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STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

November 29, 2001

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

Re: Report 2001-F-37

Dear Mr. Seymour:

Pursuant to the State Comptroller's authority as set forth in Chapter 469 of the Laws of 1989, we have reviewed the actions taken by officials of the New York Power Authority (NYPA) as of June 26, 2001, to implement the recommendations contained in our audit report, *New York Power Authority Management and Operations* (Report 95-S-110) issued on July 31, 1996. That audit reviewed four main areas: (1) NYPA's ability to meet its revenue requirements; (2) NYPA's effectiveness in administering its economic development program; (3) the propriety of NYPA's economic evaluation of its nuclear power plants; and (4) the adequacy of NYPA's staff planning and work management practices.

Background

In 1931, Governor Franklin D. Roosevelt signed into law the Power Authority Act, under which NYPA was established. A corporate municipal instrumentality and political subdivision of the State, NYPA was created to help provide the people of New York State with a continuous and adequate supply of dependable electric power and energy. NYPA generates, transmits and sells electric power and energy, principally at wholesale. Its primary customers are government agencies, job-producing companies, community-owned electric systems, the State's seven investor-owned utilities, and certain out-of-State customers. During the prior audit, NYPA owned and operated seven major generating facilities (three hydro-power, two nuclear and two fossil-fuel) and five small hydroelectric facilities, with a combined generating capacity of nearly 7 million kilowatts (kW). In addition, NYPA owned more than 1,400 miles of transmission lines. In November 2000, before our follow-up review began, NYPA completed the sale of its two nuclear power plants to the Entergy Corporation.

NYPA had a workforce of about 3,400 employees; but, after the sale, the workforce was reduced by about 1,700 employees. Those that remained with NYPA work at two headquarter offices located in Albany and White Plains, and eleven facilities throughout New York State. The other employees remained at the nuclear facilities.

Summary of Conclusions

Our prior audit identified shortcomings in all four main focus areas. First, losses at NYPA's nuclear and fossil-fuel generating plants (Poletti, Flynn, Indian Point 3, and FitzPatrick), were subsidized by NYPA's net revenues from its hydroelectric plants, profits on sales of purchased power, and earnings on investments. The Poletti, Flynn, Indian Point 3, and FitzPatrick plants had been losing money in the recent past and were expected to lose money in the future. NYPA's allocation practices for costs, investment income, and re-pricing purchased power distorted the actual operating results of the individual plants. Second, the allocation and pricing of power through NYPA's economic development program may not have provided maximum economic value to the State, and may not have been optimum in what was likely to become a competitive market for electricity generation. Third, NYPA's nuclear plants were plagued with problems: both suffered from management problems and experienced extended shutdowns. Fourth, NYPA did not have the staffing policies, procedures and tools necessary to minimize the size of its employee workforce.

In 2000, NYPA sold its nuclear power generating plants for $967 million and entered into a contract to purchase electricity from these plants to serve the needs of the New York City area market until the year 2004. Due to NYPA selling its nuclear facilities, some of the recommendations from the prior audit are no longer applicable. Also, NYPA assumed responsibility for small combustion-turbine power generation in the New York City area and for the construction of a new power generating plant at the Poletti site. These were defining events at NYPA and have resulted in dramatic changes in its business operations and workforce. For example, with the sale of the nuclear plants, NYPA reduced its workforce from about 3,400 employees to about 1,700 employees. These, and several other changes within NYPA, have caused them to rethink their business operations in what is becoming an increasingly-competitive market for electricity generation.

Summary of Status of Prior Audit Recommendations

Of the 20 prior audit recommendations: 2 were implemented, 1 was partially implemented, 7 were not implemented, and 10 were no longer applicable.

Follow-up Observations

Recommendation 1

The Governor and the Legislature need to reassess the roles, functions and assets of NYPA, and in the context of the restructuring of the electric utility industry, evaluate anew what the State should own, what it should operate, what services it should provide, what it should fund, and what it should do in the electric business.

Status - Not implemented

Auditor's Comment - This recommendation was not specifically addressed to NYPA. However, during our recent audit, we were not provided any information that it was implemented. Our report, NYPA - *Management and Operations* (Report 2000-S-61) was issued July 31, 2001. In that report, one of the recommendations to NYPA's Board of Trustees was that they seek statutory support for a clear description of NYPA's role in New York State's competitive wholesale and retail power market.

Recommendation 2

Maximize the direct charging of administrative and support costs to reduce the level of allocated costs. Develop a method for allocating remaining indirect costs based on an empirical study that demonstrates the casual relationship between the indirect activities and the operating units.

Status - Not Implemented

Agency Action - NYPA officials did not agree with this recommendation. They asserted that the administrative and support costs were already being direct-charged at a satisfactory level. They also believed that it would not be cost-effective to perform an empirical study on the allocation of the remaining indirect costs. NYPA officials further stated that they continually analyze costs to determine which costs can be directly charged.

Recommendation 3

Treat investment income as institutional income and do not allocate it to individual operating units for purposes of reporting and evaluating the financial performance of individual facilities.

Status - Not Implemented

Agency Action - NYPA officials did not agree with this recommendation. Although investment income was allocated to the individual operating units, NYPA officials asserted that they looked at operating costs and revenues separately when evaluating the financial performance of individual facilities.

Recommendation 4

For purposes of reporting and evaluating the financial performance of individual facilities, do not allocate net revenues from purchased power sales. Instead, separately account for purchased power costs and revenues. Account for the transfer of support power at the market value of the power to credit the "producing facility" with the realized revenues.

Status - No Longer Applicable

Auditor's Comment - The Independent System Operator (a recently created not-for-profit entity regulated by the Federal Energy Regulatory Commission, to manage the sale, purchase and transmission of electricity in New York) is currently responsible for all transfers of power. This is true for transfers within NYPA facilities as well. Therefore, this recommendation is no longer applicable.

Recommendation 5

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 equitable compensation for the value of the services provided to Con Ed.

Status - Not Implemented

Agency Action - NYPA officials disagreed with the concept of this recommendation. They emphasized that they need a reason to renegotiate the agreement; they cannot do so just because the contract is not beneficial for them. NYPA officials stated, however, that they would try to renegotiate the agreement if there is a basis for doing so.

Recommendation 6

Seek optimal changes in FitzPatrick's ownership structure or its financial structure and NYPA's enabling legislation that would eliminate the constraints on FitzPatrick's pricing and customers. Also, market uncommitted FitzPatrick power out-of-State.

Status - No Longer Applicable

Auditor's Comment - NYPA sold its nuclear facilities in November 2000.

Recommendation 7

Pursue all possible steps to limit the losses associated with operation of the Flynn plant, including additional contract renegotiations with Enron and LILCO. Also, seriously consider options to the continued ownership of the Flynn plant.

Status - Not Implemented

Agency Action - NYPA officials disagreed with the concept of this recommendation. They emphasized that they need a reason to renegotiate; they cannot do so just because the contract is not beneficial for them. NYPA also did not provide us with any evidence that it critically evaluated continued ownership of the Flynn plant.

Auditor's Comment - Given the changing nature of the electric industry in New York State (such as the State take-over of the Long Island Lighting Company), NYPA may have missed opportunities to renegotiate the contracts associated with the Flynn plant.

Recommendation 8

Establish a State task force or employ an independent expert to evaluate programs, policies and procedures related to NYPA's sale of electricity for economic development purposes, including the allocation and pricing of allocable hydroelectric power. Ensure that the economic development programs maximize benefits to the State.

Status - Not Implemented

Agency Action - NYPA officials did not agree with the concept of this recommendation.

Recommendation 9

Develop and implement appropriate controls, including adequate documentation, over the economic development program to ensure that companies allocated lower cost power meet program criteria and achieve program goals.

Status - Implemented

Agency Action - NYPA now has a central filing system and a database for its economic development programs. NYPA has also hired PricewaterhouseCoopers to audit the validity of reported job commitments of more than 100 Power for Jobs customers.

Recommendation 10

Conduct an independent analysis and evaluation of options to maximize the value of NYPA's nuclear assets before October 1, 1996, when proposals for transitioning to a competitive market are due to the Public Service Commission.

Status - No Longer Applicable

Auditor's Comment - In November 2000, NYPA sold its nuclear facilities to the Entergy Corporation.

Recommendation 11

Take steps to enhance capabilities and skills in performing economic analyses.

Status - No Longer Applicable

Auditor's Comment - This recommendation is no longer applicable because it was related to NYPA's nuclear facilities that were sold in November 2000. Notwithstanding the sale of the nuclear plants, NYPA officials state that they have capable analytical staff.

Recommendation 12

Maintain the momentum to improve management and operating economies at Indian Point 3 and FitzPatrick.

Recommendation 13

Aggressively pursue opportunities for sharing resources with neighboring nuclear facilities, and hold managers accountable for achieving related cost savings or other benefits.

Recommendation 14

Complete an economic analysis of contracting out the management of NYPA's nuclear plants before engaging any company to perform such services.

Recommendation 15

Fully examine the potential efficiencies and other benefits that could result from the common management of New York's nuclear plants.

Recommendation 16

Implement staff planning policies that require quantification of workload, activity-based time recording, and the use of staff planning to accurately determine required staffing levels.

Status - Recommendations 12 to 16 are No Longer Applicable

Auditor's Comment - In November 2000, NYPA sold its nuclear facilities to the Entergy Corporation.

Recommendation 17

Eliminate cultural barriers to structured workforce management policies and procedures in non-nuclear facilities.

Status - Not Implemented

Agency Action - NYPA officials stated that they believe that there should not be any cultural barriers in the workforce and that they have adequate policies and procedures in place to prevent these barriers from being accepted or established. NYPA officials also asserted that the entire organization attended a Focus Workshop in which this subject was the topic.

Recommendation 18

Accelerate the implementation of NYPA's MRM program. Emphasize job planning and estimating, and include the independent development and implementation of challenging job performance standards.

Status - No Longer Applicable

Agency Action - YPA officials did not agree there was a need to accelerate the implementation of the Maintenance Resource Management (MRM) program. They stated that they believe the existing pace is adequate. NYPA officials stated that the MRM program is fully implemented at this time.

Recommendation 19

Hold managers, supervisors and employees accountable for productivity and efficiency improvements, and provide adequate incentives for achieving real reductions in costs.

Status - Implemented

Agency Action - NYPA officials stated that NYPA has a "360 Degree Feedback" program, in which middle level managers report on the performance of the lower level staff, while the lower level staff report on the performance of the middle level managers to the higher level managers. Therefore, the middle level managers' performance is rated by both the higher and lower level staff. This holds employees accountable for productivity and efficiency improvements, but does not provide adequate incentive for achieving real cost reductions. In addition, NYPA employees have "Performance Plus" contracts: one type for manager/supervisors, another for salaried employees, and a "group" type for union employees. This program requires employees to set specific, measurable targets for the year. Compensation adjustments are linked to the final performance ratings.

Recommendation 20

Implement work performance indicators that correlate directly with costs. Use these to identify actions which can result in real cost reductions.

Status - Partially Implemented

Agency Action - NYPA reports on performance measures quarterly. NYPA officials stated that they have reduced costs because actual costs are below targeted budgets. One example of this is in the area of safety: if there are no accidents in a calendar quarter, NYPA has savings associated with not having employees miss work due to injury and/or not having to rectify the situation causing an accident. However, this system just shows spending cuts rather than NYPA's proactive actions to achieve real cost reductions.

Major contributors to this report were Roger Mazula, William Lichtenberg, and Brandon Ogden.

We would appreciate your response to this report within 30 days, indicating any actions planned or taken to address any unresolved matters discussed in this report. We also thank the management and staff of the New York Power Authority for the courtesies and cooperation extended to our auditors during this review.

Very truly yours,

Carmen Maldonado
Audit Director

cc: Deirdre Taylor, DOB