MINUTES OF THE SPECIAL MEETING
OF
THE AUDIT COMMITTEE

March 23, 2010

A special meeting of the Audit Committee was held via videoconference at the Authority's office at 123 Main Street, White Plains, New York and at King Video Center, 14 Suntree Place, Melbourne, Florida at approximately 8:30 a.m.

The following Members of the Audit Committee were present:

Trustee D. Patrick Curley (Chairman) (White Plains)
Trustee Jonathan F. Foster (White Plains)
Trustee Eugene L. Nicandri (Melbourne)

Also in attendance were:

Gil Quiniones	*Chief Operating Officer*
Terryl Brown	*Executive Vice President and General Counsel*
Elizabeth McCarthy	*Executive Vice President and Chief Financial Officer*
Donald Russak	*Senior Vice President – Corporate Planning and Finance*
Thomas Davis	*Vice President – Energy Risk and Assessment*
Lesly Pardo	*Vice President – Internal Audit*
Karen Delince	*Corporate Secretary*
Brian McElroy	*Treasurer*
Angela Graves	*Deputy Corporate Secretary*
Thomas Concadoro	*Director – Accounting*
Mary Jean Frank	*Associate Corporate Secretary*
Jamie Cote	*Senior Manager, KPMG*
Dean Bell	*Transaction Services, KPMG*
Emily Sheikh	*Senior Associate, Transaction Services, KPMG*

1. Presentation to the Audit Committee on Derivatives

Audit Committee Chairman D. Patrick Curley said that he had requested KPMG to make this presentation because he wanted the Audit Committee to have more in-depth information on derivatives and Government Account Standards Board ("GASB") Statement No. 53. Mr. Jamie Cote introduced Mr. Dean Bell and Ms. Emily Sheikh of KPMG, saying that Ms. Sheikh had worked at GASB and had worked on drafting GASB Statement No. 53.

The KPMG presentation is attached as Exhibit "1-A."

In response to a question from Audit Committee Chairman Curley, Ms. Sheikh said that management can decide whether to look at multiple derivatives together to see if they are effective. Responding to a question from Authority Vice Chairman Foster, Ms. McCarthy said that the Authority's decision making with regard to derivatives is done through the Energy Risk Committee (which is being reconstituted as a higher-level committee), but that much work is also done in collaboration with the Authority's SENY governmental customers.

Responding to a question from Authority Vice Chairman Foster, Ms. McCarthy said that staff is working on the Board policy and revising current procedures, which should be improved, especially with regard to reporting to senior management and the Authority's Board.

In response to a question from Authority Vice Chairman Foster, Ms. McCarthy said that going forward the monthly Chief Financial Officer report would include more about the Authority's energy commodity swap portfolio and a quarterly report will include disclosures about the Authority's commodity and interest rate swap portfolios.

Responding to a question from Audit Committee Chairman Curley, Ms. McCarthy said that the Authority's SENY governmental customers want to be involved in hedging decisions. For instance, in 2010, the SENY customers chose to keep a piece of their energy price risk floating. Responding to a question from Trustee Nicandri, Ms. McCarthy said that the SENY customers have their own experts analyzing the hedges.

Mr. Jamie Cote said that the fair value of a hedge can be deferred on the balance sheet if hedge accounting requirements or the criteria of FAS #71 are met.

In response to a question from Authority Vice Chairman Foster about credit risk, Ms. McCarthy said that the level of risk is mitigated by contracting with multiple counterparties and by putting appropriate credit limits and credit support agreements in place (which could include the posting of collateral). Mr. Thomas Davis added that the Authority's recently negotiated SENY long-term hedge involves two counterparties and covers five years of activity with negotiated credit support agreements. The credit risk to the Authority is limited to $30 million. In response to a comment from Authority Vice Chairman Foster, Ms. McCarthy said that the Audit Committee will be receiving additional information on these hedging arrangements.

GASB Statement No. 53

New York Power Authority

March 23, 2010

AUDIT ▪ TAX ▪ ADVISORY

Overview

- **Derivatives in the Public Utility Sector**
- **Summary of Statement 53**
  - Definition of Derivative Instrument
  - Scope
  - Recognition and Measurement
  - Hedging Derivative Instruments
  - Effective Date and Transition
  - Derivative Management – Governance Considerations

Derivatives in the Public Utility Sector
Examples

- **Swaps**
  - Forward-based contracts in which two parties agree to swap streams of payments for a specified period of time
    - Interest rate swaps
    - Commodity swaps
- **Forward/Futures Contracts**
  - Contract to purchase/sell a specific quantity of a financial instrument, currency, or commodity at a specific price with delivery and settlement at a specified future date
  - Futures are standardized forward contracts sold in a market

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Derivatives in the Public Utility Sector
Examples

- **Options (puts, calls, caps, floors, collars)**
  - Allow, but do not require, the holder to buy (call) or sell (put) a commodity or financial instrument at a specified price during a specified period or on a specific date
  - Governments can write (give away) or purchase (hold) the option
  - Examples include puts, calls, caps, floors, collars
  - “Swaptions” give the purchaser of the option the right, but not the obligation, to enter into an interest rate swap

Derivatives in the Public Utility Sector

Why Utilities Enter into Derivative Instruments

- **Often, utilities enter into derivative instruments to hedge financial risks pertaining to either:**
  - Existing assets or liabilities, or
  - Expected transactions
- **The most common derivative instruments for New York Power Authority:**
  - Interest rate swaps used to hedge outstanding debt , such as revenue bonds
  - Interest rate caps
  - Energy swaps to 1) fix the cost of energy purchases, 2) fix the margin between energy purchases and sales of energy, and 3) to fix inputs such as natural gas and oil

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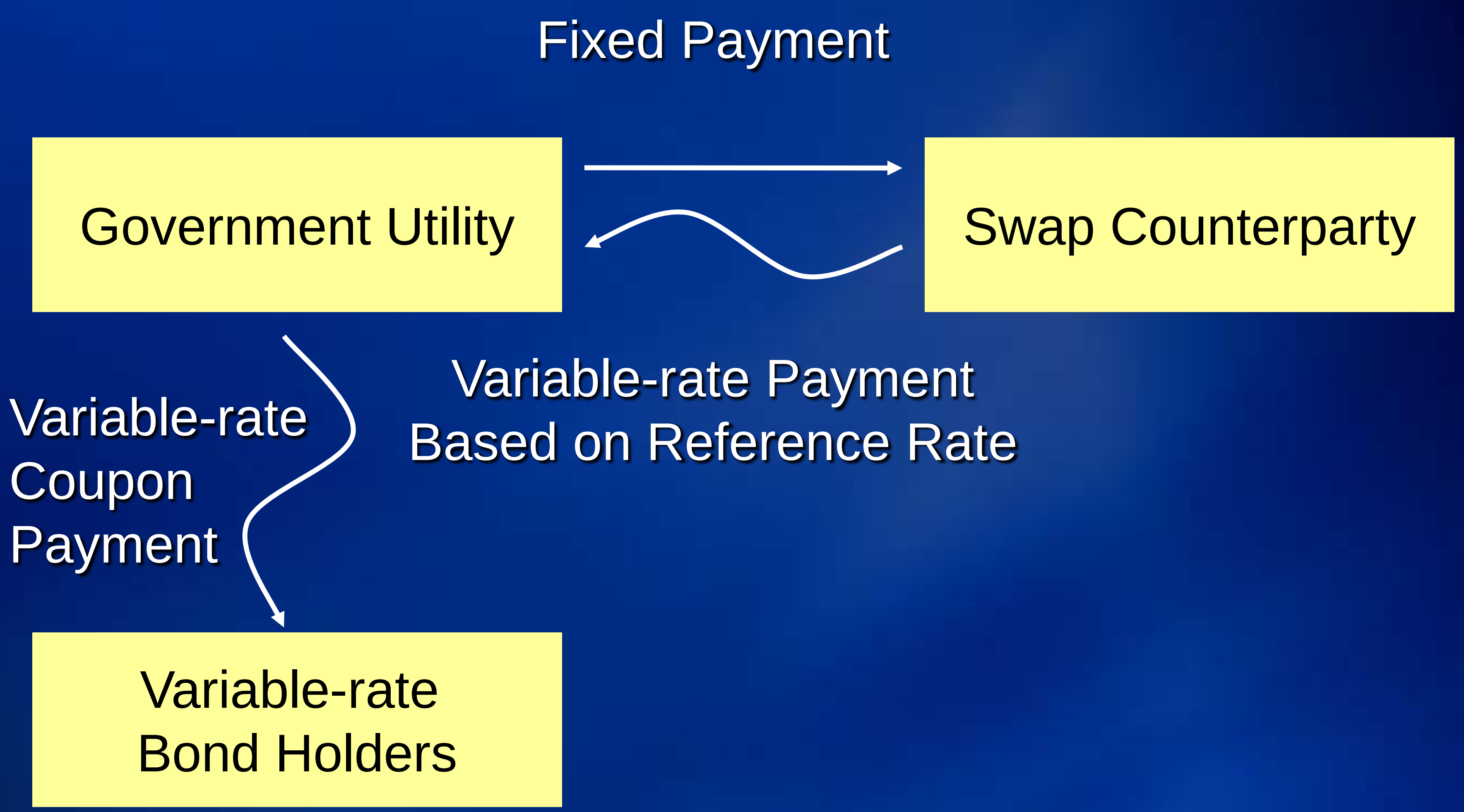
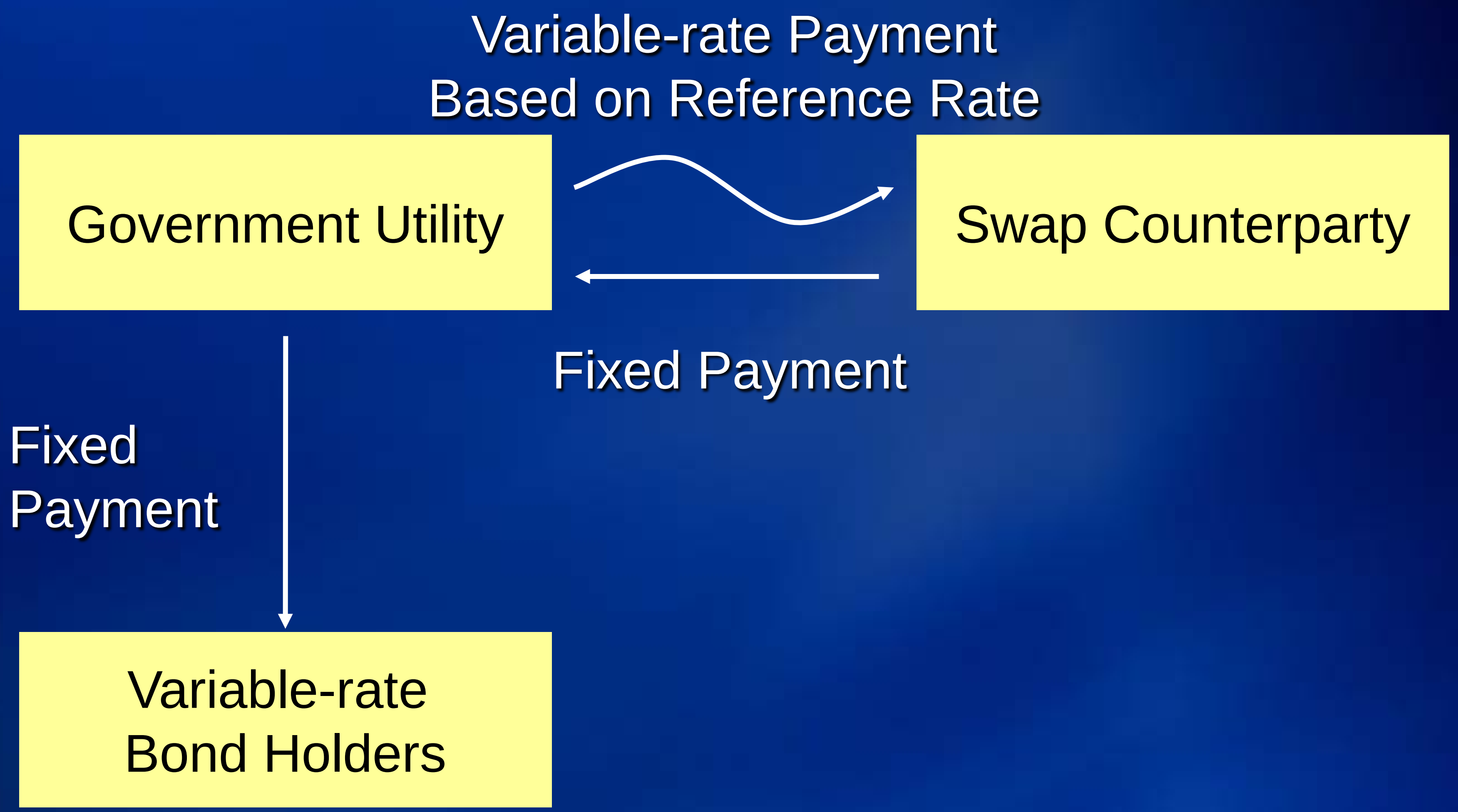
Derivatives in the Public Utility Sector

Cash Flow Hedge



Derivatives in the Public Utility Sector
Fair Value Hedge



Definition of a Derivative Instrument

- **A derivative instrument is a financial instrument or contract that has all of the following:**
  - Settlement factors
    - One or more reference rates (underlyings)
    - One or more notional amounts or payment provisions or both
  - Leverage
    - Requires little or no net investment yet responds to market change similarly to contracts that require net investment
  - Net settlement
    - Contract terms require or permit net settlement
    - Can be readily settled net outside the contract through a market mechanism; or
    - Provides for delivery of an asset that is readily convertible to cash or is itself a derivative instrument

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Recognition and Measurement
Derivative Instruments are Reported at Fair Value

- **Generally, all derivative instruments within the scope of GASB 53 should be reported on the statement of net assets at fair value**

- **How is the derivative classified**
  1. ***Hedge accounting***
     - Entire fair value change is deferred on the statement of net assets (deferred inflow and outflow accounts)

  2. ***Investment accounting***
     - Fair value change is reported on the change statement in the period it occurs (investment revenue classification)

Hedging Derivative Instruments

A Hedging Derivative Instrument (HDI) is established, and hedge accounting MUST be applied if there is:

- ***Association***: Derivative instrument is *associated* with a hedgeable item

AND

- ***Substantial Offset***: Derivative instrument is effective in *substantially offsetting* changes in cash flows or fair value of the hedgeable item → ***hedge effectiveness***

- **Hedge accounting is NOT an option, and documentation is encouraged, but NOT required**

Disclosures
Summary of Derivative Instrument Activity

- **Summary of derivative instrument activity by:**
  1. Government activities, business-type activities, and fiduciary activities
  2. Then by fair value hedges, cash flow hedges, and investment derivatives
  3. Then by type:
     - Receive-fixed interest rate swap
     - Rate caps
     - Futures contracts
- **Summary should include the following information:**
  - Notional amount
  - Fair values and changes in fair value where reported
  - Fair values of derivatives reclassified from hedging to investment derivatives and the deferral amount reported in investment revenue

Disclosures

Example: Summary of Derivative Instrument Activity

		Change in Fair Value		Fair Value at June 30, 2008	
	Notional	Classification	Dr. (Cr.) Amount	Classification	Dr. (Cr.) Amount
<u>Governmental activities</u>					
Fair value hedges					
Receive-fixed interest rate swap	$ 30,000	Deferral	$(277)	Debt	$ 1,572
Cash flow hedges					
Pay-fixed interest rate swaps	$ 84,000	Deferral	(143)	Debt	(1,253)
Rate cap	$ 10,000	Deferral	28	Debt	77
Investment derivatives					
Pay-fixed interest rate swap	$ 18,000	Investment income	1,277	Investment	(1,277)
<u>Business-type activities</u>					
Cash flow hedges					
Pay-fixed interest rate swap	$ 37,000	Deferral	(548)	Debt	4,236
Commodity forward	1,000,000 MMBTUs	Deferral	(111)	Derivatives	111
<u>Fiduciary funds</u>					
Investment derivatives					
Foreign currency forward	20,000UK	Investment income	721	Investment	(721)

The pay-fixed interest rate swap listed as an investment derivative under governmental activities was evaluated to be an ineffective hedge for accounting and financial reporting purposes during fiscal year 2008. Accordingly, the changes in fair value of the swap that had been deferred through June 30, 2007 of $(1,409) along with the change in fair value of the swap in fiscal year 2008 of $132 have been recorded as investment income for the year ended June 30, 2008.

Effective Date and Transition

- Effective for financial statements for periods beginning after June 15, 2009
- Provisions should be retroactively applied; restate prior periods presented if practical

Derivative Management – Governance Considerations

Derivative Management Policy:

- **Formally approved written document which include discussion of risks and rewards and senior management personnel responsible for monitoring these risks**
- **This policy can include:**
  - Operating parameters for entering into and executing derivatives
  - Types of transactions that can and cannot be entered into
  - Credit decision matrices
  - Levels of maximum risk exposure
- **The policy should discuss 1) the purpose for entering into derivative transactions, 2) authorization protocol, 3) risk controls and mitigation strategies, 4) oversight, 5) disclosure, and 6) overall derivative strategy**
- **This policy should be institutionalized within management and financial policies**

Derivative Management – Governance Considerations
Management Role

- **Negotiate and structure derivative transactions in relation to hedged item**
  - Including terms, duration, termination payment methods, and cross default provisions
- **Mitigate counterparty credit risk**
  - Collateral and guarantee policies
  - Diversification of counterparties
- **Monitor derivative transactions over the life of the derivative**
  - Fair value calculations
  - Hedge effectiveness
  - Annual management review
- **Maintain adequate reserves cover any liquidity shortfalls**
- **Follow and adhere to derivative policies**

Derivative Management – Governance Considerations
Audit Committee Role

- **Understand the risks and rewards associated with derivative transactions**
- **Review management policies on derivatives**
  - Gain an understanding of the processes behind entering into and monitoring derivative activities
  - Understand business purpose for entering into derivative transactions
- **Review financial statement disclosures on derivative transactions and compare with understanding of management's intent and policies**
- **Ensure proper compliance with policies**

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Derivative Management – Governance Considerations
Auditor Role

- **Understand management's overall derivatives strategy**
- **Review management policies on derivatives**
  - Gain an understanding of the processes behind entering into and monitoring derivative activities
- **Obtain supporting documentation for specific derivative transactions**
  - Fair value considerations
  - Hedge effectiveness testing
  - Transition to GASB 53
- **Review financial statement reporting and disclosures related to derivative transactions for compliance with US GAAP**

Questions

2. Next Meeting

Audit Committee Chairman Curley, Authority Vice Chairman Foster and Trustee Nicandri agreed that the next regular meeting of the Committee would be held at 8:30 a.m. on Tuesday, July 27, 2010. Ms. McCarthy said that the six-month financial statements and Internal Audit report would be presented at that meeting.

On motion made and seconded, the meeting was adjourned at approximately 9:45 a.m.