

**MINUTES OF THE MEETING  
OF  
THE AUDIT COMMITTEE**

**March 27, 2012**

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A meeting of the Audit Committee was held via videoconference at the Authority's offices at 123 Main Street, White Plains, New York at approximately 10:38 a.m.

**The following Members of the Audit Committee were present:**

*Trustee D. Patrick Curley, Chairperson*  
*Vice Chairman Jonathan Foster*  
*Trustee Eugene L. Nicandri*

**Also in attendance were:**

<i>Michael J. Townsend</i>	<i>Chairman</i>
<i>John S. Dyson</i>	<i>Trustee</i>
<i>R. Wayne LeChase</i>	<i>Trustee</i>
<i>Gil Quiniones</i>	<i>President and Chief Executive Officer</i>
<i>Judith McCarthy</i>	<i>Executive Vice President and General Counsel</i>
<i>Donald Russak</i>	<i>Acting Chief Financial Officer</i>
<i>Edward Welz</i>	<i>Acting Chief Operating Officer</i>
<i>Karen Delince</i>	<i>Corporate Secretary</i>
<i>Brian McElroy</i>	<i>Treasurer</i>
<i>Thomas Concadoro</i>	<i>Vice President and Controller</i>
<i>Lesly Pardo</i>	<i>Vice President – Internal Audit</i>
<i>Scott Scholten</i>	<i>Vice President and Chief Risk Officer</i>
<i>Dennis Eccleston</i>	<i>Chief Information Officer</i>
<i>Lorna Johnson</i>	<i>Assistant Corporate Secretary</i>
<i>Sheila Baughman</i>	<i>Senior Secretary, Corporate Secretary's Office</i>
<i>Ken Deon</i>	<i>Managing Partner, KPMG</i>
<i>Brendan Kennedy</i>	<i>Senior Manager, KPMG</i>

**Introduction**

*Chairman D. Patrick Curley welcomed committee members Trustees Foster and Nicandri and also Chairman Townsend and Trustees Dyson and LeChase, Ken Deon and Brendan Kennedy from KPMG and senior staff to the meeting.*

**1. Adoption of the Proposed Meeting Agenda**

By motion made and seconded the agenda for the meeting was approved.

2. **Approval of the Minutes of the Regular Meeting of November 15, 2011**

The minutes of the Committee's Regular Meeting of November 15, 2011 were adopted.

3. **Year-end 2011 Financial Statements**

Mr. Thomas Concadoro provided highlights of the Authority's financial statements for the year ended 2011 as follows:

**Management's Discussion and Analysis (MD&A):**

- A comparison of operating results for the years 2011 and 2010 showed an increase in net income from \$181 million (2010) to \$235 million (2011). This was due mainly to a decrease in non-operating expenses attributable to lower voluntary contributions to New York State (decrease of \$82 million to \$65 million in 2011 from \$147 million in 2010).
- Operating income for 2011 (\$282 million) was slightly higher than 2010. Variations in fuel (+\$34 million) and purchased power expenses (-\$77 million) resulted primarily from the Astoria Energy II Plant ("AE II") coming into service in July. Cost variations were substantially offset by customer revenues.
- Net generation of 28.1 million mwh's in 2011 was 15% higher than 2010. This includes increases at the Niagara and St. Lawrence Plants due to higher water flows and at the fossil facilities due to the operation of the Astoria Energy II facility.
- Long-term debt decreased by \$145 million in 2011 due to scheduled maturities and early retirements further improving the Authority's debt/equity ratio. Also, of note, the Authority's long-term debt is at its lowest level since 1975.
- Updates to voluntary contributions to the state, including \$60 million paid in January 2012 and \$65 million proposed for state fiscal year 2012/13 (included in the Governor's proposed budget).

**Balance Sheet**

The following changes were highlighted:

- An increase in current assets (\$173 million) reflects higher investment balances due to reinvestment of cash generated by operations.
- An increase in restricted funds of \$51 million primarily due to appreciation of investments in the nuclear decommissioning trust fund. The increase is offset 100% by an increase in the related liability to Entergy.
- An increase in capital assets of \$1.2 billion. This reflects the treatment of the Authority's AE II agreement as a capital lease. Also, of note, all the output from AE II is utilized to serve the Authority's SENY customers.

**Income Statement**

- A new item, "Contributed Capital" represents the value of transmission assets related to wind farms that the Authority took title to at the end of the year.

**Cash Flow Statement**

- Debt reduction activity as a result of bond retirements shown in financing section. Also, \$40 million contribution to OPEB trust fund made during the year.
- Net cash provided as a result of operating activities (+\$400 million) slightly down from 2010.

**Footnotes**

- Accounting Policies – There were no significant changes in the accounting policies; no new GASB pronouncements and no significant changes in reporting requirements.

**Commitments and Contingencies**

- Nuclear Fuel settlement (\$11 million) recorded in Other Income.
- RNY – details of the program and the end of Power for Jobs effective 6/30/12
- New York State Budget and Other Matters – Updated amounts and policy statement adopted by the Board regarding using a reference point of 2.0 for debt coverage
- Wind and Solar Initiatives – Updates for closing out of the GLOW Project; also indicates Board is expected to act on solar initiative in 2012. This will be updated as necessary before the financials are issued.

In response to a comment from Chairman Curley, Mr. Ken Deon said he understands his preference for the loans as opposed to contributions to the state. In response to further question from Chairman Curley, Mr. Deon said the Auditors reviewed the accounting for the Astoria Energy II Agreement in detail.

**4. Summary of 2011 Annual Audit of Financial Statements**

Mr. Ken Deon, KPMG's audit engagement partner, presented an overview of the Authority's 2011 audit results. He said that as of February 17, 2012, KPMG completed, substantially, all scheduled audit work for 2011 and outlined the audit results which were consistent with KPMG's 2011 Audit Plan. Mr. Deon also said there were no proposed audit adjustments to the Financial Statements and no significant deficiencies or material weakness in the Authority's internal controls. KPMG will be issuing an unqualified opinion of the Authority's Financial Statements and will not be issuing a management letter for 2011. Mr. Deon said the 2011 audit went well and KPMG received full cooperation from all levels of the Authority's management.

In response to a question from Trustee Nicandri, Mr. Deon said the Audit Committee and Board of Trustees are supportive of KPMG's team; Mr. Brendan Kennedy concurred, adding that he received full cooperation and prompt responses to any requests from the staff.

Mr. Kennedy, KPMG's Senior Manager for the Authority's 2011 Audit reported on the key audit risks and issues and gave an overview of the Reports to be issued as a part of KPMG's audit. He said that, based on the tests performed, KPMG found no issues during the audit.

On motion made and seconded KPMG's report on the 2011 Annual Audit of the Authority's Financial Statements were accepted.

On motion made and seconded the following resolution was unanimously adopted.

**WHEREAS, the Executive Vice President and Chief Financial Officer and Vice President and Controller have prepared, reviewed and submitted for consideration of the Audit Committee the attached financial statements for the year ending 2011; and**

**WHEREAS, the Audit Committee has itself reviewed the attached financial statements;**

**NOW THEREFORE BE IT RESOLVED, That the Audit Committee recommend that the Authority's Trustees approve the financial statements for the year ended December 31, 2011.**

**5. 2012 Internal Audit Plan**

Mr. Lesly Pardo presented an overview of the 2012 Internal Audit Plan to the Committee. He said that the plan is based on the results of the risk assessment survey and discussions with management and provided the following highlights:

- 40 audits have been scheduled (30 financial/operational and 10 Information Technology) covering all Business Units
- 9 audits will be conducted at the operating facilities
- Key audits include Energy Services Operations; ReCharge New York Customer Revenues; ReCharge New York Program Management and operational audits at SENY and Blenheim-Gilboa
- Assistance to KPMG in their audit of NYPA's Financial Statements
- Economic Development Job Commitments audits
- Outside Vendor Contract audits
- Support to the Ethics office

Mr. Pardo provided a summary of the planning process for the 2012 audit plan which includes a review of the Authority's Strategic Plan, key business objectives and internal control systems. Mr. Pardo also provided an overview of the Authority's internal audit risk assessment methodology as follows:

- Meetings and interviews with business owners were conducted to obtain feedback on critical business objectives and risks
- Risk assessment performed on all auditable entities
- Based on the risk assessment performed by Internal Audit, audits are ranked from high to low in terms of their relative risk
- Based on the results of the risk assessment and management input an Audit Plan is developed
- The proposed Audit Plan is presented to the Executive Management and the Audit Committee for discussion and feedback

Mr. Pardo provided background information on the Internal Audit staff. He said the staff totaled 12 employees who have vast experience in auditing; most of them are Certified Public Accountants or have other professional certifications. In response to a question from Trustee Nicandri, Mr. Pardo said that the majority of the staff has been employed at the Authority for more than 10 years; some up to 20 years.

In response to a question from Chairman Curley, Mr. Deon said that Mr. Pardo assisted KPMG's auditors during their audits. Mr. Pardo added that KPMG receives a copy of all Internal Audit Reports.

In response to further question from Trustee Nicandri, Mr. Deon said that, if necessary, the KPMG Auditors would make recommendations regarding additional internal audit areas, however, no suggestions were made for the 2011 audit.

**6. Internal Audit Activity Report**

Mr. Lesly Pardo presented an overview of Internal Audit's activity for the year 2011. He provided the following highlights:

- 36 audits had been completed as of December 31, 2010
- All audits in the revised Audit Plan have been completed
- 30 audit reports have been issued
- 61 recommendations were made to improve internal controls or promote operational efficiency

Mr. Pardo ended by stating that all of the recommendations in the audit reports had been accepted by management and the accepted recommendations are being actively tracked. The Internal Audit staff received full cooperation and support from management and was able to meet or exceed its performance goals for 2011.

7. **Next Meeting**

The next regular meeting of the Audit Committee will be held on Tuesday, July 31, 2012, to commence at approximately 9:30 a.m., at the Clarence D. Rappleyea Building, White Plains, New York.

On motion made and seconded, the meeting was adjourned at approximately 11:10 a.m.

March 27, 2012

**EXHIBITS**

**For**

**March 27, 2012**

**Meeting Minutes**

*Final Editorial Review Not Completed*

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**NEW YORK POWER AUTHORITY**

Financial Statements

December 31, 2011 and 2010

(With Independent Auditors' Report Thereon)

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## NEW YORK POWER AUTHORITY

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## Management Report

Management is responsible for the preparation, integrity and objectivity of the financial statements of the Power Authority of the State of New York (the Authority), as well as all other information contained in the Annual Report. The financial statements have been prepared in conformity with U.S. generally accepted accounting principles and, in some cases, reflect amounts based on the best estimates and judgments of management, giving due consideration to materiality. Financial information contained in the Annual Report is consistent with the financial statements.

The Authority maintains a system of internal controls to provide reasonable assurance that transactions are executed in accordance with management's authorization, that financial statements are prepared in accordance with U.S. generally accepted accounting principles and that the assets of the Authority are properly safeguarded. The system of internal controls is documented, evaluated and tested on a continuing basis. No internal control system can provide absolute assurance that errors and irregularities will not occur due to the inherent limitations of the effectiveness of internal controls; however, management strives to maintain a balance, recognizing that the cost of such system should not exceed the benefits derived.

The Authority maintains an internal auditing program to independently assess the effectiveness of internal controls and to report findings and recommend possible improvements to management. This program includes a comprehensive assessment of internal controls as well as testing of all key controls to ensure that the system is functioning as intended. Additionally, as part of its audit of the Authority's financial statements, KPMG LLP, the Authority's independent auditors, considers internal controls over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for purpose of expressing an opinion on the effectiveness of the Authority's internal controls over financial reporting. Management has considered the recommendations of its internal auditors, the Office of the State Comptroller (OSC), and the independent auditors concerning the system of internal controls and has taken actions that it believed to be cost-effective in the circumstances to respond appropriately to these recommendations. Based on its structure and related processes, management believes that, as of December 31, 2011, the Authority's system of internal controls provides reasonable assurance as to the integrity and reliability of the financial statements, the protection of assets from unauthorized use or disposition and the prevention and detection of fraudulent financial reporting.

The members of the Authority's Board of Trustees, appointed by the Governor, by and with the advice and consent of the Senate, are not employees of the Authority. The Trustees' Audit Committee meets with the Authority's management, its Vice President of Internal Audit and its independent auditors periodically, throughout the year, to discuss internal controls and accounting matters, the Authority's financial statements, the scope and results of the audit by the independent auditors and the periodic audits by the OSC, and the audit programs of the Authority's internal auditing department. The independent auditors, the Vice President of Internal Audit and the Vice President of Labor Relations & Chief Ethics and Compliance Officer have direct access to the Audit Committee.



Donald A. Russak  
Acting Chief Financial Officer

March 27, 2012

## Independent Auditors' Report

The Board of Trustees  
Power Authority of the State of New York:

We have audited the balance sheets, statements of revenues, expenses, and change in net assets and statements of cash flows of the Power Authority of the State of New York (the Authority) as of and for the years ended December 31, 2010 and 2011. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards for financial statement audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority as of December 31, 2011 and 2010, and the changes in its financial position and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated March \_\_\_\_, 2012 on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The accompanying management's discussion and analysis and the schedule of funding progress listed in the accompanying table of contents are not a required part of the basic financial statements but are supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

March \_\_, 2012

## **NEW YORK POWER AUTHORITY**

### Management's Discussion and Analysis

December 31, 2011 and 2010

(Unaudited)

#### **Overview of the Financial Statements**

This report consists of three parts: management's discussion and analysis, the basic financial statements, and the notes to the financial statements.

The financial statements provide summary information about the New York Power Authority's (Authority) overall financial condition. The notes provide explanation and more details about the contents of the financial statements.

The Authority is considered a special-purpose government entity engaged in business-type activities and follows financial reporting for enterprise funds. The Authority's financial statements are prepared in accordance with generally accepted accounting principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB). In accordance with GASB standards, the Authority has elected to comply with all authoritative pronouncements applicable to nongovernmental entities (i.e., Accounting Standards Codification of the Financial Accounting Standards Board) that do not conflict with GASB pronouncements.

#### **Forward Looking Statements**

The statements in this management discussion and analysis (MD&A) that are not historical facts are forward-looking statements based on current expectations of future events and are subject to risks and uncertainties that could cause actual results to differ materially from those expressed or implied by such statements. In addition, we, through our management, from time to time make forward-looking public statements concerning our expected future operations and performance and other developments. All of these forward-looking statements are subject to risks and uncertainties that may change at any time, and, therefore, our actual results may differ materially from those we expected. We therefore caution against placing substantial reliance on the forward-looking statements contained in this MD&A. All forward-looking statements included in this MD&A are made only as of the date of this MD&A and we assume no obligation to update any written or oral forward-looking statements made by us or on our behalf as a result of new information, future events or other factors.

## NEW YORK POWER AUTHORITY

### Management's Discussion and Analysis

December 31, 2011 and 2010

(Unaudited)

The following is a summary of the Authority's financial information for 2011, 2010, and 2009:

#### Summary of Revenues, Expenses, and Changes in Net Assets (In millions)

	2011	2010	2009	2011 vs. 2010 favorable (unfavorable)	2010 vs. 2009 favorable (unfavorable)
Operating revenues	\$ 2,655	2,568	2,595	3%	(1)%
Operating expenses:					
Purchased power	854	931	905	8	(3)
Fuel	258	224	366	(15)	39
Wheeling	548	528	436	(4)	(21)
Operations and maintenance	519	443	438	(17)	(1)
Depreciation	194	163	164	(19)	1
Total operating expenses	<u>2,373</u>	<u>2,289</u>	<u>2,309</u>	(4)	1
Operating income	<u>282</u>	<u>279</u>	<u>286</u>	1	(2)
Nonoperating revenues	145	138	132	5	5
Nonoperating expenses	<u>192</u>	<u>236</u>	<u>165</u>	19	(43)
Nonoperating loss	<u>(47)</u>	<u>(98)</u>	<u>(33)</u>	52	(197)
Net income	235	181	253	30	(28)
Contributed capital	59	—	—		
Change in net assets	<u>294</u>	<u>181</u>	<u>253</u>		
Net assets – beginning	<u>3,001</u>	<u>2,820</u>	<u>2,567</u>	6	10
Net assets – ending	<u>\$ 3,295</u>	<u>3,001</u>	<u>2,820</u>	10	6

The following summarizes the Authority's financial performance for the years 2011 and 2010:

The Authority had net income of \$235 million for the year ended December 31, 2011 compared to \$181 million in 2010. This current year increase of \$54 million included higher operating income of \$3 million, higher non-operating revenues of \$7 million and lower non-operating expenses of \$44 million. Operating income was higher primarily due to higher net generation at Niagara resulting in higher energy sales into the New York Independent System Operator (NYISO) market. Large variations in purchased power, fuel and depreciation expenses from year to year were substantially attributable to the operation of the Astoria Energy II generating station (AEII) starting on July 1, 2011. This facility was utilized to serve the New York City (NYC) governmental customers and related cost variations were offset by recoveries through operating revenues. Operations and maintenance expenses increased mainly due to the operation of AEII and the recognition of residential consumer discounts associated with the Recharge New York power program legislation. This legislation provides for the funding of such discounts from the sale of hydro-power withdrawn from investor-owned utilities. Nonoperating expenses were lower in 2011 due to lower voluntary contributions to New York State (\$82 million) partially offset by higher interest expenses (\$38 million) primarily relating to AEII.

Net assets increased by \$294 million in 2011 including contributed capital of \$59 million relating to the contribution of wind farm transmission assets to the Authority.

During 2011, long-term debt decreased by \$145 million, or 10%, primarily due to scheduled maturities, early extinguishments of debt (other than the refunded debt) and cash funding of capital expenditures. Interest expense was \$38 million higher than 2010 primarily due to interest expense on the capitalized lease obligation related to AEII in 2011. During the period 2001 to 2011, the Authority reduced its

## NEW YORK POWER AUTHORITY

### Management's Discussion and Analysis

December 31, 2011 and 2010

(Unaudited)

total debt/equity ratio from 1.43 to 0.55. Total debt as of December 31, 2011 (\$1.81 billion) is at its lowest level since December 31, 1975 (\$1.64 billion).

The Authority had net income of \$181 million in the year 2010, compared to \$253 million in 2009. This \$72 million decrease in net income is primarily due to higher nonoperating expenses (\$65 million) as a result of higher voluntary contributions to New York State. Operating income was slightly lower (\$7 million) than the prior year. Lower fuel costs and higher purchased power expenses in 2010 were substantially attributable to changes in resources utilized to serve the Authority's Southeast New York (SENY) Governmental Customers necessitated by the cessation of operations of the Authority's Poletti plant on January 31, 2010. Wheeling expenses increased due to a Con Ed rate increase for delivery service to the SENY Governmental Customers. The majority of these cost variations are offset through revenues as variances are reflected in customer rates. Nonoperating revenues increased by \$6 million in 2010 including an increased mark-to-market adjustment for investments in 2010 due to lower market interest rates partially offset by lower realized investment income.

### Operating Revenues

Operating revenues of \$2,655 million in 2011 were \$87 million or 3% higher than the \$2,568 million in 2010, primarily due to higher market-based sales mainly due to higher generation from the Niagara plant.

### Purchased Power and Fuel

Purchased power costs decreased by 8% in 2011 to \$854 million from \$931 million in 2010, primarily due to lower purchase volumes needed to serve SENY governmental customers as a result of the July 1, 2011 commercial operation date of AEII. Fuel costs were \$34 million (15%) higher during 2011, also primarily due to the July 1, 2011 commercial operation date of AEII which is one of the resources utilized to serve the NYC governmental customers.

### Operations and Maintenance (O&M)

O&M expenses increased by \$76 million or 17% in 2011 to \$519 million primarily due to expenditures relating to transitional discount payments to residential consumers who will no longer receive hydropower allocations (\$42 million); voluntary contributions to New York State relating to the Power for Jobs program (\$14 million); and AEII O&M expense for the period since it started commercial operations on July 1, 2011 (\$13 million).

### Nonoperating Revenues

For 2011, nonoperating revenues increased by \$7 million or 5% due to the \$11 million settlement of the spent nuclear fuel claim against the United States Department of Energy. This increase was partially offset by reduced investment income due to lower average interest rates on investments. Nonoperating revenues for 2011 and 2010 include income recognition of \$72 million for each year resulting from a value sharing agreement relating to the nuclear power plants sold by the Authority to subsidiaries of Entergy Corporation in 2000. See note 11(a), "Nuclear Plant Divestiture," for additional information.

### Nonoperating Expenses

For 2011, nonoperating expenses decreased by \$44 million or 19% primarily due to a decrease of \$82 million in the Authority's voluntary contribution to New York State (\$65 million) that was not related to the Power for Jobs program partially offset by higher interest expenses (\$38 million) primarily related to the capitalized lease obligation recorded for AEII.

### Cash Flows

During 2011, the Authority generated cash flows of \$412 million from operations compared to \$427 million in 2010. Cash flows from operating activities for 2011 were lower than 2010 primarily due to delivery service refunds to SENY customers relating to prior years.

### Net Generation

Net generation for 2011 was 28.1 million megawatt-hours (MWh) compared to the 24.5 million MWh generated in 2010. Net generation from the Niagara (14.6 million MWh) and St. Lawrence (7.3 million MWh) plants were both 10% higher than 2010 as a result of higher water flows. During 2011, net generation was approximately 108% of long-term average and above 2010, which was 98% of long-term

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### Management's Discussion and Analysis

December 31, 2011 and 2010

(Unaudited)

average. Combined net generation of the fossil fuel plants for 2011 was 6.3 million MWh or 36% higher than 2010 (4.6 million MWh) with the bulk of the 1.7 million MWh increase attributable to the commercial start of AEII (1.5 million MWh).

The following is a summary of the Authority's balance sheets for 2011, 2010, and 2009:

#### Summary Balance Sheets

(In millions)

	2011	2010	2009	2011 vs. 2010	2010 vs. 2009
Current assets	\$ 1,809	1,636	1,396	11%	17%
Capital assets	4,910	3,697	3,711	33	0
Other noncurrent assets	2,316	2,288	2,203	1	4
Total assets	<u>9,035</u>	<u>7,621</u>	<u>7,310</u>	19	4
Current liabilities	\$ 982	938	830	5	13
Long-term liabilities	4,758	3,682	3,660	29	1
Total liabilities	<u>5,740</u>	<u>4,620</u>	<u>4,490</u>	24	3
Net assets	<u>3,295</u>	<u>3,001</u>	<u>2,820</u>	10	6
Total liabilities and net assets	<u>\$ 9,035</u>	<u>7,621</u>	<u>7,310</u>	19	4

The following summarizes the Authority's balance sheet variances for the years 2011 and 2010:

In 2011, current assets increased by \$173 million (11%) to \$1,809 million primarily due to increases in investments (\$127 million) reflecting the investment of cash generated by operations; cash (\$15 million); and deferred outflows (\$31 million). Capital assets increased by \$1,213 million (33%) to \$4,910 million primarily due to the capitalization of lease payments related to AEII (\$1,241 million) in July 2011. Current liabilities increased by \$44 million (5%) to \$982 million primarily due to changes in fair market values related to the Authority's energy commodity hedging transactions (\$31 million) and an increase in short-term debt (\$51 million) relating to the Authority's Energy Services programs offset by a decrease in long-term debt due within one year (\$39 million). Long-term liabilities increased by \$1,076 million (29%) to \$4,758 million primarily due to the capitalized lease obligation relating to AEII (\$1,225 million) and an increase in the nuclear plant decommissioning obligation (\$58 million) offset by decreases in long-term debt resulting from reclassifications to long-term debt due within one year and early termination of debt (\$145 million) and a decrease in liabilities related to risk management activities – derivatives (\$54 million). The increase in the nuclear plant decommissioning obligation reflects the increase in the market value of the decommissioning fund (i.e., the Authority's obligation is limited to no more than the amount in the decommissioning fund and therefore the liability increases or decreases to reflect the fair value of the decommissioning fund). (See note 11(c) for more information on decommissioning.) The changes in net assets for 2011 and 2010 are discussed in the summary of revenues, expenses and changes in net assets in this Management's Discussion and Analysis.

In 2010, current assets increased by \$240 million (17%) to \$1,636 million primarily due to an increase in investments (\$204 million) reflecting the investment of cash generated by operations. Capital assets decreased by \$14 million (0.4%) to \$3,697 million primarily due to annual depreciation (\$163 million) substantially offset by an increase in plant assets which includes Life Extension and Modernization programs at St. Lawrence and Blenheim-Gilboa (B-G) (\$154 million). Other noncurrent assets increased by \$85 million (4%) to \$2,288 million primarily due to an increase in the market value of the nuclear decommissioning fund (\$90 million). Current liabilities increased by \$108 million (13%) to \$938 million primarily due to changes in fair market values related to the Authority's energy commodity hedging transactions (\$65 million) and an increase in short-term debt (\$34 million) relating to the Authority's Energy Services programs. Long-term liabilities increased by \$22 million (1%) to \$3,682 million primarily due to increases in other long-term liabilities (\$140 million) which includes an increase in the nuclear plant decommissioning obligation (\$90 million) offset by decreases in long-term debt resulting from reclassifications to long-term debt due within one year (\$121 million). The increase in the nuclear plant decommissioning obligation reflects the increase in the market value of the decommissioning fund (i.e., the Authority's obligation is limited to no more than the amount in the decommissioning fund and therefore the liability increases or decreases to reflect the fair value

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## Management's Discussion and Analysis

December 31, 2011 and 2010

(Unaudited)

of the decommissioning fund). (See note 11(c) for more information on decommissioning.) The changes in net assets for 2011 and 2010 are discussed in the summary of revenues, expenses and changes in net assets in this Management's Discussion and Analysis.

**Capital Asset and Long-Term Debt Activity**

The Authority currently estimates that it will expend approximately \$1,020 million for various capital improvements over the five-year period 2012-2016. The Authority anticipates that these expenditures will be funded using existing construction funds, internally generated funds and additional borrowings. Such additional borrowings are expected to be accomplished through the issuance of additional commercial paper notes and/or the issuance of long-term fixed rate debt. Projected capital requirements during this period include (in millions):

## Projects:

Plant Modernization Program (Lewiston Pump Generating Plant, St. Lawrence)	\$	260
MA1 and MA2 Transmission Line		113
Switchyard Modernization Program (St. Lawrence, Niagara, Clark Energy Center)		83
Stator Rewind and Restack Projects (Niagara, St. Lawrence)		55
Relicensing Compliance/Implementation (B-G, Niagara, St. Lawrence)		51
Quick Start Modification Projects (500 MW, SCPP)		39
St. Lawrence Synchronous Condenser Refurbishment		27
500 MW Spare Rotor		22
Replacement of Superstructure Bridges at RMNPP		22
IT Initiatives		20
St. Lawrence Generator Step-up Transformer Replacement		18
Niagara Relay Replacement Program		10
Other (projects less than \$9 million)		300
	\$	<u>1,020</u>

In addition, the Authority's capital plan includes the provision of \$960 million in financing for Energy Services and Technology projects to be undertaken by the Authority's governmental customers and other public entities in the State. It should also be noted that due to projects currently under review as well as energy initiatives announced in the Governor's State of the State address, there is a potential for significant increases in the capital expenditures indicated in the table above. Such additional capital expenditures would be subject to evaluation and Trustee approval.

In June 2010, the Authority's Trustees approved a \$460 million Life Extension and Modernization ("LEM") Program at the Lewiston Pump-Generating Plant. The work to be done includes a major overhaul of the plant's 12 pump turbine generator units. The LEM Program will increase pump and turbine efficiency, operating efficiency, and the peaking capacity of the overall Niagara Project. The Authority intends to file an application with the Federal Energy Regulatory Commission (FERC) for a non-capacity license amendment in connection with the program. The unit work is scheduled to begin in late 2012, with the final unit being completed in 2020.

By order issued March 15, 2007, FERC issued the Authority a new 50-year license for the Niagara Project effective September 1, 2007. In doing so, FERC approved six relicensing settlement agreements entered into by the Authority with various public and private entities. By decision dated March 13, 2009, the U.S. Court of Appeals for the District of Columbia Circuit denied a petition for review of FERC's order filed by certain entities, thereby concluding all litigation involving FERC's issuance of the new license. The Authority currently expects that the costs associated with the relicensing of the Niagara Project will be at least \$495 million over a period of 50 years, which includes \$50.5 million in administrative costs associated with the relicensing effort and does not include the value of the power allocations and operation and maintenance expenses associated with several habitat and recreational elements of the settlement agreements. Of the \$495 million, \$218 million has been spent through December 31, 2011.

In addition to internally generated funds, the Authority issued additional debt obligations in October 2007 to fund, among other things, Niagara relicensing costs. The costs associated with the relicensing of the Niagara Project, including the debt issued therefore, were incorporated into the cost-based rates of the Project beginning in 2007.

**NEW YORK POWER AUTHORITY**

## Management's Discussion and Analysis

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(Unaudited)

More detailed information about the Authority's capital assets is presented in notes 2 and 5 to the financial statements.

**Capital Structure**

	<u>2011</u>	<u>2010</u>	<u>2009</u>
		(In millions)	
Long-term debt:			
Senior:			
Revenue bonds	\$ 1,064	1,111	1,154
Adjustable rate tender notes	115	122	131
Subordinated:			
Commercial paper	173	264	330
Total long-term debt	<u>1,352</u>	<u>1,497</u>	<u>1,615</u>
Net assets	<u>3,295</u>	<u>3,001</u>	<u>2,820</u>
Total capitalization	<u>\$ 4,647</u>	<u>4,498</u>	<u>4,435</u>

In July 2011, the Authority's Trustees authorized the issuance of up to \$341 million of additional revenue bonds for the purpose of refunding certain revenue bonds and commercial paper and/or extendible commercial paper notes. In September 2011, the Authority issued \$108.4 million of Series 2011 A Revenue Bonds (2011 Bonds). The proceeds from the issuance of the 2011 Bonds and cash-on-hand were used to (i) refund \$77.2 million of the Authority's Series 2000 A Revenue Bonds; (ii) defease \$41.7 million of the Authority's Series 2002 A Revenue Bonds; and (iii) pay financing and other costs relating to the issuance of the 2011 Bonds.

During 2011, taking into account the issuance of the 2011 Bonds for the refunding of certain bonds, long-term debt, net of current maturities, decreased by \$145 million primarily due to scheduled maturities, early extinguishments of debt other than the refunded debt and cash funding of capital expenditures.

During 2010, long-term debt, net of current maturities, decreased by \$118 million primarily due to scheduled maturities and cash funding of capital expenditures.

Total Debt to Equity as of December 31, 2011, decreased to .55-to-1 from .65-to-1 as of December 31, 2010. Total debt as of December 31, 2011 (\$1.81 billion) is at its lowest level since December 31, 1975 (\$1.64 billion).

**NEW YORK POWER AUTHORITY**

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**Debt Ratings**

	<u>Moody's</u>	<u>Standard &amp; Poor's</u>	<u>Fitch</u>
NYPA's underlying credit ratings:			
Senior debt:			
Long-term debt	Aa2	AA-	AA
Adjustable rate tender notes	Aa2/VMIG1	AA-/A-1+	N/A
Subordinate debt:			
Commercial paper	P-1	A-1	F1+
Municipal bond insurance support ratings:			
Senior debt:			
Series 2007 A, B and C Revenue Bonds due 2013 to 2047	Aa2*	AA-*	AA*
Series 2006 A Revenue Bonds due 2012 to 2020	Aa2*	AA-*	AA*
Series 2003 A Revenue Bonds due 2012 to 2033	Aa2*	AA-*	AA*

The Authority has a \$550 million line of credit with a syndicate of banks supporting the Commercial Paper Notes which line expires January 20, 2014. More detailed information about the Authority's debt is presented in note 6 to the financial statements.

In September 2011, Moody's Investor Service, Inc., Standard & Poor's Rating Service and Fitch Ratings affirmed the Authority's senior and subordinate debt ratings.

In November 2011, S&P downgraded Assured Guaranty Municipal Corp's AA+ rating (formerly Financial Security Assurance Inc.) to AA-. All other bond insurers' ratings are no longer above the Authority's underlying rating and/or are no longer rated. Consequently, the insured bonds carry the Authority's underlying rating denoted by an asterisk (\*) after the rating set forth in the table above.

The impact of the bond insurers' credit downgrades on the market value of the Authority's insured bonds was not discernible because of the Authority's strong underlying ratings.

**Risk Management**

The objective of the Authority's risk management program is to manage the impact of interest rate, energy commodity price and fuel cost volatility on its earnings and cash flows. To achieve these objectives, the Authority's Trustees have authorized the use of various interest rate, energy-price and fuel-price forward instruments for hedging purposes. In addition, the Authority also has a program designed to assess and manage enterprise-wide risk across the Authority.

The Vice President and Chief Risk Officer reports to the Executive Vice President and Chief Financial Officer and is responsible for establishing procedures for identifying, reporting and controlling energy commodity exposure and risk exposure connected with enterprise-wide risk.

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act ("DF Act") which addresses almost every aspect of the financial services industry. Among other things, the DF Act addresses forward interest rate and energy transactions of the type in which the Authority engages, and many of the requirements and processes in this area are expected to be set forth in regulations promulgated by the Commodities Futures Trading Commission in the coming months. Depending on the ultimate resolution of numerous issues, which is uncertain, including whether and to what extent forward transactions are required to be cleared through clearinghouses and/or traded on exchanges with accompanying collateral and/or margin requirements; whether and to what extent forward transactions entered into prior to the enactment of the DF Act are required to be collateralized; and whether and to what extent public power entities such as the Authority are exempted from these requirements, the impact of the DF Act on the Authority's liquidity and/or future risk mitigation activities could be significant. In the event such regulations are applied retroactively to forward positions

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predating the enactment of the DF Act, it could require the Authority to post as much as \$185 million in collateral to maintain its open hedge positions as of July 16, 2012 (the revised, full-implementation date adopted by the CFTC in December 2011). The Authority has sufficient liquidity to post such collateral, if required.

### Economic Conditions

The Authority operates in a competitive and sometimes volatile market environment. Volatility in the energy market has, in previous years, unfavorably impacted the Authority in its role as a buyer and has resulted in higher costs of purchased power and fuel in its NYC Governmental Customer and other market areas. The NYC Governmental Customer market cost situation is mitigated by the cost recovery provisions in the long-term supplemental electricity supply agreements and generation from the Authority's 500-MW plant and AEII. Wholesale electricity prices, which declined towards the 2008 year-end reflecting weaknesses in the economy and in commodity prices, continued at relatively low levels in 2010 and 2011 resulting in lower costs of purchased power and fuel, but also unfavorably impacted the Authority in its role as a seller in the electricity market.

According to the National Bureau of Economic Research, a recession in the United States began in December 2007 and ended in June 2009. However, the economy continues to grow slowly and unemployment is high. Forecasted recovery time for these economic conditions range from a few to many years. In this environment, the Authority has continued to utilize its financial flexibility to support its mission and its customers. In December 2010, the Governor approved long-term contract extensions for the continued supply of low-cost hydropower to more than 100 of Western New York's leading companies. These expansion and replacement power customers, who account for more than 70 percent of the manufacturing jobs in the region, are integral to the area's economy with wide-ranging impacts associated with spinoff jobs, payments to suppliers for goods and services, local tax revenues and financial support of local communities and organizations.

In response to the economic downturn's effects on New York's manufacturing sector, the Authority's Trustees in March 2009 approved execution of an agreement with Alcoa, Inc. to provide temporary relief from certain power sales contract provisions relating to the temporary shutdown of one of its two smelters served by the Authority in Massena, New York, including allowing Alcoa to release back to the Authority certain hydropower allocated to it, temporary waivers of certain minimum bill and employment thresholds, and entry into arrangements with the Authority for inclusion of a portion of Alcoa's load in the NYISO's demand response programs. In addition, in May 2009, the Authority's Trustees authorized a temporary program whereby up to \$10 million would be utilized to provide electric bill discounts for up to a year to businesses located in Jefferson, St. Lawrence, and Franklin counties. These counties constitute the geographic region served by the Authority's Preservation Power program. The source of the \$10 million was the net margin resulting from the sale of a portion of Alcoa's currently unused Preservation Power allocation into the NYISO markets. In September 2010, the Authority's Trustees approved extension of the electric bill discount program for the lesser of one year or the duration of the temporary curtailment of operations at the affected Alcoa facility. During the first quarter of 2011, Alcoa restarted the temporarily curtailed facility and the associated bill discount program ceased shortly thereafter.

In March 2009, the Authority's Trustees approved the deferral for recovery in the future of a proposed hydropower rate increase for the Authority's municipal electric and rural cooperative customers, neighboring state municipal customers, upstate investor-owned utilities, and certain other customers that was scheduled to go into effect on May 1, 2009; and in August 2010, the Authority announced an extension of such deferral through the end of 2010. In November 2011, the Authority's Trustees approved a 41-month rate plan providing for certain phased-in increases to these rates and the Trustees also approved commencement of rate recovery of the deferred amount. Further, in March 2009, the Authority also suspended the application of two annual, contractually-indexed hydropower rate increases for its Replacement Power, Expansion Power, and certain other industrial customers that were scheduled to go into effect on May 1, 2009 and May 1, 2010, respectively, totaling approximately \$6.9 million. The Authority's Trustees in July 2011 approved the reinstatement of these indexed rate adjustments, resulting in an increase in these rates effective September 1, 2011 in the annualized amount of approximately \$5.3 million.

The Authority is requested, from time to time, to make financial contributions or transfers of funds to the State. Any such contribution or transfer of funds must (i) be authorized by State legislation (generally budget legislation), and (ii) satisfy the requirements of the Authority's Bond Resolution. The Bond Resolution requirements to withdraw moneys "free and clear of the lien and pledge created by the [Bond] Resolution" are as follows: (1) such withdrawal must be for a "lawful corporate purpose as determined by the Authority," and (2) the Authority must determine "taking into account, among other considerations, anticipated future receipt of Revenues or other moneys constituting part of the Trust Estate, that the funds to be so withdrawn are not needed" for (a) payment of reasonable and necessary operating expenses, (b) an Operating Fund reserve for working capital, emergency repairs or replacements, major renewals, or for

## NEW YORK POWER AUTHORITY

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retirement from service, decommissioning or disposal of facilities, (c) payment of, or accumulation of a reserve for payment of, interest and principal on senior debt, or (d) payment of interest and principal on subordinate debt.

Legislation enacted into law, as part of the 2000-2001 State budget, as amended in subsequent years, has authorized the Authority "as deemed feasible and advisable by the trustees," to make a series of "voluntary contributions" into the State treasury in connection with the Power for Jobs (PFJ) Program and for other purposes as well. Beginning December 2002 through January 2012, the Authority has made voluntary contributions to the State of \$469 million in connection with the Power for Jobs Program with another \$6 million authorized for payment in the first quarter of 2012, and an additional \$402 million unrelated to the Power for Jobs Program. The 2011 (\$65 million) and the 2010 (\$147 million) contributions to the State which are not related to the PFJ Program were recorded as nonoperating expenses and classified as contributions to New York State in the 2011 and 2010 statements of revenues, expenses and changes in net assets, respectively. The \$60 million paid in January 2012 will be reported as a nonoperating expense in the 2012 financial statements. In the Governor's proposed budget for State Fiscal Year 2012-2013, released in January 2012, it is proposed that the Authority be authorized to make an additional voluntary contribution of up to \$65 million unrelated to the Power for Jobs Program during such fiscal year. The proposed budget has not yet been enacted into law. Such contributions will only be made if approved by the Authority's Trustees as feasible and advisable at that time. See notes 12(a) and 12(g), "Recharge New York Power Program," for a discussion of recent legislative activity involving the State Fiscal Year 2012-2013 budget, the PFJ Program, and related matters.

By budget legislation enacted in February 2009, the Authority was further authorized to make certain temporary asset transfers to the State of reserve funds. Pursuant to the terms of a Memorandum of Understanding dated February 2009 (MOU) between the State, acting by and through the Director of Budget of the State, and the Authority, the Authority agreed to transfer \$215 million associated with its Spent Nuclear Fuel Reserves (Asset B) by the end of State Fiscal Year 2008-2009. The Spent Nuclear Fuel Reserves are funds that have been set aside for the liability to the federal government sometime in the future when the federal government accepts the spent nuclear fuel for permanent storage. The MOU provides for the return of these funds to the Authority, subject to appropriation by the State Legislature and the other conditions described below, at the earlier of the Authority's payment obligation related to the transfer and disposal of the spent nuclear fuel or September 30, 2017. Further, the MOU provides for the Authority to transfer during State Fiscal Year 2009-2010 \$103 million of funds set aside for future construction projects (Asset A), which amounts would be returned to the Authority, subject to appropriation by the State Legislature and the other conditions described below, at the earlier of when required for operating, capital or debt service obligations of the Authority or September 30, 2014. Both transfers were approved by the Authority's Trustees and made in 2009.

The MOU provides that the obligation of the State to return all or a portion of an amount equal to the moneys transferred by the Authority to the State would be subject to annual appropriation by the State Legislature. Further, the MOU provides that as a condition to any such appropriation for the return of the monies earlier than September 30, 2017 for the Spent Nuclear Fuel Reserves and earlier than September 30, 2014 for the construction projects, the Authority must certify that the monies available to the Authority are not sufficient to satisfy the purposes for which the reserves were established.

The Authority classified the transfers of Asset A and Asset B (\$318 million) as a long-term loan receivable. In lieu of interest payments, the State waived certain future payments from the Authority to the State. The waived payments include the Authority's obligation to pay until September 30, 2017 the amounts to which the State is entitled under a governmental cost recovery process for the costs of central governmental services. These payments would have been approximately \$5 million per year based on current estimates but the waiver will be limited to a maximum of \$45 million in the aggregate during the period. Further, the obligation to make payments in support of certain State park properties and for the upkeep of State lands adjacent to the Niagara and St. Lawrence power plants will be waived from April 1, 2011 to March 31, 2017. These payments would have been approximately \$8 million per year but the waiver will be limited to a maximum of \$43 million for the period. The present value of the waivers approximates the present value of the lost interest income on the transferred reserve funds.

### Contacting the Authority

This financial report is designed to provide our customers and other interest parties with a general overview of the Authority's finances. If you have any questions about this report or need additional financial information, contact the New York Power Authority, 123 Main Street, White Plains, New York 10601-3107.

## NEW YORK POWER AUTHORITY

## Balance Sheets

December 31, 2011 and 2010

(In millions)

<b>Assets and Deferred Outflows</b>	<b>2011</b>	<b>2010</b>
Current assets and deferred outflows:		
Cash and cash equivalents	\$ 65	50
Investment in securities	1,159	1,032
Interest receivable on investments	6	6
Accounts receivable	190	212
Materials and supplies:		
Plant and general	80	75
Fuel	23	15
Miscellaneous receivables and other	169	160
Deferred outflows	117	86
<b>Total current assets</b>	<b>1,809</b>	<b>1,636</b>
Noncurrent assets and deferred outflows:		
Restricted funds:		
Cash and cash equivalents	20	20
Investment in securities	1,147	1,096
<b>Total restricted funds</b>	<b>1,167</b>	<b>1,116</b>
Capital funds:		
Cash and cash equivalents	5	17
Investment in securities	93	130
<b>Total capital funds</b>	<b>98</b>	<b>147</b>
Capital assets:		
Capital assets not being depreciated	288	273
Capital assets, net of accumulated depreciation	4,622	3,424
<b>Total capital assets</b>	<b>4,910</b>	<b>3,697</b>
Other noncurrent assets and deferred outflows:		
Unamortized debt expense	13	15
Regulatory assets - risk management activities	34	34
Due from New York State	318	318
Deferred charges, long-term receivables and other	541	445
Notes receivable – nuclear plant sale	53	68
Deferred outflows	92	145
<b>Total other noncurrent assets</b>	<b>1,051</b>	<b>1,025</b>
<b>Total noncurrent assets</b>	<b>7,226</b>	<b>5,985</b>
<b>Total assets</b>	<b>\$ 9,035</b>	<b>7,621</b>

## NEW YORK POWER AUTHORITY

## Balance Sheets

December 31, 2011 and 2010

(In millions)

Liabilities and Net Assets	2011	2010
Current liabilities:		
Accounts payable and accrued liabilities	\$ 404	408
Short-term debt	374	323
Long-term debt due within one year	82	121
Capital lease obligation due within one year	5	—
Risk management activities - derivatives	117	86
Total current liabilities	<u>982</u>	<u>938</u>
Noncurrent liabilities:		
Long-term debt:		
Senior:		
Revenue bonds	1,064	1,111
Adjustable rate tender notes	115	122
Subordinated:		
Commercial paper	173	264
Total long-term debt	<u>1,352</u>	<u>1,497</u>
Other noncurrent liabilities:		
Capital lease obligation	1,225	—
Liability to decommission divested nuclear facilities	1,090	1,032
Disposal of spent nuclear fuel	216	216
Relicensing	329	335
Deferred credits and other	414	416
Risk management activities - derivatives	132	186
Total other noncurrent liabilities	<u>3,406</u>	<u>2,185</u>
Total noncurrent liabilities	<u>4,758</u>	<u>3,682</u>
Total liabilities	<u>5,740</u>	<u>4,620</u>
Net assets:		
Invested in capital assets, net of related debt	1,821	1,748
Restricted	32	34
Unrestricted	1,442	1,219
Total net assets	<u>3,295</u>	<u>3,001</u>
Total liabilities and net assets	<u>\$ 9,035</u>	<u>7,621</u>

See accompanying notes to financial statements.

## NEW YORK POWER AUTHORITY

## Statements of Revenues, Expenses, and Changes in Net Assets

Years ended December 31, 2011 and 2010

(In millions)

	<u>2011</u>	<u>2010</u>
Operating revenues:		
Power sales	\$ 1,960	1,889
Transmission charges	147	151
Wheeling charges	548	528
Total operating revenues	<u>2,655</u>	<u>2,568</u>
Operating expenses:		
Purchased power	854	931
Fuel oil and gas	258	224
Wheeling	548	528
Operations	420	350
<b>Maintenance</b>	<b>99</b>	<b>93</b>
Depreciation	194	163
Total operating expenses	<u>2,373</u>	<u>2,289</u>
Operating income	<u>282</u>	<u>279</u>
Nonoperating revenues and expenses:		
Nonoperating revenues:		
Investment income	37	41
Other income	108	97
Total nonoperating revenues	<u>145</u>	<u>138</u>
Nonoperating expenses:		
Contributions to New York State	65	147
Interest on long-term debt	71	75
Interest - other	63	21
Interest capitalized	(4)	(4)
Amortization of debt premium	(3)	(3)
Total nonoperating expenses	<u>192</u>	<u>236</u>
Nonoperating loss	<u>(47)</u>	<u>(98)</u>
Net income before contributed capital	235	181
<b>Contributed capital - Wind farm transmission assets</b>	<b>59</b>	<b>—</b>
Change in net assets	294	181
Net assets at January 1	<u>3,001</u>	<u>2,820</u>
Net assets at December 31	<u>\$ 3,295</u>	<u>3,001</u>

See accompanying notes to financial statements.

**NEW YORK POWER AUTHORITY**  
 Statements of Cash Flows  
 Years ended December 31, 2011 and 2010  
 (In millions)

	<u>2011</u>	<u>2010</u>
Cash flows from operating activities:		
Received from customers for the sale of power, transmission and wheeling	\$ 2,672	2,531
Disbursements for:		
Purchased power	(849)	(930)
Fuel oil and gas	(272)	(213)
Wheeling of power by other utilities	(581)	(512)
Operations and maintenance	(558)	(449)
<b>Net cash provided by operating activities</b>	<u>412</u>	<u>427</u>
Cash flows from capital and related financing activities:		
Issuance of series 2011 A bonds	108	—
<b>Earnings received on capital fund investments</b>	<b>3</b>	<b>4</b>
Issuance of commercial paper	3	4
Repayment of notes	(8)	(8)
<b>Retirement of bonds</b>	<b>(118)</b>	<b>(40)</b>
<b>Defeasance of series 2002 A bonds</b>	<b>(42)</b>	<b>—</b>
Repayment of commercial paper	(135)	(80)
Gross additions to capital assets	(109)	(80)
Sale of Tri-Lakes transmission assets	33	—
Interest paid, net	(70)	(74)
<b>Net cash used in capital and related financing activities</b>	<u>(335)</u>	<u>(274)</u>
Cash flows from noncapital – related financing activities:		
Energy conservation program payments received from participants	112	123
Energy conservation program costs	(176)	(139)
Issuance of commercial paper	163	159
Repayment of commercial paper	(113)	(125)
Interest paid on commercial paper	(1)	(1)
<b>Contribution to OPEB trust fund</b>	<b>(40)</b>	<b>—</b>
Contributions to New York State	(73)	(160)
DOE settlement	11	—
Entergy value sharing agreement	72	72
Entergy notes receivable	30	30
<b>Net cash used in noncapital – related financing activities</b>	<u>(15)</u>	<u>(41)</u>
Cash flows from investing activities:		
Earning received on investments	24	28
Purchase of investment securities	(7,728)	(5,852)
Sale of investment securities	7,645	5,682
<b>Net cash used in investing activities</b>	<u>(59)</u>	<u>(142)</u>
<b>Net increase (decrease) in cash</b>	<b>3</b>	<b>(30)</b>
Cash and cash equivalents, January 1	<u>87</u>	<u>117</u>
Cash and cash equivalents, December 31	<u>\$ 90</u>	<u>87</u>
Reconciliation to net cash provided by operating activities:		
Operating income	\$ 282	279
Adjustments to reconcile operating income to net cash provided by operating activities:		
Provision for depreciation	194	163
Change in assets and liabilities:		
Net decrease in prepayments and other	12	1
Net decrease/(increase) in receivables and inventory	9	(15)
Net decrease in accounts payable and accrued liabilities	(85)	(1)
<b>Net cash provided by operating activities</b>	<u>\$ 412</u>	<u>427</u>
<b>Supplemental disclosures for noncash transactions:</b>		
New capital lease/ debt agreements	<u>\$ 1,225</u>	<u>—</u>

See accompanying notes to financial statements.

## NEW YORK POWER AUTHORITY

### Notes to Financial Statements

December 31, 2011 and 2010

#### (1) General

The Power Authority of the State of New York (Authority), doing business as The New York Power Authority, is a corporate municipal instrumentality and political subdivision of the State of New York (State) created in 1931 by Title 1 of Article 5 of the Public Authorities Law, Chapter 43-A of the Consolidated Laws of the State, as amended (Power Authority Act or Act).

The Authority is authorized by the Power Authority Act to help provide a continuous and adequate supply of dependable electricity to the people of the State. The Authority generates, transmits and sells electricity principally at wholesale. The Authority's primary customers are municipal and rural cooperative electric systems, investor-owned utilities, high-load-factor industries and other businesses, various public corporations located within the metropolitan area of New York City, including The City of New York, and certain out-of-state customers.

The Authority's Trustees are appointed by the Governor of the State, with the advice and consent of the State Senate. The Authority is a fiscally independent public corporation that does not receive State funds or tax revenues or credits. It generally finances construction of new projects through sales of bonds and notes to investors and pays related debt service with revenues from the generation and transmission of electricity. Accordingly, the financial condition of the Authority is not controlled by or dependent on the State or any political subdivision of the State. However, pursuant to the Clean Water/Clean Air Bond Act of 1996 (Bond Act), the Authority administers a Clean Air for Schools Projects program, for which \$125 million in Bond Act monies have been allocated for effectuation of such program. Also, in accordance with legislation enacted in 2006, the Authority was appropriated \$25 million to implement the Lower Manhattan Energy Independence Initiative involving certain clean energy and energy efficiency measures. Under the criteria set forth in Governmental Accounting Standards Board (GASB) Statement No. 14, *The Financial Reporting Entity*, as amended by Governmental Accounting Standard (GAS) No. 39, *Determining Whether Certain Organizations Are Component Units* and GAS No. 61, *The Financial Reporting Entity: Omnibus--an amendment of GASB Statements No. 14 and No. 34*, the Authority considers its relationship to the State to be that of a related organization.

Income of the Authority and properties acquired by it for its projects are exempt from taxation. However, the Authority is authorized by Chapter 908 of the Laws of 1972 to enter into agreements to make payments in lieu of taxes with respect to property acquired for any project where such payments are based solely on the value of the real property without regard to any improvement thereon by the Authority and where no bonds to pay any costs of such project were issued prior to January 1, 1972.

#### (2) Summary of Significant Accounting Policies

The Authority's significant accounting policies include the following:

##### (a) General

The Authority complies with all applicable pronouncements of the GASB. In accordance with GAS No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Authority also has elected to comply with all authoritative pronouncements applicable to nongovernmental entities (i.e., Accounting Standards Codification (ASC) of the Financial Accounting Standards Board) that do not conflict with GASB pronouncements. The Authority also applies the standard that allows utilities to capitalize or defer certain costs or revenues based on management's ongoing assessment that it is probable these items will be recovered or reflected in the rates charged for electricity. The operations of the Authority are presented as an enterprise fund following the accrual basis of accounting in order to recognize the flow of economic resources. Under this basis, revenues are recognized in the period in which they are earned and expenses are recognized in the period in which they are incurred.

##### (b) Accounting for the Effects of Rate Regulation

The Authority is subject to the provisions of ASC Topic 980, Regulated Operations (FAS No. 71, Accounting for the Effects of Certain Types of Regulation). These provisions recognize the economic ability of regulators, through the ratemaking process, to create future economic benefits and obligations affecting rate-regulated companies. Accordingly, the Authority records these future economic benefits and obligations as regulatory assets and regulatory liabilities, respectively.

Regulatory assets represent probable future revenues associated with previously incurred costs that are expected to be recovered from customers. Regulatory liabilities represent probable future reductions in revenues associated with amounts that are expected to be refunded to customers through the ratemaking process.

## NEW YORK POWER AUTHORITY

### Notes to Financial Statements

December 31, 2011 and 2010

In order for a rate-regulated entity to continue to apply the provisions of ASC Topic 980, it must continue to meet the following three criteria: (1) the enterprise's rates for regulated services provided to its customers must be established by an independent third-party regulator or its own governing board empowered by a statute to establish rates that bind customers; (2) the regulated rates must be designed to recover the specific enterprise's costs of providing the regulated services; and (3) in view of the demand for the regulated services and the level of competition, it is reasonable to assume that rates set at levels that will recover the enterprise's costs can be charged to and collected from customers.

Based upon the Authority's evaluation of the three criteria discussed above in relation to its operations, and the effect of competition on its ability to recover its costs, the Authority believes that the provisions of ASC Topic 980 continue to apply.

**(c) Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**(d) Capital Assets**

Capital assets are recorded at original cost and consist of amounts expended for labor, materials, services and indirect costs to license, construct, acquire, complete and place in operation the projects of the Authority. Interest on amounts borrowed to finance construction of the Authority's projects is charged to the project prior to completion. Borrowed funds for a specific construction project are deposited in a capital fund account. Earnings on fund investments are held in this fund to be used for construction. Earnings on unexpended funds are credited to the cost of the related project (construction work in progress) until completion of that project. Construction work in progress costs are reduced by revenues received for power produced (net of expenditures incurred in operating the projects) prior to the date of completion. The costs of current repairs are charged to operating expense, and renewals and betterments are capitalized. The cost of capital assets retired less salvage is charged to accumulated depreciation. Depreciation of capital assets is generally provided on a straight-line basis over the estimated lives of the various classes of capital assets.

The related depreciation provisions at December 31, 2011 and 2010 expressed as a percentage of average depreciable capital assets on an annual basis are:

	Average depreciation rate	
	2011	2010
Type of plant:		
Production:		
Hydro	2.0%	1.9%
Gas turbine/combined cycle	3.2	3.5
Transmission	2.4	2.6
General	3.7	3.3
	2.8%	2.7%

**(e) Asset Retirement Obligation**

The Authority applies the applicable provisions of ASC Topic 410 Asset Retirement and Environmental Obligations (FAS No. 143, Accounting for Asset Retirement Obligations) which requires an entity to record a liability at fair value to recognize legal obligations for asset retirements in the period incurred and to capitalize the cost by increasing the carrying amount of the related long-lived asset. The Authority determined that it had legal liabilities for the retirement of certain Small Clean Power Plants (SCPPs) in New York City and, accordingly, has recorded a liability for the retirement of this asset. In connection with these legal obligations, the Authority has also recognized a liability for the remediation of certain contaminated soils discovered during the construction process.

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ASC Topic 410 does not apply to asset retirement obligations involving pollution remediation obligations that are within the scope of GAS No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. The Authority applies GAS No. 49 which, upon the occurrence of any one of five specified obligating events, requires an entity to estimate the components of expected pollution remediation outlays and determine whether outlays for those components should be accrued as a liability or, if appropriate, capitalized when goods and services are acquired. The Authority had no liabilities recorded related to GAS No. 49 at December 31, 2011 or 2010.

In addition to asset retirement obligations, the Authority has other cost of removal obligations that are being collected from customers and accounted for under the provisions of ASC Topic 980. The balances of these other cost of removal obligations as of December 31, 2011 and 2010 were approximately \$235 million and \$228 million, respectively, and are recorded in other noncurrent liabilities on the balance sheets.

Asset retirement obligations (ARO) and cost of removal obligation amounts included in other noncurrent liabilities are as follows:

	<b>ARO amounts</b>	<b>Cost of removal obligation</b>
	(In millions)	
Balance – December 31, 2010	\$ 22	228
Depreciation expense	—	7
	\$ 22	235
Balance – December 31, 2011	\$ 22	235

**(f) Long Lived Assets**

The Authority applies GAS No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, which states that asset impairments are generally recognized only when the service utility of an asset is reduced or physically impaired.

GAS No. 42 states that asset impairment is a significant, unexpected decline in the service utility of a capital asset. The service utility of a capital asset is the usable capacity that at acquisition was expected to be used to provide service, as distinguished from the level of utilization which is the portion of the usable capacity currently being used. Decreases in utilization and existence of or increases in surplus capacity that are not associated with a decline in service utility are not considered to be impairments.

**(g) Cash, Cash Equivalents and Investments**

Cash includes cash and cash equivalents and short-term investments with maturities, when purchased, of three months or less. The Authority accounts for investments at their fair value. Fair value is determined using quoted market prices. Investment income includes changes in the fair value of these investments. Realized and unrealized gains and losses on investments are recognized as investment income in accordance with GAS No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*.

**(h) Derivative Instruments**

The Authority uses financial derivative instruments to manage the impact of interest rate, energy price and fuel cost changes on its earnings and cash flows. The Authority recognizes the fair value of all derivative instruments as either an asset or liability on its balance sheets with the offsetting gains or losses recognized in earnings or deferred charges. The Authority applies GAS No. 53, *Accounting and Financial Reporting for Derivative Instruments*, which establishes accounting and reporting requirements for derivative instruments.

**(i) Accounts Receivable**

Accounts receivable are classified as current assets and are reported net of an allowance for uncollectible amounts.

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**(j) *Materials and Supply Inventory***

Material and supplies are valued at weighted average cost and are charged to expense during the period in which the material or supplies are used.

**(k) *Deferred Charges***

At December 31, 2011 and 2010, deferred charges include \$141 million and \$146 million, respectively, of energy services program costs. These deferred costs will be recovered from certain customers through the terms of contracts.

**(l) *Deferred Debt Refinancing Charges***

Debt refinancing charges, representing the difference between the reacquisition price and the net carrying value of the debt refinanced, are amortized using the interest method over the life of the new debt or the old debt, whichever is shorter, in accordance with GAS No. 23, *Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities*.

**(m) *Compensated Absences***

The Authority accrues the cost of unused sick leave which is payable upon the retirement of its employees. The current year's cost is accounted for as a current operating expense in the statement of revenues, expenses, and changes in net assets and in other noncurrent liabilities on the balance sheets.

**(n) *Net Assets***

Net Assets represent the difference between assets and liabilities and are classified into three categories:

- a. Investment in Capital Assets, Net of Related Debt – This reflects the net assets of the Authority that are invested in capital assets, net of related debt and accounts. This indicates that these assets are not accessible for other purposes.
- b. Restricted Net Assets – This represents the net assets that are not accessible for general use because their use is subject to restrictions enforceable by third parties.
- c. Unrestricted Net Assets – This represents the net assets that are available for general use.

Restricted and unrestricted resources are utilized, as applicable, by the Authority for their respective purposes.

**(o) *Revenues***

Revenues are recorded when power is delivered or service is provided. Customers' meters are read, and bills are rendered, monthly. Wheeling charges are for costs incurred for the transmission of power over transmission lines owned by other utilities. Sales and purchases of power between the Authority's facilities are eliminated from revenues and operating expenses. Energy costs are charged to expense as incurred. Sales to the Authority's five (5) largest customers (three governmental customers and two investor-owned utilities) operating in the State accounted for approximately 53% and 53% of the Authority's operating revenues in 2011 and 2010, respectively. The Authority distinguishes operating revenues and expenses from nonoperating items in the preparation of its financial statements. The principal operating revenues are generated from the sale, transmission, and wheeling of power. The Authority's operating expenses include fuel, operations and maintenance, depreciation, purchased power costs, and other expenses related to the sale of power. All revenues and expenses not meeting this definition are reported as nonoperating income and expenses.

**(p) *Reclassifications***

Certain prior year amounts have been reclassified to conform with the current year's presentation. These reclassifications had no effect on net income and changes in net assets.

**(3) *Bond Resolution***

On February 24, 1998, the Authority adopted its "General Resolution Authorizing Revenue Obligations" (as amended and supplemented up to the present time, the Bond Resolution). The Bond Resolution covers all of the Authority's projects, which it

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defines as any project, facility, system, equipment or material related to or necessary or desirable in connection with the generation, production, transportation, transmission, distribution, delivery, storage, conservation, purchase or use of energy or fuel, whether owned jointly or singly by the Authority, including any output in which the Authority has an interest authorized by the Act or by other applicable State statutory provisions, provided, however, that the term "Project" shall not include any Separately Financed Project as that term is defined in the Bond Resolution. The Authority has covenanted with bondholders under the Bond Resolution that at all times the Authority shall maintain rates, fees or charges, and any contracts entered into by the Authority for the sale, transmission, or distribution of power shall contain rates, fees or charges sufficient together with other monies available there for (including the anticipated receipt of proceeds of sale of Obligations, as defined in the Bond Resolution, issued under the Bond Resolution or other bonds, notes or other obligations or evidences of indebtedness of the Authority that will be used to pay the principal of Obligations issued under the Bond Resolution in anticipation of such receipt, but not including any anticipated or actual proceeds from the sale of any Project), to meet the financial requirements of the Bond Resolution. Revenues of the Authority (after deductions for operating expenses and reserves, including reserves for working capital, operating expenses or compliance purposes) are applied first to the payment of, or accumulation as a reserve for payment of, interest on and the principal or redemption price of Obligations issued under the Bond Resolution and the payment of Parity Debt issued under the Bond Resolution.

The Bond Resolution also provides for withdrawal for any lawful corporate purpose as determined by the Authority, including but not limited to the retirement of Obligations issued under the Bond Resolution, from amounts in the Operating Fund in excess of the operating expenses, debt service on Obligations and Parity Debt issued under the Bond Resolution, and subordinated debt service requirements. The Authority has periodically reacquired revenue bonds when available at favorable prices.

#### (4) Cash and Investments

Investment of the Authority's funds is administered in accordance with the applicable provisions of the Bond Resolution and with the Authority's investment guidelines. These guidelines comply with the New York State Comptroller's investment guidelines for public authorities and were adopted pursuant to Section 2925 of the New York Public Authorities Law.

##### (a) Credit Risk

The Authority's investments are restricted to (a) collateralized certificates of deposit, (b) direct obligations of or obligations guaranteed by the United States of America or the State of New York, (c) obligations issued or guaranteed by certain specified federal agencies and any agency controlled by or supervised by and acting as an instrumentality of the United States government, and (d) obligations of any state or any political subdivision thereof or any agency, instrumentality or local government unit of any such state or political subdivision which is rated in any of the three highest long-term rating categories, or the highest short-term rating category, by nationally recognized rating agencies. The Authority's investments in the debt securities of Federal National Mortgage Association (FNMA), Federal Home Loan Bank (FHLB), Federal Farm Credit Bank (FFCB) and Federal Home Loan Mortgage Corp. (FHLMC) were rated Aaa by Moody's Investors Services (Moody's), AAA by Fitch Ratings (Fitch) and AA+ by Standard & Poor's (S&P).

##### (b) Interest Rate Risk

Securities that are the subject of repurchase agreements must have a market value at least equal to the cost of the investment. The agreements are limited to a maximum fixed term of five business days and may not exceed the greater of 5% of the investment portfolio or \$100 million. The Authority has no other policies limiting investment maturities.

##### (c) Concentration of Credit Risk

There is no limit on the amount that the Authority may invest in any one issuer; however, investments in authorized certificates of deposit shall not exceed 25% of the Authority's invested funds. At December 31, 2011, \$337 million (14%), \$188 million (8%) and \$575 million (23%) of the Authority's investments were in securities of Federal Home Loan Bank (FHLB), Federal Farm Credit Bank (FFCB) and Federal National Mortgage Association (FNMA or Fannie Mae), respectively.

##### (d) Decommissioning Fund

The Decommissioning Trust Fund is managed by external investment portfolio managers. Under the Decommissioning Agreements (see note 11), the Authority will make no further contributions to the Decommissioning Funds. The

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Authority's decommissioning responsibility will not exceed the amounts in each of the Decommissioning Funds. Therefore, the Authority's obligation is not affected by various risks which include credit risk, interest rate risk, and concentration of credit risk. In addition, the Decommissioning Trust Fund is not held within the Trust Estate of the Bond Resolution and therefore is administered under separate investment guidelines from those of the Authority or New York State.

**(e) Other**

All investments are held by designated custodians in the name of the Authority. At December 31, 2011 and 2010, the Authority had investments in repurchase agreements of \$48 million and \$50 million, respectively. The bank balances were \$52 million and \$29 million, respectively, of which \$51 million and \$28 million, respectively, were uninsured, but were collateralized by assets held by the bank in the name of the Authority.

Cash and Investments of the Authority at December 31, 2011 and 2010, are as follows:

December 31, 2011	Total	Total restricted	Decommissioning Trust Fund	Restricted		Capital fund	Unrestricted
				POCR and CAS projects and other	ART note debt reserve		
				(In millions)			
Cash and investments:							
Cash and cash equivalents	\$ 90	20	—	20	—	5	65
U.S. government:							
GNMA	19	—	—	—	—	—	19
	19	—	—	—	—	—	19
Other debt securities:							
FNMA	575	5	—	—	5	6	564
FHLMC	78	36	—	36	—	9	33
FHLB	337	9	—	—	9	15	313
FFCB	188	—	—	—	—	33	155
All other	112	7	—	—	7	30	75
	1,290	57	—	36	21	93	1,140
Portfolio Manager	1,090	1,090	1,090	—	—	—	—
Total investments	2,399	1,147	1,090	36	21	93	1,159
	\$ 2,489	1,167	1,090	56	21	98	1,224
Summary of maturities (years):							
0 – 1	\$ 374	56	—	56	—	53	265
1 – 5	924	21	—	—	21	31	872
5 – 10	37	—	—	—	—	—	37
10+	64	—	—	—	—	14	50
Portfolio manager	1,090	1,090	1,090	—	—	—	—
	\$ 2,489	1,167	1,090	56	21	98	1,224

Petroleum Overcharge Restitution (POCR) Funds and Clean Air for Schools (CAS) Projects Funds – Legislation enacted into State law from 1995 to 2002, 2007 and 2008 authorized the Authority to utilize petroleum overcharge restitution (POCR) funds and other State funds (Other State Funds), to be made available to the Authority by the State pursuant to the legislation, for a variety of energy-related purposes, with certain funding limitations. The legislation also states that the Authority “shall transfer” equivalent amounts of money to the State prior to dates specified in the legislation. The use of PCR funds is subject to comprehensive Federal regulations and judicial orders, including restrictions on the type of projects that can be financed with PCR funds, the use of funds recovered from such projects and the use of interest and

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income generated by such funds and projects. Pursuant to the legislation, the Authority is utilizing POCR funds and the Other State Funds to implement various energy services programs that have received all necessary approvals.

The disbursements of the POCR funds and the Other State Funds to the Authority, and the Authority's transfers to the State totaling \$60.9 million to date, took place from 1996 to 2009. The POCR funds are included in restricted funds in the balance sheets. The funds are held in a separate escrow account until they are utilized.

The New York State Clean Water/Clean Air Bond Act of 1996 made available \$125 million for Clean Air for Schools Projects (CAS Projects) for elementary, middle and secondary schools, with the Authority authorized to undertake implementation of the CAS Projects program. The CAS Projects are designed to improve air quality for schools and include, but are not limited to, projects that replace coal-fired furnaces and heating systems with furnaces and systems fueled with oil or gas. The conversion of the last 6 of 80 schools was in process as of December 31, 2011. As of December 31, 2011, restricted funds include the POCR fund (\$14 million), the CAS Projects fund (\$9 million), the Lower Manhattan Energy Independence Initiative fund (\$13 million) and the Fish & Wildlife Habitat Enhancement fund related to the Niagara relicensing costs (\$17 million).

As of December 31, 2010, restricted funds include the POCR fund (\$16 million), the CAS Projects fund (\$10 million), the Lower Manhattan Energy Independence Initiative fund (\$18 million) and the Fish & Wildlife Habitat Enhancement fund related to the Niagara relicensing costs (\$17 million).

December 31, 2010	Total	Total restricted	Decommissioning Trust Fund	Restricted		Capital fund	Unrestricted
				POCR and CAS projects and other (In millions)	ART note debt reserve		
Cash and investments:							
Cash and cash equivalents	\$ 87	20	—	20	—	17	50
U.S. government:							
Treasury bills	43	43	—	43	—	—	—
GNMA	38	—	—	—	—	—	38
	81	43	—	43	—	—	38
Other debt securities:							
FNMA	232	5	—	—	5	22	205
FHLMC	158	—	—	—	—	6	152
FHLB	371	5	—	—	5	6	360
FFCB	266	4	—	—	4	54	208
All other	118	7	—	—	7	42	69
	1,145	21	—	—	21	130	994
Portfolio Manager	1,032	1,032	1,032	—	—	—	—
Total investments	2,258	1,096	1,032	43	21	130	1,032
	\$ 2,345	1,116	1,032	63	21	147	1,082
Summary of maturities (years):							
0 – 1	\$ 317	63	—	63	—	47	207
1 – 5	826	21	—	—	21	74	731
5 – 10	69	—	—	—	—	—	69
10+	101	—	—	—	—	26	75
Portfolio manager	1,032	1,032	1,032	—	—	—	—
	\$ 2,345	1,116	1,032	63	21	147	1,082

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## (5) Capital Assets

The following schedule summarizes the capital assets activity of the Authority for the year ended December 31, 2011:

	<u>Beginning balance</u>	<u>Additions</u>	<u>Deletions/ Transfers</u>	<u>Ending balance</u>
	(Amounts in millions)			
Capital assets, not being depreciated:				
Land	\$ 148	6	—	154
Construction in progress	125	132	(123)	134
Total capital assets not being depreciated	<u>273</u>	<u>138</u>	<u>(123)</u>	<u>288</u>
Capital assets, being depreciated:				
Production – Steam	437	—	—	437
Production – Hydro	1,749	50	(3)	1,796
Production – Gas turbine/combined cycle	1,248	1,166	—	2,414
Transmission	1,785	157	(33)	1,909
General	1,070	46	(3)	1,113
Total capital assets being depreciated	<u>6,289</u>	<u>1,419</u>	<u>(39)</u>	<u>7,669</u>
Less accumulated depreciation for:				
Production – Steam	436	—	—	436
Production – Hydro	628	32	(3)	657
Production – Gas turbine/combined cycle	497	74	—	571
Transmission	951	44	(2)	993
General	353	40	(3)	390
Total accumulated depreciation	<u>2,865</u>	<u>190</u>	<u>(8)</u>	<u>3,047</u>
Net value of capital assets, being depreciated	<u>3,424</u>	<u>1,229</u>	<u>(31)</u>	<u>4,622</u>
Net value of all capital assets	<u>\$ 3,697</u>	<u>1,367</u>	<u>(154)</u>	<u>4,910</u>

**Wind Farm Transmission Assets**

The Authority is allowing three Wind Farm power facilities to interconnect to its bulk transmission system between the Willis and Plattsburgh 230 kv substations. Noble Ellenburg Wind Park LLC, the wind farm developers, transferred title to three substations

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(valued at \$59 million) to the Authority in order for the Authority to maintain reliability standards and control of its bulk transmission system. The transfer was accounted for as a capital contribution.

The following schedule summarizes the capital assets activity of the Authority for the year ended December 31, 2010:

	<u>Beginning balance</u>	<u>Additions</u>	<u>Deletions/ Transfers</u>	<u>Ending balance</u>
	(Amounts in millions)			
Capital assets, not being depreciated:				
Land	\$ 148	—	—	148
Construction in progress	144	149	(168)	125
Total capital assets not being depreciated	<u>292</u>	<u>149</u>	<u>(168)</u>	<u>273</u>
Capital assets, being depreciated:				
Production – Steam	437	—	—	437
Production – Hydro	1,689	74	(14)	1,749
Production – Gas turbine/combined cycle	1,236	12	—	1,248
Transmission	1,749	47	(11)	1,785
General	1,037	35	(2)	1,070
Total capital assets being depreciated	<u>6,148</u>	<u>168</u>	<u>(27)</u>	<u>6,289</u>
Less accumulated depreciation for:				
Production – Steam	436	—	—	436
Production – Hydro	614	28	(14)	628
Production – Gas turbine/combined cycle	448	49	—	497
Transmission	910	42	(1)	951
General	321	34	(2)	353
Total accumulated depreciation	<u>2,729</u>	<u>153</u>	<u>(17)</u>	<u>2,865</u>
Net value of capital assets, being depreciated	<u>3,419</u>	<u>15</u>	<u>(10)</u>	<u>3,424</u>
Net value of all capital assets	<u>\$ 3,711</u>	<u>164</u>	<u>(178)</u>	<u>3,697</u>

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## (6) Long-Term Debt

## (a) Components

	Amount		Interest rate	Maturity	Earliest redemption date prior to maturity
	2011	2010			
	(In millions)				
Senior debt:					
Revenue Bonds (Tax-Exempt):					
Series 2000 A Revenue Bonds:					
Term Bonds	\$ —	10	5.25%	Refunded	Refunded
Term Bonds	—	67	5.25%	Refunded	Refunded
Series 2002 A Revenue Bonds:					
Serial Bonds	53	120	3.375% to 5.00%	11/15/2012 to 2013 **	N/A
Series 2006 A Revenue Bonds:					
Serial Bonds	123	134	3.5% to 5.0%	11/15/2012 to 2020	11/15/2015
Series 2007 A Revenue Bonds:					
Term Bonds	82	82	4.5% to 5.0%	11/15/2047	11/15/2017
Series 2007 C Revenue Bonds:					
Serial Bonds	264	264	4.0% to 5.0%	11/15/2014 to 2021	11/15/2017
Series 2011 A Revenue Bonds:					
Serial Bonds	69	—	2.0% to 5.0%	11/15/2012 to 2031 *	11/15/2021
Term Bonds	39	—	4.0% to 5.0%	11/15/2032 to 2038	11/15/2021
Revenue Bonds (Taxable):					
Series 2003 A Revenue Bonds:					
Serial Bonds	10	14	4.67% to 4.83%	11/15/2012 to 2013	Any date
Term Bonds	186	186	5.230% to 5.749%	11/15/2018 to 2033	Any date
Series 2007 B Revenue Bonds:					
Serial Bonds	18	18	5.253% to 5.603%	11/15/2013 to 2017	Any date
Term Bonds	239	239	5.905% to 5.985%	11/15/2037 and 2043	Any date
	1,083	1,134			
Plus unamortized premium and discount	34	21			
Less deferred refinancing costs	10	4			
	1,107	1,151			
Less due in one year	43	40			
	\$ 1,064	1,111			

\* \$26.4 million due 2022 is non-callable.

\*\* Principal due 2014 - 2022 defeased in November 2011.

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	Amount		Interest rate	Maturity	Earliest redemption date prior to maturity
	2011	2010			
	(In millions)				
Adjustable Rate Tender Notes:					
2016 Notes	\$ 48	55	0.19%	3/1/2016	Any adjustment date
2020 Notes	75	75	0.19%	3/1/2020	Same as above
	123	130			
Less due in one year	8	8			
	115	122			
Subordinate debt:					
Commercial Paper:					
EMCP (Series 1)	78	141	0.18%	2012 to 2023	
CP (Series 2)	82	128	0.16%	2012 to 2015	
CP (Series 3)	44	68	0.22%	2012 to 2021	
	204	337			
Less due within one year	31	73			
	173	264			
Total Long-term debt	1,434	1,618			
Less due within one year	82	121			
Long-term debt, net of due in one year	\$ 1,352	1,497			

Interest on Series 2003 A and 2007 B Revenue Bonds is not excluded from gross income for bondholders' Federal income tax purposes.

### Senior Debt

As indicated in note 3, "Bond Resolution," the Authority has pledged future revenues to service the Obligations and Parity Debt (Senior Debt) issued under the Bond Resolution. Annual principal and interest payments on the Senior Debt are expected to require less than 35% of operating income plus depreciation. The total principal and interest remaining to be paid on the Senior Debt is \$2.0 billion. Principal and interest paid for 2011 and operating income plus depreciation were \$108 million and \$476 million, respectively.

Senior revenue bonds are subject to redemption prior to maturity in whole or in part as provided in the supplemental resolutions authorizing the issuance of each series of bonds, beginning for each series on the date indicated above, at principal amount or at various redemption prices according to the date of redemption, together with accrued interest to the redemption date.

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In July 2011, the Authority's Trustees authorized the issuance of up to \$341 million of additional revenue bonds for the purpose of refunding certain revenue bonds and commercial paper and/or extendible commercial paper notes. In September 2011, the Authority issued \$108.4 million of Series 2011 A Revenue Bonds (2011 Bonds). The proceeds from the issuance of the 2011 Bonds and cash-on-hand were used to (i) refund \$77.2 million of the Authority's Series 2000 A Revenue Bonds; (ii) defease \$41.7 million of the Authority's Series 2002 A Revenue Bonds; and (iii) pay financing and other costs relating to the issuance of the 2011 Bonds.

In prior years, the Authority defeased certain revenue bonds and general purpose bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Authority's financial statements. At December 31, 2011 and 2010, \$310 million and \$268 million, respectively, of outstanding bonds were considered defeased.

The Adjustable Rate Tender Notes may be tendered to the Authority by the holders on any adjustment date. The rate adjustment dates are March 1 and September 1. The Authority has entered into a revolving credit agreement (Agreement) with The Bank of Nova Scotia to provide a supporting line of credit. Under the Agreement, which terminates on September 1, 2015, the Authority may borrow up to \$123 million for the purpose of repaying, redeeming or purchasing the Notes. The Agreement provides for interest on outstanding borrowings (none outstanding at December 31, 2011 or 2010) at either (i) the Federal Funds Rate plus a percentage, or (ii) a rate based on the London Interbank Offered Rate (LIBOR) plus a percentage. The Authority expects that it will be able to renew or replace this Agreement as necessary. In accordance with the Adjustable Rate Tender Note Resolution, a Note Debt Service Reserve account has been established in the amount of \$20 million. See note 8 for the Authority's risk management program relating to interest rates.

At December 31, 2011 and 2010, the current market value of the senior debt was approximately \$1.347 billion and \$1.294 billion, respectively. Market values were obtained from a third party that utilized a matrix-pricing model.

#### **Subordinate Debt – Commercial Paper**

Under the Extendible Municipal Commercial Paper (EMCP) Note Resolution, adopted December 17, 2002, and as subsequently amended and restated, the Authority may issue a series of notes, designated EMCP Notes, Series 1, maturing not more than 270 days from the date of issue, up to a maximum amount outstanding at any time of \$200 million (EMCP Notes).

The proceeds of the Series 2 and 3 Commercial Paper Notes (CP Notes) were used to refund General Purpose Bonds and for other corporate purposes. The proceeds of the EMCP Notes were used to refund Series 2 and 3 CP Notes. CP Notes and EMCP Notes have been used, and may in the future be used, for other corporate purposes. It is the Authority's intention to renew the Series 2 and 3 CP Notes and the EMCP Notes as they mature so that their ultimate maturity dates will range from 2012 to 2023, as indicated in the table above.

The Authority has a line of credit under a 2011 revolving credit agreement (the 2011 RCA) to provide liquidity support for the Series 1-3 CP Notes, with a syndicate of banks, providing \$550 million for such CP Notes until January 20, 2014, which succeeded another revolving credit agreement (the 2008 RCA) in January 2011. No borrowings have been made under the 2011 RCA or the 2008 RCA. The Authority has the option to extend the maturity of the EMCP Notes and would exercise such right in the event there is a failed remarketing. This option serves as a substitute for a liquidity facility for the EMCP Notes.

CP Notes and EMCP Notes are subordinate to the Series 2002 A Revenue Bonds, the Series 2003 A Revenue Bonds, the Series 2006 A Revenue Bonds, the Series 2007 A, B, and C Revenue Bonds, the Series 2011 A Revenue Bonds and the Adjustable Rate Tender Notes.

Interest on the CP (Series 3) is taxable for Federal income tax purposes.

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Maturities and Interest Expense	Long-Term Debt (In millions)			Capitalized Lease Obligations (In millions)			
	Principal	Interest	Hedging Derivative Instruments, Net	Total	Principal	Interest	Total
Year:							
2012	\$ 82	57	7	146	5	98	103
2013	98	55	6	159	8	98	106
2014	99	53	5	157	12	97	109
2015	95	50	3	148	16	96	112
2016	82	47	2	131	20	95	115
2017 – 2021	420	191	—	611	186	437	623
2022 – 2026	113	132	—	245	383	326	709
2027 – 2031	119	104	—	223	600	119	719
2032 – 2036	112	69	—	181	—	—	—
2037 – 2041	77	42	—	119	—	—	—
2042 – 2046	92	19	—	111	—	—	—
2047	21	1	—	22	—	—	—
	1,410	820	23	2,253	1,230	1,366	2,596
Plus unamortized bond premium	34	—	—	34	—	—	—
Less deferred refinancing cost	10	—	—	10	—	—	—
	\$ 1,434	820	23	2,277	1,230	1,366	2,596

The interest rate used to calculate future interest expense on variable rate debt is the interest rate at December 31, 2011.

**(b) Terms by Which Interest Rates Change for Variable Rate Debt****Adjustable Rate Tender Notes**

In accordance with the Adjustable Rate Tender Note Resolution adopted April 30, 1985, as amended up to the present time (Note Resolution), the Authority may designate a rate period of different duration, effective on any rate adjustment date. The Remarketing Agent appointed under the Note Resolution determines the rate for each rate period which, in the Agent's opinion, is the minimum rate necessary to remarket the notes at par.

**CP Notes and EMCP Notes (Long-Term Portion)**

The Authority determines the rate for each rate period which is the minimum rate necessary to remarket the notes at par in the Dealer's opinion. If the Authority exercises its option to extend the maturity of the EMCP Notes, the reset rate will be the higher of (SIFMA + E) or F, where SIFMA is the Securities Industry and Financial Markets Association Municipal Swap Index, which is calculated weekly, and where "E" and "F" are fixed percentage rates expressed in basis points (each basis point being 1/100 of one percent) and yields, respectively, that are determined based on the Authority's debt ratings subject to a cap rate of 12%. As of December 31, 2011, the reset rate would have been 7.33%.

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**(c) Changes in Long-Term Liabilities**

Changes in the Authority's long-term liabilities for the year ended December 31, 2011 are comprised of the following:

	<u>Beginning balance</u>	<u>Additions</u>	<u>Maturities/ refundings and other</u>	<u>Ending balance</u>	<u>Due within one year</u>
	(Amounts in millions)				
Senior debt:					
Revenue bonds	\$ 1,134	108	159	1,083	43
Adjustable rate tender bonds	130	—	7	123	8
Subtotal	<u>1,264</u>	<u>108</u>	<u>166</u>	<u>1,206</u>	<u>51</u>
Subordinate debt:					
Commercial paper	337	3	136	204	31
Subtotal	<u>337</u>	<u>3</u>	<u>136</u>	<u>204</u>	<u>31</u>
Net unamortized discounts/ premiums and deferred losses	17	21	14	24	—
Total debt, net of unamortized discounts/ premiums/ deferred losses	<u>\$ 1,618</u>	<u>132</u>	<u>316</u>	<u>1,434</u>	<u>82</u>
Other long-term liabilities:					
Capitalized lease obligation	\$ —	1,294	64	1,230	5
Nuclear decommissioning	1,032	58	—	1,090	—
Disposal of nuclear fuel	216	—	—	216	—
Relicensing	335	17	23	329	—
Deferred revenues and other	602	17	73	546	—
Total other long-term liabilities	<u>\$ 2,185</u>	<u>1,386</u>	<u>160</u>	<u>3,411</u>	<u>5</u>

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Changes in the Authority's long-term liabilities for the year ended December 31, 2010 are comprised of the following:

	<u>Beginning balance</u>	<u>Additions</u>	<u>Maturities/ refundings and other</u>	<u>Ending balance</u>	<u>Due within one year</u>
	(Amounts in millions)				
Senior debt:					
Revenue bonds	\$ 1,174	—	40	1,134	40
Adjustable rate tender bonds	138	—	8	130	8
Subtotal	<u>1,312</u>	<u>—</u>	<u>48</u>	<u>1,264</u>	<u>48</u>
Subordinate debt:					
Commercial paper	413	4	80	337	73
Subtotal	<u>413</u>	<u>4</u>	<u>80</u>	<u>337</u>	<u>73</u>
Net unamortized discounts/ premiums and deferred losses	19	—	2	17	—
Total debt, net of unamortized discounts/ premiums/ deferred losses	<u>\$ 1,744</u>	<u>4</u>	<u>130</u>	<u>1,618</u>	<u>121</u>
Other long-term liabilities:					
Nuclear decommissioning	\$ 942	90	—	1,032	—
Disposal of nuclear fuel	216	—	—	216	—
Relicensing	331	17	13	335	—
Deferred revenues and other	556	83	37	602	—
Total other long-term liabilities	<u>\$ 2,045</u>	<u>190</u>	<u>50</u>	<u>2,185</u>	<u>—</u>

**(7) Short-Term Debt**

CP Notes (short-term portion) outstanding was as follows:

	<b>December 31</b>			
	<b>2011</b>		<b>2010</b>	
	<u>Availability</u>	<u>Outstanding</u>	<u>Availability</u>	<u>Outstanding</u>
	(In millions)			
CP Notes (Series 1)	\$ 400	374	400	323

Under the Commercial Paper Note Resolution adopted June 28, 1994, as subsequently amended and restated, the Authority may issue from time to time a separate series of notes maturing not more than 270 days from the date of issue, up to a maximum amount outstanding at any time of \$400 million (Series 1 CP Notes). See note 6 – Long-term Debt for Series 2 and 3 CP Notes and

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the EMCP Notes. The proceeds of the Series 1 CP Notes have been and shall be used to finance the Authority's current and future energy services programs and for other corporate purposes.

The changes in short-term debt are as follows:

	<u>Beginning balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending balance</u>
	(In millions)			
Year:				
2010	\$ 289	159	125	323
2011	323	164	113	374

CP Notes are subordinate to the Series 2000 A Revenue Bonds, the Series 2002 A Revenue Bonds, the Series 2003 A Revenue Bonds, the Series 2006 A Revenue Bonds, the Series 2007 A, B, and C Revenue Bonds, the Series 2011 A Revenue Bonds and the Adjustable Rate Tender Notes.

## (8) Risk Management and Hedging Activities

### Overview

The Authority purchases insurance coverage for its operations, and in certain instances, is self-insured. Property insurance purchase protects the various real and personal property owned by the Authority and the property of others while in the care, custody and control of the Authority for which the Authority may be held liable. Liability insurance purchase protects the Authority from third-party liability related to its operations, including general liability, automobile, aircraft, marine and various bonds. Insured losses by the Authority did not exceed coverage for any of the four preceding fiscal years. The Authority self-insures a certain amount of its general liability coverage and the physical damage claims for its owned and leased vehicles. The Authority is also self-insured for portions of its medical, dental and workers' compensation insurance programs. The Authority pursues subrogation claims as appropriate against any entities that cause damage to its property.

Another aspect of the Authority's risk management program is to manage the impacts of interest rate, energy and fuel market fluctuations on its earnings, cash flows and market values of assets and liabilities. To achieve its objectives the Authority's Trustees have authorized the use of various interest rate, energy, and fuel derivative instruments that are considered financial derivatives under GAS No. 53, *Accounting and Financial Reporting for Derivative Instruments* (GAS No. 53).

The fair values of all Authority derivative instruments, as defined by GAS No. 53, are reported in current and noncurrent assets or liabilities on the balance sheet as risk management activities. For designated hedging derivative instruments, changes in the fair values are deferred and classified as deferred inflows or deferred outflows in current and other noncurrent assets or liabilities. For designated interest rate option hedging instruments the change in fair value is applied to interest expense. Renewable energy contracts, designated as investment derivative instruments, are deferred as regulatory assets or liabilities, as they are recoverable from customers by contractual agreements. The fair value of interest rate swap contracts take into consideration the prevailing interest rate environment and the specific terms and conditions of each contract. The fair values were estimated using the zero-coupon discounting method. The fair value of the interest rate option contracts were measured using an option pricing model that considers probabilities, volatilities, time, underlying prices, and other variables. The fair value for over-the-counter energy, renewable energy and natural gas transportation contracts are determined by the monthly market prices over the lifetime of each outstanding contract using the latest end-of-trading-month forward prices published by Platts or derived from pricing models based upon Platt's prices.

### Counterparty Credit Risk

The Authority's policy regarding the creditworthiness of counterparties for interest rate derivative contracts is defined in the Bond Resolution. The policy requires that such counterparties be rated in at least the third highest rating category for each appropriate rating agency maintaining a rating for qualified swap providers at the time the derivative contract is executed or have a guarantee from another appropriate entity or an opinion from the rating agencies that the underlying bonds or notes will not be downgraded

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on the derivative contract alone. In January, 2011, the Authority's Board of Trustees adopted a Policy for the Use of Interest Rate Exchange Agreements which provides the overall framework for delegation of authority; allowable interest rate hedging instruments; counterparty qualifications and diversification as well as reporting standards.

Since 2010, the Authority has imposed thresholds, based on agency-published credit ratings, for unsecured credit that can be extended to counterparties to the Authority's commodity derivative transactions. The thresholds are established in bilateral credit support agreements with counterparties and require collateralization of mark-to-market values in excess of the thresholds. In addition, the Authority regularly monitors each counterparty's market-implied credit ratings and financial ratios and can restrict transactions with counterparties on the basis of that monitoring, even if the applicable unsecured credit threshold is not exceeded.

Based upon the fair values as of December 31, 2011 the Authority's individual or aggregate exposure to derivative contract counterparty credit risk is not significant.

The following table shows the fair value of derivatives contracts for 2011 and 2010:

Derivative instrument description	Fair value balance December 31, 2010	Net change in fair value (In millions)	Fair value balance December 31, 2011	Type of hedge or transaction	Financial statement classification for changes in fair value	Notional amount December 31, 2011	Volume
<b>Interest rate contracts (Swaps/Options):</b>							
Series 2 CP Notes	\$ (8.7)	\$ 2.6	\$ (6.1)	Cash Flow	Deferred inflow	81.8	USD
ART Notes	(12.7)	(1.0)	(13.7)	Cash Flow	Deferred outflow	122.9	USD
Series 1 CP Notes (Option)	—	—	—	Cash Flow	Interest Expense	300.0	USD
<b>Energy contracts (Swaps):</b>							
Economic Cost Savings Benefits	(0.1)	0.1	—	Cash Flow	Deferred inflow	—	MWh
SENY Customer Load	(101.0)	29.1	(71.9)	Cash Flow	Deferred inflow	2,854,800	MWh
SENY Customer Load	(108.8)	(8.7)	(117.5)	Cash Flow	Deferred outflow	5,041,200	MWh
<b>Renewable energy contracts: (Swaps)</b>							
SENY Renewable Energy	(33.8)	0.2	(33.6)	Investment	Regulatory Asset	1,096,288	MWh
Totals	<u>\$ (265.1)</u>	<u>\$ 22.3</u>	<u>\$ (242.8)</u>				

#### Interest Rate Contracts:

*Series 2 CP Notes:* In 1998, the Authority entered into forward interest rate swaps to fix rates on long-term obligations initially issued to refinance \$268.2 million of Series 1998 B Revenue Bonds required to be tendered in the years 2002 (the 2002 Swaps). Based upon the terms of these forward interest rate swaps, the Authority would pay interest calculated at a fixed rate of 5.1% to the counterparties through February 15, 2015. In return, the counterparties would pay interest to the Authority based upon the SIFMA municipal swap index (SIFMA Index) on the established reset dates. On November 15, 2002 the Authority completed the mandatory payment on the Series 1998 B Revenue Bonds from the proceeds of the issuance of Series 2 CP Notes. The 2002 Swaps became active on November 15, 2002 and are scheduled to terminate on February 15, 2015. Net settlement payments were \$4.3 and \$6.7 million in 2011 and 2010 respectively.

*ART Notes:* In 2006, the Authority entered into a forward interest rate swap having an initial notional amount of \$156 million (which declines over time to \$75 million) with the objective of fixing the interest rates on the Authority's Adjustable Rate Tender Notes (ART Notes) for the period September 1, 2006 to September 1, 2016. Based upon the terms of the forward interest rate swap, the Authority pays interest calculated at a fixed rate of 3.7585% on the outstanding notional amount. In return, the counterparty pays interest to the Authority based upon 67% of the six-month LIBOR established on the reset dates that coincide with the ART Notes interest rate reset dates. Net settlement payments were \$4.3 and \$4.5 million in 2011 and 2010 respectively.

*Series 1 CP Notes (Option):* On January 26, 2011 an interest rate option(cap) was purchased with the objective of limiting exposure to rising interest rates relating to the Series 1 CP Notes at a premium cost of \$200 thousand. The interest rate for the

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Series 1 CP Notes is capped at 5.5 percent and is based upon the SIFMA Index for a notional amount of \$300 million through January 25, 2014.

#### Energy Contracts:

*Energy Cost Savings Benefits:* In 2011 and 2010, the Authority purchased a number of short-term energy swaps. The objective of these short-term energy swaps was to fix the cost of energy purchases in the NYISO electric market to meet the forecasted load requirements of certain Energy Cost Saving Benefits program (ECSB) customers. These short-term energy swaps have terminated and are not outstanding as of December 31, 2011. Net settlement payments were \$1.4 and \$0.6 million in 2011 and 2010 respectively.

*NYC Customer Load:* In 2009, the Authority entered into the first of two medium-term forward energy swaps to fix the cost of energy purchases in the NYISO electric market to meet certain long-term NYC Governmental Customers load requirements between 2010 and 2012. Net settlement payments were \$50.2 and \$27.7 million in 2011 and 2010 respectively.

*NYC Customer Load:* In 2009, the Authority entered into the second of two medium-term forward energy swaps to fix the cost of energy purchases in the NYISO electric market to meet certain long-term NYC Governmental Customers load requirements between 2011 and 2014. Net settlement payments were \$27.8 million in 2011.

#### Renewable Energy Contracts:

*SENY Renewable Energy:* In 2006, the Authority entered into long-term forward energy swaps and purchase agreements based upon a portion of the generation of the counterparties' wind-farm-power-generating facilities between 2008 and 2017. The fixed price ranges from \$74 to \$75 per megawatt and includes the purchase of the related environmental attributes. The intent of the swaps and purchase agreements is to assist specific governmental customers in acquiring and investing in wind power and related environmental attributes to satisfy certain New York State mandates to support renewable energy. Net settlement payments were \$6.2 and \$4.2 million in 2011 and 2010 respectively. The Authority anticipates the recovery or distribution of any net settlements through specific contractual agreements with customers.

#### Other Considerations:

In addition, the Authority used derivatives during the periods to hedge certain exposures. There were no open positions in these derivatives on December 31, 2011 or 2010. These derivatives included:

- *Power for Jobs Program:* In 2010, the Authority purchased a number of short-term energy swaps. The objective of these short-term energy swaps was to fix the price of purchases of energy in the NYISO electric market to meet short-term forecasted load requirements for the Authority's Power for Jobs program (which will be replaced by Recharge New York Power program on July 1, 2012). These short-term energy swaps terminated in less than one year. Net settlement payments were \$ 0.4 million in 2010.
- *NYC Customer Load:* In 2008 and 2009, the Authority purchased a number of short-term energy swaps. The objective of these short-term energy swaps was to fix the cost of energy purchases in the NYISO electric market for the benefit of the NYC Governmental Customers. These short-term energy swaps terminated in less than two years. Net settlement payments were \$17.7 million in 2010.
- *NYC Customer Load:* In 2005, the Authority entered into a long-term forward energy swap to fix the cost of energy purchases in the NYISO electric market to meet certain long-term NYC Governmental Customers load requirements between 2008 and 2010. Net settlement payments were \$14.5 million in 2010.

The Authority from time to time may be exposed to any of the following risks defined under GAS 53.

*Basis risk:* The Authority is exposed to basis risk on its pay-fixed interest rate swaps because the variable-rate payments received by the Authority on these hedging derivative instruments are based upon indexes other than the actual interest rates the Authority pays on its hedged variable-rate debt. Under the terms of the related hedging fixed rate swap transactions, the Authority receives a variable rate based upon SIFMA and sixty-seven percent of LIBOR, respectively. The Authority remarkets its Notes at rates that approximate SIFMA and sixty-seven percent of LIBOR after considering other factors such as the Authority's creditworthiness.

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The Authority is exposed to other basis risk in a portion of its electrical commodity based swaps where the electrical commodity swap payments received are based upon a reference price in a NYISO Market Zone that differs from the Zone in which the hedged electric energy load is forecasted. If the correlation between these Zones' prices should fall the Authority may incur costs as a result of the hedging derivative instrument's inability to offset the delivery price of the related energy.

*Tax risk:* The Authority is at risk that a change in Federal tax rates will alter the relationship between the actual rates at which the Authority remarkets its ART Notes and LIBOR Index used in the pay-fixed receive-variable interest rate swap transaction.

*Rollover risk:* The Authority is exposed to certain rollover risk on its variable ART Notes. Certain of the ART Notes mature on March 1, 2020 while its pay-fixed, receive-variable ART Notes swap terminates on September 1, 2016 leaving the Authority exposed to interest rate volatility during the period September 1, 2016 to March 1, 2020.

Certain electrical commodity, natural gas and natural gas pipeline transportation based derivative instruments are based upon projected future customer loads or facility operations. Beyond the terms of these derivative instruments (varying from one month to 48 months) the Authority is subject to the corresponding market volatilities.

*Termination risk:* The Authority or its counterparties may terminate a derivative instrument if the other party fails to perform under the terms of the contract. The Authority is at risk that a counterparty will terminate a swap (interest rate or commodity swaps) at a time when the Authority owes the counterparty a termination payment. The Authority has mitigated this risk by specifying that the counterparty has the right to terminate only as a result of certain events, including: a payment default by the Authority; other Authority defaults which remain uncured within a defined time-frame after notice; Authority bankruptcy; insolvency of the Authority (or similar events); or a downgrade of the Authority's credit rating below investment grade. If at the time of termination, a hedging derivative instrument is in a liability position, the Authority would be liable to the counterparty for a payment equal to the liability, subject to netting arrangements.

*Market-Access Risk:* The Authority remarkets its CP Notes on a continuous basis and its ART Notes every March 1 and September 1. Should the market experience a disruption or dislocation, the Authority may be unable to remarket its Notes for a period of time. To mitigate this risk, the Authority has entered into liquidity facilities with highly rated banks to provide loans to support both the CP Note and ART Note program.

## (9) Pension Plans, Other Postemployment Benefits, Deferred Compensation and Savings Plans

### (a) Pension Plans

The Authority and substantially all of the Authority's employees participate in the New York State and Local Employees' Retirement System (ERS) and the Public Employees' Group Life Insurance Plan (the Plan). These are cost-sharing, multiple-employer defined benefit retirement plans. The ERS and the Plan provide retirement benefits as well as death and disability benefits. Obligations of employers and employees to contribute and benefits to employees are governed by the New York State Retirement and Social Security Law (NYSRSSL). As set forth in the NYRSSL, the Comptroller of the State of New York (Comptroller) serves as sole trustee and administrative head of the ERS and the Plan. The Comptroller adopts and may amend rules and regulations for the administration and transaction of the business of the ERS and the Plan, and for the custody and control of their funds. The ERS and the Plan issue a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to the New York State and Local Employees' Retirement System, 110 State Street, Albany, NY 12236.

The ERS is contributory except for employees who joined the ERS on or prior to July 27, 1976. Employees who joined between July 28, 1976 and December 31, 2009 and have less than ten years of service, contribute 3% of their salary. Employees who join the ERS on or after January 1, 2010 contribute 3% of their salary during their entire length of service. Under the authority of the NYRSSL, the Comptroller shall certify annually the rates expressed as proportions of payroll of members, which shall be used in computing the contributions required to be made by employers to the pension accumulation fund.

The Authority is required to contribute at an actuarially determined rate. The required contributions for 2011, 2010 and 2009 were \$21.0 million, \$17.1 million and \$9.6 million, respectively. The Authority's contributions made to the ERS were equal to 100% of the contributions required for each year.

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During 2008, the global decline in financial markets adversely impacted state pension investment market values including those of the ERS. The average contribution rates relative to payroll for the fiscal years ended March 31, 2012 and 2013 have been set at approximately 16% and 18%, respectively. If ERS's investment market values do not recover, significant increases in the annual contributions to ERS in subsequent years are expected. For the Authority, such increases initially appeared during calendar year 2010 (State fiscal year 2011).

During 2010, the New York State Legislature passed a bill authorizing a temporary retirement incentive for certain State employees and other public employees. Under the legislation, public employees were able to either retire without penalty at 55 years of age with a minimum of 25 years of service (Part B), or be targeted to receive an additional month of pension credit for each year of service not to exceed 36 months (Part A) if the employee was 50 years of age or more and had a minimum of 10 years of service. On July 22, 2010 the Authority's Trustees authorized (a) participation in the Part B incentive program for all eligible employees and (b) participation in the Part A incentive on a limited basis for targeted employees at the Poletti plant. The open period for eligible employees ended on December 29, 2010 for the Part A incentive and October 30, 2010 for the Part B incentive. The Authority recognized a liability for an additional contribution to the System based on eligible employees who accepted the incentive. The incremental cost of participation was \$4.6 million of which \$4 million was recognized in 2010 and \$0.6 million was recognized in 2011.

**(b) Other Postemployment Benefits (OPEB)**

The Authority provides certain health care and life insurance benefits for eligible retired employees and their dependents under a single employer noncontributory (except for certain optional life insurance coverage) health care plan. Employees and/or their dependents become eligible for these benefits when the employee has at least 10 years of service and retires or dies while working at the Authority. Approximately 4,100 participants, including 1,600 current employees and 2,500 retired employees and/or spouses and dependents of retired employees, were eligible to receive these benefits at December 31, 2011. The Authority's post-retirement health care trust does not issue a stand-alone financial report.

Through 2006, other postemployment benefits (OPEB) provisions were financed on a pay-as-you-go basis and the plan was unfunded. In December 2006, the Authority's Trustees authorized staff to initiate the establishment of a trust for OPEB obligations (OPEB Trust), with the trust fund to be held by an independent custodian. Prior to 2009, the Authority funded the OPEB Trust with contributions totaling \$225 million. Plan members are not required to contribute to the OPEB Trust. The Authority did not make any contributions to the OPEB Trust in 2010. During 2011, the Authority's Trustees approved on-going annual funding of the Trust in order to strengthen the Authority's financial position. **A contribution of \$40 million was made to the OPEB Trust during 2011.**

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The following table shows the components of the Authority's annual OPEB cost for the year, the amount actually contributed to the plan, and changes in the Authority's net OPEB obligation (dollar amounts in millions)

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Annual OPEB cost:			
Annual required contribution (ARC):			
Normal cost	\$ 9	8	7
Amortization payment	22	20	13
Interest to the end of the year	—	—	1
Total	<u>31</u>	<u>28</u>	<u>21</u>
ARC adjustment	7	8	8
Interest on net OPEB obligation	<u>(3)</u>	<u>(4)</u>	<u>(5)</u>
Annual OPEB cost	<u>\$ 35</u>	<u>32</u>	<u>24</u>
Net OPEB obligation:			
Net OPEB (asset) obligation at beginning of fiscal year	\$ (46)	(61)	(69)
Annual OPEB cost	35	32	24
Employer contribution:			
Payments for retirees during the year	20	17	16
Trust fund contributions	<u>40</u>	<u>—</u>	<u>—</u>
Total employer contribution	<u>60</u>	<u>17</u>	<u>16</u>
Net OPEB (asset) obligation at end of fiscal year	<u>\$ (71)</u>	<u>(46)</u>	<u>(61)</u>

The \$71 million OPEB asset is reported as an other noncurrent asset in the balance sheets.

The Authority's annual OPEB cost for 2011 was \$35 million, which is reflected as an expense in the statement of revenues, expenses, and changes in net assets. The Authority's annual OPEB cost (expense) is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GAS No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. As indicated herein, the Authority uses a twenty (20) year amortization period.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits. The Authority's most recent actuarial evaluation was performed as of January 1, 2010 and resulted in an actuarial accrued liability of \$400 million which was funded with assets totaling \$218 million indicating that the Authority's retiree health plan was 55% funded as of the evaluation date. As of December 31, 2011, the balance in the OPEB Trust was \$282 million and the actuarial accrued liability was \$437 million, resulting in the retirees' health plan being 65% funded.

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Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation. The actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. In the 2010 actuarial valuation, the projected unit credit actuarial cost method was used with benefits attributed on a level basis. The actuarial assumptions included a 7% investment rate of return (net of administrative expenses) and an annual healthcare cost trend rate of 9% (net of administrative expenses) including inflation, declining approximately 1% each year to an ultimate trend rate of approximately 5%. Both the cost trend rate and the ultimate trend rate include a 4.5% inflation assumption. Commencing with the January 1, 2010 actuarial valuation, the Authority commenced amortizing gains and losses, first recognized in 2010, over an open 20-year period while continuing to amortize its initial unfunded accrued liability (beginning January 1, 2002 through January 1, 2009) over a closed 20-year period.

#### (c) *Deferred Compensation and Savings Plans*

The Authority offers union employees and salaried employees a deferred compensation plan created in accordance with Internal Revenue Code, Section 457. This plan permits participants to defer a portion of their salaries until future years. Amounts deferred under the plan are not available to employees or beneficiaries until termination, retirement, death or unforeseeable emergency.

The Authority also offers salaried employees a savings plan created in accordance with Internal Revenue Code, Section 401(k). This plan also permits participants to defer a portion of their salaries. The Authority matches contributions of employees up to limits specified in the plan. Such matching annual contributions were approximately \$2.4 million per year for 2011 and 2010.

Both the deferred compensation plan and the savings plan have a loan feature.

Independent trustees are responsible for the administration of the 457 and 401(k) plan assets under the direction of a committee of union representatives and nonunion employees and a committee of nonunion employees, respectively. Various investment options are offered to employees in each plan. Employees are responsible for making the investment decisions relating to their savings plans.

#### (10) NYISO

Pursuant to FERC Order No. 888, the New York investor-owned electric utilities (the IOUs), a subsidiary of the Long Island Power Authority (doing business as LIPA hereafter referred to as LIPA) and the Authority, and certain other entities, established two not-for-profit organizations, the New York Independent System Operator (NYISO) and the New York State Reliability Council (Reliability Council). The mission of the NYISO is to assure the reliable, safe and efficient operation of the State's major transmission system, to provide open-access nondiscriminatory transmission services and to administer an open, competitive and nondiscriminatory wholesale market for electricity in the State. The mission of the Reliability Council is to promote and preserve the reliability of electric service on the NYISO's system by developing, maintaining, and from time to time, updating the reliability rules relating to the transmission system. The Authority, the current IOUs and LIPA are members of both the NYISO and the Reliability Council.

The NYISO is responsible for scheduling the use of the bulk transmission system in the State, which normally includes all the Authority's transmission facilities, and for collecting ancillary services, losses and congestion fees from transmission customers. Each IOU and the Authority retains ownership, and is responsible for maintenance of its respective transmission lines. All customers of the NYISO pay fees to the NYISO. Each customer also pays a separate fee for the benefit of the Authority that is designed to assure that the Authority will recover its entire transmission revenue requirement.

The Authority dispatches power from its generating facilities in conjunction with the NYISO. The NYISO coordinates the reliable dispatch of power and operates a market for the sale of electricity and ancillary services within the State. The NYISO surveys the capacity of generating installations serving the State (installed capacity) and the load requirements of the electricity servers and provides an auction market for generators to sell installed capacity. The NYISO also administers day-ahead and hourly markets whereby generators bid to serve the announced requirements of the local suppliers of energy and ancillary services to retail customers. The Authority participates in these markets as both a buyer and a seller of electricity and ancillary services. A

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significant feature of the energy markets is that prices are determined on a location-specific basis, taking into account local generating bids submitted and the effect of transmission congestion between regions of the State. The NYISO collects charges associated with the use of the transmission facilities and the sale of power and services bid through the markets that it operates. It remits those proceeds to the owners of the facilities in accordance with its tariff and to the sellers of the electricity and services in accordance with their respective bids.

Because of NYISO requirements, the Authority is required to bid into the NYISO day-ahead market (DAM) virtually all of the installed capacity output of its units. The NYISO then decides which Authority units will be dispatched, if any, and how much of such units' generation will be dispatched. The dispatch of a particular unit's generation depends upon the bid prices for the unit submitted by the Authority and whether the unit is needed by the NYISO to meet expected demand. If an Authority unit is dispatched by the NYISO, the Authority receives a fixed price (the Market Clearing Price), based on NYISO pricing methodology, for the energy dispatched above that needed to meet Authority contractual load (the Excess Energy). For the energy needed to meet Authority contractual load (the Contract Energy), the Authority receives the price in its contracts with its customers (the Contract Price).

This procedure has provided the Authority with economic benefits from its units' operation when selected by the NYISO and may continue to do so in the future. However, such bids also obligate the Authority to supply the energy in question during a specified time period, which does not exceed two days (the Short Term Period), if the unit is selected. If a forced outage occurs at the Authority plant that is to supply such energy, then the Authority is obligated to pay during the Short Term Period (1) in regard to the Excess Energy amount, the difference between the price of energy in the NYISO hourly market and the Market Clearing price in the day-ahead market, and (2) in regard to the Contract Energy amount, the price of energy in the NYISO hourly market, which is offset by amounts received based on the Contract Price. This hourly market price is subject to more volatility than the day-ahead market price. The risk attendant with this outage situation is that, under certain circumstances, the Market Clearing Price in the day-ahead market and the Contract Price may be well below the price in the NYISO hourly market, with the Authority required to pay the difference. In times of maximum energy usage, this cost could be substantial. This outage cost risk is primarily of concern to the Authority in the case of its 500-MW plant (discussed in note 12(f)) because of its size, nature and location.

In addition to the risk associated with the Authority bidding into the day-ahead market, the Authority could incur substantial costs, in times of maximum energy usage, by purchasing replacement energy for its customers in the NYISO day-ahead market or through other supply arrangements to make up for lost energy due to an extended outage of its units or failure of its energy suppliers to meet their contractual obligations. As part of an ongoing risk mitigation program, the Authority investigates financial hedging techniques to cover, among other things, future maximum energy usage periods.

## (11) Nuclear Plant Divestiture and Related Matters

### (a) Nuclear Plant Divestiture

On November 21, 2000 (Closing Date), the Authority sold its nuclear plants (Indian Point 3 (IP3) and James A. FitzPatrick (JAF)) to two subsidiaries of Entergy Corporation (collectively Entergy or the Entergy Subsidiaries) for cash and noninterest-bearing notes totaling \$967 million (subsequently reduced by closing adjustments to \$956 million) maturing over a 15-year period. The present value of these payments recorded on the Closing Date, utilizing a discount rate of 7.5%, was \$680 million.

As of December 31, 2011 and 2010, the present value of the notes receivable were:

	<u>2011</u>	<u>2010</u>
	(In millions)	
Notes receivable – nuclear plant sale	\$ 68	82
Less due within one year	15	14
	<u>\$ 53</u>	<u>68</u>

The long-term portion of this notes receivable is reported in other noncurrent assets and deferred outflows in the balance sheet.

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On September 6, 2001, a subsidiary of Entergy Corporation completed the purchase of Indian Point 1 and 2 (IP1 and IP2) nuclear power plants from Consolidated Edison Company of New York Inc. Under an agreement between the Authority and Entergy, which was entered into in connection with the sale of the Authority's nuclear plants to Entergy, the acquisition of the IP2 nuclear plant by a subsidiary of Entergy resulted in the Entergy subsidiary which now owns IP3 being obligated to pay the Authority \$10 million per year for 10 years beginning September 6, 2003, subject to certain termination and payment reduction provisions upon the occurrence of certain events, including the sale of IP3 or IP2 to another entity and the permanent retirement of IP2 or IP3. The September 6, 2011 and 2010 payments were received and are included in other income.

As part of the Authority's sale of its nuclear projects to Entergy Subsidiaries in November 2000, the Authority entered into two Value Sharing Agreements (VSAs) with them. In essence, these contracts provide that the Entergy Subsidiaries will share a certain percentage of all revenues they receive from power sales in excess of specific projected power prices for a ten-year period (2005 – 2014). During 2006 and 2007, disputes arose concerning the calculation of the amounts due the Authority for 2005 and 2006, respectively. In October 2007, the parties reached an agreement resolving these disputes and amending the VSAs. In essence, these amended VSAs provide for the Entergy Subsidiaries to pay the Authority a set price (\$6.59 per MWh for IP3 and \$3.91 per MWh for JAF) for all MWhs metered from each plant between 2007 and 2014, with the Authority being entitled to receive annual payments up to a maximum of \$72 million. Relating to calendar year 2011, payments totaling \$72 million have been accrued by the Authority and are reflected in other income in the Authority's statements of revenues, expenses, and changes in net assets. The Authority has received the maximum annual payments related to calendar years 2010 and 2011. In all other material respects, the terms of the amended and original VSAs are substantially similar. The payments, related to the calendar years ending after December 31, 2011, are subject to continued ownership of the facilities by the Entergy Subsidiaries or its affiliates.

As a result of competitive bidding, and not related to the sale of the nuclear plants, the Authority agreed to purchase energy from Entergy's IP3 and IP2 nuclear power plants in the total amount of 200 MW during the period 2009 to 2013.

#### **(b) Nuclear Fuel Disposal**

In accordance with the Nuclear Waste Policy Act of 1982, in June 1983, the Authority entered into a contract with the U.S. Department of Energy (DOE) under which DOE, commencing not later than January 31, 1998, would accept and dispose of spent nuclear fuel. In conjunction with the sale of the nuclear plants, the Authority's contract with the DOE was assigned to Entergy. The Authority remains liable to Entergy for the pre-1983 spent fuel obligation (see note 12(g), "New York State Budget and Other Matters" relating to a temporary transfer of such funds to the State). As of December 31, 2011, the liability to Entergy totaled \$216 million. The Authority retained its pre-closing claim against DOE under the DOE standard contract for failure to accept spent fuel on a timely basis.

Following the stay of the case for a period of years to await the outcome of appeals in other relevant cases, the parties served various motions and engaged in extensive discovery and other proceedings. Ultimately, in July 2011, the parties executed a settlement agreement in full and final settlement of the Authority's claims and pursuant to which the Authority received a payment, in August 2011, of approximately \$11 million. This item is reported as other income in the nonoperating revenues section of the statement of revenues, expenses, and changes in net assets. This litigation is now concluded.

#### **(c) Nuclear Plant Decommissioning**

The Decommissioning Agreements with each of the Entergy Subsidiaries deal with the decommissioning funds (the Decommissioning Funds) currently maintained by the Authority under a master decommissioning trust agreement (the Trust Agreement). Under the Decommissioning Agreements, the Authority will make no further contributions to the Decommissioning Funds.

The Authority will retain contractual decommissioning liability until license expiration, a change in the tax status of the fund, or any early dismantlement of the plant, at which time the Authority will have the option of terminating its decommissioning responsibility and transferring the plant's fund to the Entergy Subsidiary owning the plant. At that time, the Authority will be entitled to be paid an amount equal to the excess of the amount in the Fund over the Inflation Adjusted Cost Amount, described below, if any. The Authority's decommissioning responsibility is limited to the lesser of the Inflation Adjusted Cost Amount or the amount of the plant's Fund.

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The Inflation Adjusted Cost Amount for a plant means a fixed estimated decommissioning cost amount adjusted in accordance with the effect of increases and decreases in the U.S. Nuclear Regulatory Commission (NRC) minimum cost estimate amounts applicable to the plant.

Certain provisions of the Decommissioning Agreements provide that if the relevant Entergy Subsidiary purchases, or operates, with the right to decommission, another plant at the IP3 site, then the Inflation Adjusted Cost Amount would decrease by \$50 million. In September 2001, a subsidiary of Entergy purchased the Indian Point 1 and Indian Point 2 plants adjacent to IP3.

If the license for IP3 or JAF is extended, an amount equal to \$2.5 million per year, for a maximum of 20 years, would be paid to the Authority by the relevant Entergy Subsidiary for each year of life extension during which the plant operates. In April 2007, the NRC received a license renewal application (for an additional 20 years) for IP3. The original licenses for JAF and IP3 expire in 2014 and 2015, respectively. On September 9, 2008, the NRC renewed the operating license of JAF for 20 years to October 17, 2034.

Decommissioning Funds of \$1,090 million and \$1,032 million are included in restricted funds and other noncurrent liabilities in the balance sheets at December 31, 2011 and 2010, respectively.

If the Authority is required to decommission IP3 or JAF pursuant to the relevant Decommissioning Agreement, an affiliate of the Entergy Subsidiaries, Entergy Nuclear, Inc. would be obligated to enter into a fixed price contract with the Authority to decommission the plant, the price being equal to the lower of the Inflation Adjusted Cost Amount or the plant's Fund amount.

## (12) Commitments and Contingencies

### (a) *Competition*

The Authority's mission is to provide clean, low-cost, and reliable energy consistent with its commitment to the environment and safety, while promoting economic development and job development, energy efficiency, renewables and innovation, for the benefit of its customers and all New Yorkers. The Authority's financial performance goal is to have the resources necessary to achieve its mission, to maximize opportunities to serve its customers better and to preserve its strong credit rating.

To maintain its position as a low cost provider of power in a changing environment, the Authority has undertaken and continues to carry out a multifaceted program, including: (a) the upgrade and relicensing of the Niagara and St. Lawrence-FDR projects; (b) long-term supplemental electricity supply agreements with its governmental customers located mainly within the City of New York (NYC Governmental Customers); (c) construction of a 500-megawatt (MW) combined-cycle electric generating plant at the Authority's Poletti plant site (500-MW plant); (d) a long-term electricity supply contract with Astoria Generating LLC for the purchase of the output of a new 550-MW power plant in Astoria, Queens, adjacent to its existing plant, which entered into service on July 1, 2011; (e) a significant reduction of outstanding debt; and (f) implementation of an energy and fuel risk management program. The Authority operates in a competitive and sometimes volatile market environment. Volatility in the energy market has impacted the Authority in its role as a buyer and until recent years had resulted in higher costs of purchased power and fuel in its NYC Governmental Customer and other market areas. The NYC Governmental Customer market cost situation is mitigated by the cost recovery provisions in the long-term supplemental electricity supply agreements and generation from the Authority's 500-MW plant. The Authority also has implemented a restructuring program for its long-term debt through open-market purchases, early retirements and refundings, which has resulted in cost savings and increased financial flexibility. The Authority can give no assurance that even with these measures it will not lose customers in the future as a result of the restructuring of the State's electric utility industry and the emergence of new competitors or increased competition from existing participants. In addition, the Authority has a variety of legal restrictions on its ability to market its power and energy on a competitive basis.

According to the National Bureau of Economic Research, a recession in the United States began in December 2007 and ended in June 2009. However, the economy continues to grow slowly and unemployment remains high. Forecasted recovery time for these economic conditions ranges from a few to many years. In this environment, the Authority has continued to utilize its financial flexibility to support its mission and its customers. In December 2010, the Governor approved long-term contract extensions for the continued supply of low-cost hydropower to more than 100 of Western New

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York's leading companies. These expansion and replacement power customers, who account for more than 70 percent of the manufacturing jobs in the region, are integral to the area's economy with wide-ranging impacts associated with spinoff jobs, payments to suppliers for goods and services, local tax revenues and financial support of local communities and organizations. In addition to other actions and programs aimed at creating and maintaining jobs, the Authority has also used low cost energy to attract businesses to New York State.

In response to the economic downturn's effects on New York's manufacturing sector, the Authority's Trustees in March 2009 approved execution of an agreement with Alcoa, Inc. to provide temporary relief from certain power sales contract provisions relating to the temporary shutdown of one of its two smelters served by the Authority in Massena, New York, including allowing Alcoa to release back to the Authority certain hydropower allocated to it, temporary waivers of certain minimum bill and employment thresholds, and entry into arrangements with the Authority for inclusion of a portion of Alcoa's load in the NYISO's demand response programs. In addition, in May 2009, the Authority's Trustees authorized a temporary program whereby up to \$10 million would be utilized to provide electric bill discounts for up to a year to businesses located in Jefferson, St. Lawrence, and Franklin counties. These counties constitute the geographic region served by the Authority's Preservation Power program. The source of the \$10 million is the net margin resulting from the sale of a portion of Alcoa's currently unused Preservation Power allocation into the NYISO markets. In September 2010, the Authority's Trustees approved extension of the electric bill discount program for the lesser of one year or the duration of the temporary curtailment of operations at the affected Alcoa facility. During the first quarter of 2011, Alcoa restarted the temporarily curtailed facility and the associated bill discount program ceased shortly after.

In March 2009, the Authority's Trustees approved the deferral for recovery in the future of a proposed hydropower rate increase for the Authority's municipal electric and rural cooperative customers, neighboring state municipal customers, upstate investor-owned utilities, and certain other customers that was scheduled to go into effect on May 1, 2009; and in August 2010, the Authority announced an extension of such deferral through the end of 2010. In November 2011, the Authority's Trustees approved a 41-month rate plan providing for certain phased-in increases to these rates and the Trustees also approved commencement of rate recovery of the deferred amount. Further, in March 2009, the Authority also suspended the application of two annual, contractually-indexed hydropower rate increases for its Replacement Power, Expansion Power, and certain other industrial customers that were scheduled to go into effect on May 1, 2009 and May 1, 2010, respectively, totaling approximately \$6.9 million. The Authority's Trustees in July 2011 approved the reinstatement of these indexed rate adjustments, resulting in an increase in these rates effective September 1, 2011 in the annualized amount of approximately \$5.3 million.

#### **Recharge New York Power Program**

Legislation enacted into law on March 31, 2011 (Chapter 60 of the Laws of 2011) establishes the "Recharge New York Power Program (RNYPP). The RNYPP is a new power program, administered by the Authority and the EDPAB, which has as its central benefit up to 910 MW of power comprised of up to 455 MW of hydropower from the Niagara and St. Lawrence-FDR Projects (which power, until August 1, 2011, had been provided to residential and farm customers of three upstate utilities) and up to 455 MW of other power procured or produced by the Authority. The 910 MW of power will be available for allocation to eligible new and existing businesses and not-for-profit corporations under contracts of up to seven years effective no sooner than July 1, 2012. The legislation also temporarily extends the PFJ and ECSB Programs through June 30, 2012 at which time the two programs will end and be replaced by the RNYPP. Those PFJ and ECSB Program customers that do not receive RNYPP allocations will be eligible to apply for certain "transitional electricity discounts". Under the legislation, these transitional discounts, which may be paid only if deemed feasible and advisable by the Authority's Trustees, will gradually decline to zero by June 30, 2016. The legislation also authorizes the Authority, as deemed feasible and advisable by its Trustees, to provide annual funding of \$100 million for the first three years following withdrawal of the hydropower from the residential and farm customers, \$70 million for the fourth year, \$50 million for the fifth year, and \$30 million each year thereafter, for the purpose of funding a residential consumer discount program for those customers that received the hydropower that will be utilized in the RNYPP. The 455 MW of hydropower was withdrawn by the Authority on August 1, 2011. The Authority's Trustees have authorized the use of revenues from the sales of such power into the wholesale market or, as necessary, internal funds to fund the residential consumer discount program for its first year. For the period August 1, 2011 through December 31, 2011, operations and maintenance expenses include \$42 million in residential consumer discounts. In addition, in January 2012, the Authority's Trustees authorized up to \$50 million for the six months ending August 2012 for the Residential Consumer Discount Program incorporated in the RNYPP.

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### Legislation

Chapter 436 of the Laws of 2010 established a Western New York Economic Development Fund Benefit program, and authorized the Authority to fund the program from net earnings from the Authority's sale of unallocated, relinquished, and withdrawn Expansion Power and Replacement Power into the wholesale market. Net earnings are defined as any excess revenues earned from such power allocated to the wholesale market over the revenues that would have been received had the power been sold at the Expansion Power and Replacement Power rates. Proceeds from the Fund may be used to support eligible projects undertaken within a 30-mile radius of the Niagara Project that qualify under applicable criteria. The law authorizes the Authority to administer the new program with assistance from public and private entities. Payments from the Authority to the Fund are estimated to range between \$6 million in 2012 declining to \$0 by 2015 when power is anticipated to be fully sold.

### **(b) Governmental Customers in the New York City Metropolitan Area**

In 2005, the Authority and its eleven NYC Governmental Customers, including the Metropolitan Transportation Authority, The City of New York, the Port Authority of New York and New Jersey (Port Authority), the New York City Housing Authority, and the New York State Office of General Services, entered into long-term supplemental electricity supply agreements (Agreements). Under the Agreements, the NYC Governmental Customers agreed to purchase their electricity from the Authority through December 31, 2017, with the NYC Governmental Customers having the right to terminate service from the Authority at any time on three years' notice and, under certain limited conditions, on one year's notice, provided that they compensate the Authority for any above-market costs associated with certain of the resources used to supply the NYC Governmental Customers.

Under the Agreements, the Authority will modify rates annually through a formal rate case where there is a change in fixed costs to serve the NYC Governmental Customers. Except for the minimum volatility price option, changes in variable costs, which include fuel and purchased power, will be captured through contractual pricing adjustment mechanisms. Under these mechanisms, actual and projected variable costs are reconciled and all or a portion of the variance is either charged or credited to the NYC Governmental Customers. The Authority provides the customers with indicative electricity prices for the following year reflecting market-risk hedging options designated by the NYC Governmental Customers. Such market-risk hedging options include a full cost energy charge adjustment ("ECA") pass-through arrangement relating to fuel, purchased power, and NYISO-related costs (including such an arrangement with some cost hedging) and a sharing option where the customers and the Authority will share in actual cost variations as specified in the Agreements.

For 2011 and 2012, the NYC Customers chose a market-risk hedging price option designated an "ECA with hedging" pricing option whereby actual cost variations in variable costs are passed through to the customers as specified above.

With the customers' guidance and approval, the Authority will continue to offer up to \$100 million annually in financing for energy efficiency projects and initiatives at governmental customers' facilities, with the costs of such projects to be recovered from such customers.

In response to the Authority's Request for Proposals for Long-Term Supply issued in March 2005, Authority staff entered into negotiations for the execution of a firm transmission capacity purchase agreement with the winning bidder, Hudson Transmission Partners, LLC (HTP), to serve the long-term requirements of the Authority's NYC Governmental Customers through the transmission rights associated with HTP's proposed 345 kV underground/submarine transmission line (Line) extending from Bergen County, New Jersey, to Con Edison's West 49<sup>th</sup> Street substation in midtown Manhattan. The New York Public Service Commission issued a certificate of environmental compatibility and public need for the Line on September 15, 2010 determining, among other things, that the Line would improve electric system reliability and promote network security by enhancing New York City's transmission infrastructure and its access to generation resources outside of the City. On April 15, 2011, the Authority executed a Firm Transmission Capacity Purchase Agreement (FTCPA) with HTP and the Line is currently under construction. The FTCPA will provide the Authority with 75% of the firm transmission capacity of the 660 MW Line for 20 years. The Authority's obligation to make payments under the FTCPA will begin upon commercial operation of the Line, which is expected in the summer of 2013. Based on minimum monthly payment obligations, the Authority estimates that it will pay an annual amount of approximately \$56 million in the initial year with amounts escalating annually until the annual amount paid in the 20<sup>th</sup> year will be approximately \$88 million for transmission capacity under the contract. The average of the annual payments over the 20-year term of the contract is approximately \$70 million. The Authority will enter into separate power purchase agreements for the supply of electricity for which the transmission capacity will be utilized.

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Under the FTCPA, the Authority also will pay the costs of certain interconnection and transmission upgrades associated with the Line once it enters into service, estimated to total approximately \$200 million.

The Authority is currently in negotiations with certain of its NYC Governmental Customers and other third parties regarding partial recovery of the costs of the Line. It is estimated that the revenues derived from the Authority's rights under the FTCPA will cover the Authority's costs over the life of the Line but not be sufficient to fully cover the Authority's costs under the FTCPA during its initial 20 year term. Depending on a number of variables, it is estimated that the authority's underrecovery of costs under the FTCPA could be in the range of approximately \$40 million to \$80 million per year during the first five years of commercial operation. The Authority expects based on current projections that its entry into the FTCPA it will be able to continue to meet its debt service coverage ratio, cash, and reserve requirements in the future; however, there can be no assurance such requirements will be met.

In anticipation of the closure of the Authority's existing Poletti plant in January 2010, and in addition to its supply agreements, the Authority, in November 2007, issued a nonbinding request for proposals for up to 500 MW of in-city unforced capacity and optional energy to serve the needs of its NYC Governmental Customers. This process which included, among other things, approvals of the NYC Governmental Customers, the Authority and Astoria Energy II LLC, resulted in a long-term electricity supply contract in July 2008 with Astoria Energy II LLC for the purchase of the output of AEII which was constructed and entered into commercial operation on July 1, 2011 in Astoria, Queens, adjacent to its existing plant. The costs associated with the contract are being borne by these customers for the life of the contract. The Authority is accounting for and reporting this lease transaction as a capitalized lease in the amount of \$1.24 billion which reflects the present value of the monthly portion of lease payments allocated to real and personal property as of July 1, 2011. The balance of the monthly lease payments represents the portion of the monthly lease payment allocated to operations and maintenance costs which is recorded monthly. Fuel for the 550-MW power plant is provided by the Authority and the costs thereof are being recovered from the NYC Governmental Customers.

The Authority's other Southeastern New York (SENY) Governmental Customers are the County of Westchester and numerous municipalities, school districts, and other public agencies located in Westchester County (collectively, the "Westchester Governmental Customers"). By early 2008, the Authority had entered into a new supplemental electricity supply agreement with all 103 Westchester Governmental Customers. Among other things, under the agreement, an energy charge adjustment mechanism is applicable, and customers are allowed to partially terminate service from the Authority on at least two months notice prior to the start of the NYISO capability periods. Full termination is allowed on at least one year's notice, effective no sooner than January 1 following the one year notice.

#### (c) **Power for Jobs**

In 1997 and subsequent years, legislation was enacted into New York law which authorized the Power for Jobs Program (the "PFJ Program") to make available low-cost electric power to businesses, small businesses, and not-for-profit organizations. Under the PFJ Program, the New York Economic Development Power Allocation Board ("EDPAB") recommends for Authority approval allocations to eligible recipients of power from power purchased by the Authority through a competitive procurement process and power from other sources. In 2004, legislation was enacted which amended the PFJ Program in regard to contracts of certain customers. Under the amendment, certain contracts terminating in 2004 and 2005 could be extended by the affected customer, or the customer could opt for "Power for Jobs electricity savings reimbursements" ("PFJ Reimbursements") from the Authority. Generally, the amount of such PFJ Reimbursements for a particular customer is based on a comparison of the current cost of electricity to such customer with the cost of electricity under the prior Power for Jobs contract during a comparable period.

Thereafter, the PFJ Program has been extended numerous times and pursuant to the new Recharge New York Power Program ("RNYPP") legislation enacted in 2011, discussed above, the PFJ Program will end on June 30, 2012. The Authority has approved PFJ Reimbursements payments totaling \$280 million for the years 2005-2011 and expects such payments will not exceed \$79 million for the remainder of the extended PFJ Program through June 30, 2012. See notes 12(a) and 12(g), "Recharge New York Power Program," for a discussion of recent legislative activity involving the PFJ Program.

The Power for Jobs legislation authorizes the Authority "as deemed feasible and advisable by the trustees," to make annual "voluntary contributions" to the State in connection with the Program. **Commencing in December 2002 through January**

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2012, the Authority made such voluntary contributions to the State in an aggregate amount of \$469 million in connection with the Power for Jobs Program with another \$6 million authorized for payment in the first quarter of 2012.

#### (d) *Legal and Related Matters*

In 1982 and again in 1989, several groups of Mohawk Indians, including a Canadian Mohawk tribe, filed lawsuits against the State, the Governor of the State, St. Lawrence and Franklin counties, the St. Lawrence Seaway Development Corporation, the Authority and others, claiming ownership to certain lands in St. Lawrence and Franklin counties and to Barnhart, Long Sault and Croil islands (St. Regis litigation). These islands are within the boundary of the Authority's St. Lawrence-FDR Project and Barnhart Island is the location of significant Project facilities. Settlement discussions were held periodically between 1992 and 1998. In 1998, the Federal government intervened on behalf of all Mohawk plaintiffs.

On May 30, 2001, the United States District Court (the Court) denied, with one minor exception, the defendants' motion to dismiss the land claims. However, the Court barred the Federal government and one of the tribal plaintiffs, the American Tribe of Mohawk Indians from relitigating a claim to 144 acres on the mainland which had been lost in the 1930s by the Federal government. The Court rejected the State's broader defenses, allowing all plaintiffs to assert challenges to the islands and other mainland conveyances in the 1800s, which involved thousands of acres.

On August 3, 2001, the Federal government sought to amend its complaint in the consolidated cases to name only the State and the Authority as defendants. The State and the Authority advised the Court that they would not oppose the motion but reserved their right to challenge, at a future date, various forms of relief requested by the Federal government.

The Court granted the Federal government's motion to file an amended complaint. The tribal plaintiffs still retain their request to evict all defendants, including the private landowners. Both the State and the Authority answered the amended complaint. In April 2002, the tribal plaintiffs moved to strike certain affirmative defenses and, joined by the Federal government, moved to dismiss certain defense counterclaims. The defendants filed their opposition papers in September 2002. In an opinion, dated July 28, 2003, the Court left intact most of the Authority's defenses and all of its counterclaims.

Thereafter, settlement discussions produced a land claim settlement, which if implemented would include, among other things, the payment by the Authority of \$2 million a year for 35 years to the tribal plaintiffs, the provision of up to 9 MW of low cost Authority power for use on the reservation, the transfer of two Authority-owned islands; Long Sault and Croil, and a 215-acre parcel on Massena Point to the tribal plaintiffs, and the tribal plaintiffs withdrawing any judicial challenges to the Authority's new license, as well as any claims to annual fees from the St. Lawrence-FDR project. Members of all three tribal entities voted to approve the settlement, which was executed by them, the Governor, and the Authority on February 1, 2005. The settlement would also require, among other things, Federal and State legislation to become effective. Litigation in the case had been stayed to permit time for passage of such legislation and thereafter to await decision of appeals in two relevant New York land claim litigations (Cayuga and Oneida) to which the Authority is not a party.

The legislation was never enacted and once the Cayuga and Oneida appellate decisions were issued in 2005 and 2006, respectively, efforts to obtain legislative approval for the settlement ceased. Because these appellate decisions dismissed land claims by the Cayugas and Oneidas based on the lengthy delay in asserting such claims (i.e., the defense of laches), the defense in the instant actions, in motions filed in November 2006, moved to dismiss the three Mohawk complaints as well as the United States' complaint on similar delay grounds. The Mohawks and the Federal government filed papers opposing those motions in July 2007, and additional briefing by the parties occurred thereafter. By order dated May 16, 2008, U.S. Magistrate Lowe granted the defense motion to stay all proceedings until the U.S. Court of Appeals for the Second Circuit issued its decision in the Oneida case, one raising similar laches issues.

On August 9, 2010, the Second Circuit issued a decision in the Oneida case (Oneida Indian Nation of New York et al. v County of Madison et al.), thereby lifting the stay of this litigation. The Second Circuit, in that case, dismissed both the Native American and U.S. claims in their entirety finding, among other things, that those claims were barred by equitable principles as articulated in the earlier Cayuga and other decisions. U.S. Magistrate Lowe then ordered all parties in the St. Regis case to submit supplemental briefs and, thereafter, oral argument on the pending motions was held before him on June 17, 2011. On February 10, 2012, this case was reassigned. As a result, it would appear that a decision on the outstanding motion will be delayed until the new judge familiarizes herself with the long history of this case.

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The Authority had previously accrued an estimated liability based upon the provisions of the settlement described above. This liability is reflected in the balance sheet as of December 31, 2011.

The Authority is unable to predict the outcome of the matters described above, but believes that the Authority has meritorious defenses or positions with respect thereto. However, adverse decisions of a certain type in the matters discussed above could adversely affect Authority operations and revenues.

In late November 2011, approximately 14 notices of claim were received by the Authority involving the heavy rains and widespread flooding resulting from Tropical Storm Irene's passage through the Northeast in late August 2011. The notices of claim essentially claim that property and other damages allegedly incurred by certain landowners were the result of the Authority's negligence in its operations at its Blenheim-Gilboa Pumped Storage Power Project located on the Schoharie Creek in Schoharie County, New York. In addition, in mid-January 2012, the County of Schoharie, eight towns and villages therein, and one school district ("Municipalities") filed a motion in Schoharie County Supreme Court requesting leave to serve late notices of claim on the Authority. The Municipalities similarly allege in their late notices of claim that they sustained property damage, as well as lost tax revenues, as a result of the Authority's negligence in its operations at the Blenheim-Gilboa Pumped Storage Power Plant. In late February 2012, a private landowner filed a similar motion in such court. While the Authority cannot presently predict whether and to what extent any lawsuits will be initiated based on such notices of claim or similar claims that may be filed in the future, or the outcome of any such litigation, the Authority believes that it has meritorious defenses and positions with respect thereto.

In addition to the matters described above, other actions or claims against the Authority are pending for the taking of property in connection with its projects, for negligence, for personal injury (including asbestos-related injuries), in contract, and for environmental, employment and other matters. All of such other actions or claims will, in the opinion of the Authority, be disposed of within the amounts of the Authority's insurance coverage, where applicable, or the amount which the Authority has available therefore and without any material adverse effect on the business of the Authority.

**(e) Construction Contracts and Net Operating Leases**

Estimated costs to be incurred on outstanding contracts in connection with the Authority's construction programs aggregated approximately \$486 million at December 31, 2011.

Noncancelable operating leases primarily include leases on real property (office and warehousing facilities and land) utilized in the Authority's operations. Commitments under noncancelable operating leases are as follows:

	<u>Total</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>
	(In millions)						
Operating leases	\$ <u>2.2</u>	<u>0.8</u>	<u>0.5</u>	<u>0.4</u>	<u>0.3</u>	<u>0.1</u>	<u>0.1</u>

**(f) Small, Clean Power Plants and 500-MW Plant**

To meet capacity deficiencies and ongoing load requirements in the New York City metropolitan area, which could also adversely affect the statewide electric pool, the Authority placed in operation, in the Summer of 2001, the Small, Clean Power Plants (SCPPs), consisting of eleven natural-gas-fueled combustion-turbine electric units, each having a nameplate rating of 47 MW at six sites in New York City and one site in the service region of LIPA.

As a result of the settlement of litigation relating to certain of the SCPPs, the Authority has agreed under the settlement agreement to cease operations at one of the SCPP sites, which houses two units, as early as the commercial operation date of either the 500-MW plant (December 31, 2005) or another specified plant being constructed in the New York City area, if the Mayor of New York City directs such cessation. No such cessation has occurred.

To serve its NYC Governmental Customers and to comply with the NYISO in-city capacity requirement in the New York City area, the Authority has constructed a 500-MW combined-cycle natural-gas-and-distillate-fueled power plant at the Poletti site (the 500-MW plant) as the most cost-effective means of effectuating such compliance. In connection with the licensing of the 500-MW plant, the Authority entered into an agreement that resulted in the cessation of operation of the Authority's Poletti plant (which had entered into service in 1977) on January 31, 2010.

## NEW YORK POWER AUTHORITY

### Notes to Financial Statements

December 31, 2011 and 2010

#### (g) *New York State Budget and Other Matters*

Section 1011 of the Power Authority Act (Act) constitutes a pledge of the State to holders of Authority obligations not to limit or alter the rights vested in the Authority by the Act until such obligations together with the interest thereon are fully met and discharged or unless adequate provision is made by law for the protection of the holders thereof. Bills are periodically introduced into the State Legislature, which propose to limit or restrict the powers, rights and exemption from regulation which the Authority currently possesses under the Act and other applicable law or otherwise would affect the Authority's financial condition or its ability to conduct its business, activities, or operations, in the manner presently conducted or contemplated by the Authority. It is not possible to predict whether any such bills or other bills of a similar type which may be introduced in the future will be enacted.

In addition, from time to time, legislation is enacted into New York law which purports to impose financial and other obligations on the Authority, either individually or along with other public authorities or governmental entities. The applicability of such provisions to the Authority would depend upon, among other things, the nature of the obligations imposed and the applicability of the pledge of the State set forth in Section 1011 of the Act to such provisions. There can be no assurance that in the case of each such provision, the Authority will be immune from the financial obligations imposed by such provision. Examples of such legislation affecting only the Authority include legislation, discussed below and elsewhere herein, relating to the Authority's voluntary contributions to the State, the Authority's temporary transfer of funds to the State, the Power for Jobs and Energy Cost Savings Benefits programs, and the establishment of the Western New York Economic Development Fund.

#### **Budget**

The Authority is requested, from time to time, to make financial contributions or transfers of funds to the State. Any such contribution or transfer of funds must (i) be authorized by State legislation (generally budget legislation), and (ii) satisfy the requirements of the Bond Resolution. The Bond Resolution requirements to withdraw moneys "free and clear of the lien and pledge created by the (Bond) Resolution" are as follows: (1) such withdrawal must be for a "lawful corporate purpose as determined by the Authority," and (2) the Authority must determine "taking into account, among other considerations, anticipated future receipt of Revenues or other moneys constituting part of the Trust Estate, that the funds to be so withdrawn are not needed" for (a) payment of reasonable and necessary operating expenses, (b) an Operating Fund reserve for working capital, emergency repairs or replacements, major renewals, or for retirement from service, decommissioning or disposal of facilities, (c) payment of, or accumulation of a reserve for payment of, interest and principal on senior debt, or (d) payment of interest and principal on subordinate debt.

In addition, in May 2011, the Authority's Trustees adopted a policy statement ("Policy Statement") which relates to, among other things, voluntary contributions, transfers, or other payments to the State by the Authority after that date. The Policy Statement provides, among other things, that in deciding whether to make such contributions, transfers, or payments, the Authority shall use as a reference point the maintenance of a debt service coverage ratio of at least 2.0, in addition to making the other determinations required by the Bond Resolution. The Policy Statement may at any time be modified or eliminated at the discretion of the Authority's Trustees.

Legislation enacted into law, as part of the 2000-2001 State budget, as amended in subsequent years, has authorized the Authority "as deemed feasible and advisable by the trustees," to make a series of "voluntary contributions" into the State treasury in connection with the Power for Jobs (PFJ) Program and for other purposes as well. Beginning December 2002 through January 2012, the Authority has made voluntary contributions to the State of \$469 million in connection with the Power for Jobs Program with another \$6 million authorized for payment in the first quarter of 2012, and an additional \$402 million unrelated to the Power for Jobs Program. The 2011 (\$65 million) and the 2010 (\$147 million) contributions to State which are not related to the PFJ Program were recorded as a nonoperating expense and classified as contributions to New York State in the 2011 and 2010 statement of revenues, expenses and changes in net assets, respectively. The \$60 million paid in January 2012 will be reported as a nonoperating expense in the 2012 financial statements. In the Governor's proposed budget for State Fiscal Year 2012-2013, released in January 2012, it is proposed that the Authority be authorized to make an additional voluntary contribution of up to \$65 million unrelated to the Power for Jobs Program during such fiscal year. The proposed budget has not yet been enacted into law. Such contributions will only be made if authorized by legislation and approved by the Authority's Trustees as feasible and advisable at that time. See note 12(a), "Recharge New York Power Program," for a discussion of recent legislative activity involving the State Fiscal Year 2012-2013 budget.

## NEW YORK POWER AUTHORITY

### Notes to Financial Statements

December 31, 2011 and 2010

By budget legislation enacted in February 2009, the Authority was further authorized to make certain temporary asset transfers to the State of funds in reserves. Pursuant to the terms of a Memorandum of Understanding dated February 2009 (MOU) between the State, acting by and through the Director of the Budget of the State, and the Authority, the Authority agreed to transfer \$215 million associated with its Spent Nuclear Fuel Reserves (Asset B) by March 27, 2009. The Spent Nuclear Fuel Reserves are funds that have been set aside for the liability to the federal government sometime in the future when the federal government accepts the spent nuclear fuel for permanent storage. The MOU provides for the return of these funds to the Authority, subject to appropriation by the State Legislature and the other conditions described below, at the earlier of the Authority's payment obligation related to the transfer and disposal of the spent nuclear fuel or September 30, 2017. Further, the MOU provides for the Authority to transfer within 180 days of the enactment of the 2009-2010 State budget \$103 million of funds set aside for future construction projects (Asset A), which amounts would be returned to the Authority, subject to appropriation by the State Legislature and the other conditions described below, at the earlier of when required for operating, capital or debt service obligations of the Authority or September 30, 2014. Both transfers were approved by the Authority's Trustees and made in 2009.

The MOU provides that the obligation of the State to return all or a portion of an amount equal to the moneys transferred by the Authority to the State would be subject to annual appropriation by the State Legislature. Further, the MOU provides that as a condition to any such appropriation for the return of the monies earlier than September 30, 2017 for the Spent Nuclear Fuel Reserves and earlier than September 30, 2014 for the construction projects, the Authority must certify that the monies available to the Authority are not sufficient to satisfy the purposes for which the reserves, which are the source of the funds for the transfer, were established.

The Authority classified the transfers of Assets A and B (\$318 million) as a long-term loan receivable. In lieu of interest payments, the State waived certain future payments from the Authority to the State. The waived payments include the Authority's obligation to pay until September 30, 2017 the amounts to which the State is entitled under a governmental cost recovery process for the costs of central governmental services. These payments would have been approximately \$5 million per year based on current estimates but the waiver will be limited to a maximum of \$45 million in the aggregate during the period. Further, the obligation to make payments in support of certain State park properties and for the upkeep of State lands adjacent to the Niagara and St. Lawrence power plants will be waived from April 1, 2011 to March 31, 2017. These payments would have been approximately \$8 million per year but the waiver will be limited to a maximum of \$43 million for the period. The present value of the waivers approximates the present value of the lost interest income.

In May 2009, the County of Niagara, "on behalf of its residents", and several individuals commenced an Article 78 lawsuit in Niagara County Supreme Court against the Authority, its Trustees, the State of New York, and the State Comptroller. The lawsuit challenged on numerous grounds the legality of the two temporary asset transfers totaling \$318 million and two voluntary contributions made by the Authority to the State totaling \$226 million (except as such contributions relate to the Power for Jobs Program). Among other things, the lawsuit sought judgment providing for the return to the Authority of any such monies that have been paid; prohibiting such asset transfers and voluntary contributions in the future; directing the Authority to utilize such returned monies only for "statutorily permissible purposes"; directing the Authority to "rebat" to certain customers receiving hydropower from it some portion, to be determined, of the monies returned to the Authority; and directing that the Authority submit to an audit by the State Comptroller.

By decision dated December 23, 2009, the court denied respondents' motion to dismiss the petition; however, by decision dated March 25, 2011, the Appellate Division unanimously reversed the lower court's ruling and dismissed the amended petition in its entirety; and the Court of Appeals subsequently denied petitioners' motion seeking leave to appeal thereby concluding this litigation.

### Energy Cost Savings Benefits

Legislation was enacted into law in July 2005 (Chapter 313, 2005 Laws of New York) (the 2005 Act) which amended the Act and the New York Economic Development Law (EDL) in regard to several of the Authority's economic development power programs and the creation of energy cost savings benefits to be provided to certain Authority customers. Relating to the Energy Cost Savings Benefits (ECS Benefits), the 2005 Act revises the Act and the EDL to allow up to 70 MW of relinquished Replacement Power and up to 38.6 MW of Preservation Power that might be relinquished or withdrawn in the future to be sold by the Authority into the market and to use the net earnings, along with other funds of the Authority, as deemed feasible and advisable by the Authority's Trustees, for the purpose of providing ECS Benefits. The ECS Benefits are administered by the New York State Economic Development Power Allocation Board (EDPAB) and awarded based on

## NEW YORK POWER AUTHORITY

### Notes to Financial Statements

December 31, 2011 and 2010

criteria designed to promote economic development, maintain and develop jobs, and encourage new capital investment throughout New York State. The ECS Benefits are available only for business customers served under the Authority's High Load Factor, Economic Development Power and Municipal Distribution Agency programs which would have, in the absence of the ECS Benefits, faced rate increases beginning November 1, 2005.

In August 2006, legislation was enacted into law that extended the ECS Benefits Program through June 30, 2007 and also provided that the Authority make available for allocation to customers the 70 MW of hydropower that had been utilized as a source of funding the ECS Benefits. Subsequently, legislation has been enacted that extends the ECS Benefits Program through June 30, 2012, at which time the Program will end pursuant to the legislation establishing the RNYPP, discussed above. From the inception of the ECS Benefits Program through December 2007, there were no ECS Benefits paid by the Authority from internal funds, as opposed to funds derived from the sale of such hydropower. For 2008, the Authority paid \$21 million in ECS Benefits from internal funds. In 2009-2011, no ECS Benefits were paid from internal funds, which is reflective of the current lower market prices for electric energy. See "Recharge New York Power Program" within note 12(a) for a discussion of recent legislative activity involving the ECS Benefits Program.

#### **Other Legislation**

The "Public Authorities Accountability Act of 2005" ("PAAA") was signed into law in January 2006 and its various provisions address public authority reporting, governance, budgeting, oversight, and auditing matters, among other things. Additional public authority reform legislation took effect on March 1, 2010 which provides, among other things, for State Senate approval of certain authorities' chief executive officers, including the Authority, and also provides the State Comptroller with discretionary authority to review and approve certain contracts entered into by public authorities, including the Authority.

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act ("DF Act") which addresses, among other things, interest rate and energy swap transactions of the type in which the Authority engages ("Swaps"). Many of the requirements and processes in this area are to be set forth in regulations promulgated by the Commodities Futures Trading Commission ("CFTC"). The CFTC issued an order on July 14, 2011 that delayed implementation of many of the substantive provisions of the DF Act until December 31, 2011. Depending on the ultimate resolution of numerous issues, which is uncertain, including whether and to what extent Swaps are required to be cleared through clearinghouses and/or traded on exchanges with accompanying collateral and/or margin requirements; whether and to what extent Swaps entered into prior to the enactment of the DF Act are required to be collateralized; and whether and to what extent public power entities such as the Authority are exempted from these requirements, the impact of the DF Act on the Authority's liquidity and/or future risk mitigation activities could be significant. In the event such regulations are applied retroactively to Swap positions predating the enactment of the DF Act, it could require the Authority to post as much as \$185 million in collateral to maintain its open hedge positions as of July 16, 2012 (the revised, full-implementation date adopted by the CFTC in December 2011). The Authority has sufficient liquidity to post such collateral, if required.

In the Governor's proposed budget for State Fiscal Year 2012-2013, released in January 2012, it is proposed that public benefit corporations be authorized to make voluntary contributions into the State treasury or to other public benefit corporations in such amounts as the governing board of such corporation deems feasible and advisable, after due consideration of such corporation's legal and financial obligations, and that any such contribution will be deemed to be a valid and proper purpose for which available funds may be applied. The proposed budget legislation has not yet been enacted into law.

#### **(h) Relicensing of Niagara**

By order issued March 15, 2007, FERC issued the Authority a new 50-year license for the Niagara Project effective September 1, 2007. In doing so, FERC approved six relicensing settlement agreements entered into by the Authority with various public and private entities. By decision dated March 13, 2009, the U.S. Court of Appeals for the District of Columbia Circuit denied a petition for review of FERC's order filed by certain entities, thereby concluding all litigation involving FERC's issuance of the new license. The Authority currently expects that the costs associated with the relicensing of the Niagara Project will be at least \$495 million (2007 dollars) over a period of 50 years, which does not include the value of the power allocations and operation and maintenance expenses associated with several habitat and recreational elements of the settlement agreements. Of the \$495 million, \$218 million has been spent as of December 31, 2011.

## NEW YORK POWER AUTHORITY

### Notes to Financial Statements

December 31, 2011 and 2010

In addition to internally generated funds, the Authority issued additional debt obligations in October 2007 to fund, among other things, Niagara relicensing costs. The costs associated with the relicensing of the Niagara Project, including the debt issued therefore, were incorporated into the cost-based rates of the Project beginning in 2007.

In December 2009, the Authority's Trustees approved an amendment of the Niagara Relicensing Settlement Agreement (Settlement Agreement) to implement a proposal to expedite the then current funding stream provided for Buffalo's waterfront redevelopment effort under the Settlement Agreement in order to facilitate the completion of the Canal Side project and reinvigorate downtown Buffalo's inner harbor area. This acceleration in funding results in the Authority providing a payment stream of \$4.7 million a year for 20 years in lieu of the original payment stream of \$3.5 million per year for the remaining 47 years of the Niagara License.

In addition, the EDPAB and the Authority's Trustees approved an Industrial Incentive Award which provides an additional \$3.7 million a year from 2010 to 2029 to support the harbor revitalization efforts. The second \$3.7 million payment was made in October 2011.

#### (i) **Regional Greenhouse Gas Initiative and Air Pollution Rule**

The Regional Greenhouse Gas Initiative (RGGI) is a cooperative effort by Northeastern and Mid-Atlantic states (including New York) to hold carbon dioxide emission levels steady from 2009 to 2014 and then reduce such levels by 2.5% annually in the years 2015 to 2018 for a total 10% reduction. Central to this initiative is the implementation of a multi-state cap-and-trade program with a market-based emissions trading system. The program requires electricity generators to hold carbon dioxide allowances in a compliance account in a quantity that matches their total emissions of carbon dioxide for the compliance period. The Authority's Flynn, SCPPs, and 500-MW Plant are subject to the RGGI requirements as is AEII. The Authority has participated in program auctions commencing in September 2008 and expects to recover RGGI costs through its power sales revenues. The Authority is monitoring federal legislation and proposed programs that would impact RGGI.

During the last half of 2011, the Environmental Protection Agency ("EPA") issued a series of rulings to establish the Cross-State Air Pollution Rule ("CSAPR"). The CSAPR establishes emission allowance budgets for sulfur dioxide and nitrogen oxides for eastern states, including New York, and requires power plants in those states to hold allowances to cover their emissions. Certain trading of allowances is authorized under the CSAPR. On December 30, 2011, the U.S. Court of Appeals (D.C. Circuit) granted a stay of the CSAPR pending the court's resolution of numerous petitions for review. In the interim, the court indicated that the EPA should continue to enforce its Clean Air Interstate Rule ("CAIR") which the CSAPR was designed to replace. The Authority has been able to operate its fossil plants and the Astoria Energy II plant within the allocated allowances under the CAIR. In the event the CSAPR as promulgated by the EPA ultimately is implemented following judicial review, the Authority anticipates that operation of its fossil plants and the Astoria Energy II plant would not be impacted.

#### (j) **Wind and Solar Initiatives**

In December 2009, the Authority issued a non-binding RFP for development of a utility scale, offshore wind power project in the range of 120 MW to 500 MW to be located within New York State waters of Lake Erie and/or Lake Ontario. The RFP indicated that the Authority would purchase the full output of the project under a long-term power purchase agreement. In June 2010, the Authority announced that five proposals had been received in response to the RFP. Based on a multi-disciplinary review, which included among other things, costs, economic development benefits, community response, and environmental impacts, in September 2011, the Authority's Trustees voted to end the competitive solicitation process for the proposed Great Lakes Offshore Wind Project (GLOW) without awarding a contract for project development.

The Long-Island-New York City Offshore Wind Collaborative (Collaborative), which consists of the Authority, Con Edison, the Long Island Power Authority (LIPA), the City of New York and other New York City and New York State governmental entities, is evaluating the potential development of between 350 MW up to 700 MW of offshore wind. The Collaborative is currently planning the next steps in project evaluation.

In January 2010, the Authority issued an RFP for 100 MW Statewide Solar Photovoltaic initiative seeking pricing for solar energy and related environmental attributes from 100 MW of solar power capacity to be installed statewide by 2014. The purpose of this initiative is to support New York State energy policies and, in particular, the "45 x 15" initiative which is

## NEW YORK POWER AUTHORITY

Notes to Financial Statements

December 31, 2011 and 2010

seeking to meet 45% of the State's energy needs through improved energy efficiency and clean, renewable energy by 2015. All of the solar photovoltaic ("PV") systems would be installed, owned and operated by solar developers who would sell all energy and environmental attributes to the Authority under a 20-year power purchase agreement with the Authority reselling the energy to the host site. The solar PV would be installed primarily at schools and government facilities statewide. Responses to the RFP were received in April 2010 and it is anticipated that the Authority's Trustees will act on this matter later in 2012.

**REQUIRED SUPPLEMENTARY INFORMATION  
(UNAUDITED)**

**NEW YORK POWER AUTHORITY**

Required Supplementary Information

Schedule of Funding Progress for the Retiree Health Plan (Unaudited)

(In millions)

<b>Actuarial valuation date</b>	<b>Actuarial value of assets (a)*</b>	<b>Actuarial Liability (AAL) – projected unit credit method (b)</b>	<b>Unfunded AAL (UAAL) (b – a)</b>	<b>Funded ratio (a/b)</b>	<b>Covered payroll (c)</b>	<b>UAAL as a percentage of covered payroll ((b – a)/c)</b>
January 1, 2010	\$ 218	400	182	55%	\$ 141	129%
January 1, 2008	100	337	237	30	133	178
January 1, 2006	—	301	301	—	130	232
January 1, 2004	—	279	279	—	116	241
January 1, 2002	—	271	271	—	107	253

See accompanying independent auditors' report.



*cutting through complexity*

# New York Power Authority

2011 Audit

Audit Committee

March 27, 2012

[kpmg.com](http://kpmg.com)



# Agenda

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# Audit Results

## Results of Audit:

Completed substantially all audit test work as of February 17, 2012

- Scope and Audit testing consistent with that discussed in November 2011 presentation of 2011 Audit Plan
- Scope focused on:
  - Derivatives (Purchased Power and Financial)
  - NYISO, SENY and Wholesale revenues/receivables
  - Long term debt including compliance with covenants
  - Nuclear Liabilities
  - Litigation/contingencies
  - Investments and compliance with State investment regulations
- No material misstatements identified
- No corrected or uncorrected adjustments identified
- No identified significant deficiencies or material weaknesses in internal controls
- KPMG to issue an unqualified opinion on the Authority's Financial Statements
- KPMG to issue an unqualified opinion on the Authority's compliance with its investment guidelines with no exceptions noted in compliance or internal control

# KPMG Responsibilities under GAAS

## **Our Responsibilities under GAAS:**

We have a responsibility to conduct our audit in accordance with generally accepted auditing standards. In carrying out this responsibility, we planned and performed the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Because of the nature of audit evidence and the characteristics of fraud, we are to obtain reasonable, not absolute, assurance that material misstatements are detected. We have no responsibility to plan and perform the audit to obtain reasonable assurance that misstatements, whether caused by error or fraud, that are not material to the financial statements are detected.

In addition, in planning and performing our audit, we considered internal controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. An audit does not include examining the effectiveness of internal controls and does not provide assurance on internal controls. However, our internal control testwork did not identify any deficiencies in internal controls over financial reporting that we consider to be material weaknesses.

# Significant Accounting Policies

- Significant accounting policies are disclosed in the financial statements
- We have reviewed the accounting policies used by management in preparation of the financial statements and found such policies to be appropriate

Significant Accounting Policies	Financial Statement Accounts Affected	Literature Guidance Summary	Alternative Methods
<ul style="list-style-type: none"> <li>■ Accounting for Rate Regulation</li> </ul>	<ul style="list-style-type: none"> <li>■ Deferred charges</li> <li>■ Regulatory assets/liabilities</li> </ul>	<ul style="list-style-type: none"> <li>■ ASC Topic 980, <i>Regulated Operations</i></li> </ul>	<ul style="list-style-type: none"> <li>■ None</li> </ul>
<ul style="list-style-type: none"> <li>■ Revenue Recognition</li> <li>■ Billed and Unbilled</li> </ul>	<ul style="list-style-type: none"> <li>■ Receivables</li> <li>■ Revenue</li> </ul>	<ul style="list-style-type: none"> <li>■ SAB 101</li> <li>■ FASB Concept 5 and 6</li> </ul>	<ul style="list-style-type: none"> <li>■ None</li> </ul>
<ul style="list-style-type: none"> <li>■ Derivatives – Energy and Interest Rate</li> </ul>	<ul style="list-style-type: none"> <li>■ Purchased power costs</li> <li>■ Interest/financing cost</li> <li>■ Deferred outflows</li> </ul>	<ul style="list-style-type: none"> <li>■ GASB 53</li> </ul>	<ul style="list-style-type: none"> <li>■ None</li> </ul>
<ul style="list-style-type: none"> <li>■ Cash and Investments</li> </ul>	<ul style="list-style-type: none"> <li>■ Cash and investments</li> <li>■ Investment income</li> </ul>	<ul style="list-style-type: none"> <li>■ GASB 31</li> <li>■ GASB 3</li> <li>■ GASB 40</li> </ul>	<ul style="list-style-type: none"> <li>■ None</li> </ul>
<ul style="list-style-type: none"> <li>■ Capital Assets</li> </ul>	<ul style="list-style-type: none"> <li>■ Capital assets, depreciation</li> </ul>	<ul style="list-style-type: none"> <li>■ GASB 34</li> </ul>	<ul style="list-style-type: none"> <li>■ Other depreciation methods</li> </ul>
<ul style="list-style-type: none"> <li>■ Asset Retirement Obligations</li> </ul>	<ul style="list-style-type: none"> <li>■ Other assets</li> <li>■ Other liabilities</li> </ul>	<ul style="list-style-type: none"> <li>■ ASC Topic 410, <i>Asset Retirement and Environmental Obligations</i></li> </ul>	<ul style="list-style-type: none"> <li>■ None</li> </ul>

# Significant Judgments and Estimates

- We have reviewed the accounting estimates used by management in preparation of the financial statements. We evaluated the key factors and assumptions used by management and found such factors and assumptions to be reasonable.

Accounting Area	Literature Guidance Summary	Financial Statement Accounts Affected
<ul style="list-style-type: none"> <li>■ Self-Insurance Accruals                             <ul style="list-style-type: none"> <li>– Claims and Damages</li> <li>– Environmental Reserves</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>■ ASC Topic 450, <i>Contingencies</i></li> <li>■ GASB 10</li> <li>■ GASB 49</li> </ul>	<ul style="list-style-type: none"> <li>■ Deferred credits and other</li> <li>■ Operating expense</li> </ul>
<ul style="list-style-type: none"> <li>■ Asset Retirement Obligations</li> </ul>	<ul style="list-style-type: none"> <li>■ ASC Topic 410</li> </ul>	<ul style="list-style-type: none"> <li>■ Deferred charges, long-term receivables and other</li> <li>■ Deferred credits and other</li> </ul>
<ul style="list-style-type: none"> <li>■ Energy Derivatives</li> <li>■ Interest Rate Derivatives</li> </ul>	<ul style="list-style-type: none"> <li>■ GASB 53</li> </ul>	<ul style="list-style-type: none"> <li>■ Deferred outflows</li> <li>■ Risk management obligations</li> </ul>
<ul style="list-style-type: none"> <li>■ Other Post-employment Benefits (OPEB)</li> </ul>	<ul style="list-style-type: none"> <li>■ GASB 45</li> </ul>	<ul style="list-style-type: none"> <li>■ Miscellaneous receivables and other</li> <li>■ Deferred charges, long-term receivables and other</li> </ul>
<ul style="list-style-type: none"> <li>■ Accounting for Rate Regulation</li> </ul>	<ul style="list-style-type: none"> <li>■ ASC Topic 980</li> </ul>	<ul style="list-style-type: none"> <li>■ Regulatory assets – risk management activities</li> <li>■ Deferred charges, long-term receivables and other</li> </ul>

# Audit Risks and Issues

Key audit risks/account balances and primary procedures to address the risk:

- Derivatives
  - Valuation of derivatives associated with energy price and interest rate fluctuations
    - Verification of external pricing sources and confirmations/statements from counterparties
    - Testing management's determination of hedging effectiveness
    - Review of risk management policies by KPMG Financial Risk Management professionals
- Revenue
  - Appropriate revenue recorded as power is delivered
    - Confirmation of Receivables and detailed testing of SENY / Wholesale revenue
    - Confirmation of Revenue/Receivables with NYISO
- Nuclear Decommissioning Liabilities
  - Reporting and receipt of information and accounting for decommissioning trust and liabilities
    - Review of financial statements for completeness and accuracy of trust assets and obligations
- Capital Lease Accounting
  - Determination of lease accounting for AE II transaction
    - Review of agreement to verify contract provisions
    - Review of key assumptions used

## Audit Risks and Issues (continued)

- Management Judgments and accounting estimates
  - Appropriate methodologies and assumptions in assessing exposures / liabilities
  - Reviewed methodology, assumptions (and third party statements where applicable) for reasonableness of amounts set up as reserves/liabilities
  - Refer to detailed listing of significant judgments and estimates on page 5
- Manual Journals and non recurring transactions
  - Appropriate accounting for existence and accuracy of unusual nonrecurring transactions
  - Selection and review of material journals, large and unusual entries, frequency, management approvals, etc.
- Investments
  - Appropriate accounting for investments in accordance with approved guidelines
  - Fair market value testing of all investments
  - Review of sample of investments for compliance with Board approved policies

# Involvement of Specialists

## Involvement of Specialists and Others

- Information Risk Management
  - Tested Information Technology general controls over SAP and certain Information Technology application controls
- Actuaries
  - Involved an actuary to assist with evaluating the method and assumptions used to estimate the Authority's OPEB obligation and annual cost
- Valuation Specialists
  - Involved our investment pricing desk to assist with verifying the valuation of investments
  - Involved a valuation specialist to assist with evaluating the method and assumptions used to estimate the fair value and effectiveness of the Authority's derivative instruments
- Concurring Review Partner
  - Detail review of financial statements
  - Review of critical audit areas
  - Concurrence on engagement teams planned approach and conclusions

# Consideration of Fraud Risks

## Summary of Fraud-Related Audit Procedures

In accordance with Statement on Auditing Standards (SAS) No. 99, *Consideration of Fraud in a Financial Statement Audit*, we have a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud.

## Presumed fraud risk factors under SAS No. 99

- Risk of misstatement relating to revenue recognition
- Risk of management override of controls
  - Journal entries and adjustments
  - Significant accounting estimates
  - Significant unusual transactions

## Principal Audit Procedures

In executing our fraud-related audit procedures under SAS No. 99, we:

- Performed fraud risk assessment, which included the following:
  - Reviewed analytical procedures performed in planning the audit
  - Completed client/engagement continuance procedures
  - Reviewed interim financial statements
  - Held a meeting among engagement team personnel regarding fraud risk factors
- Evaluated client programs and controls to prevent, detect, and deter fraud
- Made inquiries of certain members of management and others within the entity about the risks of fraud and their knowledge of any fraud
- Reviewed postclosing journal entries and significant accounting estimates
- Reviewed significant accounting estimates and nonroutine transactions

## Other Required Communications

- There were no audit adjustments for the year-ended December 31, 2011.
- There were no disagreements with management on financial accounting and reporting matters.
- We encountered no difficulties in dealing with management in performing our audit.
- Significant Written Communications Between Auditor and Management:
  - Engagement Letter/Contract
  - Management Representation Letter
- Other Information in Documents Containing Audited Financial Statements:
  - Our report does not extend beyond the financial information identified in our report, and we have no obligation to perform any procedures to corroborate other information contained in these documents, for example, Management’s Discussion and Analysis.
  - We have, however, read the other information included in the Authority’s MD&A, and no matters came to our attention that cause us to believe that such information is materially inconsistent with the information, or manner of its presentation, appearing in the financial statements.
- We are in compliance with the Public Authority Accountability Act in regards to non-audit services.
- We are independent in accordance with AICPA Standards and Governmental Auditing Standards (Yellow Book Requirements).

## KPMG Reports

- Audit Opinion on the Authority's Financial Statements as of and for the year ended December 31, 2011
- Accountant's Report on Investment Compliance with New York State Guidelines
- Required Communications to the Audit Committee
- Auditor's Report on Internal Control over Financial Reporting and on Compliance on Other Matters
- Management Letter – not applicable this year



*cutting through complexity*

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# AUDIT COMMITTEE

## 2012 INTERNAL AUDIT PLAN

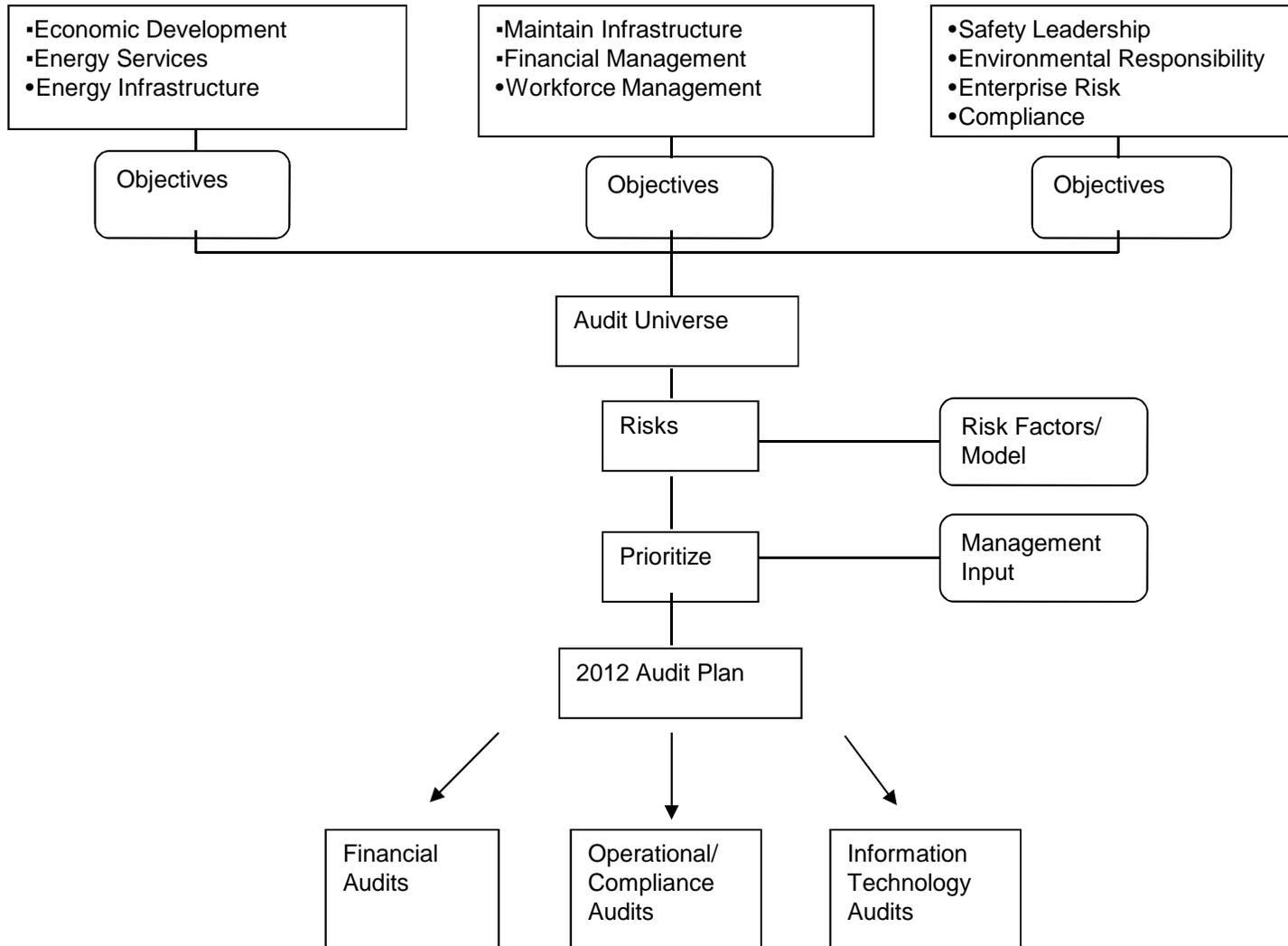
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# 2012 AUDIT PLAN SUMMARY

- 2012 Plan is based on the results of the risk assessment survey and management input.
- Focus on the high risk areas as identified by our risk assessment.
- Forty (40) audits are scheduled including 30 financial/operational and 10 information technology audits covering all Business Units.
- Nine (9) financial/operational and/or information technology audits will be conducted at the facilities.
- Key audits scheduled include Generation Resource Management, Counterparty Credit, Energy Services Operations, Safety Program, ReCharge NY Customer Revenues, ReCharge NY Program Management, Power Supply Operational Planning, and operational audits at SENY and Blenheim-Gilboa.
- Other projects include assistance to KPMG in their audit of NYPA's Financial Statements, work on Economic Development Job Commitment audits, vendor contract audits and the usual support to the Ethics office.
- 2012 Plan will provide comprehensive audit coverage, deploying Internal Audit resources in an effective and efficient manner.
- Performance Goals
  - Completion of high risk audit areas – goal of 100%.
  - Completion of the Audit Plan – goal  $\geq$  90%.

# 2012 Audit Plan Planning Process Strategic Result Areas



# 2012 AUDIT PLAN

## RISK ASSESSMENT METHODOLOGY

- NYPA's Strategic Plan, business activities and related control systems are examined to determine auditable entities (Audit Universe).
- Meetings and interviews with business owners were conducted to obtain feedback on critical business objectives and risks.
- A risk assessment is performed on all auditable entities based upon the following risk factors (see Appendix A on page 11 for definition of risk factors):
  - Profit and Loss Impact of the Business Function
  - Perception/Reputational Risk
  - Changes in Operations or Systems/Known Control Issues
  - Customer Impact from Process Disruption/Failure
  - Business Model Complexity/Organizational Size
  - Legal/Regulatory Compliance
  - Level of Impact on Financial Reporting
  - Strategic Alignment
- Audits are ranked from high to low in terms of the relative risk they represented based on the risk assessment performed by Internal Audit.
- Audit Plan is developed based on the results of the risk assessment and management input.
- Proposed Audit Plan is presented to Executive Management and the Audit Committee for discussion and feedback.

# 2012 Audit Plan

	Financial/Operational Audits	Business Unit	Description
1	ReCharge NY Program Management	Marketing & Economic Development	Review NYPA's governance documents to ensure program is set up in accordance with the legislation. Review customer files and verify compliance with policies and procedures. Review rate setting process to ensure adequacy and effectiveness of controls.
2	Energy Services Operations	Energy Services & Technology	Review implementation of prior audit recommendations. Evaluate operating procedures and controls over vendor selection, vendor management, project management, cost estimation, contingencies, and risk mitigation/management. Review performance metric for applicability and ensure metrics are accurately monitored and reported.
3	Power Supply Operational Planning	Power Supply	Evaluate operational planning activities including short and long term plans. Determine how current events and/or equipment failure are considered in the operational planning process. Review information and communication between regional and Headquarters personnel involved in the planning activities.
4	Public Authorities Law (PAL) Compliance	Law Department/Various	Evaluate the overall processes/controls implemented by NYPA to ensure compliance with PAL requirements. Confirm that NYPA is complying with the reporting, governance and administrative requirements of the PAL. Verify compliance with selected NYPA policies and procedures.
5	Counterparty Credit	Business Services	Confirm the resolution of prior audit issues. Evaluate the effectiveness of management's process for monitoring, assessing, and managing counterparty risks in relation to energy and treasury activities.
6	SENY Government Services Program	Energy Services & Technology	Review controls and procedures over (1) Project Selection and Facility Audits, (2) Construction Authorization, (3) Procurement of Material and Installation Labor, (4) Accounting for Project Costs, (5) Program Recovery and Overhead Costs, and (6) Project Closeout.
7	Salary Administration	Enterprise Shared Services/Human Resources	Review NYPA's policies, procedures and controls over Salary Administration. Verify compliance with Salary Administration Policy. Confirm that documentation exists to support approval and justification for promotions and upgrades.

# 2012 Audit Plan

	Financial/Operational Audits	Business Unit	Description
8	Generation Resource Management	Power Supply/Energy Resource Management	Review processes and controls over the bidding of NYPA generation resources in the NYISO markets. Verify compliance with established policies and procedures. Assess the effectiveness of management's monitoring and reporting process.
9	Hydro Revenues	Business Services/Energy Resource Management	Determine the adequacy and effectiveness of procedures and controls over Niagara/St. Lawrence revenues. Review procedures for billings of Municipal customers, Expansion and Replacement customers and Direct Service Industrial customers. Review processes related to Energy Accounting.
10	ReCharge NY Customer Revenues	Business Services/ Marketing & Economic Development	Review procedures, processes and controls related to billings of ReCharge NY customers and cash receipts. Ensure that customers are billed accurately based upon meter data received and at the proper rates. Verify compliance with the terms of customer contracts.
11	SENY Long Term Agreement (LTA)	Business Services	Review processes and controls in the development of Annual Cost of Service and the reliability of financial and operating information used in connection with the LTA. Review process for billing of costs. Verify compliance with the various terms and conditions of the LTA. Review management reporting process for timeliness and accuracy.
12	NYISO Energy Settlements – Load Serving Entities	Energy Resource Management	Review processes and controls associated with Energy Scheduling, Energy Settlements, NYISO Settlement Data and Reconciliation, NYISO Rebills and recording of Energy Settlements in SAP.
13	Public & Governmental Affairs Expenditures	Public & Governmental Affairs	Review procedures, processes and controls over Public & Governmental Affairs Expenditures. Review Budget Monitoring procedures, Contributions and Sponsorships, and Department expenditures. Verify compliance with established policies and procedures.
14	St. Lawrence Life Extension	Power Supply	Review implementation of prior audit recommendations. Evaluate the adequacy and effectiveness of project management/administrative controls. Verify the accuracy of project activity reports. Ensure appropriateness of financial management activities including compliance with procurement, cost estimating, quality assurance plan and Accounting policies and procedures.

# 2012 Audit Plan

	Financial/Operational Audits	Business Unit	Description
15	Enterprise Risk Management	Business Services	Review Enterprise Risk (ER) Management Program policies and procedures to ensure that they are up-to-date and consistent with NYPA's current risk management efforts. Review NYPA's compliance with ER Program policies and procedures.
16	Astoria Energy II Project Agreement	Energy Resource Management	Review procedures, processes and controls over NYPA's Tolling Agreement with Astoria Energy II. Verify compliance with the various terms and conditions of the Tolling Agreement.
17	Licensing Operations and Compliance	Power Supply	Evaluate processes and controls associated with ensuring compliance with existing licenses (tracking, monitoring and performance). Review Licensing expenditures and related controls. Verify compliance with established NYPA policies and procedures. Review management reporting processes for timeliness and reporting.
18	SENY Outage Management	Power Supply	Review outage management practices at SENY including project scoping, cost estimation, vendor selection and vendor management activities. For the 2011 Flynn outage and recent outages at Small Clean Power Plants, review cost and schedule activities.
19	Central Region O&M	Power Supply	Confirm that controls remain adequate and effective as it relates to plant reliability, efficiency and effectiveness. Evaluate processes and procedures for the planning, monitoring and controlling of operating and maintenance expenses including outside contractors. Confirm compliance with selected NERC Reliability Compliance Requirements. Test for site's compliance with the Maintenance Resource Management Program.
20	Fleet Operations/Corporate Plane	Enterprise Shared Services	Review processes and controls associated with the management of NYPA's fleet vehicles and Corporate Plane. Review usage controls and operating and maintenance expenses. Review fleet acquisitions and disposals. Verify compliance with NYPA policies and procedures.
21	Safety Program	Power Supply	Confirm the resolutions of prior audit issues. Review processes/controls related to identifying required safety training as well as developing, delivering and tracking/monitoring required training. Review Health & Safety Program goals and performance metrics.

# 2012 Audit Plan

	Financial/Operational Audits	Business Unit	Description
22	Purchasing/Warehousing – CEC	Enterprise Shared Services	Review processes and controls associated with purchasing and warehousing activities at the Clark Energy Center. Verify compliance with established NYPA policies and procedures.
23	Headquarters ProCard	Enterprise Shared Services	Verify compliance with the Procurement Credit Card Policy and review processes and controls over (1) ProCard purchases, (2) Approval of ProCard purchases, (3) Monitoring of ProCard purchases, and (4) Records Retention.
24	B-G Finance & Administration	Business Services	Review procedures, processes and controls over budget monitoring, accounts payable, payroll and travel and living expenses. Verify compliance with established NYPA policies and procedures.
25	NYISO Installed Capacity	Marketing & Economic Development	Review procedures, processes and controls associated with the determination of NYPA’s Installed Capacity (ICAP) requirements in NYC, Long Island and the rest of New York State. Review NYPA’s monthly ICAP certification to the NYISO. Review sales of surplus capacity and purchases for deficient capacity.
26	Small Clean Power Plants O&M	Power Supply	Review implementation of prior audit recommendations. Evaluate NYPA’s vendor management controls in place to oversee contractor performance. Review for compliance with contract terms and conditions.
27	Configuration Management Program	Power Supply	Review NYPA-wide compliance with the Configuration Management Policy. Ensure governance documents clarify program scope, roles and responsibilities. Confirm that controls exist for ensuring compliance when third party engineering firms are a party to configuration changes. Review procedures and processes for Headquarters and sites.
28	NYISO Transmission Settlements	Energy Resource Management	Review processes and controls associated with Transmission revenues and charges billed by the NYISO. Review NYISO Transmission User Charges for congestion and losses. Review NYPA Transmission Adjustment Charge. Review congestion charges billed to Con Edison.
29	Assistance to KPMG	Business Services	Assist KPMG in their annual audit of NYPA’s financial statements.
30	Vendor Audits	Enterprise Shared Services/ Various	For selected procurement contracts, determine that contractor charges are supported and in agreement with contract terms and conditions. Determine that the contractor provided all information and services outlined in the contract and internal controls exist to oversee the contractor’s performance.

# 2012 Audit Plan

	Information Technology Audits	Business Unit	Description
1	Mobile Device Security and Controls	Enterprise Shared Services	Test and evaluate the security and controls over mobile devices to determine if they are adequately protected from unauthorized access, use, disclosure or modifications, damage, or loss using best security practices.
2	SAP – General Ledger	Enterprise Shared Services	Review, test and evaluate SAP General Ledger application controls, documentation and procedures.
3	Electronic Record Management System (LiveLink)	Enterprise Shared Services	Review, test and evaluate Records Management System application controls, documentation and procedures.
4	Energy Management System	Power Supply	Test and evaluate the Energy Management System (EMS) application controls, documentation and procedures. Also, review and test the interfaces with NYISO and NYPA network to determine if EMS is adequately protected from unauthorized access, use, disclosure or modification, damage or loss using best security practices.
5	Information Security – SAP	Enterprise Shared Services	Test and evaluate the SAP Security to determine if it is adequately protected from unauthorized access, use, disclosure or modification, damage or loss using best security practices.
6	SCADA System	Power Supply	Test and evaluate the procedures, access security, controls and documentation implemented over the SCADA systems. Review and test for compliance with NERC-CIP requirements.
7	SAP Business Intelligence	Enterprise Shared Services	Review, test and evaluate SAP Business Intelligence application controls, documentation and procedures.
8	IT Disaster Recovery Plan	Enterprise Shared Services	Evaluate the IT Disaster Recovery Plan (ITDRP) to determine if it is adequate to ensure the recovery of critical systems, applications, data and operations in the WPO. Review the training and testing plans, results and the updating of ITDRP.
9	WPO Data Center	Enterprise Shared Services	Test and evaluate procedures and controls over the White Plains Office Data Center. Review physical security, environmental controls and fire protection.
10	SAP Business Planning Consolidation	Enterprise Shared Services	Review, test and evaluate SAP Business Planning Consolidation application controls, documentation and procedures.

# Annual Audit Planning Tool: Risk Rating Factors (Utilize in the ranking & prioritization of potential audits) Appendix A

These eight factors are utilized in the ranking & prioritization of potential audits. The highest combined score warrants the area to be on the current year's audit plan.

## 1. P&L Impact of the Business Function:

- 4 Low P&L Impact or Capital Allocation (< 1% income)
- 8 Moderate P&L Impact or Capital Allocation (>1%, <5% income)
- 12 High P&L Impact or Capital Allocation (>5% income)

## 2. Changes in Operations or Systems / Known Control Issues:

- 4 Minor Business Changes or Reported Control Issues
- 8 Moderate Changes (Business Restructuring; Major System Release; High/Key Turnover) or Reported Control Issues
- 12 Significant Changes (New Mission-Critical Systems; In/Out-Sourcing of Process) or Reported Control Issues

## 3. Customer Impact from Process Disruption/Failure:

- 4 Minor – Slight Delays or disruption in delivery services to customers
- 8 Moderate – Significant Delays or short term Inability of delivery services to customers
- 12 Significant – Broken Promises or Inability to Meet Customer Commitments

## 4. Business Model Complexity/Organizational Size:

- 2 Low – Limited 3<sup>rd</sup> Party or Cross-Functional Dependency (<25%) / Low Transaction Volume
- 4 Moderate – Some 3<sup>rd</sup> Party or Cross-Functional Dependency (>25% and <50%) / Moderate Transaction Volume
- 6 Significant – Significant 3<sup>rd</sup> Party or Cross-Functional Dependency (>50%) / High Transaction Volume

## 5. Legal/Regulatory Compliance:

- 2 Minimal Risk of Litigation or government actions / Minimal Compliance Effort Required
- 4 Moderate Risk of Litigation or government actions / Moderate Compliance Effort Required
- 6 Significant Risk of Litigation or government actions / Significant Compliance Effort Required

## 6. Level of Impact on Financial Reporting (PAAA) Controls:

- 2 Low – Area impacts operational issues and is not an input or output to financial reporting data
- 4 Moderate – Area has indirect or some factors in the input or output to financial reporting data
- 6 High – Area has direct effect on the input or output of financial reporting data

## 7. Strategic Alignment:

- 2 Low – Audit has Indirect Impact on Corporate Initiatives
- 4 Moderate – Audit has Direct Impact on a Minor Corporate Initiative
- 6 High – Audit has Direct Impact on a Major Corporate Initiative

## 8. Perception / Reputational Risk

- 4 Low likelihood & impact of reputational and political / public opinion
- 8 Medium likelihood & impact of reputational and political / public opinion
- 12 High likelihood & impact of reputational and political / public opinion

# 2012 Audit Plan

## Internal Audit



# 2012 Audit Plan

## Internal Audit Staff

### Educational Background and Experience

#### **Lesly Pardo**

Vice President – Internal Audit

Education: BBA – Baruch College

MBA – St. John's University

Certifications: Certified Public Accountant, Certified Internal Auditor, Certified Information Systems Auditor, Certified Fraud Examiner, Certified Management Accountant

Experience: Over 32 years of experience including 5 years in Public Accounting and 26 years in Internal Auditing

#### **Steven Apa**

Manager – Special Audit Services

Education: BSBA – Northeastern University

Certifications: Certified Public Accountant, Certified Fraud Examiner, Certified Financial Forensic

Experience: Over 27 years of experience; 9 years private industry; 18 years Public Accounting & Consulting

#### **Frank Deaton**

Manager – Operational Audit

Education: BS Accounting – SUNY Albany

Certifications: Certified Bank Auditor

Experience: Over 21 years of experience primarily in the financial services industry. 15 years of Internal Auditing experience – joined NYPA in April 2007

#### **George Varughese**

Manager – Internal Audit

Education: BS Accounting – CUNY, NY

MS Information Systems Auditing – New York University Wagner School

Certifications: Certified Public Accountant

Experience: Over 29 years of diversified accounting/auditing experience

# Audit Committee

Internal Audit Activity Report

December 31, 2011

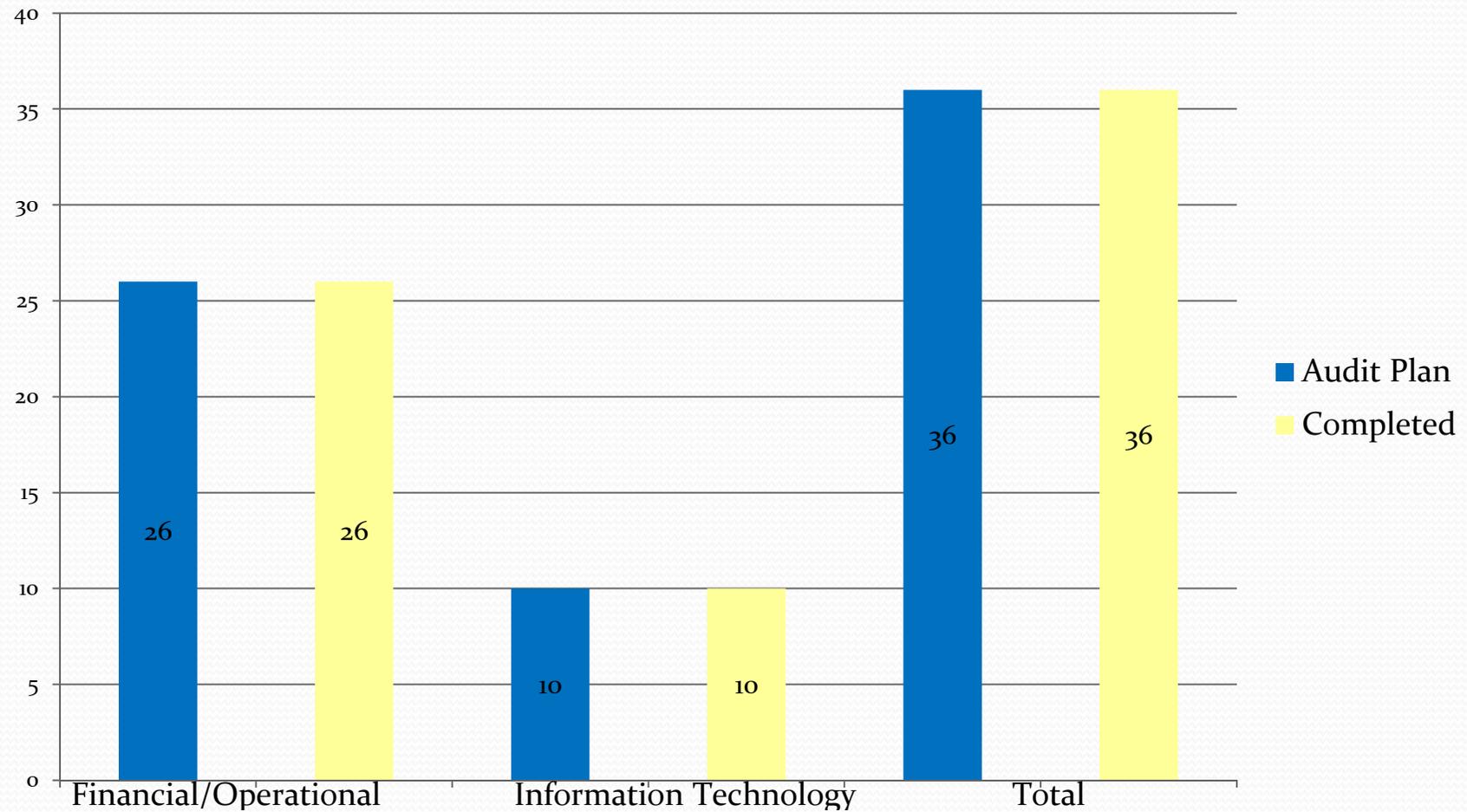
2011 INTERNAL AUDIT PLAN  
ACTIVITY REPORT  
12/31/11  
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2011 INTERNAL AUDIT PLAN  
ACTIVITY REPORT  
12/31/11  
SUMMARY

- Completed 36 audits and projects including 26 financial/operational and 10 information technology audits.
- All audits in the revised Audit Plan were completed.
- Issued 30 audit reports. Six (6) reports under review as of 12/31/11.
- Sixty-one (61) recommendations were made to improve internal controls/operational efficiency.
- All recommendations have been accepted by management. Accepted recommendations are being actively tracked and critical recommendations implemented are being verified.
- Met or exceeded performance goals for:
  - Completion of high risk audit areas – 100% (goal 100%).
  - Completion of the Audit Plan – 100% (goal 90%).
- We are receiving management’s full cooperation and support.

2011 INTERNAL AUDIT PLAN  
ACTIVITY REPORT  
12/31/11  
AUDIT PLAN STATUS



# 2011 INTERNAL AUDIT PLAN ACTIVITY REPORT 12/31/11 AUDIT PLAN UPDATE

## FINANCIAL

- Customer Load Forecasting (C)
- Medical & Dental Benefits (C)
- Niagara Purchasing & Warehousing (C)
- Power for Jobs Revenues (C)
- Energy Cost Savings Benefit Customer Revenues (C)
- Investments/Investment Income (C)
- NYISO Generation Settlements (C)
- Headquarters Accounts Payable (C)
- Fuel Operations (C)
- NYPA Energy Services Program (C)
- SENY Revenue (C)
- Energy Services- Solar Projects (1)
- Niagara Finance & Administration (C)
- NYISO Ancillary Service Revenues & Expenses (C)
- Headquarters Procurement – Outline Agreements (C)
- Headquarters Travel & Living Expenses (C) (2)

## INFORMATION TECHNOLOGY

- SAP Fixed Assets (C)
- SAP – Human Resources (C)
- Change Control – SAP (C)
- Information Security – SAP (C)
- Energy Management System (C)
- Intrusion Prevention & Detection (C)
- Energy Control Center LAN (C)

C = Completed  
(1) = Audit Postponed  
(2) = Audit Added

## INFORMATION TECHNOLOGY (Continued)

- Internet/Intranet Security (C)
- Database Administration (C)
- Niagara LAN (C)

## OPERATIONAL/COMPLIANCE

- Environmental, Health & Safety Audit Programs (C)
- Maintenance Resource Management Program (C)
- Revenue Requirements (C)
- Customer Power Contracts (C)
- Law Department Selected Activities (C)
- Records Management (C)
- Transmission Line Maintenance (C)
- Energy Hedging (C)
- Engineering Support Services (C)
- Central Region O&M (1)
- Northern Region O&M (C)
- Compliance with NYS Comptroller's Contract Review and Reporting Requirements (C) (2)

## OTHERS

- BPS Enterprise Audit Software Implementation (C)
- NERC Reliability Compliance – Consulting (C)
- Vendor Contract Audits (C)
- EDP Customer Job Commitment Audits (C)
- Assistance to KPMG (C)

# 2011 INTERNAL AUDIT PLAN

## ACTIVITY REPORT

### 12/31/11

### REPORT RECAP

Report Name	High-Level Audit Objectives	Observations/Findings/ Recommendations
Northern Region Operations & Maintenance	Determine that (1) Water Entitlements are being managed in accordance with written agreements, (2) Assets are being managed in the manner which optimizes plant reliability and availability, (3) Maintenance procedures support the facility's objectives of optimal plant reliability and availability, (4) Costs are being appropriately monitored and controlled, and (5) Information Technology controls are in place.	<ul style="list-style-type: none"> <li>-Overall controls are adequate and working effectively.</li> <li>-Supervisory review of plant performance data should be documented.</li> <li>-Work Management Committee and Maintenance Resource procedures should be consistently followed.</li> </ul>
Energy Management System	Test and evaluate controls over changes, maintenance, and upgrades to the Energy Management System. Review user access controls, backup and recovery controls.	<ul style="list-style-type: none"> <li>-Controls over the Energy Management System application are effective.</li> <li>-The actual application roles granted to users of the Energy Management System application should be reviewed as part of the quarterly review process.</li> </ul>
Headquarters Travel & Living Expenses	Review procedures, processes and controls over (1) Travel Reservation Procedures, (2) Processing of Employee Expense Statements, (3) Direct Billed Account for air/train travel, and (4) Access controls over SAP Travel Module. Verify compliance with the Travel and Business Meal Policies.	<ul style="list-style-type: none"> <li>-Overall controls are working effectively.</li> <li>-NYPA's Business Meal Policy should be revised to require the most senior staff in attendance to pay and claim reimbursement for the off premises meals with other NYPA employees and contractors.</li> </ul>

# 2011 INTERNAL AUDIT PLAN

## ACTIVITY REPORT

### 12/31/11

### REPORT RECAP

Report Name	High-Level Audit Objectives	Observations/Findings/Recommendations
Niagara Local Area Network (LAN)	Review, test and evaluate the physical security and access controls of the Niagara LAN. Assess the environmental controls (air conditioning, humidity, electrical, fire protection and water detection). Verify that backup and recovery procedures are effective.	-Overall controls over the LAN activities provide adequate protection for the Authority's Niagara LAN and its components.
Governmental Billing - SENY	Determine the adequacy and effectiveness of controls over SENY Revenues. Review procedures and processes for processing of meter reading data and billings of customers.	<p>-For the first nine months of 2011, energy sales to SENY customers consisted of 7.4 billion Kwh with total billed revenues of \$1.4 billion.</p> <p>-Controls over customer billings, processing of meter reading data and customer consumption review procedures are effective.</p> <p>-An edit report to check for accounts that lack demand or energy charges should be developed.</p>
Energy Control Center Local Area Network (LAN)	Review, test and evaluate the physical security and access controls of the ECC LAN. Assess the environmental controls (air conditioning, humidity, electrical, including UPS and backup generators), fire protection, and water detection and protection. Verify that backup and recovery procedures are effective.	Overall controls over the LAN and Data Center activities provide adequate protection for the Authority's ECC LAN and Data Center and components.

**2011 INTERNAL AUDIT PLAN  
ACTIVITY REPORT  
12/31/11  
REPORT RECAP**

Report Name	High-Level Audit Objectives	Observations/Findings/ Recommendations
Niagara Finance and Administration	Review procedures, processes and controls over budget monitoring, accounts payable, payroll and travel and living expenses.	<ul style="list-style-type: none"> <li>-Controls over the processing of new hires and union employees salary changes in SAP need improvements.</li> <li>-Develop formal procedures to cover the approval process for new hires.</li> </ul>
Compliance with NYS Comptroller's Contract Review and Reporting Requirements Audit	Confirm compliance with contract submission and filing requirements for eligible and exempt procurement contracts as required by NYCRR Title 2 Part 206.	<ul style="list-style-type: none"> <li>-Controls to ensure compliance with NYS Comptroller's Reporting and Review requirements for contract amendments can be improved.</li> <li>-Update Procurement Guidelines to clarify expectations for handling of contract amendments.</li> </ul>
Engineering Support Services – FERC Compliance Audit	Evaluate the adequacy and effectiveness of internal controls related to NYPA's FERC Dam Safety Program.	<ul style="list-style-type: none"> <li>-Controls are adequate and generally effective.</li> <li>-Update FERC compliance governance materials.</li> <li>-Work orders in the Maximo System should be periodically reviewed.</li> </ul>
Energy Hedging Transactions	Determine whether activities and controls of the Front, Middle and Back Offices related to energy hedging are in compliance with NYPA policies and procedures.	Current systems of control are satisfactory to ensure energy hedging transactions are entered into and managed consistently with the related hedging objectives and in compliance with NYPA policies and procedures.

**2011 INTERNAL AUDIT PLAN**  
**ACTIVITY REPORT**  
**12/31/11**  
**REPORT RECAP**

<b>Report Name</b>	<b>High-Level Audit Objectives</b>	<b>Observations/Findings/ Recommendations</b>
Fuel Operations	Test and evaluate procedures and controls over procurement of fuel oil and natural gas, Fuel Operations scheduling, natural gas deliveries, and the review and approval of supplier invoices.	Internal controls over fuel purchases and expenditures were found to be adequate and effective.
Internet/Intranet Security	Evaluate the adequacy and effectiveness of internal controls over the NYPA firewalls and to ensure compliance with established policies, procedures, guidelines and best security practices.	Overall controls over the Internet/Intranet Security provide adequate protection for the Authority's network and its components.
Data Base Administration	Review controls and procedures over NYPA's Data Bases and verify that controls allow only authorized access to the Data Bases based on job responsibilities.	Controls over NYPA's Data Base Management System and Data Bases were found to be adequate and effective.
Outline Agreement	Evaluate the adequacy and effectiveness of controls and processes over the issuance of Outline Agreements, processing of purchase order releases and the monitoring and reporting of Outline Agreements.	-Controls are effective and operating as designed. -Outline Agreements were processed in accordance with NYPA's Expenditure Authorization Procedures.