

FOR CONSIDERATION

May 19, 2021

TO: The Board of Trustees

FROM: Thomas Falcone

SUBJECT: Consideration of the Adoption of Capital Project and Budget Development and Monitoring Process Improvement Recommendations

Requested Action

The Board of Trustees (the “Board”) of the Long Island Power Authority (“LIPA”) is requested to adopt a resolution, attached hereto as **Exhibit “A,”** approving certain recommendations developed by LIPA to improve the Capital Budget development and monitoring process (the “Capital Budget Process Improvement Recommendations”) and directing PSEG Long Island to develop associated Project Implementation Plans.

Discussion

Over the past several months, LIPA and PSEG Long Island have worked to improve the Operating Budget development and oversight process in accordance with the recommendations adopted by the Board on December 16, 2020. However, the Operating Budget only captures half the financial picture. In 2021, PSEG Long Island is budgeted to spend \$727 million on capital projects. This spending targets critical investments in system reliability, technology, infrastructure upgrades, and load growth requirements. The existing Capital Budget development and project oversight process shares many of the same weaknesses as the Operating Budget process that the Board has already taken steps to improve.

The main result of these weaknesses is that PSEG Long Island’s requests for Capital Budgets are routinely in excess of the funds expended. In addition, there is a high level of variance between the funds requested for the year by project and category as compared to those expended, with the result of large shifts between projects and categories of spending from those planned and approved by the Board. This leads to a loss of accountability for project delivery and controls, as well as can result in higher borrowing costs for customers. As an example, the table below shows the original Board-approved Capital Budget for each year since 2014 as compared to the funds actually spent.

Year	Budget (\$M) *	Actual (\$M)	Variance (\$M)
2015	\$577	\$375	\$202
2016	\$644	\$524	\$120
2017	\$670	\$658	\$12
2018	\$695	\$591	\$104
2019	\$815	\$690	\$125
2020	\$785	\$753	\$32

**Does not reflect Capital Budget amendments, which are principally to roll over unspent funds.*

Prior Management Audits have pointed to needed reforms in capital project optimization, capital project estimating, risk and contingency management, project management performance reporting, the definition and quantification of work standards, and other areas that contribute to the development and management of capital projects and the Capital Budget. PSEG Long Island has implemented improvements in many of these areas, while some still require greater effort. An improved process governing capital project and Capital Budget review and approval, including managing changes during the year, will enhance transparency and accountability of customer funds and ensure adequate information flow to LIPA to conduct oversight on behalf of our customers.

Recommendations

Pursuant to Section 4.4(16), Rights and Responsibilities of LIPA, of the Amended and Restated Operations Services Agreement (“OSA”), LIPA, in part, has the right to “make recommendations to the Service Provider, in each case as may be reasonably necessary or appropriate to perform LIPA’s oversight responsibilities and obligations with respect to the provision of Operations Services under this Agreement and as may otherwise be necessary or appropriate to comply with LIPA’s legal, contractual and fiduciary obligations. . .”

LIPA Staff recommends that the Board adopt the following Capital Project and Budget Development and Monitoring Process Improvement Recommendations to be implemented with the 2022 Capital Budget.

A. Recommendation -- Capital Project and Budget Review and Approval Process

- **Complete Project Justification Descriptions:** For a project to be considered by the Board for inclusion in the LIPA Board-Adopted Consolidated Budget, which includes the PSEG Long Island Capital Budget as well as the balance of the 8-Year Capital Plan, LIPA’s Chief Executive Officer or their designee (“CEO”), must first have reviewed and approved a Project Justification Description (“PJD”) containing the project level information detailed in Section 4.13 (A) of the OSA, including:
 - Project location
 - Schedule: initiation date and expected duration
 - Cost Estimate:
 - An estimate of the amount of the costs, including the dollar amount per year if the project requires more than a year to complete. The cost estimate must be itemized by category, including in-house labor costs, contractor costs, and the level of Risk and Contingency (“R&C”) included in the project total cost estimate and the cost estimate confidence level. The level of R&C should be consistent with the inherent risk associated with a project.
 - Long Term Plan: Explanation of the relationship to other planned or subsequently required Capital Improvements
 - Project Life: Anticipated useful life of each Capital Improvement
 - Justification: Economic and engineering justifications for such project
- **Preliminary Project Justification Descriptions:** If PSEG Long Island is unable to provide a full and complete PJD prior to consideration of the PSEG Long Island Capital Budget by

the LIPA Board, PSEG Long Island may submit a preliminary PJD as part of its Capital Budget request. Based on its sole judgment regarding the completeness of the PJD, LIPA's CEO may recommend to the Board that the project be included in the LIPA Consolidated Capital Budget on a contingent basis, therefore outside of the PSEG Long Island Capital Budget. The LIPA CEO may propose to the Board that limited funds for the project be included within the PSEG Long Island Capital Budget to be used for preliminary engineering, design, and study. The remaining portion of the project funds, referred to as Contingent Project Authorization, would be excluded from the PSEG Long Island Capital Budget but included in the LIPA Consolidated Capital Budget.

The Board will delegate authority to LIPA's CEO to increase the approved PSEG Long Island Capital Budget up to the aggregate amount of Contingent Project Funding Authorization, as reflected in the LIPA Consolidated Budget, after LIPA's review and approval of a full and complete PJD. The Board's Finance and Audit Committee will be provided reports on a quarterly basis of all such actions taken by the CEO pursuant to this authority.

- **New Projects or Changes in Project Scopes Between Capital Budgets:** In the event PSEG Long Island proposes to add a new project to the PSEG Long Island Capital Budget portion of the Board-approved LIPA Consolidated Budget, or in the event of a material change in project scope from that was previously reviewed and approved, PSEG Long Island will need to submit a new PJD to LIPA's CEO for review in accordance with the process outlined above regarding the consideration of a project for inclusion in the current year LIPA approved Consolidated Budget and 8-year Plan.

PSEG Long Island may incur up to \$0.2 million in project costs for preliminary engineering, study, or design costs prior to submitting the PJD to LIPA. LIPA acknowledges that preliminary engineering, study, and design efforts are required to develop detailed project plans and project justifications.

The LIPA Board will delegate to LIPA's CEO the authority and obligation to review the addition of such new projects, or materially changed projects, to the PSEG Long Island Capital Budget. Such projects will be funded from within the Board-approved PSEG Long Island Capital Budget for the year, without additional budget authorization. The Board may at any time consider a budget amendment for such projects, if warranted.

B. Recommendation -- Capital Budget Changes and Reallocations

- **Annual Project Justification Description Updates:** PSEG Long Island should provide LIPA with annual updates to PJDs highlighting changes from the prior PJD and reflecting the current cost estimates, including R&C, schedule, and scope details as part of the annual budget process. For multi-year projects that have progressed through more advanced project design stages since the prior budget (e.g. order of magnitude, conceptual estimate, design estimate, definitive estimate), the PJD and budget request should reflect an updated R&C estimate.
- **Capital Budget Reallocation Explanations:** To fulfill PSEG Long Island's obligation to consult with LIPA prior to reallocating budgeted funds, PSEG Long Island must submit to LIPA's CEO a Capital Budget Reallocation Explanation form, in a format requested by LIPA,

when proposing to reallocate funds within the adopted Capital Budget when projected year-end spending at the project level is forecasted to result in a variance to the Annual Budget for that project equal to or greater than 10% and \$0.5 million. The Reallocation Explanation must address:

- The reason for increasing a project's funding
- Why the adopted budget did not anticipate the issue
- The impact to the projects where funding is being reduced
- The duration of the issue causing the reallocation
- A description of whether the reallocation is due to a change in total project cost, scope, or duration

C. Recommendation -- Capital Budget Carryover

- **Carryover Projects:** If a Capital Project funded within the Adopted LIPA Consolidated Capital Budget is delayed into the subsequent year's Capital Budget, PSEG Long Island must identify the change in the project schedule and propose to carryover the approved Capital Budget funds from the current adopted Capital Budget to the proposed Capital Budget as part of the next year's Capital Budget adoption process. LIPA CEO shall not recommend to the Board the re-funding of a project scope that was re-scheduled from a prior budget year if the funding was not carried over from the prior year.

To ensure the Capital Budget Process Improvement Recommendations are successfully implemented, the Board directs PSEG Long Island to develop Project Implementation Plans that outline the steps PSEG Long Island will take to conform to the Recommendations, including addressing any changes to existing policies and procedures. PSEG Long Island should submit the Project Implementation Plans no later than June 4, 2021, for consideration by the Board at its June 23, 2021 meeting.

Recommended Action

Based upon the foregoing, I recommend approval of the above requested action by adoption of a resolution in the form attached hereto.

Attachments

Exhibit "A" Resolution

RESOLUTION ADOPTING CAPITAL BUDGET PROCESS IMPROVEMENT RECOMMENDATIONS AND REQUIRING PROJECT IMPLEMENTATION PLANS

WHEREAS, pursuant to Section 4.4(16), Rights and Responsibilities of LIPA, of the Amended and Restated Operations Services Agreement (“OSA”), LIPA, in part, has the right to “make recommendations to the Service Provider, in each case as may be reasonably necessary or appropriate to perform LIPA’s oversight responsibilities and obligations with respect to the provision of Operations Services under this Agreement and as may otherwise be necessary or appropriate to comply with LIPA’s legal, contractual and fiduciary obligations. . .”; and

WHEREAS, pursuant to Section 5.2 (B), Pass Through Expenditures: Budgets of the OSA, requires PSEG Long Island to submit the proposed Consolidated Budget for LIPA’s review, revision, and approval, which includes the PSEG Long Island Operating and Capital Budgets; and

WHEREAS, Section 4.13 (A) of the OSA requires PSEG Long Island to include in each such Capital Budget a description of each capital project constituting Capital Improvements in sufficient detail to enable LIPA to make a fully informed analysis and assessment thereof, including (i) the project location, (ii) the planned initiation date and expected duration, (iii) an estimate of the amount of the costs including the dollar amount per year if the project requires more than a year to complete, (iv) an explanation of the relationship to other planned or subsequently required Capital Improvements, (v) the anticipated useful life of each Capital Improvement and (vi) the economic and engineering justifications for such project; and

WHEREAS, Section 5.2 (B) obligates PSEG Long Island to consult with LIPA prior to any reallocation of budgeted funds; and

WHEREAS, LIPA Staff has developed Capital Budget Process Improvement Recommendations, as described in the accompanying memorandum; and

NOW, THEREFORE, BE IT RESOLVED, the Board hereby adopts the Capital Budget Process Improvement Recommendations; and

BE IT FURTHER RESOLVED, that the Board hereby directs LIPA Staff, together with PSEG Long Island, to implement the Capital Project and Budget Development and Monitoring Process Improvement Recommendations effective with the 2022 Budget, including the creation of Project Implementation Plans for consideration by the Board at its June 2021 meeting.

Dated: May 19, 2021