

**MANAGEMENT'S DISCUSSION AND ANALYSIS  
OF THE CONSOLIDATED RESULTS OF OPERATIONS  
FOR THE SIX MONTHS ENDED JUNE 30, 2003**

*Consolidated Results of Operations*

The accompanying consolidated financial information reflects the operating results of the Authority and LIPA for the six months ended June 30, 2003 and 2002. Note that the 2002 results of operations have been restated to correct the effects of the KeySpan revenue error.

*Excess of Revenues over Expenses*

The excess of expenses over revenues for the six months ended June 30, 2003 was approximately \$86 million compared with approximately \$17 million for the similar period in 2002. The variation of approximately \$69 million is primarily attributable to higher fuel and purchased power costs partially offset by higher revenues.

*Revenue*

Revenue for the six months ended June 30, 2003, increased approximately \$69 million when compared to the similar period in 2002. The increase is primarily attributable to system load growth totaling approximately \$45 million, higher recoveries of excess fuel costs totaling approximately \$22 million, and the effects of weather, estimated to have positively impacted revenue by approximately \$2 million.

*Fuel and Purchased Power Costs*

Fuel and purchased power costs increased approximately \$137 million. This increase is due in part to a \$50 million increase in fuel and purchased power costs not recoverable through the Fuel and Purchased Power Cost Adjustment mechanism ("FPPCA"), a decrease in the mark-to-market valuation of LIPA's fuel hedges of approximately \$39 million, higher sales volumes of approximately \$26 million, and higher FPPCA recoveries of approximately \$22 million.

LIPA's tariff includes a fuel recovery provision—the FPPCA. In February 2003, LIPA's Board of Trustees changed the method for recovery from customers of fuel costs in excess of those included in base rates, ("Excess Fuel Costs"). When fully implemented in 2004, the FPPCA will collect the portion of Excess Fuel Costs in the year incurred (as opposed to on a deferral basis), necessary to reach revenues in excess of expenses of \$20 million on an annual basis. The modified FPPCA also contains the following transition provisions:

- 2002 deferred fuel costs totaling \$129 million will be recovered over a ten-month period which began March 7, 2003. (During March through June 2003, approximately \$36 million has been billed to customers.)
- 2003 Excess Fuel Costs will be recovered in three tranches: (i) \$75 million will be collected in 2003 between March and December; (ii) \$70 million will be deferred and collected over the full year of 2004; and (iii) the remaining portion of Excess Fuel Costs necessary to reach an excess of revenue over expenses of \$20 million in 2003 will be deferred and collected in level annual amounts over a ten year period commencing January 1, 2004.

During the six months ended June 30, 2003, Excess Fuel Costs totaled approximately \$243 million. Of this amount, \$22 million has been billed to customers and \$32 million has been deferred for recovery in 2004. Approximately \$128 million has been deferred for collection over the 10-year period to begin January 1, 2004. The remaining \$61 million was charged to expense, as LIPA's current estimates indicate that portion of Excess Fuel Cost does not need to be recovered through the FPPCA in order to reach the target of revenues in excess of expenses of \$20 million for the year ending December 31, 2003.

During the six months ended June 30, 2002, excess fuel costs totaled \$65 million. Of this excess, \$55 million was deferred for recovery beginning in March 2003. The balance was charged to fuel and purchased power in that period.

Included in fuel and purchased power expense for the six month period ended June 30, 2003, is an unrealized loss of approximately \$6 million as opposed to a gain of approximately \$33 million during this period last year. The unrealized loss and gain are related to Financial Accounting Standards Board Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133"). SFAS No. 133 requires the fuel-related derivatives to be re-valued each period to its fair market value. The \$6 million mark-to-market unrealized loss resulted from the change in fuel related derivative values at June 30, 2003 when compared to its values at December 31, 2002.

After eliminating the effects of the FPPCA and SFAS No. 133, fuel and purchased power costs in 2003 increased by approximately \$203 million when compared to the six month period ended June 30, 2002. Approximately \$26 million is attributable to increased sales for the 2003 period compared to 2002, and the balance is attributable to increased fuel and purchased power prices.

#### Operations and Maintenance Expense ("O&M")

O&M decreased approximately \$11 million for the six months ended June 30, 2003 when compared to the similar period in 2002. This decrease is primarily attributable to increased utilization of the MSA workforce for capital activities, and the absence of the costs associated with the Y-50 repair (as of June 30, 2002, \$10 million had been accrued for the Y-50 repair costs).

These decreases were partially offset by a \$5 million charge related to the Shoreham Settlement Agreement; increased PSA costs totaling approximately \$6 million due to property tax increases; increased customer accounts expense totaling approximately \$2 million; and the recognition of approximately \$2 million related to the accretion of an Asset Retirement Obligation (ARO) as required under Financial Accounting Standards Board Statement No. 143-- "Accounting for Asset Retirement Obligations" (as more fully discussed below under the caption *Other Significant Items*).

#### General and administrative

General and administrative expenses increased approximately \$2 million primarily as a result of increased consulting fees associated with auditing and energy risk management activities.

#### Depreciation and amortization

Depreciation and amortization increased approximately \$8 million. Approximately \$6 million of that increase is related to an adjustment to nuclear decommissioning accruals. The remaining increase is due to higher utility plant balances in 2003 when compared to 2002.

Other Income

Other income increased approximately \$2 million primarily as a result of the sale of emission credits in January and February 2003 totaling approximately \$4 million. This increase was partially offset by lower investment earnings totaling approximately \$1 million due to lower cash balances; and lower insurance dividend distributions in 2003 totaling approximately \$1 million.

Interest Charges and Credits

Total interest charges increased relative to the same period in 2002 by approximately \$2 million resulting primarily from lower credits from the allowance for funds used during construction ("AFC").

Other Significant Items

On January 1, 2003, the Authority adopted Financial Accounting Standards Board Statement No. 143-"Accounting for Asset Retirement Obligations." An Asset Retirement Obligation ("ARO") exists when there is a legal obligation associated with the retirement of a tangible long-lived asset that results from the acquisition, construction, or development and/or normal operation of the asset. LIPA as an 18% owner of Nine Mile Point 2 nuclear power station has a legal obligation associated with its retirement. Accordingly, a new caption appears in the liability section of the balance sheet titled, "Asset Retirement Obligation". This obligation is offset by the capitalization of the obligation and is included in "Utility plant, net".

The cumulative effect of the change in accounting principle results in a benefit of approximately \$2.8 million and is shown as an adjustment to the opening balance of Accumulated Deficit.

**Consolidated Statement of Revenues, Expenses and  
Changes in Accumulated Deficit  
(Thousands of Dollars)**

	<b>Six Months Ended June 30,</b>	
	<b>2003 (unaudited)</b>	<b>2002 (unaudited)</b>
<b>Electric Revenue</b>	\$ 1,130,407	\$ 1,061,659
<b>Expenses</b>		
Operations - fuel and purchased power	496,877	359,479
Operations and maintenance	350,224	360,783
General and administrative	20,907	19,146
Depreciation and amortization	116,288	107,880
Payments in lieu of taxes	101,819	101,377
Total Operating Expenses	<u>1,086,115</u>	<u>948,665</u>
<b>Excess of operating revenue over expenses</b>	<u>44,292</u>	<u>112,994</u>
<b>Other income, net</b>		
Investment income	6,205	7,344
Carrying charges on regulatory asset	15,061	14,212
Other	4,802	2,942
Total other income, net	<u>26,068</u>	<u>24,498</u>
<b>Excess of revenues over expenses before interest charges and (credits)</b>	<u>70,360</u>	<u>137,492</u>
<b>Interest charges and (credits)</b>		
Interest on long-term debt, net	146,671	147,643
Other interest	12,773	11,711
Allowance for borrowed funds used during construction	<u>(2,776)</u>	<u>(5,168)</u>
Total interest charges	<u>156,668</u>	<u>154,186</u>
<b>Excess of expenses over revenues</b>	(86,308)	(16,694)
<b>Accumulated deficit</b>		
Beginning balance as previously reported	(11,253)	(31,365)
Change in accounting principle	<u>2,873</u>	<u></u>
Ending	<u>\$ (94,688)</u>	<u>\$ (48,059)</u>

**Consolidated Statement of Financial Position**  
(Thousands of Dollars)

	<b>June 30, 2003 (unaudited)</b>	<b>December 31, 2002 (audited)</b>
<b>Assets</b>		
<b>Utility Plant, net</b>	\$ 3,140,525	\$ 3,040,592
<b>Property and Equipment, net</b>	1,003	1,107
<b>Current Assets</b>		
Cash and cash equivalents and investments	470,759	610,326
Accounts receivable (less allowance for doubtful accounts of \$19,485)	210,685	236,856
Other accounts receivable	350	21,971
Fuel inventory	53,534	46,839
Material and supplies inventory	7,506	7,277
Interest receivable	648	1,409
Prepayments and other current assets	24,067	4,942
<b>Total Current Assets</b>	<b>767,549</b>	<b>929,620</b>
<b>Promissory Notes Receivable</b>		
KeySpan Energy	155,425	602,425
Niagara Mohawk Power Corporation	2,822	2,822
<b>Total Promissory Notes Receivable</b>	<b>158,247</b>	<b>605,247</b>
<b>Nonutility Property and Other Investments</b>		
	70,975	75,324
<b>Deferred Loss related to Non Fuel Derivatives</b>		
	95,529	39,597
<b>Deferred Charges</b>		
	78,206	70,456
<b>Regulatory Assets</b>		
Shoreham settlement	583,396	544,098
Fuel and purchased power cost recoverable	249,233	148,984
<b>Total Regulatory Assets</b>	<b>832,629</b>	<b>693,082</b>
<b>Acquisition Adjustment (net of accumulated amortization of \$733,870 and \$677,530, respectively)</b>		
	3,361,641	3,417,981
<b>Total Assets</b>	<b>\$ 8,506,304</b>	<b>\$ 8,873,006</b>
<b>Capitalization</b>		
Long-term debt	\$ 6,948,135	\$ 7,267,657
Accumulated deficit	(94,688)	(11,253)
<b>Total Capitalization</b>	<b>6,853,447</b>	<b>7,256,404</b>
<b>Asset Retirement Obligation</b>		
	62,628	-
<b>Capital Lease Obligation</b>		
	586,946	599,871
<b>Current Liabilities</b>		
Short-term debt	100,000	100,000
Current maturities of long-term debt	132,050	147,180
Accounts payable and accrued expenses	316,555	342,318
Accrued taxes	30,934	41,265
Accrued interest	40,811	47,745
Customer deposits	24,273	24,658
<b>Total Current Liabilities</b>	<b>644,623</b>	<b>703,166</b>
<b>Deferred Credits</b>		
	222,756	156,992
<b>Deferred Gain on Series 1998A Bonds Swapion</b>		
	-	25,955
	114,256	106,411
<b>Claims, Damages and Storm Reserves</b>		
	21,648	24,207
<b>Commitments and Contingencies</b>		
<b>Total Capitalization and Liabilities</b>	<b>\$ 8,506,304</b>	<b>\$ 8,873,006</b>

**Consolidated Statement of Cash Flows**  
(Thousands of Dollars)

	<b>Six Months Ended June 30,</b>	
	<b>2003 (unaudited)</b>	<b>2002 (unaudited)</b>
<b>Cash Flows From Operating Activities</b>		
Received for system sales and other operating revenues, net of refunds	\$ 1,167,525	\$ 1,055,790
Paid to suppliers and employees		
Operations and maintenance	(407,326)	(358,457)
Purchased power	(258,901)	(196,561)
Fuel oil and gas	(335,940)	(212,858)
Payments in lieu of taxes	(151,562)	(166,723)
Net cash provided by operating activities	13,796	121,191
<b>Investing Activities</b>		
Earnings received on investments	5,201	7,466
Other	307	539
Net cash provided by investing activities	5,508	8,005
<b>Cash Flows from Capital and related Financing Activities</b>		
Capital and nuclear fuel expenditures	(109,318)	(131,114)
Insurance proceeds	-	1,444
Proceeds from the issuance of swaption, net	29,892	-
Proceeds from KeySpan promissory note	447,000	-
Proceeds from bond issuance	1,605,552	27,565
Bond issuance costs	(23,455)	(336)
Interest paid, net	(138,385)	(138,245)
Redemption of long-term debt	(1,970,157)	(115,145)
Net cash used in capital and related financing activities	(158,871)	(355,831)
Net decrease in cash, cash equivalents and investments	(139,567)	(226,635)
Cash, cash equivalents and investments at beginning of period	610,326	688,369
Cash, cash equivalents and investments at end of period	\$ 470,759	\$ 461,734
<b>Reconciliation to Net Cash Provided by Operating Activities</b>		
Excess of operating revenues over operating expenses	\$ 44,292	\$ 112,994
<b>Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities</b>		
Depreciation and amortization	116,288	107,880
Nuclear fuel burned	3,067	2,436
Shoreham Credits	(24,922)	(37,903)
Provision for claims and damages	5,250	5,235
Change in the fair market value of fuel related derivatives	5,980	(33,232)
Other	(2,108)	2,959
<b>Changes in operating assets and liabilities</b>		
Accounts receivable, net	26,171	(8,955)
Fuel and Material & supplies inventory	(6,924)	(823)
Fuel and purchased power costs recovered related to prior periods	59,921	59,269
Excess fuel and purchased power costs deferred	(160,170)	(55,223)
Prepaid assets	(9,510)	(11,347)
Accounts payable and accrued expenses	(28,920)	18,963
Accrued taxes	(19,812)	(41,372)
Other, net	5,193	310
Net cash provided by operating activities	\$ 13,796	\$ 121,191