- *Accountability*
- *Transparency*
- *Integrity*

Governance Review

New York State Environmental Facilities Corporation

August 6, 2007

GR-2007-01

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Executive Summary

Purpose and Authority:

The Authority Budget Office (ABO) is authorized by Section 27(1) 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. Our governance review of the Environmental Facilities Corporation was performed in June 2007 and conducted in accordance with our compliance review protocols that are based on generally accepted professional standards. The purpose of our review was to provide an objective determination of the extent of the Authority's compliance with applicable provisions of the Act and Public Authorities Law.

Background Information:

The Environmental Facilities Corporation (Corporation) was established in 1970 as a public benefit corporation under Sections 1280 to 1298 of Public Authorities Law. The Law authorizes the Corporation to plan, finance, construct, maintain and operate sewage treatment works, sewage collecting systems, air pollution control facilities, water management facilities, storm water collecting systems, solid waste disposal facilities and State park infrastructure projects. The Corporation has seven Board members: three ex-officio members and four appointed by the Governor, with the consent of the State Senate, and is managed by a President/CEO. Primary sources of capital for projects are federal grants and State matching funds. The Corporation received approximately $529 million in revenue for fiscal year 2006-2007.

Results:

We found that the Environmental Facilities Corporation appears to be a well-functioning public authority with a well-informed and involved Board. Overall, the Corporation has done an effective job of complying with the requirements of State laws, and is continuing to make progress in complying with the provisions of the Act by revising and adopting additional policies, as necessary. The Corporation's process for assessing its internal controls appears to be highly effective and could be used as a model for other public authorities. The Corporation can continue to improve the accountability and transparency of its operations by refining its by-laws and Board committee charters, and formalizing additional practices in policies.

Introduction and Background of the Authority

The Environmental Facilities Corporation (Corporation) was established in 1970 as a public benefit corporation under Sections 1280 to 1298 of Public Authorities Law. The Law authorizes the Corporation to plan, finance, construct, maintain and operate sewage treatment works, sewage collecting systems, air pollution control facilities, water management facilities, storm water collecting systems, solid waste disposal facilities and state park infrastructure projects. The Corporation has a seven-member Board of Directors. Three of the Directors are ex-officio members; they are the Commissioner of Environmental Conservation, who acts as chair, the Commissioner of Health and the Secretary of State. The remaining four directors are appointed by the Governor with the advice and consent of the Senate, and serve staggered six-year terms. The Corporation has an 8-person executive team that is managed by the President/CEO.

The Corporation acts primarily as a financing authority. Its mission is to provide low-cost capital and expert technical assistance to municipalities, businesses and State agencies for environmental projects in New York State and to help public and private entities comply with Federal and State environmental requirements.

The Corporation has 126 employees across seven main divisions. These include the Executive Division, Corporate Operations Division, Legal Division, Engineering & Program Management Division, Technical Advisory Services Division, Corporate Communications Division, and Finance Division.

The Corporation’s fiscal year begins on April 1, and as of March 31, 2007, the Corporation reported $11.6 billion in assets with $7.2 billion in total outstanding debt and $2.9 billion in investments. Annual revenue received by the Corporation was over $529 million for fiscal year 2006-2007, while operating expenses totaled $490 million.

The Corporation’s major programs include the Clean Water State Revolving Fund, which provides municipalities with low-interest rate financing to construct water quality protection; the Drinking Water State Revolving Fund, which provides local governments with subsidized low interest financing and limited grants for construction of eligible water system projects; and the Industrial Finance Program, which assists clients in managing wastes, controlling pollution, and building and improving drinking water, waste water and solid waste facilities, as well as complying with environmental regulations. Other programs provided by the Corporation are the Pipeline for Jobs Program, which provides financial assistance for the planning, design and construction of eligible projects that create, improve or extend water supply facilities; the Clean Vessel Assistance Program, which provides federally funded grants to assist marinas, municipalities and not-for-profit organizations install pumpout and dump station facilities to receive sewage from recreational marine vessels; the Financial Assistance to

Business Program, which helps businesses cope with the cost of complying with environmental protection mandates; the Small Business Environmental Assistance Program, which offers free and confidential assistance to small businesses regarding compliance with State and federal air emissions requirements; and the Beginning Farmer Loan Program, which provides low interest loans for the purchase of agricultural property and equipment to beginning farmers. In addition, the Corporation operates three programs as part of its role in the New York City Watershed Agreement: the Catskill Fund for the Future, the New Sewage Treatment Infrastructure Program, and the Wastewater Treatment Plant Upgrade Program.

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 governance review was conducted to provide an objective determination of the Environmental Facilities Corporation's compliance with applicable provisions of the Act and Public Authorities Law.

Compliance Review Scope and Methodology

Our compliance review was conducted in June 2007, and covered the Corporation's operations for the period of January 2006 through June 30, 2007. Our review was focused on the Corporation's governance practices, board responsibilities, management policies and procedures, and audits of its operations. We reviewed the Corporation's policies and procedures, interviewed appropriate personnel, reviewed financial and organizational documents and records, attended a Board meeting and audit committee meeting and performed such other procedures as we considered necessary to achieve our objectives. Our report contains recommendations to ensure the Corporation's compliance with the Public Authorities Law, as well as recommendations for improvements of management's governance practices. We also discussed the results and recommendations of our compliance review with Corporation management, and their comments have been considered and are reflected where appropriate, within this report.

Compliance Review Results

Governance and Oversight

Board Duties

Section 2824 of Public Authorities Law indicates that public authority board members should execute direct oversight of senior management in the administration of the authority and understand, review and monitor the implementation of fundamental financial and management controls and operational decisions of the authority. Further, good governance principles dictate that public authority board members act in good faith and in the authority's best interest, and perform their oversight function consistent with the mission of the public authority and the public's interests. In addition, authorities should conduct business in an environment that fosters transparency and enhanced public disclosure, focuses on accountability, and supports external oversight.

We found that the Corporation's Board was generally well-informed and involved in Corporation operations. We reviewed Board meeting minutes for the period June 2006 to June 2007 and found that a quorum was present at all 13 meetings. Corporation management generally provides the Board with adequate information one week prior to each Board meeting to allow them to effectively make informed decisions regarding the Corporation's operations, and meeting minutes indicate that Board members are actively involved in making decisions about the Corporation's projects. These minutes reflect an active discussion of relevant issues regarding the Corporation's financial and performance data, and indicate that Board members, when necessary, request additional information prior to acting on proposals that have been presented.

Further, Corporation management helps ensure that Board members are well informed of Corporation operations by providing newly appointed Board members with an orientation handbook that contains an introduction to the Corporation and its programs, the by-laws, enabling legislation and other applicable State and Federal Laws. This handbook also describes the Corporation's debt structure, yearly Board meeting schedule, and other pertinent documents relating to the Corporation's operations.

Good governance practices suggest that public authority board member duties and responsibilities should be clearly defined, so that board members understand their roles and are better able to effectively perform their governance responsibilities consistent with the mission of the public authority. We found that the Corporation's by-laws clearly state the fiduciary responsibilities of Board members. For example, the Corporation's by-laws indicate that the Board has direct oversight of the President and other officers and senior management and that each Board member is to understand financial and management controls and operational decisions of the corporation.

The Corporation's Board has also appropriately adopted a code of ethics and a policy regarding salary and compensation for executive management, and has established by-laws that adequately address defense and indemnification of Board members and Corporation staff, as required by Section 2824 of Public Authorities Law. We noted instances where Board members abstained from voting on issues where potential conflicts could be perceived, and that the compensation provided to Corporation staff is in line with pay rates provided to New York State employees. In addition, the Board has continued to make progress in adopting good governance practices: we noted that at its June 2007 meeting the Board adopted a whistleblower protection policy, amended its code of ethics to address recent revisions required by the Governor's Executive Orders 1 and 2, and delineated Corporation Board member responsibilities.

Although Corporation management indicated that the Corporation does not grant credit or provide compensation or benefits to Board members, the Board has not adopted policies to ensure that the current practices are continued in the future. Corporation management indicate that they adhere to the existing laws that prohibit extension of credit to Board members (Public Authorities Law Section 2824(5)) and prohibit Board members from receiving compensation (Public Authorities Law Section 1282), and that the adoption of policies that address these issues would be redundant and inappropriate. However, we believe that, while existing laws prohibit these practices, establishing internal policies that re-enforce these prohibitions represents sound corporate governance practices. Laws are often subject to interpretation, and the establishment of internal policies can help ensure that the intended purpose of the law is upheld. For example, many public authorities are prohibited by law from compensating board members for other than ordinary expenses. Yet several of these public authorities were criticized recently for providing health insurance coverage to Board members in apparent violation of this restriction. The establishment of an internal policy prohibiting compensation would help to clarify the definition of 'compensation', and serve as guidance for future Board members.

We found that Corporation management compares financial results with the budgeted financial projections on a quarterly basis, and determines the underlying causes for such deviations. However, the quarterly comparisons are not presented to the Board. Instead, the Board is only presented with the actual financial results; the comparison to the budgeted projections and any explanation of deviations is not included. We believe that the ability of the Board to provide appropriate oversight of Corporation activities would be improved if they were to receive a comparison of the actual results to the budgeted projections. Further, the Corporation is also subject to Office of the State Comptroller oversight and regulations, and Part 203.8 (a) of the regulations require public authorities to provide board members with quarterly updates on the status of actual revenues and expenses compared to annual budget targets. The updates should also explain and quantify any significant variances that may occur.

<u>Committees</u>

Section 2824(4) of Public Authorities Law requires authorities to establish an audit committee and a governance committee. The audit committee is to be responsible for recommending a certified independent accounting firm, establishing the independent auditor's compensation and providing direct oversight of the execution of the authority's independent audit. The governance committee is to be responsible for reviewing corporate governance trends, keeping the Board informed of best practices in governance, updating the authority's corporate governance principles and advising appointing authorities on the skills and experiences required of potential board members. The formal establishment of the audit and governance committees helps a public authority to improve oversight and accountability within the organization and assist the board of directors in making better decisions.

We found that the Corporation has established an Audit Committee and a Governance Committee and that both these committees had met and were functioning during our review period. In addition, the Corporation has established charters for both the Audit Committee and the Governance Committee to guide the operations and activities of these committees.

However, we identified some items where improvements could continue to be made in the performance of these committees. For example, although the Corporation has established charters to guide the operations of the Governance and Audit Committees, neither of the committee charters require that agendas be created for each meeting and minutes be recorded. Article 7 of Public Officers Law stipulates that board committee meetings are subject to the Open Meetings Law, and requires that minutes of these meetings be taken and recorded. We found that meeting minutes were recorded for all of the Audit Committee meetings held, but that minutes were not recorded for all Governance Committee meetings. Although Board meeting minutes indicate that the Governance Committee met four times between May 2006 and May 2007, minutes were recorded for only two of these four meetings (May 2006 and October 2006).

In addition, there was no indication that the Board reviewed the Audit Committee or Governance Committee charters, or evaluated the performance of either of these committees. And, while the Audit Committee charter appropriately identifies the responsibilities of the committee, the Governance Committee charter should be expanded to include a review of all fundamental Corporation policies. For example, we found that there was no review of the Corporation's equal opportunity and affirmative action policies, nor a review of the Corporation's bylaws.

Training

Section 2824 (2) of Public Authorities Law requires all individuals appointed to the board of a public authority to participate in State-approved training regarding their legal, fiduciary, financial and ethical responsibilities as directors of an authority within one year of appointment to the Board. At the time of our review, the Corporation had seven Board members in place, and three of them had served as Board members for at least one year. Two of these members have attended training, but there is no indication that the third Board member has attended the State-approved training, as required. Having recently been appointed to the board, the remaining four board members have one year from their date of appointment to attend the required training. It is important for all board members to attend this training, since there has been a shift in focus in Board members' responsibilities from one of simply providing guidance to management, to one of being responsible for compliance and enhanced oversight of management. Appropriate training is therefore essential to enable Board members to comfortably evolve into this new role.

Management Practices

<u>Internal Control Assessment</u>

Section 2800 of Public Authorities Law requires authorities to assess and report on the effectiveness of their internal control structure and procedures. We found that the Corporation has developed and implemented a highly effective process for completing this assessment. Each division's management is responsible for identifying the major functions within their division, assessing the vulnerability of each of these functions, and assigning a corresponding risk level for each function. The assigned level of risk determines how frequently each function is reviewed. High risk functions are reviewed every year, while moderate risk functions are reviewed every two years, and low risk functions are reviewed every three years by the responsible division Director.

The internal control reviews conducted by each division follow a standardized approach established by the Corporation. Each review identifies the specific functions or activities performed by the division and assigns a risk level to each function. The expected result of each function, and the process followed to accomplish those results are also identified. The internal control review then lists the procedures in place to ensure the function is effective and identifies any weaknesses in controls that may exist. When weaknesses are identified, a Corrective Action Plan is developed. The Corporation has designated the Deputy Director of Corporate Operations as the Internal Control Officer, and that individual monitors the process to ensure that all reviews are performed in accordance with the schedule, and that any Corrective Action Plans are developed and implemented in accordance with an established timeframe.

Another effective tool that the Corporation has adopted is the use of a Compliance Review Calendar. The purpose of this calendar is to help the Corporation prepare for important filing requirements, scheduled meetings and other deadlines that may impact financing programs. It outlines important dates throughout the year and is available on the Corporation's employee intranet site.

<u>Required Guidelines</u>

Section 2896 of Public Authorities Law requires public authorities to adopt guidelines regarding the use, awarding, monitoring and reporting of contracts for the disposal of property. Although the Corporation does not own real property, we found that the Corporation has formally adopted guidelines for the disposition of property. The guidelines, in essence, require the Corporation to address how real property will be disposed prior to entering any agreement to obtain real property.

Section 2879 of the Public Authorities Law requires public authorities to establish guidelines for procurement of goods and services and policies

regarding disclosure of persons who attempt to influence the procurement process. We found that the Corporation has formally adopted procurement guidelines in which they outline the requirements regarding the selection of contractors for procurement contracts. The guidelines provide procedural controls that prohibit improper lobbying influence. The Corporation also prepares an annual report on procurement contracts and submits it to appropriate oversight entities, as required. The Corporation has designated the Deputy Director of Corporate Operations as the Procurement Integrity Officer.

Section 2925 of the Public Authorities Law requires all authorities to establish investment guidelines to govern the investment dealings of an authority, and to produce an investment report and conduct an audit of their investment guidelines. The Corporation has established appropriate investment guidelines that apply to investment of monies held by the Corporation. These investment guidelines describe permitted investments and describe special requirements and elements to be considered in selecting particular investment vehicles, and comply with the provisions of the Corporation's enabling legislation. Further, the Corporation has an annual audit of investments conducted, and annually prepares a report on its investment practices.

<u>Policies and Procedures</u>

Section 2825(3) of Public Authorities Law requires board members, officers and employees of State authorities to file annual financial disclosure statements as required by Public Officers Law. Employees are required to file financial disclosure forms if they are deemed to be in policy-making positions, or serve in a job title with an annual salary rate in excess of a specified rate (which is $77,661 in 2007.) The Corporation has identified the individuals that meet these criteria and provides a list of these individuals to the State Ethics Commission.

Section 2824 of Public Authorities Law requires board members to adopt establish written policies and procedures on personnel. We found that the Corporation has appropriately established time and attendance policies, and an Internet Usage policy to guide employee behavior and work expectations. The Internet Usage policy has also been revised to incorporate the Governor's Executive Order 1.

<u>Annual Report</u>

Section 2800 of Public Authorities Law requires authorities to prepare annual reports disclosing information related to their operations, management and finances. We found that the Corporation generally prepares and issues an annual report by July 1 each year, and that this report provides appropriate detail on the Corporation's operations, management and finances.

However, with the implementation of the Act, additional information was required to be included within the annual report, specifically an assessment of internal controls and the Corporation's code of ethics. In response to this change, the Corporation took additional steps to provide the additional information by issuing a separate annual report that is designed to meet the requirements of Public Authorities Law, and has posted this report on its web site.

Budget Report

Section 2801 of Public Authorities Law requires authorities to submit budget information on operations and capital construction, setting forth the proposed receipts and expenditures for the next fiscal year, the estimated receipts and expenditures for the current fiscal year and the actual receipts and expenditures for the last completed fiscal year. For State public authorities, this report is required to be submitted at least 90 days prior to the start of the public authority's fiscal year.

We found that the Corporation's Budget and Financial plan complies with the requirements of Section 2801 of Public Authorities Law and provides beneficial information about the projected revenues and expenses of the Corporation's programs. The report contains an actual vs. budgeted summary for the previous fiscal year based on the main programs of the Corporation. It also contains condensed budgeted revenues, expenditures and changes in current net assets and a condensed statement of net assets for the next fiscal year as well as three out-years. Additionally, the President/CEO and the Controller and Director of Corporate Operations of the Corporation certify in writing that the budget is based on reasonable assumptions and methods of estimations and in conformity with applicable regulations.

Disclosure

Section 2800(1) (b) of Public Authorities Law requires State authorities to make information accessible to the public to the extent practicable through the use of the authorities' Internet web sites. We found that the Corporation has an established web site and provides significant information on its web site pertaining to its mission, current activities, financial reports, and its current year budget. Although the Corporation had not posted its code of ethics on its Internet web site prior to July 2007; these documents are now included in the annual report that is designed to meet the requirements of Public Authorities Law, and are available on the Corporation's web site.

Recommendations

Compliance Issues

1. The Board of Directors should ensure that all committee meetings comply with the provisions of Public Officers Law by taking and recording minutes of all committee meetings.

2. The Board of Directors should ensure that all its members attend State-approved training regarding their ethical and fiduciary duties, within one year of being appointed to the Board.

Good Governance Practices

1. The Corporation should adopt formal policies that prohibit extending credit to the Board and prohibit Board members from receiving compensation for their services to the Corporation.

2. Corporation management should provide the Board with interim comparisons of actual operations to budgeted projections, to enhance the Board's oversight capabilities.

3. The Governance Committee and Audit Committee charters should require that agendas be created for each meeting and meeting minutes be recorded.

4. The Board of Directors should formally evaluate or review performance and charters of the Audit and Governance Committees at least annually.

5. The Governance Committee Charter should be expanded to identify all the fundamental Corporation policies that are to be reviewed by the Committee, including the equal opportunity and affirmative action policies.