DRAFT INTERIM REPORT

OF THE

PUBLIC AUTHORITIES GOVERNANCE

ADVISORY COMMITTEE

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I. History of Public Authorities

There are over 640 New York State public authorities, ranging widely in size and scope, created to undertake specific purposes to serve the public. Public authorities, with their management and operating flexibility, are considered an effective means by which public needs, that may not otherwise be met within the budget, program, and statutory limitations imposed on agencies, may be achieved. The authorities' activities cover a wide spectrum of public projects and initiatives, from building infrastructure to developing and maintaining the State's waterways to financing debt.

These entities can be either public benefit or non-profit corporations, and are established by the Legislature. The enabling statute of each authority defines its purpose, powers and how Board of Trustees or Board of Directors appointments are made. Oversight and governance of these authorities is vested in each authority's board of directors, whose members, may be appointed by the Governor, State Legislature or local governing bodies, or serve as ex officio members by virtue of holding an elected or appointed government office.

The extent to which the operating budgets of State authorities depend on State funding varies. In some cases, a public authority may receive an appropriation of funds in the State Budget. In most cases, however, a public authority is expected to be self-funded and rely on its ability to collect rents, user fees and assessments, and other dedicated revenues to finance its operations and repay bonds issued to support its project portfolio.

New York's use of public authorities to administer public projects arose from action taken during the 1846 State Constitutional Convention. Through much of the 1800s, New York was permitted to incur public debt for specific purposes, and by 1842 the State was on the brink of bankruptcy. In order to prevent this problem from recurring, after extensive debate, the 1846 Convention agreed by an overwhelming majority that "the State could not contract debt without the vote of the people," as many believed that neither an executive nor a legislative body should have carte blanche authority to incur debt required to be paid off with future taxes.

Years later, as the State's fiscal needs expanded, the public authority concept began to develop as a mechanism to avoid the public referendum requirement. It has been used by Governors and Legislatures for more than 80 years.

The first New York public authority was created in 1921 to administer transportation, terminal and other facilities in New York and New Jersey. Known today as the Port Authority of New York and New Jersey (the "Port Authority"), it was created under a 1915 law authorizing the creation of river regulation districts. The statute provided that these districts were to be designated as "public corporations," with boards appointed by the Governor. Further, the bonds of this corporation were not the debt of the state, nor was the state obligated to pay such bonds. Thus, the public authority structure was born, and, overall, the authorities have provided a useful mechanism for meeting many of the public needs of the State.
From the formation of the Port Authority in 1921 to today, as the number of public authorities has substantially increased, there have been several reviews of, and modifications to, authorities regarding their formation, responsibilities and powers. By 1967, as reported by the Office of the State Comptroller, authorities had not only increased in number and size, but had evolved from entities which undertook public works projects to those which financed projects and issued debt. All earlier reports on public authorities have noted the continuous proliferation of authorities and called for some “reform.”

Concerns over the amount of debt authorities incur, as well as recent media attention, has focused the public on the activities of a few public authorities and has led to the current questioning of the oversight, accountability, transparency and disclosure of public authorities. A review of these issues is always in order since the authorities are integral to the State’s economy and functioning.

II. The Public Authority Advisory Committee and the Public Authority

A. The Public Authority Advisory Committee

In February 2004, Governor George E. Pataki launched a reform initiative aimed at improving the oversight, accountability and transparency of the New York State public authorities. In a memorandum from John P. Cahill, Secretary to the Governor, dated February 19, 2004, to the heads of 31 state public authorities (the “Cahill Memo”), each public authority was provided a set of Model Governance Principles and directed to develop an action plan and legislative recommendations for the implementation of these Model Governance Principles. The Model Governance Principles are based on “best practices” of corporate governance utilized by private sector companies as well as the requirements of the federal Sarbanes-Oxley Act of 2002. Action plans were due from these public authorities no later than May 14, 2004.

Governor Pataki appointed Ira M. Millstein to serve as Chairman of the newly established Public Authority Governance Advisory Committee (the “Committee”). Thereafter, the Governor appointed the following additional members to the Committee: Peter C. Clapman; Abraham L. Lackman; Professor Louis Lowenstein; Susan L. Malley; and John K. Wulf. The purpose of the Committee, as stated in the Cahill Memo, is to

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1 There are some controls in place on the ability of authorities to issue debt, such as approval by the Public Authority Control Board and statutory limits on the form of debt and allowable purposes for debt issuance. In addition, the Debt Reform Act of 2002 established limits on the amounts of state supported debt allowed to be issued by authorities.

2 A list of the public authorities which received the Cahill memo is attached as Appendix A hereto.

3 The Cahill Memo and the Model Governance Principles are attached as Appendix B hereto.


5 The biographies of the members of the Committee are attached as Appendix C hereto. The Committee wishes to thank Bethany J. Cooper and Gabriel G. Matus of Weil, Gotshal & Manges LLP for their
“help improve oversight, accountability, and transparency at our State public authorities, thereby strengthening public confidence in their important work.”

B. The Public Authority Structure

The Committee considers its role to be to assess the responses to the Cahill Memo, and to suggest the extent to which it was feasible to apply to State public authorities the concepts of Sarbanes-Oxley, Self-Regulatory Organization (“SRO”) standards, and best practices in corporate governance.

In the Committee’s view, as a first step in this process, it is necessary to determine and articulate the extent to which a public authority, in structure, is analogous to the publicly held corporations to which those concepts were made applicable.

Of course there are no public “shareholders” of an authority, shareholders to whom the corporation’s management and board, under law, owe a fiduciary duty—that is a duty of loyalty, care, honesty, and good faith in the management of the asset entrusted to them. This fiduciary duty stems from the simple notion that the management is an agent dealing with other people’s money (the shareholders). The board is the representative of the shareholders to oversee and monitor that agent to assure that the asset is being managed efficiently and for the purposes intended, and not for the individual benefit of the managers.

While there are no “shareholders,” in the traditional sense, of a public authority, the management of the authority is also dealing with other people’s money. The Committee’s review has demonstrated that the “other people” in the case of the authorities can be, depending on the authority, bondholders, other lenders, the State, localities, the federal government and, of course, in a broad sense, the taxpayers of the State. Added to this list to whom a fiduciary duty is owed are the Governor of the State and the Senate and Assembly who created the authority. In some cases, the Governor appoints the majority of the authorities’ board, the Chairman of that board, and sometimes members of management, and in other cases the Legislature has designated other political bodies to do so.

The statutory scheme pursuant to which these authorities were created was put in place well before Sarbanes-Oxley, the SRO’s new listing standards and best corporate practices were articulated, and yet interestingly followed the public corporation paradigm. They are corporations with boards. Those boards have been put in place to oversee and monitor management to assure those who have provided its capital, and the Governor and Legislature, that management is exercising its fiduciary duty in the management of the asset.

Invaluable assistance in organizing the work of the Committee and in the preparation of this report. Additionally, students from the Benjamin N. Cardozo School of Law assisted the Committee in its work.

6 The Committee has not been charged with the task of reviewing the corporate governance of local authorities.

7 Self Regulatory Organizations include the New York Stock Exchange, The Nasdaq Stock Market, and others.
Since Governors and other political bodies have the responsibility for the appointment of the Chairman of the authority, and often a majority of the board, Governors and those political bodies have a primary responsibility to assure that their appointees understand and execute their duties of oversight and monitoring. Just as shareholders should select their boards, articulate the standards to which those boards will be held, and remove non-performers, so too should those who appoint authority board members. Certainly, as the Committee suggests later in this report, Governors, State Legislatures, and State Comptrollers all have a responsibility for continuous oversight of public authorities. However, since the Legislature has granted the Governor or other political bodies the power of appointment of board members, the Committee believes that such power carries special responsibilities regarding those appointments.

The Committee believes that while not always explicit, this must implicitly be the intended statutory paradigm for public authorities. To the extent that this paradigm is not expressly articulated in current State legislation, the Committee recommends that it be so articulated -- particularly the fiduciary relationships and duties described above. The Committee suggests that this can be done by Executive Order of the Governor or legislation, after a more detailed examination of the statutory framework of the authorities.

Once the corporate/public paradigm of the authorities is thus understood, the central role of their boards becomes very clear. Those boards are there to assure their primary appointor, the Governor, and then the Legislature, providers of capital, and others, that they are actively and diligently carrying out their duties of oversight. The Committee's effort in this first review is to suggest the issues the board should address in best discharging its duties, based on the concepts contained in Sarbanes-Oxley, SRO listing standards and "best practices."

Fundamental to these suggestions is the Committee's belief that the role of a board is not primarily to fix problems once identified, but, more importantly, to avoid problems by: (i) selecting the best management available; (ii) appropriately compensating and incentivizing that management; (iii) assuring itself that management has in place appropriate systems and processes to identify and deal with risks that management faces, to assure financial transparency and internal controls; (iv) organizing the business of the board so as to assure itself that it will be current with the conduct of the affairs of the corporation and the activities of management; and (v) assuring itself that management is faithfully and efficiently carrying out the mission of the corporation. Properly functioning and structured boards should thus be in a position to cause the corporation to avoid problems in the first instance.

The Committee's belief is that although some regulation and outside controls and inspection are a necessary part of the governance scheme, a properly functioning and structured board is the public's best assurance that the corporation will avoid major mishaps.

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See generally The American Law Institute, Principles of Corporate Governance, and in particular § 3.02
The Committee believes, therefore, that before adding additional layers of bureaucracy in the oversight of public authorities, the State should implement, by Executive Order or legislation, reforms which will assure, insofar as possible, that the authorities have properly structured and functioning boards.

III. Model Governance Principles for Authorities

The Model Governance Principles were a first distillation of the principles of Sarbanes-Oxley, the SRO standards, and best practices, which might be applied to public authorities. As later described, the Committee’s work to date suggests modifications and additions to the Model Governance Principles.

The Model Governance Principles cover topics such as: training; separating oversight and executive functions; establishing a coordinated committee structure; governance and ethics; audits and accountability; strengthening internal controls; and transparency and disclosure. Each of the 31 public authorities which received the Cahill Memo was asked to develop and submit an action plan for implementing the reforms and report back to the Committee. The public authorities were also asked to identify any legislative changes that would be necessary to implement the principles.

With the assistance of the New York State Division of the Budget, the Committee reviewed and analyzed the action plans. Overall, the responses the Committee received from the public authorities were positive. In some instances, authorities were already in compliance with certain of the Model Governance Principles and, in any event, most were undertaking to adopt them. However, as discussed below, certain authorities noted that, due to provisions contained in the enabling statutes under which they were established, implementation of certain of the Model Governance Principles will not be possible without legislative reform. Other authorities had suggestions not contained in the Model Governance Principles.9

In addition to reviewing the action plans, the Committee has met with heads of certain of the authorities.10 These face-to-face meetings have been extremely helpful in facilitating discussions among these authorities and the Committee and in helping the Committee to understand the concerns of the authorities, and the authorities to better understand “good governance.”

As a result of these meetings, the Committee has a better understanding of each of the authorities’ specific circumstances and legislative mandate – both of which play a part in implementing the Model Governance Principles. Importantly, the Committee has learned from these meetings, as well as from the submitted action plans, that each of the public authorities is somewhat unique in its purpose, operations,

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9 See, for example, the complete action plan of the New York State Environmental Facilities Corporation, dated May 14, 2004, attached as Appendix D hereto.

10 As of the date of this report, the Committee has met with representatives of the Dormitory Authority, the New York State Housing and Finance Authority, the New York State Environmental Facilities Corporation, the New York State Power Authority, the Empire State Development Corporation, and the Long Island Power Authority.
experiences, needs and ability under their respective enabling statutes to implement governance reforms. Thus, the Committee has determined that even given a uniform set of principles, any successful implementation must be on an authority-by-authority basis.

IV. Tasks Performed

To date, the Committee has performed the following tasks:

- Reviewed the action plans submitted by the public authorities and met with board members and senior management of certain public authorities to discuss such plans.

- Reviewed the Model Governance Principles to assess issues or impediments with respect to the implementation of such principles.

- Worked with representatives from the New York State Division of the Budget, municipal bond experts, and members of the public authority accounting community, as well as with leaders of the financial community familiar with the workings of public authorities, in order to understand the operational and financial structure of the public authorities.

It should be noted that the scope of the Committee’s review is limited to the governance of State public authorities and the Model Governance Principles.

The Committee would like to thank the representatives of the public authorities for their efforts in preparing the action plans and for meeting with the Committee. The authorities have all been extremely cooperative and interested in improving their board processes. While not every authority has agreed with each of the Model Governance Principles or with the Committee’s recommendations, the Committee believes that the distribution of the Cahill Memo and Model Governance Principles to these public authorities, and requesting responses and action plans, has been a significant consciousness raising exercise for the authorities. The authorities which received the Cahill Memo with the Model Governance Principles conducted a good faith self-assessment of their current governance practices to determine which of the Model Governance Principles they could implement on their own, and which principles required further discussion with the Committee or would require legislative action.

V. The MTA

In June 2003, Chairman Millstein was retained by the Metropolitan Transportation Authority (the “MTA”) to review the MTA’s corporate governance. Chairman Millstein was asked to examine the following issues: (1) the interaction and division of authority among the Chair, the Executive Director, the Agency Presidents, and MTA executive management; and (2) the role of the Chair, the Board, the various Board committees, and Board practices and procedures in providing oversight for the organization.

This corporate governance review of the MTA is ongoing and has resulted in many recommendations being made regarding each board member’s ability to better discharge his or her important oversight responsibilities to the authority. Additionally,
important lessons were learned from the MTA review which can be applied to the Committee’s review of public authorities: the unique way in which public authorities, and their boards, operate; and, that reform is not accomplished simply with mandates, it requires continuing review based on the experiences of the authority.

VI. The Committee’s Suggestions

The Committee recognizes that each authority has unique characteristics, needs and circumstances and firmly believes that the best approach to governance reform is not a “one-size-fits-all” solution. However, the Committee believes, after reviewing the responses to the Cahill Memo, that in order for boards to effectively carry out their oversight functions, most public authorities can implement certain governance principles, after they are further defined, as discussed in this section.

The Committee has critically examined the Model Governance Principles in order to determine whether any modifications are appropriate, and what additions may be helpful. The following is an item by item review of principles which can be implemented after further definition, and probably discussion and assistance. After further definition, some are matters which can be addressed through an Executive Order and some by legislation (a decision will have to be made as to which is appropriate).

A. Board Members.

The board members with whom the Committee met were individuals who have voluntarily, and without financial gain or compensation, seriously undertaken board assignments with good intentions, and have tried hard to do a good job. The Committee believes that these board members want to perform their duties, but by and large have not been instructed or oriented as to the scope or specifics of their board responsibilities. Additionally, it was not made clear to the Committee whether these board members had been selected because their individual skill sets or experiences fit their board assignments.

The Committee believes that one of the most important aspects of any corporate governance reform is the ability to create an effective, functioning board. That means appointing effective board members and assisting existing board members in understanding the scope of their responsibilities, and how best to carry out those responsibilities. That also means constant attention to the quality and capacity of persons to be appointed to boards in the future. The Committee suggests that the governance committee of each authority prepare a profile of the skill sets and experiences of individuals best equipped to be constructive board members of that authority. That profile can be a guide to those making appointments.

With the significant fiduciary duties and oversight responsibilities required by the Model Governance Principles, as modified, attracting responsible and qualified board members is of even greater importance. Compensated board members are likely to take their responsibilities more seriously than non-paid members. Additionally, given

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11 In the past board members of public authorities had received compensation, however this practice was stopped during Governor Cuomo’s administration. If, after thoughtful consideration, compensation is determined to be feasible, only independent board members, and not members who are employees of the
the enhanced responsibilities of board members in general (such as meeting attendance and the volumes of materials to be reviewed in advance of meetings), as well as those responsibilities suggested by the Committee (such as the requirements of audit and governance committees and that board members sign the authority’s annual report), thought should be given to some form of compensation for board members. The level of compensation would also be subject to further discussion and may be determined by such factors as the size or complexity of the authority.

The Committee also believes that, given these enhanced responsibilities and the related liability that directors may be exposed to, it is appropriate to review the State’s current indemnification and defense procedures for directors of public authorities and to recommend any necessary amendments or additional legislation. Additionally, it may be appropriate to examine the possibility of coverage of directors of public authorities under a Directors and Officers Insurance policy.

B. Need for Disclosure and Transparency.

Through the Committee’s meetings with the public authorities and municipal bond experts, the Committee has learned that there are no uniform rules for public authorities as to the disclosure of financial and other information.\textsuperscript{12} Although the public authorities which issue bonds or other debt do make financial disclosures in their offering documents, even within that group of disclosures there is little standardization. Additionally, such disclosures are meant for and generally made available to bond and other debt holders. Thus, there may be information which the general public seeks to obtain, but which is not included in the offering statements or which is not readily accessible to them. Therefore, the Committee believes that each public authority should be required to disclose certain uniform financial information. It may make sense for the authorities to have a matrix or a template to follow so that all such disclosures are consistent in format and content. Members of the financial community and the Division of the Budget should consider a model for public disclosure of financial information, which may take the form of an omnibus procedures act covering matters such as the corporate functions, bond issuances and financial disclosures of public authorities.

The matter of accessibility of materials, including financial statements, offering statements and annual reports is another area where the Committee believes that consistent standards among the authorities should be required. There are differences among the public authorities regarding what information, if any, is publicly available. While certain authorities may make materials available on their respective web sites, others only grant information via a Freedom of Information Act request. The Committee believes that at a minimum each authority should have its annual report and adopted budget easily accessible to the general public. Such an annual report, which must be signed by each board member of the authority, should include information regarding the

\textsuperscript{12} Although public authorities must make certain annual statutory filings required by the Public Authorities Law, there is no uniformity among the authorities regarding such filings.
authority's activities from the previous year, as well as its plan for the upcoming year (including, for example, a budget reconciliation), all modeled on the reports filed by publicly held companies pursuant to the federal securities laws, including Management's Discussion and Analysis of Financial Condition and Results of Operations contained in the annual report filed under Form 10-K.

C. Audit Functions.

The Committee firmly believes that each public authority should have an audit committee made up of at least a majority of independent members, with all members having financial experience and, if possible, at least one member who qualifies as a financial expert. The Committee understands that authorities are bound by statutory requirements which give the authority for appointing board members to the Governor and/or State Legislature and/or others, and thus may not currently have board members who meet these qualifications. This may be an area where legislative change is preferable, so that the experience and qualifications required of audit committee members are considered during the appointment process.

Other matters about which the Committee is concerned are whether each public authority has an internal auditor and how the external auditor is chosen (the enabling statutes of certain public authorities require that the Division of Budget select the authority's independent auditor).

The Committee believes the internal audit function is essential, and that the external auditor serves a critical function. Additionally, the Committee recognizes the important role of the State Comptroller with respect to the public authorities. Although the State Comptroller has a mandate to conduct audits of every public authority at least once every five years (but may rely on audits conducted by external auditors to fulfill this obligation), given the number of public authorities, as well as the enormity of the task of auditing even one public authority, the Committee wonders whether any Comptroller alone can completely execute this enormous responsibility. Additionally, the enabling statutes of certain authorities require that the Comptroller (or his designee) be a member of the board — this may raise questions regarding conflicts of interest which need to be addressed. Further, a once in five year audit is simply not a sufficient assurance to the public.

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13 This is a modification of the Model Governance Principles, which call for an audit committee comprised entirely of independent members.

14 The Institute of Internal Auditors Board of Directors defines internal auditing as "an independent, objective, assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve effectiveness of risk management, control, and governance processes."

15 The Comptroller or his designee currently sits on the Boards of the Dormitory Authority, the State of New York Mortgage Agency, Nassau County Interim Finance Authority; Buffalo Fiscal Stability Authority; and Local Government Assistance Corporation (where the Comptroller serves as one of only three board members, and has sole responsibility for the issuance and management of the authority's debt).
D. Separation of Chairman and Chief Executive Officer.

As stated in the Model Governance Principles and as a matter of best practice, the Committee believes that the roles of Chairman of the Board and Chief Executive Officer should be separate. However, as Chairman Millstein learned from the MTA, and as the Committee is discovering through its review of the other public authorities, certain statutory requirements may impede the separation of the Chairman and chief executive roles. For example, the enabling statutes of the Empire State Development Corporation, the New York State Environmental Facilities Corporation and the New York State Thruway Authority require that the Chairman serve as the Chief Executive Officer. In the case of the MTA, in order to effect the separation of the functions of the Chairman and chief executive without engaging the legislative process, a de facto separation of the roles was effected by delegating the typical responsibilities of a chief executive to the MTA Executive Director, without delegating the nominal title of chief executive officer to the Executive Director.

Although the Committee believes that separation should be embedded in any Executive Order or legislative proposal, for certain smaller public authorities this separation may not be practical and such authorities should be granted a waiver from this requirement. For the larger public authorities, a solution such as the one implemented at the MTA may be possible. Additionally, for the larger authorities and any others who wish to implement this principle, the Committee believes that the separation should take place as soon as possible, but taking into account special circumstances.

E. Board Independence.

The Model Governance Principles define a board member of a public authority to be "independent" if he or she is "(a) not employed by the authority, (b) not employed by a state or local government and (c) not employed by an entity, public or private, that is, or is likely, to do business with the particular authority." However, the Committee recognizes that for some authorities, many, if not all, of the board members are, by statute, appointed by the Governor and/or State Legislature and/or others and thus may be employed by the state or a local government. Thus, in order to deal with political realities, as well as attract qualified board members, the Committee believes that prong "b" should no longer apply. Additionally, the Committee believes that prong "a" should be expanded to include a prohibition of any immediate family member of a board member being employed by that public authority.

The Committee believes that due to the fact that the public authorities do not control the appointment of directors to the board, a board made up completely of independent members should be an aspiration, rather than a requirement.

F. Governance Committee.

In addition to the functions of the governance committee set forth in the Model Governance Guidelines, additional responsibilities should include keeping up to

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16 The MTA defines an independent board member as one who is not employed by (a) the MTA, or (b) a private entity that does, or is likely to do, business with the MTA.
date with current governance practices, continually reviewing corporate governance trends and best practices, and updating the authority's corporate governance documents accordingly. The governance committee should also consider making recommendations to the Governor or State Legislature regarding the kinds of people (not necessarily specific individuals) the authority believes should be appointed to the board for reasons such as experience, qualifications or otherwise. Additionally, the Committee believes that each public authority should have a governance committee made up of at least a majority of independent members.\footnote{This is a modification of the Model Governance Principles, which call for a governance committee comprised entirely of independent members.}

G. Committee Charters.

As articulated in the Model Governance Principles, the charters of board committees should be made explicit.

H. Training.

The Committee agrees with the comment by many of the public authorities that there should be a central place for authorities to send their board members for training. This is especially important given the enhanced responsibilities of directors, as suggested by the Committee.

I. Waivers.

There should be some vehicle for granting waivers to authorities which demonstrate an inability to adopt a specific principle.

J. Going Forward.

In addition to any Executive Order or legislation which may eventually be proposed in order to implement the Committee's recommendations, the Committee believes that the corporate governance principles which each major authority puts in place, as well as the actions of the board, should be examined on an ongoing basis. Just as the corporate governance practices of public company boards are highly scrutinized, so too should the boards of public authorities.

The corporate governance practices of public company boards are examined by large institutional shareholders such as the California Public Employees' Retirement System ("CalPERS") and Teachers Insurance and Annuity Association – College Retirement Equities Fund ("TIAA-CREF") (which both have issued guidelines expressing their expectations about how boards carry out their functions), as well as shareholder groups such as the Council of Institutional Investors, and proxy advisers such as Institutional Shareholder Services ("ISS"). Rating services (e.g., ISS, GovernanceMetrics International and Standard & Poors) are also focusing on governance practices and, as a result, a board's ability to demonstrate and communicate a commitment to good governance practices.

Similar to the public company experience, the Committee believes that the compliance of public authority boards with the governance guidelines should be subject
to continuous examination. Possibilities for such examination include representatives from the Governor's Office, the State Legislature and the State Comptroller who would have the task of reviewing the corporate governance practices of the authority boards, or a corporate governance officer, who would be hired by and report directly to the board of the authority and whose responsibilities would include assisting the board with the ongoing review, development and implementation of effective governance policies and procedures and publicly reporting periodically to the Governor's Office, the State Legislature and the State Comptroller on the status and effectiveness of such policies and procedures. Alternative and/or supplemental oversight mechanisms can also be considered.

VII. Conclusion

These are the preliminary generic suggestions of the Committee — the basis for all these suggestions is to strengthen the board's ability to prevent problems before they occur (attached as Appendix E is a more detailed elaboration of these suggestions):

First -- Legislative study should be undertaken to determine whether the fiduciary duty of public authority board members is sufficiently articulated.

Second -- The Model Governance Principles should be modified as discussed herein. Meanwhile, these principles are reasonably robust, and the authorities can continue to endeavor to implement them.\textsuperscript{18}

Third -- There are important matters which are either not elaborated in the Model Governance Principles, or which require modification (e.g., internal audit and payment and indemnification of board members). These matters need further study and discussion with the Governor's Office, representatives of the authorities, the financial community, and relevant experts, before recommendations for an unambiguous Executive Order or legislative language are proposed.

Fourth -- Boards should develop a means of self-evaluation as well as a means to orient and train future and existing board members (director training should include topics such as distinguishing the role of the board from the day-to-day management of operations).

Fifth -- Some means should be developed to assist the authorities in implementing these reforms, and to subject the implementation of governance guidelines by the boards of authorities to continuous examination.

Whether this Committee is to undertake any of these tasks is not clear. They could be carried out by the Governor's Office — or some other designated body. The Committee raises these questions because the next stage of this project will be time

\textsuperscript{18} Most of the 31 authorities which received the Cahill Memo are forging ahead with the implementation of the Model Governance Principle reforms to their authorities insofar as they believe possible and practicable. Nothing contained herein should impede them from doing so. Additionally, many of the modifications to the Model Governance Principles recommended herein have been discussed with those authorities which have met with the Committee.
Consuming, require expert drafting assistance, and the interaction of knowledgeable people. The Committee had not originally anticipated this role, but it is a role which is necessary and which was realized as the Committee's work progressed.

To conclude, reform such as the Committee suggests has been many decades in coming. The Committee suggests that a little more time be taken to sort out and detail a total package of reforms, some by Executive Order, some by legislation -- rather than reacting piecemeal. The Committee would hope this process would be a cooperative one between all interested parties. Reform is a goal of all.
APPENDIX A

PUBLIC AUTHORITIES RECEIVING THE CAHILL MEMO

1. Albany Port District Commission
2. Hugh L. Carey Battery Park City Authority
3. Capital District Transportation Authority
4. Central New York Regional Transportation Authority
5. New York State Bridge Authority
6. Development Authority of the North Country
7. Dormitory Authority of the State of New York
8. New York State Energy Research and Development Authority
9. New York State Urban Development Corporation (d/b/a Empire State Development Corporation)
10. New York State Housing Finance Authority
11. Hudson River-Black River Regulating District
12. New York Convention Center Operating Corporation
13. Long Island Power Authority
14. Metropolitan Transit Authority
15. New York State Environmental Facilities Corp.
16. Municipal Assistance Corporation
17. Niagara Falls Bridge Commission
18. Niagara Frontier Transportation Authority
19. Ogdensburg Bridge & Port Authority
20. Olympic Regional Development Authority
21. Pennsylvania Station Redevelopment Corp.
22. Port of Oswego Authority
23. New York State Power Authority
24. Rochester – Genesee Regional Transportation Authority
25. Roosevelt Island Operating Corporation of the State of New York
26. Thousand Island Bridge Authority
27. New York State Thruway Authority
29. United Nations Development Corporation
30. Waterfront Commission of New York Harbor
31. Port Authority of New York & New Jersey
APPENDIX B

MEMORANDUM
EXECUTIVE CHAMBER
OFFICE OF THE SECRETARY TO THE GOVERNOR

February 19, 2004

TO: Heads of State Public Authorities

FROM: John P. Cahill, Secretary to the Governor

SUBJECT: Governance of Public Authorities

We are proud of the fact that under the leadership of Governor George E. Pataki, the State’s agencies and public authorities have made tremendous progress in their efforts to better serve the people of New York. The sweeping reforms, innovations and improvements that have been implemented since 1995 have enhanced services for New Yorkers, while also increasing the effectiveness, accountability and openness of State government. But while tremendous progress has already been made, we must commit ourselves to making even more progress in the days and months to come.

I am pleased to inform you that I have asked Ira Millstein, a widely respected expert on corporate governance, to serve as Chairman of a newly established Public Authority Governance Advisory Committee, which will consist of prominent members of New York’s business, legal, accounting and academic communities with recognized expertise in issues relating to corporate governance.

With the advice and counsel of Chairman Millstein, we have developed a set of model corporate governance principles to help improve oversight, accountability, and transparency at our State public authorities, thereby strengthening public confidence in their important work. The model governance principles are based on “best practices” of corporate governance utilized by private sector companies as well as the requirements of the federal Sarbanes-Oxley Act of 2002. As additional members are added and the work of Advisory Committee progresses, the Committee may circulate revisions to the model governance principles; however, Chairman Millstein advises that he does not expect major changes. I have also asked the Advisory Committee to put together a package of background materials on corporate governance and the Sarbanes-Oxley Act for distribution to the State’s public authorities.

I am calling upon the board of directors of each State public authority to develop an action plan for implementing the model governance principles as quickly as practicable. Chairman Millstein and I recognize that, in some cases, legislative changes will be necessary to allow the principles to be fully implemented. Accordingly, the board of each authority should identify and develop the recommended legislation, if any, that the authority requires to fully implement the model governance principles.

I request that you provide your authority’s action plan and legislative recommendations to the Advisory Committee no later than May 14, 2004, for its review and recommendations. In addition, building upon the submissions of the authorities, the Advisory Committee will develop
recommendations for any legislation that it deems necessary or desirable to fully implement the model governance principles within State public authorities.

To ensure the success of this important reform effort, within one year following implementation of the model governance principles, an outside auditor will be retained to ensure that the model governance principles have been fully implemented by the authorities to the extent permitted by law.

Chairman Millstein is a preeminent expert on a wide range of corporate governance and management issues, and I have every confidence that if we work together with him and his colleagues on the Advisory Committee to fully implement the model governance principles in the State’s public authorities, we can continue to improve oversight, accountability and transparency and promote public confidence. I call upon you, your board of directors and all employees of your authority to provide the Advisory Committee with your full cooperation, support and assistance.

Also, please be advised that I have designated Adam L. Barsky, Deputy Secretary for Public Authorities, Finance & Housing, to serve as my liaison to the State’s public authorities, the Advisory Committee and State government in connection with this reform effort.

Many of the governance principles we are now advancing are already being successfully applied at the Metropolitan Transportation Authority. In fact, under the bold leadership of its board of directors and executive director, the MTA has implemented a wide array of improvements and reforms that have increased accountability, enhanced the openness of its budgeting process and improved the quality of services that the MTA provides to New Yorkers.

Other agencies and authorities are also moving forward with important reforms and innovations. Our State Department of Transportation, for example, has advanced an innovative plan that will more closely coordinate the operations of New York’s transportation agencies and authorities, with a goal of creating a seamless statewide transportation system. This effort will improve efficiency, produce savings, and ensure better coordination among upstate transportation systems like the DOT, the Thruway Authority, the Bridge Authority and other transportation providers.

I am also pleased to report that every State agency and authority is now required to comply with Executive Order No. 127, which, for the first time in State history, mandates the collection and public disclosure of information pertaining to procurement lobbying. Moreover, under New York’s highly successful “Government Without Walls” e-commerce initiative, the general public now has instant access to far more information about our State agencies and authorities than ever before.

While we are tremendously proud of the reforms and improvements that are already being implemented, we must also look forward to building on these successes to ensure that the people of New York continue to have the finest, most open and most accountable State government in the nation.

Thank you for your immediate attention to this important matter.
MODEL GOVERNANCE PRINCIPLES FOR AUTHORITIES

1. The Public Authority Board - Training

   • Board members shall receive appropriate training regarding their legal, fiduciary and ethical responsibilities as directors of a public authority.

2. The Public Authority Board - Separating Oversight and Executive Functions

   • The primary responsibility of the board of directors shall be overseeing the authority’s chief executive and other senior management in the effective and ethical management of the authority.

   • The board shall understand, review and monitor the implementation of fundamental financial, management and operational decisions of the authority.

   • The chair of the board of directors shall not be a member of management and shall be charged with leading the board’s oversight role, including setting the board’s agenda, managing the flow of information to the board, coordinating the work of the board’s committees and serving as the primary liaison between the board and senior management.

   • The day-to-day management responsibilities of the authority shall be vested in a separate chief executive who serves at the pleasure of the board.

   • The board of directors shall establish policies regarding the payment of salary, compensation and reimbursements to, and establish rules for the time and attendance of, the chief executive and senior management of the authority.

3. The Public Authority Board - Establishing a Coordinated Committee Structure

   • The authority’s board shall establish board committees with clearly defined responsibilities pursuant to a written charter.

   • Every authority shall have a governance committee and an audit committee comprised entirely of independent members. A member shall be deemed “independent” if he or she is: (a) not employed by the authority, (b) not employed by a state or local government and (c) not employed by an entity, public or private, that is, or is likely, to do business with the particular authority.
4. The Public Authority Board - Renewed Focus on Governance & Ethics

- The responsibilities of the governance committee shall include establishing policies to promote honest and ethical conduct by authority directors, officers and employees and enhance public confidence in the authority.

- The governance committee shall review and regularly update the authority's code of conduct and written policies regarding conflicts of interest. Such code of conduct and policies shall be at least as stringent as the laws, rules, regulations and policies applicable to state officers and employees.

- The governance committee shall review and regularly update the authority's written policies regarding procurement of goods and services and the acquisition of real property or interests therein, including policies relating to the implementation of Executive Order No. 127 and the disclosure of persons who attempt to influence the authority's procurement process.

- The governance committee shall review and regularly update the authority's written policies regarding the disposition of real and personal property.

- The governance committee shall review and regularly update the authority's written policies regarding the protection of whistleblowers from retaliation.

5. The Public Authority Board - Renewed Focus on Audits & Accountability

- The responsibilities of the audit committee shall include:

  (1) reviewing and approving the authority's financial statements;

  (2) overseeing the authority's internal controls and compliance systems;

  (3) appointing, compensating and overseeing outside auditors retained by the authority;

  (4) resolving disagreements with respect to, and overseeing compliance with, accounting policies and principles;

  (5) reviewing management reports on internal controls and the attestation of such reports by the authority's outside auditors; and
(6) investigating compliance with the authority’s policies and/or referring instances of non-compliance to the State Inspector General (or, where applicable, the authority’s Inspector General) for investigation.

- The audit committee shall establish procedures for the receipt, retention, investigation, and/or referral to the State Inspector General (or, where applicable, the authority’s Inspector General) of complaints received by the authority regarding accounting, internal controls, and auditing.

- The audit committee shall establish policies and procedures to ensure that every director, officer and employee of the authority shall report promptly to the State Inspector General (or, where applicable, the authority’s Inspector General) any information concerning allegations of corruption, fraud, criminal activity, conflicts of interest or abuse by the directors, officers or employees of the authority or any persons having business dealings with the authority. The audit committee shall review all reports and draft reports delivered by the State Inspector General (or, where applicable, the authority’s Inspector General) to the authority and shall serve as a point of contact with such Inspector General.

- The authority shall ensure that the audit committee has access to sufficient resources to carry out its duties.

- Insofar as practicable, at least one member of the audit committee should be a “financial expert” and this shall be disclosed in the annual report of the authority.

6. Internal Auditors & Outside Auditors - Strengthening Internal Controls

- The authority shall have an internal auditor with clearly defined responsibilities who shall report directly to the audit committee and serve at its pleasure.

- The responsibilities of the internal auditor shall include directing authority-wide internal audit functions, including conducting financial, operational, procurement, compliance, contract, ethics and any other necessary audits. In addition, the internal auditor shall coordinate its work with the work of the outside auditors retained by the audit committee.

- The board, acting through its audit committee, shall engage an independent auditing firm to audit the financial statements, internal controls, compliance, and Operations and management of the authority on a regular basis.

- An outside auditor retained by an authority shall be prohibited from providing non-audit services to the authority.
• The chief executive, chief financial officer and auditor director shall not have been employed by the authority's outside auditors during the two year period preceding the audit.

7. Transparency & Disclosure

• The authority should file an annual operational and financial report, modeled on the reports filed by publicly held companies pursuant to the federal securities laws, so as to accurately present to the public with the financial condition and results of operation of the authority, including a comparison of actual financial results versus financial projections. These reports and other information concerning the finances of the authority shall be available to the public on the Internet.

• Each board member shall sign the authority’s annual report.

• The chief executive, chief financial officer, the audit director and other senior management of the authority shall certify the appropriateness of the financial statements and disclosures contained in the authority’s report, and that those financial statements and disclosures fairly present, in all material respects, the operations and financial condition of the authority.

• Each annual report of an authority shall contain an “internal control report,” signed by the chief executive, chief financial officer, audit director and other senior management of the authority, which shall state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting, and contain an assessment of the effectiveness of the internal control structure and procedures of the authority for financial reporting. The authority’s auditor shall attest to, and report on, such assessment, and the audit committee shall review and approve such report.
APPENDIX C

Biographies of the Public Authorities Governance Advisory Committee

Ira M. Millstein (Chairman): Ira Millstein is the Eugene F. Williams Jr. Visiting Professor in Competitive Enterprise and Strategy at the Yale School of Management. He is also Honary Chairman of the Board of Advisors of the International Institute for Corporate Governance at Yale SOM and a board member of the Yale SOM/Goldman Sachs Foundation Partnership on Nonprofit Ventures. In addition, he is a Senior Partner in the international law firm Weil, Gotshal & Manges LLP and a leading expert on antitrust, government regulation, and corporate governance matters.

Professor Millstein also serves as Chairman of the Private Sector Advisory Group of the World Bank/OECD Global Corporate Governance Forum, and has served as Co-Chair of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees, Chairman of the Board of Columbia University's Center for Law & Economic Studies' Institutional Investor Project, Fellow of the Faculty of Government at Harvard University's JFK School of Government, and Elected Fellow of the American Academy of Arts and Sciences. He is a graduate of Columbia Law School.

Professor Millstein has counseled numerous boards on issues of corporate governance, including the boards of General Motors, Westinghouse, Bethlehem Steel, the California Public Employees Retirement System, Tyco, Disney, and the Metropolitan Transportation Authority. He also serves as pro bono counsel to the Board of Directors of the Lower Manhattan Development Corporation, the agency overseeing the redevelopment of lower Manhattan.

Peter C. Clapman: Peter Clapman is Senior Vice President and Chief Counsel, Corporate Governance, TIAA-CREF. He formerly was chief investment lawyer for TIAA-CREF for 28 years. He heads the domestic and global corporate governance program; in this capacity, he has developed TIAA-CREF governance policies and strategies on such issues as board and committee composition and effectiveness, anti-takeover measures, executive compensation and global initiatives. The TIAA-CREF corporate governance program has been cited in Business Week and elsewhere as a most effective and influential program.

Abraham M. Lackman: Mr. Lackman serves as the President of the Commission on Independent Colleges and Universities. He previously served as the Secretary of the New York State Senate Finance Committee, where his responsibilities included evaluation of the fiscal and budgetary implications of all major State legislation. Concurrently, he was a special advisor to the Senate’s Majority Leader, Joseph L. Bruno. He has also served as budget director of the City of New York under Mayor Rudolph Giuliani, and as the Senate Finance Committee’s director of fiscal studies. He has held positions as guest lecturer at Albany Law School as well as New York University’s School of Law, and as an adjunct instructor in economics in the MBA program at the Graduate School of Business of the State University of New York at Albany (UAlbany).
Louis Lowenstein: Louis Lowenstein is the Simon H. Rifkind Professor Emeritus of Finance and Law at Columbia University. From 1988 to 1995, he was also the Director of the Institutional Investor Project, a Law School project undertaken in collaboration with the New York Stock Exchange. He was a member of the Panel on Audit Effectiveness appointed at the request of SEC Chairman Levitt, which issued over 100 recommendations dealing with auditor independence and related issues growing out of concerns over the rise in various financial reporting abuses.

Susan L. Malley, PhD: Susan Malley is President and Chief Investment Officer of Malley Associates Capital Management, an asset management firm specializing in the management of U.S. Equity and fixed income portfolios, for institutions and private clients. Prior to founding Malley Associates, Dr. Malley was Chief Investment Officer for Citicorp Investment Services from 1990 to 1995.

John K. Wulff: John Wulff was recently elected to the Board of Directors of Moody’s Corporation. Wulff is currently Chairman of Hercules Incorporated and a member of the Board of Sunoco, Inc. He was a member of the Financial Accounting Standards Board from 2001 to 2003 and prior to that served as Chief Financial Officer of Union Carbide Corporation. During his time at Union Carbide, Mr. Wulff also served as Vice President and Principal Accounting Officer, as well as Controller.
APPENDIX D

ACTION PLAN AND LEGISLATIVE PROPOSALS FOR IMPLEMENTATION OF MODEL GOVERNANCE PRINCIPLES FOR AUTHORITIES

SUBMITTED BY:
NEW YORK STATE ENVIRONMENTAL FACILITIES CORPORATION
MAY 14, 2004
Program provides technical assistance to bring businesses into environmental compliance; the Watershed Program provides consulting services for various wastewater treatment system upgrade projects in the New York City watershed pursuant to the historic Watershed Memorandum of Agreement negotiated by Governor Pataki.

The Model Principles and Action Plan

We have reviewed the Model Principles as prepared by the Advisory Committee and Chairman Millstein. These Model Principles attempt to adopt the spirit of the Sarbanes-Oxley Act of 2002 by clarifying the role of the Board of Directors and management in the day-to-day operation of the Corporation. The Model Principles recommend the adoption of a committee structure to insure proper oversight of the Corporation's activities by the Board. The Model Principles also encourage “transparency” to insure that the actions taken by the Corporation are disclosed to the Board while discouraging the Board from micro-managing such actions.

As discussed fully in the Action Plan, the Corporation is an entity that in the past has successfully used a coordinated committee structure to assist its Board of Directors. For years, the Corporation has operated with an Audit Committee and a Policy Committee. These committees each meet frequently throughout the Corporation's fiscal year. In addition, the Corporation's Board is an active one, as financings occur regularly, and meetings must occur on a monthly basis to insure that needed projects receive timely financing. The Board is also mindful of changing needs. For example, the Board has already adopted an Audit Committee Charter in the form recommended by the Model Principles, which is annexed as Exhibit “D”. Additionally, through the Policy Committee, the Corporation has provided regular training to the Board members with respect to their legal, technical and fiduciary obligations.

The annexed Action Plan addresses each of the issues raised by the Model Principles. The Action Plan provides the Board's comment on each Principle separately (which in most cases is a summary of what the Board's practice is) and then describes what the Board plans to do, if anything, to more fully comply with the Principle. As noted by the Advisory Committee, to fully accomplish the goals of the Model Principles, certain statutory amendments are required. These are annexed as Exhibits “B”, “F” and “G”.

The Action Plan raises some issues for which the Board requests further clarification and/or guidance from the Advisory Committee. For example:

(i) the Model Principles make it mandatory that the Corporation engage the services of an internal auditor. Currently, the Public Authorities Law requires the engagement of an independent audit firm but leaves the engagement of an internal auditor up to the discretion of the Board. We believe that this discretion is critical to the Board's oversight function. Engaging an internal auditor, which reports to the Board, raises employment questions which we believe need to be fully discussed by the
NEW YORK STATE ENVIRONMENTAL FACILITIES CORPORATION —
ACTION PLAN FOR IMPLEMENTATION OF THE MODEL GOVERNANCE
PRINCIPLES FOR AUTHORITIES

NOTE: The Action Plan of the Corporation appears below each principle.

1. The Public Authority Board - Training

• Board members shall receive appropriate training regarding their legal, fiduciary and ethical responsibilities as directors of a public authority.

Comment: Historically, the Corporation has provided regular training to its Board members regarding their legal, technical and fiduciary duties. For example, the Board members have received a presentation from the Corporation’s bond counsel reviewing the federal securities and fiduciary issues affecting municipal bonds. In addition, the Corporation’s financial advisor regularly reviews the pricing of the Corporation’s bond issuances with the Board members and has also provided Board members with a presentation, or “bond school”, on the fundamentals of municipal finance. The Board members have also received, upon appointment, an orientation packet which outlines their duties, responsibilities and statutory obligations.

Three members of the Corporation’s Board are ex officio members who have received ethics training as part of their official positions. Formal ethics training for the independent Board members has not occurred. Upon appointment, the independent Board members each received a copy of Section 74 of the Public Officers Law.

Action Plan: The regular training of Board members regarding their legal, technical and fiduciary responsibilities will continue. In addition, the New York State Ethics Commission has agreed to provide training to the entire Board of the Corporation at the Board meeting scheduled for June 10, 2004. Finally, the Corporation has developed a formal Handbook for its Board members (entitled “New York State Environmental Facilities Corporation - Handbook for Board Members”). A copy of the Handbook’s Table of Contents is attached to this Action Plan as Exhibit “A”. This
Corporation will issue a Request for Proposals to engage various consultants and receives copies of all such Requests. The Board has, from time to time, participated in the process of interviewing the proposed consultants. The Board reviews and approves all financings proposed by the Corporation, contracts with vendors, regulations and policies. In addition, the Board's Policy Committee (consisting of all Board members) meets bi-monthly with the President and Senior Management to discuss initiatives and policies of the Corporation, and the Board's Audit Committee (consisting of three Board members) meets as needed, but not less than annually with the President and Senior Management. The Audit Committee also meets annually with the Corporation's independent auditor. By reason of the activities of the Board and its Committees, the Board is routinely advised and receives recommendations of management, and comments on the various financial, management and operational decisions impacting the Corporation.

**Action Plan:** It is expected that by continuing the past practice of holding monthly Board meetings, bi-monthly Policy Committee meetings, at least annual Audit Committee meetings, by reviewing the various policies followed by the Corporation annually, and by approving financings, contracts and consultant engagements, the Corporation's Board will continue to understand, review and monitor the implementation of the fundamental financial, management and operational decisions of the Corporation.

- The chair of the board of directors shall not be a member of management and shall be charged with leading the board's oversight role, including setting the board's agenda, managing the flow of information to the board, coordinating the work of the board's committees and serving as the primary liaison between the board and senior management.

**Comment:** Currently, the Commissioner of Environmental Conservation is designated by statute as the Chair and the CEO of the Corporation. (See, Public Authorities Law Section 1282.1)

**Action Plan:** The current statute needs to be amended to separate the offices of the Chair and CEO. It is proposed that such amendment designate the President as CEO. It is also proposed to retain the designation of the Commissioner of Environmental Conservation as Chair. A copy of the proposed amendment is made a part of this Plan as Exhibit "B".
3. The Public Authority Board - Establishing a Coordinated Committee Structure

- The authority's board shall establish board committees with clearly defined responsibilities pursuant to a written charter.

Comment: Since the inception of the Corporation, the Board of Directors has established Committees with clearly defined responsibilities. The Committee structure is specifically permitted by the Corporation's By-Laws (Exhibit "C", see, Article V). The By-Laws encourage the Committee(s) to adopt rules for their management. As discussed below, the Audit Committee approved and the Board adopted a Charter for the Audit Committee on April 6, 2004. (Exhibit "D"). On that date, at the meeting of the Corporation's Policy Committee of the Board, proposed Charters for the Policy Committee, Compensation Committee and Governance Committee were distributed for review and consideration.

Action Plan: The Board will continue to operate with the assistance of a coordinated Committee structure as discussed above. The Board has targeted the establishment of a Governance Committee and a Compensation Committee, with Charters for each of those Committees and the Policy Committee, for the annual meeting of the Board in September, 2004.

- Every authority shall have a governance committee and an audit committee comprised entirely of independent members. A member shall be deemed "independent" if he or she is: (a) not employed by the authority, (b) not employed by a state or local government and (c) not employed by an entity, public or private, that is, or is likely, to do business with the particular authority.

Comment: The Board has targeted its annual meeting in September, 2004 for the establishment of and adoption of a Charter for the Governance Committee. Each member of the Governance Committee shall be "independent" from the Corporation.

As a result of the additional responsibilities to be undertaken by independent Board members under the Model Principles, the Board believes that annual compensation should be provided to the independent members for their increased duties and responsibilities. Currently, pursuant to Section 1282.2 of the Public Authorities Law, the Board members do not receive a salary or other compensation, but are entitled to reimbursement for actual and necessary expenses incurred in the performance of their
• The governance committee shall review and regularly update the authority’s written policies regarding procurement of goods and services and the acquisition of real property or interests therein, including policies relating to the implementation of Executive Order No. 127 and the disclosure of persons who attempt to influence the authority’s procurement process.

• The governance committee shall review and regularly update the authority’s written policies regarding the disposition of real and personal property.

• The governance committee shall review and regularly update the authority’s written policies regarding the protection of whistleblowers from retaliation.

5. The Public Authority Board – Renewed Focus on Audits & Accountability

Comment: The Board has operated with an Audit Committee since 1996 and before that, a Finance Committee. The Audit Committee has met at least once a year with senior management. In addition, the Audit Committee has met separately with the Corporation’s independent auditor. Since 2002, the Audit Committee has considered the adoption of a Charter based, in part, upon the recommendations set forth in the Sarbanes-Oxley Act of 2002. This Charter was approved by the Audit Committee and adopted by the Board at its April 6, 2004 meeting. All of the provisions set forth in Model Principle No. 5 are included in the Charter, as adopted, except for references to the Corporation’s internal auditor, and the requirement in Model Principle No. 3 that all members be independent. The Board will review the requirement of an internal auditor over the following months.

Action Plan: Monitor guidance issued by the Advisory Committee concerning the appointment of an internal auditor and amend the Audit Committee Charter as necessary.

• The responsibilities of the audit committee shall include:

1. reviewing and approving the authority’s financial statements;

2. overseeing the authority’s internal controls and compliance systems;
6. Internal Auditors & Outside Auditors - Strengthening Internal Controls

- The authority shall have an internal auditor with clearly defined responsibilities who shall report directly to the audit committee and serve at its pleasure.

**Comment:** Public Authorities Law Section 2932 requires the Corporation to determine and periodically review whether an internal audit function is required. That section also provides that if an internal auditor is determined to be required, and is appointed by the Board, the internal auditor will report directly to the Board. In accordance with this section, the Board has periodically determined that an internal auditor was not required.

This Model Principle is consistent with the SEC regulation requiring an internal auditor to report to the Audit Committee. This requirement is inconsistent with the existing provisions of the Public Authorities Law.

**Action Plan:** Legislation should be introduced, in the form annexed as Exhibit "G" to make the existing statute consistent with this Model Principle. The Board requests that the Advisory Committee issue guidance regarding the appointment and duties of the internal auditor.

- The responsibilities of the internal auditor shall include directing authority-wide internal audit functions, including conducting financial, operational, procurement, compliance, contract, ethics and any other necessary audits. In addition, the internal auditor shall coordinate its work with the work of the outside auditors retained by the audit committee.

**See above Action Plan for Comment and Implementation.**

- The board, acting through its audit committee, shall engage an independent auditing firm to audit the financial statements, internal controls, compliance, and operations and management of the authority on a regular basis.

**Comment:** An independent auditor has been engaged by the Board since the Corporation's inception. The independent auditor is selected in accordance with the Corporation's Procurement Guidelines approved annually by the Board. The Audit Committee meets annually with the independent auditor.
• Each board member shall sign the authority's annual report.

Comment: This requirement is different from the provisions of the Sarbanes-Oxley Act. The Board has historically approved the Corporation's annual financial statements and Annual Information Statement. These two documents essentially form the basis of the Corporation's annual report. The formal requirement of a "signature" raises several questions and the Board requests that the Advisory Committee provide guidance as to what is meant by "sign". Additionally, the Board believes that the formal action of "signing" the annual report will increase their respective liability. Accordingly, the Board recommends that the indemnification and defense provisions of the Public Officers Law (specifically Sections 17 and 19) be expanded to include all actions of the Board. A form of such legislation is annexed as Exhibit "F".

Action Plan: Upon receipt of guidance from the Advisory Committee, the Board will implement the appropriate internal changes to have the Board "sign" the annual report at its annual meeting in September, 2004.

• The chief executive, chief financial officer, the audit director and other senior management of the authority shall certify the appropriateness of the financial statements and disclosures contained in the authority's report, and that those financial statements and disclosures fairly present, in all material respects, the operations and financial condition of the authority.

Comment: This provision is consistent with the provisions of the Sarbanes-Oxley Act.

Action Plan: The practice of the chief executive, chief financial officer, and other senior management executing the financial statements of the Corporation shall be implemented with the approval of the financial statements for the fiscal period ending March 31, 2004 unless otherwise directed by the Advisory Committee. The Board requests guidance from the Advisory Committee on the role and responsibilities of the "audit director".

• Each annual report of an authority shall contain an "internal control report," signed by the chief executive, chief financial officer, audit director and other senior management of the authority, which shall state the responsibility of
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VIII. 2002-2003 Annual Report
government or employees of an entity, public or private, that is, or is likely, to do business with the corporation, shall serve for terms of six years each, provided, however, that of the directors first appointed, two shall serve for terms of two years, the remaining two for terms of four and six years, respectively, from January first next succeeding their appointment. The appointed members of the New York state pure waters authority in office on the effective date of this act shall be deemed to be directors first appointed in accordance with the foregoing and shall hold office for the balance of the terms for which they were severally appointed. Any vacancy occurring otherwise than by expiration of term shall be filled in the same manner as the original appointment for the balance of the unexpired term. The board of directors of the corporation shall appoint, by resolution, the president of the corporation. The president shall be the chief executive officer of the corporation and shall serve at the pleasure of the board of directors of the corporation.

§ 2. This act shall take effect immediately.
Commissioner of Health, and the Secretary of State, is entitled to a per diem allowance incurred in the performance of his or her official duties, as provided for in Public Authorities Law Section 1282 (2).

Section 3. Deputy Directors. The Commissioner of Environmental Conservation, the Secretary of State and the Commissioner of Health may, by official proxy filed with and approved by the Board of Directors, designate an officer in their respective Department or office to perform, in their absence, their respective duties to the Corporation.

ARTICLE III

OFFICERS - EMPLOYEES -
CONSULTANTS - INDEMNIFICATION

Section 1. Officers. The Commissioner of Environmental Conservation is the Chief Executive Officer of the Corporation, which office shall not be held by any other officer of the Corporation. In addition to the Chief Executive Officer, the officers of the Corporation are the Executive Director, Director of Finance, Secretary and such other officers as may be deemed necessary by the Chairman to transact the business and exercise the general and special powers and duties of the Corporation. With the exception of the Chief Executive Officer, all officers of the Corporation shall be appointed by the Chief Executive Officer subject to approval by resolution of the Board of Directors. Any two or more offices may be held by the same person, but neither the Chief Executive Officer nor the Executive Director may also serve as Secretary or Director of Finance of the Corporation.

Section 2. Chairman and Chief Executive Officer. The Commissioner of Environmental Conservation is Chairman of the Board of Directors as well as Chief Executive Officer of the Corporation (hereinafter referred to as "Chairman"). The Chairman shall preside at all meetings of the Board of Directors of the Corporation. The Chairman shall exercise those powers and duties that may be delegated to him by the Board of Directors. The Chairman is to have executive supervision over, and be in administrative charge of the Corporation. The Chairman shall perform all such duties subject to the direction of the Board of Directors. The Chairman shall also be responsible for the execution of the policies and programs of the Corporation as established by the Board of Directors. The Chairman may delegate any of his executive and administrative duties to any officer or employee of the Corporation, except where the Act or a resolution of the Board of Directors provides otherwise. Any such delegation shall be revocable at will by the Chairman.

Section 3. Executive Director. The Executive Director of the Corporation shall perform such duties as are delegated to him by the Chairman.

The Chairman shall have direct supervision of the Executive Director, and all corporate acts of the Executive Director must be approved by the Chairman, who is subject to control of the Board of Directors.
Section 8. Removal of Officers of the Corporation. Except for the Chief Executive Officer, the officers of the Corporation shall be removed from office with or without cause by resolution by a majority vote of the Directors of the Corporation present at a meeting at which a quorum is in attendance. The action to remove an officer of the Corporation from office shall be taken by vote at a meeting, provided that fourteen (14) days' actual written notice of such proposed action is given to all Directors.

Section 9. Removal of Employees by the Chairman. All employees shall hold employment at the pleasure of the Chairman and may be removed either with or without cause, at any time, by the Chairman.

Section 10. Indemnification of Officers, Directors and Employees. The Corporation shall indemnify and hold harmless all Directors, officers and employees of the Corporation to the full extent permitted by, and in the manner as State employees are indemnified in their official actions by, law, as the same may exist at the time such person may become entitled to indemnification by the Corporation.

ARTICLE IV
MEETINGS

Section 1. Annual Meeting. The annual meeting of the Corporation shall be held on the first Tuesday of September of each year at a place and time designated by the Chairman. The calendar day of the annual meeting may be changed by vote of the Board of Directors or by the Chairman with the consent of the Board of Directors. The agenda for the annual meeting, together with the Corporation's proposed budget for the next fiscal year, must be provided to each member of the Board at least two weeks prior to the scheduled annual meeting.

Section 2. Regular Meetings. Regular meetings of the Corporation shall be held every other month on the first Monday of the month at a location within New York State selected by the Chairman or at such other time and place as may be determined by the Directors of the Corporation.

Section 3. Special Meetings. The Chairman may, when he deems it expedient, call a special meeting of the Corporation. A majority of the Directors, when they deem it expedient, may request the Chairman to call a special meeting of the Corporation and the Chairman, or, in his absence, the Secretary, thereupon, shall call for such a special meeting. The call for a special meeting, specifying the time and place of such meeting, shall be by telephone or delivered in person or mail to the business or home address of each Director of the Corporation at least two (2) days prior to the date of such special meeting. The agenda for the meeting and all proposals and resolutions must be delivered in writing. Special meetings must be limited to the purpose explicitly indicated in the notice; no other subject matter shall be covered.
Section 11. Attendance and Failure to Object. Attendance of a Director of the Corporation at a meeting shall constitute waiver of notice of the meeting except where such attendance is for a special purpose.

ARTICLE V
COMMITTEES

Section 1. Committees. A majority of the Directors on their own initiative or the Chairman, subject to prior approval by the Board, may appoint committees and a chairman thereof to conduct studies or investigations as shall be determined to be in the interests of the Corporation and make recommendations to the Board of Directors. Each member of a committee shall serve until the next annual meeting of the Board of Directors and thereafter until his or her successor is appointed. One member of each committee shall be appointed chairman. The committee chairman shall be responsible for convening the committee, keeping records of transactions and reporting to the Board of Directors at each regular meeting of the Board. A majority of the members of a committee shall constitute a quorum, and the recommendation of a majority of the members present at a meeting at which a quorum is present shall be the recommendation of the committee and not that of the Corporation. Each committee may adopt rules for its own management.

Section 2. Finance Committee. The Board of Directors or the Chairman shall designate the members and chairman of the Finance Committee in the same manner as provided in Section 1 hereof. In addition, the majority of Directors appointed to the Finance Committee shall consist of those Directors appointed by the Governor as provided in the New York State Environmental Facilities Corporation Act. This Committee shall make recommendations concerning the management of all funds of the Corporation, general accounting system, and conduct a preliminary review of all proposed submittals to the Division of the Budget and render advice with regard to financial policies. In the event this Committee recommends an audit of the Corporation, the Corporation shall retain an independent auditor in accordance with Article III, Section 7 of these By-laws. Any audit of the Corporation conducted pursuant to State law resulting in the issuance of interim or formal reports shall also be filed with this Committee and reported on by the Committee to the Board at the regular meetings of the Directors.

Section 3. Compliance with Open Meetings Law. Any committee or subcommittee established by the Corporation, which is comprised of two (2) or more Directors of the Corporation, is subject to the requirements and provisions of the Open Meetings Law of the State of New York and shall conduct itself in compliance with such Law.
Exhibit D

AUDIT COMMITTEE CHARTER
New York State Environmental Facilities Corporation ("Corporation")
EFFECTIVE APRIL 6, 2004

Purpose

The Audit Committee is appointed by the Board of Directors to assist the Board in monitoring: (1) the integrity of the financial statements of the Corporation, and, (2) the Corporation’s independent auditor’s qualifications and independence.

Committee Membership

To the extent practicable, the Audit Committee shall consist of three Board Members, at least two of which shall be independent Board Members. A Board Member shall be deemed independent if he or she is: (a) not employed by the Corporation; (b) not employed by a state or local government; and (c) not employed by an entity, public or private, that is, or is likely, to do business with the Corporation. The members of the Audit Committee shall be appointed by a majority vote of the Board of Directors at the Corporation’s annual meeting. At least one member of the Audit Committee should be a financial expert, if practicable. Each member of the Audit Committee shall serve until the next annual meeting of the Board of Directors and thereafter until his or her successor is appointed. Audit Committee members may be replaced by a majority vote of the Board of Directors.

Meetings

The Audit Committee shall meet as often as it determines, but not less frequently than annually. The Audit Committee shall meet at least annually together with the Corporation’s Executive Staff, the Controller to the Corporation and the Corporation’s independent auditor. The Audit Committee shall meet annually in a separate meeting with the Corporation’s independent auditor. The Audit Committee may request any officer or employee of the Corporation, or the Corporation’s outside counsel or independent auditor, to attend a meeting of the Committee or to meet with any member(s) of, or consultant(s) to, the Committee.

Committee Authority and Responsibilities

The Audit Committee shall be responsible for recommending to the Board of Directors the appointment of the independent auditor retained by the Corporation. The Audit Committee’s recommendation should include the compensation terms of the independent auditor. In no event shall the independent auditor be permitted to provide non-audit services to the Corporation. The Audit Committee shall be responsible for the review of the work of the Corporation’s independent auditor (including resolution of disagreements...
statements, including any significant changes in the Corporation’s selection or application of accounting principals, any major issues as to the adequacy of the Corporation's internal controls and special steps adopted in light of material control deficiencies.

4. Review reports from the Corporation's independent auditors, Executive Staff or the Corporation's Controller, if any, on:

a) All critical accounting policies and practices to be used.

b) All alternative treatments of financial information within generally accepted accounting principles that have been discussed with the Executive Staff; the ramifications of the use of such alternative disclosures and treatments; and the treatment preferred by the Corporation's independent auditor.

c) Other material written communications between the Corporation's independent auditor and the Executive Staff such as any management letter or schedule of unadjusted differences.

d) Internal controls and the attestation of such reports by the Corporation's independent auditor.

5. Discuss with the Executive Staff, the financial information provided to rating agencies.

6. Discuss with the Executive Staff the Corporation's major financial risk exposures and the steps the Executive Staff have taken to monitor and control such exposure, including the Corporation's risk assessment and risk management policies.

Oversight of the Corporation's Relationship with the Corporation's independent auditor

The Audit Committee, to the extent it deems necessary or appropriate, shall:

1. Review and evaluate the lead partner of the Corporation's independent auditor team.

2. Obtain and review a report from the Corporation's independent auditor at least annually regarding (a) the Corporation's independent auditor's internal quality-control procedures, (b) any material issues raised by the most recent internal quality-control review, or peer review, of the firm or by any inquiry or investigation by governmental or professional authorities within the preceding five years respecting one or more independent audits carried out by the firm, (c) any steps taken to deal with
and procedures regarding compliance with applicable laws and regulations.

3. Establish procedures for the confidential receipt, retention and investigation of complaints to be received by the Audit Committee regarding accounting, internal accounting controls or auditing matters, and the confidential, anonymous submission by employees of concerns regarding questionable or auditing matters. Procedures shall also be established for the referral of such matters to the State Inspector General.

4. Discuss with the Executive Staff and the Corporation’s independent auditor any correspondence with regulators or governmental agencies and any published reports which raise material issues regarding the Corporation’s financial statements or accounting policies.

5. Discuss with the Corporation’s General Counsel any legal matters that may have a material impact on the financial statements or the Corporation’s compliance policies.

**Limitation of Audit Committee’s Role**

While the Audit Committee has the responsibilities and powers set forth in this Charter, it is not the duty of the Audit Committee to plan or conduct audits or to determine that the Corporation’s financial statements and disclosures are complete and accurate and are in accordance with generally accepted accounting principles and applicable rules and regulations. These are the responsibilities of the Executive Staff and the Corporation’s independent auditor.
AN ACT to amend the public officers law in relation to defense and indemnification of directors, officers and employees of the New York state environmental facilities corporation.

The People of the State of New York, represented in Senate and Assembly, do enact as follows:

Section 1. Paragraph (e) of Subdivision 1 of section 17 of the public officers law, as amended by chapter 440 of the laws of 1984, is amended to read as follows:

(e) For the purposes of this section, the term "employee" shall include directors, for the performance of any duty or function as a director, officers and employees of the environmental facilities corporation for corporate projects involving (i) hazardous waste, (ii) industrial solid waste activities as defined in section twelve hundred eighty-five-g of the public authorities law, and (iii) all other activities not covered by professional liability insurance.

§ 2. Paragraph (e) of Subdivision 1 of section 19 of the public officers law, as amended by chapter 440 of the laws of 1984, is amended to read as follows:

(e) For the purposes of this section, the term "employee" shall include directors, for the performance of any duty or function as a director, officers and employees of
AN ACT to amend the public authorities law in relation to internal audit responsibilities of public authorities

The People of the State of New York, represented in Senate and Assembly, do enact as follows:

Section 1. Subdivision 1 of section 2932 of the public authorities law, as amended by chapter 510 of the laws of 1999, is amended to read as follows:

1. The governing board of each covered authority or its designee shall determine, and periodically review the determination of, whether an internal audit function within the covered authority is required. Establishment of such function shall be based upon an evaluation of exposure to risk, costs and benefits of implementation, and any other factors that are determined to be relevant. In the event it is determined that an internal audit function is required, the governing board of each covered authority shall establish an internal audit function which operates in accordance with generally accepted professional standards for internal auditing. Any such internal audit function shall be directed by appoint an internal audit director who shall report directly to the audit committee of the governing board of the authority and serve at its pleasure. Internal audit director
Exhibit F

EFC #

May 14, 2004

AN ACT to amend the public officers law in relation to defense and indemnification of directors, officers and employees of the New York state environmental facilities corporation.

The People of the State of New York, represented in Senate and Assembly, do enact as follows:

Section 1. Paragraph (e) of Subdivision 1 of section 17 of the public officers law, as amended by chapter 440 of the laws of 1984, is amended to read as follows:

(e) For the purposes of this section, the term "employee" shall include directors, for the performance of any duty or function as a director, officers and employees of the environmental facilities corporation, for corporate projects involving (i) hazardous waste, (ii) industrial solid waste activities as defined in section twelve hundred eighty-five of the public authorities law, and (iii) all other activities not covered by professional liability insurance.

§ 2. Paragraph (e) of Subdivision 1 of section 19 of the public officers law, as amended by chapter 440 of the laws of 1984, is amended to read as follows:

(e) For the purposes of this section, the term "employee" shall include directors, for the performance of any duty or function as a director, officers and employees of
APPENDIX E
MODIFICATIONS AND ADDITIONS
TO THE MODEL GOVERNANCE PRINCIPLES

The following are modifications and additions to the Model Governance Principles:

- **Composition of Board Committees** – Every authority shall have a governance committee and an audit committee comprised of a majority of independent members. The Model Governance Principles originally required that such committees be comprised *entirely* of independent members.

- **Independence** – A member shall be deemed “independent” if: (a) such member, and each member of its immediate family, is not employed by the authority and (b) such member is not employed by an entity, public or private, that does, or is likely to do, business with the authority. The Model Governance Principles originally required that independent board members not be employed by a state or local government. In addition, clause (a) was expanded to include immediate family members of the member.

- **Financial Experience of Audit Committee Members** – Each member of the audit committee shall have financial experience and, if possible, at least one member who qualifies as a financial expert. The Model Governance Principles originally only required that one member of the audit committee be a “financial expert”, in so far as possible.

- **Timing of Separation of Chairman/CEO Roles** – Separation of the roles of Chairman of the Board and Chief Executive Officer of the authority should take place as soon as possible, but taking into account special circumstances. The Model Governance Principles originally did not state a timeframe for implementing this principle.

- **Governance Committee** – The responsibilities of the Governance Committee shall include the preparation of a profile of the skill sets and experiences of individuals best equipped to be constructive board members of that authority; keeping up-to-date with current governance practices; continually reviewing corporate governance trends and best practices; and updating the authority’s corporate governance documents accordingly. Additionally, the Governance Committee should consider making recommendations to the Governor or State Legislature regarding the kinds of people (not necessarily specific individuals) the authority believes should be appointed to the board for reasons such as experience, qualifications or otherwise. These responsibilities are in addition to those originally set forth in the Model Governance Principles.
The following are reforms suggested by the Committee in addition to the Model Governance Principles:

- **Director Compensation** – Thought should be given to compensating certain board members.

- **Indemnification and D&O Insurance** – Given the enhanced responsibilities of directors and the related liability that directors may be exposed to, it is appropriate to review the State’s current indemnification and defense procedures for directors of public authorities and to recommend any necessary amendments or additional legislation. Additionally, it may be appropriate to examine the possibility of coverage of directors of public authorities under a Directors and Officers Insurance policy.

- **Disclosure and Transparency** – The matter of accessibility of materials, including financial statements, offering statements and annual reports is an area where the Committee believes that consistent standards among the authorities should be required. There are differences among the public authorities regarding what information, if any, is publicly available. While certain authorities may make materials available on their respective web sites, others only grant information via a Freedom of Information Act request.
  
  o The Committee believes that at a minimum each authority should have its annual report and adopted budget easily accessible to the general public. Such annual report, which must be signed by each board member of the authority, and should contain information regarding the authority’s activities from the previous year, as well as its plan for the upcoming year (including, for example, a budget reconciliation), all modeled on the reports filed by publicly held companies pursuant to the federal securities laws, including Management’s Discussion and Analysis of Financial Condition and Results of Operations contained in the annual report filed under Form 10-K.
  
  o Additionally, authorities should have a matrix or a template to follow so that all public disclosures are consistent in format and content. Members of the financial community and the Division of the Budget should consider a model paradigm for public disclosure of financial information, which may take the form of an omnibus procedures act covering matters such as the corporate functions, bond issuances and financial disclosures of public authorities.

- **Fiduciary Duties** – Legislative study should be undertaken to determine whether the fiduciary duty of public authority board members is sufficiently articulated.

- **Board Self-Evaluation and Training** – Boards should develop a means of self-evaluation as well as a means to orient and train future and existing board members (director training should include topics such as distinguishing the role of the board from the day-to-day management of operations). In addition, there should be a central place for authorities to send their board members for training.
• **Internal Audit Function** – The development of an internal audit function is an important aspect of governance reforms in public authorities and, collectively with other issues identified herein, requires further study and discussion with the Governor’s Office, representatives of the authorities, the financial community, and relevant experts, before recommendations for an unambiguous Executive Order or legislative language is proposed.

• **Continuous Review of Governance of Public Authorities** – Some means should be developed to subject the implementation of governance guidelines by the boards of authorities to continuous examination.

• **Waivers** – There should be some vehicle for granting waivers to authorities which demonstrate an inability to adopt a specific principle.