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STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

August 24, 2005

Ms. Maryanne Gridley
Executive Director
Dormitory Authority of the State of New York
515 Broadway
Albany, NY 12207

Re: Selected Aspects of the Bond Issuance

Process

Report 2004-S-72

Dear Ms. Gridley:

Pursuant to the State Comptroller's authority as set forth in Article X, Section 5 of the State Constitution and Section 2803 of the Public Authorities Law, we have audited the Dormitory Authority of the State of New York's practices relating to selected aspects of its bond issuance process. Our audit covered the period April 1, 2001 through March 31, 2004.

A. Background

The Dormitory Authority of the State of New York (Authority) is a public benefit corporation created by legislation in 1944 to provide financing and construction services to public and private universities, not-for-profit health care facilities and other institutions which serve the public good. The Authority is governed by the New York State Public Authorities Law, Article 8, Title 4. The Authority issues tax-exempt securities, and then lends the proceeds to clients to finance the construction, rehabilitation, or equipping of facilities needed to furnish services to New Yorkers. In general, the Authority's clients fall into several categories: higher education, health care, government, and non-profit agencies. The Authority's eleven-member Board of Directors (Board) sets Authority policies, approves each bond sale, and monitors adherence to Authority guidelines. A Board-appointed Executive Director manages the Authority's daily operations. The Authority's mission is to be the public finance and construction partner of choice, providing its customers with low cost, quality sources of capital and facilities delivered on time by a responsive, innovative team of professionals.

The Authority's Office of Public Finance has primary responsibility for the Authority's project financing. The Office of Public Finance raises money in the capital markets for Authority customers by determining the feasibility and structure of financing, and oversees bond issuances.

In general, the bond issuance process is divided into four major phases: feasibility review, document development, marketing and closing. The primary purpose of the feasibility review phase is to ensure that the proposed project is practical and that all relevant financial, statistical, and legal information has been considered. A resolution is then prepared for the Board to formally approve proceeding with the issuance of the bonds. The primary goal of the document development phase is to have the bond documents approved by the Board. During the marketing phase of the bond issuance process, if the Authority uses a negotiated sale process, the lead underwriter buys the bonds from the Authority at an agreed upon rate, and then subsequently sells the bonds to the secondary market. The lead underwriter is required to send the Authority a good faith deposit when the deal is finalized. In the closing phase, the transaction is finalized and the underwriter officially purchases the bonds.

The Authority issued 36 bonds totaling \$2.9 billion in the fiscal year ending March 31, 2002, 44 bonds totaling \$4.1 billion in the fiscal year ending 2003, and 61 bonds totaling \$5.8 billion in the fiscal year ending 2004. Of the total 141 bonds issued for the three years, 69 were issued for non-public clients and 72 were issued for public clients. As of March 31, 2004, the Authority had total bonds and notes outstanding in the amount of \$31.2 billion. Of the 141 bonds issued during our audit scope period, three bond sales were issued on a competitive basis, one for a public client and two for non-public clients. The remaining 138 bond sales were issued on a negotiated basis. Authority officials stated that most of the Authority's bond sales are made using a negotiated method due to the size of the bond issues, the complexity of the programs covered by the issue and/or the issuance of bonds for relatively unknown customers. They also believe that negotiated sales allow the Authority to better time the issuance of the bonds to favorable market conditions.

B. Audit Scope, Objectives and Methodology

We audited the Authority's practices relating to selected aspects of its bond issuance process. The objectives of our audit were to determine whether the Authority has established policies and procedures that provide an adequate level of internal control over its bond issuance process, and to determine whether Authority employees follow these policies and procedures. Our audit covered the period April 1, 2001 through March 31, 2004.

To accomplish our objectives, we interviewed Authority staff, reviewed applicable laws, rules, polices and procedures for bond issuance, reviewed Authority records and files and conducted limited compliance testing to provide reasonable assurance that Authority staff complied with established policies and procedures.

We conducted our audit in accordance with Generally Accepted Government Auditing Standards. Such standards require that we plan and perform our audit to adequately assess those operations of the Authority which are included within our audit scope. Further, these standards require that we understand the Authority's internal control structure and its compliance with those laws, rules and regulations that are relevant to the operations which are included in our audit scope. An audit includes examining, on a test basis, evidence supporting transactions recorded in the accounting and operating records and applying such other auditing procedures as we consider necessary in the circumstances. An audit also includes assessing the estimates, judgments and decisions made by management. We believe that our audit provides a reasonable basis for our findings, conclusions and recommendations.

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

C. Results of Audit

We determined that the Authority has established policies and procedures that provide an appropriate level of internal control over the bond issuance process and that the Authority is complying with these policies and procedures. We found that for the public issuances, the Authority appeared to assign the work to bond counsels and underwriters in an equitable manner, however, the Authority did not maintain documentation to document the decisions made in the underwriter selection process. In the case of bond issues for non-public clients, Authority officials stated that many of these clients will come to the Authority with a preferred underwriter. However, all but one of the underwriters selected by the non-public clients were among the underwriters on the Authority's list of pre-qualified underwriters.

The Authority also regularly issues Requests for Proposals (RFPs) to develop and maintain a list of pre-qualified underwriters but does not regularly issue RFPs for its list of pre-qualified bond counsels. We also found that the Authority does not independently review the bids obtained by underwriters for bond insurance.

1. Bond Issuance Policies and Procedures

The Authority has established policies and procedures that provide an appropriate level of internal control over its bond issuance process. For example, the Authority has developed procurement guidelines, bond sale guidelines, and a flow chart that depicts the various steps of its bond sale process. As required by the Authority's procurement guidelines and bond sale guidelines, we found that the Authority has regularly issued RFPs to update their list of pre-qualified underwriters.

To determine whether the Authority has complied with its policies and procedures for selecting bond counsel and underwriting services, we tested a sample of 21 bond sale transactions. We selected a judgmental sample of six negotiated bond sales, consisting of one public issuance and one non-public issuance from each of the three years in our audit scope period. We also selected a random sample of 15 bond sales from throughout the audit scope period. For the random sample, 14 were negotiated sales, six for non-public clients and eight from public clients. The lone competitive sale in our random sample was for a non-public client.

After testing the 21 bond sale transactions, we concluded that the Authority has adhered to their policy and procedures. We found that the Authority is complying with bond issuance

requirements including: contracting with only pre-qualified firms for both underwriting and bond counsel services, obtaining Board approval for the bond issuances, providing the Office of the State Comptroller with required documents, conducting feasibility studies and/or credit analyses where appropriate, holding public hearings when needed, obtaining Public Authorities Control Board approval and limiting applicable issuance costs to two percent of the bond issuance proceeds.

2. Documenting the Selection of Lead Underwriter

The Authority paid nearly \$80 million in fees to lead underwriters for the 141 projects undertaken during our audit scope period. According to Authority officials, for bonds issued on behalf of non-public clients, the client will often recommend to the Authority what underwriter it would like to use for the bond issue and the Authority will review this request, in light of the list of pre-qualified underwriters. Thus, the Authority assumes less responsibility for the selection of the underwriter in the case of a non-public issue. For bonds issued on behalf of public clients, it is the responsibility of the Authority to select the underwriter for the sale. Authority officials told us that selection of lead underwriters for public bond sales is determined by evaluating several factors including: information provided by the underwriter on its response to the RFP, support provided to the Authority through general marketing of bonds and development of new financing programs, any potential conflict of interest, and such other factors deemed relevant to the particular bond issue. These criteria are designed to help ensure that the underwriter selected is well-matched to the bond sale in terms of experience, expertise and cost.

As shown in the following table, the underwriting work appears to be dispersed amongst a number of underwriters, even after allowing the non-public clients to influence the selection process. The Authority used 22 different underwriters for the 141 bond issues during the audit period. Although some of the underwriters received only one or two issuances to handle, only one firm received more than 20 of the bond issues.

Underwriter	Dollars	Projects	% of Total Dollars
A	\$405,088	2	0.51%
B	\$7,400,438	16	9.27%
C	\$12,519,748	11	15.68%
D	\$13,474,699	26	16.88%
E	\$10,051,799	10	12.59%
F	\$494,903	6	0.62%
G	\$1,899,067	6	2.38%
H	\$8,853,635	14	11.09%
I	\$566,007	2	0.71%
J	\$494,109	3	0.62%
K	\$708,213	1	0.89%
L	\$4,721,721	10	5.91%
M	\$10,729,292	13	13.44%
N	\$692,974	1	0.87%
O	\$282,564	1	0.35%
P	\$824,916	4	1.04%
Q	\$327,987	2	0.41%
R	\$1,308,965	2	1.64%
S	\$2,341,476	7	2.93%
T	\$1,163,682	2	1.46%
U	\$264,504	1	0.33%
V	<u>\$302,148</u>	<u>1</u>	0.38%
Total	\$79,827,935	141	

We conclude that, based on an analysis of underwriters selected for the 141 bonds issued during our scope period and discussions with Authority staff, the Authority did comply with its procedures for selecting underwriters based upon the criteria discussed. However, the Authority was unable to provide us with documentation of the decisions made by its staff including any specific analysis and/or justification used to select the lead underwriters. We believe that better documentation to support the Authority's selections of lead underwriters will provide further assurance that the Authority has followed its underwriter selection process. The Authority was able to provide us with documentation describing criteria, analysis and justification for the underwriter selected for the one bond sale that was issued on a competitive basis. We found that the documentation provided by the Authority in this instance was adequate to justify the selection of the underwriter.

During our audit, Authority officials told us that they do evaluate underwriters based on the criteria mentioned above, but do not always document the evaluation. Officials stated that in the future, they will document their analyses and maintain this information.

3. Bond Counsel RFPs

The Authority's bond issuance guidelines require the Authority to issue RFPs to solicit bond underwriters on a periodic basis; once every year for judicial and educational projects and every three years for all other projects. Periodically issuing RFPs helps ensure the widest possible field of qualified firms has the opportunity to serve as lead underwriters of Authority bond issuances. Furthermore, this process helps ensure that new underwriting firms or those waiting for the opportunity to work as an Authority bond underwriter will not have to wait for an extensive period of time and will know when to expect the next RFP.

We found that although the Authority has regularly issued RFPs for underwriting services, the Authority has not regularly issued RFPs to develop a list of pre-qualified bond counsels. According to Authority officials, the last RFP for bond counsel services was conducted in 1995. During our audit officials explained that the current bond counsel panel includes many of the nationally-recognized bond counsel firms doing business in New York State and that the rates charged by each of them are substantially lower than their corporate rates. The officials also pointed out that the bond counsel list developed in 1995 has not remained stagnant. Mergers and other changes in bond counsel firms have resulted in additions and deletions to the 1995 list. The Authority generally seeks to distribute bond counsel work to firms equitably unless a particular issue has some unique factors that could necessitate a particular bond counsel firm should handle the project. Our review disclosed that the Authority used a total of nine firms. The number of bond issuances handled by the nine firms ranged from a low of five to a high of 24 issuances, with an average of 12 issuances being handled per firm. The fees earned by each firm also varied in a similar manner.

Authority officials informed us that they plan to establish a policy requiring that a RFP for bond counsel should be issued every five years and plan to issue a new RFP for bond counsel services in January 2005.

4. Documentation of Bond Insurance

Generally, when bond insurance is obtained on behalf of a private client, the private client will select the bond insurance company. For public issues, the Authority is responsible for obtaining bond insurance when it is determined that such insurance is beneficial. When bond insurance is needed, the Authority allows the underwriter to solicit the bids for the bond insurance. The underwriter advises the Authority of the various bid amounts and recommends the best insurance option from among the bids.

To verify if the best insurance option was selected, we chose from our sampled issuances the five public issuances that had bond insurance. The cost of the bond insurance ranged from \$44,000 to \$1.6 million. We found that the Authority did not obtain any documentation from the underwriter regarding the bid amounts. Authority officials stated that they discuss insurance company selection with the underwriter, and most of the insurance bid information is provided by telephone or e-mail.

They generally do not maintain records of this communication. Additionally, officials stated that the Division of the Budget also receives the same information via telephone or e-mail from the underwriter and is ultimately responsible for selecting the company that will provide the insurance.

To help ensure the integrity of the bidding process, we recommend that the Authority obtain documentation from its underwriters of the insurance company bids and the justification for the insurance company selected. We also recommend that the Authority consider independently verifying the bids with the insurance company.

Authority officials agreed that it would be beneficial to obtain this documentation and will consider verifying the bids with the insurance companies.

Recommendations

- 1. Prepare and maintain appropriate documentation of the criteria, analysis and justification used to select lead underwriters for all Authority bond issues.*
- 2. Establish a timeframe to issue RFPs for bond counsel.*
- 3. When bond insurance is used on public issuances, maintain documentation that identifies the names of bond insurance bidders, the amount of their bids and the rationale for selecting the bond insurance company. When appropriate, independently verify the bids with the insurance companies.*

We provided Authority officials with draft copies of this report for their review and comment. Their comments have been considered in the preparation of this report, and are included as Appendix A. Authority officials agreed with all of the observations and accepted all of the recommendations in the report.

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

Major contributors to this report were Brian Mason, Karen Bogucki, Brittany Hayes, Kevin Kissane, and Richard Podagrosi.

We wish to thank the management and staff of the Authority for the courtesies and cooperation extended to our auditors during the audit.

Very truly yours,

Steven E. Sossei
Audit Director

cc: Gail H. Gordon, DASNY
Michael Corrigan, DASNY
Robert Barnes, Division of the Budget



**Dormitory Authority
State of New York**

*Gail Hill Gordon, Chair
Maryanne Gridley, Executive Director*

April 13, 2005

Mr. Steven Sossei
Audit Director
Office of the State Comptroller
110 State Street
Albany, New York 12236

Re: Dormitory Authority – State of New York
Selected Aspects of the Bond Issuance Process
Report 2004-S-72

Dear Mr. Sossei:

The Dormitory Authority of the State of New York has reviewed the Office of the State Comptroller's draft report.

The audit recognized the Authority's existing procedures and guidelines and recommends additional documentation of the selection of lead underwriters, verification of bond issuance costs and a more frequent schedule of bond counsel procurement. The Authority has accepted all of OSC's recommendations.

We appreciate this opportunity to respond to the Comptroller's evaluation of our bond issuance process, and we look forward to updating the Comptroller, the Governor and the Legislature on our process upon the final release of the report.

Sincerely,

A handwritten signature in black ink that reads "Maryanne Gridley".

Maryanne Gridley
Executive Director

cc: Gail H. Gordon, Chair
Michael T. Corrigan, Deputy Executive Director
Cheryl L. Ishmael, Managing Director Public Finance
Jeffery M. Pohl, General Counsel

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