



**Long Island Power Authority**

2007 Audit

Finance and Audit Committee

March 27, 2008

Audit

# AGENDA

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# AUDIT RESULTS

## Results of Audit:

Complete audit test work as of March 17, 2008

- Scope and Audit testing consistent with that discussed in October 2007 presentation of 2007 Audit Plan

Scope focused on:

- Derivatives (Fuel and Financial)
- Revenues/receivables
- Fuel and Purchase Power/Fuel and Purchase Power Recovery
- Lease Accounting (Neptune)
- Litigation/contingencies
- Long Term Debt including compliance with Covenants
- National Grid Transactions
- Reserves
- GASB 45 (OPEBs)

- No material misstatements identified
- No identified "significant deficiencies" or material weaknesses in internal controls
- KPMG to issue an unqualified opinion dated March 17, 2008
- Management Letter to be issued outlining improvements in internal control
  - Human Resource Reviews and Policies and Procedures Manual
  - Derivatives
  - Tracking of LIPA IT Changes
  - Contract Communications



## KPMG Responsibilities under GAAS

### **Our Responsibilities under GAAS:**

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

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



## Significant Accounting Policies

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

Significant Accounting Policies	Financial Statement Accounts Affected	Literature Guidance Summary	Alternative Methods
Accounting for Rate Regulation	<ul style="list-style-type: none"> <li>▪ Deferred charges</li> <li>▪ Regulatory assets/liabilities</li> </ul>	<ul style="list-style-type: none"> <li>▪ SFAS 71</li> </ul>	<ul style="list-style-type: none"> <li>▪ None</li> </ul>
Revenue Recognition - Billed and unbilled	<ul style="list-style-type: none"> <li>▪ Receivables</li> <li>▪ Revenue</li> </ul>	<ul style="list-style-type: none"> <li>▪ SAB 101</li> <li>▪ FASB Concept 5 and 6</li> </ul>	<ul style="list-style-type: none"> <li>▪ None</li> </ul>
Derivatives—Fuel and Non-fuel	<ul style="list-style-type: none"> <li>▪ Fuel &amp; purchased power costs</li> <li>▪ Interest/financing cost</li> </ul>	<ul style="list-style-type: none"> <li>▪ SFAS 133/138/149</li> <li>▪ SFAS 71</li> </ul>	<ul style="list-style-type: none"> <li>▪ None</li> </ul>
Cash and Investments	<ul style="list-style-type: none"> <li>▪ Cash, investment income</li> <li>▪ Investments</li> </ul>	<ul style="list-style-type: none"> <li>▪ GASB 31</li> <li>▪ GASB 3</li> </ul>	<ul style="list-style-type: none"> <li>▪ None</li> </ul>
Capitalized Lease Obligations	<ul style="list-style-type: none"> <li>▪ Property, equipment and leases</li> <li>▪ Debt</li> </ul>	<ul style="list-style-type: none"> <li>▪ SFAS 13, EITF 01-08</li> <li>▪ SFAS 71</li> </ul>	<ul style="list-style-type: none"> <li>▪ None</li> </ul>
Utility Plant	<ul style="list-style-type: none"> <li>▪ Utility plant, depreciation</li> </ul>		<ul style="list-style-type: none"> <li>▪ Other depreciation methods</li> </ul>
Acquisition Adjustment	<ul style="list-style-type: none"> <li>▪ Other assets</li> <li>▪ Impairment if recovery method is altered</li> </ul>	<ul style="list-style-type: none"> <li>▪ SFAS 144</li> <li>▪ SFAS 71</li> <li>▪ GASB 42</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
Self-Insurance Accruals <ul style="list-style-type: none"> <li>Claims and Damages</li> <li>Storms Reserves</li> <li>Environmental Reserves</li> </ul>	<ul style="list-style-type: none"> <li>SFAS 5</li> <li>GASB 10</li> </ul>	<ul style="list-style-type: none"> <li>Accrued liabilities</li> <li>Operating expense</li> </ul>
Bad Debt Allowance/Credit Risk Accruals	<ul style="list-style-type: none"> <li>SFAS 5</li> </ul>	<ul style="list-style-type: none"> <li>Accounts receivable</li> <li>Operating expense</li> </ul>
Unbilled Revenue	<ul style="list-style-type: none"> <li>FASB Concept 5 and 6</li> </ul>	<ul style="list-style-type: none"> <li>Accounts receivables</li> <li>Revenue</li> </ul>
Fuel Derivatives Interest Rate Derivatives	<ul style="list-style-type: none"> <li>SFAS 133</li> </ul>	<ul style="list-style-type: none"> <li>Fuel Derivatives</li> <li>Deferred unrealized loss – financial derivatives</li> <li>Regulatory Liability – fuel and purchased power costs</li> </ul>
OPEBS	<ul style="list-style-type: none"> <li>GASB 45</li> </ul>	<ul style="list-style-type: none"> <li>OPEBs Expense</li> <li>Accrued Expenses</li> </ul>

## Audit Risks and Issues

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

- Derivatives
  - Valuation of derivatives associated with fuel price and interest rate fluctuations
  - Verification of external pricing sources and confirmations/statements from counterparties
  - Review of risk management policies by KPMG Financial Risk Management professionals
  - Review of cash settlements of settled trades
- Fuel Clause Adjustment
  - Appropriate accounting for previously deferred and recoverable excess fuel and purchased power costs
  - Review and approval of reconciliation of costs and deferrals
- Revenue
  - Appropriate revenue recorded as power is delivered including unbilled revenue accounting
  - Review of revenue reconciliation provided by National Grid, analytical review of revenues adjusted for seasonal fluctuations, review of reasonableness of unbilled revenues
  - Testing of bills and rates
  - Confirmations of receivables were not completed; however alternative liquidation testing was completed to substantiate year end balances
- Lease Accounting
  - Purchase Power Agreements with third parties as leases or executory contracts
  - Review of contracts for correct classification as capital or operating pursuant to accounting literature
  - Review of calculation of amounts to be capitalized
- Nuclear Plant (Nine Mile Point 2)
  - 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
    - ISO Reserves
    - National Grid Payments
    - Storm reserves
    - Bad Debt Reserves
    - Derivatives – Fuel and Interest Rate
      - Reviewed methodology, assumptions (and third party statements where applicable) for reasonableness of amounts set up as reserves/liabilities
- 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 (FMV testing of all investments – including mortgage backed securities)
    - Review of investments for compliance with policies as approved
- Debt Obligations
  - Compliance with financial and non financial covenants (including review of exposure related to Auction Rate Debt Obligations)
    - Review of debt compliance calculations in accordance with terms of agreements
- Asset retirement obligation
  - Proper application of accounting standards related to the asset retirement obligation
    - Review of methodology and calculation of liabilities required for capital assets pursuant to applicable accounting standards
- National Grid Transactions
  - Appropriate accounting for merger related transactions (including settlement of prior disputes)

## Agreements with National Grid

In addition to our testing on the significant accounting policies and judgments and estimates and account balances, we reviewed the following information provided by National Grid and relied upon it in preparation of the financial statements:

- National Grid Agreements
  - Revenue and accounts receivable
  - Property, plant and equipment
  - Fuel and purchased power procurement
  - Review of Sox 404 documentation specific to LIPA processes including deficiencies identified and remediation of deficiencies (No deficiencies noted)
  - IT General Controls Review
  - IT Controls over significant applications
    - Billing and revenue collections
    - Capital expenditures
    - Procurement of fuel and purchased power
  
- In addition, KPMG reviewed the following new agreements related to National Grid to ensure they are properly accounted for:
  - New Management Services Agreement (MSA)
  - Agreement and Waiver Document
  - Settlement and Agreement Document



## Fraud

During the course of our audit, KPMG has undertaken fraud discussions with the following members of LIPA senior management:

Finance and Audit Committee

Kevin Law – Chief Executive Officer

Elizabeth McCarthy – Chief Financial Officer

Lynda Nicolino – Acting General Counsel

Kenneth Kane – Controller

Corey Horowitz – Director of Risk Management

In addition, KPMG designed audit procedures and conducted walkthroughs of significant account balances to identify potential instances of fraud and sampled journal entries using computer assisted auditing techniques

Based upon our inquiries and testing, no financial statement fraud came to our attention for the year ended December 31, 2007.



# Audit Communications

## KPMG Communications

- One uncorrected balance sheet audit adjustment of \$5.8 million related to the recording of the receivable from Neptune related to a Settlement agreement and related side letter.
- One corrected balance sheet audit adjustment of \$1.4 million related to unrealized gains of fuel derivatives.
- Disagreements with Management
  - There were no disagreements with management on financial accounting and reporting matters
- Difficulties Encountered in Performing the Audit
  - We encountered no difficulties in dealing with management in performing our audit.
- Significant Written Communications Between Auditor and Management
  - Engagement Letter / Contract
  - Management Representation Letter
  - Management Letter forthcoming
- 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.
- Public Authority Accountability Act
  - Current compliance with Act for other non-audit services
  - Partner Rotation Requirement



# Independence / Fees for Services Provided by KPMG

## **Independence**

We are independent in accordance with AICPA Standards and *Governmental Auditing Standards* (Yellow Book Requirements).

## **Fees for Services**

Fees per
<u>Engagement Letter</u>
\$604,892

Audit of Authority 2007 Financial Statements  
*(In accordance with contract provisions approved by the NYS Office of the State Comptroller)*



## **New Accounting Pronouncements**

### **For Fiscal Year Ending December 31, 2008**

- FASB Statement No. 157 - Fair Value Measurements
- GASB Statement No. 49 – Accounting and Financial Reporting for Pollution Remediation Obligations

## KPMG REPORTS

- Audit Opinion on LIPA's Financial Statements as of and for the year ended December 31, 2007
- Debt Compliance Letter
- Required Communications Letter to the Board of Trustees
- Independent Accountants' Report on Investment Compliance
- Agreed Upon Procedures Letter related to Rate Covenant Calculation and Amounts Held in the Rate Stabilization Fund
- Report on Internal Control over Financial Reporting and on Compliance and Other Matters based on an Audit of Financial Statements performed in accordance with *Government Auditing Standards*
- Management Letter

