



- *Accountability*
- *Transparency*
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Operational Review

**Dormitory Authority of the State
of New York**

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Executive Summary

Purpose and Authority:

The Authority Budget Office (ABO) is authorized by Section 27 of the Public Authorities Accountability Act (Act) to review and analyze the operations, practices and reports of public authorities and to assess compliance with various provisions of Public Authorities Law and other relevant State statutes. This includes rendering conclusions and opinions regarding the performance of public authorities and to assist these authorities improve management practices and the procedures by which their activities and financial practices are disclosed to the public. Our operational review of the Dormitory Authority of the State of New York was performed from January to May 2009 and was conducted in accordance with our statutory authority and compliance review protocols which are based on generally accepted professional standards. The purpose of our review was to provide an objective evaluation of the Authority's operations and the extent of the Authority's statutory compliance, and make necessary recommendations to improve their business practices.

Background Information:

The Dormitory Authority of the State of New York (Authority) was established in 1944 as a public benefit corporation under Article 8 Title 4 of Public Authorities Law. The Law authorizes the Authority to provide financing and project management services to public and private universities, not-for-profit health care facilities, courts, and other various public and private institutions that service the public. The Authority has eleven Board members: five appointed by the Governor with the consent of the State Senate, one appointee by each the State Comptroller, Assembly Speaker, and Temporary President of the State Senate, and three ex-officio members. The Authority is managed by an Executive Director. Its primary source of revenue for Authority operations includes fees for financing, project management and bond management services. For fiscal year 2007-2008, these fees totaled \$90.1 million, while the cost of operating the Authority totaled \$88.8 million.

Results:

Our review found that the responsibilities of the Authority have significantly changed over time and that the Authority appears to have adjusted to these statutory changes and is operating effectively. We conclude that the Authority is generally in compliance with and particularly effective in

implementing the good governance practices required by the Act and is up to date in submitting its required reports. We noted that the Authority should be more restrictive in its use of executive session and strengthen its internal control assessment practices.

The report does identify two issues that warrant further study and discussion. First, we recommend that the Authority examine its billing practices and re-evaluate the method used to calculate fees charged to public clients. The Authority has adopted a prospective billing methodology that charges public clients for estimated future expenses, rather than actual costs incurred. We also found that the Authority is charging State agencies for a portion of the Authority's cost recovery fee, a charge to the Authority for services provided by New York State. We also understand that the Authority does not routinely provide all of its public clients with sufficiently detailed bills to enable those clients to reconcile the amount billed to the services provided. Rather, information on how the fees are calculated is provided only upon request. Similarly, as a matter of routine practice, the State does not require the Authority to document its cost components.

Secondly, the Authority should expand its data collection to improve the evaluation and assessment of its operations. While the Authority has begun to review its financing guidelines, the Authority could collect additional information on institutions most likely to benefit from any revision to these guidelines. With additional documentation as to why certain applicants are denied financing or an understanding as to why otherwise eligible institutions do not apply for financing, the Authority's ability to make informed decisions on any revisions could be strengthened. This information could also be useful for determining when exceptions to the guidelines should be recommended.

Introduction and Background of the Authority

The Dormitory Authority of the State of New York (Authority) was established in 1944 as a public benefit corporation pursuant to Title 4 of Public Authorities Law. The Authority's original enabling legislation authorized the Authority to finance and construct dormitories for 11 State teachers' colleges. Over the years, the State has amended the Authority's enabling legislation to authorize financing and project management services for hospitals, government agencies, court facilities, and other public and not-for-profit institutions. As a result, the current mission of the Authority is to be the public finance and construction partner of choice, providing customers with low-cost capital and professional design and project management services.

The Authority is governed by an 11 member Board of Directors comprised of five members appointed by the Governor with the consent of the Senate, one member each appointed by the State Comptroller, the Assembly Speaker, and the temporary President of the Senate, and three ex-officio members: the Director of the Budget, the Commissioner of Education, and the Commissioner of Health. Members of the Authority Board serve without compensation other than reimbursement of actual and necessary expenses.

The Board provides policy direction and oversight to executive management and appoints the Executive Director, who manages the Authority's operations and directs a staff of over 600 employees. The Authority is organized around six administrative and operational offices: the Office of Executive Direction, the Office of General Counsel, the Office of Finance, the Office of Construction, the Office of Public Finance and Portfolio Monitoring, and the Office of Executive Initiatives. Of these offices, the Office of Construction and the Office of Public Finance and Portfolio Monitoring are most directly involved in services to clients. Each office is headed by a managing director, most of which are appointed by the Board.

The Office of Executive Direction is responsible for the administration and operating practices of the Authority, such as payroll and budget, as well as coordinating with the managing directors and reporting to the Board. The Office of General Counsel provides advice to the Authority on litigation, contract matters, and the legal aspects of all financings. The Office of Finance is responsible for the accounting and treasury functions, including the investment of funds, financial reporting, accounts payable, accounts receivable, debt service administration, information services and funds management, and represents the Authority at bond closings. The Office of Executive Initiatives is responsible for overseeing communications, opportunity programs, environmental initiatives, client outreach, training, and legislative and special projects. The Office of Construction is the largest staff unit within the Authority and provides project management services for clients, while the Office of Public Finance and Portfolio

Monitoring determines the applicability and feasibility of potential financing for Authority clients, and monitors the performance and re-payment of those bonds.

The Authority serves both public and private entities. Public entities are State and municipal agencies, and consist primarily of the State University of New York (SUNY), the City University of New York (CUNY), New York City and county court facilities, the State Education Department, the State Department of Health and the New York City Health and Hospitals Corporation, school districts and the State Department of Mental Hygiene. Private entities consist of independent colleges and universities, private hospitals, nursing homes, medical research centers, facilities for the elderly, libraries and other not-for-profit organizations.

The Authority has an April to March fiscal year, and elects to report conduit debt in its financial statements. As a result, as of March 31, 2008, the Authority reported \$38.3 billion in assets and \$35.6 billion in total outstanding debt, which consists solely of debt issued on behalf of its clients and the State. The Authority supports its operations primarily through fees charged to clients. For 2007-08, revenue from these fees totaled \$90.1 million. Total Authority operating costs, which consist of personnel service, maintenance and operations and New York State assessments, totaled \$88.8 million. As of March 31, 2008 the Authority's annual audit reported over \$81.4 million in unrestricted net assets, about \$40 million of which is undesignated for specific uses. During 2008, the Authority had over 637 outstanding bond series, and managed and monitored 834 active construction projects. In addition, the Authority closed on 54 new financings.

The Authority appears to be controlling its operating expenses to align with the State's directive to reduce spending. Since March 2006, the Authority's operating budget has increased less than two percent. Personal service and employee benefit costs have increased less than three percent, while other operating costs decreased six percent. In addition, although not obligated to follow the Governor's hiring freeze directive, the Authority has limited its active staffing level to 617 staff; as of December 2008 the Authority had 616 staff on its payroll.

Compliance Review Objectives

The Authority Budget Office (ABO) is authorized by Section 27(1) of the Public Authorities Accountability Act (Act) to conduct reviews and analyses of the operations, practices and reports of public authorities to assess compliance with provisions of the Act and Public Authorities Law. Our operational review was conducted to provide an objective determination of the Dormitory Authority's operations, as well as determine the Authority's compliance with applicable provisions of the Act, Public Authorities Law, and other statutes.

Compliance Review Scope and Methodology

Our compliance review was conducted from January to May 2009, and covered the Authority's operations for the period of April 2007 through March 2009. Our review was focused on the effectiveness of Authority management, its Board, and the overall operations of the Authority in relation to its core mission. Specifically, we reviewed the following:

- Organizational documents and records
- Independent financial audits and other financial records
- Policies and procedures of the Authority and those required under the Act, Public Authorities Law, Public Officers Law, and State Finance Law
- Board duties, committee involvement, and independence
- Internal control structure of the Authority

In addition to reviewing financial and organizational documents and records, we interviewed appropriate management, Authority staff and Board members; attended Board and Committee meetings; and performed other testing we considered necessary to achieve our objectives. Our report contains recommendations to improve the effectiveness of the operations of the Authority and ensure the Authority's compliance with the Public Authorities Law and other applicable laws. The results and recommendations of our compliance review were discussed with Authority management and their comments have been considered and are reflected in this report where appropriate.

Operational Review

Changes in Responsibility

The Authority was created in 1944 to finance and construct dormitories for 11 State teachers' colleges. The Authority's enabling legislation has been revised to expand the organizations it could serve, but it was not until the 1960's that the Authority was empowered to diversify its portfolio and finance and construct facilities other than for educational purposes. Over time the State has significantly expanded the scope of services provided by the Authority. By law, the Authority is now authorized to finance and construct hospitals, health care, and higher education facilities, municipal court facilities, and certain nonprofit institutions, as well as projects for public agencies. In addition, the Authority issues State debt to finance specific grants and programs authorized by the State. The chronology of changes in the Authority's responsibilities is depicted in the table below.

Year	Description of Change in Responsibility
1944	Created to finance and construct dorms for the State University of New York
1964	Authorized to finance and construct hospital facilities
1979	Authorized to finance and construct facilities for the aged
1986	Authorized to issue debt for first student loan program
1987	Authorized to finance and construct local court facilities and facilities for other government and nonprofit agencies
1988	Authorized to finance SUNY academic facilities and facilities for certain Special Acts Schools
1995	The Medical Care Facilities Finance Agency and the Facilities Development Corporation were merged into the Authority
1997	Authorized to finance grants approved by the State
2002	Authorized to finance local school district capital projects

In 1995, the size and scope of the Authority was significantly expanded when the New York State Medical Care Facilities Finance Agency and the New York State Facilities Development Corporation were merged into the Authority. This made the Authority the largest government building construction agency and the largest public authority issuer of tax-exempt bonds in the country at the time. The merger resulted in a dramatic change in the Authority's responsibilities and staffing, and a transition to serving additional hospitals, nursing homes and large government agencies.

The State has also authorized the Authority to assist certain clients that are not directly related to the Authority's original core mission, such as the State's Homeless Housing Assistance Corporation. The Authority also manages a Tax-

Exempt Equipment Leasing Program and the School District Building Aid Revenue Bond Program, which provides cost-efficient financings to municipalities and local school districts. Further, although not specifically authorized in the Authority's enabling legislation, the State has authorized the Authority to finance and administer grants intended to improve community facilities and address other economic development needs throughout the State. In 2007-08, the Authority issued \$996 million in bonds to support these grant projects. The Authority has adjusted to these additional responsibilities by allocating its resources effectively.

Current Debt Structure

Debt issued by public authorities is classified as State debt, authority debt, or conduit debt. State debt is debt issued on behalf of the State and supported by a State appropriation or dedicated State revenue, generally personal income tax revenue. Authority debt is issued by a public authority for its own purposes and paid for by the fees and revenues generated by the authority. Conduit debt is debt issued on behalf of a third party. The debt is retired by that third party, such as a private institution or company, using its own revenue sources, and the authority has no obligation to assume the debt in the event the client is unable to make its payments. The Authority has not issued authority debt, but has typically issued conduit debt. At the direction of the State, the Authority has begun to issue an increasing amount of State debt to fund non-construction programs.

The Authority has elected to report all outstanding debt, including conduit debt, in its financial statements. As a result, the Authority's revenues and expenditures reflect debt service payments made on behalf of its clients, as well as the fees charged to clients for finance and project management services. As of March 31, 2008, the Authority reported a total of \$35.65 billion in outstanding debt, 49 percent of which is State debt, such as \$66 million issued for the New York State Veteran's Home at Oxford. The remaining 51 percent is conduit debt, which includes projects financed for clients such as Cornell and Rockefeller University. The Authority is authorized to issue Personal Income Tax (PIT) Revenue Bonds to support a variety of purposes including education, health care and economic development projects. These bonds account for 29 percent of the Authority's outstanding State debt. In addition, for 2009-10 the State enacted legislation that increases the Authority's ability to issue PIT bonds for any authorized purpose.

During our review period the Authority issued \$3 billion in new debt; 56 percent of which was State debt, approved by the Executive and the Legislature, and 44 percent was conduit revenue bonds. The Authority also refunded or refinanced approximately \$621 million of debt. All debt issued by the Authority is subject to the review and approval of the Public Authorities Control Board (PACB).

Financial Services

The Authority provides financing to public and private clients by issuing tax-exempt revenue bonds and lending the proceeds to the client. The Office of Public Finance and Portfolio Monitoring reviews an applicant's eligibility, determines financial viability, and issues the bonds. It also monitors bond payments and compliance with bond covenant agreements. The Office is comprised of 20 staff who analyze each request for financing and if appropriate summarize the request, which is then presented to the Board for approval. Once a private client has been approved, the Office monitors the client to ensure that bond payments and other covenants are met throughout the life of the bond.

We found that the Authority has adopted different approaches for reviewing and approving financings depending on whether the project is financed through State or conduit debt. For projects financed with State debt, the Board's review and approval process focuses primarily on whether the project is authorized under the Authority's enabling legislation and has the funding support of the State. If the project meets these criteria, the Authority will submit the project to the PACB for approval prior to issuing the bonds. Once the bonds are issued, the Authority works with the Division of the Budget to ensure timely and appropriate payments are made to bondholders.

Projects financed with conduit debt are subject to more extensive requirements for financing approval and ongoing bond monitoring. The Authority's Board has established "Guidelines on Security of Authority Financings for Independent Institutions" (financing guidelines). The Authority bases its guidelines on credit ratings issued by nationally recognized municipal bond rating agencies. The credit ratings consider an entity's creditworthiness, likelihood of meeting financial commitments, and ability to afford protection in the event of adverse financial circumstances. Ratings range from prime or high investment grade to non-investment grade or default grade. In general, a rating in the A category means an entity has a high credit quality and a very low risk of default on debt service. In accordance with the financing guidelines, the Authority approves those eligible institutions that secure a rating of A1/A+ or higher for financings, which is higher than an A rating.

Clients with lower investment ratings can still qualify for financing and may be required to secure appropriate credit enhancements, such as a letter of credit or bond insurance. The Authority may also require these clients to maintain additional debt service reserve funds or to make contingency plans to engage a management consultant in the event that the bond covenants are not met. However, in the current financial market, credit enhancements have become more difficult to obtain, limiting the ability of those potentially viable institutions with lower investment grade ratings from financing through the Authority. Under its existing guidelines, the Authority Board has the ability to authorize financings that do not qualify to proceed as exceptions to the Authority's guidelines.

As a result of the current market conditions, the Board is conducting special workshops with financial experts, investors and representatives of private clients. The purpose of these sessions is to determine whether continuing to apply the existing financing guidelines is the best way for the Authority to fulfill its mission and meet the needs of statutorily eligible clients. We agree that undertaking this examination is a sound business decision.

Prior to approving financing for a project funded with conduit debt, the Authority determines whether the client and its project are authorized in the Authority's enabling legislation. If the client meets the rating criteria described above, Authority staff conduct a credit analysis, which includes a review of the client's financial condition, short-term and long-term business plans, cash flow projections and other documentation on the client's financial standing and long-term ability to repay the debt. This credit analysis is summarized and presented to the Board for approval.

If the client does not have the requisite rating under the Authority's financing guidelines or cannot obtain credit enhancement, staff may still recommend to the Board that the financing be considered. However, the Board has not identified the factors that must exist to qualify the project as an exception. As a result, there is limited assurance that all appropriate factors are considered for those projects that do not meet the financing guidelines.

After review and approval by the Board, a "Resolution to Proceed" is adopted; this authorizes Authority staff to prepare the appropriate financing documents. Once the Board resolves to proceed, the PACB must also provide its approval. After all necessary approvals, the final documents are compiled and provided to the Board a second time for its approval. This resolution is called the "Adoption of Documents" and authorizes staff to go to market with the bonds.

The Authority also monitors its private clients' financial and operating performance and compliance with bond covenants. This monitoring seeks to avoid potential defaults in the Authority's bond portfolio and to avoid calling on bond insurance or letters of credit. Authority staff review the client's annual financial statements to track its financial position, and perform trend analyses to ensure that clients are able to meet current and future bond obligations and covenant agreements. Although the financing for private clients is conduit debt and not a general obligation of the Authority, management states that the Authority has never had a client default on its bond payment. The purpose of this monitoring is to protect the interest of the bondholders and to protect the Authority's reputation.

Notwithstanding the Authority's efforts to monitor the financial position of these clients, some institutions experience financial problems or risk not meeting scheduled debt payments. When this occurs, the Authority takes additional steps to avoid a bond default or calling on insurance, by lending its own funds to clients

to satisfy short-term bond obligations. If the client experiences long-term financial problems, any credit enhancements that were required by the Authority, such as bond insurance or a letter of credit, are used to pay the bond holders. Currently the Authority is closely monitoring the financial condition of six private clients, due to arrears of these clients. These clients represent less than two percent of the Authority's private debt issuances.

The Authority is designated as the administrator of the Health Care Restructuring Pool, which provides funds to assist general hospitals respond to the changes occurring in the health care field, and interest free loans to clients that are experiencing financial distress. In addition, the Authority has designated \$10 million of its own funds to provide interest-free loans through a Health Care Portfolio Management Fund to assist nursing homes and clinics that have difficulty meeting bond obligations and covenant requirements. The Board must approve all loans that exceed \$250,000. Since 1996, the Authority has provided loans from its own funds to eight clients; as of December 31, 2008, two of these clients had outstanding loans of \$351,000.

IDAs as an Alternative Financing Option

A commonly shared perception is that the Authority is in competition with industrial development agencies (IDAs) for certain private clients such as not-for-profit colleges, universities and hospitals. Historically, IDAs funded economic development projects for these and other not-for-profit clients, while the Authority's bond portfolio has been a mix of private not-for-profits and public clients. Both provide tax-exempt debt to finance construction of private, not-for-profit institutions, although the Authority is not authorized to provide financing to every not-for-profit entity that could be financed by IDAs.

Our review found that the Authority and IDAs operate with different policy perspectives. The Authority's focus is on the financial viability of the client and the project. IDAs' focus are on the economic viability, community impact and job creation potential of the project. Moreover, for the past year IDAs have been prohibited from financing not-for-profit projects. Although Authority management indicated that some projects that would have been financed by IDAs were submitted to the Authority, there is no evidence to suggest that a significant number of these projects were submitted to the Authority for approval. In fact, its share of projects supported by State debt increased. Had third-party not-for-profit organizations secured an increased share of Authority financing, an increase in conduit financing would have been expected. This did not occur despite the moratorium and the availability of interest rates through the Authority that were equivalent to those offered by IDAs. Authority management indicated that this may be caused by current economic conditions.

In addition, we found that the differences in the approval processes followed by the Authority and IDAs, as well as their different fee schedules make the

Authority less attractive to certain potential borrowers. For example, while the Authority requires high credit ratings and has a rigorous review process with multiple approval levels in place, IDAs generally do not require applicants to have a certain credit rating to obtain financing. Further, while the Authority monitors the ability of the client to meet its debt service requirements, IDAs, as conduit debt issuers, generally rely on the applicant and the bondholders to ensure that debt service obligations are met. Finally, the Authority has a significant administrative fee structure, starting at \$75,000 per project with additional fees paid throughout the life of the bonds, while IDAs generally charge a minimal application fee and a onetime administrative fee based on the amount of the bonds issued.

Further, the Authority prides itself on never having a client default on debt service payments. However, there have been relatively few reported instances of municipal bond defaults by recipients of debt issued by IDAs.

As indicated, the Authority has begun discussions with investors and representatives of not-for-profit organizations regarding the financing opportunities available to not-for-profit organizations. These groups indicated that the lack of flexibility in the Authority's financing guidelines and procedures may have discouraged them from applying to the Authority.

Revenue Generation and Billing Practices

For 2007-08, the Authority received approximately \$90 million in fees from clients, 14 percent of which was received from private clients while 86 percent was received from public clients. About 13 percent of the Authority's operating costs apply to services provided to private clients while 87 percent apply to services provided to public clients.

The Authority charges its private clients a fixed fee for processing an application and issuing debt. This fee ranges from \$75,000 to \$150,000 depending on the nature and complexity of the financing. Generally, private clients pay these financing fees at bond issuance. In addition, these clients pay an annual administrative fee over the life of the bonds of less than one-tenth of one percent of the outstanding balance (for debt issued prior to 2008 the fee is based on a percentage of the original bond issuance.) The fees are intended to cover all costs associated with administering and monitoring private clients' debt. Additional fees are assessed if the client utilizes the Authority's construction management services.

In contrast, the Authority bills its public clients an annual amount equal to the estimated direct costs to be incurred by the Authority on behalf of the public client and the public client's share of the Authority's overhead costs. While the intent of this methodology is to bill public clients for actual costs plus overhead, the Authority bills prospectively based on an estimate of its direct labor charges and

overhead. Bills to public clients have averaged over \$70 million annually over the last three fiscal years. The Authority believes that requiring agencies to pay their estimated bills in full prior to a full accounting of the work actually performed by the Authority is necessary to provide sufficient funds to cover Authority operating costs. This is due in part to the timing of the payments being made by the public clients, which is established in agreements with each client.

For example, the agreement may require that payments be made in April and October of each fiscal year. In the preceding year, the Authority would estimate the costs that will be incurred for that client based on past experience and projected project workload, apply an overhead rate, and use this estimate to establish a preliminary fee. The public client would make a portion of this payment in April to cover anticipated costs through September, and the balance in October to cover anticipated costs for the remainder of the fiscal year. This is in addition to any debt service payments made to the Authority. Any adjustment for over or under payments made by the client in that year is not reflected in its bill for two years, when actual costs for the period are known.

Authority management indicate that a primary reason for advance estimates is to enable State agencies to include the costs in their budget proposals, which are due to the Division of the Budget approximately six months before the start of the next fiscal year. While this timeline is correct, the amount of these payments does not need to be based on prospective costs.

To manage the payments made by public clients, the Authority establishes an escrow, or operating, account for each client. Payments made by public clients are held by the Authority in these accounts, and withdrawn as the Authority incurs expenses. The balance in these accounts fluctuate throughout the year, but as of March 31, 2008, the Authority had approximately \$48 million available in public clients' operating accounts. This advanced payment methodology was adopted at a time when there was concern that the Authority had limited reserves and insufficient unrestricted assets to cover future costs. However the Authority now appears to be well financed; as of March 2008 it had over \$81 million in unrestricted net assets, of which according to its audited financial statements \$41 million had been designated by the Board for a specific purpose and the remaining \$40 million was undesignated. Authority management indicated that the entire \$40 million of undesignated funds may not be available for its discretionary use since approximately \$15 million has been Board designated for other purposes. Authority management also indicated that although the State is paying prospectively, it has frequently relied on the Authority to provide funds from the Authority's unrestricted net assets. They indicated that since 2000, the State has swept a total of over \$81 million from the Authority. This would not always be possible if the Authority's billing practice was revised, and cash balances were reduced.

Furthermore, pursuant to Section 2975 of Public Authorities Law, State public authorities are to reimburse the State an allocable share of the costs attributed to the provision of government services to public benefit corporations. The amount to be charged to each State authority is determined annually by the Budget Director. Some of the expenses that this fee is intended to recover include direct costs for personal service, indirect costs of employee benefits, and other allocable maintenance and operation costs of the State. The Authority paid approximately \$6.5 million in cost recovery fees in 2007-08. The Authority recoups most of these costs by including this chargeback in the fees charged to public clients, which includes certain agencies of the State. More than 50 percent of the Authority's cost recovery assessment is passed through to public clients for payment. In effect, State agencies are billed for a portion of the State's overhead costs for services provided to the Authority, rather than the Authority absorbing those costs.

Authority management defended this practice as reasonable. They indicated that since the State determines the amount to charge specific authorities based on the amount of bonds outstanding it is appropriate for the Authority to allocate these costs among all its clients, including the State, based on the amount of outstanding bonds issued by the Authority. Our concern is not the methodology used to allocate costs, but rather whether it is appropriate that these costs are passed through to the State. Authority management also claim that New York State is aware that the Authority is passing the cost recovery fee on to the State in its billings, and that the financial agreements with the State, that provide for a recovery of Authority costs incurred on the public projects, allow for this.

We found that as a matter of practice the majority of the bills provided to public clients do not include sufficient information for the clients to reconcile to the services provided. Bills generally provide only the total amount of the bill and do not provide detail as to how this amount is calculated. For example, we reviewed the documentation provided to one public client, and although a detailed list of individuals and hours worked was included there was no information to show how this generated the total amount billed. The Authority stated that any detail provided to these clients varies from agency to agency and is based on their request for additional information and is always available for inspection by the client and the Office of the State Comptroller.

For the most part, State agencies pay these bills from funds appropriated in the State Budget. We met with representatives from select agencies to discuss this process, and found no evidence to suggest that, as part of the budget process, these bills are subject to any formal evaluation. It appears that this funding is routinely approved and that the accuracy and efficacy of the bill's cost components are not scrutinized by either the agencies or the Budget Division. Further, while the Authority maintains and monitors public client accounts to ensure that they are sufficiently funded to meet its cash flow needs, there is limited action taken by the State to independently verify that State agency

account balances are appropriate or necessary. Authority management indicated that the Health Commissioner and Budget Director sit on the Authority's Board and review and approve the Authority's budget and financial statements which include revenues and expenditures allocable to public clients.

Construction Management Services

The Authority offers project management services to its clients. These services generally consist of project design, contract management and project management, and include purchasing, contracting, MWBE compliance, quality assurance and other construction support services. As of January 2009, the Authority provided project management services to 724 active projects with a value of \$7.4 billion; 90 percent of the projects were for public clients while 10 percent of the projects were for private clients. Authority management stated that the Authority acts as the owner's representative on these projects. The Authority also financed 110 projects, with a value of \$6 billion, for clients that opted to retain a private construction management firm or represented themselves.

The Authority evaluates the effectiveness of its project management services based on the number of projects completed on time, the number of projects completed within budget and the number of change orders required. During the 2008 fiscal year the Authority completed 47 major capital construction projects all of which were for public clients. The Authority's records indicate that 10 projects exceeded the initial cost estimate and 28 projects were completed later than their estimated completion date. Of the 28 projects that were completed late, 6 had no change orders and 22 had an average of 31, with the number of change orders ranging from 1 to 216. We found six of the projects were both over budget and late, and averaged 60 change orders. Although the Authority is the client's representative and responsible for project management, these clients are provided with information to evaluate the effectiveness of Authority staff and make informed decisions regarding change orders, costs and timing issues.

Although the Authority offers project management services to all clients, it is unable to compare the effectiveness of its services to those projects where the clients represent themselves or choose another entity to represent them. As a result, the Authority cannot measure the effectiveness of its project management services in comparison to those services provided. In addition, clients may not have the ability to assess whether these services are competitively priced; however Authority management indicated that the Authority measures its performance to industry standards, therefore provided clients with a level of assurance to the effectiveness of the Authority's services. Authority management stated that it may not be useful to collect this information, since the clients that represent themselves would not be interested in using the Authority's project management services.

As a part of an overall effort to improve the quality of work provided to its customers, the Authority engaged a consultant in 2007 to conduct an assessment of the Authority's Construction Services Division. The consultant's report found that the Division's business support procedures were overly complex and its "one size fits all" policies lacked flexibility to meet client needs and did not account for variations in the dollar value and risks associated with projects. Based on the consultant's recommendations, the Authority has changed some policies and management practices. The Authority created a Project Controls unit to improve its estimating, scheduling, risk-management and capital budgeting procedures to ensure projects are completed on-time and within budget. The Authority also developed a more streamlined process to manage its smaller programs, and began to follow-up on feedback received from its clients from past customer satisfaction surveys. Since these changes only took effect recently it is too soon to evaluate how effective they have been.

Data Collection

While we agree that the Authority should review its financing guidelines frequently in response to changes in the municipal bond market, we also believe that additional information could be useful as part of this assessment. Authority management indicated that the Board will be reviewing the guidelines and any changes will be based on an assessment of potential risks and acceptable risk tolerances. While this is appropriate the number of clients potentially impacted should be considered as part of the risk assessment. However, we found that the Authority does not keep a record of those institutions that are authorized by statute to receive Authority financing, but are denied financing because they do not meet the Authority's guidelines, or of institutions that might qualify for financing if the guidelines were revised. We believe that, without this additional information, it may be difficult for the Authority to reach a reasoned judgment on how flexible any new guidelines should be and how many additional clients would qualify and actually apply for Authority financing. It will also be difficult to estimate the effect extending financing to these new projects will have on the Authority's bond portfolio, which impacts the assessment of acceptable risk. Therefore, to maximize the benefits of its review, the Authority should initiate a parallel effort to improve the information available so that positive changes to the Authority's financing guidelines will be considered.

As outreach to clients, the Authority periodically conducts customer satisfaction surveys of its private clients to obtain feedback on its financing services and fees and to identify areas for improvement. Authority management explained that these surveys led, in part, to the Authority's decision to revise its administrative fee structure for its private clients. However, the Authority has not conducted similar surveys of its public clients on the financing and bond management services of the Authority, but instead relies on these clients to volunteer any feedback without solicitation from the Authority. Authority management indicates that their primary client for State debt is the Division of the Budget, and that they

have frequent, ongoing dialogues with the Division regarding the services provided. However, we believe that it would be beneficial for the Authority to reach out to its public clients to determine the appropriate level of detail provided in the Authority's bills, as well as obtaining any other feedback from those clients regarding the financing and bond management services provided.

Compliance Issues

We found that the Authority is in compliance with almost all of the provisions of the Public Authorities Accountability Act, and has been particularly effective implementing the good governance practices required by the Act. For example, the Authority has implemented appropriate written policies and procedures governing its operations, and has made a significant amount of financial and operational information available on its public web site. The Authority is also up to date in submitting its required reports.

Further, we found the Board to be well informed by management and actively involved in the oversight of Authority operations. For example, every financing done by the Authority is approved by the Board. Even for projects that do not require State debt, the Authority staff and bond counsel provide comprehensive presentations to the Board explaining the need for the financings and the viability of the client. Before approval, the Board thoroughly discusses the matter and asks specific questions of staff to ensure that it is fully educated on each financing. The Board has also engaged in various workshops with clients, investors and other market participants to educate themselves about the challenges facing the market and the role the Authority should play in this changing environment.

Despite the Authority's record of compliance, we did identify a few areas where improvements could be made to further increase accountability and transparency.

Use of Executive Session

Sections 100 and 103 of Public Officers Law state that it is essential for public business to be performed in an open and public manner, and that every meeting of a public body should be open to the general public, except that of executive session. Section 105 of Public Officers Law limits the purposes for which a public body may conduct an executive session. Such purposes include discussions regarding proposed, pending, or current litigation; the medical, employment, or financial history of a particular person or corporation; or the proposed acquisition, sale, or lease of real property when publicity would substantially affect the value of such property. During the scope of our review, a total of 20 Board meetings were held. The Board entered executive session at least once during each meeting, and during six meetings entered executive session more than once. In general these are to discuss the financial history of specific clients, which is an appropriate use of executive session.

Although the Board appears to appropriately enter into executive session, we found one exception in June 2007 where the Board entered into executive

session with its independent audit firm. Management stated that the reason for this was to discuss the cooperation of management and staff with the audit firm during its engagement as well as other matters relating to the audit. However, this use of executive session does not meet the exceptions stipulated in Section 105 of Public Officers Law, since the purpose of the session was not to discuss the medical, employment, financial or credit history of a particular person, or matters leading to the appointment, employment, promotion, demotion, discipline, suspension, dismissal or removal of a particular person. Further, the Committee on Open Government has opined that the records and information relevant to the performance of one's official duties is public information, and not an appropriate reason for entering into executive session.

We also noted that the Authority's Audit Committee entered into executive session for five of its six meetings held during our review period. As justification for these executive sessions, the Committee cited "personnel matters", discussions with the independent auditors, discussions on the Authority's audit plan, and to discuss the engagement of a forensic consultant. The justifications used by the Committee do not meet the exceptions stipulated in Section 105 or the opinions issued by the Committee on Open Government. The Authority stated that the "personnel matters" involved reviewing the performance of the Authority's internal audit staff. However, if this were a proper exception permitted by Public Officer's Law, the Authority is still obligated to clearly state in open session the appropriate exception being used to invoke executive session.

Authority management asserts that the Board appropriately enters executive session in compliance with exceptions cited within the Law. The Authority provided an opinion from its General Counsel justifying entering into executive sessions as part of the exit conference with the Authority's independent auditing firm. The opinion states that the exit conferences held with the auditors by the Audit Committee and the full Board are held in open session and that these bodies go into executive session for the narrow purpose of discussing with the auditors the performance of the managing directors who are appointed by and serve at the pleasure of the Board. The only persons in attendance during these sessions are members of the Board and the independent auditors. We question whether it is the role of the independent auditor to assess the performance of managing directors. This may be a more appropriate role for the Governance Committee and executive management. Further, the Committee on Open Government agreed with our conclusion that the use of executive session to discuss the cooperation of management with the independent auditor is not an appropriate use of executive session under Public Officers Law.

Internal Control Assessment

Section 2931 of Public Authorities Law requires state authorities to establish and maintain a system of internal control and a program of internal control review to identify internal control weaknesses and identify

actions needed to correct weaknesses, as well as monitor the implementation of necessary corrective actions and to annually assess and report on the effectiveness of their internal control structure and procedures. The Authority has established a system of internal control. Management has made available to members and staff applicable operating policies and procedures with which they are expected to comply. The Authority has designated an Internal Control Officer to implement and review the internal control responsibilities and program established by the Authority. The Authority also requires that an annual Management Certification be completed and submitted to the Internal Control Officer by management employees of the Authority. This document certifies that management has assessed the risks pertaining to their unit and identified and reported any significant internal control deficiencies.

During 2004 and 2005, the Authority identified 18 critical business functions and undertook an extensive internal control review that resulted in a formally documented control self assessment for each function. The assessments identified the risks and controls associated with each function, as well as any observations for improvements. The Authority then implemented a system to track and monitor implementation of the recommendations made for each function.

According to management, the recommendations from the 2004-05 assessments are continuing to be reviewed and implemented; as a result only a limited number of additional internal control assessments have been conducted. However, the Authority has continued to annually submit its Internal Control Certification to the Division of the Budget describing and certifying to the effectiveness of its internal control structure even though it has revised its procedures and operations, and implemented an organizational restructuring. As a result, these annual certifications may be based on outdated processes.

Compliance Issue Summary

Use of Executive Session

The Authority Board has invoked executive session to meet with its independent auditors for purposes not stipulated under Section 105 of Public Officer's Law.

The Audit Committee has used Executive Session for purposes that are not allowable under Section 105 of Public Officer's Law.

Internal Control Assessment

The Authority has not conducted an annual assessment of its internal control structure, as required by Section 2931 of Public Authorities Law.

Recommendations

1. The Board should establish policies that define the circumstances that allow staff to propose to the Board an exception to the financing guidelines. This should include the criteria to be used to determine whether an applicant is eligible for an exception and the steps to be followed to provide information to the Board.
2. The State, together with the Authority, should evaluate the methodology for calculating fees charged to public clients to determine if that methodology properly balances the financial needs of the Authority with the interests of taxpayers and public clients.
3. The Authority should reach out to its public clients to determine the appropriate level of detail to be included in its bills, and obtain any other feedback from those clients.
4. The Authority should work with the State to determine if it is appropriate to include the cost recovery fees it is charged by the State to its State clients.
5. The Authority should improve its data collection and analytical capabilities so that it can adequately evaluate its performance and costs, determine if its project management results are consistent with industry standards, and whether it can successfully market its services to new clients.
6. In evaluating the need to revise the Authority's financing guidelines, the Authority should also collect information on those institutions that have been denied financing and determine how potential revisions would impact the Authority.
7. The Board and its committees should restrict the use of executive session only to those purposes set forth in Public Officers Law and the reasons for adjourning to executive session should be stipulated more precisely in the public meeting.
8. The Authority should annually conduct an assessment of its current internal control structure. This assessment process should be documented and initiated by management.