NYPA does not buy what it does not need for customer requirements and does not sell what it does not have. Where appropriate, NYPA will seek to hire employees who bring special expertise that may be needed in the future to complement NYPA's workforce.	* Note 38

* See State Comptroller's Notes, Appendix C

	Recommendation		NYPA Response
7.	Develop an action plan for correcting the weaknesses described in this report in the procedures, practices, job descriptions, management reports, and performance measures relating to NYPA's energy trading activities.		We disagree with this recommendation. Energy purchasing and bulk power functions at NYPA **are** supported by processes and procedures required for effective management of these functions. NYPA has been proactive in addressing the requirements of this area, fully recognizing its increased importance. The OSC audit ignores the many actions NYPA has taken to lay the foundation for "best in class" performance.
	Convertible Static Compensator Transmission Project Recommendation		
8.	Provide the Governor and State Legislature with quarterly reports on the progress of the CSC project. These reports should include: updates on the on-line monitoring of Phase I of the CSC Project, updates on the progress toward completion of Phase II of the CSC Project, notification that both Phase I and Phase II of the project are operating satisfactorily, and updates on the actual project cost recovery through operation of the TCC'S.		We disagree with this recommendation. The legislative reporting process relating to NYPA capital projects is already in place. Periodic reports are filed with the Division of the Budget. The Management Committee is responsible for day-to-day operations. The Board of Trustees, the Management Committee and the President have scheduled monthly meetings. In addition, the Governor and the Legislature generally request information from NYPA and NYPA complies. The Governor and the Legislature need not be told what information they should receive. In view of the fact that this very technical project has widespread industry involvement, has been put into service and will be subject to ISO control, we see no need for the monitoring and other reports recommended by the auditors.

* Note 38

* Note 27

* Note 39

See State Comptroller's Notes, Appendix C

	Recommendation	NYPA Response	
	Upgrades at the Two Major Hydroelectric Plants Recommendation		
9.	Take appropriate actions to prevent further slippage in the upgrade schedule at the St. Lawrence plant.	We disagree with this recommendation. The characterization that there is a need to prevent "further slippage" implies that there has been "slippage" prior to this time. The first St. Lawrence unit will be completed on a schedule comparable to or better than that achieved by other industry leaders for such work. The Authority plans to progressively reduce outage duration for future work to hold the long-term program schedule.	* Note 40
	Organizational Staffing and Decision-Making ***Need for an Organizational Assessment Recommendations***		
10.	Promptly complete the organizational assessment and present the results, conclusions and recommendations directly to the Board of Trustees as well as the Governor and the Legislature.	This is another recommendation that simply states an action that NYPA began on its own initiative and is ongoing. NYPA management recognized that headquarter staffing levels should be reviewed and analyzed in light of the nuclear divestiture, but also realized that any decisions made in haste could have significant ramifications throughout the Authority. As previously stated, NYPA maintains that the organization is going through an adjustment period and the current organization is adapting to rapid changes in the utility industry coupled with the implementation of major, aggressively scheduled projects. As previously stated the assessment was placed on hold pending the outcome of this transitional period. There is no reason to presume that PwC would not complete their assignment and issue a report of useful findings and recommendations.	* Note 6 * Note 41

* See State Comptroller's Notes, Appendix C

* See State Comptroller's Notes, Appendix C

	Recommendation	NYPA Response	
11.	Provide full documentation to the Governor and the Legislature of actions taken to implement the recommendations contained in the organizational assessment.	We disagree with this recommendation. The Governor and the Legislature generally request information from NYPA and NYPA complies. The Governor and the Legislature need not be told what information they should receive.	* Note 42
	Information for Management Decisions Recommendations		
12.	Immediately implement the consultant's recommendations for improving management reports, beginning with a total redesign of the standard reports.	This is another recommendation that simply states an action that NYPA began on its own initiative and is ongoing. NYPA management recognized that it would need relevant, timely and focused information to address the issues NYPA faces in the changing energy industry environment. NYPA sought PricewaterhouseCoopers' (PwC) assistance in identifying improvements in the management reports available to decision-makers. The PwC report entitled "Management Reporting Review" issued in May, 2000 did identify seven "Key Findings" in process, content, system and organizational areas which NYPA should focus on in making improvements to management reports. NYPA is working with internal resources and with outside consultants, including PwC, to plan the implementation of the recommendations in a prioritized fashion. NYPA disagrees with the comment that efforts to follow up on the PwC findings and recommendations have not been substantial. The following substantial actions are completed or in process: 1. Risk management-related actions include organizational changes and utilization of expert consultants for implementation of a strong Risk Management function and reporting system.	* Note 43

	Recommendation		NYPA Response	
			2. ISO revenue and expense reports by project are now included in monthly financial reports provided to senior management. Databases for related information are under development. 3. In 1999 NYPA began using the SAP enterprise resource planning system. SAP is a primary source of information used in management reporting.	
13.	Develop the capability to upgrade the Long-Range Financial Plan on-demand, and perform such updates at least once a year and whenever major changes in strategy, projects or assumptions are anticipated.		We disagree with this recommendation. NYPA's Long Range Financial Plan (LRFP) has been its central planning tool for a number of years. An LRFP has been produced every year since 1985 – with the month of completion varying anywhere from February to October depending on that year's particular planning cycle requirements.	* Note 44
	Selected Energy Programs ***The Power for Jobs Program Recommendations***			
14.	Either develop valid performance indicators for the Power for Jobs Program or hire an independent consultant to develop such indicators.		We disagree with this recommendation. The program is intended to create and/or protect jobs. The auditors fail to recognize the role of low cost power as an economic development tool to create and protect jobs. This program has received broad legislative support because the focus has been on job creation. Jobs per megawatt is the most appropriate benchmark for a job creation/retention program although jobs per mw is not the only benchmark used.	* Note 45
15.	Routinely perform timely on-site audits of selected participants in the Power for Jobs Program to verify their reported employment levels. Routinely schedule audits for participants whose reported employment levels are less than the amount needed to maintain		This is another recommendation that simply states an action that NYPA began on its own initiative and is ongoing. Internal Audits currently perform reviews of selected participants.	* Note 46

* See State Comptroller's Notes, Appendix C

* See State Comptroller's Notes, Appendix C

	Recommendation		NYPA Response	
	their power allocations, but whose allocations are not reduced or terminated, to verify expected increases in employment levels.		The results of these reviews are forwarded to Marketing representatives who follow up on Internal Audits findings. Marketing annually reviews all employment data submitted by customers. Business Power Allocations and Compliance (BPAC) staff investigate shortfalls and the specific situation for each customer is considered. BPAC Manager and staff conduct several review meetings to determine a course of action for each customer not meeting their job commitment. In addition, NYPA has retained an outside consultant to audit the compliance of approximately 200 customers.	
16.	Incorporate all the criteria included in the law into the process for evaluating applications for the Power for Jobs Program.		This recommendation is based on an inaccuracy. As discussed in various interviews, the Auditors have been told several times, NYPA follows the criteria enumerated in Section 184 of the Economic Development law.	* Note 16 * Note 47
	Energy Efficiency Programs Recommendations			
17.	Develop a process for verifying the actual savings of energy efficiency projects.		We have already indicated to the Auditors that this was done in November 1994 through an outsider contractor, RLW Analytics. This report validated our original savings assumptions and any recommendations to improve our estimates were implemented at the time. As to the verification of the actual savings of current energy efficiency programs, NYPA has no objections to such verifications.	* Note 17
18.	Perform customer-satisfaction surveys for energy efficiency projects in all areas of the State.		Customer satisfaction surveys for energy efficiency projects are currently being done in the SENY customer area.	

	Recommendation		NYPA Response	
			A large part of our non-SENY customer work is performed for OGS. Currently, we meet monthly with OGS to review current and future work. Any problems relating to completed projects would also be addressed at these meetings. In addition, all customers are provided with a one-year warranty for all equipment installed. In those instances where customers have reached out to NYPA after the installation is complete, we have always responded promptly to their requests.	
19.	Increase the internal audit coverage for energy efficiency programs, and use the internal audits (and other available means) to provide assurance that energy efficiency projects are properly approved by program participants.		We disagree with this recommendation. Internal Audits (IA) audits at least one energy service program a year sometimes two. Based on IA's annual audit risk assessment, this is acceptable (particularly since NYPA's exposure is minimal based on past experience). Since IA's resources are limited, increasing coverage of areas where the risk exposure is minimal decreases coverage in other more important areas.	* Note 49
	Selected Management Practices ***Travel-Related Practices Recommendations***			
20.	Sell one of the NYPA corporate aircraft.		We disagree with this recommendation. The Authority has benefited from the efficiencies and cost effectiveness of using corporate aircraft rather than commercial or charter flights to complete substantial travel assignments. These travel assignments to the operating sites, construction projects, public hearings, trustees' meetings, regulatory and relicensing meetings, and various litigation sites have shown substantial increases in volume. The auditors recommendation fails to fully value the increased	* Note 50

* See State Comptroller's Notes, Appendix C

	Recommendation	NYPA Response
		productivity and flexibility made possible by the corporate aircraft.
21.	Improve controls over travel-related costs by taking the following actions:	
	• Accumulate information about the use of NYPA's video-conferencing facilities to identify opportunities for increasing the use of the facilities, and develop performance management goals to encourage the use of the facilities.	Regarding video conferencing system usage information, NYPA agrees that there is merit in having detailed information readily available that tracks the system usage of our video conferencing system.
	• Develop a process that enables the Travel Desk to review travel requests to ensure that the cost of the travel is minimized.	Regarding the use of Travel Desk expertise, Travel Desk personnel do encourage economical alternatives to air travel. For example, travel personnel negotiated discounted Amtrak rail service between New York City, Westchester and Albany. This service is routinely promoted by the travel staff and utilized by NYPA employees on a frequent basis.
	• Analyze the use of the corporate vehicles at the different locations. If the variations in the employee-to-automobile ratios are not justified by business use, sell all the unneeded vehicles.	As a routine procedure,NYPA has analyzed automobile usage. This process is ongoing. For example, for the past six months we have been monitoring the maintenance and utilization of the Corporate Fleet from a coordinated perspective. The fleet policy was recently revised to reflect this approach; reporting mechanisms are now in place to record and analyze fleet usage on a monthly basis. As a result of our recently enacted change in policy that has led to the centralized management of the NYPA fleet of on-road vehicles, a comprehensive analysis of the Headquarters fleet has resulted in ten vehicles being sold which will not be replaced. The Fleet Management Program will be ongoing and we envision that the corporate fleet will continue to be reduced over time. (* Note 18) (* Note 51) With regard to the finding that there are variations in the vehicle to staff ratio, this circumstance is to be expected due to the differences in size, coverage area and work responsibilities at each facility. For example, the Richard M. Flynn Power Plant has very few vehicles due

	Recommendation		NYPA Response
			to the fact that it is a small combined cycle plant with most operations in walking distance of each other. Ninety percent of the employees' assignments occur within the confines of the property. The Clark Energy Center, on the other hand, consists of multiple properties of considerable acreage and facilities in addition to nearly four hundred miles of transmission lines, all of which are maintained and inspected by staff utilizing the vehicles assigned to the State-wide energy control center. While recognizing that each facility will require varying levels of support and equipment, we will continue to evaluate the fleet utilization and make recommendations for downsizing and redeployment as deemed appropriate.
	• Summarize per diem payments by employee and make all such payments by check. Consider making such payments from a designated travel expense account rather than from petty cash accounts.		We disagree with this recommendation. Relating to the use of petty cash accounts, we do not consider disbursements from petty cash for per diems and other business travel & living expenses to be a weakness in internal control. All such disbursements are properly charged to the appropriate cost center and project accounts.
	• Reevaluate the assignments of employees to long-term travel status. Consider either outsourcing such assignments or assigning the work to an employee closer to the work location.		Relating to reevaluation of the assignment of employees to field assignments, a limited number of employees with specific educational backgrounds and successful work experiences have been selected for strategic assignments. These temporary work assignments are intended to bring special skills to bear on certain tasks and to provide valuable cross training experiences for the employees. This approach will add depth and flexibility to the Authority's individual contributors capability and will enhance overall operational effectiveness. The business travel expenses incurred with this approach are considered to be reasonable professional development costs that are required to accomplish organizational goals. It is intended that these employees will return to their official workstation with enhanced qualifications following completion of such temporary assignments.

* Note 52

* Note 53

* See State Comptroller's Notes, Appendix C

* See State Comptroller's Notes, Appendix C

	Recommendation	NYPA Response	
	• Enforce the policy of requiring employees to use NYPA's Corporate credit_card for business travel expenses.	We are in agreement relating to the enforcement of the use of the corporate card for business travel.	
	Information Technology Planning Recommendations		
22.	Develop a formal strategic plan for Information Technology functions, which supports NYPA's overall business strategy.	We disagree with this recommendation. Information Technology has a strategic plan, which incorporates the business requirements of the New York Power Authority. The OSC auditors were provided documentation based on their document requests and several discussions were held to with the auditors to further define the overall process	* Note 54
23.	Formally analyze the impact of an interruption in NYPA's data processing functions, and on the basis of this analysis, develop a complete disaster recovery plan. Test the plan periodically_to ensure its viability.	We disagree with this recommendation. Information Technology, working with the Business Units, performed a business impact analysis during the Y2K project. This analysis was driven by a need to determine what impact an interruption to the application would have on the data processing requirements of the business. As described to the OSC auditors in answer to their document requests on Disaster Recovery, Information Technology believes that the primary component to NYPA's disaster-recovery plan is a backup process for every system on a regular basis. This backup process is typically to tape and with an off-site backup periodically developed as a copy. The Information Technology department views disaster as a failure of one of the following forms: • Failure in the software in production • Failure of the hardware in production • Loss of Network connectivity	* Note 55

	Recommendation		NYPA Response
			• Loss of Telecomm • Loss of Facility Each of the first four forms of failure happens in the real NYPA production environment occasionally. This allows Information Technology to hone its process for minimizing the overall disruption to the business. The last form is the worst-case scenario and seems to be the one that the OSC auditors want to focus on. Periodically planning and testing for this scenario seems to be unnecessary.

STATE COMPTROLLER'S NOTES

In its official response to our draft report, NYPA has chosen to make comments that attempt to dismiss the legitimacy and value of our audit, and most significant, its findings of deficiencies and recommendations for improvement. We believe, however, that it is important not to let the comments and claims of NYPA officials go unanswered.

There are two bases for our concern: NYPA's lack of forthrightness in its representations to the public and its posture toward this legislatively-mandated but unwanted audit.

The first issue is the representations NYPA makes to the public. We did not audit whether all that NYPA says is supported by facts, but in the course of our audit work we found many important claims that are not factually supportable. Two examples illustrate this point:

- While NYPA discounts our audit findings, and issues frequent and carefully worded press releases and reports to the contrary, there is no hard evidence that supports the claims that NYPA makes about the benefits of the Power for Jobs program.

- NYPA's site on the World Wide Web includes a section on its plans to build power plants in New York City, a topic we tried to address in this audit. One of the pages shows a graph of a forecast of future demand and supply for electricity. The graph shows peak demand growing while the line that represents supply is flat. Understanding that many parties other than NYPA are working on developing new capacity in New York, we asked NYPA about its basis for the graphs, and were told that the line for supply was based on the current installed capacity, and did not include any additions of generation that developers have planned—a topic about which NYPA is well-informed. We see only disadvantage to the public when a government entity misleads it about a serious subject, and especially when the level of concern of the citizenry is high, and appropriately so.

The second issue is NYPA's posture toward this audit. Typically, no one welcomes an audit. But most government agencies recognize that the Office of the State Comptroller has a job to do under the State Constitution and a legislative mandate to fulfill. Chapter 469 of the Laws of 1989 requires the State Comptroller to do a program, financial, and operations audit of NYPA at least once every five years. NYPA officials contend that the Legislature intended this process to be a periodic review that would ensure that NYPA's operations were in conformance with New York State energy policy. Nowhere in the law is this intent conveyed or stated, notwithstanding NYPA's assertions to the contrary. In fact, the mandate of the Legislature, as stated in the law, is that our audit encompasses all aspects of NYPA's programs and operations. Moreover, the law reaffirms the State Comptroller's independence to audit such other elements as the Comptroller may determine necessary and appropriate.

This audit is the third under Chapter 469 of the Laws of 1989 and, over the years, we have observed a disturbing trend by NYPA officials to try to manipulate the audit process, oppose our legitimate audit work, and attempt to slow our progress. There are too many examples of this problem to describe here, but they include the following:

- **Controlling our access to agency personnel** - This ranged from the petty—not giving auditors cards to open doors, requiring auditors to get escorts to meetings or review documents—to the serious, in rejecting requests to interview the NYPA personnel of our choice, and instead deciding with whom at NYPA auditors could speak. Also, the auditors were required to schedule interviews in several weeks advance (which delayed audit work). There often were as many as three observers at these meetings who took notes and sometimes prompted the people who were interviewed, and some NYPA employees declined to answer our questions.

- **Restricting and impeding our access to agency documents** - The customary practice auditors follow is to select documents themselves, thus helping to ensure that the records they examine have not been subject to any tampering. NYPA, however, insisted that auditors submit written requests, a requirement to which we acceded only in the interest of expedience. In return, we expected NYPA to respond to our requests in a complete and timely manner, as stated in the written Memorandum of Agreement between NYPA and the Office of the State Comptroller governing the conduct of the audit. Our experience, however, was disappointing and exactly to the contrary: NYPA was slow to produce the documents, and did not answer our questions completely. This had a detrimental effect on our progress and ability to follow up on issues as we learned more about them. NYPA's assertion that it incurred nearly $2.3 million in audit costs is in no small part self-inflicted and directly attributable to NYPA's intense efforts to manipulate the audit process. While there are numerous instances of obvious delaying tactics NYPA used, one stands out far above the others. In September 2000, we asked for a list of reports provided to NYPA by its consultants. It took until May 2001 to receive these documents. We therefore question whether NYPA did in fact provide us with all known relevant information, as NYPA officials assert in the management representation letter we ask officials of all audited agencies to sign.

Thus, despite our reservations and those expressed by our management-consulting firm, The Liberty Consulting Group (see Appendix D, Management-Consulting Firm Comments on NYPA Audit), we conducted our audit under conditions that were far from ideal, while making every effort to ensure that our audit would be comply fully with government auditing standards and meet our statutory responsibility to report to the Governor and legislative leaders by the deadline in the law that requires this audit.

We take exception to the criticism leveled by NYPA in its cover letter, executive summary, audit process commentary, and NYPA's lengthy comment document. To help ensure that our consideration of NYPA's comments (found in Appendix B) is clear, we have included the following notes to NYPA's response.

Note 1. Contrary to the assertions made, if NYPA considered our recommendations in the constructive spirit in which they were made, NYPA, its customers, and the citizens of New York State would enjoy benefits that are worth several times more than the audit costs claimed by NYPA. We also find it presumptuous of NYPA to speak on behalf of all the potential users of this report by characterizing it as not being beneficial to anyone. Even at this late stage in the audit process, we hope that NYPA will abandon its efforts to resist and discredit the results of this independent audit and acknowledge that improvement opportunities can be made in certain aspects of its operations.

In the section of the executive summary called audit process, NYPA makes a number of comments about its responses to our requests for information. Contrary to NYPA's claim, we conducted substantially fewer than 344 hours of interviews—in part because of roadblocks NYPA put in our way—and are perplexed about the claim of 7,000 hours of NYPA staff time to support the interviews, implying 20 hours of staff time for every hour of interviews that NYPA mistakenly believes we conducted. While NYPA has not provided us with an analysis supporting the statistics it cites, we can say categorically that the cost would have been lower had NYPA officials been cooperative.

Note 2. Liberty Consulting Group is a leading consulting firm in serving utility regulators and others with oversight responsibility. Liberty has performed over 200 projects for more than 40 energy utilities and more than half of the state-regulatory commissions in the United States. In addition to its work for the State Comptroller in the immediately-preceding NYPA audit, Liberty has done management audits of: three utilities for the Pennsylvania Public Utility Commission, three utilities for the New York Public Service Commission, three utilities for the Connecticut Department of Public Utility Control, and one utility each for the Arkansas, Maryland, New Hampshire, and Tennessee commissions. Liberty has also worked for municipalities and other government-owned utilities, and for rural electric cooperatives. As NYPA officials know, The Liberty Consulting Group was selected for this work through a competitive procurement process.

Note 3. In its response, on several occasions, NYPA officials refer to the 1996 audit in particular with respect to findings and conclusions related to the Poletti plant and to the two nuclear plants that NYPA sold in 2000. In referring to the last report, NYPA officials distort and misrepresent what was reported. With regards to the Poletti plant, NYPA officials assert that the last report stated that NYPA's continued ownership and operation of Poletti was not in the best interests of the State. What was said in that report is "NYPA's Poletti power plant may be necessary to meet electric needs in New York City, but NYPA's continued ownership and operation of the plant may not be in the best interests of the State. NYPA's ownership and operation of Poletti may be more for the benefit of Consolidated Edison than for the benefit of NYPA customers." The actual recommendation in the 1996 report was as follows: "serious consideration should be given to the option of selling Poletti. If NYPA continues to own and operate Poletti, NYPA should seek to renegotiate the Planning and Supply Agreement to reflect changes in circumstances and obtain compensation for the value of the service provided to Con Ed."

Likewise, with regards to the two nuclear plants, we did not say that NYPA should shut down its nuclear plants, an option NYPA had itself examined. Instead, we made the following statement in the 1996 report: "We have reached no conclusions about whether NYPA should continue to operate either or both of the nuclear plants. We believe, however, that NYPA's most recent economic analysis of its nuclear plants is faulty." We then pointed out: "NYPA reportedly spent more than $100 million for improvements during a 14-month outage at FitzPatrick…. NYPA spent over $400 million at Indian Point 3 during the three-year period that began with the shutdown in February 1993, at least $100 million more than what would have been expected before the performance problems led to the extended shutdown." While operation of both plants had improved, given their history it is not surprising we were unsure that NYPA should continue to own and operate the two nuclear plants. And, in fact, NYPA must have concluded it did not have the necessary skills and talent to own and operate its two nuclear plants because it sold the two nuclear power plants to the Entergy Corporation on November 21, 2000.

Note 4. Chapter 469 of the Laws of 1989 requires the State Comptroller to do a program, financial, and operations audit of NYPA at least once every five years. Contrary to NYPA's assertion, the law does not limit the scope to NYPA's conformance with New York State energy policy.

Note 5. Despite what the NYPA response says, the report does not take issue with the legislature's finding about the significance of electricity for economic development. We do, however, take issue with NYPA's claims about the contributions of the Power for Jobs program and NYPA's administration of it. Our concerns are supported by the facts we present in the audit report and were developed through extensive analysis of NYPA's files.

Note 6. The role of the audit team is not to provide a duplicative advisory or consulting service to NYPA, but to audit the management and operations of the Authority. Our review of consulting reports has the objective of ensuring that accurate and important consulting recommendations related to audit topics are implemented in a timely and beneficial fashion. The consulting engagements alluded to by NYPA are the organizational assessment and the Management Reporting Review, both performed by PriceWaterhouseCoopers

(PWC), NYPA's external auditor. As reported in Chapter 2 of this report, NYPA has not completed or implemented the organizational assessment. We conservatively estimate that NYPA could eliminate $10.5 million in unnecessary expenses annually if an organizational assessment were completed and its recommendations implemented. NYPA has also not followed the specific recommendations of PWC to upgrade its management reporting, which is also explained in Chapter 2. We strongly recommend the completion and implementation of these consulting engagements as components of our management and operations audit charge.

Note 7. We did not say that NYPA had entered into extensions of its contracts with Entergy. Additionally, the concerns we raised about NYPA's lack of analysis supporting major decisions are not "bogus."

Note 8. We understand that NYPA currently does not function like an energy trading company, but in the future NYPA will have to compete with national energy trading companies.

Note 9. In the professional opinion of our management-consulting firm, on two counts NYPA is not currently well-equipped to deal effectively in the challenging energy trading environment. On the first count, NYPA personnel do not have the expertise to perform in today's dynamic power supply market. NYPA has even acknowledged this through their decision to contract with an outside firm on risk management issues: if NYPA had the necessary talent, it would likely have used its own resources to provide this critical component of power procurement. On the second count, NYPA does not have the job descriptions, processes or procedures to be effective in this area. If NYPA proceeds with its current options, it could have 2,800 megawatts of capability in a market with only 1,700 megawatts of demand and would be in the position of a merchant generator. It would then be speculating in the power market and would be engaged in these energy trading activities, which NYPA has said it is not engaged in, and will not engage in.

Note 10. An adjustment was made to recognize accurate factual information conveyed on NYPA's response to our draft report.

Note 11. We never say that NYPA must be like Williams Energy and Enron, but only cite these companies as examples of the sophistication of the market for trading electric power. Furthermore, because New York asset ownership is not a requirement for participating in the New York power market, NYPA must have the experience to deal with these market players effectively.

Note 12. NYPA described a cost recovery mechanism for this project. Follow-up is needed to confirm that the payback schedule and quantities are as predicted by NYPA. Also, since this project has the potential to be a significant benefit to the State of New York, we believe that the suggested reports are needed in order to ensure that New Yorkers do in fact benefit from this project.

Note 13. We identified delays in commencing work on the first St. Lawrence unit which gave us concerns as to whether this was an early warning sign of project slippage of not only the first turbine upgrade, but of the remaining units as well.

Note 14. NYPA officials have taken the position that NYPA is going through an adjustment period that leads to a conclusion that the organizational assessment is not immediately needed. However, the information from the organizational assessment is crucial to guiding NYPA through such a transition period by identifying required staffing changes.

Note 15. NYPA emphasizes the use of its integrated financial, procurement and human resources system (SAP system) since 1999 as a primary source of management reporting information. However, the Management Reporting Review, completed in May 2000, concluded that "Current systems do not support the management reporting process." Moreover, contrary to NYPA's assertion, SAP is not a management reporting system.

Note 16. While the application requests information related to the twelve statutory criteria, we did not find that NYPA's staff considered information other than jobs when recommending an action by the Economic Development Power Allocation Board.

Note 17. There are many opportunities for NYPA to expand its customer satisfaction survey process beyond its New York City area customers in the HELP program.

Note 18. NYPA should take action to reduce the size of its automobile fleet as dictated by the results of its analysis.

Note 19. NYPA officials did not document that there was an increased demand for use of its corporate aircraft that could not be met by commercial airlines or chartered aircraft at a lower cost. Furthermore, NYPA's cost study did not place a value on increased flexibility and productivity made possible by a second aircraft; we used the same initial cost data provided by NYPA and it did not justify the purchase of the second corporate plane.

Note 20. Planning for the loss of a facility is a crucial element in any information technology disaster recovery plan; testing for loss of a facility should be an important part of the contingency planning process.

Note 21. As stated in our report, NYPA is considering actions that could increase its generating capacity to supply customers in the New York City area to as much as 2,800 megawatts: a Poletti expansion (500 megawatts), PowerNow turbines (500 megawatts), the potential extension of the Indian Point 3 contract (980 megawatts), and either the existing Poletti plant (825 megawatts) or its potential replacement. However, the peak demand for NYPA's existing customers in the New York City area is only 1,700 to 1,800 megawatts.

Note 22. There was no change from the original audit scope, but rather we changed the organization of our report to better communicate our audit findings.

Note 23. The purpose of the May 31st meeting was not to brief the auditors on the status of the Long-Range Financial Plan, as claimed by NYPA. The meeting was held at NYPA officials' request to enable them to present information that they believed was relevant to our preliminary conclusions and recommendations. NYPA officials presented their recent attempts to model the New York City market and to evaluate an additional (or second) expansion at Poletti that was not addressed in this audit because we were not told about it in a timely fashion. NYPA did not have a 2001 Long-Range Financial Plan and, as of the time of our audit, did not have this central planning tool for 15 months.

Note 24. NYPA used the *Poletti Repowering Report* as its basis for determining the need for a new in-City generating plant at Poletti. We concluded this report was inadequate. NYPA officials state in their response to our draft report that certain assumptions regarding this decision were included in its 2000 Long Range Financial Plan. As described in this report, we asked NYPA officials during our audit for the data supporting the information in the *Poletti Repowering Report* but did not receive such documentation, so we could not evaluate the appropriateness of NYPA's decision.

Note 25. While NYPA does not dispute that it is reviewing a number of power supply alternatives that could bring generating capacity for the New York City area to 2,800 megawatts, it does disagree that it would increase this generating capacity by more than 50 percent greater than its customer load. As stated in our report, NYPA has estimated financial commitments totaling more than $1 billion of operating costs annually for these power supply alternatives. Our report merely cautions NYPA that there are risks in over-expanding its power supply in the New York City area.

Note 26. In the past, there has been little interest by others in serving NYPA loads, and consequently what NYPA may view as a competitive market has not been one at all, and is certainly not a good model for what will happen in the future. The whole point of our discussion on NYPA's role in the electric-power market is that the future will be very different, and NYPA must be ready for it.

Note 27. We commend NYPA's new risk management actions. However, if NYPA is so confident that obtaining power is a simple and risk-free activity, then it is surprising that NYPA saw the need to contract with an outside firm to obtain its risk management expertise.

Note 28. NYPA did not disclose or provide us with any reports they prepare and file with the Division of the Budget. This disclosure concerns us because it is the first time NYPA informed us of such reports and it is at odds with NYPA officials' assertion in their management representation letters stating that they provided us with all relevant information.

Note 29. We identified delays commencing work on the first St. Lawrence unit. According to records at NYPA, the upgrade program was supposed to begin in September 2000, but the first unit was not delivered until May 2001. This gave us concerns as to whether this was an early warning sign of project slippage of not only the first turbine upgrade, but of the remaining units as well.

Note 30. NYPA officials have taken the position that NYPA is going through an adjustment period that leads to a conclusion that the organizational assessment is not immediately needed. However, the information from the organizational assessment is crucial to guiding NYPA through such a transition period by identifying required staffing changes.

Note 31. Concerning the organization assessment, we are perplexed that it was placed on hold at a time when NYPA needed information to right-size its support staff and to identify new expertise for its changing business. Also, we question why NYPA paid the full contract price of $200,000 if the assessment was not completed and what incentives the consultant would have to complete the work and issue a report if it were already fully paid for the work which was scheduled to be completed in July 2000.

Note 32. NYPA officials state that even if approval documentation is not in the project files, the work is approved implicitly because their customers paid for the work. However, we believe that complete project documentation of all approvals is a good business practice and necessary to prevent possible disputes.

Note 33. This has been deleted based on NYPA's response.

Note 34. We believe that the Board of Trustees would be best served by contracting for an independent analysis instead of in-house evaluations of the above referenced issues.

Note 35. The Power Authority Act and related legislation do not address NYPA's role in New York State's competitive wholesale and retail power markets. Consequently, NYPA's comments are non-responsive to the recommendation.

Note 36. This is also non-responsive. While NYPA officials provided us with a representation letter subsequent to the issuance of our draft report, we still question the quality of the information we received for the reasons previously stated, such as incomplete responses to information requests, delays in delivery of requested documents, and questionable access to people.

Note 37. We note that the actions taken by NYPA occurred during our evaluation of its energy trading capability. With the potential of increased competition for NYPA customers beginning in 2002, NYPA should expedite completion of this important function.

Note 38. NYPA needs to make significant improvements in its energy purchasing and bulk power functions because it may find itself in direct competition with large, successful companies.

Note 39. NYPA did not disclose or provide us with any reports they prepare and file with the Division of the Budget. In addition, NYPA described a cost recovery mechanism for this project. Follow-up is needed to confirm that the payback schedule and quantities are as predicted by NYPA. Also, since this project has the potential to be a significant benefit to the State of New York, we believe that the suggested reports are needed in order to ensure that New Yorkers do in fact benefit from this project.

Note 40. NYPA was not responsive to this recommendation. However, we identified delays commencing work on the first St. Lawrence unit which gave us concerns as to whether this was an early warning sign of project slippage of not only the first turbine upgrade, but of the remaining units as well.

Note 41. NYPA officials have taken the position that NYPA is going through an adjustment period that leads to a conclusion that the organizational assessment is not immediately needed. However, the information from the organizational assessment is crucial to guiding NYPA through such a transition period by identifying required staffing changes.

Note 42. We believe that the organizational assessment results need to be openly shared with the identified State officials to ensure appropriate oversight and implementation.

Note 43. NYPA's position is not responsive to most of the key recommendations made by the consultant regarding management reporting. Specifically, the consultant recommended that a new set of management reports be developed, because existing reports do not support analysis or strategy, and are of limited value for identifying issues and helping make decisions. NYPA has not moved forward on implementing this first and most basic recommendation. Information regarding trading performance, customer margins, current and future market conditions, competition, risk management and external benchmarks were identified as requirements; however NYPA is only addressing two of these six areas more than one year after the consultant issued its report. Finally, NYPA emphasizes the use of its SAP system since 1999 as a primary source of management reporting information. However, the management Reporting Review, completed in May 2000, concluded that "Current systems do not support the management reporting process."

Note 44. We conclude that NYPA managers do not have adequate decision-making information if its central planning tool is not updated for 15 months. Also, NYPA should be capable of producing this report on demand because of the dynamic nature of the electric-power industry.

Note 45. Our audit did not question the Legislature's finding about the effect of the cost of electricity on economic development and energy levels. Contrary to NYPA's assertions, we maintain this is a constructive recommendation to improve how NYPA administers the program. Furthermore, while the legislation provides a number of criteria for program participation, NYPA routinely focuses just on job performance indicators.

Note 46. Recommendation deleted based on NYPA's response.

Note 47. Our audit found that the application requests information related to the twelve statutory criteria, but we did not find that NYPA's staff considered information other than jobs when recommending an action by the Economic Development Power Allocation Board.

Note 48. There are many opportunities for NYPA to expand its customer satisfaction survey process beyond its New York City area customers in the HELP program.

Note 49. While we understand that internal-audit resources may be limited, the energy efficiency programs still represent an investment in excess of $500 million.

Note 50. We used NYPA's own data and found that purchase of a second aircraft would cost NYPA $1.9 million instead of saving $167,000. NYPA's analysis did not consider improvement in productivity and flexibility.

Note 51. NYPA should take action to reduce the size of its automobile fleet as dictated by the results of its analysis.

Note 52. Recommendation deleted based on NYPA's response.

Note 53. NYPA tries to justify the benefits of its actions, without recognizing the opportunities for saving travel costs by considering our recommendation. There were a number of employees who received large travel reimbursement in both 1999 and 2000 equal to between 37 percent and 95 percent of their salary, with NYPA's White Plains office as the destination location. Considering the large amounts of travel expense so paid, we believe this recommendation is valid.

Note 54. NYPA officials did not provide us with any documentation to support their claim that they have a formal IT strategic plan that supports their overall business strategy.

Note 55. Complete testing of all computer failure possibilities is a key element of any effective disaster recovery plan.

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July 27, 2001

Ms. Carmen Maldonado
Audit Director
Office of the State Comptroller
123 William Street, 21st Floor
New York, New York 10038

Dear Carmen:

You have asked that we compare the level of cooperation NYPA has shown to that which we have received from other utilities in management audits. I regret very much the need to express observations of this type, but I respect your right to seek our candid opinions, which I offer below. Were NYPA officials' conduct in the areas I mention at all within the range of our prior experience, I would not cite them. It is only because I consider them extreme that I do so.

In our more than 14 years of service to the utility industry, we have conducted engagements for nearly two-thirds of the country's public-service commissions. Many of them have involved major audits or other detailed examinations of management and operations. That work has included electricity, natural gas, and telecommunications utilities, quite a number of them larger than NYPA. Our work extends as well to most regions of the country and it has involved both investor-owned utilities and member- or publicly-owned utilities. We have also conducted work in circumstances where the exposure of the audited utility to direct economic repercussions from our work has been more immediate and obvious. Please also note also that we continue, as we always have, to enjoy the confidence of both regulators and those that they regulate; our client list includes even more utility service providers than it does regulators.

The absence of cooperation with our audit work shown by NYPA officials was extraordinary, compared with what we have experienced from others, in the following facets:

- Lack of respect for the goals and usefulness of such an audit.
- Weakness of efforts to make prompt and complete responses to requests for information.
- Unwillingness to extend normal levels of personal and professional courtesy.

These factors made the conduct of this audit much more difficult than it should have been, and provided an essentially constant threat to its timely and successful completion.

Sincerely,

Larry Koppelman

Lawrence N. Koppelman
Vice President

Appendix D