

**Alan G. Hevesi  
COMPTROLLER**



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**OFFICE OF THE  
NEW YORK STATE COMPTROLLER**

**DIVISION OF STATE SERVICES**

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**NEW YORK STATE  
ENERGY RESEARCH AND  
DEVELOPMENT  
AUTHORITY AND THE  
PUBLIC SERVICE  
COMMISSION**

**ADMINISTRATION OF THE  
SYSTEM BENEFITS  
CHARGE**

**Report 2005-S-16**

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## AUDIT OBJECTIVES

Our three objectives were to determine whether: the Public Service Commission (Commission) ensures that the private utilities calculate and collect the correct amount of System Benefits Charge (SBC) funds and subsequently transfer them to the New York State Energy Research and Development Authority (Authority) as required; the Authority expends SBC funds solely for properly authorized programs and purposes; and the Commission adequately monitors the performance of SBC-funded programs to ensure continuation of the SBC is appropriate.

## AUDIT RESULTS - SUMMARY

The SBC was established to provide funds for various public benefit programs that serve the needs of the State's energy consumers, including residential and commercial consumers. In general, we found that the Commission and the Authority are properly administering the programs funded by the SBC. Utilities set accurate rates to fund SBC programs, and they transfer the appropriate funds to the Authority. In addition, the Authority expends these funds for the stated purposes of the programs, and the Commission properly monitors program progress to determine the future of the SBC.

We determined that the Commission properly oversees how the SBC rate is calculated by the various participating utilities. We also determined that the utilities properly distribute SBC funds to the Authority. [Page 4]

The Authority has established good controls to ensure that SBC funds are expended on authorized programs and used to achieve the goals set by the Commission. However, we found that the Authority does not require contractors to submit documentation of their indirect rate calculations. As a result, the Authority cannot determine the reasonableness of the indirect cost charges. [Pages 4-5]

In general, we found that the Authority has procedures to ensure that SBC-related goods and services are paid in accordance with contract terms. We also found that the Commission properly monitors the overall performance of the SBC-funded programs and has proper procedures to determine whether the SBC should continue in the future. [Pages 5-6]

Our report contains two recommendations to correct the problems identified during our audit. Authority and Commission officials generally agreed with our recommendations and are taking steps to implement changes.

This report dated April 18, 2006, is available on our website at: <http://www.osc.state.ny.us>. Add or update your mailing list address by contacting us at: (518) 474-3271 or Office of the State Comptroller  
Division of State Services  
State Audit Bureau  
110 State Street, 11th Floor  
Albany, NY 12236

## BACKGROUND

During the 1990s, the State's electric utility industry transitioned from a regulated environment to a more competitive market. To help the State's utility customers in this time of change, the Commission established the SBC, which is a surcharge included on each customer's utility bill. The SBC funds programs relating to energy efficiency, low income assistance, and research and development, as well as the administration and program evaluation to support such programs. The SBC's enabling legislation assumed that such programs would not otherwise be provided in a deregulated, competitive marketplace. The SBC was initially authorized for the period July 1, 1998 through June 30, 2001. Funding for the period was set at \$234.3 million. On January 26, 2001, the Commission authorized a second funding cycle, with funding of \$749.9 million for the five years from July 1, 2001 through June 30, 2006 (see chart below).

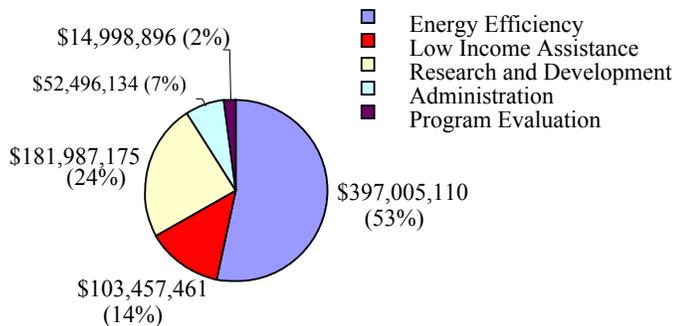
to their customers' utility bills (see table below).

### Authorized SBC Funding By Investor-Owned Utility July 1, 2001 through June 30, 2006

Utility	Funding
Central Hudson	\$ 26,625,000
Consolidated Edison	364,701,500
New York State Electric and Gas	96,651,835
Niagara Mohawk	198,704,350
Orange and Rockland	24,450,611
Rochester Gas and Electric	22,311,480
Sub-Total	733,444,776
Interest Earned by Authority	16,500,000
Total	<u>\$749,944,776</u>

Utilities make SBC payments to the Authority on a quarterly basis. (Certain utilities are allowed to retain a small portion of SBC monies to fund specific energy-efficiency and low-income energy assistance programs.) The Authority uses the SBC funds to finance eligible programs on a statewide basis, and is responsible for the overall administration of the portfolio of programs funded by the SBC. The Commission is responsible for overseeing the Authority's performance as program administrator. Annually, the Authority evaluates each funded program and submits a report to the Commission, which must decide on the SBC's future at the close of each funding cycle.

#### Authorized SBC Funding By Major Program Category July 1, 2001 through June 30, 2006



Six investor-owned utilities (Central Hudson, Consolidated Edison, New York State Electric and Gas, Niagara Mohawk, Orange and Rockland, and Rochester Gas and Electric) collect the SBC as a surcharge added

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## AUDIT FINDINGS AND RECOMMENDATIONS

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### *Rate Setting and Collections*

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The Commission approves the SBC rate and the amount that each utility company can collect in the form of a surcharge from its customers. The Commission requires the utilities to submit, on January 1<sup>st</sup> of each year, information supporting the rates to be charged. The utilities factor prior years' electricity sales and any over/under charges into their rate calculations. These calculations are reviewed by staff from the Department of Public Service (Department), which is the agency that provides staff support to the Commission. We reviewed the Department's annual reconciliations of the information submitted from each of the utilities for the SBC's second funding cycle and found that this rate setting process is working as intended.

Utilities distribute SBC funds to the Authority on a quarterly basis. The Authority has agreements with each utility outlining the dates and amounts due. We reviewed this process and determined that the utilities remitted the funds in accordance with the agreements. From January 1, 2001 through July 14, 2005, the Authority collected \$594.9 million in SBC funds due from the six participating utilities.

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### *Contracting Procedures and Indirect Cost Rates*

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From July 1, 2002 through May 18, 2005, the Authority entered into 9,279 contracts totaling \$442.4 million of SBC funds. We reviewed a judgmental sample of 75 contracts to determine whether these contracts were let in accordance with Authority policies and procedures, which require competitive

bidding (unless otherwise justified) and technical evaluation to determine whether the contract will meet the authorized purposes of the SBC-funded program. Attempting to review a cross-section of contract types, we selected our sample based on cost, type of contract, contractor history, and description of work to be performed. In general, we found that contracts were let properly, each following an appropriate selection process and consistent with authorized programs and purposes. We also reviewed the 75 contracts to determine if they were on schedule, according to the project timelines contained within the contracts. Although we identified some contracts that were behind schedule, the Authority was aware of these problems and was taking steps to correct them. In some cases, program managers were working with contractors to get them back on schedule, while in other cases the Authority canceled the contracts and made the funds available for future projects.

Most contracts we reviewed included a provision for the contractor's indirect costs, which can be a significant portion of the total project cost. Each contract contained standard language defining the reimbursable indirect costs, including fringe benefits, overhead, and general and administrative expenses. However, we reviewed five contracts and found significant variation among the contracts regarding how those reimbursements are calculated. For example, one company calculates its indirect costs as 100 percent of direct labor and fringe benefit costs; while another company charges a rate of 22 percent of its total direct costs such as direct labor, travel, and equipment. When asked to explain these wide variations, Authority officials stated that they do not require contractors to substantiate the indirect cost rates.

Authority officials also responded that indirect costs should be reasonable and consistent. They have hired an auditor to assist them in monitoring contracts and indicated that part of the auditor's responsibilities will be to verify the indirect cost rates charged by selected contractors. In addition, the Authority is developing procedures that would require contractors to submit documentation outlining their calculations.

### **Recommendations**

To Authority Management:

1. Develop a policy and related procedures to ensure indirect cost rates are reasonable.
2. Audit selected contractors to ensure their indirect cost rates are accurate and consistent with Authority policy.

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### *Program Payments*

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In general, the Authority pays contractors based on work completed. When processing contract payments, Authority staff check the invoice for mathematical accuracy, ensure that the unexpended contract budget is sufficient to pay the invoice, compare the invoice to the contract budget, and review the invoice to ensure that supporting documentation is adequate for the amounts billed. However, we identified two instances where the Authority paid contractors without having adequate supporting documentation, as follows:

- In one instance, a project manager adjusted an invoice for 2004 to include payment for certain work completed in 2003. However, the program manager did not use the correct reimbursement rate in effect for 2003 to calculate the payments

due to the contractor. As a result, the Authority overpaid the contractor by more than \$21,000. We brought this to the attention of Authority officials, who recovered the funds.

- In another instance, the Authority paid an invoice for a program before an approved, final contract was in place between the appropriate parties.

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### *Commission Oversight of the SBC*

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At the end of each SBC cycle, the Commission must determine whether the SBC will continue, at what funding level, and for what period of time. To accomplish this, the Authority contracts with numerous consultants to review all the funded programs for the period of the cycle. (The current cycle expires June 30, 2006.) The Authority combines these consultant reports into one report on the SBC, which is reviewed by an advisory group and presented to the Authority's Board for approval. The Board approves the report and forwards it to the Commission for review and approval. Department staff evaluate the various consultants' reports to determine whether the consultants' methodologies were technically sound and whether their conclusions were properly formed. Department staff prepare a recommendation as to whether the SBC should continue and, if so, at what funding level and for what period of time.

The Department posts this recommendation to its website and sets aside a period for public comment. Department staff evaluate the public comments and adjust the recommendation when necessary. The Department then forwards its recommendation to the Commission. The Commission reviews the recommendation and makes its final decision on the SBC.

We found that Department staff followed policies and procedures for evaluating the Authority's report and supporting methodologies. At the close of our field work, the staff was in the process of finalizing its recommendation to the Commission regarding the current SBC cycle.

### **AUDIT SCOPE AND METHODOLOGY**

We conducted our performance audit in accordance with generally accepted government auditing standards. We audited the administration of the SBC for the period July 1, 2002 through September 30, 2005. To accomplish our objectives, we met with appropriate Authority and Commission officials and staff to determine the procedures they use in overseeing and administering the SBC programs. We reviewed the Commission's determination of the SBC funds due from each participating utility and the corresponding rate setting. We reviewed bank statements and payment schedules to determine whether the Authority collected all SBC funds due from the utilities during the period. We judgmentally selected a total of 75 competitive and non-competitive contracts to review the contracting process and determine whether the contracts were let in accordance with the Authority's contracting policies and procedures and whether the contractors were paid according to the terms of the contracts. In addition, we met with Commission officials and staff and reviewed appropriate documentation to determine whether the Commission properly oversees the SBC and follows prescribed procedures to determine whether the SBC should continue.

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.

### **AUTHORITY**

The audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 and Article X, Section 5 of the State Constitution, Article II, Section 8 of the State Finance Law, and Section 2803 of the Public Authorities Law.

### **REPORTING REQUIREMENTS**

Draft copies of this report were provided to Authority and Commission officials for their review and comments. Their comments were considered in preparing this report, and are included as Appendices A and B.

Within 90 days of the final release of this report, as required by Section 170 of the Executive Law, the Chairman of the New York State Energy Research and Development Authority and the Chairman of the Public Service Commission 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.

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## **CONTRIBUTORS TO THE REPORT**

Major contributors to this report include Frank Houston, John Buyce, Joel Biederman, Greg Petschke, Chris Morris, John Karwacki, Holly Thornton and Paul Bachman.

## APPENDIX A - AUDITEE RESPONSE



**New York State Energy Research and Development Authority**

Vincent A. Delorio, Esq., *Chairman*

Peter R. Smith, *President*

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February 13, 2006

Mr. Frank J. Houston, Audit Director  
Office of the State Comptroller  
Division State Services  
State Audit Bureau  
123 William Street – 21<sup>st</sup> Floor  
New York, NY 10038

Dear Mr. Houston:

This letter is in reply to your draft audit report (2005-S-16) addressing the administration of programs funded with the System Benefits Charge (SBC) for the period July 1, 2002 through September 30, 2005. NYSERDA is pleased with the report's findings that the Authority has established good controls to ensure that SBC funds are expended on authorized programs and are used to achieve the goals set by the Public Service Commission. We believe that the report reflects well on both the substance of the Authority's system of internal controls and its effective implementation by Authority staff and management, under the direction and oversight of its Board.

The draft report includes recommendations for further strengthening the Authority's system of internal controls, each of which we address below.

**Recommendation #1.** Develop a policy and related procedures to ensure indirect cost rates are reasonable.

**Response:** After reviewing our existing procedures for monitoring contractor indirect costs for those contracts that reimburse any of such costs, effective November 2005 we modified our procedures to require prospective contractors to provide additional details in support of their indirect cost rates. This more detailed information will be reviewed by contract management and program staff for reasonableness, prior to entering into a contract.

**Recommendation #2.** Audit selected contractors to ensure their indirect cost rates are accurate and consistent with Authority policy.

**Response:** As part of its periodic review of internal controls, NYSERDA determined that establishing an Associate Contract Auditor position was appropriate and in September 2005 a certified public accountant was hired to fill the position. This individual is now engaged in performing

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selected audits of contractor costs to ensure adherence to contract terms, to confirm the appropriateness of indirect cost rates, and to verify supporting documentation for billings.

Also in accordance with internal control policy, the Authority's Director of Internal Audit will be monitoring these efforts and reporting to the Authority's Audit and Finance Committee on the incorporation of these process changes.

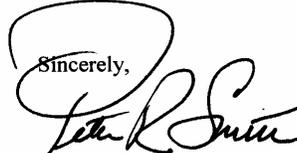
We discussed with your staff certain clarifications and corrections to the draft audit report for your consideration for the final audit report. First, the draft audit report contained a recommendation #3 for NYSEDA to recover a \$21,000 program incentive overpayment; however, this recommendation was already addressed through NYSEDA's prompt recovery of the overpayment in November 2005 prior to the end of the audit, so there is no further follow up needed. Second, we recommend correcting the first sentence in the last paragraph on page 3 of the report to read "Utilities make SBC payments to the Authority on a quarterly basis in accordance with amounts set forth in the Commission Order. (Certain utilities are allowed to retain a small portion of SBC monies to fund specific energy efficiency and low income energy assistance programs.)" Third, we recommend clarifying the first sentence in the last paragraph on page 4 of the report to replace the phrase "most contracts include" with "most contracts we reviewed include", since only about forty percent of the Authority's overall contracts (and twenty-five percent of the dollars contracted) contain such provisions. Thank you for considering these changes.

\*

**Comment**

I also thank you for the courtesies extended to us by your staff, including their professionalism in conducting the audit.

Please contact me if you have any questions or need additional information.

Sincerely,  
  
Peter R. Smith  
President

cc: The Members of the Authority

\* State Comptroller's Comment - Changes have been made to the report based upon NYSEDA officials' response.

## APPENDIX B - AUDITEE RESPONSE

STATE OF NEW YORK DEPARTMENT OF PUBLIC SERVICE  
THREE EMPIRE STATE PLAZA, ALBANY, NY 12223-1350  
Internet Address: <http://www.dps.state.ny.us>

PUBLIC SERVICE COMMISSION

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DAWN JABLONSKI RYMAN  
*General Counsel*

JACLYN A. BRILLING  
*Secretary*

February 9, 2006

Mr. Frank J. Houston  
Audit Director  
Office of the State Comptroller  
Division State Services – State Audit Bureau  
123 William Street – 21<sup>st</sup> Floor  
New York, NY 10038

Dear Mr. Houston:

Thank you for providing the Department of Public Service with the opportunity to review the draft audit report on the New York State Energy Research and Development Authority (NYSERDA) and the Public Service Commission (PSC) in regards to the administration of the System Benefits Charge (SBC) program. I am pleased that the draft report reinforces the PSC's view that the SBC program is being administered effectively and efficiently by NYSERDA, with proper and adequate oversight by the Department of Public Service (DPS) and the PSC.

One factual point in the draft that should be corrected appears on page 3, in the first sentence of the second column. That sentence states: "On a quarterly basis, the utilities transfer 75 percent of the SBC funds collected to the Authority." This statement needs clarification and correction. Utilities do retain certain funds to continue long-term demand-side management initiatives that they had entered into prior to the creation of the SBC program. These initiatives are being spent down and the funding level retained by utilities has declined accordingly throughout the course of program. In fact, utilities will retain only 11 percent, not 25 percent, of the SBC funds over the eight-year period. More importantly, the amount retained by each utility is spelled out in Commission orders and monitored by DPS staff. The statement on page 3 should be modified to more accurately reflect the amount of funds retained by the utilities and the purpose for allowing them to do so. I understand that my staff has communicated specific suggested changes to your staff.

\*  
Comment

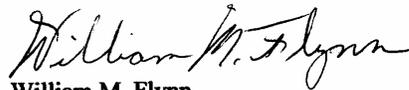
\* State Comptroller's Comment - Changes have been made to the report based upon PSC officials' response.

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With respect to its comments about the role of the PSC, I agree with the report's conclusion that, "...the Commission properly monitors the overall performance of the SBC-funded programs and has proper procedures to determine whether the SBC should continue in the future." The SBC programs were created in 1998 and subsequently extended as a result of open, public proceedings conducted by DPS staff in which any interested party has had the opportunity to provide input about the need for such programs or the areas such programs should emphasize.

Again, thank you for the opportunity to review the draft report on this audit. I look forward to seeing the final report.

Sincerely,



William M. Flynn  
Chairman

cc: Peter R. Smith, NYSERDA  
Steve Suriano, DPS