

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

**March 21, 2013**

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Minutes of the regular meeting of the New York Power Authority's Audit Committee held at the Authority's offices at 123 Main Street, White Plains, New York at approximately 9:30 a.m.

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

Trustee Terrance P. Flynn, Chairperson  
Trustee R. Wayne LeChase

Trustee Eugene L. Nicandri, Excused

**Also in attendance were:**

John Koelmel	Chairman, New York Power Authority
Gil Quiniones	President and Chief Executive Officer
Edward Welz	Chief Operating Officer
Judith McCarthy	Executive Vice President and General Counsel
Donald Russak	Executive Vice President and Chief Financial Officer
William Nadeau	Senior Vice President and Chief Risk Officer
Karen Delince	Corporate Secretary
Thomas Concadoro	Vice President and Controller
Dennis Eccleston	Vice President – Information Technology/Chief Information Officer
Lesly Pardo	Vice President – Internal Audit
Frank Deaton	Director – Enterprise Risk Management
Gary Schmid	Manager – Network Services
Lorna Johnson	Associate Corporate Secretary
Sheila Baughman	Assistant Corporate Secretary
Kenneth Deon	Engagement Partner, KPMG
Scott Heiser	Senior Manager, KPMG

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Chairman Terrance P. Flynn presided over the meeting. Corporate Secretary Delince kept the Minutes.

**Introduction**

*Chairman Terrance Flynn welcomed committee member Trustee LeChase, the Authority's Chairman and senior staff to the meeting. He said the meeting had been duly noticed as required by the Open Meetings Law and called the meeting to order pursuant to section B(4) of the Audit Committee Charter.*

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

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

2. **Consent Agenda:**

Upon motion made and seconded the Consent Agenda was approved.

a. **Approval of the Minutes**

Upon motion made and seconded, the Minutes of the Committee's Regular Meeting of September 24, 2012 were approved.

**b. 2013 Internal Audit Plan**

The Vice President of Internal Audit submitted the following report:

SUMMARY

“The Internal Audit Plan summarizes the audits and projects that Internal Audit anticipates performing during 2013. The 2013 Internal Audit Plan was developed through a formal risk assessment process and taking into account NYPA’s Strategic Plan.

BACKGROUND

“The Internal Audit Department is an independent, objective and consulting function designed to add value by improving the Authority’s internal control structure and operations. It helps the organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate, test and improve the effectiveness of internal controls, risk management and governance processes.

“The Audit Committee Charter states that the Committee shall provide oversight of the Office of Internal Audit (“OIA”) and the OIA’s resources and activities to facilitate the OIA’s improvement of internal controls. In addition, the Committee shall meet at least three times a year with the head of the OIA for the purpose of reviewing audit activities, audit findings, management’s responses, remedial action plans, and providing the OIA with an opportunity to discuss items and topics of relevance to the Audit Committee.

DISCUSSION

“Highlights of the 2013 Internal Audit Plan

- The 2013 Internal Audit Plan is based on the results of a formal risk assessment process and management input.
- The risk assessment process considered various risk factors such as: financial impact, reputational risk, complexity, size, changes in operations/systems and internal controls. Exhibit “2b-A” summarizes the risk assessment process.
- NYPA’s Strategic Plan and operating/capital budgets were reviewed and meetings were conducted with business owners to help ensure all potential risk areas were identified.
- Focus on the high risk areas identified by the risk assessment process. Forty-one (41) audits are scheduled, including 31 financial/operational and 10 information technology audits, covering all Business Units. The 2013 Internal Audit Plan is shown on Exhibit “2b-B.”
- Ten (10) financial/operational and/or information technology audits will be conducted at the facilities.
- Key audits scheduled include Emergency Management, Energy Hedging, Energy Efficiency Program, Safety Program, Recharge New York Program Management, NERC Compliance, Lewiston Pump Generation Plant Life Extension and Modernization, Fuels Operations, and operational audits at Niagara and Southeast New York (“SENY”).
- Other audit activities include assistance to KPMG in its audit of NYPA’s Financial Statements, work on Economic Development Job Commitment audits, vendor contract audits and the usual support to the Ethics office.
- The 2013 Internal Audit Plan will provide comprehensive audit coverage, deploying Internal Audit resources in an effective and efficient manner.

- The Internal Audit Plan was prepared based on current staffing levels. Internal Audit includes ten professional auditors and an executive administrative staff.
- The Audit staff holds professional certifications such as Certified Public Accountant, Certified Internal Auditor and Certified Information Systems Auditor, and some have earned advanced educational degrees. Exhibit “2b-C” provides the organizational structure of Internal Audit along with staff’s educational and experience information.
- Performance Goals
  - Completion of the Internal Audit Plan – goal  $\geq$  90%.
  - Completion of high risk audit areas – goal of 100%.
- Internal Audit will participate in an external quality assurance review as required by the International Standards for the Professional Practice of Internal Auditing (IIA Standards) once every five years. The objective of the review is to determine whether Internal Audit is in compliance with IIA Standards and to identify improvement opportunities.”

**DISCUSSION AGENDA:**

**3. Year-end 2012 Financial Report**

The Vice President and Controller submitted the following report:

**SUMMARY AND DISCUSSION**

“Pursuant to Section 2800 of the Public Authorities Law, as amended by the Public Authorities Accountability Act of 2005 (‘PAAA’), the Authority is required to file its financial report for the year ended December 31, 2012 and submit this report to the Governor, legislative leaders, the State Comptroller and the Authorities Budget Office (Exhibit ‘3-A’). The PAAA reflects the State’s commitment to maintaining public confidence in public authorities by ensuring that the essential governance principles of accountability, transparency and integrity are followed at all times.

“This year-end 2012 financial report includes financial statements that present the financial position and results of operations of the Authority as of December 31, 2012 under generally accepted accounting principles. The report is prepared by staff and the financial statements are audited by independent accountants from KPMG LLP. As required by the PAAA, the financial reports have been certified by the Authority’s Chief Executive Officer and Chief Financial Officer. After the Audit Committee’s review, the 2012 financial report is scheduled to be presented for approval by the Authority’s Trustees at their meeting later today. Changes of particular significance have been highlighted in the attached draft to facilitate the Audit Committee’s review.

**RECOMMENDATION**

“It is requested that the Audit Committee recommend that the Authority’s Trustees approve the financial statements for the year ended December 31, 2012.”

*Mr. Thomas Concadoro presented highlights of the financial statements to the Committee. He said that net income for the year 2012 was \$175 million, which was \$60 million lower than 2011 primarily due to higher State Contributions and lower investment income. He also said that the variances in depreciation, interest expense and operations and maintenance expenses were primarily attributable to operations of the Astoria Energy II generating station and residential consumer discounts associated with the Recharge New York Power Program. Mr. Concadoro indicated that, for the reporting period, current assets increased and this was due primarily to the positive results of operations.*

*In response to a question from Authority Chairman, John Koelmel concerning the Other Post-Employment Benefits Trust, Mr. Concadoro said the Authority uses a discount rate of seven percent for Post-Employment health benefits and that government entities recognize this obligation differently than commercial entities. Mr. Ken Deon added that it is normal for government entities to have a higher discount rate because government entities are required to utilize projected earnings rates for this purpose which differs from requirements for commercial entities. He said the KPMG actuarial group examined the assumptions for the use of this rate and they are satisfied with it.*

*Responding to a question from Trustee Flynn, Ms. Judith McCarthy said the Authority is in litigation with the St. Regis tribe regarding land claims. She has had discussion with Mr. Concadoro regarding the reversal of the related accrued liability and is in agreement with the decision to make this change. She said that she would discuss this issue further during the executive session.*

The following resolution, as submitted by the Vice President and Controller, was unanimously approved.

**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 2012; 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, 2012.**

4. Summary of 2012 Annual Audit of Financial Statements

*Mr. Ken Deon, KPMG's Audit Engagement Partner, presented an overview of the Authority's 2012 Annual Audit of Financial Statements (Exhibit "4-A"). He introduced Mr. Scott Heiser, the Senior Manager on the Audit. Mr. Deon said, despite the tight deadline, the audit for 2012 went smoothly and the auditors received full cooperation from the Authority's management throughout the process. He outlined the responsibilities of the Authority's management and Audit Committee as well as KPMG's. He said during the audit they did not identify any material weaknesses or significant deficiencies in the internal controls related to financial reporting and he found that the Authority's management has strong controls over its financial reporting. He ended by stating that KPMG will issue an unqualified opinion on the financial statements.*

*Mr. Scott Heiser highlighted the key accounting policies and procedures which the audit focused on for the year 2012. He outlined some of the entity-wide controls, audit risks and issues. He said, overall, the audit went well, the Authority's controls are strong and the auditors received full cooperation from management during the audit. He ended by stating that KPMG will issue a SAS 114 letter with required communications to the audit committee.*

*Responding to a question from Trustee LeChase, Mr. Deon said that for public companies, there is a 5-year rotation policy for audit partners. Mr. Concadoro said the Authority goes out for bid once every 5 years on the audit contract and is scheduled to go out for bid after the 2013 audit is completed. Responding to a further question from Trustee LeChase, Mr. Deon said the audit included Information Technology processes. Mr. Heiser added that KPMG tested the Authority's IT applications related to financial reporting and found no significant issues. In response to a question from Chairman Koelmel, Mr. Deon said, the auditors would ensure that future projects which would potentially involve significant investments by the Authority, such as those associated with the Energy Highway initiative, are appropriately recorded in the financial statements.*

5. **Risk Management Update**

The Senior Vice President and Chief Risk Officer submitted the following report:

**SUMMARY**

“This memorandum provides an update to the Audit Committee on the Authority’s risk management activities.

**BACKGROUND**

“In accordance with the Audit Committee Charter (‘Charter’), the Chief Risk Officer is required to provide an update on the Authority’s risk management activities. The Charter indicates that the Audit Committee will provide guidance to the Authority’s Chief Risk Officer on critical business objectives, risks and philosophy and tolerance for risk mitigation. Through regular Chief Risk Officer informational updates, the Audit Committee will be informed of the Authority’s risk management activities to assist in meeting their Charter objectives.

**DISCUSSION**

“The Chief Risk Officer last provided an update at the Audit Committee’s meeting on September 24, 2012. The PowerPoint presentation (Exhibit ‘5-A’) represents activities since that time to be reviewed with the Audit Committee at the March 21, 2013 meeting.”

*Mr. William Nadeau provided an update on the Authority’s risk management activities to the Committee. Responding to a question from Chairman Flynn and Trustee LeChase, President Quiniones said staff plans to set up a “real-time dashboard” prioritizing the risks as identified by staff so that the Trustees can have immediate access to this information and be able to seek clarification on any topic at each Audit committee meeting. Mr. Nadeau said, based on the comments from the Trustees, he will enhance the next report focusing on the key risk areas and actions that will be taken regarding the Authority’s aging infrastructure.*

**a. Corporate Policy – Risk Management and Executive Risk Management Committee Charter**

The Director of Energy Risk Management submitted the following report:

**SUMMARY**

“The Audit Committee of the Board of Trustees (the ‘Audit Committee’) is requested to review and recommend approval by the Trustees of the Corporate Policy – Risk Management (the ‘Policy’) and the Executive Risk Management Committee Charter (the ‘Charter’), which are attached hereto as Exhibits ‘5a-A’ and ‘5a-B.’ Together, the Policy and Charter will supersede the Governing Policy for Energy Risk Management (the ‘Governing Policy’), which was last approved by the Trustees at their meeting of January 31, 2012, and is attached hereto as Exhibit ‘5a-C.’

“The proposed Policy and Charter document the philosophy, framework and delegation of authority for the Authority's risk management activities, including those related to energy commodity and credit risk. The previously approved Governing Policy focused on energy commodity and credit risk management. The proposed Policy and Charter expand and improve the governance structure and controls in the Governing Policy. They align with the Authority's corporate governance structure and establish accountabilities more broadly for all Authority risk management activities. Previously established controls, including the delegation of authority to the Executive Risk Management Committee (the ‘ERMC’) for energy commodity transactions and credit risk management and the posting of any necessary collateral in support of such transactions, remain unchanged.

“The members of the ERMC and the Executive Management Committee reviewed the proposed Policy and Charter and recommend their approval to supersede the Governing Policy.

**BACKGROUND**

“At their meeting of September 28, 2010, the Trustees approved the Governing Policy. Subsequently, on January 31, 2012, the Trustees approved modifications to the Governing Policy to clarify transaction types and authorities. The Governing Policy outlines the philosophy, framework and delegation of authority for the Authority's program for energy commodity and credit risk management. The Governing Policy also provides the necessary authority to an appointed ERMC to oversee program implementation, including the authority to enter into forward hedging transactions and to post any necessary collateral in support of such transactions.

“In addition, at their meeting of May 19, 2009, the Trustees approved the adoption of an Enterprise Risk Management Program (the ‘Program’). At that time, it was acknowledged that risk management is a coordinated approach to identifying, assessing and managing risks across the enterprise. The development of the proposed Policy and Charter are important to mature the Authority's enterprise risk management activities.

**DISCUSSION**

“The Policy and Charter are designed to broaden the Authority's governance materials to appropriately reflect the enterprise's view of risk management as adopted by the Trustees at their May 19, 2009 meeting. In this regard, the ERMC's current role of overseeing the Authority's risk management activities related to energy commodity and credit risk will expand to incorporate all enterprise risks. In addition, the Policy and Charter aligns risk management governance materials with existing Authority governance documents including the Board of Trustees Charter of the Audit Committee. The core philosophy and framework for risk management outlined within the Policy and Charter are consistent with the Program approved at the May 19, 2009 meeting, as well as the predecessor Governing Policy approved at the January 31, 2012 meeting. The Audit Committee will be asked annually to review and recommend approval by the Trustees of the Policy and Charter.

RECOMMENDATION

“The Senior Vice President – Chief Risk Officer recommends that the Audit Committee review and recommend approval by the Trustees of the Corporate Policy – Risk Management and the Executive Risk Management Committee Charter as reflected in Exhibits ‘5a-A’ and ‘5a-B’ and discussed above.”

*Mr. Frank Deaton provided highlights of the report to the Committee.*

*Upon motion made and seconded, the Corporate Policy – Risk Management and Executive Risk Management Committee Charter were unanimously approved.*

**6. Internal Audit Activity Report – December 31, 2012**

The Vice President of Internal Audit submitted the following report:

SUMMARY

“The Internal Audit Activity Report covers the performance of the Internal Audit Department for the period of January 1 through December 31, 2012. The report provides the status of the 2012 Audit Plan as of December 31, 2012, including a summary of completed audits, audits in progress, and reports issued since the last Audit Committee meeting in September.

BACKGROUND

“The Internal Audit Department is an independent, objective and consulting function designed to add value by improving the Authority’s internal control structure and operations. It helps the organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate, test and improve the effectiveness of internal controls, risk management and governance processes.

“The Audit Committee Charter states that the Committee is to provide direct oversight of the internal audit function and shall meet at least three times a year with the head of the Office of Internal Audit (‘OIA’) for the purpose of reviewing audit activities, audit findings, management’s responses, remedial action plans, and providing the OIA with an opportunity to discuss items and topics of relevance to the Audit Committee.

“The purpose of this report is to provide the Audit Committee the status of the 2012 Internal Audit Plan, which was reviewed by the Committee at its meeting in March.

DISCUSSION

1. Highlights as of December 31, 2012

“During 2012, Internal Audit accomplished the following:

- Completed 38 audits and one special project including 29 financial/operational and nine (9) information technology audits.
- One audit was in progress.
- Nine-five (95) percent of the Plan was completed, exceeding staff’s performance target of 90%.
- Issued 36 audit reports containing 81 recommendations to improve internal controls/operational efficiency.
- All issues and recommendations are being appropriately addressed by management and have either been implemented or are scheduled for implementation.
- No restrictions have been placed on Internal Audit’s work. Full cooperation is being received at all levels.
- There are no matters that need the Committee’s attention.

2. Audits Completed/In-Progress

- A. Exhibit ‘6-A’ provides the Audit Plan status as of December 31, 2012. Exhibit ‘6-B’ lists all audits in the 2012 Audit Plan and their current status. As of December 31, 2012, approximately 95% of the audits in the Audit Plan have been completed, exceeding staff’s performance target of 90% for completion of the Audit Plan. The following reports were issued since the last Audit Committee Meeting in September:

<u>Report Title</u>	<u>Report Date</u>
Astoria Energy II Project Agreement	08/31/12
Counterparty Credit	09/20/12
CEC Purchasing/Warehousing	09/30/12
Public Authorities Laws	10/17/12
NYISO Transmission Settlements	10/26/12
SAP-FI General Ledger	10/31/12
Licensing Operations	10/31/12
Public & Governmental Affairs Expenditures	11/28/12
Small Clean Power Plants O&M	11/30/12
Energy Management System	12/15/12
SAP Billing System (Recharge NY)	12/21/12
NYISO Installed Capacity	12/31/12
Niagara SCADA System	12/31/12
Energy Efficiency Programs	12/31/12
Recharge NY Program Management	12/31/12
Configuration Management Program	12/31/12

Exhibit '6-C' provides a summary of audit reports issued, including audit objectives and findings and/or recommendations.

B. Audit in Progress: Salary Administration

3. Audit Plan Changes

Added:

SAP Billing System (Recharge NY)

Transmission Consulting Project

Postponed:

Electronic Record Management System

SAP Business Planning Consolidation"

**7. Non- Audit Services: Authorization to Engage KPMG to Perform Agreed-Upon Procedures Relating to Seaway Private Equity Corporation and Notification of Additional Funding for the Contract with KPMG**

The Vice President and Controller submitted the following report:

**SUMMARY**

“This memorandum requests the Audit Committee’s approval to engage KPMG LLP (‘KPMG’) to perform agreed-upon procedures relating to Seaway Private Equity Corporation’s (‘SPEC’) investment activities and notifies the Audit Committee of additional funding for the Authority’s contract with KPMG LLP that was recently approved by the Executive Vice President and Chief Financial Officer.

**BACKGROUND**

“The Authority’s contract with KPMG (2009 thru 2013) for accounting services was awarded for \$1.6 million and was approved by the Trustees at their meeting on July 28, 2009.

“In 2006, with the Trustees’ prior approval, the Authority entered into an agreement with SPEC that enabled the Authority to provide up to \$10 million of grant funds to SPEC. Under the agreement, SPEC is required to use the funds to make investments in new technology / environmental development businesses that also promote new jobs. While the agreement gave the Authority the right to audit SPEC’s records, it did not give the Authority the right to approve SPEC’s investments. Therefore, in 2009, the Audit Committee approved the engagement of the Authority’s independent auditor, Ernst & Young (‘E&Y’), to perform agreed-upon procedures that would provide assurance that SPEC’s investments (2006 to 2009) were consistent with the terms (i.e. investment criteria, etc.) of its agreement with the Authority.

“In May, 2012, the Audit Committee approved the engagement of KPMG to perform an investigation of the Authority’s per diem payment practices at the upstate plants. The initial funding for this project, estimated to cost \$100,000, came from funds existing within the contract that were not specifically allocated and not expended nor committed.

“On July 31, 2012, the Audit Committee approved the engagement of KPMG to provide tax and other consulting services for the planning, structuring and operation of the proposed joint venture identified as the Transco project. As planned, Transco’s membership would consist of NYS’ public and private transmission owners and focus on developing transmission projects to expand NYS’ power system. The initial funding for this project, estimated to cost \$70,000 for 2012, also came from funds existing within the contract that were not specifically allocated and not expended nor committed.

**DISCUSSION**

“It has been approximately three years since the issuance of E&Y’s report on agreed-upon procedures concerning SPEC’s investments. Staff has determined that an updated review of SPEC’s investment activities, covering the last three years, from 2010 thru 2012, should be performed. Therefore, at the request of staff, KPMG has provided their estimated fee to perform agreed-upon procedures concerning SPEC’s investment activities, for the three-year period from 2010 thru 2012. KPMG’s fee for performing this work, which will be billed at the hourly rates in Compensation Schedule C-Non-Audit Services, included in its contract with the Authority, is estimated to be \$60,000 including out-of-pocket expenses. Staff considers KPMG’s estimated fee to be reasonable. The Authority’s contract with KPMG requires the pre-approval by the Audit Committee of non-audit services.

“Based on a current review by staff of the Authority’s contract with KPMG (\$1,600,000) and a current forecast of future services, staff concluded that additional funding of \$180,000 would be required in connection with the following projects: 1) \$20,000 for KPMG to complete its work relating to the special per diem review; 2) \$100,000 for KPMG’s 2013 services relating to the Transco project; and 3) \$60,000 for agreed-upon procedures concerning SPEC’s investment activities. In accordance with the Authority’s Expenditure Authorization

Procedures, the Executive Vice President and Chief Financial Officer is authorized to approve funding up to 25% (\$400,000) above the Trustees' approved limit (\$1,600,000). Therefore, in February, 2013, staff requested, and the Executive Vice President and Chief Financial Officer approved, \$180,000 of additional funding for the Authority's contract with KPMG.

RECOMMENDATION

"The Vice President and Controller recommend that the Audit Committee approve the engagement of KPMG to perform agreed-upon procedures relating to SPEC's investment activities, for the three years from 2010 thru 2012."

*Mr. Thomas Concadoro provided highlights of the item to the Committee. In response to a question from Chairman Flynn, Mr. Concadoro said, under this agreement, KPMG would be engaged to perform procedures to verify contract compliance regarding investments by Seaway Private Equity Corporation ("SPEC"). Ms. McCarthy added that, based on the Agreement between the Authority and SPEC, SPEC decides which organizations will benefit from the funds received from the Authority. This audit will provide the Authority with a mechanism to help ensure that the funds are being allocated in accordance with the Agreement.*

*Responding to a question from Chairman Flynn, Mr. Russak said the types of businesses that receive the funds are energy and technology related firms in the North Country. He added that the funds were provided as part of the relicensing agreement and staff is asking that the Audit Committee allow periodic independent review of those investments to make sure SPEC is properly allocating the funds.*

The following resolution, as submitted by the Vice President and Controller was approved by the Audit Committee.

**RESOLVED, That the Audit Committee hereby authorizes the engagement of KPMG LLC to perform agreed-upon procedures relating to Seaway Private Equity Corporation's ("SPEC") investment activities, for the three years from 2010 through 2012, under the existing contract with KPMG for independent accounting services.**

8. **Motion to Conduct an Executive Session**

*Mr. Chairman, I move that the Authority conduct an executive session pursuant to the Public Officers Law of the State of New York section §105 to discuss matters leading to the appointment, employment, promotion, demotion, discipline, suspension, dismissal or removal of a particular person or corporation.* Upon motion made and seconded, an Executive Session was held.

9. **Motion to Resume Meeting in Open Session**

*Mr. Chairman, I move to resume the meeting in Open Session.* Upon motion made and seconded, the meeting resumed in Open Session.

**10. Next Meeting**

Chairman Flynn said that the next regular meeting of the Audit Committee will be held on Tuesday, July 23, 2013, at 9:30 a.m. in White Plains, New York.

**Closing**

On motion made and seconded, the meeting was adjourned by the Chairman at approximately 11:00 a.m.

A handwritten signature in cursive script, appearing to read "Karen Delince".

Karen Delince  
Corporate Secretary

March 21, 2013

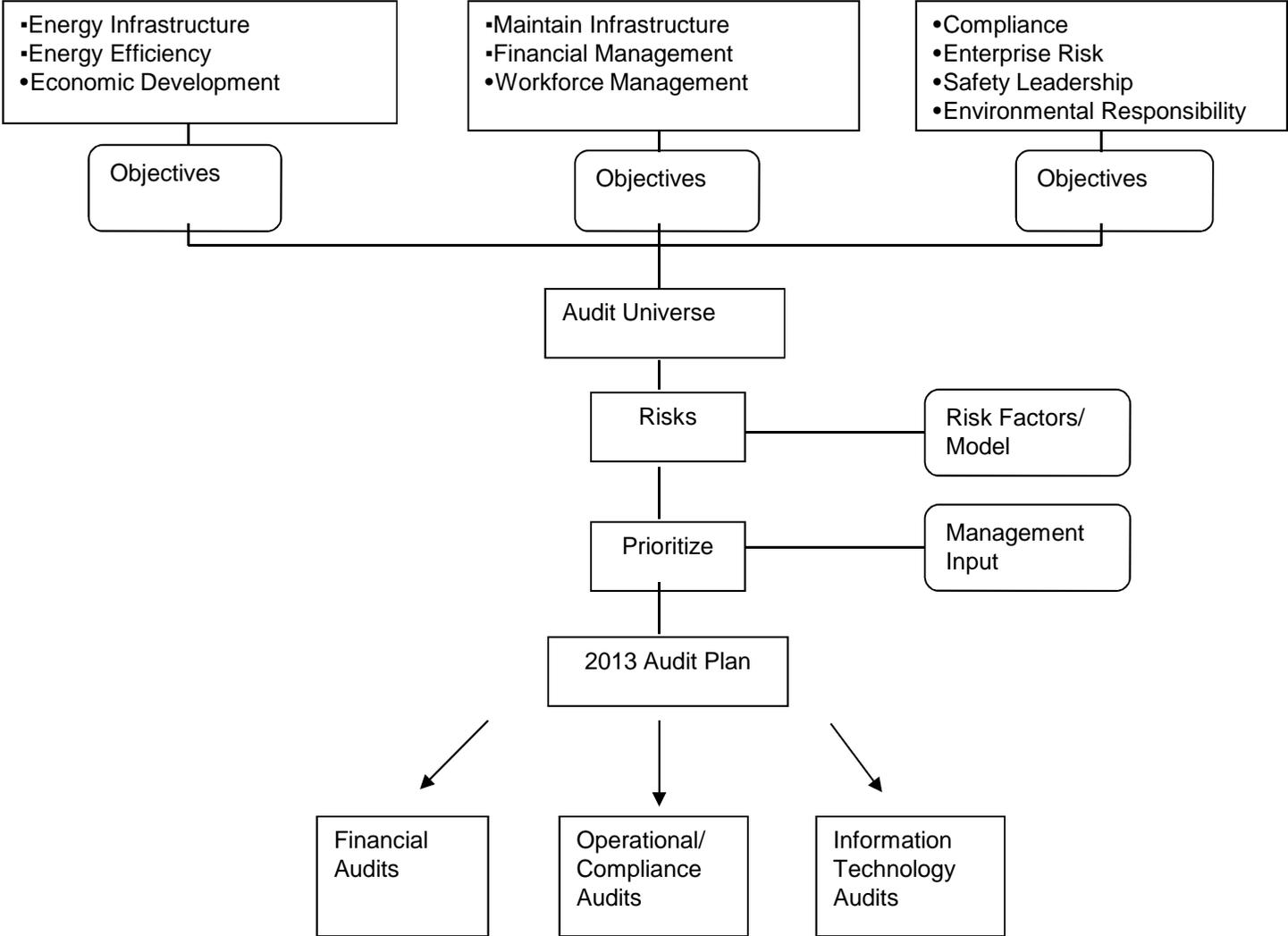
**EXHIBITS**

**For**

**March 21, 2013**

**Meeting Minutes**

# 2013 INTERNAL AUDIT PLAN PLANNING PROCESS STRATEGIC RESULT AREAS



# 2013 INTERNAL 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 :
  - 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.

# 2013 INTERNAL AUDIT PLAN

Exhibit B

	Financial/Operational Audits	Linkage to Strategic Goals	Business Unit	Description
1	Recharge NY Program Management	<ul style="list-style-type: none"> <li>• Economic Development</li> </ul>	Marketing & Economic Development	Confirm the resolution of prior audit recommendations. Review NYPA's governance documents to ensure ongoing compliance with the legislation. Review customer files and verify compliance with policies and procedures. Review program compliance monitoring process and accuracy of program reporting.
2	Energy Efficiency – Statewide Program	<ul style="list-style-type: none"> <li>• Energy Efficiency</li> <li>• Financial Management</li> </ul>	Energy Efficiency	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.
3	Emergency Management	<ul style="list-style-type: none"> <li>• Safety Leadership</li> <li>• Environmental Responsibility</li> <li>• Compliance</li> </ul>	Operations	Review NYPA's Emergency Management plans, policies and procedures. Evaluate emergency planning, communication, training and testing processes.
4	Lewiston Pump Generation Plant LEM	<ul style="list-style-type: none"> <li>• Maintain Infrastructure</li> <li>• Financial Management</li> </ul>	Operations	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 and Accounting policies and procedures. Evaluate Project Risk Management, Cost Management and Quality Management processes.
5	Safety Program	<ul style="list-style-type: none"> <li>• Safety Leadership</li> </ul>	Operations	Confirm the resolutions of prior audit issues. Review processes, procedures and controls over the Health and Safety Program. Review process for monitoring of site health and safety activities. Review Health & Safety Program goals and performance metrics.
6	Transmission LEM	<ul style="list-style-type: none"> <li>• Maintain Infrastructure</li> <li>• Financial Management</li> </ul>	Operations	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.

# 2013 INTERNAL AUDIT PLAN

	Financial/Operational Audits	Linkage to Strategic Goals	Business Unit	Description
7	Western Region O&M	<ul style="list-style-type: none"> <li>• Maintain Infrastructure</li> <li>• Compliance</li> <li>• Environmental Responsibility</li> </ul>	Operations	Assess the effectiveness of processes, procedures and controls used in the day-to-day monitoring and maintenance of the Niagara Power Project operations. Confirm compliance with selected NERC Reliability Compliance requirements. Test for site's compliance with the Maintenance Resource Management Program. Review established goals and performance metrics.
8	Fuel Operations	<ul style="list-style-type: none"> <li>• Financial Management</li> <li>• Maintain Infrastructure</li> </ul>	Operations/Energy Resource Management	Determine the adequacy and effectiveness of controls over (1) Fuel Operations Scheduling, (2) Fuel Procurement, (3) Monitoring of Natural Gas Deliveries, (4) Gas Transportations and Balancing, and (5) Payments to Suppliers.
9	500 MW O&M	<ul style="list-style-type: none"> <li>• Maintain Infrastructure</li> <li>• Compliance</li> <li>• Environmental Responsibility</li> </ul>	Operations	Review procedures, processes and controls used in the monitoring and maintenance of the 500 MW operations. Ensure 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.
10	Recharge NY Customer Revenues	<ul style="list-style-type: none"> <li>• Financial Management</li> <li>• Economic Development</li> </ul>	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	Energy Hedging Transactions	<ul style="list-style-type: none"> <li>• Financial Management</li> </ul>	Operations/Energy Resource Management	Review processes and controls associated with Energy Hedging transactions. Verify that information is provided to management in a timely and accurate manner to allow for decision-making. Ensure hedging transactions are authorized through an approved risk management strategy. Confirm that the middle-office is adequately monitoring hedging activities for compliance with internal policies and procedures. Confirm that documentation exists to support adherence to GASB53.

# 2013 INTERNAL AUDIT PLAN

	Financial/Operational Audits	Linkage to Strategic Goals	Business Unit	Description
12	NYISO Energy Settlements – Load Serving Entities	<ul style="list-style-type: none"> <li>• Financial Management</li> </ul>	Operations/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	Flynn/Sound Cable Revenues	<ul style="list-style-type: none"> <li>• Financial Management</li> </ul>	Energy Resource Management/Business Services	Determine the adequacy and effectiveness of procedures and controls over billings to LIPA for the Flynn and Sound Cable Projects.
14	Headquarters Procurement	<ul style="list-style-type: none"> <li>• Financial Management</li> <li>• Maintain Infrastructure</li> </ul>	Enterprise Shared Services	Determine the extent of compliance with required procurement policies and procedures. Assess the adequacy and effectiveness of controls over (1) Requisition processing, (2) Bid Solicitation/Evaluation, (3) Contract Awards, (4) Change Order Procedures, (5) Release of Funds Against Outline Agreements, and (6) Vendor File Maintenance.
15	SENY Revenues	<ul style="list-style-type: none"> <li>• Financial Management</li> </ul>	Business Services	Determine the adequacy and effectiveness of controls over SENY Revenues. Review procedures and processes for processing of meter reading data and billings of SENY customers.
16	Budgetary Control – O&M and Capital	<ul style="list-style-type: none"> <li>• Financial Management</li> </ul>	Business Services	Review procedures, processes and controls over the preparation and monitoring of the O&M and Capital Budgets. Verify compliance with established policies and procedures.
17	Transmission O&M Follow-Up	<ul style="list-style-type: none"> <li>• Maintain Infrastructure</li> <li>• Compliance</li> </ul>	Operations	Confirm implementation of action agreed to by management during prior audit. Evaluate processes and procedures for the planning, monitoring and controlling of transmission maintenance costs including outside contractor costs. Review transmission availability reporting to confirm that overall performance remains consistent with NYPA’s expectations.

# 2013 INTERNAL AUDIT PLAN

	Financial/Operational Audits	Linkage to Strategic Goals	Business Unit	Description
18	Physical Security Program	<ul style="list-style-type: none"> <li>• Safety Leadership</li> <li>• Compliance</li> <li>• Maintain Infrastructure</li> </ul>	Operations	Review of physical security programs including inspections/ monitoring activities, guard services, capital improvement program, etc. impacting all NYPA locations (generation, transmission including substations, headquarters, etc.). Verify compliance with established NYPA policies and procedures.
19	Energy Efficiency Contractors (SENY Govt. Program)	<ul style="list-style-type: none"> <li>• Energy Efficiency</li> <li>• Financial Management</li> </ul>	Energy Efficiency	For selected Implementation Contractors, verify that contractor charges are supported and in agreement with contract terms and conditions. Review procedures, processes and controls.
20	Facility Management	<ul style="list-style-type: none"> <li>• Financial Management</li> <li>• Compliance</li> </ul>	Enterprise Shared Services	Review processes, procedures and controls over (1) Building Expenditures (Capital and O&M), (2) Budget Monitoring, (3) Use of Outside Services, (4) Credit Card Procurement, (5) Rental Income, and (6) Building Operations and Maintenance activities.
21	Energy Efficiency – Contractors (Statewide Program)	<ul style="list-style-type: none"> <li>• Energy Efficiency</li> <li>• Financial Management</li> </ul>	Energy Efficiency	For selected Implementation Contractors, verify that contractor charges are supported and in agreement with contract terms and conditions. Review procedures, processes and controls.
22	NYISO Ancillary Services/Transmission Charges	<ul style="list-style-type: none"> <li>• Financial Management</li> </ul>	Energy Resource Management	Review processes and controls associated with Ancillary Services and charges billed by the NYISO. Review NYISO Transmission User Charges for congestion and losses. Review Ancillary Services Charges.
23	Headquarters Accounts Payable	<ul style="list-style-type: none"> <li>• Financial Management</li> </ul>	Business Services	Review procedures, processes and controls over the processing of vendor invoices, payment processing, wire transfers and access controls over SAP.

# 2013 INTERNAL AUDIT PLAN

	Financial/Operational Audits	Linkage to Strategic Goals	Business Unit	Description
24	Headquarters Travel & Living Expenses	<ul style="list-style-type: none"> <li>• Financial Management</li> </ul>	Business Services	Verify compliance with Business Meals and Travel Policies. Review controls, procedures and processes 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.
25	Purchasing/Warehousing – SENY	<ul style="list-style-type: none"> <li>• Financial Management</li> <li>• Maintain Infrastructure</li> </ul>	Enterprise Shared Services	Review processes and controls associated with purchasing and warehousing activities at the 500 MW project. Verify compliance with established NYPA policies and procedures.
26	SENY Finance & Administration/Human Resources	<ul style="list-style-type: none"> <li>• Financial Management</li> <li>• Workforce Management</li> </ul>	Business Services/Human Resources	Review procedures, processes and controls over budget monitoring, accounts payable, payroll, travel and living expenses, and Human Resources. Verify compliance with established NYPA policies and procedures.
27	CEC Finance & Administration/Human Resources	<ul style="list-style-type: none"> <li>• Financial Management</li> <li>• Workforce Management</li> </ul>	Business Services/Human Resources	Review procedures, processes and controls over budget monitoring, accounts payable, payroll, travel and living expenses, and Human Resources. Verify compliance with established NYPA policies and procedures.
28	St. Lawrence Finance & Administration/Human Resources	<ul style="list-style-type: none"> <li>• Financial Management</li> <li>• Workforce Management</li> </ul>	Business Services/Human Resources	Review procedures, processes and controls over budget monitoring, accounts payable, payroll, travel and living expenses, and Human Resources. Verify compliance with established NYPA policies and procedures.
29	Headquarters Business Expenses	<ul style="list-style-type: none"> <li>• Financial Management</li> </ul>	Various	Review procedures, processes and controls over Headquarters Business Expenses. Verify compliance with established NYPA policies, procedures and guidelines.
30	Assistance to KPMG	<ul style="list-style-type: none"> <li>• Financial Management</li> </ul>	Business Services	Assist KPMG in their annual audit of NYPA’s financial statements.

# 2013 INTERNAL AUDIT PLAN

	Financial/Operational Audits	Linkage to Strategic Goals	Business Unit	Description
31	Vendor Audits	Financial Management	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.

	Information Technology Audits	Linkage to Strategic Goals	Business Unit	Description
1	NERC – CIP Compliance	• Compliance	Operations	Test and evaluate the NERC-CIP program administration, controls, documentation and procedures in compliance with the requirements set by NERC-CIP standards.
2	IT Disaster Recovery – Niagara	• Maintain Infrastructure	Operations	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 Niagara Power Project. Review the training, test plans, test results and the update of ITDRP.
3	IT Disaster Recovery - Energy Control Center	• Maintain Infrastructure	Operations	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 Clark Energy Center.
4	SAP Materials Management	• Financial Management	Enterprise Shared Services	Test and evaluate the SAP – Material Management application controls, security, documentation and procedures including the administration of vendor master file, creation and approval of purchase order and its interfaces to other enterprise applications.
5	SAP Accounts Payable	• Financial Management	Enterprise Shared Services	Review, test and evaluate SAP Accounts Payable module to ensure compliance with established policies, procedures. Perform post- implementation review of the electronic invoice imaging project.

# 2013 INTERNAL AUDIT PLAN

	Information Technology Audits	Linkage to Strategic Goals	Business Unit	Description
6	Electronic Record Management System (LiveLink)	<ul style="list-style-type: none"> <li>• Compliance</li> </ul>	Enterprise Shared Service	Review, test and evaluate Records Management System application controls, security, documentation and procedures.
7	Time Warner Wide Area Network	<ul style="list-style-type: none"> <li>• Financial Management</li> <li>• Maintain Infrastructure</li> </ul>	Enterprise Shared Services	Test and evaluate the Time Warner Area Network security to determine if it is adequately protected from unauthorized access, use, disclosure or modifications, damage or loss and at par with best security practices.
8	Internet/Intranet Security	<ul style="list-style-type: none"> <li>• Maintain Infrastructure</li> </ul>	Enterprise Shared Services	Test and evaluate the internet/intranet security to determine if it is adequately protected from unauthorized access, use, disclosure or modifications, damage or loss and at par with best security practices.
9	Intrusion Prevention and Monitoring	<ul style="list-style-type: none"> <li>• Maintain Infrastructure</li> </ul>	Enterprise Shared Services	Test and evaluate whether internal controls are adequate within the intrusion prevention and detection activities and ensure compliance with established policies, procedures and security best practices.
10	SAP Project Systems	<ul style="list-style-type: none"> <li>• Financial Management</li> </ul>	Enterprise Shared Services	Review, test and evaluate SAP Project Systems application controls, security, documentation and procedures including the management of energy services projects through the use of Work Breakdown Structures (WBS).

**NEW YORK POWER AUTHORITY**

Financial Statements

December 31, 2012 and 2011

(With Independent Auditors' Report Thereon)

# 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, 2012, 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  
Chief Financial Officer

March 21, 2013



**KPMG LLP**  
515 Broadway  
Albany, NY 12207

## **Independent Auditors' Report**

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

### **Report on the Financial Statements**

We have audited the accompanying financial statements of the Power Authority of the State of New York (the Authority), which comprise the balance sheets as of December 31, 2012 and 2011, and the statements of revenues, expenses and changes in net position, and cash flows for the years then ended, and the related notes to the financial statements.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditors' Responsibility***

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 of America and the standards applicable to financial 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### ***Opinions***

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, 2012 and 2011, and the changes in its net position and its cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

### ***Other Matters***

#### ***Required Supplementary Information***

U.S. generally accepted accounting principles require that management's discussion and analysis and the schedule of funding progress listed in the accompanying table of contents be presented to supplement the basic financial statements. Such information,

although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated March \_\_\_, 2013 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control over financial reporting and compliance.

March \_\_\_, 2013

KPMG LLP, a U.S. limited liability partnership, is the U.S. member firm of KPMG International, a Swiss cooperative.

# **NEW YORK POWER AUTHORITY**

## **Management's Discussion and Analysis**

December 31, 2012 and 2011

(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 (the 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's 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, 2012 and 2011

(Unaudited)

### Summary of Revenues, Expenses and Changes in Net Position

The following is a summary of the Authority's financial information for 2012, 2011, and 2010:

	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2012 vs. 2011 favorable (unfavorable)</u>	<u>2011 vs. 2010 favorable (unfavorable)</u>
	(In millions, except percentages)				
Operating revenues	\$ 2,673	\$ 2,655	\$ 2,568	1%	3%
Operating expenses:					
Purchased power	744	854	931	13	8
Fuel	228	258	224	12	(15)
Wheeling	598	548	528	(9)	(4)
Operations and maintenance	558	519	443	(8)	(17)
Depreciation	226	194	163	(16)	(19)
Total operating expenses	<u>2,354</u>	<u>2,373</u>	<u>2,289</u>	1	(4)
Operating income	<u>319</u>	<u>282</u>	<u>279</u>	13	1
Nonoperating revenues	120	145	138	(17)	5
Nonoperating expenses	<u>264</u>	<u>192</u>	<u>236</u>	(38)	19
Net income	175	235	181	(26)	30
Contributed capital	—	59	—		
Change in net position	<u>175</u>	<u>294</u>	<u>181</u>		
Net position – beginning	<u>3,295</u>	<u>3,001</u>	<u>2,820</u>	10	6
Net position – ending	<u>\$ 3,470</u>	<u>\$ 3,295</u>	<u>\$ 3,001</u>	5	10

The following summarizes the Authority's financial performance for the years 2012 and 2011:

The Authority had net income of \$175 million for the year ended December 31, 2012 compared to \$235 million in 2011. The decrease in 2012 net income of \$60 million was due to lower non-operating revenues of \$25 million and higher non-operating expenses of \$72 million partially offset by higher operating income of \$37 million. Non-operating revenues were lower primarily due to reduced income on the investment portfolio attributable to the aging of fixed income securities combined with lower market interest rates. In addition, non-operating revenues for 2011 included a non-recurring gain of \$11 million, which resulted from a claim settlement against the U.S. Department of Energy, relating to spent fuel disposal at the previously owned nuclear plants. Non-operating expenses were higher in 2012 primarily due to a \$20 million higher voluntary contribution to New York State and the recognition of higher interest expense (\$52 million) mostly related to interest expense on the capital lease of the Astoria Energy II (AEII) generating station, which began operations in July 2011. The additional interest expense related to AEII is recovered through customer rates along with the operating expenses for this facility.

Higher operating income in 2012 consisted of increased operating revenues of \$18 million and lower operating expenses of \$19 million. The increase in operating revenues was substantially attributable to a full year of operation at AEII compared to six months in 2011. Variation in purchased power was primarily due to lower costs resulting from lower prices and lower purchase volumes. Fuel costs were also lower due to lower prices partially offset by higher generation resulting from a full year of operations of AEII. Variations in depreciation, and operations and maintenance expenses from year to year were substantially attributable to the full year of operations at AEII. AEII is used to serve the New York City (NYC) governmental customers and related costs were offset by recoveries through operating revenues. Operations and maintenance expenses increased mainly due to the operations of AEII and the recognition of a full year of residential consumer discounts associated with Recharge New York Power Program (RNYPP) legislation. This legislation provides for the partial funding of such discounts from the sale of hydropower withdrawn from investor owned utilities.

Net position increased by \$175 million in 2012 due to positive net income.

# NEW YORK POWER AUTHORITY

## Management's Discussion and Analysis

December 31, 2012 and 2011

(Unaudited)

The Authority had net income of \$235 million for the year ended December 31, 2011 compared to \$181 million in 2010. The 2011 year increase of \$54 million included higher operating income of \$3 million, higher nonoperating revenues of \$7 million and lower nonoperating 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 NYC governmental customers and related costs 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 RNYPP legislation. This legislation provides for the partial 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.

### Operating Revenues

Operating revenues of \$2,673 million in 2012 were \$18 million or 1% higher than the \$2,655 million in 2011, primarily due to higher Southeastern New York (SENY) governmental customer revenues resulting from increased third-party transmission ("wheeling charges"), which are recovered from the customers, and the full year of operation of AEII, partially offset by lower market-based energy revenues at the hydro facilities resulting from lower generation and lower energy prices.

### Purchased Power and Fuel

Purchased power costs decreased by 13% in 2012 to \$744 million from \$854 million in 2011, primarily due to lower prices and lower purchase volumes attributable to the termination of the Power for Jobs and Energy Cost Savings Benefits programs effective June 30, 2012. Fuel costs were \$30 million (12%) lower during 2012, also primarily due to lower prices partially offset by higher generation resulting from a full year of operations 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 \$39 million, or 8%, in 2012 to \$558 million, primarily due to expenditures relating to residential consumer discounts associated with the RNYPP (\$58 million), and a full year of AEII O&M expense (\$15 million) in 2012, compared to a half a year in 2011, partially offset by decreases in Power for Jobs program-related expenses (\$30 million) such as rebates, restitution and voluntary contributions to New York State.

### Nonoperating Revenues

For 2012, nonoperating revenues decreased by \$25 million, or 17%, primarily due to reduced income on the investment portfolio attributable to the aging of fixed income securities combined with lower market interest rates. Nonoperating income in 2011 also included an \$11 million settlement of the spent nuclear fuel claim against the United States Department of Energy. Nonoperating revenues for 2012 and 2011 include income recognition of \$71.7 million and \$72 million, respectively, 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," of notes to the financial statements, for additional information.

### Nonoperating Expenses

For 2012, nonoperating expenses increased by \$72 million, or 38%, primarily due to an increase of \$20 million in the Authority's voluntary contribution to New York State (\$85 million) and an increase of \$52 million in interest expenses primarily related to the capitalized lease obligation recorded for AEII.

### Cash Flows

During 2012, the Authority generated cash flows of \$391 million from operations compared to \$412 million in 2011. Cash flows from operating activities for 2012 were lower than 2011 primarily due to higher expenditures related to the residential consumer discount program associated with RNYPP.

### Net Generation

Net generation for 2012 was 28.1 million megawatt-hours (MWh) essentially unchanged from the level generated in 2011. Net generation from the Niagara (13.4 million MWh) and St. Lawrence (6.7 million MWh) plants were 9% and 8%, respectively, lower than 2011 due to lower water flows. During 2012, net hydro generation was approximately 99% of long-term average and below 2011, which was 108% of long-term average. Combined net generation of the fossil fuel plants for 2012 was 7.99 million MWh, or 27% higher than 2011 (6.3 million MWh), with the bulk of the 1.7 million MWh increase attributable to a full year of operations at AEII.

# NEW YORK POWER AUTHORITY

## Management's Discussion and Analysis

December 31, 2012 and 2011

(Unaudited)

### Summary Balance Sheets

The following is a summary of the Authority's balance sheets for 2012, 2011, and 2010:

	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2012 vs. 2011</u>	<u>2011 vs. 2010</u>
	(In millions, except percentages)				
Current assets	\$ 1,875	\$ 1,692	\$ 1,550	11%	9%
Capital assets	4,819	4,910	3,697	(2)	33
Other noncurrent assets	2,320	2,224	2,143	4	4
Deferred outflows	107	209	231	(49)	(10)
<b>Total assets &amp; deferred outflows</b>	<b>\$ 9,121</b>	<b>\$ 9,035</b>	<b>\$ 7,621</b>	<b>1</b>	<b>19</b>
Current liabilities	\$ 1,030	\$ 982	\$ 938	5	5
Noncurrent liabilities	4,621	4,758	3,682	(3)	29
<b>Total liabilities</b>	<b>5,651</b>	<b>5,740</b>	<b>4,620</b>	<b>(2)</b>	<b>24</b>
<b>Net position</b>	<b>3,470</b>	<b>3,295</b>	<b>3,001</b>	<b>5</b>	<b>10</b>
<b>Total liabilities and net position</b>	<b>\$ 9,121</b>	<b>\$ 9,035</b>	<b>\$ 7,621</b>	<b>1</b>	<b>19</b>

The following summarizes the Authority's balance sheet variances for the years 2012 and 2011:

In 2012, current assets increased by \$183 million (11%) to \$1,875 million primarily due to increases in investments reflecting the investment of cash generated by operations and cash. Capital assets decreased by \$91 million (2%) to \$4,819 million, primarily due to a full year of depreciation related to AEII capital lease, offset by additions to construction in progress. Other noncurrent assets increased \$96 million (4%) primarily due to an increase in the Decommissioning Trust Fund investment portfolio and energy efficiency program work in progress, partially offset by a decrease in the capital fund investment portfolio and other deferred charges. Deferred outflows decreased by \$102 million (49%) primarily due to the expiration of a medium-term forward energy swap in December 2012. Current liabilities increased by \$48 million (5%), to \$1,030 million, primarily due to increases in liabilities related to short-term debt (\$57 million), reclassifications related to the Niagara relicensing (\$12 million), long-term debt and capital lease obligations due within one year (\$12 million) and other various accruals (\$23 million) partially offset by decreases in fair market values related to the Authority's energy commodity hedging transactions (\$59 million). Noncurrent liabilities decreased by \$137 million (3%) to \$4,621 million primarily due to the decreases in long-term debt resulting from reclassifications to long-term debt due within one year and scheduled repayments of debt (\$132 million), risk management activities – derivatives (\$45 million), Niagara relicensing (\$26 million), and various other deferred credits (\$46 million) partially offset by increases in the nuclear plant decommissioning obligation (\$96 million) and the issuance of \$25 million Subordinated Notes, Series 2012. The increase in the nuclear plant decommissioning obligation reflects the increase in investment earnings 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). The changes in net assets for 2012 and 2011 are discussed in the summary of revenues, expenses and changes in net assets in this Management's Discussion and Analysis.

In 2011, current assets increased by \$142 million (9%) to \$1,692 million primarily due to increases in investments (\$127 million) reflecting the investment of cash generated by operations and cash (\$15 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. Deferred outflows decreased by \$22 million (10%) primarily due to net change in fair value of derivatives related to risk management activities. 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. 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.

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### Capital Asset and Long-Term Debt Activity

The Authority currently estimates that it will expend approximately \$1,292 million for various capital improvements over the five-year period 2013-2017. 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 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 and St. Lawrence)	\$	262
MA1 and MA2 Transmission Line		166
Switchyard Modernization Program (St. Lawrence, Niagara, Blenheim-Gilboa, Clark Energy Center)		123
Relay Replacement Program ( St. Lawrence, Niagara)		105
Marcy-South Series Compensation		58
Stator Rewind and Restack Projects (Niagara, St. Lawrence)		42
Relicensing Compliance/Implementation (B-G, Niagara, St. Lawrence)		38
765/230KV Autotransformer Replacement (Massena)		38
PV-20 Line Assessment/Replacement/Submerged Portion		37
Replacement of Superstructure Bridges (Niagara)		32
St. Lawrence Generator Step-up Transformer Replacement		26
St. Lawrence Headgate Automation		21
Shunt Reactor (Coopers Corners)		11
Quick Start Modification Projects (500 MW, Small Clean Power Plants)		10
Energy Control Center Operation Backup		10
Enterprise Infrastructure Purchases		9
IT Initiatives		17
Other (projects less than \$9 million)		287
	\$	<u>1,292</u>

In addition, the Authority's capital plan includes the provision of \$1,242.5 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 December 2012, the Authority's Trustees approved a \$726 million Transmission Life Extension and Modernization ("LEM") Program on the Authority's Transmission system. The Transition LEM Program encompasses transmission assets in the Central, Northern and Western regions of New York and will include work to be done such as upgrades, refurbishments and replacements associated with switchyards and substations, transmission line structures or towers and associated hardware and replacement of the submarine cable on PV-20. Reinvestment in this strategic component of the Authority's overall mission supports the repair, upgrade and/or expansion of the transmission infrastructure. The Authority intends to finance this LEM Program with internal funds and proceeds from tax-exempt obligations to be issued by the Authority.

In June 2010, the Authority's Trustees approved a \$460 million Life Extension and Modernization ("LEM") Program at the Niagara project's Lewiston Pump-Generating Plant, of which \$253 million of expenditures have been authorized and \$48 million spent as of December 31, 2012. The work to be done includes a major overhaul of the plant's 12 pump turbine generator units. This LEM Program will increase pump and turbine efficiency, operating efficiency, and the peaking capacity of the overall Niagara project. The Authority filed an application with the Federal Energy Regulatory Commission (FERC) for a non-capacity license amendment in connection with the program on December 15, 2011 and supplemented it on February 15, 2012. The amendment was approved with a FERC order issued on April 25, 2012. The unit work began in late 2012, with the final unit to be 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. In 2007, the Authority estimated that the capital cost associated with the relicensing of the Niagara project would be approximately \$495 million. This estimate 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. As of December 31, 2012, the balance in the liability associated with the relicensing on the balance sheet is \$301 million (\$33 million in current and \$268 million in noncurrent liabilities).

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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.

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

### Capital Structure

	2012	2011	2010
	(In millions)		
Long-term debt, net of current maturities:			
Senior:			
Revenue bonds	\$ 1,012	\$ 1,064	\$ 1,111
Adjustable rate tender notes	106	115	122
Subordinated:			
Subordinated Notes, Series 2012	24	—	—
Commercial paper	102	173	264
Total long-term debt, net of current maturities	1,244	1,352	1,497
Net position	3,470	3,295	3,001
Total capitalization	\$ 4,714	\$ 4,647	\$ 4,498

In November 2012, the Authority's Trustees authorized the issuance of Subordinated Notes, in a principal amount not to exceed \$30 million for the purpose of accelerating the funding for the State Parks Greenway Fund, which was established pursuant to the Niagara Relicensing Settlement entered into by the Authority and the New York State Office of Parks, Recreation & Historic Preservation in connection with the Niagara project's relicensing. The Authority issued the Subordinated Notes, Series 2012 (Subordinated Notes) on December 18, 2012 in the amount of \$25 million. These Subordinated 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.

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 2012, considering the issuance of the 2012 Subordinate Notes, long-term debt, net of current maturities, decreased by \$108 million, primarily due to scheduled maturities, early extinguishments of debt and cash funding of capital expenditures.

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.

Total debt to equity ratio as of December 31, 2012, decreased to .51-to-1 from .55-to-1 as of December 31, 2011 and from 1.56 in 2002. Total debt as of December 31, 2012 (\$1.77 billion) is at its lowest level since December 31, 1975 (\$1.64 billion).

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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 (a)	Aa2	AA-	AA
Adjustable rate tender notes	Aa2/VMIG1	AA-/A-1+	N/A
Subordinate debt:			
Subordinate Note, Series 2012	N/A	N/A	AA
Commercial paper	P-1	A-1	F1+

- (a) Long term debt includes certain bonds - Series 2007 A, B and C Revenue Bonds, Series 2006 A Revenue Bonds and Series 2003 A Revenue Bonds - which are covered by Municipal bond insurance. 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 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.

The Authority has a revolving credit agreement (Agreement) with The Bank of Nova Scotia, which terminates on September 1, 2015, to provide a supporting line of credit for the purpose of repaying, redeeming or purchasing the Adjustable Rate Tender Notes. Under the Agreement, the Authority may borrow up to the outstanding principle of the ART Notes, which at December 31 2012 was \$115 million. The Agreement provides for interest on outstanding borrowings 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 addition, the Authority also has a \$550 million line of credit (with a syndicate of banks supporting the Commercial Paper Notes which line expires January 20, 2014. As of December 31, 2012 and 2011, there were no outstanding borrowings under either the Agreement supporting the ART Notes or line of credit supporting the Commercial Paper Notes. More detailed information about the Authority's debt is presented in note 6 of notes to the financial statements.

In December 2012, Fitch Ratings affirmed the Authority's senior and subordinate debt ratings. In January 2013, Standard & Poor's Rating Service affirmed the Authority's senior and subordinate debt ratings and also assigned a positive outlook. Moody's Investor Service, Inc. affirmed the Authority's senior and subordinate debt ratings in September 2011.

### 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 Authority's Senior 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. In addition, the Authority also has an Executive Risk Management Committee (ERMC) established pursuant to its Trustee authorized Governing Policy for Energy Risk Management, which is chaired by the Executive Vice President and Chief Financial Officer. The ERMC oversees and provides guidance for the implementation of the Authority's Energy Risk Management Program.

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 related commodity swap transactions of the type in which the Authority engages ("Swaps"). The requirements and processes are set forth in regulations promulgated by the Commodities Futures Trading Commission ("CFTC"). Pursuant to CFTC rules, thus far, the Authority, as a public entity and electric utility which uses swaps solely to manage its risk, will be exempted from posting collateral beyond that of any existing credit support annexes in support of its open over-the-counter ("OTC") hedge positions. These CFTC rules are not anticipated to have significant impact on the Authority's liquidity and/or future risk mitigation activities. CFTC DF Act rules are still being promulgated, and Authority will continue to track their potential impact on the Authority's liquidity and/or future risk mitigation activities.

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### Economic Conditions

#### *Competitive Environment*

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.

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.

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, 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.

#### *Rate Actions*

Power and energy from the St. Lawrence-FDR and Niagara hydroelectric facilities are sold to municipal electric systems, rural electric cooperatives, industrial and other business customers, certain public bodies, investor-owned utilities, and out-of-state customers, as provided for under the state and federal laws. The charges for firm and/or firm peaking power and associated energy sold by the Authority, as applicable, to the fifty-one municipal electric systems and rural electric cooperatives in New York State, two public transportation agencies, three investor-owned utilities for the benefit of rural and domestic customers, and seven out-of-state public customers have been established on the basis of the cost to serve these loads. These charges are among the lowest found throughout the United States. In November 2011, the Authority's Trustees approved a 41-month rate plan providing for certain phased-in increases to these rates which result in effective hydro rate increases of 5.5% on December 1, 2011 and annual increases of approximately 5.5% from May 1, 2012 to May 1, 2014.

Niagara's expansion and replacement power industrial customers and St. Lawrence-FDR's industrial customers are allocated over 40% of the firm contract demand of the plants. Their rates are subject to annual adjustment based on the average of three contractually agreed-upon economic indices reflecting changes in industrial energy prices. In March 2009, the Authority suspended the application of these indices, but effective September 1, 2011, the application of these indices was reinstated resulting in an increase in these rates. The effective 2012 industrial rates increased revenue by approximately \$8.5 million during the year.

In an order issued January 27, 1999, the Federal Energy Regulatory Commission ("FERC") approved the use of a \$165.4 million transmission system revenue requirement in developing rates for use of NYPA's transmission facilities in the NYISO market. FERC also approved, among other things, the imposition of a NYPA Transmission Adjustment Charge ("NTAC") and the NYPA Transmission Service Charges ("TSC") which are the tariff elements established to effect full recovery of the Authority's annual transmission revenue requirement. In July 2012, the Authority filed for its first requested increase in the revenue requirement with FERC since the implementation of the NYISO. A number of NYISO market participants challenged the level of the increase and settlement talks have been ongoing as of December 31, 2012. A ruling by FERC on the settled rate increase, likely in the \$10 million range annually, is expected in the first half of 2013 with the increase being retroactive to August 1, 2012.

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### **Power Programs for Business**

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 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 2011, Chapter 60 (Part CC) of the Laws of 2011 (Chapter 60) established a new economic development permanent power program which commenced July 1, 2012, the Recharge New York Power Program ("RNYPP"), to replace and expand upon a previous array of economic development programs, most prominently, the Power for Jobs ("PFJ") and Energy Cost Savings Benefits ("ECSB") programs.

The RNYPP is a new power program, administered by the Authority, which has as its central benefit up to 910 MW of low cost power, comprised of up to 455 MW of hydropower from the Niagara and St. Lawrence-FDR Projects and up to 455 MW of other power procured by the Authority from other sources. The 910 MW of power is available for allocation as provided by Chapter 60 to eligible new and existing businesses and not-for-profit corporations under contracts of up to seven years. RNYPP was effective beginning July 1, 2012. The RNYPP legislation also temporarily extended the Power for Jobs (PFJ) and Energy Cost Savings Benefit (ECSB) programs through June 30, 2012 at which time the two programs terminated.

The hydropower used for the RNYPP was power formerly used to provide discounted electricity to domestic and rural customers of the three private utilities that serve upstate New York. To mitigate the impacts from the redeployment of this hydropower for the RNYPP, Chapter 60 created a "Residential Consumer Discount Program" (RCDP). The RCDP 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 had formerly received the hydropower that is utilized in the RNYPP. Chapter 60 further authorizes the Authority, as deemed feasible and advisable by the Trustees, to use revenues from the sales of hydroelectric power, and such other funds of the Authority, as deemed feasible and advisable by the Trustees, to fund the RCDP. The Authority's Trustees have authorized the release of \$250 million in support of the RCDP through January 2014. The Authority supplemented the market revenues through the use of internal funds, from the start of the program through December 31, 2012, totaling cumulatively \$60 million. Operations and maintenance expenses included \$100 million and \$42 million of residential consumer discounts for the years ended December 31, 2012 and 2011, respectively.

Effective March 30, 2012, Chapter 58 (Part GG) of the Laws of 2012 (Chapter 58) created the Western New York Power Proceeds Act (WNYPPA). The WNYPPA authorizes the Authority, as deemed feasible and advisable by the Trustees, to deposit net earnings from the sale of unallocated Expansion Power and Replacement Power from the Authority's Niagara project into an account administered by the Authority known as the Western New York Economic Development Fund (Fund). Net earnings are defined as any excess revenues earned from such power sold into 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 power project that satisfy applicable criteria. Chapter 58 also establishes a five-member Western New York Power Allocations Board, which is appointed by the Governor.

Chapter 58 also repealed Chapter 436 of the Laws of 2010 which had created a similar program that could not be effectively implemented. In June 2012, the Authority's Trustees approved the release of up to \$20 million in net earnings, calculated for the period August 30, 2010 through December 31, 2012 as provided in the legislation, for deposit into the Fund. Payments from the Power Authority to the fund for 2013 to 2016 are estimated to be in the range of \$5 million to \$11 million annually.

### **New York State Legislation**

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 law (typically, legislation enacted in connection with the State budget), 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.

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In May 2011, the Authority's Trustees adopted a policy statement (Policy Statement) that 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 up to the present time, 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. The PFJ Program, which had been extended to June 30, 2012, has ended and was replaced by the RNYPP, discussed above and in note 12(b) "Recharge New York Power Program" of the notes to the financial statements. Pursuant to Chapter 59 of the Laws of 2012, the Authority, as deemed feasible and advisable by its Trustees, has been authorized to make an additional voluntary contribution to the State unrelated to the PFJ program.

In 2012 and 2011, the Authority made \$85 million, and \$65 million, respectively, in contributions to the State that are not related to the PFJ Program and which were recorded as nonoperating expenses in the year ended December 31, 2012 and 2011 statements of revenues, expenses and changes in net position. These contributions were consistent with the related State fiscal year budgets and were authorized by the Authority's Trustees. The 2012 contributions of \$85 million include \$10 million that was paid to Empire State Development in December 2012 to support the New York State Open for Business economic development initiative in lieu of the voluntary contributions to the State's General Fund for the State fiscal year 2012-2013. An additional \$40 million was paid to support this initiative in January 2013 pursuant to Trustee approval and this amount will be recognized as a nonoperating expense in the Authority's 2013 fiscal year. Cumulatively through December 31, 2012, the Authority has made voluntary contributions to the State totaling \$475 million in connection with the PFJ Program and \$427 million unrelated to the PFJ Program.

### **Temporary Asset Transfers**

In addition to the authorization for voluntary contributions, as a result of budget legislation enacted in February 2009, the Authority was requested to provide temporary asset transfers to the State of funds held in reserves. Pursuant to the terms of a Memorandum of Understanding dated February 2009 (MOU) between the State, acting by and through the State's Director of Budget, and the Authority, the Authority agreed to transfer approximately \$215 million associated with its Spent Nuclear Fuel Reserves (Asset B) by March 27, 2009. The Spent Nuclear Fuel Reserves are funds that had been set aside for payment 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 is 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.

In February 2009, the Authority's Trustees authorized the execution of the MOU relating to the temporary transfers of Asset B (\$215 million) and Asset A (\$103 million) and such transfers were made in March 2009 and September 2009, respectively, following Trustee approval.

The Authority has classified the transfers of Assets A and B (\$318 million) as a long-term loan receivable. In lieu of interest payments, the State has 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 is 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 is waived from April 1, 2011 to March 31, 2017. These payments would have been approximately \$8 million per year but the waiver would 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.

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### ***New York State Executive Budget***

The Governor's Executive Budget for State Fiscal Year 2013-2014, released in January 2013, contains language authorizing the Authority, as deemed feasible and advisable by its Trustees, to (i) make a contribution to the State treasury to the credit of the General Fund, or as otherwise directed in writing by the Director of the Budget, in an amount of up to \$90 million for the State fiscal year commencing April 1, 2013, the proceeds of which will be utilized for economic development, energy efficiency, or energy cost mitigation purposes, and (ii) transfer up to \$25 million of any such contribution by June 30, 2013 and the remainder of any such contribution by March 31, 2014.

As part of his Executive Budget plan, Governor Andrew M. Cuomo has proposed the creation of a new \$50 million Innovation Venture Capital Fund (IVCF) to provide early-stage funding to incentivize new business formation and growth in New York State. The proposal indicates that such IVCF would be administered by the Empire State Development Corporation (ESD), and funded by Authority funds and funds redirected from underutilized investment programs administered by ESD. The proposed budget legislation has not yet been enacted into law. A portion of the \$90 million that would be authorized if the budget is adopted as proposed may be considered for this purpose.

### ***New York Energy Highway***

In his January 2012 State of the State address, Governor Andrew M. Cuomo announced the New York Energy Highway initiative which is envisioned as a public-private partnership to upgrade and modernize the State's electric power system. The Governor formed a task force comprised of various State officials to oversee implementation of the initiative (Task Force) which is co-chaired by the Authority's President and Chief Executive Officer, Gil C. Quiniones. In April 2012, the Task Force issued a request for information seeking ideas and proposals in furtherance of the initiative. Approximately 85 organizations responded to the Task Force's request for information and the responses included a large number of different generation and transmission project proposals. Based on the response of all these organizations, the Energy Highway Task Force issued an action plan in October 2012. The resulting Energy Highway Blueprint, calling for public and private investments in the State's energy system of about \$5.7 billion over the next five to 10 years, proposed 13 specific actions, divided among four major categories: Expand and Strengthen the System, Accelerate Construction and Repair, Support Clean Energy and Technology Innovation. All of the 13 actions are underway at this point, moving forward on or ahead of the schedule the Task Force established. Two prominent actions discussed in the Blueprint include (i) the initiation of electric transmission upgrades to move excess power from upstate to downstate, and (ii) the creation of contingency plans to prepare for large generator retirements.

In response to the request for information, the New York Transmission Owners (NYTOs), comprised of the State's largest private utilities, the Long Island Power Authority, and the Authority, indicated that they were exploring the creation of a new Statewide transmission entity (NY Transco) to pursue development, construction, operation, and ownership of new transmission projects. The NYTOs proposed to the Task Force several transmission projects that could be undertaken by a NY Transco entity.

Other recommended actions, some of which will include the Authority, are investments to improve the reliability, safety and storm resilience in the areas of electric generation and transmission and natural gas distribution, facilitation of clean and renewable energy development, and funding of "Smart-Grid" technologies to improve the transmission system performance.

### ***Build Smart NY Initiative***

On December 28, 2012, Governor Andrew M. Cuomo issued Executive Order No. 88 directing state agencies collectively to reduce energy consumption in state-owned and managed buildings by 20 percent within seven years – an initiative designed to produce significant savings for New York taxpayers, generate jobs, and significantly reduce greenhouse gas emissions. To meet this initiative, the Governor launched Build Smart NY, a plan to strategically implement the Executive Order by accelerating priority improvements in energy performance. The Authority offered to provide \$450 million in low-cost financing for this initiative for state owned buildings and an additional \$350 million for towns and municipalities.

### **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

(In millions)

Assets and Deferred Outflows	December 31,	
	2012	2011
Current Assets:		
Cash and cash equivalents	\$ 77	\$ 65
Investment in securities	1,269	1,159
Interest receivable on investments	6	6
Receivables - customers	223	190
Materials and supplies, at average cost:		
Plant and general	83	80
Fuel	18	23
Miscellaneous receivables and other	199	169
<b>Total current assets</b>	<b>1,875</b>	<b>1,692</b>
Noncurrent Assets:		
Restricted funds:		
Cash and cash equivalents	21	20
Investment in securities	1,245	1,147
<b>Total restricted assets</b>	<b>1,266</b>	<b>1,167</b>
Capital funds:		
Cash and cash equivalents	-	5
Investment in securities	58	93
<b>Total capital funds</b>	<b>58</b>	<b>98</b>
Capital Assets:		
Capital assets not being depreciated	334	288
Capital assets, net of accumulated depreciation	4,485	4,622
<b>Total capital assets</b>	<b>4,819</b>	<b>4,910</b>
Other Noncurrent Assets:		
Unamortized debt expense	12	13
Regulatory assets-risk management activities	32	34
Receivable - New York State	318	318
Deferred charges, long-term receivables and other	597	541
Notes receivable - nuclear plant sale	37	53
<b>Total other noncurrent assets</b>	<b>996</b>	<b>959</b>
<b>Total noncurrent assets</b>	<b>7,139</b>	<b>7,134</b>
<b>Total assets</b>	<b>9,014</b>	<b>8,826</b>
Deferred outflows:		
Accumulated decrease in fair value of hedging derivatives	107	209
<b>Total assets and deferred outflows</b>	<b>\$ 9,121</b>	<b>\$ 9,035</b>

(Continued)

# NEW YORK POWER AUTHORITY

## Balance Sheets

(In millions)

Liabilities and Net Position	December 31,	
	2012	2011
Current liabilities:		
Accounts payable and accrued liabilities	\$ 442	\$ 404
Short-term debt	431	374
Long-term debt due within one year	91	82
Capital lease obligation due within one year	8	5
Risk management activities - derivatives	58	117
Total current liabilities	1,030	982
Noncurrent liabilities:		
Long-term debt:		
Senior:		
Revenue bonds	1,012	1,064
Adjustable rate tender notes	106	115
Subordinated:		
Subordinated Notes, Series 2012	24	-
Commercial paper	102	173
Total long-term debt	1,244	1,352
Other noncurrent liabilities:		
Capital lease obligation	1,217	1,225
Liability to decommission divested nuclear facilities	1,186	1,090
Disposal of spent nuclear fuel	216	216
Relicensing	303	329
Deferred credits and other	368	414
Risk management activities - derivatives	87	132
Total other noncurrent liabilities	3,377	3,406
Total noncurrent liabilities	4,621	4,758
Total liabilities	5,651	5,740
Net position:		
Net investment in capital assets	1,893	1,821
Restricted	27	32
Unrestricted	1,550	1,442
Total net position	3,470	3,295
Total liabilities and net position	\$ 9,121	\$ 9,035

See accompanying notes to the financial statements.

## NEW YORK POWER AUTHORITY

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

(In millions)

	Year Ended December 31,	
	2012	2011
Operating revenues:		
Power sales	\$ 1,925	\$ 1,960
Transmission charges	150	147
Wheeling charges	598	548
Total operating revenues	2,673	2,655
Operating Expenses:		
Purchased power	744	854
Fuel oil and gas	228	258
Wheeling	598	548
Operations	454	420
Maintenance	104	99
Depreciation	226	194
Total operating expenses	2,354	2,373
Operating income	319	282
Nonoperating revenues and expenses:		
Nonoperating revenues:		
Investment income	27	37
Other	93	108
Total nonoperating revenues	120	145
Nonoperating expenses		
Contribution to New York State	85	65
Interest on long-term debt	67	71
Interest - other	120	63
Interest capitalized	(5)	(4)
Amortization of debt premium	(3)	(3)
Total nonoperating expenses	264	192
Net income before contributed capital	175	235
Contributed capital – Wind farm transmission assets	–	59
Change in net position	175	294
Net position, January 1	3,295	3,001
Net position, December 31	\$ 3,470	\$ 3,295

See accompanying notes to the financial statements.

# NEW YORK POWER AUTHORITY

## Statements of Cash Flows

(In millions)

	Year Ended December 31,	
	2012	2011
Cash flows from operating activities:		
Received from customers for the sale of power, transmission and wheeling	\$ 2,577	\$ 2,672
Disbursements for:		
Purchased power	(748)	(849)
Fuel, oil and gas	(218)	(272)
Wheeling of power by other utilities	(600)	(581)
Operations and maintenance	(620)	(558)
<b>Net cash provided by operating activities</b>	<b>391</b>	<b>412</b>
Cash flows from capital and related financing activities:		
Earnings received on construction fund investments	2	3
Issuance of series 2011 A bonds	-	108
<b>Issuance of Subordinated Notes, Series 2012</b>	<b>25</b>	<b>-</b>
Issuance of commercial paper	-	3
Repayment of notes	(8)	(8)
Repayment of bonds	(43)	(118)
Repayment of commercial paper	(46)	(135)
Defeasance of series 2002 A bonds	-	(42)
Gross additions to capital assets	(145)	(109)
Sale of Tri-Lakes transmission assets	-	33
Interest paid, net	(67)	(70)
Net cash used in capital and related financing activities	(282)	(335)
Cash flow from noncapital-related financing activities:		
Energy conservation program payments received from participants	178	112
<b>Energy conservation program costs</b>	<b>(239)</b>	<b>(176)</b>
Issuance of commercial paper	218	163
Repayment of commercial paper	(185)	(113)
Interest paid on commercial paper	(4)	(1)
Contributions to OPEB trust fund	(22)	(40)
Contributions to New York State	(91)	(73)
DOE settlement	-	11
Entergy value sharing agreement	72	72
Entergy notes receivable	30	30
Net cash used in noncapital-related financing activities	(43)	(15)
Cash flow from investing activities:		
Earnings received on investments	26	24
Purchase of investment securities	(5,278)	(7,728)
Sale of investment securities	5,194	7,645
Net cash used in investing activities	(58)	(59)
Net increase in cash	8	3
Cash and cash equivalents, January 1	90	87
Cash and cash equivalents, December 31	\$ 98	\$ 90
Reconciliation to net cash provided by operating activities:		
Operating income	\$ 319	\$ 282
Adjustments to reconcile operating income to net cash provided by operating activities:		
Change in assets, deferred outflows, liabilities and deferred inflows:		
Provision for depreciation	226	194
Net decrease in prepayments and other	30	12
Net (increase) decrease in receivables and inventory	(88)	9
Net decrease in accounts payable and accrued liabilities	(96)	(85)
Net cash provided by operating activities	\$ 391	\$ 412
<b>Supplemental disclosures for noncash transactions:</b>		
Capital lease/debt agreements	\$ -	\$ 1,225

See accompanying notes to the financial statements

# NEW YORK POWER AUTHORITY

## Notes to the Financial Statements

December 31, 2012 and 2011

### (1) General

The Power Authority of the State of New York (the 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 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 of New York, 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. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, the Authority applies 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*. 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.

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

# NEW YORK POWER AUTHORITY

## Notes to the Financial Statements

December 31, 2012 and 2011

(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, 2012 and 2011 expressed as a percentage of average depreciable capital assets on an annual basis are:

	<b>Average depreciation rate</b>	
	<b>2012</b>	<b>2011</b>
Type of plant:		
Production:		
Hydro	2.0%	2.0%
Gas turbine/combined cycle	3.2	3.2
Transmission	2.5	2.4
General	3.6	3.7
	2.8%	2.8%

**(e) Asset Retirement Obligation**

The Authority applies the applicable provisions of ASC Topic 410, *Asset Retirement and Environmental 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.

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, 2012 or 2011.

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

# NEW YORK POWER AUTHORITY

## Notes to the Financial Statements

December 31, 2012 and 2011

obligations as of December 31, 2012 and 2011 were approximately \$241 million and \$235 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, 2011	\$ 22	235
Depreciation expense	—	6
Balance – December 31, 2012	<u>\$ 22</u>	<u>241</u>

**(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 financial 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.

**(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, 2012 and 2011, deferred charges include \$201 million and \$141 million, respectively, of energy services program costs. These deferred costs will be recovered from certain customers through the terms of contracts.

# NEW YORK POWER AUTHORITY

## Notes to the Financial Statements

December 31, 2012 and 2011

**(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 position and in other noncurrent liabilities on the balance sheets.

**(n) Net Position**

In 2012, the Authority retroactively adopted GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position*. This Statement provides reporting guidance for deferred outflows of resources and deferred inflows of resources to be reported in the statement of financial position in a separate section following assets and liabilities, respectively. This Statement also amends the net asset requirements of Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets.

Net Position represents the difference between assets plus deferred outflows and liabilities plus deferred inflows and is classified into three components:

- a. Net investment in capital assets – This consists of capital assets, net of depreciation reduced by related outstanding debt and accounts. This indicates that these assets are not accessible for other purposes.
- b. Restricted – This represents restricted assets reduced by related liabilities and deferred inflows of resources that are not accessible for general use because their use is subject to restrictions enforceable by third parties.
- c. Unrestricted – This represents the net amount of assets, deferred outflows of resources, liabilities and deferred inflows of resources that are not included in the components noted above and 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 54% and 53% of the Authority's operating revenues in 2012 and 2011, 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) New Accounting Pronouncements**

In 2012, GASB issued GAS No. 65, *Items Previously Reported as Assets and Liabilities*, which establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities, such as refunding of debt and recognizes, as outflows of resources (expenses or expenditures) and inflows of resources (revenues), certain items that were previously reported as assets and liabilities, such as debt issuance costs. The provisions of this statement are effective for financial statements for periods beginning after December 15, 2012. The Authority does not anticipate any significant impact upon adoption of GAS No. 65.

# NEW YORK POWER AUTHORITY

## Notes to the Financial Statements

December 31, 2012 and 2011

### **(q) 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 position or cash flows.

### **(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 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 or Fannie Mae), 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, 2012, \$513 million (19%), \$407 million (15%), \$276 million (10%) and \$49 million (2%) of the Authority's investments were in securities of FNMA or Fannie Mae, FHLMC, FHLB and FFCB, respectively.

## NEW YORK POWER AUTHORITY

### Notes to the Financial Statements

December 31, 2012 and 2011

At December 31, 2011, \$575 million (23%) \$337 million (14%), \$188 million (8%) and \$78 (3%) million of the Authority's investments were in securities of FNMA or Fannie Mae, FHLB, FFCB and FHLMC, respectively.

**(d) Decommissioning Fund**

The Decommissioning Trust Fund is managed by external investment portfolio managers. Under the Decommissioning Agreements (see note 11 of notes to the financial statements), the Authority will make no further contributions to the Decommissioning Funds. The 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, 2012 and 2011, the Authority had investments in repurchase agreements of \$50 million and \$48 million, respectively. The bank balances were at December 31, 2012 and 2011 \$60 million and \$52 million, respectively, of which \$59 million and \$51 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, 2012 and 2011 are as follows:

<u>December 31, 2012</u>	<u>Total</u>	<u>Total restricted</u>	<u>Decommiss- ioning Trust Fund</u>	<u>Restricted POCR and CAS projects and other (In millions)</u>	<u>ART note debt reserve</u>	<u>Capital fund</u>	<u>Unrestricted</u>
Cash and investments:							
Cash and cash equivalents	\$ 98	21	—	21	—	—	77
U.S. government:							
Treasury Bills	18	3	—	3	—	15	—
GNMA	18	—	—	—	—	—	18
	<u>36</u>	<u>3</u>	<u>—</u>	<u>3</u>	<u>—</u>	<u>15</u>	<u>18</u>
Other debt securities:							
FNMA	513	—	—	—	—	6	507
FHLMC	407	21	—	21	—	4	382
FHLB	276	24	—	15	9	4	248
FFCB	49	—	—	—	—	12	37
All other	105	11	—	—	11	17	77
	<u>1,350</u>	<u>56</u>	<u>—</u>	<u>36</u>	<u>20</u>	<u>43</u>	<u>1,251</u>
Portfolio Manager	1,186	1,186	1,186	—	—	—	—
Total investments	<u>2,572</u>	<u>1,245</u>	<u>1,186</u>	<u>39</u>	<u>20</u>	<u>58</u>	<u>1,269</u>
	<u>\$ 2,670</u>	<u>1,266</u>	<u>1,186</u>	<u>60</u>	<u>20</u>	<u>58</u>	<u>1,346</u>
Summary of maturities (years):							
0 – 1	\$ 421	71	—	60	11	47	303
1 – 5	1,022	9	—	—	9	5	1,008
5 – 10	1	—	—	—	—	—	1
10+	40	—	—	—	—	6	34
Portfolio manager	1,186	1,186	1,186	—	—	—	—
	<u>\$ 2,670</u>	<u>1,266</u>	<u>1,186</u>	<u>60</u>	<u>20</u>	<u>58</u>	<u>1,346</u>

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

# NEW YORK POWER AUTHORITY

## Notes to the Financial Statements

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(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 POOCR funds is subject to comprehensive Federal regulations and judicial orders, including restrictions on the type of projects that can be financed with POOCR funds, the use of funds recovered from such projects and the use of interest and income generated by such funds and projects. Pursuant to the legislation, the Authority is utilizing POOCR funds and the Other State Funds to implement various energy services programs that have received all necessary approvals.

The disbursements of the POOCR 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 POOCR 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. As of December 31, 2012, the conversions to the schools are substantially complete and the Authority is currently in its closeout process regarding the CAS projects.

As of December 31, 2012, restricted funds include the POOCR fund (\$12 million), the CAS Projects fund (\$3 million), the Lower Manhattan Energy Independence Initiative fund (\$7 million) and the Fish & Wildlife Habitat Enhancement fund related to the Niagara relicensing costs (\$16 million), the Western New York Economic Development Fund (\$18 million) and other (\$4 million). As of December 31, 2011, restricted funds include the POOCR fund (\$14 million), the CAS Projects fund (\$9 million), the Lower Manhattan Energy Independence Initiative fund (\$13 million), the Fish & Wildlife Habitat Enhancement fund related to the Niagara relicensing costs (\$17 million) and other (\$3 million).

<u>December 31, 2011</u>	<u>Total</u>	<u>Total restricted</u>	<u>Decommiss- ioning Trust Fund</u>	<u>Restricted POCR and CAS projects and other</u>	<u>ART note debt reserve</u>	<u>Capital fund</u>	<u>Unrestricted</u>
				(In millions)			
Cash and investments:							
Cash and cash equivalents	\$ 90	20	—	20	—	5	65
U.S. government:							
Treasury bills							
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
	<u>\$ 2,489</u>	<u>1,167</u>	<u>1,090</u>	<u>56</u>	<u>21</u>	<u>98</u>	<u>1,224</u>
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	—	—	—	—
	<u>\$ 2,489</u>	<u>1,167</u>	<u>1,090</u>	<u>56</u>	<u>21</u>	<u>98</u>	<u>1,224</u>

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Notes to the Financial Statements

December 31, 2012 and 2011

**(5) Capital Assets**

The following schedule summarizes the capital assets activity of the Authority for the year ended December 31, 2012:

	<u>Beginning balance</u>	<u>Additions</u>	<u>Deletions/ Transfers</u>	<u>Ending balance</u>
	(Amounts in millions)			
Capital assets, not being depreciated:				
Land	\$ 154	2	—	156
Construction in progress	134	126	(82)	178
Total capital assets not being depreciated	<u>288</u>	<u>128</u>	<u>(82)</u>	<u>334</u>
Capital assets, being depreciated:				
Production – Steam	437	—	—	437
Production – Hydro	1,796	37	(3)	1,830
Production – Gas turbine/combined cycle	2,414	4	—	2,418
Transmission	1,909	20	(1)	1,928
General	1,113	23	(2)	1,134
Total capital assets being depreciated	<u>7,669</u>	<u>84</u>	<u>(6)</u>	<u>7,747</u>
Less accumulated depreciation for:				
Production – Steam	436	—	—	436
Production – Hydro	657	30	(3)	684
Production – Gas turbine/combined cycle	571	104	—	675
Transmission	993	48	(1)	1,040
General	390	38	(1)	427
Total accumulated depreciation	<u>3,047</u>	<u>220</u>	<u>(5)</u>	<u>3,262</u>
Net value of capital assets, being depreciated	<u>4,622</u>	<u>(136)</u>	<u>(1)</u>	<u>4,485</u>
Net value of all capital assets	\$ <u>4,910</u>	<u>(8)</u>	<u>(83)</u>	<u>4,819</u>

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December 31, 2012 and 2011

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 (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.

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Notes to the Financial Statements

December 31, 2012 and 2011

**(6) Long-Term Debt**

**(a) Components**

	<u>Amount</u>		<u>Interest rate</u>	<u>Maturity</u>	<u>Earliest redemption date prior to maturity</u>
	<u>2012</u>	<u>2011</u>			
	(In millions)				
Senior debt:					
Revenue Bonds (Tax-Exempt):					
Series 2002 A Revenue Bonds:					
Serial Bonds	\$ 27	\$ 53	3.50% to 5.00%	11/15/2013	N/A
Series 2006 A Revenue Bonds:					
Serial Bonds	111	123	3.625% to 5.0%	11/15/2013 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	69	2.0% to 5.0%	11/15/2013 to 2031 *	11/15/2021
Term Bonds	39	39	4.0% to 5.0%	11/15/2032 to 2038	11/15/2021
Revenue Bonds (Taxable):					
Series 2003 A Revenue Bonds:					
Serial Bonds	5	10	4.83%	11/15/2013	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
	<u>1,040</u>	<u>1,083</u>			
Plus unamortized premium and discount	29	34			
Less deferred refinancing costs	<u>9</u>	<u>10</u>			
	<u>1,060</u>	<u>1,107</u>			
Less due in one year	<u>48</u>	<u>43</u>			
	<u>\$ 1,012</u>	<u>\$ 1,064</u>			

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

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## Notes to the Financial Statements

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	Amount		Interest rate	Maturity	Earliest redemption date prior to maturity
	2012	2011			
	(In millions)				
Adjustable Rate Tender Notes:					
2016 Notes	\$ 40	\$ 48	0.19%	3/1/2016	Any adjustment date
2020 Notes	75	75	0.19%	3/1/2020	Same as above
	115	123			
Less due in one year	9	8			
	106	115			
Subordinate debt:					
Subordinated Notes, Series 2012	25	—	0.45% to 4.05%	2013 to 2037	N/A
Commercial Paper:					
EMCP (Series 1)	70	78	0.18%	2013 to 2023	
CP (Series 2)	65	82	0.16%	2013 to 2015	
CP (Series 3) (a)	—	44	0.22%		
	160	204			
Less due within one year	34	31			
	126	173			
Total Long-term debt	1,335	1,434			
Less due within one year	91	82			
Long-term debt, net of due in one year	\$ 1,244	\$ 1,352			

Interest on Series 2003 A and 2007 B Revenue Bonds and Subordinated Notes, Series 2012 is not excluded from gross income for bondholders' Federal income tax purposes.

### Senior Debt

As indicated in note 3 of notes to the financial statements, "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 \$1.92 billion. Principal and interest paid for 2012 and operating income plus depreciation were \$108 million and \$545 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.

In 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.

# NEW YORK POWER AUTHORITY

## Notes to the Financial Statements

December 31, 2012 and 2011

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. As of December 31, 2011, \$310 million, of outstanding bonds were considered defeased. As of December 31, 2012, there were no bonds outstanding that 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 a revolving credit agreement (Agreement) with The Bank of Nova Scotia, which terminates on September 1, 2015, to provide a supporting line of credit for the purpose of repaying, redeeming or purchasing the Adjustable Rate Tender Notes. Under the Agreement, the Authority may borrow up to the outstanding principle of the ART Notes, which at December 31 2012 was \$115 million. The Agreement provides for interest on outstanding borrowings 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. As of December 31, 2012 and 2011, there were no outstanding borrowings under this Agreement. 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 of notes to the financial statements for the Authority's risk management program relating to interest rates.

At December 31, 2012 and 2011, the current market value of the senior debt was approximately \$1.329 billion and \$1.347 billion, respectively. Market values were obtained from a third party that utilized a matrix-pricing model.

### Subordinate Debt:

**Subordinate Notes** – In November 2012, the Authority's Trustees authorized the issuance of Subordinated Notes, in a principal amount not to exceed \$30 million for the purpose of accelerating the funding for the State Parks Greenway Fund, which was established pursuant to the Niagara Relicensing Settlement entered into by the Authority and the New York State Office of Parks, Recreation & Historic Preservation. The Authority issued the Subordinated Notes, Series 2012 (Subordinated Notes) on December 18, 2012 in the amount of \$25 million. These Subordinated 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.

**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). It is the Authority's intent to remarket the EMCP Notes as they mature with their ultimate retirement to range from 2013 to 2022. 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.

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), \$450 million (Series 2 CP Notes), \$350 million (Series 3 CP Notes) and \$220 million (Series 4 CP Notes). See note 7 of the notes to the financial statements for Series 1, and certain Series 2 and Series 3 CP Notes designated as short-term debt. There were no Series 4 CP Notes outstanding at December 31, 2012.

The proceeds of certain 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 2013 to 2022, as indicated in the table above.

The Authority has a line of credit under a 2011 revolving credit agreement (the 2011 RCA) with a syndicate of banks, to provide liquidity support for the Series 1-3 CP Notes, under which the Authority may borrow up to \$550 million in aggregate principal amount outstanding at any time for certain purposes, including the repayment of the Series 1-3 CP Notes. This revolving line of credit expires January 20, 2014. No are no outstanding borrowings under the 2011 RCA.

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 to holders for Federal income tax purposes.

# NEW YORK POWER AUTHORITY

## Notes to the Financial Statements

December 31, 2012 and 2011

Maturities and Interest Expense:	Long-Term Debt				Capitalized Lease Obligations		
	(In millions)						
	Principal	Interest	Hedging Derivative Instruments, Net	Total	Principal	Interest	Total
Year:							
2013	\$ 91	55	6	152	8	98	106
2014	94	53	5	152	12	97	109
2015	90	51	3	144	16	96	112
2016	77	48	2	127	20	94	114
2017	85	47	—	132	25	95	120
2018 – 2022	373	179	—	552	218	420	638
2023 – 2027	91	128	—	219	434	293	727
2028 – 2032	134	99	—	233	492	75	567
2033 – 2037	109	63	—	172	—	—	—
2038 – 2042	74	38	—	112	—	—	—
2043 – 2047	97	14	—	111	—	—	—
	1,315	775	16	2,106	1,225	1,268	2,493
Plus unamortized bond premium	29	—	—	29	—	—	—
Less deferred refinancing cost	9	—	—	9	—	—	—
	\$ 1,335	775	16	2,126	1,225	1,268	2,493

The interest rate used to calculate future interest expense on variable rate debt is the interest rate at December 31, 2012.

**(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 Authority and the remarketing agent appointed under the Note Resolution determine 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, 2012, the reset rate would have been 7.33%.

# NEW YORK POWER AUTHORITY

## Notes to the Financial Statements

December 31, 2012 and 2011

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

Changes in the Authority's long-term liabilities for the year ended December 31, 2012 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	\$ 1,083	—	43	1,040	48
Adjustable rate tender bonds	123	—	8	115	9
Subtotal	<u>1,206</u>	<u>—</u>	<u>51</u>	<u>1,155</u>	<u>57</u>
Subordinate debt:					
Subordinated Notes, Series 2012	—	25	—	25	1
Commercial paper	204	—	69	135	33
Subtotal	<u>204</u>	<u>25</u>	<u>69</u>	<u>160</u>	<u>34</u>
Net unamortized discounts/ premiums and deferred losses	<u>24</u>	<u>—</u>	<u>4</u>	<u>20</u>	<u>—</u>
Total debt, net of unamortized discounts/ premiums/ deferred losses	<u>\$ 1,434</u>	<u>25</u>	<u>124</u>	<u>1,335</u>	<u>91</u>
Other long-term liabilities:					
Capitalized lease obligation	\$ 1,230	—	13	1,217	8
Nuclear decommissioning	1,090	96	—	1,186	—
Disposal of nuclear fuel	216	—	—	216	—
Relicensing	329	20	46	303	—
Deferred revenues and other	546	16	107	455	—
Total other long-term liabilities	<u>\$ 3,411</u>	<u>132</u>	<u>166</u>	<u>3,377</u>	<u>8</u>

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## Notes to the Financial Statements

December 31, 2012 and 2011

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:					
Nuclear decommissioning	\$ —	1,294	64	1,230	5
Disposal of nuclear fuel	1,032	58	—	1,090	—
Relicensing	216	—	—	216	—
Deferred revenues and other	335	17	23	329	—
Total other long-term liabilities	<u>\$ 602</u>	<u>17</u>	<u>73</u>	<u>546</u>	<u>—</u>
	<u>\$ 2,185</u>	<u>1,386</u>	<u>160</u>	<u>3,411</u>	<u>5</u>

### (7) Short-Term Debt

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

	<u>December 31,</u>			
	<u>2012</u>		<u>2011</u>	
	<u>Availability</u>	<u>Outstanding</u>	<u>Availability</u>	<u>Outstanding</u>
	(In millions)			
CP Notes (Series 1)	\$ 70	\$ 330	\$ 26	\$ 374
CP Notes (Series 2) (a)	305	80	450	—
CP Notes (Series 3)	329	21	350	—

(a) Availability includes long-term CP Notes (Series 2) of \$65 million outstanding at December 31, 2012.

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

# NEW YORK POWER AUTHORITY

## Notes to the Financial Statements

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amount outstanding at any time of \$400 million (Series 1 CP Notes), \$450 million (Series 2 CP Notes), \$350 million (Series 3 CP Notes) and \$220 million (Series 4 CP Notes). See note 6 “Long-term Debt – Subordinated Debt–Commercial Paper” of notes to the financial statements for Series 2 CP Notes designated as long-term debt. It had been and shall be the intent of the Authority to use the proceeds of the Series 1 CP Notes and certain Series 2 CP and Series 3 CP 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:

Year:	<u>Beginning balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending balance</u>
	(In millions)			
2012	\$ 374	242	185	431
2011	\$ 323	164	113	374

## (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 and commodity option hedging derivative instruments the change in fair value is applied to interest expense and related commodity revenue or 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 agreements take into consideration the prevailing interest rate environment and the specific terms and conditions of each agreement. The fair values were estimated using the zero-coupon discounting method. The fair value of interest rate options were measured using an option pricing model that considers certain variables such as volatilities, time and underlying prices. The fair value for over-the-counter energy, renewable energy derivative instruments is determined by the monthly market prices over the lifetime of each outstanding derivative instrument using the latest end-of-trading-month forward prices published by Platts or derived from pricing models for option and/or option-based derivative instruments using the underlying price, time and observed volatilities based upon Platts published prices and other variables.

### Counterparty Credit Risk

The Authority’s policy regarding the creditworthiness of counterparties for interest rate derivative instruments 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 instrument 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 on the derivative instrument 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.

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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 the Authority 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, 2012 the Authority's individual or aggregate exposure to derivative instrument counterparty credit risk is not significant.

### Derivative Instruments

The following table shows the fair value of derivatives instruments for 2012 and 2011:

Derivative instrument description	Fair value balance December 31, 2011	Net change in fair value	Fair value balance December 31, 2012	Type of hedge or transaction (in millions)	Financial statement classification for changes in fair value	Notional amount December 31, 2012	Volume
<b>Interest rate contracts (Swaps/Options):</b>							
Series 2 CP Notes	\$ (6.1)	\$ 2.9	\$ (3.2)	Cash Flow	Deferred outflow	65.5	USD
ART Notes	(13.7)	2.4	(11.3)	Cash Flow	Deferred outflow	114.8	USD
CP Notes, Series 1 (Option)	—	—	—	Cash Flow	Interest Expense	300.0	USD
<b>Energy instruments (Swaps/Swaptions):</b>							
NYC Customer Load	(71.9)	71.9	—	Cash Flow	Deferred outflow	—	MWh
NYC Customer Load	(117.5)	25.2	(92.3)	Cash Flow	Deferred outflow	3,504,000	MWh
Hydro Generation Revenue	—	—	—	Investment	Power sales	184,000	MWh
<b>Renewable energy contracts: (Swaps)</b>							
SENY Renewable Energy	(33.6)	1.2	(32.4)	Investment	Regulatory Asset	909,983	MWh
Totals	<u>\$ (242.8)</u>	<u>\$ 103.6</u>	<u>\$ (139.2)</u>				

### Interest Rate Derivative Instruments

**CP Notes, Series 2.** – 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 5.123% to the counterparties through February 15, 2015. In return, the counterparties would pay interest to the Authority based upon the Securities Industry and Financial Markets Association 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 \$3.4 and \$4.3 million in 2012 and 2011, 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 \$3.8 and \$4.3 million in 2012 and 2011, respectively.

**CP Notes, Series 1.** – In January 2011, the Authority purchased an interest rate cap with the objective of limiting exposure to rising interest rates relating to \$300 million of its Series 1 CP Notes at a premium cost of \$0.2 million. The interest rate for the Series 1 CP Notes is capped at 5.5 percent based upon the SIFMA Index through January 2013 upon which date it expired. There were no changes to the fair value of this interest rate cap during 2012.

### Energy Derivative Instruments

**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

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between 2010 and 2012. This medium-term forward swap expired in December 2012. Net settlement payments were \$90.1 million and \$50.2 million in 2012 and 2011, 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 \$49.6 million and \$27.8 million in 2012 and 2011, respectively.

**Hydro Generation Revenue.** – In May 2012, the Authority purchased energy swaptions for certain months of 2013 and 2014. The objective of these transactions was to limit the Authority's price exposure related to significant downward movement in the sales price of certain forecasted merchant sales from generation at certain of its operating facilities in the NYISO electric market. As of December 31, 2012, a decrease in the forecasted generation has rendered these out-of-the-money swaptions to be ineffective. The 2012 changes in the fair value of the swaptions charged to power sales in the statement of revenues, expenses and changes in net position were insignificant.

### 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 \$7.1 million and \$6.2 million in 2012 and 2011, respectively. The Authority anticipates the recovery or distribution of any net settlements through specific contractual agreements with customers.

### Other Considerations

The Authority from time to time may be exposed to any of the following risks:

**Basis risk.** – The Authority is exposed to basis risk on its pay-fixed interest rate swaps since it receives variable-rate payments on these hedging derivative instruments based on indexes which differ from the actual interest rates the Authority pays on its variable-rate debt. The Authority remarkets its Notes at rates that approximate SIFMA and LIBOR after considering other factors such as the Authority's creditworthiness.

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 interest rates incurred on its ART Notes and LIBOR Index used in the pay-fixed receive-variable interest rate swap transaction.

**Rollover risk.** – The Authority is exposed to rollover risk on hedging derivative instruments that terminate prior to the maturity of the Authority's ART Notes, which these derivative instruments hedge. When the derivative instruments terminate the Authority will be re-exposed to the variable interest rate risk being hedged by the derivative instruments. The termination of the interest rate swaps on September 1, 2016 exposes the Authority to rollover risk since the hedged debt matures on March 1, 2020.

Certain electrical commodity-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 agreement if the either party fails to perform under the terms of the agreement. The risk that such termination may occur at a time which may be disadvantageous to the Authority has been mitigated by including certain terms in these agreements by which the counterparty has the right to terminate only as a result of certain events, which includes a payment default by the Authority; other Authority defaults which remain uncured within a defined time-frame after notice; bankruptcy or 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 the Authority has a liability position, related to its hedging derivative instruments, 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

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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 programs. See note 6 of the notes to the financial statements.

### **Dodd Frank Act**

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 related commodity swap transactions of the type in which the Authority engages ("Swaps"). The requirements and processes are set forth in regulations promulgated by the Commodities Futures Trading Commission ("CFTC"). Pursuant to CFTC rules thus far, the Authority, as a public entity and electric utility which uses swaps solely to manage its risk, will be exempted from posting collateral beyond that of any existing credit support annexes in support of its open over-the-counter ("OTC") hedge positions. These CFTC rules are not anticipated to have significant impact on the Authority's liquidity and/or future risk mitigation activities. CFTC DF Act rules are still being promulgated, and Authority will continue to monitor their potential impact on the Authority's liquidity and/or future risk mitigation activities.

## **(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 NYSRSSL, 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 joined the ERS on or after January 1, 2010 contribute 3% of their salary during their entire length of service. Employees who joined the ERS on or after April 1, 2012 contribute 3% of their salary through March 31, 2013 and up to 6% thereafter, based on their annual salary, during their entire length of service. Under the authority of the NYSRSSL, 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 2012, 2011 and 2010 were \$27.0 million, \$21.0 million and \$17.1 million, respectively. The Authority's contributions to the ERS were equal to 100% of the required contributions for each year.

Global decline in financial markets could adversely impact state pension investment market values, including those of the ERS. If ERS's investment market values do not recover, increases in the annual contributions to ERS in subsequent years may occur. The average contribution rate relative to payroll for the fiscal years ended March 31, 2012 was 16%. The average contribution rates relative to payroll for the fiscal years ended March 31, 2013 and 2014 have been set at approximately 18% and 21%, respectively.

### **(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 4,200 participants, including 1,600 current employees and 2,600 retired employees and/or spouses and dependents of retired employees, were eligible to receive these benefits at December 31, 2012. 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

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ongoing annual funding of the Trust in order to strengthen the Authority's financial position. Contributions of \$22 million and \$40 million were made to the OPEB Trust during 2012 and 2011, respectively.

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).

	2012	2011	2010
Annual OPEB cost:			
Annual required contribution (ARC):			
Normal cost	\$ 10	\$ 9	\$ 8
Amortization payment	27	22	20
Total	37	31	28
ARC adjustment	9	7	8
Interest on net OPEB obligation	(5)	(3)	(4)
Annual OPEB cost	\$ 41	\$ 35	\$ 32
Net OPEB obligation:			
Net OPEB (asset) obligation at beginning of fiscal year	\$ (71)	\$ (46)	\$ (61)
Annual OPEB cost	41	35	32
Employer contribution:			
Benefit payments for retirees during the year	(19)	(20)	(17)
Trust fund contributions	(22)	(40)	—
Total employer contribution	(41)	(60)	(17)
Net OPEB (asset) obligation at end of fiscal year	\$ (71)	\$ (71)	\$ (46)

The net OPEB asset of \$71 million, which consists of \$22 million current assets and \$49 million noncurrent assets, is reported in miscellaneous receivables and other and deferred charges, long-term receivables and other, respectively, in the balance sheet at December 31, 2012.

The Authority's annual OPEB cost for 2012 was \$41 million, which is reflected as an expense in the statement of revenues, expenses, and changes in net position. 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 valuation was performed as of January 1, 2012 and resulted in an actuarial accrued liability of \$517 million which was funded with assets totaling \$283 million indicating that the Authority's retiree health plan was 55% funded as of the valuation date. As of December 31, 2012, the balance in the OPEB Trust was \$341 million and the actuarial accrued liability was \$544 million, resulting in the retirees' health plan being 63% funded.

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 2012

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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 approximately 9% (net of administrative expenses), including inflation, declining approximately 1/2% each year to an ultimate trend rate of approximately 5%. Both the cost trend rate and the ultimate trend rate include a 3% 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 2012 and 2011.

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 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

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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(d) "Small, Clean Power Plants and 500-MW Plant" of the notes to the financial statements) 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 (see note 8 of notes to the financial statements).

### (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, 2012 and 2011, the present value of the notes receivable were:

	2012	2011
	(In millions)	
Notes receivable – nuclear plant sale	\$ 53	\$ 68
Less due within one year	16	15
	\$ 37	\$ 53

The long-term portion of this notes receivable is reported in other noncurrent assets in the balance sheets at December 31, 2012 and 2011.

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 Authority received its final \$10 million payment on September 6, 2012. The 2012 and 2011 payments received were included in other nonoperating 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

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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. As of December 31, 2012, payments totaling \$71.7 million have been accrued by the Authority and are reflected in other nonoperating income in the Authority's statements of revenues, expenses, and changes in net position. The Authority has received the maximum annual payment of \$48 million in each of the calendar years 2012 and 2011 for IP3. The Authority has received payments of \$23.7 million and \$24 million in 2012 and 2011 respectively for JAF. The 2012 payment for JAF was less than the \$24 million maximum primarily due to an unplanned maintenance outage in November 2012. The payments, related to the calendar years ending after December 31, 2012, 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(f) "New York State Budget and Other Matters" relating to a temporary transfer of such funds to the State). As of December 31, 2012 and 2011, the liability to Entergy totaled \$216 million for each year. 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 was reported as other income in the nonoperating revenues section of the statement of revenues, expenses, and changes in net assets for the year ended December 31, 2011. 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.

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.

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Decommissioning Funds of \$1,186 million and \$1,090 million are included in restricted funds and other noncurrent liabilities in the balance sheets at December 31, 2012 and 2011, 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) *Competitive Environment*

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.

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.

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, 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.

### (b) *Power Programs*

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

Chapter 60 (Part CC) of the Laws of 2011 (Chapter 60) established the "Recharge New York Power Program" (RNYPP). The RNYPP is a new power program, administered by the Authority, which has as its central benefit up to 910 MW of low cost power comprised of up to 455 MW of hydropower from the Niagara and St. Lawrence-FDR Projects and up to 455 MW of other power procured or produced by the Authority from other sources. The 910 MW of power is available for allocation as provided by Chapter 60 to eligible new and existing businesses and not-for-profit corporations under contracts of up to seven years. RNYPP was effective beginning July 1, 2012.

The RNYPP legislation also temporarily extended the Power for Jobs (PFJ) and Energy Cost Savings Benefit (ECSB) Program through June 30, 2012 at which time the two programs terminated. Those PFJ and ECSB Program customers who are in substantial compliance with contractual commitments under the PFJ and ECSB Programs and who apply but do not receive RNYPP allocations are eligible to apply for transitional electricity discounts, as provided for in Chapter 60. This transitional electricity discounts program provides for declining levels of discounts through June 30, 2016 when the program terminates, if payment of such discounts is deemed feasible and advisable by the Authority's Trustees. In June 2012, the Authority's Trustees authorized transitional electricity discount payments of up to \$9 million for the year July 1, 2012 – June 30, 2013.

# NEW YORK POWER AUTHORITY

## Notes to the Financial Statements

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The hydropower used for the RNYPP was power formerly used to provide discounted electricity to domestic and rural customers of the three private utilities that serve upstate New York. To mitigate the impacts from the redeployment of this hydropower for the RNYPP, Chapter 60 created a "Residential Consumer Discount Program" (RCDP). The RCDP 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 had formerly received the hydropower that is utilized in the RNYPP. Chapter 60 further authorizes the Authority, as deemed feasible and advisable by the Trustees, to use revenues from the sales of hydroelectric power, and such other funds of the Authority, as deemed feasible and advisable by the Trustees, to fund the RCDP. The Authority's Trustees have authorized the release of \$250 million in support of the RCDP through January 2014. The Authority supplemented the market revenues through the use of internal funds, from the start of the program through December 31, 2012, totaling cumulatively \$60 million. Operations and maintenance expenses included \$100 million and \$42 million of residential consumer discounts for the years ended December 31, 2012 and 2011, respectively.

In November 2012, the Authority's Trustees authorized the funding in an amount not to exceed \$10 million to provide rebates to eligible RNYPP customers for the purchase of energy efficient equipment to replace equipment damaged or lost in the 2012 Hurricane Sandy storm. The Authority's offering will be made available to businesses and not-for-profit organizations on Long Island, in New York City and Westchester and Rockland counties and other areas in New York that may subsequently be subject to a major federal disaster declaration relating to the 2012 Hurricane Sandy storm.

### **Power for Jobs**

In 1997, legislation was enacted into New York law which authorized the Power for Jobs (PFJ) Program to make low-cost electric power available to businesses, small businesses and not-for-profit organizations. The PFJ Program power was sold to the local utilities of the eligible recipients pursuant to sale-for-resale agreements at rates which were based on the cost of the competitive procurement (or alternative acquisition) power plus a charge for the transmission of such power.

In 2004, legislation was enacted into New York law that amended the PFJ Program in regard to contracts of certain PFJ Program customers. Under the amendment, certain customer 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 Rebates). Generally, the amount of such PFJ Rebates for a particular customer was 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 was extended for short periods of time, pending the expected adoption by the State of a new, long term power-based economic development program. As noted above, the PFJ Program was finally terminated effective June 30, 2012 by Chapter 60 which created the RNYPP. The Authority has approved PFJ Rebate payments totaling \$309 million for the years 2005 through December 31, 2012 and in connection with the ending of the program expects the remainder of such payments will not exceed \$52 million.

The Power for Jobs legislation authorized the Authority as deemed feasible and advisable by the trustees, to make annual voluntary contributions to the State in connection with the Program. Commencing from December 2002 through June 2012, the Authority made such voluntary contributions to the State in an aggregate amount of \$475 million in connection with the Power for Jobs Program.

### **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 revised 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 program has been administered by the New York State Economic Development Power Allocation Board (EDPAB) and awarded by the Power Authority based on criteria designed to promote economic development, maintain and develop jobs, and encourage new capital investment throughout New York State. The ECS Benefits were 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.

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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.

Chapter 60 of the Laws of 2011 extended the ECS Benefits Program through June 30, 2012, at which time the Program terminated along with the PFJ due to the creation of the RNYPP discussed above in note 12 (c) "Governmental Customers in the New York Metropolitan Area" of the notes to the financial statements. 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 2009-2012, no ECS Benefits were paid from internal funds, which is reflective of the current lower market prices for electric energy.

### **Western New York Power Proceeds Allocation Act**

Effective March 30, 2012, Chapter 58 (Part GG) of the Laws of 2012 (Chapter 58) created the Western New York Power Proceeds Act (WNYPPA). The WNYPPA authorizes the Authority, as deemed feasible and advisable by the Trustees, to deposit net earnings from the sale of unallocated Expansion Power and Replacement Power from the Authority's Niagara project into an account administered by the Authority known as the Western New York Economic Development Fund (Fund). Net earnings are defined as any excess revenues earned from such power sold into 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 power project that satisfy applicable criteria. Chapter 58 also establishes a five-member Western New York Power Allocations Board, which is appointed by the Governor.

Chapter 58 also repealed Chapter 436 of the Laws of 2010 which had created a similar program that could not be effectively implemented. In June 2012, the Authority's Trustees approved the release of up to \$20 million in net earnings, calculated for the period August 30, 2010 through December 31, 2012 as provided in the legislation, for deposit into the Fund.

### **(c) 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 annually financing for energy efficiency projects and initiatives at governmental customers' facilities, with the financing for such projects and initiatives to range from \$150 million to \$190 million. The costs of such projects are to be recovered from such customers.

As a result of a 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 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 transmission line (Line) extending from Bergen County, New Jersey, to Consolidated Edison's West 49<sup>th</sup> Street substation. 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

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the Authority with 75% of the firm transmission capacity of 660 MW line (the Line) for 20 years. The Authority's obligation to make payments under the FTCPA will begin upon commercial operation, which is expected in the summer of 2013. 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 not be sufficient to fully cover the Authority's costs under the FTCPA during the initial 20-year term of the FTCPA. Depending on a number of variables, it is estimated that the Authority's under-recovery of costs under the FTCPA could be in the range of approximately \$50 million to \$70 million per year during the first five years of commercial operation. The Authority expects, based on current projections, that 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 Poletti plant in 2010, the Authority, in 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 approval of the NYC Governmental Customers, resulted in a long-term electricity supply contract in 2008 between the Authority and Astoria Energy II LLC for the purchase of the output of Astoria Energy II, a new 550-MW plant, which was constructed and entered into commercial operation on July 1, 2011 in Astoria, Queens. The costs associated with the contract will be borne by these customers for the life of the Astoria Energy II contract. The Authority is accounting for and reporting this lease transaction as a capital lease in the amount of \$1.225 billion as of December 31, 2012, which reflects the present value of the monthly portion of lease payments allocated to real and personal property. The balance of the monthly lease payments represents the portion of the monthly lease payment allocated to operations and maintenance costs which are recorded monthly. Fuel for the 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 Westchester County 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.

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

To meet capacity deficiencies and ongoing load requirements in the New York City metropolitan area that 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.

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

#### **St. Regis Litigation**

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.

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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 re-litigating a claim to 144 acres on the mainland that 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, the U.S. Magistrate 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. The U.S. Magistrate 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 to a new U.S. Magistrate. On September 28, 2012, the U.S. Magistrate recommended dismissal of all land claims brought against the Authority by three St. Regis tribal factions as well as the Federal government. The Magistrate upheld the Authority's laches defense and also recommended dismissal on the same grounds of all claims by the same plaintiffs against the other defendants relating to all but one of the other challenged mainland parcels. On October 2, 2012, a new Senior Judge was assigned. Plaintiff tribes, the Federal government and the State filed their objections to the U.S. Magistrate's report and recommendation noted above and all parties have filed their objections. The Senior Judge may accept, modify or reject, in whole or in part, the U.S. Magistrate's report and recommendation.

The Authority had accrued an estimated liability based upon the provisions of the February 1, 2005 settlement related to this litigation. However, while the Authority is unable to predict the outcome of the matters described above, the Authority believes that it has meritorious defenses and positions with respect thereto and as result of current court rulings has reversed its previously accrued estimated liability. The reversal of this liability did not have any effect on the Authority's net income for 2012. Conversely, adverse decisions of a certain type in the matters discussed above could adversely affect Authority operations and revenues.

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### **Tropical Storm Irene**

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. In August 2012, Municipalities initiated a lawsuit in Schoharie County Supreme Court against the Authority involving the heavy rains and widespread flooding resulting from Tropical Storm Irene's passage through the Northeast in August 2011. The Municipalities essentially allege that they sustained property damage and lost tax revenues resulting from lowered assessed valuation of taxable real property due to the Authority's negligence in its operations at the Blenheim-Gilboa pumped-storage hydroelectric facility located on the Schoharie Creek in Schoharie County, New York. In February 2012, a private landowner filed a similar motion and lawsuit in such court.

Plaintiffs seek at least \$5 million in damages, at least \$5 million in punitive damages, as well as attorney's fees. The second lawsuit was brought on behalf of a park campground and makes nearly the same allegations with the plaintiff seeking at least \$5 million in damages, at least \$5 million in punitive damages, as well as attorney's fees. In November 2012, the Authority formally responded to the two lawsuits.

In December 2012, the Authority was served with a third lawsuit by five plaintiffs arising out of Tropical Storm Irene and the Authority's operation of its Blenheim-Gilboa Pumped Storage Project. Plaintiffs previously filed timely notices of claim. The five plaintiffs include three individual landowners and two corporations. The three individual landowners own properties located in Schoharie, NY and Central Bridge, NY and are claiming damages in the aggregate amount of \$1.55 million. The two corporations also own properties in Schoharie, NY and are claiming damages in the aggregate amount of \$1.05 million.

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.

### **Other Actions or Claims**

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.

### **(f) 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 that 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 that 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, and contributions and transfers to fund temporary and permanent programs administered by the Authority and other State entities.

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### 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 law (typically, legislation enacted in connection with the State budget), 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 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 up to the present time, 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. The PFJ Program, which had been extended to June 30, 2012, has ended and was replaced by the RNYPP, discussed above in note 12(b) “Recharge New York Power Program” of the notes to the financial statements. Pursuant to Chapter 59 of the Laws of 2012, the Authority, as deemed feasible and advisable by its Trustees, has been authorized to make an additional voluntary contribution to the State unrelated to the PFJ program.

In 2012 and 2011, the Authority made \$85 million and \$65 million, respectively, in contributions to the State that are not related to the PFJ Program and which were recorded as nonoperating expenses in the year ended December 31, 2012 and 2011 statements of revenues, expenses and changes in net position. These contributions were consistent with the related State fiscal year budgets and were authorized by the Authority’s Trustees. The 2012 contributions of \$85 million include \$10 million that was paid to Empire State Development in December 2012 to support the New York State Open for Business economic development initiative in lieu of the voluntary contributions to the State’s General Fund for the State fiscal year 2012-2013. An additional \$40 million was paid to support this initiative in January 2013 pursuant to Trustee approval and this amount will be recognized as a nonoperating expense in the Authority’s 2013 fiscal year. Cumulatively through December 31, 2012, the Authority has made voluntary contributions to the State totaling \$475 million in connection with the PFJ Program and \$427 million unrelated to the PFJ Program.

### Temporary Asset Transfers

In addition to the authorization for voluntary contributions, as a result of budget legislation enacted in February 2009, the Authority was requested to provide temporary asset transfers to the State of funds held in reserves. Pursuant to the terms of a Memorandum of Understanding dated February 2009 (MOU) between the State, acting by and through the State’s Director of Budget, and the Authority, the Authority agreed to transfer approximately \$215 million associated with its Spent Nuclear Fuel Reserves (Asset B) by March 27, 2009. The Spent Nuclear Fuel Reserves are funds that had been set aside for payment 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 is 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 moneys 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

# NEW YORK POWER AUTHORITY

## Notes to the Financial Statements

December 31, 2012 and 2011

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.

In February 2009, the Authority's Trustees authorized the execution of the MOU relating to the temporary transfers of Asset B (\$215 million) and Asset A (\$103 million) and such transfers were made in March 2009 and September 2009, respectively, following Trustee approval.

The Authority has classified the transfers of Assets A and B (\$318 million) as a long-term loan receivable. In lieu of interest payments, the State has 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 is 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 is waived from April 1, 2011 to March 31, 2017. These payments would have been approximately \$8 million per year but the waiver would 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.

### New York State Executive Budget

The Governor's Executive Budget for State Fiscal Year 2013-2014, released in January 2013, contains language authorizing the Authority, as deemed feasible and advisable by its Trustees, to (i) make a contribution to the State treasury to the credit of the General Fund, or as otherwise directed in writing by the Director of the Budget, in an amount of up to \$90 million for the State fiscal year commencing April 1, 2013, the proceeds of which will be utilized for economic development, energy efficiency, or energy cost mitigation purposes, and (ii) transfer up to \$25 million of any such contribution by June 30, 2013 and the remainder of any such contribution by March 31, 2014.

As part of his Executive Budget plan, Governor Andrew M. Cuomo has proposed the creation of new \$50 million Innovation Venture Capital Fund (IVCF) to provide early-stage funding to incentivize new business formation and growth in New York State. The proposal indicates that such IVCF would be administered by the Empire State Development Corporation (ESD), and funded by Authority funds and funds redirected from underutilized investment programs administered by ESD. The proposed budget legislation has not yet been enacted into law. A portion of the \$90 million that would be authorized if the budget is adopted as proposed may be considered for this purpose.

### 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 reforms were made by Chapter 506 of the Laws of 2009 ("Chapter 506") which took effect on March 1, 2010. For example, Chapter 506 provided for (i) the creation of an "Authorities Budget Office" to provide oversight and other functions regarding public authorities, including the Authority; (ii) enhanced reporting requirements for public authorities, including the Authority; (iii) additional governance responsibilities for the boards of public authorities, including the Authority; (iv) New York State Comptroller review and approval of certain contracts of public authorities, including the Authority; (v) restrictions on property disposal by public authorities, including the Authority; and (vi) State Senate approval of certain authorities' chief executive officers, including the Authority.

### (g) Construction Contracts and Net Operating Leases

Estimated costs to be incurred on outstanding contracts in connection with the Authority's construction programs aggregated approximately \$542 million at December 31, 2012.

Noncancelable operating leases primarily include leases on real property (office and warehousing facilities and land) utilized in the Authority's operations. Rental expense for years ended December 31, 2012 and 2011 was \$2 million and \$1.5 million. Commitments under noncancelable operating leases are as follows:

	<u>Total</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>Thereafter</u>
	(In millions)						
Operating leases	\$ 2.3	0.7	0.5	0.4	0.2	0.1	0.4

# NEW YORK POWER AUTHORITY

## Notes to the Financial Statements

December 31, 2012 and 2011

### **(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. In 2007, the Authority estimated that the capital cost associated with the relicensing of the Niagara project would be approximately \$495 million. This estimate 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. As of December 31, 2012, the balance in the liability associated with the relicensing on the balance sheet is \$301 million (\$33 million in current and \$268 million in noncurrent liabilities).

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. The Settlement Agreement, signed February 11, 2011, provides for a one-time payment of \$5.9 million followed by payments of \$4.7 million per year through 2028 in lieu of the original payment stream of \$3.5 million per year for the remaining 47 years of the Niagara License.

### **(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 plant, 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. In December 2011, the U.S. Court of Appeals for the D.C. Circuit (the "Court") granted a stay of the CSAPR pending the Court's resolution of numerous petitions for review and 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. By decision issued August 21, 2012, the Court vacated the CSAPR; directed the EPA to develop a replacement rule; and directed that the CAIR continue to be enforced pending the development of the replacement rule. On October 5, 2012, the EPA filed a petition seeking en banc rehearing of the Court's decision, which the Court denied on January 24, 2013. It is uncertain whether the EPA will see to appeal the Court's decision. CAIR remains in effect. The Authority has operated its fossil fuel 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, the Authority anticipates that operation of its fossil fuel plants and the Astoria Energy II plant would not be impacted.

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

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. On January 3, 2013 the Bureau of Ocean Energy Management (BOEM) issued a request to determine whether there is competitive interest in wind power development in federal waters off the coast of the Rockaway Peninsula and Long Island. When BOEM's review is completed, the agency will determine whether competitive interest in the lease area exists. If there is such interest, BOEM will use an auction(s) to award lease(s) under its competitive lease process.

# NEW YORK POWER AUTHORITY

## Notes to the Financial Statements

December 31, 2012 and 2011

In January 2010, the Authority issued an RFP for a 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. In March 2012, the Authority's Trustees determined to close the 100 MW solar initiative competitive solicitation without an award. At that time, the Trustees also authorized up to \$30 million in funding over five years for a solar market acceleration program involving solar research, training, and demonstration projects.

### (k) *Other Developments*

#### **New York Energy Highway**

In his January 2012 State of the State address, Governor Andrew M. Cuomo announced the New York Energy Highway initiative, which is envisioned as a public-private partnership to upgrade and modernize the State's electric power system. The Governor formed a task force comprised of various State officials to oversee implementation of the initiative (Task Force) which is co-chaired by the Authority's President and Chief Executive Officer, Gil C. Quiniones. In April 2012, the Task Force issued a request for information seeking ideas and proposals in furtherance of the initiative. Approximately 85 organizations responded to the Task Force's request for information and the responses included a large number of different generation and transmission project proposals. Based on the response of all these organizations, the Energy Highway Task Force issued an action plan in October 2012. The resulting Energy Highway Blueprint, calling for public and private investments in the State's energy system of about \$5.7 billion over the next five to 10 years, proposed 13 specific actions, divided among four major categories: Expand and Strengthen the System, Accelerate Construction and Repair, Support Clean Energy and Technology Innovation. All of the 13 actions are underway at this point, moving forward on or ahead of the schedule the Task Force established. Two prominent actions discussed in the Blueprint include (i) the initiation of electric transmission upgrades to move excess power from upstate to downstate, and (ii) the creation of contingency plans to prepare for large generator retirements.

In response to the request for information, the New York Transmission Owners (NYTOs), comprised of the State's largest private utilities, the Long Island Power Authority, and the Authority, indicated that they were exploring the creation of a new Statewide transmission entity (NY Transco) to pursue development, construction, operation, and ownership of new transmission projects. The NYTOs proposed to the Task Force several transmission projects that could be undertaken by a NY Transco entity.

Other recommended actions, some of which will include the Authority, are investments to improve the reliability, safety and storm resilience in the areas of electric generation and transmission and natural gas distribution, facilitation of clean and renewable energy development, and funding of "Smart-Grid" technologies to improve the transmission system performance.

#### **Build Smart NY Initiative**

On December 28, 2012, Governor Andrew M. Cuomo issued Executive Order No. 88 directing state agencies collectively to reduce energy consumption in state-owned and managed buildings by 20 percent within seven years – an initiative designed to produce significant savings for New York taxpayers, generate jobs, and significantly reduce greenhouse gas emissions. To meet this initiative, the Governor launched Build Smart NY, a plan to strategically implement the Executive Order by accelerating priority improvements in energy performance. The Authority has offered to provide \$450 million in low-cost financing for this initiative for state owned buildings and an additional \$350 million for towns and municipalities.

#### **Energy Efficiency Market Acceleration Program**

In June 2012, the Authority's Trustees authorized up to \$30 million in funding over five years for an energy efficiency market acceleration program involving energy efficiency research, demonstration projects, and market development.

**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 Accrued 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, 2012	\$ 283	\$ 517	\$ 234	55%	\$ 143	163%
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

\* During 2007, a trust for the Authority's OPEB obligations was funded with an initial amount of \$100 million. This amount is reflected in the table above as of the 1/1/08 Actuarial Valuation Date.

See accompanying independent auditors' report.



*cutting through complexity*

# New York Power Authority

2012 Audit Results Presentation to the  
Audit Committee

March 21, 2013

Presented by:

Ken Deon and Scott Heiser

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



# Agenda

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# Responsibilities

Management is responsible for:

- Adopting sound accounting policies
- Fairly presenting the financial statements in conformity with generally accepted accounting principles
- Establishing and maintaining effective internal controls
- Identifying and confirming that the Authority complies with laws and regulations applicable to its activities
- Making all financial records and related information available to the auditor
- Providing the auditor with a letter confirming certain representations made during the audit that includes, but are not limited to management's:
  - disclosure of all significant deficiencies, including material weaknesses, in the design or operation of internal controls that could adversely affect the Authority's ability to record, process, summarize, and report financial data; and
  - acknowledgement of their responsibility for the design and implementation of programs and controls to prevent and detect fraud

## Responsibilities (continued)

The Audit Committee is responsible for:

- Oversight of the financial reporting process and internal control

Management and the Audit Committee are responsible for:

- Establishing and maintaining internal controls to prevent, deter, and detect fraud
- Setting the proper tone and creating and maintaining a culture of honesty and high ethical standards

The audit of the financial statements does not relieve management or the Audit Committee of their responsibilities.

# Responsibilities (continued)

KPMG is responsible for:

- Forming and expressing an opinion about whether the financial statements that have been prepared by management with the oversight of the Audit Committee are presented fairly, in all material respects, in conformity with generally accepted accounting principles
- Planning and performing the audit to obtain reasonable – not absolute – assurance about whether the financial statements are free of material misstatement, whether caused by fraud or error. Because of the nature of audit evidence and the characteristics of fraud, we are able to obtain reasonable, but not absolute, assurance that material misstatements will be detected.
- Evaluating:
  - (a) whether the Authority’s controls sufficiently address identified risks of material misstatement due to fraud; and
  - (b) controls intended to address the risk of management override of other controls
- Communicating to you in writing all significant deficiencies and material weaknesses in internal control identified in the audit and reporting to management all deficiencies noted during our audit that are of sufficient importance to merit management's attention
- Conducting our audit in accordance with professional standards
- Complying with the rules and regulations of the Code of Professional Conduct of the American Institute of Certified Public Accountants, and the ethical standards of relevant CPA societies and relevant state boards of accountancy
- Planning and performing our audit with an attitude of professional skepticism
- Communicating all required information, including significant matters, to management and the Audit Committee

# Responsibilities (continued)

## Other Information in Documents Containing Audited Financial Statements

- The auditors' report on the financial statements does not cover other information in documents containing audited financial statements, excluding required supplementary information.
- We are required to read the other information to identify material inconsistencies or misstatement of facts, if any, with the audited financial statements and make appropriate arrangements with management or the Audit Committee to obtain the other information prior to the date of the auditors' report.

# Audit results

## Results of Audit:

Completed substantially all audit test work as of March 1, 2013

- Scope and Audit testing consistent with that discussed on September 24, 2012 (2012 Audit Plan)
- Scope focused on:
  - Derivatives (Purchased Power and Financial)
  - NYISO, SENY and Wholesale revenues/receivables
  - Long term debt including compliance with covenants
  - Nuclear decommissioning liabilities
  - Litigation and contingencies
  - Investments and compliance with the New York State Comptroller's investment regulations
  - Capital assets additions testing
  - Deferred charges and related liabilities and regulatory related balances
- 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

# 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>■ Unbilled revenues are not considered significant and not accrued for at year end</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> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>■ ASC Topic 450, <i>Contingencies</i></li> <li>■ GASB 10</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
- 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

# 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
- 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

# 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.

## 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

- Significant Written Communications Between Auditor and Management:
  - Engagement Letter/Contract
  - Management Representation Letter
  - SAS 114 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.
- In our professional judgment, we are independent with respect to the Authority as that term is defined by the professional standards (AICPA and GAO).

# KPMG reports

- Audit Opinion on the Authority's Financial Statements as of and for the year ended December 31, 2012
- Accountant's Report on Investment Compliance with New York State Guidelines
- Required Communications to the Audit Committee (SAS 114 Letter)
- Auditor's Report on Internal Control over Financial Reporting and on Compliance on Other Matters
- Management Letter – not applicable this year

# Other Matters

Going Concern	No events or conditions were identified that may cast substantial doubt on the entity's ability to continue as a going concern for a reasonable amount of time.
Related Party Transactions	No issues were noted.
Litigations, Claims, and Assessments	No issues were noted.
Illegal Acts or Fraud	No instances of fraud or suspected fraud involving management or employees who have significant roles in controls or others where fraud may result in a material misstatement of the financial statements were noted.
Non-compliance with Laws and Regulations	No matters involving actual or suspected non-compliance with laws and regulations came to our attention during the course of the audit.

## Other Matters (continued)

Other Information in Documents Containing Audited Financial Statements	No matters to report
Significant Difficulties Encountered During the Audit	No matters to report
Disagreements with Management	No matters to report
Management's Consultation with Other Accountants	No matters to report
Significant Issues Discussed, or Subject to Correspondence, with Management	No matters to report
Alternative Accounting Treatments Discussed with Management	No matters to report
Other Findings or Issues Relevant Regarding Oversight of the Financial Reporting Process	No matters to report
Communications with the Firm's National Office	No matters to report

# KPMG's Audit Committee Institute (ACI)

## *Communicating with Audit Committees Since 1999*

### Upcoming Events

- Audit Committee Quarterly Webcast Series

- March 28, 2013 11:00 a.m. EST

- A quarterly webcast providing updates and insights into issues affecting Audit Committee/Board oversight – from key accounting and regulatory changes to developments in risk oversight.

### Resources

- *Audit Committee Insights – U.S. and International editions (biweekly electronic publications):* [www.kpmginsights.com](http://www.kpmginsights.com)
- ACI Website: [www.auditcommitteeinstitute.com](http://www.auditcommitteeinstitute.com)
- ACI mailbox: [auditcommittee@kpmg.com](mailto:auditcommittee@kpmg.com)
- ACI hotline: [1-877-KPMG-ACI](tel:1-877-KPMG-ACI)



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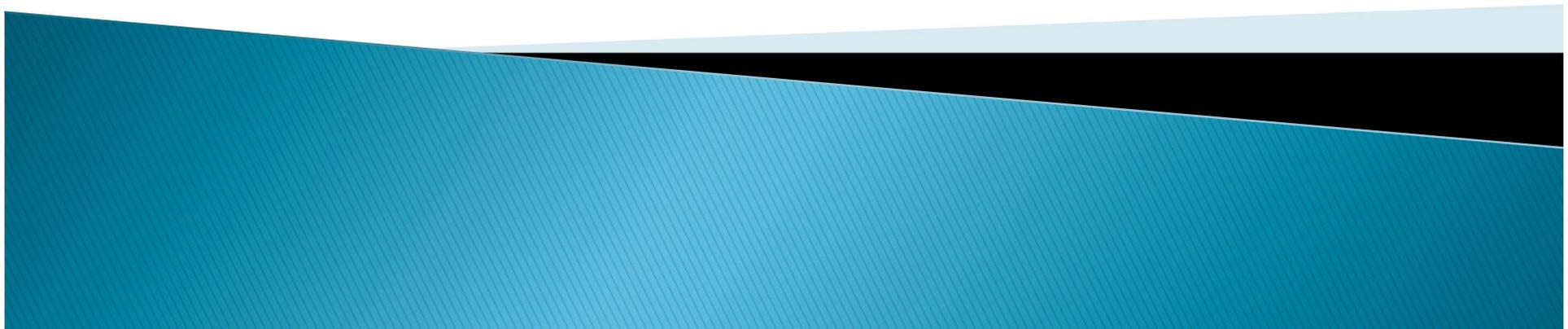
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Exhibit A

# Risk Management Update

March 2013 - Audit Committee Meeting



# Risk Management Update

- ▶ October 2012 – Hired Director of Enterprise Risk
  - Reorganized Risk Management Group to better leverage available resources
- ▶ November 2012 – Issued inaugural Enterprise Risk Report
- ▶ January 2013 – Facilitated prioritization assessment with Executive Risk Management Committee (ERMC)
- ▶ February 2013 – Issued updated Enterprise Risk Report
- ▶ Drafted governance materials to clarify roles and responsibilities and align with existing governance materials/structure
  - Corporate Policy – Risk Management
  - ERMC Charter



# Enterprise Risk Report – Overview

- ▶ Risk Profile – key risk drivers aligned to strategy and mission objectives
- ▶ Categorizes the 42 “top risks” (based on probability and impact)
- ▶ Quantification – Provides a risk informed range for 2013 for debt service coverage, generation market readiness and transmission availability metric. Metric thresholds have been agreed to by the ERM.
- ▶ Provides insight into emerging risk areas and areas that can be built out further
- ▶ Limited information on risk response/mitigation – general information on existing controls



# Next Steps

## Executive Risk Management Committee (ERMC)

- Priority Consensus



Complete – January 2013

## Incorporate Risk in Capital Allocation

- Asset Investment Planning



## Governance

- Finalize Materials
- Audit Committee Update

## Key Risk Indicators (KRI)

- Development and Draft



## Enhance Coordination

- Strategy
- Audit
- Compliance



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**SUBJECT: RISK MANAGEMENT****1.0 SCOPE**

In the course of its operations, the New York Power Authority (“the Authority”) is subject to various sources of uncertainty which, if realized, could materially impair or enhance its ability to carry out its mission objectives. These sources of uncertainty, or “risks,” stem from the Authority’s ongoing operations as well as external market, regulatory, and geo-political environments; taken together, these various risks comprise the Authority’s Risk Profile. The Authority seeks to maintain a robust and resilient organization and operation that reliably serves, protects and defends the value delivered by resources under its stewardship.

The Authority considers the management of risk to be an integral part of its duties. The Authority is committed to embedding Risk Management into existing business practices and processes so that it becomes part of the corporate culture and is not viewed as an independent activity. Therefore, the Authority is committed to practicing Risk Management to:

- Enable successful delivery of its goals and objectives
- Encounter fewer unanticipated outcomes
- Encourage identification, ownership and assessment of risks
- Communicate to stakeholders what the Authority is doing to manage its risks
- Empower the Authority to withstand future uncertainty and volatility

The objective, framework and management controls necessary to govern the Authority’s Risk Management activities are set forth in this Risk Management Policy (“Policy”).

**2.0 Definitions**

- 2.1** Risk Management – An integrated approach to identifying, assessing and addressing areas of uncertainty that could materially impair or enhance achievement of the Authority’s mission objectives.
- 2.2** Risk Dimension – a categorization of risks that aligns with a strategic goal.



- 2.3 Risk Profile – the portfolio of risks across the enterprise categorized by Risk Dimension.
- 2.4 Risk Tolerance – predefined limits of risk exposure to Authority’s mission and vision.
- 2.5 Risk Response – action or measure taken in advance of, or after, a risk occurs aimed at achieving the Authority’s mission objectives.
- 2.6 Strategic Goal – a specific area in which the Authority focuses resources and efforts over the horizon of the strategic plan. The Authority’s Strategic Goals are grouped within three categories of Mission, Stewardship and Accountability that, respectively, define the Authority’s: purpose; intention to maintain and grow entrusted resources; and commitment to responsible leadership.
- 2.7 Hedge Transaction – a contract with an exchange or directly with a counterparty company, establishing the price for future delivery of a specified energy related commodity quantity, or the financially settled equivalent of such future delivery, where such contract offsets an existing risk exposure.

### **3.0 IMPLEMENTATION**

- 3.1 Adherence - This Policy shall be adhered to by the staff of all Authority Business Units and Departments.
- 3.2 Procedures - Implementing procedures shall be prepared to define the necessary management controls.
- 3.3 Changes - Recommendations for changes to this policy or a new corporate policy shall be processed in accordance with CP1-1 “Corporate Policy Program Administration”.

### **4.0 OBJECTIVE**

This Policy serves to support the following Risk Management objectives:

- Employ a coordinated approach to identifying, assessing and managing risks across the Authority.



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- Identify risk concentrations and analyze potential correlations to other risks; thereby enhancing the facilitation and integration of Risk Management between departments and business units.
  - Utilize Risk Management to inform decisions in a risk-based corporate planning process, aligning risk with strategy in a systematic, structured framework.
  - Establish the delegation of authority and associated control limits necessary to enter into transactions in the normal conduct of business.

## **5.0 FRAMEWORK**

This Policy establishes the following Risk Management framework:

- Risk Management will include a structured process for consolidating risk assessments into an expression of risk around categories, such as financial liquidity, operational reliability, safety, workforce management, energy market (price and volume), credit, energy efficiency objectives and legal and regulatory compliance.
- Risk Management will provide a forward-looking perspective as to the potential outcomes that may be realized in order to inform stakeholders and executive management in advance of the potential for unacceptable outcomes.
- Risk Management will establish a Risk Profile to enable the Authority to fulfill its mission with a more informed forward-looking risk view.
- Risk Management will include business processes, procedures, evaluation tools, and methodologies for risk identification, assessment, and communication.
- Risk Management will evaluate the Risk Response to unacceptable exposures. Risk Response will be conducted according to a "non-speculative" philosophy, in which the primary mandate of Risk Response shall be the containment of exposures within established Risk Tolerances.



## **6.0 MANAGEMENT CONTROLS**

### **6.1 General**

All Risk Management activities will be conducted in accordance with this Policy. Controls and procedures to be further delineated by management shall be in conformance with this Policy.

To align efforts, an integrated approach among the Office of Ethics and Compliance, Internal Audit, Strategy Management and Risk Management Department will exist. The sharing of mutual interests will strive to capture and manage information in a common language and context to provide enterprise collaboration, and facilitate the flow of communication across the Authority. This process will assist in the Authority's efforts to achieve optimal performance and demonstrate adherence to all mandated requirements.

### **6.2 Responsibilities**

#### **6.2.1 Delegation of Authority**

a) **President and Chief Executive Officer**

This Corporate Policy is established under the authority of the President and Chief Executive Officer (CEO).

b) **Board of Trustees**

In accordance with leading industry practice, the Board of Trustees' shall affirm the philosophy, framework and delegation of authority for the Authority's Risk Management activities.

c) **"Audit Committee" of the Board of Trustees**

The Audit Committee seeks to enhance the Authority's Risk Management infrastructure and ensure timely and effective identification and mitigation of critical business risks. The Audit Committee shall provide guidance to the Authority's Chief Risk Officer ("CRO") on critical business objectives, risks and philosophy, tolerance for Risk Response and reporting requirements.

d) **Executive Risk Management Committee**

An Executive Risk Management Committee ("ERMC") is established by this Policy as management's controlling authority with respect to Risk Management activities; the ERMC shall be governed by the provisions herein and outlined in the ERMC Charter. The Board of Trustees, based



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on the recommendation of the Audit Committee, has delegated to the ERMC the authority by which energy commodity related hedge transactions may be entered into as necessary to offset financial risks to the Authority or its customers. The ERMC is responsible for the delegation of that authority as well as the establishment of necessary controls. The Chief Financial Officer (CFO) serves as the chair of the ERMC and is ultimately responsible for the financial integrity of the Authority and, accordingly, no delegation of authority to the ERMC is intended to impair the CFO's ability to protect such financial integrity.

e) Chief Risk Officer ("CRO")

The CRO is responsible for providing overall leadership, vision, and direction for Risk Management. The CRO develops the Risk Management approach and provides risk reports to the Audit Committee and the ERMC in accordance with their respective charters. The CRO will work with the ERMC to ensure this Policy and related implementing procedures are maintained to direct Risk Management processes.

f) Authority Personnel and Contractors

All Authority personnel and contractors are responsible for the management of risk. Authority personnel and contractors are expected to make and support risk-informed decisions and remain vigilant in identifying and communicating emerging risk issues that could jeopardize the Authority's success.

g) Risk Management Department

Under the CRO's direction, the Risk Management Department coordinates, administers and sustains the Authority's Risk Management activities. The Risk Management Department is responsible for maintaining governance materials to codify the Authority's risk philosophy and framework, facilitating the enterprise risk identification and assessment process, developing Risk Management tools and techniques, and administering the Energy Commodity and Credit Risk Management program. The Energy Commodity and Credit Risk Management program governs staff activities and establishes necessary controls for the effective conduct of energy commodity and credit risk management, including: risk measurement, hedging activities, counterparty credit, collateral management and the control of all related activities.

h) Office of Ethics and Compliance

The Office of Ethics and Compliance will conduct independent evaluations of the Risk Profile to ensure compliance with applicable laws, regulations and standards and adherence to the business conduct expected of employees contained in the Ethics Code of Conduct. It will facilitate the review and verification of all risks contained in the Legal/Regulatory



Compliance Risk Dimension consistent with the Risk Management processes.

i) Internal Audit

In accordance with its independent role (CP 5.1 – Internal Audit Program), Internal Audit shall conduct periodic independent evaluations of the adequacy and effectiveness of the Authority's Risk Management processes.

## **7.0 REFERENCES**

- 7.1** CP 1-1 Corporate Policy Program Administration
- 7.2** CP 5-1 Internal Audit Program
- 7.3** Audit Committee Charter
- 7.4** Executive Risk Management Committee Charter
- 7.5** Enterprise Risk – Thresholds Guide
- 7.6** Procedure for Energy Commodity & Credit Risk Management
- 7.7** Corporate Accounting Policy 1.3 – Internal Control
- 7.8** Ethics Code of Conduct

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**President and Chief Executive Officer**

**Executive Risk  
Management Committee**

**Charter**

## **1.0 PURPOSE**

The objective of the Executive Risk Management Committee (“ERMC”) is to provide oversight for the management of NYPA’s Risk Profile. The Risk Profile is a representation of the entire portfolio of risk across the enterprise.

The ERMC advises the President and Chief Executive Officer (“CEO”), Executive Management Committee (“EMC”), and Audit Committee of the Board of Trustees in accordance with the Corporate Policy 2-15 – Risk Management 3/21/2013 and the Resolution by the Board of Trustees dated March 21, 2013.

The Board of Trustees has delegated to the ERMC the authority by which NYPA staff may enter into energy commodity related hedge transactions as necessary to offset financial risks to the Authority or its customers.

## **2.0 DEFINITIONS**

- 2.1 Risk Management – An integrated approach to identifying, assessing and addressing areas of uncertainty that could materially impair or enhance achievement of the Authority’s mission objectives.
- 2.2 Risk Dimension – a categorization of risks that aligns with a strategic goal.
- 2.3 Risk Profile – the portfolio of risks across the enterprise categorized by Risk Dimension.
- 2.4 Risk Tolerance – predefined limits of risk exposure to Authority’s mission and vision.
- 2.5 Risk Threshold – early warning metrics or indicators to address potential risk impacts.
- 2.6 Risk Response – action or measure taken in advance of, or after, a risk occurs aimed at achieving the Authority’s mission objectives.
- 2.7 Strategic Goal – a specific area in which the Authority focuses resources and efforts over the horizon of the strategic plan. The Authority’s Strategic Goals are grouped within three categories of Mission, Stewardship and Accountability that, respectively, define the Authority’s: purpose; intention to maintain and grow entrusted resources; and commitment to responsible leadership.
- 2.8 Hedge Transaction – a contract with an exchange or directly with a counterparty company, establishing the price for future delivery of a specified energy related commodity quantity, or the financially settled equivalent of such future delivery, where such contract offsets an existing risk exposure.

### **3.0 MEMBERSHIP AND ORGANIZATION**

#### **3.1 COMMITTEE COMPOSITION**

The ERMCM shall consist of a minimum of five (5) members, including the Chief Financial Officer ("CFO") and at least three (3) other members appointed from NYPA's Executive Management Committee by the CEO;

It shall be chaired by the CFO; or, in the absence of the CFO, another member delegated this responsibility by the CFO;

The Chief Risk Officer ("CRO") is a de facto, non-voting, participant of the ERMCM but shall remain independent. The CRO develops the Risk Management approach and provides risk reports to the ERMCM. The CRO will work with the ERMCM to ensure implementing procedures are maintained to direct Risk Management processes.

The Vice President of Internal Audit, the Energy Resource Management Department and the Controller's Office, each have a standing invitation to attend ERMCM meetings but such attendance does not constitute ERMCM membership nor voting rights.

A member of the Risk Management Department shall act as a coordinator to the ERMCM maintaining the meeting schedule, agenda and meeting minutes.

#### **3.2 QUORUM and VOTING**

A quorum shall consist of any three (3) members including the chair; participation may be in-person, by video link or by telephone provided reasonable assurance is provided of the identity and ability of such members to participate in the meeting discussion.

Voting on ERMCM matters shall be on a one member-one vote basis. When a quorum is present, the vote of a simple majority of the ERMCM members shall constitute the action or decision of the ERMCM.

#### **3.3 MEETINGS**

All ERMCM meetings shall be scheduled through the Chairperson.

The ERMCM shall meet monthly or as often as it determines to be necessary. The ERMCM may meet with the Board of Trustees, Audit Committee or CEO by telephone or video conference.

The ERMCM may request any other officer, employee, or consultant of the Authority to meet with any members of, or consultants to the ERMCM.

Authority staff shall prepare periodic risk reports to be presented to the ERMCM for review as outlined in related procedures or as otherwise requested by the ERMCM.

Authority staff shall prepare risk response strategies to be presented to the ERMCM for review and approval as outlined in related procedures or as otherwise requested by the ERMCM.

Except in the case of an emergency, the suggested notice period for a meeting in person shall be at least ten business days prior to the date of such meeting.

### 3.4 RESPONSIBILITIES

Responsibilities of the ERM are the following:

- Establish and assess the corporate Risk Profile, Risk Dimensions, Risk Tolerances and Risk Thresholds across the enterprise.
- Ensure adequate resources are being applied to risks including appropriateness of risk ownership and response planning.
- Provide guidance to NYPA management regarding all aspects of Risk Management. Approve written governance materials developed to support Risk Management activities to ensure consistency with the Corporate Policy 2-15 – Risk Management.
- Authorize a program for Energy Commodity and Credit Risk Management which may include the non-speculative use of energy related commodity hedge transactions, within appropriate processes and control limits governing their use, to offset a corresponding risk exposure.

Hedge transactions may include physical and financially settled transactions for:

- electrical energy,
- capacity, ancillary services,
- transmission rights and congestion contracts,
- natural gas, natural gas transportation, natural gas locational basis,
- fuel oil,
- traded emissions, environmental attributes, and
- other energy-market products used for generation, the fulfillment of customer load obligations or related requirements.

Such transactions shall be for no more than four (4) years beyond the last day of the month in which the transaction is entered. Transactions of more than four (4) years term, as well as competitive solicitations relating to such transactions require the prior approval of the Board of Trustees.

- Authorize energy related commodity hedge transactions in accordance with the Authority's Risk Management Policy and related implementing procedures.
- Regularly review and reassess the adequacy of this Charter and recommend any proposed changes to the Audit Committee for approval.

#### 4.0 REFERENCES

Corporate Policy 2-15 – Risk Management

Risk Management Trustee Item - March 21, 2013 Trustee meeting

Audit Committee Charter

Procedure for Energy Commodity & Credit Risk Management

## 5. Revisions to the Governing Policy for Energy Risk Management

The President and Chief Executive Officer submitted the following report:

### SUMMARY

“The Trustees are requested to reaffirm the Governing Policy for Energy Risk Management (the ‘Policy’), which is attached hereto as Exhibit ‘5-A,’ with two clarifying modifications. The Policy supersedes the version of the Policy approved by the Trustees at their meeting of September 28, 2010.

“In accordance with leading industry practice, the Trustees’ approval of the revised Policy is intended as a reaffirmation of the philosophy, framework and delegation of authority for the Authority’s Energy Risk Management Program (the ‘Program’). In addition, the revised Policy incorporates two modifications that improve the specificity of the authorizations under the Policy. First, the revised Policy clarifies that the authority for transactions relating to environmental attributes is included in the transaction authority delegated by the Policy to the Executive Risk Management Committee (the ‘ERMC’). Second, the revised Policy explicitly incorporates the requirement for Trustee approval of transactions for energy and energy-related products, including environmental attributes, for terms exceeding four years.

“The members of the ERMC have reviewed the revised Policy and recommend its approval.

### DISCUSSION

#### *1. Reaffirmation Of Policy*

“The electric energy, generation-fuel and related products required (or produced) by the Authority and its customers are subject to the forces of unregulated, wholesale commodity markets. As such, the prices of these products are volatile and uncertain, in turn, exposing the Authority’s bottom line and its customers’ rates to significant uncertainty (i.e., price risk). To enable staff to manage these market risks in a structured and well-controlled manner, the Trustees have, since 1988, taken several actions to provide the guidance and authority to enter into forward transactions for energy and energy-related products to mitigate the potential for undesirable cost outcomes.

“At their meeting of September 28, 2010, the Trustees approved the current version of the Policy. The Policy outlines the philosophy, framework and delegation of authority for the Program and provides the necessary authority to an appointed ERMC to oversee implementation of the Program, including the authority to enter into forward hedging transactions. The core philosophy and framework of the Program in the revised Policy is wholly consistent with the Policy approved at the September 28, 2010 meeting, and, in keeping with leading practices, the Trustees are to periodically review and reaffirm the Policy.

#### *2. Transaction Authority for Environmental Attributes*

“The September 28, 2010 Trustee action superseded a February 26, 2008 Trustee item, which authorized specific transaction limits by products, with the following exception:

The limits for short-term procurement of physical natural gas, gas transportation, fuel oil and emissions allowances, as required for operation of the Authority’s fossil-fueled generation plants, remains as authorized under the Trustee-approved action of February 26, 2008.

The Policy approved by the September 28, 2010 Trustee action delineates the scope of authorized transactions as follows:

...all forward transactions for electrical energy, capacity, ancillary services, transmission rights, natural gas, fuel oil, traded emissions, and other energy-market products used for generation or the fulfillment of customer load obligations.

"The language of the September 28, 2010 Trustee item did not specifically address transaction limits for the procurement of environmental attributes which had been previously authorized by the Trustees within the action of February 26, 2008. Environmental attribute transactions are principally entered into by the Authority on behalf of customers to meet requirements such as Executive Order 111, or in response to a customer's decision to increase the renewable energy component of its operations. The Authority also procures environmental attributes as required to meet Executive Order 111 and other requirements for its own facilities, including the corporate headquarters in White Plains.

"Environmental attributes represent all environmental characteristics, however defined, attributable to generation from renewable sources of energy. These attributes transact in a manner similar to other energy and energy-related products already under the purview of the Policy. Accordingly, the Trustees are requested to add the authority for transactions relating to environmental attributes to the current transaction authority consolidated under the ERM.

### 3. *Transactions of Greater than Four Years*

"At the July 26, 2010 meeting, the Trustees authorized adoption of a new Power Resource Departmental Procedure entitled 'Competitive Solicitations for Power Supply Products' which served to embody the requirement to obtain Trustee authorization prior to the issuance of competitive solicitations for purchases of energy, capacity, ancillary services and environmental attributes. Consistent with the authority to enter into energy-related forward transactions, the level of transaction authority delegated to the ERM for environmental attributes in the revised Policy is non-speculative, limited to the volumes associated with anticipated customer and Authority requirements and for a term not to exceed four years. In order to codify this across all products, the revised Policy explicitly states that Trustee authorization is required prior to entering into transactions for energy and energy-related products (including environmental attributes) of greater than a four-year term, or the issuance of competitive solicitations for the same.

"Upon the adoption of the revised Policy, the Power Resource Departmental Procedure entitled 'Competitive Solicitations for Power Supply Products' will no longer be required as the controlling document of the authority for environmental attribute transactions or the requirement to obtain Trustee approval prior to any competitive solicitations for transactions greater than a four-year term.

"A redlined version of the proposed amended Policy is attached as Exhibit '5-B.' Deletions are shown by strikethroughs in brackets; additions are shown by bolded and underscored text. The final version of the proposed amended Policy is attached as Exhibit '5-A.'

### FISCAL INFORMATION

"There is no direct fiscal impact associated with implementing the revisions to the Policy, or otherwise, by this Trustee action.

### RECOMMENDATION

"The Vice President – Chief Risk Officer recommends that the Trustees approve the Policy for Energy Risk Management as reflected in Exhibit '5-A' and discussed above.

"For the reasons stated, I recommend the approval of the above-requested action by adoption of a resolution in the form of the resolution below."

***Mr. Scott Scholten presented highlights of staff's recommendation to the Trustees. Responding to a question from Trustee Nicandri, Mr. Scholten said the Trustees are being requested to approve the Policy; it does not require approval by the Governance Committee. He added that the Policy delegates authority to the Energy***

*Risk Management Committee (“ERMC”) and outlines its limitations. Also, the Authority’s risk management program is implemented under the governance of the ERMC and the Policy sets forth the guidelines for that task.*

*In response to a question from Trustee O’Luck, Mr. Scholten said even if there are no changes to the Policy, as a rule, the Trustees are asked to reaffirm the Policy on a yearly basis.*

The following resolution, as submitted by the President and Chief Executive Officer, was unanimously adopted.

**RESOLVED, That the revised Governing Policy for Energy Risk Management (the “Policy”) establishing the philosophy, framework and delegation of authority necessary to govern the activities of the Authority related to its Energy Risk Management program is hereby adopted in the form attached as Exhibit “5-A”; and be it further**

**RESOLVED, That the Executive Risk Management Committee consisting of four members as appointed by the President and Chief Executive Officer and chaired by the Acting Chief Financial Officer is hereby granted the authority, within the requirements established by the Policy, to enter into transactions for environmental attributes to meet the requirements of Authority customers or facilities for a transaction term not to exceed four years beyond the last day of the month the transaction is entered, with specific Trustee approval required prior to entering transactions, for energy and energy-related products of greater than a four-year term, or the issuance of competitive solicitations for same; and be it further**

**RESOLVED, That the Chairman, the Vice Chairman, the President and Chief Executive Officer, the Acting Chief Operating Officer, the Acting Chief Financial Officer, the Vice President – Chief Risk Officer and any other necessary Authority officers are, and each of them hereby is, authorized on behalf of the Authority to do any and all things, take any and all actions and execute and deliver any and all agreements, certificates and other documents necessary to effectuate the foregoing resolution, subject to the approval of the form thereof by the Executive Vice President and General Counsel.**

Article I - Purpose of the Energy Risk Management Program

Section 101 - Introduction

The New York Power Authority (NYPA) is a public utility corporation that provides electric power, gas, and other energy services to the State of New York. NYPA's primary responsibility is to provide reliable and affordable energy to the State of New York. In order to fulfill this responsibility, NYPA must manage its energy risk effectively. This document, the Energy Risk Management Policy, sets forth the principles, objectives, and strategies of energy risk management at NYPA. It is intended to guide NYPA's energy risk management activities and to ensure that NYPA's energy risk management program is consistent with its mission and the public interest.

NYPA will conduct this program in accordance with the applicable laws and regulations of the State of New York.

NYPA's energy risk management program shall be consistent with the following:

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**New York Power Authority**  
**Governing Policy for Energy Risk Management**

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The purpose of this program is to identify, assess, and manage energy risk in a manner that is consistent with NYPA's mission and the public interest. This program shall be consistent with the following:

- Revision Date: January 31, 2012
- Superseding: Trustee Resolution & Policy of September 28, 2010

The objective of the program is to identify, assess, and manage energy risk in a manner that is consistent with NYPA's mission and the public interest. This program shall be consistent with the following:

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**ARTICLE I. PURPOSE OF THE ENERGY RISK MANAGEMENT PROGRAM**

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**Section 1.01 Introduction**

The New York Power Authority ("NYPA" or "the Authority") and its customers are routinely exposed to energy commodity price risk in the conduct of operations. In most cases price and volume variability impose a substantial and direct risk (or opportunity) to the goals of NYPA's business units as well as to their competitive posture. Management of these risks is important to our success and our customers' wellbeing. This Governing Policy for Energy Risk Management ("Policy") sets forth the philosophy, framework, and delegation of authority necessary to govern NYPA's activities related to its energy risk management program ("Program").

NYPA will conduct risk management activities in a manner that supports NYPA's mission, mitigates energy-market exposure related to price and volume variability, and prevents unauthorized financial risk, including counterparty risk. Subordinate to those goals, the objective of cost reduction and the achievement of financial goals will be pursued within the constraints stated herein and as further delineated by management. All Program objectives and activities will be conducted in accordance with this Policy. Controls and procedures to be further delineated by management shall be in conformance with this Policy.

**Section 1.02 Scope and Objectives**

The objectives of the program are: to identify exposures to energy price volatility as well as volumetric risk; to quantify the potential impact on the Authority's customers and its own financial condition, including the attendant credit risks; and to monitor and mitigate those exposures where they might exceed management-determined risk tolerances while maintaining adequate flexibility to improve financial performance. The successful management of NYPA's

resources as outlined in its mission statement requires predictability in financial performance related to its core business dealings. Hedging activities will be conducted to secure more certainty in this regard. The diligent measurement and awareness of risk factors will enable both enhancement of operating decisions and improved extraction of value from physical assets, thereby enhancing financial performance.

This Policy applies to all forward<sup>1</sup> transactions for electrical energy, capacity, ancillary services, transmission rights, natural gas, fuel oil, traded emissions, environmental attributes and other energy-market products used for generation, the fulfillment of customer load obligations or related requirements. The Policy governs forward physical supplies, sales and financial derivatives that impact NYPA's risk exposures in the energy market. ERMC delegation of transaction authority for forward transactions shall be for no more than four (4) years beyond the last day of the month in which the transaction is entered. Transactions of more than four (4) years term, as well as competitive solicitations relating to such transactions require the prior approval of the Trustees.

This Policy does not govern: spot<sup>2</sup> transactions for the purchase or sale of natural gas, natural gas transportation, fuel oil and emissions allowances, including CO<sub>2</sub>, NO<sub>x</sub> and SO<sub>2</sub>, transactions with the New York Independent System Operator ("NYISO"), including the bidding of generator energy and capacity, and the scheduling of load; nor transactions related to strategic procurement.

NYPA will operate under a "non-speculative" philosophy. Hedging will be conducted with a

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<sup>1</sup> "Forward" refers to all periods beyond the current month.

<sup>2</sup> "Spot" refers to transactions for physical commodities, with delivery typically during the same month in which they are transacted. In certain cases, where transactions occur later in the month, commodity delivery may occur in the following month.

clear recognition of the hierarchy of the following risk management objectives:

1. **Match Core Business Objectives:** Secure fixed or floating price structures or related options on energy-market commodities associated with generation or load-serving requirements.

*Fixed-price commitments shall not be executed for volumes in excess of high-confidence volume forecasts, including customer requirements and estimates of generating assets' supply and sales. The nature of derivative obligations shall be no more firm than the certainty of volumetric expectations, using options to secure financial rights without obligation where volumes are substantially uncertain.*

2. **Mitigate Risk:** Given volatile energy markets, manage energy and energy-related product costs and revenues toward the mitigation of unfavorable results and the promotion of results within acceptable boundaries.
3. **Improve Financial Performance:** Where practical and in deference to objectives #1 and #2, reduce costs or increase revenues relative to defined targets and/or budgets by securing market positions or realigning existing hedge positions as deemed favorable.

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## ARTICLE II. ENERGY RISK MANAGEMENT POLICY

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### Section 2.01 Delegation of Authorities

#### a) Board of Trustees

This Policy has been established by the Board of Trustees ("Trustees") and the Trustees must approve any amendments to this Policy.

#### b) Executive Risk Management Committee

Subject to Paragraph (c) below, an Executive Risk Management Committee ("ERMC") is established by this Policy as management's controlling authority with respect to energy market risk and hedging activities; the ERMC shall be governed by the provisions herein.

- The ERMC shall consist of five (5) members, including four (4) members appointed from NYPA's executive corps by the CEO;

- It shall be chaired by the Chief Financial Officer ("CFO"); or, in the absence of the "CFO", another member delegated this responsibility by the "CFO";
- A quorum shall consist of any three (3) members including the chair;
- Actions of the ERMC shall be authorized by an affirmative vote of a simple majority of appointed members.

The "ERMC" is hereby charged with the following responsibilities, and necessary authorities are conveyed accordingly:

1. To ensure that all energy market hedging activities are conducted in accordance with this Policy;
2. To establish management procedures ("Procedures") for the administration of the Program, including:
  - Hedge strategy formulation and execution protocols
  - Permissible risk-mitigation products and instruments
  - Transaction limits
  - Organizational roles and separations
  - Approval hierarchies
  - Contract procedures
  - Credit and collateral management procedures
  - Risk quantification and monitoring procedures
  - Other controls and procedures as deemed necessary for the orderly conduct of the Program;
3. To establish risk tolerances related to price and volume variability and their potential impact on financial results for NYPA and its customers; and
4. To provide directives and guidance to NYPA management regarding all aspects of the Program.

**c) Chief Financial Officer**

The Chief Financial Officer ("CFO") is ultimately responsible for the financial integrity of NYPA and, accordingly, no delegation of authority to the ERMC is intended to impair the CFO's ability to protect such financial integrity. Under normal circumstances it is expected that tolerances and other Program issues will be determined by the ERMC, but in the event of unusual circumstances the CFO may act, as deemed necessary in his or her discretion, to preserve financial viability. In the event of such circumstances the Trustees shall be notified expeditiously of the conditions and

resolution associated with such action.

### **Section 2.02: Separation of Duties**

The ERMC, in formulating Procedures, shall provide for separation of duties in a manner that assures checks and balances among three distinct organizational functions delineated below:

1. Front Office – responsible for the execution of hedge strategy and transactions,
2. Middle Office – responsible for risk and compliance monitoring
3. Back Office – responsible for deal confirmations, cash management and accounting.

In fulfilling its role, the Back Office shall independently obtain primary documentation from counterparties with respect to deal confirmations and shall not depend solely on information provided by internal sources.

Also, in accordance with its independent role, the Office of Internal Audit shall conduct periodic reviews of the Program of a scope and on a schedule of its choosing.

### **Section 2.03 Activities**

Permissible transactions for purposes of risk management shall be restricted to products and instruments specified by the ERMC and deployed for the following applications:

- i. Mitigating risk related to the cost of energy or related products to be procured for normal business purposes.
- ii. Mitigating risk related to the price of energy and related products sold by NYPA.
- iii. Mitigating risk related to margins where NYPA owns generation or other capacity.
- iv. Mitigating risk related to the locational cost differentials of energy and fuel procured or sold for transmission or transportation to an ultimate location.
- v. Mitigating risk related to customer contract obligations related to energy markets.
- vi. Mitigating risk of excessive out-of-the-money settlements associated with hedge transactions.

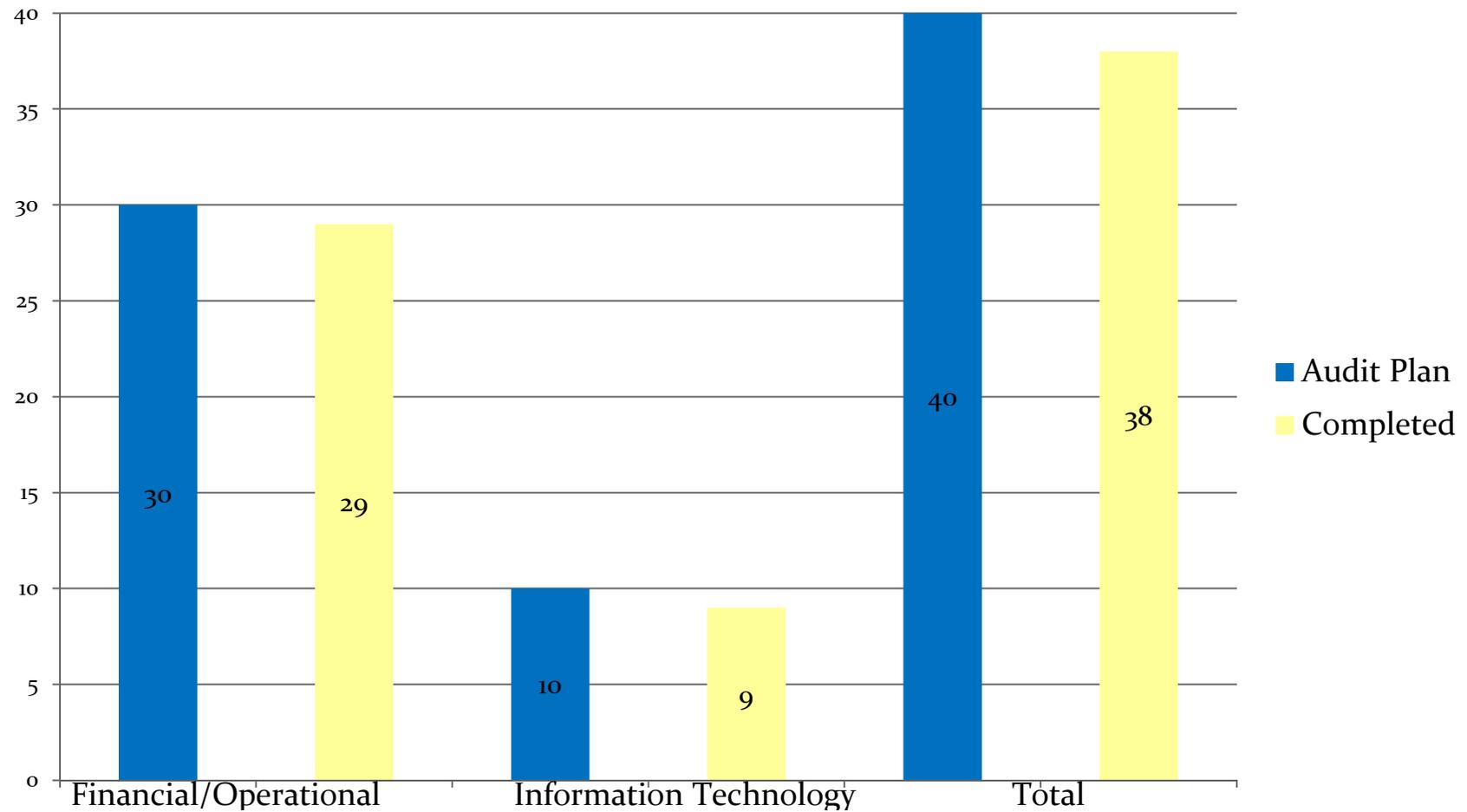
### **Section 2.04 Reporting**

Maintenance of timely reports is critical to an orderly Program. At a minimum, the Program shall maintain a record of transactions; volumes and values of hedged and floating positions, both

physical and financial; the linking of financial hedges with physical volumes; and quantification of the company's exposure to market volatility. These and other records shall be maintained in accordance with directives of the ERM.

Quarterly, the CFO shall provide to the Trustees a report regarding Procedures established under the Program, as well as Program results and a summary of compliance status for the period.

**2012 INTERNAL AUDIT PLAN  
ACTIVITY REPORT  
12/31/12  
AUDIT PLAN STATUS**



**2012 INTERNAL AUDIT PLAN  
ACTIVITY REPORT  
12/31/12  
AUDIT PLAN UPDATE**

Exhibit B

**FINANCIAL**

- SENY Government Services Program (C)
- Salary Administration (IP)
- Generation Resource Management (C)
- Hydro Revenues (C)
- ReCharge NY Customer Revenues (C)
- SENY Long-Term Agreement (C)
- NYISO Energy Settlements – Load Serving Entities (C)
- Public & Governmental Affairs Expenditures (C)
- Astoria Energy II Project Agreement (C)
- Fleet Operations (C)
- Headquarters ProCard (C)
- Purchasing/Warehousing CEC (C)
- B-G Finance & Administration (C)
- NYISO Installed Capacity (C)
- NYISO Transmission Settlement (C)

**INFORMATION TECHNOLOGY**

- Mobile Device Security and Controls (C)
- SAP – General Ledger (C)
- (1) • Electronic Record Management System
- Energy Management System (C)
- Information Security – SAP (C)
- SCADA System (C)
- SAP Business Intelligence (C)

(1) = Audit Postponed.  
(2) = Audit Added.

**INFORMATION TECHNOLOGY** (Continued)

- IT Disaster Recovery Plan (C)
- WPO Data Center (C)
- (1) • SAP Business Planning Consolidation
- (2) • SAP Billing System (ReCharge NY) (C)

**OPERATIONAL/COMPLIANCE**

- ReCharge NY Program Management (C)
- Energy Efficiency Programs (C)
- Power Supply Operational Planning (C)
- Public Authorities Law (PAL) Compliance (C)
- Counterparty Credit (C)
- St. Lawrence Life Extension (C)
- Enterprise Risk Management (C)
- Licensing Operations & Compliance (C)
- SENY Outage Management (C)
- Central Region O&M (C)
- Safety Program (C)
- Small Clean Power Plants O&M (C)
- Configuration Management Program (C)

**OTHERS**

- Transmission Consulting Project (C)
- Vendor Contract Audits (C)
- Assistance to KPMG (C)
- Hydro Customer Job Commitment Audits (C)

C = Completed  
IP = In-Progress

**2012 INTERNAL AUDIT PLAN**  
**ACTIVITY REPORT**  
**12/31/12**  
**REPORT RECAP**

Report Name	High-Level Audit Objectives	Observations/Findings/ Recommendations
ReCharge NY Program Management	Evaluate the adequacy and effectiveness of controls designed to administer the ReCharge NY program. Confirm program implementation is consistent with legislative mandate. Confirm applications are handled and contracts are issued in accordance with NYPA's governing documents; confirm the accuracy and completeness of program reporting; confirm EDPAB and NYPA Trustees' approval.	<ul style="list-style-type: none"> <li>-We confirmed that the ReCharge NY program is being administered in accordance with legislative requirements and internal controls are effective.</li> <li>-Program policies and procedures should be updated and include key processes.</li> <li>-A reporting system should be put in place to track allocations in pending status.</li> <li>-Additional quality control procedures should be implemented to reduce customer changes pertaining to reported jobs, kilowatts and capital investments.</li> <li>-Scoring models and associated weights used to evaluate ReCharge NY applications should be formally communicated to EDPAB.</li> </ul>
Energy Efficiency Programs	Evaluate key operational and financial controls over NYPA's Energy Efficiency Programs and selected SENY Governmental Services Projects. Review project management, project authorization, cost estimation, risk management, project management, project cost controls and reporting processes.	<ul style="list-style-type: none"> <li>-The organizational structure and goals and objectives of the Financial Controls function should be re-evaluated.</li> <li>-Formalize policies and procedures relating to project standardization, cost estimation and risk management.</li> <li>-A Charter for the Contract Assignment Committee covering the authority roles/responsibilities and voting should be created.</li> <li>-Ensure that Implementation Contractors follow bid solicitation requirements for subcontractor awards.</li> </ul>

**2012 INTERNAL AUDIT PLAN  
ACTIVITY REPORT  
12/31/12  
REPORT RECAP**

Report Name	High-Level Audit Objectives	Observations/Findings/ Recommendations
Public Authorities Law (PAL) Compliance Audit	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 PAL.	<ul style="list-style-type: none"> <li>-NYPA has a well established compliance program for the related PAL requirements.</li> <li>-Revisions to the Anti-Retaliation (Whistleblower) Policy should be presented to NYPA's Board of Trustees for their adoption.</li> <li>-The Corporate Accounting Policy should be updated to reflect new compliance obligations of NYPA associated with internal controls.</li> </ul>
Astoria Energy II – Long Term Supply Agreement	Review procedures, processes and controls over NYPA's Tolling Agreement with Astoria Energy II. Verify compliance with terms and conditions of the Tolling Agreement.	<ul style="list-style-type: none"> <li>-Controls over the administration of the Operating Agreement with Astoria Energy II are working effectively.</li> <li>-Vendor is complying with the terms and conditions of the Tolling Agreement.</li> <li>-Supervisory review of the Astoria Energy II incentive/penalty calculations should be documented.</li> </ul>
Counterparty Credit	Confirm the resolution of prior audit issues. Evaluate the effectiveness of management's process for monitoring, assessing, and managing counterparty risk in relation to energy and treasury activities.	<ul style="list-style-type: none"> <li>-Internal controls remain adequate to manage credit exposure of counterparty default.</li> <li>-Systematic differences still exist in the management of credit default risk for commodity versus treasury counterparties.</li> <li>-A report showing NYPA-wide and counterparty specific exposure should be created and disseminated to executive management.</li> </ul>

**2012 INTERNAL AUDIT PLAN  
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REPORT RECAP**

Report Name	High-Level Audit Objectives	Observations/Findings/ Recommendations
SAP – General Ledger	Review, test and evaluate SAP General Ledger application controls, documentation and procedures.	<ul style="list-style-type: none"> <li>-Controls over the SAP General Ledger System are adequate and effective.</li> <li>-The ability to lock and unlock an accounting period should be further restricted.</li> </ul>
NYISO Transmission Settlements	Review processes and controls associated with Transmission Revenues collected from the NYISO and congestion costs billed to Con Edison by NYPA.	<ul style="list-style-type: none"> <li>-Controls over NYISO Transmission Revenues and congestion costs reimbursed by Con Edison are working effectively.</li> <li>-There were no significant issues raised in this audit.</li> </ul>
Public & Governmental Affairs Expenditures	Review procedures, processes and controls over Public and Governmental Affairs Expenditures. Review Budget Monitoring procedures, contributions and sponsorships, and Department expenditures. Verify compliance with established policies and procedures.	<ul style="list-style-type: none"> <li>-Controls over Public Affairs expenditures are generally adequate.</li> <li>-Require that all contributions and sponsorships be processed by the WPO Office Manager.</li> <li>-Implement the proposed general budget, approval and payment procedures for contributions/sponsorships, membership dues and event participation.</li> <li>-Monthly budget variance report should be distributed to the Vice President of Public Affairs.</li> </ul>

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Report Name	High-Level Audit Objectives	Observations/Findings/ Recommendations
Licensing Operations	Evaluate processes and controls associated with ensuring compliance with existing licenses. Review Licensing expenditures and related controls. Verify compliance with established NYPA policies and procedures. Review management reporting processes for timeliness.	<ul style="list-style-type: none"> <li>-Controls over the planning and monitoring of Project Development and Licensing activities are adequate.</li> <li>-Licensing should update and finalize the project review procedures for Transmission Projects.</li> <li>-Procedures for Relicensing and Implementation activities should be established.</li> </ul>
Clark Energy Center Purchasing and Warehousing	Review processes and controls associated with purchasing and warehousing activities at the Clark Energy Center. Verify compliance with established NYPA policies and procedures.	<ul style="list-style-type: none"> <li>-Controls over purchasing and warehousing activities are adequate.</li> <li>-Controls over inventory adjustments should be strengthened.</li> </ul>
Small Clean Power Plants O&M	Evaluate NYPA's vendor management controls in place to oversee contractor performance. Confirm that key operational and maintenance procedures are being consistently followed. Evaluate controls over budget monitoring and expenditures and inventory management.	<ul style="list-style-type: none"> <li>-Controls are satisfactory to ensure day-to-day monitoring and maintenance of the Small Clean Power Plants.</li> <li>-High priority maintenance and regulatory work orders should be reviewed and closed in a timely manner.</li> </ul>
Energy Management System	Test and evaluate controls over changes, maintenance and upgrades to the Energy Management System. Review user access controls, program change controls and IT operation controls.	Internal controls over the Energy Management System were found to be adequate and working effectively.

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Report Name	High-Level Audit Objectives	Observations/Findings/Recommendations
Niagara SCADA System	Test and evaluate the procedures, access security, physical security, program change controls, backup and recovery and environmental controls over the Niagara Power Project SCADA System.	<ul style="list-style-type: none"> <li>-Internal controls over the Niagara Power Project SCADA System are effective.</li> <li>-A Fire Suppression System should be put in the Control Room to protect the critical cyber assets.</li> </ul>
NYISO Installed Capacity	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.	Controls over the processes and procedures associated with NYPA's ICAP requirements, reporting of monthly ICAP certification to NYISO, and NYISO auction purchases and sales are in place and working effectively.
Configuration Management	Determine the adequacy and effectiveness over NYPA's Configuration Management program. Review NYPA-wide compliance with NYPA policies and procedures.	<ul style="list-style-type: none"> <li>-Configuration Management Program's goals and objectives and governance documents should be reviewed and updated.</li> <li>-The flow of information between stakeholders needs to be improved .</li> <li>-A process for identifying critical equipment and components should be developed.</li> </ul>
SAP Billing (ReCharge NY)	Review procedures, processes and controls related to billings of ReCharge NY customers. Ensure that customers are billed accurately and at the proper rates. Verify compliance with the terms of customer contracts.	<ul style="list-style-type: none"> <li>-Controls over the SAP Billing process for ReCharge NY customers are effective.</li> <li>-NYPA should begin billing ReCharge NY customers for Energy Charge Adjustment to cover over-or-under recovery of energy costs.</li> </ul>