Long Island Power Authority and Subsidiaries

Consolidated Financial Statements
December 31, 2002 and 2001

Long Island Power Authority and Subsidiaries

Index

Long Island Power Authority and Subsidiaries

MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE CONSOLIDATED RESULTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2002

Overview

During 2002, LIPA made significant progress towards its goal of increasing the supply of electricity available to LIPA's nearly 1.1 million customers from both on- and off-island resources. At the same time, significant improvements were made to the transmission and distribution system, and much was accomplished to advance LIPA's energy conservation and efficiency efforts. A hot summer season created record demand for electricity, which started with an early April heat wave that set a new record for pre-summer demand. LIPA's load exceeded the 5,000 megawatts (MW) mark for the first time during the summer of 2002.

On Wednesday, July 3rd, a new Long Island Control Area (LICA) peak- hour demand record of 5,030 megawatts (MW) was established, which exceeded the previous summer's peak record of 4,906 MW by 124 MW. Twenty-six days later, on Monday, July 29th, the first day of a seven-day heat wave, a new LICA peak-hour demand record of 5,059 MWs was reached. The new record, which would eventually stand as the summer 2002 peak record, was 153 MWs in excess of the summer 2001 peak, an extraordinary year-to-year peak growth rate. A hot August resulted in demand exceeding 4,900 MW on several days.

The LICA includes three municipalities served by their own utilities, located within LIPA's service territory.

Steps Taken to Satisfy Customer Needs

- During a heat wave in the summer of 2001, LIPA concluded that additional on-island generating facilities would be needed to satisfy Long Island's anticipated peak load for the summer of 2002, forecasted at that time to be approximately 400 – 500 MW above the 2001 peak level. Both the New York State Department of Public Service ("PSC") and New York Independent System Operator ("NYISO") concurred that there was a need for additional generating capacity within LIPA's service territory. As a result of these concerns, LIPA initiated its Powering Long Island 2002. Through this initiative, ten new power generating units, built by four different developers, were licensed, constructed and placed in service at six locations throughout LIPA's service territory. Combined, the units added more than 400 megawatts of new on-island capacity available to LIPA.

- LIPA also continued its program of strategic investment in its transmission and distribution system to help improve reliability and to upgrade capacity to serve growing customer load. Capital improvements to the system, which totaled approximately $246 million, included such items as: capacity improvements; replacement and upgrade of equipment such as transformer banks, and circuit breakers; new substations; enhanced transmission lines; and upgraded command and control equipment. Also included in the $246 million discussed above, is $56 million of investment made to interconnect the ten new power generating facilities, referred to above, to the power grid.

Long Island Power Authority and Subsidiaries

MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE CONSOLIDATED RESULTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2002

Financial Discussion

Restatement

In November 2002, after numerous discussions between KeySpan Energy ("KeySpan") and Authority personnel, KeySpan confirmed that the financial information provided by KeySpan included misstatements of the Authority's electric system revenues in various periods, including 2002 and 2001. In response to this notification, the Authority retained independent accountants to conduct an investigation of the revenue error, and a separate accounting firm specializing in electric power matters, to perform a quality assurance review of KeySpan operations that service the Authority.

The revenue review concluded the following:

In 2002, KeySpan **overstated** revenues of the Authority by approximately $62.6 million;
In 2001, KeySpan **overstated** revenues of the Authority by approximately $11.6 million;
In 2000, KeySpan **understated** revenues of the Authority by approximately $5.9 million;
In 1999, KeySpan **overstated** revenues of the Authority by approximately $2.9 million;
In 1998, KeySpan **understated** revenues of the Authority by approximately $6.7 million.

The Authority's audited financial statements for 2002 reflect the revised revenue amounts. The Authority has restated 2001 results to reflect the corrected revenue figures, and has reduced the 2001 opening balance of the Accumulated deficit to capture the net revenue understatements related to 2000, 1999, and 1998, totaling approximately $9.7 million.

Financing Plans

The Authority has approved a plan of finance that it expects to complete over the next several months that includes various borrowings. The plan of finance is expected to include the following components: (i) the Authority plans to remarket its $27.3 million Electric System Subordinated Revenue Bonds, Series 8C, as fixed rate bonds scheduled to mature on April 1, 2010; (ii) the Authority plans to issue approximately $625 million of uninsured, fixed rate, senior lien bonds (the "Series 2003A & B Bonds"). The Series 2003 A & B Bonds will be issued to refund certain series of the Electric System General Revenue Bonds Series 1998A, 1998B, and 2000A that are currently insured by Financial Security Assurance ("FSA"). Subject to the planned refunding and defeasance of such bonds, FSA has committed to insure certain senior lien, variable rate bonds described below (the "Refunding VR Bonds"); (iii) in connection with the expiration of certain letters of credit supporting the Authority's $700 million Electric System Subordinated Revenue Bonds, Series 1 through 3, the Authority plans to remarket $600 million of such Bonds as subordinate lien variable rate or auction rate bonds, and refund the remaining $100 million with fixed rate senior lien bonds; the Authority plans to issue $200 million of fixed rate senior lien bonds to fund certain capital expenditures; and (iv) the Authority plans to issue approximately $600 million Refunding VR Bonds on or near June 1, 2003 to refund approximately $587 million Electric System General Revenue Bonds Series 1998A (2029 maturity, 5.50%). The Refunding VR Bonds are being issued in connection with the swaption entered into by the Authority in October 2002, which was exercised on February 3, 2003, as more fully described in Note 5 to the Authority's Consolidated Financial Statements for the year ended December 31, 2002.

Liquidity

The Authority's cash, cash equivalents and investments totaled approximately $610.3 million and $688.4 million at December 31, 2002 and 2001, respectively. The decrease is primarily the result of funding capital expenditures with cash from operations, and higher payments related to fuel and purchased power costs. Cash generated from operations, combined with available cash balances from 2001 exceeded the Authority's operating, construction and refunding requirements for 2002, and as such, the Authority was able to complete the year without the issuance of any new debt. Furthermore, the Authority has been able to maintain a $250 million balance in its Rate Stabilization Fund.

The Authority's Supplemental Bond Resolution authorizes the issuance of Commercial Paper Notes, Series CP-1 ("Notes") up to a maximum amount of $300 million. As of December 31, 2002, the Authority had Notes outstanding totaling $100 million, leaving $200 million of undrawn liquidity available. In connection with the issuance of the Notes, the Authority has entered into a Letter of Credit and Reimbursement Agreement, expiring on May 23, 2003. The Authority is currently negotiating a replacement LOC to become effective immediately upon the expiration of the existing agreement. It is expected that the replacement LOC will carry a three-year term.

Capitalization

The Authority's capitalization, including current maturities of long-term debt, is as follows:

Capitalization
(in thousands)

	Balance at December 31, 2002	Balance at December 31, 2001
General Revenue Bonds	$ 5,646,894	$ 5,778,595
Subordinated Revenue Bonds	1,165,518	1,161,196
Commercial Paper Notes	100,000	100,000
NYSERDA Notes	332,425	332,425
Debentures	270,000	270,000
	$ 7,514,837	$ 7,642,216

Long term debt decreased as a result of the scheduled maturities of approximately $140 million, partially offset by the accretion of the capital appreciation bonds totaling approximately $29 million.

In February 2003, LIPA furnished notice for a March 2003 redemption of its $270 million Long Island Lighting Company Debentures, 8.2% Series due 2023. Funding for this redemption, including interest to the date of redemption and call premium, totaling approximately $281 million was provided by KeySpan in accordance with the terms of a promissory note to LIPA.

Also in February 2003, LIPA announced its intention to redeem in March 2003, approximately $177 million of its NYSERDA financing notes. KeySpan also provided funding for this redemption in accordance with the terms of a promissory note to LIPA.

Investment Ratings

The Authority's securities are rated by Standard and Poor's Corporation (S&P), Moody's Investors Service (Moody's), and Fitch Investors Services, LP (Fitch).

Investment Ratings

	Moody's	Standard & Poors	Fitch
Senior Lien Debt	Baa1	A-	A-

- Certain Senior and all Subordinated Lien debt and the Commercial Paper notes are supported by either a Letter of Credit (LOC) or are insured. Such debt carries the ratings of the LOC syndicate or insurance company, not that of the Authority.

Over the past few years, domestic utilities and energy firms generally have come under increasing credit pressure. These pressures stem from a number of factors, including: high profile investigations of accounting irregularities related to a number of companies registered with the Securities and Exchange Commission; concerns over investments in domestic and international merchant power projects; potential overbuild of the domestic capacity markets; concern over departures from core regulated activities; great flux in the regulatory environment; and, a general slowdown of the U.S. and larger global economies. While these credit concerns have had far less of a direct impact on the public power sector, they have nonetheless added to ratings pressure because of, among other things, increased counterparty exposure risk, increased volatility of fuel costs, and the heightened concerns over liquidity.

In December 2002, S&P placed LIPA on CreditWatch negative, reflecting concerns that LIPA's financial performance could be impaired as a result of KeySpan's overstatement of LIPA's revenues for 2002. S&P stated that the "potential for an overstatement of revenues, combined with the lack of third-quarter financials, introduces risk that LIPA's net revenues could be materially reduced".

Other factors cited by S&P as putting pressure on LIPA's credit ratings were rising capital expenditures, concerns over LIPA's original fuel recovery mechanism (which has been amended, as more fully discussed below under the caption *Fuel and Purchased Power Costs—modification of the FPPCA mechanism),* and concerns over LIPA's longer term plans to meet capacity needs on Long Island.

The following is a summary of the Authority's financial information for 2002 and 2001:

Summary Statement of Financial Position
(in thousands)

	December 31, 2002	December 31, 2001
Assets		
Capital assets, net	$ 3,041,699	$ 2,299,389
Cash, cash equivalents and investments	610,326	688,369
Other current assets	319,294	263,933
Promissory notes receivable	605,247	605,289
Nonutility property and other investments	75,324	38,903
Deferred charges	110,053	76,657
Regulatory assets	693,082	572,382
Acquisition adjustment	3,417,981	3,530,662
Total Assets	$ 8,873,006	$ 8,075,584
Capitalization		
Long-term debt	$ 7,267,657	$ 7,502,131
Accumulated deficit	(11,253)	(31,365)
Total Capitalization	7,256,404	7,470,766
Capital lease obligation	599,871	-
Current liabilities	703,166	482,883
Non-current liabilites	313,565	121,935
Total Capitalization and Liabilities	$ 8,873,006	$ 8,075,584

Long Island Power Authority and Subsidiaries

MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE CONSOLIDATED RESULTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2002

Summary Statement Revenues, Expenses and Changes in Accumulated Deficit

(in thousands)

	Twelve Months Ended December 31, 2002	2001 Restated
Electric Revenue	$ 2,459,210	$ 2,356,351
Expenses		
Operations - fuel and purchased power	924,778	881,335
Operations and maintenance	767,217	719,853
General and administrative	49,780	36,746
Depreciation and amortization	220,654	212,283
Payments in lieu of taxes	218,156	219,579
Total Operating Expenses	2,180,585	2,069,796
Excess of operating revenues over expenses	278,625	286,555
Other income, net	52,204	72,049
Interest charges	310,717	338,056
Excess of revenues over expenses	20,112	20,548
Accumulated deficit - Beginning	(31,365)	(61,670)
Correction of an error in prior periods	-	9,757
Accumulated deficit - as restated	(31,365)	(51,913)
Accumulated deficit - Ending	$ (11,253)	$ (31,365)

Excess of Revenues over Expenses

The excess of revenues over expenses for the year ended December 31, 2002, was approximately $20 million compared with approximately $21 million for the prior year.

Revenue

Revenue increased by approximately $103 million as compared to 2001. The increase is primarily attributable to: system load growth totaling approximately $57 million; higher recoveries of previously deferred fuel and purchased power costs (described below) totaling approximately $25 million; the effects of weather estimated to have positively impacted revenue by approximately $23 million; and an increase of other revenue of approximately $6 million. The revenue increase was partially offset by lower Shoreham credits of approximately $8 million. The increase in other revenue was primarily the result of higher sales of ancillary services (ICAP) totaling approximately $4 million, and higher revenue due to increased transmission services fees charged to others who use LIPA's transmission and distribution facilities.

Fuel and Purchased Power Costs

LIPA's tariff includes a fuel recovery provision—the Fuel and Purchased Power Cost Adjustment ("FPPCA"). The FPPCA mechanism was designed to allow LIPA to recover from or return to customers any fuel and purchased power costs that fall outside an established base fuel and purchased power cost tolerance band. The tolerance band was designed to increase in 1% increments annually until such time as the fuel and purchased power costs increased in excess of 5% cumulatively over the original base cost. The FPPCA as designed, would have recovered in subsequent years, all costs incurred in each such period in excess of LIPA's base cost of fuel and purchased power.

For the years ended December 31, 2002, and 2001, the Authority's Board of Trustees decided, however, to limit the recovery of fuel and purchased power costs in excess of those charged to customers in base rates (excess fuel costs) to 5.8% of revenue from base rates. Amounts that exceed the 5.8% are charged to fuel and purchased power expense in the current period, as the Authority will not seek future recovery from customers for those amounts.

For the years ended December 31, 2002, and 2001, excess fuel costs totaled approximately $254 million and $207 million, respectively. Of those amounts, approximately $129 million and $125 million were deferred at December 31, 2002 and 2001. Costs incurred beyond the 5.8% deferral during the years ended December 31, 2002 and 2001 totaling approximately $125 million and $82 million, respectively, were charged to fuel and purchased power expense. The fuel and purchased power cost variation from 2001 includes an increase of approximately $25 million caused by the timing of the recovery of previously deferred fuel and purchased power costs. This variation is attributable to twelve months of recovery in the 2002 figures, compared with nine months and 24 days of recovery in the 2001 figures, as the recovery of the 2000 deferred fuel and purchased power costs began on March 7, 2001. The amortization to fuel and purchased power expense of amounts previously deferred, is equal to that which is included in revenue, and as a result, there is no impact on earnings.

In addition, fuel and purchased power expense for the year ended December 31, 2002, was reduced by an unrealized gain of approximately $40 million necessary to comply with the provisions of Financial Accounting Standards Board Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133"). SFAS No. 133 requires fuel-related derivatives to be re-valued each period to their estimated fair market value. The $40 million mark-to-market unrealized gain resulted from the change in fuel related derivatives values at December 31, 2002 when compared to their values at December 31, 2001. However, the fuel derivative values at December 31, 2002 totaled approximately $32 million. The unrealized gains/losses are included in Fuel and Purchased Power expense but because this valuation is unrealized, it is excluded from the FPPCA calculation.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE CONSOLIDATED RESULTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2002

Eliminating the effects of the accounting mechanisms used to comply with the Authority's tariffs and SFAS No. 133, reveals that fuel and purchased power costs in 2002 increased by approximately $65 million, or approximately 7%, when compared to the year ended December 31, 2001. Approximately $24 million of the increase was a result of increased sales. The remaining increase was a result of the increased costs of fuel and purchased power.

Modification to the FPPCA mechanism

In February 2003, LIPA's Board of Trustees adopted a proposal to change the method in which the Authority collects excess fuel costs from its customers. The modification, when fully implemented in 2004, will permit the Authority to collect its excess fuel costs in the year incurred (as opposed to on a deferred basis), in amounts sufficient to generate revenues in excess of expenses of $20 million on an annual basis. The modification will be implemented over a two-year transition period (2003 – 2004) as follows:

- With respect to 2002 deferred fuel costs, recovery will be over a ten-month period beginning March 2003.
- With respect to 2003 excess fuel costs: (i) $75 million will be collected in 2003 between March and December; (ii) $70 million will be deferred and collected in 2004; and (iii) an additional amount sufficient to generate 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 in January 1, 2004.
- With respect to 2004 and subsequent years' excess fuel costs, collections of these amounts will be on a current year basis in amounts sufficient to generate excess revenue over expenses of $20 million. For the years ending 2003 and beyond, excess fuel costs not deferred will be charged to expense as the Authority will not seek recovery of such amounts under this modification.

Operations and Maintenance Expense ("O&M")

O&M increased approximately $47 million for the year ended December 31, 2002 when compared to 2001. This increase is primarily attributable to the cost of renting temporary emergency stand-by generators totaling approximately $42 million and costs associated with repairing a 345 kilovolt submarine cable running under the Long Island Sound connecting Long Island to Westchester County, New York (Y-50 cable), totaling approximately $5 million. The emergency generators were necessary to ensure adequate supply and maintain reliable service during the summer of 2002. It should be noted that the Y-50 cable, once repaired, operated at 67% of its rated capacity through September, and was not returned to 100% until the beginning of October. The cable has performed without problems since being brought back to its 100% level.

Other increases included anticipated increases in the Management Services Agreement ("MSA") fee totaling approximately $21 million. This increase is the result of escalation clauses within the agreement, and additional work requested by the Authority. Additionally, higher costs were incurred due to clean energy initiatives totaling approximately $7 million (primarily as a result of the "Keep Cool Bounty

Program"); costs associated with the development of new generating facilities totaling approximately $6 million; increased preventative maintenance costs on substations not provided for in the agreed upon MSA annual fee, totaling approximately $4 million; and increased Power Supply Agreement ("PSA") property taxes totaling approximately $4 million.

These increased costs were offset by lower O&M costs being incurred under the MSA during 2002 compared with 2001 totaling approximately $22 million. This decrease was the result of a greater percentage of the MSA effort being utilized to support capital improvements, thereby reducing available funds to perform maintenance work. The Authority does not expect that this decrease in O&M will have any long-term detrimental effect on service quality.

In addition, the increase was also offset by lower costs related to Nine Mile Point 2 ("NMP2") Plant totaling approximately $4 million (in 2001 LIPA incurred a pension and benefit related curtailment loss due to the sale of the NMP2 by the other co-tenants); and decreased costs related to the amortization of deferred costs related to rebates issued to non-Suffolk customers totaling approximately $14 million.

General and Administrative Expenses ("G&A")

The increase in G&A totaling approximately $13 million is primarily attributable to increasing reserve levels for claims for injuries and damages. There was also a slight increase due to anticipated increased fees for consulting services associated with the development of new generating and transmission facilities on Long Island.

Depreciation and amortization

The increase in depreciation and amortization reflects the increase in capital expenditures in 2001 that are now being depreciated. It is anticipated that 2003 depreciation will be higher than 2002 as the Authority continues to replace and upgrade older transmission and distribution facilities to improve service quality.

Payments in Lieu of Taxes

Payments in lieu of taxes ("PILOTs") decreased approximately $1 million. There was an approximate $7 million decrease in PILOTs on the Shoreham Nuclear Power Station property as the Authority made its final related payment in January 2002. This decrease was offset by the recognition of new PILOTS primarily attributable to the new generating facilities that became operational in the summer of 2002.

Other Income

Other income decreased approximately $20 million. This decrease was primarily a result of decreased investment income of approximately $9 million as a result of lower returns realized on cash and investment balances due to the general decline in interest rates. In addition, there were lower carrying charges in 2002 related to the Regulatory Asset established upon settlement of the Shoreham litigation by approximately $7 million due to a refinement in the method of calculating this carrying charge; and the absence of interest earned on ISO rebillings during 2002 totaling approximately $7 million.

Interest Charges and Credits

Despite higher levels of debt outstanding, interest charges related to debt in 2002 were lower compared to the similar period last year, as interest rates on variable rate obligations were less in 2002.

Allowance for borrowed funds used during construction

Allowance for borrowed funds used during construction increased approximately $5 million. This is primarily the result of increased Construction Work in Process ("CWIP") balances during 2002, attributable in part to the interconnections necessitated by the Powering Long Island 2002 projects.

Risk Management

The Authority is routinely exposed to commodity and interest rate risk. In order to mitigate such exposure, the Authority, in 2002, formed an Executive Risk Management Committee to strengthen executive management oversight for the risk mitigation activities of the Authority. In addition, the Authority hired an external consultant specializing in risk management, energy markets and energy trading to enhance guidelines and protocols for energy trading activities.

Whenever the Authority enters into a transaction to mitigate risk, it becomes exposed in the event of non-performance by the counterparty. To limit its exposure to risk, the Authority will only enter into derivative transactions with counterparties that have a credit rating of "investment grade" or better.

Fuel and purchased power transactions: The Company uses derivative financial instruments to protect its customers from market price fluctuations for the purchase of fuel oil, natural gas, and/or electricity. These instruments are recorded at their market value and any unrealized gains and losses are recognized in current period results, as a component of fuel and purchased power. At December 31, 2002, the Authority recognized an unrealized gain on its fuel derivatives of approximately $40 million. At December 31, 2001, the Authority recognized an unrealized loss on these instruments of approximately $8 million.

Swaption: In October 2002, the Authority completed the sale of an option to UBS AG ("counterparty") to hedge the call feature of its approximately $587 million Electric System General Revenue Bonds, Series 1998A, 5.50% maturing in 2029. In exchange for the option, the Authority received an upfront option premium of $82 million plus administrative and other costs totaling approximately $24.4 million. As a result, the Authority recorded the swaption value at $106.4 million, and recorded a receivable and prepaid expense of approximately $21.6 million and $2.8 million, respectively.

On February 3, 2003, UBS AG exercised its option. As a result, the Authority will issue variable rate debt in late May 2003 sufficient to redeem the 1998A 5.50% Electric System General Revenue Bonds maturing in 2029. In addition, the $82 million premium that the Authority received in October 2002 will be used to reduce interest expense over the life of the variable rate debt.

Interest rate transactions: The Authority is party to an interest rate swap agreement in connection with its \$116 million Electric System General Revenue Bonds Series 2001 L. Under this swap, the Authority has effectively converted the terms of the underlying debt obligation from fixed to variable. Under the terms of this agreement, the Authority pays a variable rate equivalent to the Bond Market Association ("BMA") Index (1.52% and 1.61% at December 31, 2002, and 2001, respectively) and receives fixed rate payments at 5.1875%. The term of the swap is equal to the maturity of the Series L Bonds, May 1, 2033. The Authority marked-to-market this swap transaction at December 31, 2002, and recorded an unrealized gain of approximately \$10.4 million. This gain has been deferred, and will be charged to expense when realized. See Note 15, Subsequent Events, of the Consolidated Financial Statements for an update of this interest rate derivative transaction.

The Authority is party to interest rate swap agreements in connection with its \$250 million Electric System Subordinated Revenue Bonds Series 7 Bonds. The Authority has two separate agreements having notional amounts of \$150 million and \$100 million, respectively. These agreements effectively convert the underlying debt obligation from floating to fixed (4.2%). The interest rate swap agreements are co-terminus with the Series 7 Bonds, with optional earlier termination at the Authority's discretion. In accordance with SFAS No. 133, the Authority marked-to-market this swap transaction at December 31, 2002, and recorded an unrealized loss of approximately \$24.1 million. This loss has been deferred, and will be charged to expense when realized.

Capitalized Lease Obligations

During the summer of 2002, LIPA entered into six Power Purchase Agreements ("PPA's") for ten 44.4 MW generating units. Four of the PPA's, incorporating seven of the units, qualify as capital leases under Financial Accounting Standards Board pronouncement No. 13, "Accounting for Leases" ("SFAS No. 13"). Included in both Utility Plant and Capital Lease Obligations is approximately \$600 million, representing the unamortized net present value of the minimum lease payments under the PPA's that qualified for capitalization.

During the first quarter of 2003, the Authority entered into three PPA's for approximately 150 MW of capacity to be available for the summer of 2003. Additionally, the Authority entered into agreements to purchase approximately 50 MW from new generating facilities proposed to be constructed on Long Island by the summer of 2004.

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Report of Independent Accountants

To the Board of Trustees
Of the Long Island Power Authority and Subsidiaries:

In our opinion, the accompanying consolidated statements of financial position and of capitalization and the related consolidated statements of revenues, expenses and changes in accumulated deficit and of cash flows present fairly, in all material respects, the financial position of the Long Island Power Authority and its subsidiaries (collectively, the "Company") at December 31, 2002 and 2001, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 3 to the accompanying consolidated financial statements, the Company has restated its financial statements as of and for the year ended December 31, 2001 related to electric system revenues.

The Management's Discussion and Analysis and the supplementary information on pages 1 through 11 is not a required part of the basic financial statements but supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consist principally of inquires of management regarding the presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

PricewaterhouseCoopers LLP

March 24, 2003

Consolidated Statements of Financial Position
(Thousands of Dollars)

	December 31, 2002	(restated Note 3) 2001
Assets		
Utility Plant and Property and Equipment, net	$ 3,041,699	$ 2,299,389
Current Assets		
Cash and cash equivalents	491,986	368,866
Investments	118,340	319,503
Accounts receivable (less allowance for doubtful accounts of $19,485 and $21,480, respectively)	236,856	195,436
Other accounts receivable	21,971	-
Fuel inventory	46,839	54,418
Material and supplies inventory	7,277	9,794
Interest receivable	1,409	1,049
Prepayments and other current assets	4,942	3,236
Total Current Assets	929,620	952,302
Promissory Notes Receivable		
KeySpan Energy	602,427	602,427
Niagara Mohawk Power Corporation	2,820	2,862
Total Promissory Notes Receivable	605,247	605,289
Nonutility Property and Other Investments	75,324	38,903
Deferred Loss related to Non Fuel Derivatives	39,597	-
Deferred Charges	70,456	76,657
Regulatory Assets		
Shoreham settlement	544,098	425,056
Fuel and purchased power costs recoverable	148,984	147,326
Total Regulatory Assets	693,082	572,382
Acquisition Adjustment (net of accumulated amortization of $677,530 and 564,849, respectively)	3,417,981	3,530,662
Total Assets	$ 8,873,006	$ 8,075,584
Capitalization		
Long-term debt	$ 7,267,657	$ 7,502,131
Accumulated deficit	(11,253)	(31,365)
Total Capitalization	7,256,404	7,470,766
Capital Lease Obligation	599,871	-
Current Liabilities		
Short-tem debt	100,000	-
Current maturities of long-term debt	147,180	140,085
Accounts payable and accrued expenses	342,318	238,841
Accrued taxes	41,265	29,576
Accrued interest	47,745	49,511
Customer deposits	24,658	24,870
Total Current Liabilities	703,166	482,883
Deferred Credits	131,037	98,467
Deferred Gain on Series 1998A Bonds	25,955	-
Swaption	132,366	-
Claims and Damages	24,207	23,468
Commitments and Contingencies		
Total Capitalization and Liabilities	$ 8,873,006	$ 8,075,584

The accompanying notes are an integral part of these financial statements.

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

	Twelve Months Ended December 31, 2002	Twelve Months Ended December 31, 2001 (restated Note 3)
Electric Revenue	$ 2,459,210	$ 2,356,351
Expenses		
Operations - fuel and purchased power	924,778	881,335
Operations and maintenance	767,217	719,853
General and administrative	49,780	36,746
Depreciation and amortization	220,654	212,283
Payments in lieu of taxes	218,156	219,579
Total Operating Expenses	2,180,585	2,069,796
Excess of operating revenues over expenses	278,625	286,555
Other income, net		
Investment income	14,860	23,638
Carrying charges on regulatory asset	29,290	36,192
Other	8,054	12,219
Total other income, net	52,204	72,049
Excess of revenues over expenses before interest charges and (credits)	330,829	358,604
Interest charges and (credits)		
Interest on long-term debt, net	295,911	316,592
Other interest	23,812	25,914
Allowance for borrowed funds used during construction	(9,006)	(4,450)
Total interest charges	310,717	338,056
Excess of revenues over expenses	20,112	20,548
Accumulated deficit		
Beginning balance as previously reported		(61,670)
Correction of prior periods		9,757
Beginning balance as adjusted	(31,365)	(51,913)
Ending	$ (11,253)	$ (31,365)

Consolidated Statements of Cash Flows
(Thousands of Dollars)

	Twelve Months Ended December 31, 2002	(restated Note 3) 2001
Cash Flows From Operating Activities		
Received from customers for the system sales, net of refunds	$ 2,400,193	$ 2,336,871
Other operating revenues received	40,002	20,675
Paid to suppliers and employees:		
Operations and maintenance	(775,374)	(758,336)
Fuel and purchased power	(896,436)	(810,389)
Payments in lieu of taxes	(276,678)	(265,306)
Net cash provided by operating activities	491,707	523,515
Investing Activities		
Net purchases of investment securities	201,163	(42,429)
Earnings received on investments	14,532	21,591
Other	(3,603)	(3,850)
Net cash provided by (used in) investing activities	212,092	(24,688)
Cash Flows from Capital and related Financing Activities		
Capital and nuclear fuel expenditures	(246,636)	(201,283)
Insurance proceeds	1,209	-
Swaption proceeds	82,017	-
Proceeds from the issuance of bonds, net of issuance costs	27,487	1,916,862
Interest paid, net	(277,371)	(296,260)
Redemption of long-term debt	(167,385)	(1,647,130)
Net cash used in capital and related financing activities	(580,679)	(227,811)
Net increase in cash and cash equivalents	123,120	271,016
Cash and cash equivalents at beginning of period	368,866	97,850
Cash and cash equivalents at end of period	$ 491,986	$ 368,866
Reconciliation to Net Cash Provided by Operating Activities		
Excess of operating expenses over operating revenue as previously reported		$ 298,398
Correction of prior period		11,843
Excess of operating revenues over operating expenses	$ 278,625	286,555
Adjustments to reconcile excess of operating revenues over operating expenses to net cash provided by operating activities		
Depreciation and amortization	220,654	212,283
Nuclear fuel burned	5,228	5,340
Shoreham Credits	(78,287)	(64,880)
Provision for claims and damages	22,448	10,727
Change in the fair market value of fuel related derivatives	(39,519)	7,606
Other, net	3,784	(68)
Changes in operating assets and liabilities		
Accounts receivable, net	(41,420)	22,965
Fuel and Material and supplies inventory	10,096	(13,961)
Fuel and purchased power costs recovered related to prior periods	127,508	102,779
Excess fuel and purchased power costs deferred	(129,166)	(124,505)
Accounts payable and accrued expenses	111,756	78,674
Net cash provided by operating activities	$ 491,707	$ 523,515

The accompanying notes are an integral part of these financial statements.

Consolidated Statements of Capitalization
December 31, 2002
(Thousands of Dollars)

	Maturity	Interest Rate	Series	December 31, 2002	(restated Note 3) 2001
Electric System General Revenue Bonds					
Serial Bonds	Annually to 2016	4.250% to 6.000% a	1998A	$ 1,083,990	$ 1,136,230
Term Bonds	December 1, 2018 to 2029	5.000% to 5.750% a	1998A	1,850,575	1,850,575
Capital Appreciation Bonds	December 1, 2003 to 2028	4.400% to 5.300% a	1998A	182,723	173,955
Serial Bonds	Annually to 2016	4.000% to 5.250% a	1998B	1,018,875	1,106,720
Term Bonds	April 1, 2018	4.750% a	1998B	57,145	57,145
Capital Appreciation Bonds	June 1, 2005 to 2029	5.000% to 5.950% a	2000A	376,494	356,326
Serial Bonds	September 1, 2013 to 2021	4.600% to 5 3/8% a	2001A	21,960	21,960
Term Bonds	September 1, 2025 to 2029	5.000% to 5 3/8% a	2001A	278,040	278,040
Term Bonds	May 1, 2033	1.500% b	2001B	75,000	75,000
Term Bonds	May 1, 2033	1.100% b	2001C	25,000	25,000
Term Bonds	May 1, 2033	1.200% b	2001D	50,000	50,000
Term Bonds	May 1, 2033	1.100% b	2001E	50,000	50,000
Term Bonds	May 1, 2033	1.300% b	2001F	50,000	50,000
Term Bonds	May 1, 2033	1.300% b	2001G	50,000	50,000
Term Bonds	May 1, 2033	1.400% b	2001H	50,000	50,000
Term Bonds	May 1, 2033	1.400% b	2001I	50,000	50,000
Term Bonds	May 1, 2033	1.450% b	2001J	50,000	50,000
Term Bonds	May 1, 2033	1.400% b	2001K	50,000	50,000
Term Bonds	May 1, 2033	5.375% a	2001L	116,000	116,000
Term Bonds	May 1, 2033	1.140% b	2001M	50,000	50,000
Term Bonds	May 1, 2033	1.250% b	2001N	50,000	50,000
Term Bonds	May 1, 2033	1.150% b	2001O	50,000	50,000
Term Bonds	May 1, 2033	1.250% b	2001P	50,000	50,000
Electric System Subordinated Revenue Bonds	May 1, 2033	1.75% to 1.95% b	Series 1	250,000	250,000
	May 1, 2033	1.55% to 1.70% b	Series 2	250,000	250,000
	May 1, 2033	1.50% to 1.70% b	Series 3	200,000	200,000
	April 1, 2025	1.49% to 1.55% b	Series 7	250,000	250,000
	April 1, 2009 to 2012	4.000% to 5.250% a	Series 8	216,720	216,860
Total General and Subordinated Revenue Bonds				6,852,522	6,963,811
Commercial Paper Notes	January 7 to March 31, 2003	1.050% to 1.600% b	CP-1	100,000	100,000
Debentures	March 15, 2023	8.200% a		270,000	270,000
NYSERDA Financing Notes					
Pollution Control Revenue Bonds	March 1, 2016	5.150% a	1985 A,B	108,020	108,020
Electric Facilities Revenue Bonds	September 1, 2019	7.150% a	1989 A,B	35,030	35,030
	June 1, 2020	7.150% a	1990 A	73,900	73,900
	December 1, 2020	7.150% a	1991 A	26,560	26,560
	February 1, 2022	7.150% a	1992 A,B	13,455	13,455
	August 1, 2022	6.900% a	1992 C,D	28,060	28,060
	November 1, 2023	5.300% a	1993 B	29,600	29,600
	October 1, 2024	5.300% a	1994 A	2,600	2,600
	August 1, 2025	5.300% a	1995 A	15,200	15,200
Total NYSERDA Financing Notes				332,425	332,425
Fair market value adjustment				(25,955)	-
Unamortized premium and deferred amortization				(14,155)	(24,020)
Total Long-term debt				7,514,837	7,642,216
Less Current Maturities				247,180	140,085
Long-Term Debt				7,267,657	7,502,131
Accumulated Deficit				(11,253)	(31,365)
Total Capitalization				$ 7,256,404	$ 7,470,766

a - Fixed rate
b - Variable rate (rate presented is at December 31, 2002)

The accompanying notes are an integral part of these financial statements.

Notes to Consolidated Financial Statements

Note 1. Basis of Presentation

The Long Island Power Authority was established as a corporate municipal instrumentality of the State of New York, constituting a political subdivision of the State, created by Chapter 517 of the Laws of 1986 (the “Act”). As such, it is a component unit of the State and is included in the State’s annual financial statements.

As used herein, the term “LILCO” refers to the Long Island Lighting Company, the publicly owned gas and electric utility company as it existed prior to the LIPA/LILCO Merger, as described in Note 2, and the term “LIPA” refers to that company as it exists after the LIPA/LILCO Merger, as a wholly-owned electric utility subsidiary company of the Long Island Power Authority (the “Authority”), doing business as LIPA. LIPA has 1 share of $1 par value common stock authorized, issued and outstanding, which is held by the Authority and is eliminated in consolidation.

The Authority and its subsidiaries are referred to collectively, as the “Company.”

Note 2. Merger/Change in Control/Nature of Operations

Merger/Change in Control
On May 28, 1998, LIPA Acquisition Corp., a wholly-owned subsidiary of the Authority, was merged with and into LILCO (the “Merger”) pursuant to an Agreement and Plan of Merger dated as of June 26, 1997, by and among LILCO, MarketSpan Corporation (formerly known as BL Holding Corp., and currently known as KeySpan Energy, “KeySpan”), and the Authority, (the “Merger Agreement”).

Pursuant to the Merger Agreement, immediately prior to the Merger, all of the assets and liabilities of LILCO related to the conduct of its gas distribution business and its non-nuclear electric generation business, and all common assets used by LILCO in the operation and management of its electric transmission and distribution business and its gas distribution business and/or its non-nuclear electric generation business (the “Transferred Assets”) were sold to KeySpan.

As a result of the Merger, the Authority became the holder of 1 share of LILCO’s common stock, representing 100% of the outstanding voting securities of LILCO. In addition, KeySpan issued promissory notes to LIPA of approximately $1.048 billion. At December 31, 2002, approximately $602.4 million of those notes remain outstanding. The interest rate and timing of principal and interest payments on the promissory notes from KeySpan are identical to the terms of certain LILCO indebtedness assumed by LIPA in the Merger. KeySpan is required to make principal and interest payments to LIPA thirty days prior to the corresponding payment due dates, and LIPA transfers those amounts to debt holders in accordance with the original debt repayment schedule.

The cash consideration required for the Merger was obtained by the Authority from the proceeds of the issuance and sale of its Electric System General Revenue Bonds, Series 1998A and Electric System Subordinated Revenue Bonds, Series 1 through Series 6. The proceeds from the sale of the bonds were transferred by the Authority to LIPA in exchange for a promissory note of approximately $4.949 billion. As a result of the Merger, there was a change in control of LILCO, which effectively resulted in the creation of a new reporting entity, LIPA.

The assets and liabilities of LILCO acquired by LIPA consist of: (i) LILCO’s electric transmission and distribution system; (ii) its net investment in Nine Mile Point Nuclear Power Station, Unit 2 (“NMP2”);

(iii) certain regulatory assets and liabilities associated with its electric business, (iv) allocated accounts receivable and other assets and liabilities; and (v) substantially all of its long-term debt.

Because of the manner in which LIPA's rates and charges are established by the Authority's Board of Trustees, the original net book value of the transmission and distribution and nuclear generation assets acquired in the Merger were considered to be the fair value of the assets. The excess of the acquisition costs over the fair value of the net assets acquired has been recorded as an intangible asset titled "acquisition adjustment" and is being amortized over a 35-year period. The acquisition adjustment arose principally through the elimination of LILCO's regulatory assets and liabilities, totaling approximately $6.3 billion, and net deferred federal income tax liability of approximately $2.4 billion. The balance of the acquisition adjustment is approximately $3.4 billion and $3.5 billion at December 31, 2002 and 2001, respectively.

Effective May 29, 1998, LIPA contracted with KeySpan to provide operations and management services for LIPA's transmission and distribution system through a management services agreement ("MSA"). Therefore, LIPA pays KeySpan directly for services and KeySpan, in turn, pays the salaries of its employees. LIPA has no paid employees. LIPA is charged a management fee by the Authority to oversee LIPA's operations. LIPA contracts for capacity from the fossil fired generating plants of KeySpan, formerly owned by LILCO, through a power supply agreement ("PSA"). Energy is purchased and sold and fuel is purchased by KeySpan on LIPA's behalf through an energy management agreement ("EMA") (collectively; the "Operating Agreements").

The electric transmission and distribution system is located in the New York Counties of Nassau and Suffolk (with certain limited exceptions) and a small portion of Queens County known as the Rockaways ("Service Area"). For the year ended December 31, 2002, LIPA received approximately 51% of its revenues from residential sales, 47% from sales to commercial and industrial customers, and the balance from sales to public authorities and municipalities.

Nature of operations

LIPA, as owner of the transmission and distribution system and as party to the Operating Agreements, conducts the electric business in the Service Area. The Authority is responsible for administering, monitoring and managing the performance by all parties to the Operating Agreements.

The Authority and LIPA are also parties to an Administrative Services Agreement, which describes the terms and conditions under which the Authority provides personnel, personnel-related services and other services necessary for LIPA to provide electric service in the Service Area.

As compensation to the Authority for the services described above, the Authority charges LIPA a monthly management fee equal to the costs incurred by the Authority in order to perform its obligations under the agreements described above.

Note 3. Restatement

In late 2002, the Authority determined that certain revenue information being provided to it by KeySpan was in error. Revenue for the year ended 2001 was overstated by approximately $11.6 million, and revenue for the years 2000, 1999 and 1998 was understated by a total of approximately $9.7 million. As a result, electric revenue for 2001, in the accompanying financial statements, has been reduced by $11.6 million. The Authority's tariffs include a fuel cost deferral mechanism based upon revenue; and accordingly, the amount of the deferral was also reduced. As a result, fuel and purchased power expense recognition increased approximately $630,000. Additionally, as the Authority recognizes payments-in-lieu-of-taxes ("PILOTs") expense based in part on revenue recognition, the decrease in revenue caused a decrease of approximately $300,000 in the applicable PILOT expense. Accumulated deficit at January 1, 2001 was reduced by approximately $9.7 million to reflect the impact of 1998 through 2000 understated revenues. The financial information for 2001 included in the financial statements gives effect to the restatement.

A summary of the effects of the restatement on the Authority's consolidated financial statements for the year ended December 31, 2001 is as follows:

Restatement summary

(in thousands)	Previously reported	Restated
Electric revenue	$ 2,367,900	$ 2,356,351
Total operating expenses	2,069,502	2,069,796
Excess of operating revenues over expenses	298,398	286,555
Excess of operating revenues over expenses before interest charges and (credits)	370,447	358,604
Excess of revenues over expenses	$ 32,391	$ 20,548

Note 4. Summary of Significant Accounting Policies

General

The Company complies with all applicable pronouncements of the Governmental Accounting Standards Board ("GASB"). In accordance with GASB Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting," the Company complies with all authoritative pronouncements applicable to non-governmental entities (i.e., Financial Accounting Standards Board ("FASB") statements) that do not conflict with GASB pronouncements.

Principles of Consolidation

The consolidated financial statements include the accounts of the Authority and its subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

Accounting for the Effects of Rate Regulation

The Company is subject to the provisions of Statement of Financial Accounting Standards ("SFAS") No. 71, "Accounting for the Effects of Certain Types of Regulation" ("SFAS No. 71"). This statement recognizes the economic ability of regulators, through the ratemaking process, to create future economic benefits and obligations affecting rate-regulated companies. Accordingly, the Company 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 SFAS No. 71, it must continue to meet the following three criteria: (1) the enterprise's rates for regulated services provided to its customers must be established by an independent third-party regulator or its own governing board empowered by a statute to establish rates that bind customers; (2) the regulated rates must be designed to recover the specific enterprise's costs of providing the regulated services; and (3) in view of the demand for the regulated services and the level of competition, it is reasonable to assume that rates set at levels that will recover the enterprise's costs can be charged to and collected from customers.

Based upon the Company'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 Company believes that SFAS No. 71 continues to apply.

If the Company had been unable to continue to apply the provisions of SFAS No. 71, at December 31, 2002, the Company estimates that approximately $693 million of regulatory assets would be considered for write-off, and the acquisition adjustment, totaling approximately $3.4 billion would be considered for impairment.

Utility Plant and Property and Equipment
Utility plant was stated at fair value at the date of the Merger. Additions to and replacements of utility plant are capitalized at original cost, which includes material, labor, indirect costs associated with an addition or replacement, plus an allowance for funds used during construction. The cost of renewals and betterments relating to units of property is added to utility plant. The cost of property replaced, retired or otherwise disposed of is deducted from utility plant and, generally, together with dismantling costs less any salvage, is charged to accumulated depreciation. The cost of repairs and minor renewals is charged to maintenance expense. Mass properties (such as poles, wire and meters) are accounted for on an average unit cost basis by year of installation.

Property and equipment represents leasehold improvements, office equipment and furniture and fixtures of the Authority.

Cash and Cash Equivalents and Investments
Funds held by the Authority are administered in accordance with the Authority's investment guidelines pursuant to Section 2925 of the New York State Public Authorities Law. These guidelines comply with the New York State Comptroller's investment guidelines for public authorities. Certain investments and cash and cash equivalents have been designated by the Authority's Board of Trustees to be used for specific purposes, including rate stabilization, debt service, capital expenditures, the issuance of credits in accordance with the Shoreham Settlement Agreement, and Clean Energy initiatives. Investments are reported at amortized cost, which approximates fair market value.

Fuel Inventory
Fuel inventory represents the value of low sulfur and internal combustion fuels that LIPA had on hand at each year-end in order to meet the demand requirements of these generating stations. Fuel inventory is valued using the weighted average cost method.

Material and Supplies Inventory
During the year ended December 31, 2001, Constellation Nuclear LLC purchased 82% of the Nine Mile Point 2 ("NMP2") plant (discussed in further detail in Note 8). Coincident with the sale, LIPA was, in accordance with the terms of existing co-tenant agreements with the selling parties, required to purchase its 18% ownership interests in the materials and supplies inventory supporting the operations of NMP2.

Promissory Note Receivable—Niagara Mohawk Power Corporation
In order to facilitate the sale of NMP2, LIPA sold to Niagara Mohawk Power Corporation certain transmission assets located at the site of NMP2 in exchange for a promissory note totaling approximately $2.8 million at December 31, 2002 and 2001, payable on the fifth anniversary of the sale with interest accruing at 9.5% compounded annually.

Deferred Charges
Deferred charges represent primarily the unamortized balance of costs incurred to issue long-term debt. Such amounts are amortized to interest expense on a straight-line basis over the life of the debt issuance to which they are related.

Shoreham Settlement
In January 2000, the Authority reached an agreement with Suffolk County, Town of Brookhaven, Shoreham-Wading River Central School District, Wading River Fire District and Shoreham-Wading River Library District (which was succeeded by the North Shore Library District) (collectively, the "Suffolk Taxing Jurisdictions") and Nassau County regarding the over assessment of the Shoreham Nuclear Power Station. Under the terms of the agreement, the Authority is required to issue $457.5 million of rebates and credits to customers over a five-year period, which began May 29, 1998. In order to fund such rebates and credits, the Authority used a portion of the proceeds from the issuance in May 1998 of its Series 1998A Electric System General Revenue Bonds and issued approximately $325 million of Electric System General Revenue Bonds, Series 2000A in May 2000. Beginning in June 2003, LIPA's Suffolk County customers' bills will include a surcharge (the "Suffolk Surcharge") to be collected over the succeeding approximate 25 year period to repay the Authority for debt service on the bonds issued by the Authority to fund the Settlement, as well as, to reimburse the Authority for investment earnings the Authority would have otherwise received on the funds advanced for the payment of credits to LIPA's customers.

As future rates will be established at a level sufficient to recover all such costs identified above, LIPA recorded a regulatory asset in accordance with SFAS No. 71. The balance of the Shoreham settlement regulatory asset at December 31, 2002 and 2001 was approximately $544 million and $425 million, respectively. The balance represents costs recorded from 1998 through 2002 including rebates and credits issued to customers, costs of administering the program and debt service costs on the Bonds identified above.

In addition to the items described above, other costs related to the Settlement were incurred, but as future rates will not be established at levels to recover such costs, they fail to meet the capitalization criteria of SFAS No. 71. These costs include $25 million contributed to Nassau County to fund the Clean Energy initiative, as well as the $50 per meter rebate issued to Non-Suffolk County customers, which totaled approximately $25 million.

Fuel and purchased power costs recoverable

LIPA's tariff includes a fuel recovery mechanism – the Fuel and Purchased Power Cost Adjustment ("FPPCA") – whereby rates may be adjusted to reflect significant changes in the cost of fuel, purchased power and related costs. The FPPCA applies to all service classifications and was designed to ensure that LIPA would recover from or return to customers any fuel and purchased power costs that fall outside an established base fuel and purchased power costs tolerance band. The tolerance band was designed to increase in 1% increments annually until such time as fuel and purchased power costs increase in excess of five percent cumulatively over the original base fuel and purchased power cost, as they did for the year ended December 31, 2000. The FPPCA is designed to recover, from that year forward, all costs in excess of the original base cost.

In February 2001, the Authority announced that in 2000 the Authority's costs for fuel and purchased power exceeded the amount charged to customers through base rates (excess fuel costs) by approximately $307 million. On March 1, 2001, the Trustees approved a waiver of the FPPCA that limited cost recovery to approximately $125.6 million of the additional amount through a fuel and purchased power surcharge equaling approximately 5.8 percent of base revenue for the 12-month period beginning on March 7, 2001. At December 31, 2001, approximately $22.8 million of that balance remained outstanding. That remaining balance was fully recovered through charges to customers' bills through March 6, 2002.

In February 2002, the Authority announced that in 2001 costs for fuel and purchased power exceeded base fuel costs by approximately $206.6 million. On February 28, 2002, the Trustees approved a waiver of the FPPCA that would limit cost recovery to approximately $124.5 million of the additional amount through a fuel and purchased power surcharge of approximately 5.8 percent of base revenue for the 12 month period beginning on March 7, 2002. As a result, the Authority has charged to expense, as of December 31, 2001, approximately $82.1 million of the excess fuel and purchased power costs. At December 31, 2002, approximately $19.2 remained outstanding, which was subsequently collected through charges to customer bills through March 6, 2003.

In February 2003, the Authority announced that in 2002 costs for fuel and purchased power exceeded base fuel costs by approximately $253.8 million, of which approximately $129.2 million was deferred for future recovery, and the remaining $124.6 million was charged to fuel and purchased power expense. Also in February, the Trustees approved a modification to the FPPCA mechanism, more fully discussed below, which provides recovery of the $129.2 million deferral over a 10-month period that began in March 2003.

Modification to the FPPCA mechanism

In February 2003, LIPA's Board of Trustees adopted a proposal to change the method in which the Authority collects excess fuel costs from its customers. The modification, when fully implemented in 2004, will permit the Authority to collect its excess fuel costs in the year incurred (as opposed to on a deferral basis), in amounts sufficient to generate revenues in excess of expenses of $20 million on an annual basis. The modification will be implemented over a two-year transition period (2003 – 2004) as follows:

- With respect to 2003 excess fuel costs: (i) $75 million will be collected in 2003 between March and December; (ii) $70 million will be deferred and collected in 2004; and (iii) an additional amount sufficient to generate 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 in January 1, 2004.

- With respect to 2004 and subsequent years' excess fuel costs, collections of these amounts will be on a current year basis (with the recovery factor adjusted throughout the year as necessary) in amounts sufficient to generate excess revenue over expenses of $20 million. For the years ending 2003 and beyond, excess fuel costs not deferred will be charged to expense, as the Authority would not seek recovery of such amounts under this modification.

Capitalized Lease Obligations
During the summer of 2002, LIPA entered into six Purchase Power Agreements ("PPA's") for ten 44.4 MW generating units. Four of the PPA's, incorporating seven of the units, qualify as capital leases under SFAS No. 13, "Accounting for Leases". Included in both Utility Plant and Capital Lease Obligations is approximately $600 million, representing the unamortized net present value of the minimum lease payments under the PPA's that qualified for capitalization.

As permitted under SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation," LIPA recognizes through Fuel and Purchased Power an amount equal to the rental expense of the capitalized leases discussed above, as allowed through the ratemaking process. The value of the asset and the obligation are reduced each month so that the balance sheet properly reflects the remaining value of the obligation at each month end.

Acquisition Adjustment
The acquisition adjustment represents the difference between the purchase price paid and the net assets acquired from LILCO and is being amortized and recovered through rates on a straight line basis using a 35-year life.

Fair Values of Financial Instruments
The Company's financial instruments approximate their fair market value at December 31, 2002 and 2001. The fair values of the Company's long-term debt are based on quoted market prices.

Deferred Credits
Deferred credits represent amounts received by the Authority, the final disposition of which remains undetermined. Accordingly, the Authority has deferred the recognition of income until such determination is reached. Certain of these amounts may be returned to customers, the NYISO, or KeySpan. It is the Authority's policy to accrue carrying charges to the benefit of the eventual payee on all such amounts deferred at the Authority's average cost of money.

Claims and Damages
Losses arising from claims against LIPA, including workers' compensation claims, property damage, and general liability claims are partially self-insured. Reserves for these claims and damages are based on, among other things, experience and expected loss. Storm losses are self-insured by LIPA. In certain instances, significant portions of extraordinary storm losses may be recoverable from the Federal Emergency Management Agency.

Revenues
Revenues are comprised of cycle billings rendered to customers, based on meter reads, and the accrual of electric revenues for services rendered to customers not billed at month-end.

Depreciation
The provisions for depreciation for utility plant result from the application of straight-line rates by groups of depreciable properties in service. The rates are determined by age-life studies performed on depreciable properties.

Leasehold improvements are being amortized over the lesser of the life of the assets or the term of the lease, using the straight-line method. Property and equipment is being depreciated over its estimated useful life using the straight-line method.

Payments-in-lieu-of-taxes
The Company is required to make payments-in-lieu-of-taxes ("PILOTS") for all operating taxes previously paid by LILCO, including gross income, gross earnings, property, Metropolitan Transportation Authority and certain taxes related to fuels used in utility operations. PILOTS also include payments to municipalities and school districts in which the defunct Shoreham power plant is located. Shoreham related PILOTS paid in the first year following the Company's acquisition of Shoreham, which occurred on February 29, 1992, were equal to the taxes and assessments which would have been paid had Shoreham not been transferred to the Company. In each succeeding year through 2001, Shoreham related PILOTS have been reduced by ten percent of the first year's required payment.

In 2002, the Company made its final payment with respect to the Shoreham property and has satisfied all PILOT obligation payments related thereto.

Allowance for Borrowed Funds Used During Construction
The allowance for funds used during construction ("AFC") is the net cost of borrowed funds used for construction purposes. AFC is not an item of current cash income. AFC is computed monthly on a portion of construction work in progress.

Income Taxes
The Authority is a political subdivision of the State of New York and, therefore, the Authority and its subsidiaries are exempt from Federal, state and local income taxes.

Derivative Instruments
The Authority uses financial derivative instruments to manage the impact of interest rate, energy price and fuel cost changes on its customers, earnings and cash flows. Effective January 1, 2001, the Authority adopted SFAS No. 133—"Accounting for Derivative Instruments and Hedging Activities ("SFAS No. 133"), as amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities" to the extent appropriate under Governmental Accounting Standards.

These standards require that an entity recognize the fair value of all derivative instruments as either assets or liabilities in the balance sheet with the offsetting gains or losses recognized in earnings. These standards permit the deferral of hedge gains and losses to Other Comprehensive Income, under specific hedge accounting provisions, until the hedged transaction is realized. However, the Authority is a governmental agency and, therefore, its financial statements are prepared in accordance with the provisions of the Governmental Accounting Standards Board, which do not provide for Other Comprehensive Income.

Moreover, as the Authority is subject to the provisions of SFAS No. 71, all such gains and losses are deferred until realized. Accordingly, the Authority's balance sheet reflects the inclusion of deferred losses in deferred charges, and the deferred gains in deferred credits.

Use of Estimates
The accompanying financial statements were prepared in conformity with accounting principles generally accepted in the United States of America which require 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.

Reclassifications
Certain prior period amounts have been reclassified in the financial statements to conform with the current period presentation.

Recent Accounting Pronouncements
Accounting for Asset Retirement Obligations
Effective January 1, 2003, the Authority adopted SFAS No. 143, "Accounting for Asset Retirement Obligations ("SFAS No. 143"). SFAS No. 143 requires an entity to record the fair value of legal obligations associated with the retirement of long-lived assets as a capitalized asset and as an asset-retirement obligation. The recognition of the depreciation of such asset and the accretion of interest on such liability will be charged to expense over the life of the assets. The Authority is currently in the process of completing its analysis of SFAS No. 143 and has concluded, on a preliminary basis, that the impact on future earnings will not be significant.

Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments
During 2002, the Authority adopted GASB Statement No. 34, "Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments," (GASB 34) as amended by GASB No. 37, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus, and GASB No. 38, "Certain Financial Statement Note Disclosures." The Authority follows "business type" activity requirements of GASB 34.

Accounting for the Impairment or Disposal of Long-Lived Assets
In 2002, the Authority adopted the provisions of SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." This statement supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of." This statement requires that long-lived assets be measured at the lower of book value or fair value less cost to sell. Adoption of SFAS No. 144 did not have a material adverse effect on the Company's financial position, cash flows or results of operations.

Note 5. Risk Management

The Authority is routinely exposed to commodity and interest rate risk. In order to mitigate such exposure, the Authority, in 2002, formed an Executive Risk Management Committee. This committee established guidelines, one of which was to limit the Authority's exposure to credit risk in the event of non-performance by a counterparty, the Authority only enters into derivative transactions with counterparties that have a credit rating of "investment grade" or better.

Fuel and purchased power transactions: The Company uses derivative financial instruments to protect its customers from market price fluctuations for the purchase of fuel oil, natural gas, or electricity. These instruments are recorded at their market value and any unrealized gains and losses are recognized in current period results, as a component of fuel and purchased power. At December 31, 2002, the Authority recognized an unrealized gain on its fuel derivatives of approximately $40 million. At December 31, 2001, the Authority recognized an unrealized loss on these instruments of approximately $8 million. Despite inclusion of these amounts in current period earnings, these unrealized gains and losses are not includable in the FPPCA calculation until realized.

Fuel Derivative Transactions

(dollars in thousands, except strike price)

Type of Contract		Duration	Volume Per month	Floor $	Ceiling $	Strike Price	Fair Value
Oil Contracts	*(volumes in barrels)*						
Options							
Put	Short	Dec 02 - Dec 03	50,000-100,000			$16.50- $17.70	$ (797)
Put	Long	Jan 03 - Dec 03	50,000			$ 18.00	313
Call	Long	Dec-02	50,000			$ 19.50	362
Collar		Dec 02 - Dec 04	25,000 - 50,000	$ 13.00	$ 20.50		13,408
Swap		Dec 02 - Dec 03	200,000			$ 16.45 - $17.80	18,373
Gas Transactions	*(volumes in decatherms)*						
Put	Short	March-03	89,000 - 98,000			$3.20 - $3.50	358
Put	Long	March-03	300,000			Customized	(152)
Swap		April-03	95,000			$ 5.26	203
Market value							$ 32,068

Swaption: In October 2002, the Authority sold an option to UBS AG ("counterparty") to hedge the call feature of its 1998A 5.5% Electric System General Revenue Bonds maturing in 2029. In exchange for the option, the Authority received an upfront option premium totaling approximately $82 million. In addition, various administrative fees totaling approximately $2.8 million were paid by the counterparty and the counterparty agreed to pay closing costs of up to $21.6 million associated with the variable rate debt that the Authority will issue on or near the effective date of the swap, June 1, 2003. As a result, the Authority recorded the swaption value approximately at $106.4 million, and recorded a receivable and prepaid expenses of approximately $21.6 million and $2.8 million, respectively.

As it is the call feature that is being hedged originally (from the date of sale to the date of exercise), and as it would be the Authority's position to protect the value of that option, the transaction during this period of time is to be considered a Fair Value Hedge, under SFAS No. 133 and is marked-to-market, accordingly.

At December 31, 2002, the Authority recorded an unrealized loss totaling approximately $25.9 million on this leg of the swaption. Coincident with the loss recognition, the Authority marked-to-market the underlying security, which resulted in an unrealized gain of approximately $25.9 million, thereby neutralizing the effect on earnings.

Under the provisions of SFAS No. 71, Accounting for the Effects of Certain Types of Regulation ("SFAS No.71"), all such gains and losses are deferred until realized. Accordingly, the Authority's balance sheet reflects the inclusion of deferred losses in deferred charges, and deferred gains in deferred credits.

On February 3, 2003, the UBS AG exercised its option and paid to the Authority the $21.6 million of closing costs, referred to above. As a result, the Authority will issue variable rate debt in late May 2003 sufficient to redeem its approximately $587 million, Series 1998A, 5.50% Electric System General Revenue Bonds maturing in 2029. Effective with the issuance of the variable rate debt, the Authority will have changed the interest charges on the underlying securities from floating to fixed, which will classify this leg of the swaption as a cash flow hedge under SFAS No. 133. The Authority will continue to mark-to-market the value of this leg of the swaption, and defer any gains or losses until realized. This deferral treatment under SFAS No. 71 effectively eliminates any derivative gains or losses from earnings until the debt matures.

Interest rate transactions: The Authority is party to an interest rate swap agreement in connection with its $116 million Electric System General Revenue Bonds Series 2001 L. Under this swap, the Authority has effectively converted the terms of the underlying debt obligation from fixed to variable, and has been designated a fair value hedge in accordance with SFAS No. 133. Under the terms of this agreement, the Authority pays a variable rate equivalent to the Bond Market Association ("BMA") Index (1.52% and 1.61% at December 31, 2002, and 2001, respectively) and receives fixed rate payments at 5.1875%. The swap agreement contained an interest rate cap of 18% through May 25, 2002. After May 25, 2002 no interest rate cap exists. The agreement allows for the counter party to terminate the agreement each May 1 and November 1, commencing on May 1, 2011. The term of the swap is equal to the maturity of the Series L Bonds, May 1, 2033. In accordance with SFAS No. 133, the Authority marked-to-market this swap transaction at December 31, 2002, and recorded an unrealized gain of approximately $10.4 million. However, as the Authority is subject to the provisions of SFAS No.71, this gain has been deferred, and will be charged to expense when realized.

The Authority is party to interest rate swap agreements in connection with its $250 million Electric System Subordinated Revenue Bonds Series 7 Bonds. The Authority has two separate agreements having notional amounts of $150 million and $100 million, respectively. These agreements effectively convert the underlying debt obligation from floating to fixed (4.2%). The interest rate swap agreements are co-terminus with the Series 7 Bonds, with optional earlier termination at the Authority's discretion. In accordance with SFAS No. 133, the Authority marked-to-market these transactions at December 31, 2002, and recorded an unrealized loss of approximately $24.1 million. However, as the Authority is subject to the provisions of SFAS No.71, this loss has been deferred, and will be charged to expense when realized.

Note 6. Rate Matters

Under current New York law, the Authority is empowered to set rates for electric service in the Service Area without the approval of the PSC or any other state regulatory body. However, the Authority has agreed, in connection with the approval of the Merger by the New York State Public Authorities Control Board (the "PACB"), that it will not impose any permanent increase, nor extend or re-establish any portion of a temporary rate increase, in average customer rates over a 12 month period in excess of 2.5% without approval of the PSC, following a full evidentiary hearing. Another of the PACB conditions requires that the Authority reduce average rates within LIPA's service area by no less than 14% over a ten year period commencing on the date when LIPA began providing electric service, when measured against LILCO's base rates in effect on July 16, 1997 (excluding the impact of the Shoreham tax settlement, but adjusted to reflect emergency conditions and extraordinary unforeseeable events.).

The Act requires that any bond resolution of the Authority contain a covenant that it will at all times maintain rates, fees or charges sufficient to pay the costs of operation and maintenance of facilities owned or operated by the Company; PILOTS; renewals, replacements and capital additions; the principal of and interest on any obligations issued pursuant to such resolution as the same become due and payable, and to establish or maintain any reserves or other funds or accounts required or established by or pursuant to the terms of such resolution.

LIPA's tariff includes the FPPCA to allow LIPA to adjust customers' bills to reflect significant changes in the cost of fuel and purchased power and related costs.

LIPA's rates are largely based on LILCO's pre-Merger rate design to avoid customer confusion and facilitate an efficient transition from LILCO billing to LIPA billing. In addition, LIPA's tariff includes the FPPCA, a PILOTS recovery rider, and a rider providing for the recovery of costs associated with the Shoreham tax settlement (credits and rebates).

The Act requires LIPA to make PILOTS for certain New York State and local revenue taxes that would otherwise have been imposed on LILCO. The PILOTS recovery rider allows for LIPA's rate adjustments to accommodate the PILOTS.

For a discussion on the Shoreham tax settlement and Suffolk County matters see Note 14.

Note 7. Utility Plant and Property and Equipment

Net utility plant in service at December 31, 2002 and 2001, is as follows:

Asset classification *(in thousands)*	**December 31, 2002**	**2001**
Generation - nuclear	$ 666,007	$ 663,492
Transmission and distribution	1,961,080	1,705,112
Common	13,519	15,005
Construction work in progress	99,772	140,939
Nuclear fuel in process and in reactor	35,848	27,579
Office equipment, furniture & leasehold improvements	2,513	2,282
	2,778,739	2,554,409
Generation assets under capital lease	612,415	-
Less - Accumulated depreciation and amortization	349,455	255,020
Total Net Utility Plant	$ 3,041,699	$ 2,299,389

Changes in Capital Assets *(in thousands)*	**December 31, 2002**	**2001**
Gross utility plant, beginning balance	$ 2,413,470	$ 2,261,802
Add: Acquisitions	287,327	164,723
Less: Dispositions	21,830	13,055
Gross utility plant, ending balance	2,678,967	2,413,470
Add: Generation assets under capital lease	612,415	-
Less: Accumulated depreciation	349,455	255,020
Add: Construction work in progress	99,772	140,939
Net utility plant, ending balance	$ 3,041,699	$ 2,299,389

Note 8. Nine Mile Point Nuclear Power Station, Unit 2 ("NMP2")

LIPA has an undivided 18% interest in Nine Mile Point 2 Nuclear Power Station ("NMP2"), located in Scriba, New York which, until November 6, 2001, was operated by Niagara Mohawk Power Corporation ("NMPC"). On November 7, 2001, Constellation Nuclear LLC ("Constellation") purchased 100% of the Nine-Mile Point 1 Nuclear Power Station, and 82% of NMP2, with LIPA retaining its 18% interest in NMP2. Prior to the sale, the cotenants of NMP2 and their respective percentage ownership were as follows: LIPA (18%), NMPC (41%), New York State Electric & Gas Corporation (18%), Rochester Gas Electric Corporation (14%) and Central Hudson Gas & Electric Corporation (9%).

LIPA's share of the rated capability of NMP2 is approximately 205 megawatts ("MW"). LIPA's net utility plant investment, excluding nuclear fuel, was approximately $591 million and $613 million at December 31, 2002 and 2001, respectively. Generation from NMP2 and operating expenses incurred by

NMP2 are shared by LIPA at its 18% ownership interest. LIPA is required to provide its share of financing for any capital additions to NMP2. Nuclear fuel costs associated with NMP2 are being amortized on the basis of the quantity of heat produced for the generation of electricity.

LIPA has entered into an amended and restated operating agreement for NMP2 with Constellation, which provides for a management committee comprised of one representative from each co-tenant. Constellation controls the operating and maintenance decisions of NMP2 in its role as operator. LIPA and Constellation have joint approval rights for the annual business plan, the annual budget and material changes to the budget. In addition to its involvement through the management committee, LIPA employs an on-site nuclear oversight consultant to provide additional support to protect LIPA's interests.

Nuclear Plant Decommissioning
LIPA is making provisions for decommissioning costs for NMP2 based on a site-specific study performed in 1995. LIPA's share of the total decommissioning costs for both the contaminated and non-contaminated portions is estimated to be approximately $145 million in 1996 dollars. LIPA maintains a trust fund for its share of the decommissioning costs of the contaminated portion of NMP2, which at December 31, 2002, and 2001, had an approximate value of $37.5 million, and $33.1 million, respectively. LIPA established a separate decommissioning fund for its share of the non-contaminated portion of NMP2, which had a value at December 31, 2002, and 2001 totaling approximately $5.8 million and $4.6 million, respectively. Through continued deposits and investment returns being maintained within these trusts, the Company believes that the value of these trusts will, in 2026, be sufficient to meet the Company's decommissioning obligations.

NMP2 Radioactive Waste
Constellation has contracted with the U.S. Department of Energy ("DOE") for disposal of high-level radioactive waste ("spent fuel") from NMP2. Despite a court order reaffirming the DOE's obligation to accept spent nuclear fuel by January 31, 1998, the DOE has forecasted the start of operations of its high-level radioactive waste repository to be no earlier than 2010. LIPA has been advised by Constellation that the NMP2 spent fuel storage pool has a capacity for spent fuel that is adequate until 2012. If additional DOE schedule slippage should occur, the storage for NMP2 spent fuel, either at the plant or some alternative location, may be required. LIPA reimburses Constellation for its 18% share of the cost under the contract at a rate of $1.00 per megawatt hour of net generation, less a factor to account for transmission line losses. Such costs are included in the cost of fuel and purchased power.

Nuclear Plant Insurance
Constellation procures public liability and property insurance for NMP2 and LIPA reimburses Constellation for its 18% share of those costs.

In November 2002, the Terrorism Risk Insurance Act ("TRIA") of 2002 was enacted by the federal government. Under the TRIA, property and casualty insurance companies are required to offer insurance for losses resulting from Certified acts of terrorism. The United States Secretary of State and Attorney General determine certified acts of terrorism. The nuclear property and accidental outage insurance programs, as discussed later in this section provide coverage for Certified acts of terrorism.

Losses resulting from non-certified acts of terrorism are covered as a common occurrence, meaning that if non-certified terrorist acts occur against one or more commercial nuclear power plants insured by the insurer's of NMP2, within a 12-month period, such acts would be treated as one event and the owners of the currently licensed nuclear power plants in the United States would share one full limit of liability (currently $3.24 billion).

The Price-Anderson Amendments Act mandates that nuclear power generators secure financial protection in the event of a nuclear accident. This protection must consist of two levels. The primary level provides liability insurance coverage of $300 million (the maximum amount available) in the event of a nuclear accident. If claims exceed that amount, a second level of protection is provided through a retrospective assessment of all licensed operating reactors. Currently, this “secondary financial protection” subjects each of the 103 presently licensed nuclear reactors in the United States to a retrospective assessment of up to $88.1 million for each nuclear incident, payable at a rate not to exceed $10 million per year. LIPA’s interest in NMP2 could expose it to a maximum potential loss of $15.9 million, per incident, through assessments of up to $1.8 million per year in the event of a serious nuclear accident at NMP2 or another licensed U.S. commercial nuclear reactor.

Constellation participates in the American Nuclear Insurers Master Worker Program that provides coverage for worker tort claims filed for radiation injuries. Effective January 1, 1998, this program was modified to provide coverage to all workers whose nuclear-related employment began on or after the commencement date of reactor operations. Waiving the right to make additional claims under the old policy was a condition for coverage under the new policy. The old and new policies are described below:

> Nuclear worker claims reported on or after January 1, 1998 are covered by a new insurance policy with an annual industry aggregate limit of $200 million for radiation injury claims against all those insured by this policy.
>
> All nuclear worker claims reported prior to January 1, 1998 are still covered by the old policy. Insureds under the old policies, with no current operations, are not required to purchase the new policy described above, and may still make claims against the old policies through 2007. If radiation injury claims under these old policies exceed the policy reserves, all policyholders could be retroactively assessed, with LIPA’s share being up to $300,000.

Constellation has also procured $500 million of primary nuclear property insurance and approximately $2.25 billion of additional protection (including decontamination costs) in excess of the primary layer through the Nuclear Electric Insurance Limited (“NEIL”). Each member of NEIL, including LIPA, is also subject to retrospective premium adjustments in the event losses exceed accumulated reserves. For its share of NMP2, LIPA could be assessed up to approximately $2.7 million per loss.

LIPA has obtained insurance coverage from NEIL for the expense incurred in purchasing replacement power during prolonged accidental outages. Under this program, coverage would commence twelve weeks after any accidental outage, with reimbursement from NEIL at the rate of approximately $553,000 per week for the purchase of replacement power with a maximum limit of $77.4 million over a three-year period.

Note 9. Investments and Cash and Cash Equivalents

Funds of the Authority are administered in accordance with the Authority's investment guidelines pursuant to Section 2925 of the New York State Public Authorities Law. The Authority's investments may also be required to conform to additional restrictions contained in financing documents. The Authority's guidelines and any additional restrictions as required by financing documents comply with the New York State Comptroller's investment guidelines for public authorities.

All investments of the Authority are held by designated custodians in the name of the Authority. Investments are reported at amortized cost, which approximates fair market value at December 31, 2002 and 2001. Investments with maturities when purchased of less than 90 days are classified as cash and cash equivalents. Certain cash and cash equivalents and investments have been designated by the Authority's Board of Trustees to be used for specific purposes such as rate stabilization, capital additions, debt repayment, the funding of credits in accordance with the Shoreham Settlement Agreement, and Clean Energy initiatives.

The bank balances were $1.7 million and $1.6 million at December 31, 2002 and 2001, respectively. Cash deposits at banks were collateralized for amounts above the Federal Deposit Insurance Corporation ("FDIC") limits with securities held by the custodian banks in the Authority's name. The Authority is required to maintain compensating balances of approximately $1 million.

Investments and cash and cash equivalents of the Authority at December 31, 2002 and 2001 are detailed below:

Investments and cash and cash equivalents	**December 31,**	
(in thousands)	**2002**	**2001**
Commercial Paper	$ 397,435	$ 294,288
U.S. Government/Agencies	135,050	88,435
Money market mutual funds	31,803	196,850
Repurchase Agreement	24,310	102,473
Master Notes	13,277	5,952
Corporate Bonds	6,788	-
Demand deposits	1,663	371
Total investments and cash and cash equivalents	$ 610,326	$ 688,369

Note 10. Debt

The Authority

The Authority financed the cost of the Merger and the refinancing of certain of LILCO's outstanding debt by the issuance of approximately $6.73 billion aggregate principal amount of Electric System General Revenue Bonds and Electric System Subordinated Revenue Bonds (collectively, the "Bonds"). In conjunction with the issuance of the Bonds, LIPA and the Authority entered into a Financing Agreement, whereby LIPA transferred to the Authority all of its right, title and interest in and to the revenues generated from the operation of the transmission and distribution system, including the right to collect and receive the same. In exchange for the transfer of these rights to the Authority, LIPA received the proceeds of the Bonds evidenced by a Promissory Note.

The Bonds are secured by a Trust Estate as pledged under the Authority's Bond Resolution (the "Resolution"). The Trust Estate consists principally of the revenues generated by the operation of LIPA's transmission and distribution system and has been pledged by LIPA to the Authority.

Electric System General Revenue Bonds

Series 2001A
During the year ended December 31, 2001, the Authority issued Series 2001A Electric System General Revenue Bonds totaling $300 million. These Bonds were issued for various capital purposes and to pay costs of issuance. This Series is comprised of Serial Bonds with maturities beginning September 1, 2013 and continuing through 2021 and Term Bonds with maturities beginning September 1, 2025 and continuing through 2029. These Bonds pay interest at a fixed rate every March 1 and September 1.

Optional Redemption
These Bonds are subject to redemption prior to maturity, at the option of the Authority, on any date on and after September 1, 2011 in whole, or in part from time to time, and in any order of maturity selected by the Authority, at a redemption price of par plus accrued interest on such principal amount to the redemption date.

Sinking Fund
The Bonds that mature on September 1, 2025 (approximately $75.6 million) and September 1, 2027 (approximately $112 million) are also subject to redemption, in part, through mandatory sinking fund installments each September 1, 2022 through 2027 at 100% of the principal amount, plus accrued interest to the redemption date.

Series 2001 B through K
The Authority also issued Series 2001 B through K Electric System General Revenue Bonds totaling $500 million during the year ended December 31, 2001. The proceeds of this issuance were used to refund $500 million Electric System Subordinated Revenue Bonds, Series 5 and 6. Series 2001 B through K are comprised of Auction Rate Term Bonds with a maturity date of May 1, 2033. Each Series bears interest at an auction rate that the Auction Agent advises results from an auction conducted for each applicable auction period. The auction date and auction period for each Series as of December 31, 2002 is as follows:

Series	Auction Date	Auction Period	Interest payment Date
2001 B	Each Business day	Daily	First Business day of the succeeding month
2001 C	Each Tuesday	Seven day	Each Wednesday
2001 D	Each Tuesday	Seven day	Each Wednesday
2001 E	Each Thursday	Seven day	Each Friday
2001 F	Each fifth Monday	35 day	Each fifth Tuesday
2001 G	Each Wednesday	Seven day	Each Thursday
2001 H	Each fifth Wednesday	35 day	Each fifth Thursday
2001 I	Each fifth Tuesday	35 day	Each fifth Wednesday
2001 J	Each Thursday	Seven day	Each Friday
2001 K	Each Wednesday	Seven day	Each Thursday

Optional Redemption
Each Series of the Auction Rate Bonds are subject to optional redemption prior to maturity, by the Authority, in whole or in part, on any interest payment date immediately following an auction period, at a

redemption price equal to the principal amount plus accrued interest to the redemption date; provided, however, that in the event of a partial redemption of Auction Rate Bonds of a Series, the aggregate principal amount of Auction Rate Bonds of such Series which will remain outstanding shall be equal to or more than $10 million unless otherwise consented to by the broker-dealer which acts as the Auction Agent for such Series.

Sinking Fund
These Bonds are subject to redemption, in part, beginning on December 1, 2030 through May 1, 2033 from mandatory sinking fund installments.

Series 2001 L through P
Also during the year ended December 31, 2001, the Authority issued Electric System General Revenue Bonds, Series L through P totaling $316 million maturing on May 1, 2033. The proceeds of this issuance were used to refund $300 million of the Authority's Electric System Subordinated General Revenue Bonds consisting of Series 4 and a portion of Series 3, and to pay certain costs of issuance related to Series B through P.

Series M through P bear interest at an auction rate that the Auction Agent advises results from an auction conducted for each applicable auction period. The auction date and auction period for each Series as of December 31, 2002 is as follows:

Series	Auction Date	Auction Period	Interest payment Date
2001 M	Each Monday	Seven day	Each Tuesday
2001 N	Each Friday	Seven day	Each Monday
2001 O	Each fifth Monday	35 day	Each fifth Tuesday
2001 P	Each Thursday	Seven day	Each Friday

Series 2001 L are Fixed Rate Term Bonds that pay interest semiannually each May 1 and November 1.

Optional Redemption
Series L Bonds are subject to redemption prior to maturity, at the option of the Authority on any date on and after May 1, 2011 in whole or in part from time to time, and in any order of maturity selected by the Authority, at a redemption price of par plus accrued interest. Each Series of the M through P Auction Rate Bonds shall be subject to optional redemption by the Authority on any interest payment date immediately following an auction period, at a redemption price equal to the principal amount, plus accrued interest to the redemption date; provided, however, that in the event of a partial redemption of Auction Rate Bonds of a Series, the aggregate principal amount of Auction Rate Bonds of such Series which will remain outstanding shall be equal to or more than $10 million unless otherwise consented to by the broker-dealer which acts as the Auction Agent for such Series.

Sinking Fund
These Bonds are subject to redemption, in part, beginning on May 1, 2030 through May 1, 2033 from mandatory sinking fund installments.

Commercial Paper Notes

The Authority's Supplemental Bond Resolution authorizes the issuance of Commercial Paper Notes, Series CP-1 ("Notes") up to a maximum amount of $300 million. The aggregate principal amount of the Notes outstanding at any time may not exceed $300 million. As of December 31, 2002 and 2001, the Authority had Notes outstanding totaling $100 million. In connection with the issuance of the Notes, the Authority has entered into a Letter of Credit and Reimbursement Agreement, expiring on May 23, 2003. The Authority is currently in negotiations with a syndicate of banks to ensure that a replacement LOC is in place coincident with the expiration of the current LOC. The Authority believes that it will be successful in these negotiations and that a new LOC facility will be in place for a three year period beginning May 24, 2003. The Notes do not have maturity dates of longer than 270 days from their date of issuance and as Notes mature, the Authority continually replaces them with additional Notes. No Note can be issued with a maturity date after the expiration date of the Letter of Credit, and as the LOC expires in less than one year from the date of the statement of Financial Position, these Notes are classified as current.

Series 2000A

These Bonds were issued to fund certain rebates and credits in accordance with the Shoreham Settlement Agreement, as more fully discussed in Note 14. These Bonds are comprised of tax-exempt Capital Appreciation Bonds with maturities beginning in June 2005 and continuing each year through 2029 and are not subject to optional redemption, mandatory sinking fund redemptions or any other redemption prior to maturity. Several of these Series will be defeased, however, as part of the 2003 Plan of Finance, as more fully described in Note 15-Subsequent Events.

Series 1998A

This Series is comprised of Current Interest and Capital Appreciation Bonds. The Current Interest Bonds include: (i) tax exempt Serial Bonds with maturities that began in December 1999 and continue each year through December 2016; and (ii) tax exempt Term Bonds with maturities beginning in December 2018 and a final maturity in December 2029. The Capital Appreciation Bonds are tax exempt bonds with maturities beginning in December 2003 continuing each year through December 2028. The Current Interest Bonds pay interest at a fixed rate every June 1 and December 1. During the year ended December 31, 2002, the Authority retired at maturity, with cash from operations, its $18.6 million 5.25% and its $33.7 million 4.30% Serial Bonds. During the year ended December 31, 2001, the Authority retired at maturity, with cash from operations, its $28.9 million 4.25% and its $20.9 million 5.25% Serial Bonds.

Optional Redemption

The 5.0% Serial Bonds due on December 1, 2014 ($39.4 million) and the Serial and Term Bonds maturing on or after December 1, 2015 (except the Term Bonds maturing on December 1, 2029), which total $207 million and $1.4 billion, respectively, are subject to redemption prior to maturity, at the option of the Authority, at a price of 101% of the principal amounts on any date beginning on June 1, 2008 through May 31, 2009, or at 100.5% beginning on June 1, 2009, through May 31, 2010, or at 100% beginning June 1, 2010, through maturity, in whole, or in part from time to time, and in any order of maturity selected by the Authority. Interest accrued on such principal amount redeemed is added to the redemption price.

The Term Bonds maturing on December 1, 2029, ($587.2 million) are subject to redemption prior to maturity, at the option of LIPA, on any date on and after June 1, 2003, in whole, or in part from time to time, at a redemption price of 101% of the principal amounts, together with the interest accrued on such principal amount to the redemption date.

The Serial Bonds maturing through December 1, 2013, ($833.1 million) and the 5.25% Serial Bonds due on December 1, 2014, ($56.7 million) are not subject to redemption prior to maturity. In addition, the Capital Appreciation Bonds and the Taxable Term Bonds are not subject to redemption prior to maturity.

Sinking Fund
Certain Term Bonds are subject to redemption, in part, beginning on December 1, 2017 through December 1, 2029 at 100% of the principal amounts, plus accrued interest at the redemption date, from mandatory sinking fund installments which are required to be made in amounts sufficient to redeem such Bonds.

Certain of these Bonds will be defeased, however, as part of the 2003 Plan of Finance, as more fully described in Note 15-Subsequent Events.

Series 1998B
This Series is comprised of Serial Bonds with maturities that began in April 2000 and continue each year through April 2016 and Term Bonds maturing in April 2018. These Bonds pay a fixed rate of interest every April 1 and October 1.

During the year ended December 31, 2002 the Authority retired at maturity, with cash from operations, its $25.0 million, 4.0%, and its $62.8 million 5.0% Current Interest bonds. During 2001, the Authority retired at maturity, with cash from operations, its $44.9 million, 4.25%, and its $25.0 million 4.0% Current Interest bonds.

Optional Redemption
Securities maturing on and after April 1, 2009 ($483.5 million) are subject to redemption prior to maturity, at the option of the Authority, at a redemption price of 101% of the principal amount on any date beginning on April 1, 2008, through May 31, 2009, or at 100.5% beginning on April 1, 2009 through May 31, 2010, or at 100% beginning April 1, 2010, through maturity, in whole, or in part from time to time, and in any order of maturity selected by the Authority. Interest accrued on such principal amount redeemed is added to the redemption price.

Sinking Fund
The Term Bond that matures on April 1, 2018 is subject to redemption, in part, beginning on April 1, 2017 at 100% of the principal amount, plus accrued interest to the redemption date, from mandatory sinking fund installments which are required to be made in amounts sufficient to redeem such Bonds.

Certain of these Bonds will be defeased, however, as part of the 2003 Plan of Finance, as more fully described in Note 15-Subsequent Events.

Electric System Subordinated Revenue Bonds

Series 1 through 3
During the year ended December 31, 2001, the Authority remarketed or refinanced Series 1 through 6 as detailed below:

(in thousands)

	Outstanding at December 31, 2000	Remarketed	Refinancing Transactions		Outstanding at December 31, 2001
Series 1	$ 250,000	$ (250,000)			$ -
Series 2	250,000	(250,000)			-
Series 3	250,000	(200,000)	$ (50,000)		-
Series 4	250,000		(250,000)		-
Series 5	250,000			$ (250,000)	-
Series 6	250,000			(250,000)	-
Issued:	*Electric System General Revenue Bonds*				
Series 1A		125,000			125,000
Series 1B		125,000			125,000
Series 2A		125,000			125,000
Series 2B		100,000			100,000
Series 2C		25,000			25,000
Series 3A		100,000			100,000
Series 3B		100,000			100,000
Issued:	*Electric System General Revenue Bonds*				
Series 2001 L - P			316,000		316,000
Series 2001 B - K				500,000	500,000
	$ 1,500,000	$ -	$ 16,000	$ -	$ 1,516,000

*The Authority used $16 million to pay costs of issuance.

As a result of these transactions, the remaining outstanding Series consists of Series 1A through 3B. These Bonds are variable rate bonds payable from and secured by the Trust Estate subject to and subordinated to the Authority's Electric System General Revenue Bonds and are supported by letters of credit that expire on May 23, 2003. These Bonds are classified into various modes that determine the frequency that the interest rate is re-determined, the interest rate applied and the optional redemption features. Subseries 1A, 2A and 3A are currently Weekly Mode bonds, therefore, the applicable interest rate is re-determined on a weekly basis. Subseries 1B, 2B, 2C and 3B are currently Daily Mode, and as such, the interest rates are re-determined daily.

Provisions of the indenture allow for a change in interest rate modes, at the option of the Authority. In addition to the daily and weekly modes, the Authority also has the option to adopt a Term mode, (thereby changing the reset period e.g., from daily to monthly, semi-annually or annually), a Fixed mode, or a Commercial Paper Mode.

A debt refinancing charge of approximately $6.2 million resulted from these refundings/refinancings. In accordance with the provisions of GASB No. 23, the refinancing charge associated with this transaction has been deferred and shown in the Statement of Financial Position as Deferred amortization within long term debt and is being amortized, on a straight line basis, over the life of the new debt or the old debt, whichever is shorter.

Series 7

This Series is comprised of variable rate bonds in the Weekly Mode. Provisions of the indenture allow for a change of interest rate modes, at the option of the Authority. In addition to the daily, weekly and commercial paper modes, the Authority also has the option to adopt a Term mode, (thereby changing the reset period e.g., from daily to monthly, semi-annually or annually) or a Fixed term mode.

Principal and interest on these Bonds are secured by a financial guaranty insurance policy and the Authority has executed a Standby Bond Purchase Agreement to provide funds for the purchase of Series 7 Bonds tendered but not remarketed. The standby agreement expires in November 2008.

Optional and Mandatory Redemption

Series 7 Bonds are redeemable on their respective interest rate re-determination dates at the option of the Authority. These Bonds are redeemable at face value when they are in the Weekly, Daily or Commercial Paper mode. Term or Fixed rate mode bonds are redeemable at rates varying between 100% and 101% when the life of the mode is greater than four years. Term or Fixed Rate mode bonds are not redeemable if the life of the mode is less than four years.

Series 1A through 3B and Series 7 Bonds are also subject to mandatory redemptions from sinking funds such that they will be redeemed by their respective maturity dates. Sinking funds for Series 1A through 3B begin on December 1, 2030 and on Series 7 sinking funds begin April 1, 2019.

Series 8 (Subseries A-H)

This Series is comprised of Current Interest Bonds issued as follows:

This Series is Comprised of Subseries	Mandatory Purchase Date (April 1)	Maturity (April 1)	Principal Outstanding $(000)	Interest Rate to Mandatory Purchase Date
8A		2009	$ 23,360	5.25%
8A		2009	2,500	4.13%
8B		2009	17,160	4.30%
8B		2009	10,000	5.25%
8C	2003	2010	27,300	4.00%
8D	2004	2010	27,300	4.50%
8E	2005	2011	27,300	4.50%
8F	2006	2011	27,300	5.00%
8G	2007	2012	27,300	5.00%
8H	2008	2012	27,200	5.00%

Immediately prior to the mandatory purchase date, the Authority will determine to either purchase the Subseries or have such Subseries remarketed. Remarketed securities would then become due at the maturity date or such earlier date as determined by the remarketing. Additionally, the original interest rate on the debt issued will remain in effect until the mandatory purchase date, at which time the interest rate will change in accordance with market conditions at the time of remarketing if the Authority chooses to remarket. Principal, interest and purchase price on the mandatory purchase date are secured by a financial guaranty insurance policy.

During the year ended December 31, 2002, and 2001, the Authority remarketed its Subseries 8B Bonds and Subseries 8A Bonds, respectively. Subseries 8A and 8B bonds are in the Fixed Rate Mode, and pay interest on April 1 and October 1 of each year through its maturity date.

The Authority intends to remarket its Subseries 8C Bonds on the mandatory purchase date of April 1, 2003 and accordingly, such Bonds are not classified as current maturities of long-term debt.

No Subseries of Series 8 is subject to optional redemption or mandatory sinking fund redemption prior to its mandatory purchase date.

LIPA
The LILCO debt assumed by LIPA as part of the Merger, consisted of $1.186 billion of General and Refunding Bonds, ("G&R Bonds"), that were defeased by LIPA immediately upon the closing of the Merger, debentures totaling $2.27 billion, and tax exempt debt totaling approximately $915.7 million. As part of the Merger, KeySpan and LIPA executed Promissory Notes whereby KeySpan was obligated to LIPA for approximately $1.048 billion of the assumed debt (the "Promissory Notes"). KeySpan is required to pay LIPA principal and interest on the Promissory Notes 30 days in advance of the date amounts are due to bondholders. The balance of the Promissory Notes between KeySpan and LIPA totaled $602.4 million at December 31, 2002 and 2001.

The tax exempt debt assumed by LIPA were notes issued on behalf of LILCO by the New York State Research and Development Authority ("NYSERDA") to secure tax-exempt Industrial Development Revenue Bonds, Pollution Control Revenue Bonds ("PCRBs"), and Electric Facilities Revenue Bonds ("EFRBs") issued by NYSERDA.

Bond Defeasance/Refundings
A portion of the proceeds of the Authority's Electric System General Revenue Bonds and Subordinated Bonds (which include fixed and variable rate debt) were used in 1998 to refund all the G&R Bonds, certain Debentures and certain NYSERDA notes issued by LILCO that were assumed by LIPA as a result of the Merger. The purpose of these refundings was to achieve debt service savings.

General and Refunding Bonds
On May 29, 1998, LIPA refunded all the G&R Bonds totaling $1.186 billion by depositing $1.190 billion in an irrevocable escrow deposit account to be invested in the direct obligations of the United States of America. The maturing principal of and interest on these obligations were sufficient to pay the principal and interest on the G&R Bonds, which were defeased on June 29, 1998. At December 31, 2002, and 2001, approximately $1.130 billion of the G&R Bonds, outstanding are considered defeased.

The Authority will realize gross debt service savings from this refunding of approximately $588 million over the original life of the bonds. The refunding produced an economic gain (the present value of the debt service savings) of approximately $576 million.

Debentures
In March 2000, LIPA deposited approximately $58 million that it generated from operations, in an irrevocable escrow deposit account to be invested in direct obligations of the United States of America.

The Company has received certification from an independent verification agent that the maturing principal of and interest on these obligations will be sufficient to pay the principal and interest on the following debentures that LIPA assumed as part of the Merger, which includes the fair market value adjustment on the date of purchase (reflected at the Company's carrying value).

(in thousands)

Maturity	Interest Rate	Carrying Value
7/15/2001	6.250%	$ 8,460
3/15/2003	7.050%	5,890
3/01/2004	7.000%	2,999
6/01/2005	7.125%	14,307
11/01/2022	9.000%	26,532

As a result of this defeasance, LIPA realized a gain on the early extinguishment of debt totaling approximately $1.7 million.

In February 2003, the Authority called for redemption in March, its $270 million Long Island Lighting Company Debentures, 8.2% Series due 2023. Funding for this redemption, including interest to the date of redemption and call premium, totaling approximately $281 million was provided by KeySpan in accordance with the terms of a promissory note with LIPA.

NYSERDA Notes

During 1998, the Authority deposited $379 million in an irrevocable escrow deposit account to be invested in direct obligations of the United States of America. The maturing principal of, and interest on, such securities will be sufficient to pay the principal, interest and applicable call premium on the following issues of NYSERDA Notes: approximately $11.9 million Series 1985A, approximately $50 million Series 1989A, approximately $15 million Series 1989B, approximately $26 million Series 1990A, approximately $73 million Series 1991A, $50 million Series 1992A, approximately $36.5 million Series 1992B, $50 million Series 1992C and approximately $22 million Series 1992D, (collectively, the "Refunded NYSERDA Notes"). At December 31, 2001, the above-mentioned outstanding Refunded NYSERDA Notes are considered defeased.

As a result of this refunding and the deposit with the Escrow Agent, the Refunded NYSERDA Notes are deemed to have been paid, and they cease to be a liability of LIPA. Accordingly, the Refunded NYSERDA Notes (and the related deposit with the Escrow Agent) are excluded from the Statement of Financial Position. The Authority will realize gross debt service savings from this refunding of approximately $287 million over the life of the bonds. The refunding produced an economic gain (the present value of the debt service savings) of approximately $66 million.

Deferred Amortization

A debt refinancing charge of $61.9 million resulted from the refundings that the Authority has undertaken between May 28, 1998 and December 31, 2000, primarily because of the difference between the amounts paid for refundings, including amounts deposited with the Escrow Agent, and the carrying amount of the G&R Bonds, Debentures and NYSERDA Notes. In accordance with the provisions of GASB No. 23, approximately $61.9 million was deferred and shown in the Statement of Financial Position as Deferred amortization within long term debt and is being amortized, on a straight line method, over the shorter of the life of the new debt or the old debt. The unamortized balance at December 31, 2002 and 2001 totaled $21.0 million and $28.1 million, respectively.

In February 2003, the Authority announced its intention to redeem in March 2003, the following NYSERDA financing notes:

NYSERDA notes
(in thousands)

Series		Principal	Rate	Maturity Date		Call Premium
EFRBs Series 1989 B	$	35,030	7.15%	9/1/2019	$	701
EFRBs Series 1990 A		73,900	7.15%	6/1/2020		1,478
EFRBs Series 1991 A		26,560	7.15%	12/1/2020		531
EFRBs Series 1992 B		13,455	7.15%	2/1/2022		269
EFRBs Series 1992 D		28,060	6.90%	8/1/2022		561
Total	**$**	**177,005**			**$**	**3,540**

KeySpan also provided funding for this redemption in accordance with the terms of a promissory note with LIPA.

Debt Maturity Schedule

Debt Service
(in thousands)

Years ended December 31,		Principal		Interest		Total
2003	$	147,180	$	294,091	$	441,271
2004		163,120		298,751		461,871
2005		171,515		292,147		463,662
2006		208,915		284,693		493,608
2007		218,535		276,149		494,684
2008-2012		1,268,150		1,233,471		2,501,621
2013-2017		975,895		1,007,971		1,983,866
2018-2022		1,222,105		794,049		2,016,154
2023-2027		1,319,770		544,450		1,864,220
2028-2032		1,960,610		167,094		2,127,704
2033-2037		409,980		3,099		413,079
Total Principal and interest		8,065,775		5,195,966		13,261,741
Less: unaccreted interest on CABs		550,938				550,938
	$	7,514,837	$	5,195,966	$	12,710,803

Fair Values of Long-Term Debt
The fair values of the Company's long-term debt at December 31, 2002 and 2001 were as follows:

Fair Value *(in thousands)*	**December 31, 2002**	**2001**
Electric System General Revenue Bonds, Series 1998 A	$ 3,281,925	$ 3,165,086
Electric System General Revenue Bonds, Series 1998 B	1,155,662	1,192,204
Electric System General Revenue Bonds, Series 2000 A	428,211	375,538
Electric System General Revenue Bonds, Series 2001 A	297,011	281,347
Electric System General Revenue Bonds, Series 2001 B through K	500,000	500,000
Electric System General Revenue Bonds, Series 2001 L through P	312,544	311,360
Electric System Subordinated Revenue Bonds, Series 1-3 & 1-6	700,000	700,000
Electric System Subordinated Revenue Bonds, Series 7	250,000	250,000
Electric System Subordinated Revenue Bonds, Series 8 (subseries A-H)	236,593	225,502
Electric System Commercial Paper Notes, CP-1	100,000	100,000
Debentures	283,160	279,261
NYSERDA Notes	333,183	338,412
Total	$ 7,878,289	$ 7,718,710

Changes in Long-term Debt *(in thousands)*	**December 31, 2002**	**2001**
Long-term debt, beginning balance	$ 7,502,130	$ 7,218,890
Fair market value adjustment	(25,955)	-
Changes in deferred amortization	9,866	(18,673)
Increases	56,096	1,969,299
Decreases	(127,300)	(1,527,300)
	7,414,837	7,642,216
Due within one year	147,180	140,085
Long-term debt, ending balance	$ 7,267,657	$ 7,502,131

Changes in Short-term debt *(in thousands)*	**December 31, 2002**	**2001**
Short-term debt, beginning balance	$ -	$ -
Increases	100,000	-
Decreases	-	-
Short-term debt, ending balance	$ 100,000	$ -

Note 11. Changes in Other long-term liabilities

(in thousands)	December 31, 2002		December 31, 2001	
Deferred Credits, beginning balance	$	98,467	$	60,955
Increases		48,337		41,612
Decreases		(15,767)		(4,100)
Deferred Credits, ending balance	$	131,037	$	98,467
Claims and damages, beginning balance	$	23,468	$	23,072
Increases		23,012		10,696
Decreases		(22,273)		(10,300)
Deferred Credits, ending balance	$	24,207	$	23,468

Note 12. Retirement Plans

The Authority participates in the New York State Employees' Retirement System (the "System"), which is a cost-sharing, multi-employer, and public employee retirement system. The plan benefits are provided under the provisions of the New York State Retirement and Social Security Law that are guaranteed by the State Constitution and may be amended only by the State Legislation. For full time employees, membership in and annual contributions to the System are required by the New York State Retirement and Social Security Law. The System offers plans and benefits related to years of service and final average salary, and, effective July 17, 1998; all benefits generally vest after five years of accredited service.

Members of the System with less than "10 years of service or 10 years of membership" contribute 3 percent of their gross salaries and the Authority pays the balance of the annual contributions for these employees. Effective October 1, 2000, members of the System with at least 10 years of service or membership no longer contribute 3 percent of their gross salaries. The Authority pays the entire amount of the annual contributions of these employees.

Under this plan, the Authority's required contributions and payments made to the System were approximately $131,000, $114,000 and $82,000 for the years ended December 31, 2002, 2001, and 2000, respectively. Contributions are made in accordance with funding requirements determined by the actuary of the System using the aggregate cost method.

The State of New York and the various local governmental units and agencies which participate in the Retirement System are jointly represented, and it is not possible to determine the actuarial computed value of benefits for the Authority on a separate basis. The New York State Employees' Retirement System issues a publicly available financial report. The report may be obtained from the New York State and Local Retirement Systems, A.E. Smith State Office Building, Albany, New York 12244.

Note 13. Commitments

Existing Purchased Power and Transmission Agreements

As a result of the Merger, LIPA has assumed contracts with numerous Independent Power Producers ("IPPs") and the New York Power Authority ("NYPA") for electric generating capacity. Under the terms of the agreement with NYPA, which will expire in May 2014, LIPA may purchase up to 100% of the electric energy produced at the NYPA facility located within LIPA's service territory at Holtsville, New York. LIPA is required to reimburse NYPA for the minimum debt service payments and to make fixed non-energy payments associated with operating and maintaining the plant.

With respect to contracts entered into with the IPPs, LIPA is obligated to purchase all the energy they make available to LIPA at prices that often exceed current market prices. However, LIPA has no obligation to the IPPs it they fail to deliver energy. For purposes of the table below, LIPA has assumed full performance by the IPPs, as no event has occurred to suggest anything less than full performance by these parties.

LIPA had also assumed a contract with NYPA for firm transmission ("wheeling") capacity in connection with a transmission cable that was constructed, in part, for the benefit of LIPA. With the inception of the New York Independent System Operator ("ISO") on November 18, 1999, this contract was provided with "grandfathered rights" status. Grandfathered rights allow the contract parties to continue business as they did prior to the implementation of the ISO. That is, the concept of firm physical transmission service continues. LIPA was provided with the opportunity to convert its grandfathered rights for Existing Transmission Agreements ("ETAs") into Transmission Congestion Contracts ("TCCs"). TCCs provide an alternative to physical transmission reservations, which were required to move energy from point A to point B prior to the ISO. Under the rules of the ISO, energy can be moved from point A to point B without a transmission reservation however, the entity moving such energy is required to pay a tolling fee to the owner of the TCC. This tolling fee is called transmission congestion and is set by the ISO.

Although LIPA has converted its ETA's into TCCs, LIPA will continue to pay all transmission charges per the ETAs, which expire in 2020. In return, LIPA has the right to receive revenues from congestion charges. All such charges and revenue associated with the TCCs are considered components of or reductions to fuel costs, and as such are included in the FPPCA calculation.

Notes to Consolidated Financial Statements

The following table represents LIPA's commitments under existing purchased power and transmission contracts:

Purchased power and transmission contracts assumed from LILCO

(in thousands)	NYPA Holtsville					
	Debt Service	**Other Fixed Charges**	**Energy***	**Firm Transmission**	**IPPs***	**Total Business***
For the years ended						
2003	$ 22,050	$ 14,096	$ 16,592	$ 23,355	$ 154,800	$ 230,893
2004	22,146	14,015	15,231	23,355	136,000	210,747
2005	22,246	14,581	14,492	23,355	119,900	194,574
2006	22,351	14,899	12,936	23,355	121,700	195,241
2007	22,462	15,226	12,498	23,355	124,700	198,241
2008 through 2012	110,057	81,306	73,935	116,775	457,100	839,173
2013 through 2017	16,627	22,836	20,503	116,775	172,700	349,441
2018 through 2022	-	-	-	116,775	-	116,775
2023 through 2027	-	-	-	116,775	-	116,775
2028 through 2032	-	-	-	116,775	-	116,775
Total	237,939	176,959	166,187	700,650	1,286,900	2,568,635
Less: Imputed interest	66,079	52,890	43,975	379,172	349,700	891,816
	$ 171,860	$ 124,069	$ 122,212	$ 321,478	$ 937,200	$ 1,676,819

* Assumes full performance by NYPA and the IPPs.

Additional Power Supplies

Purchase Power Agreements

In order to meet the anticipated needs and demands of the service area for the summer of 2002, the Authority, through its subsidiary LIPA, entered into agreements with four private companies to construct and operate ten generating units at six sites throughout the service area. LIPA has entered into power purchase agreements ("PPA") with each of the companies for 100% of the capacity, and energy if needed, for the term of each PPA. The PPAs vary in duration from three to 25 years.

In accordance with accounting principles generally accepted in the United States of America, the PPAs are considered leases, and as such, will be accounted for in accordance with the provisions of SFAS No. 13, "Accounting for Leases." Four of the leases, covering seven of the ten generating units, will be accounted for as capitalized lease obligations, whereas the remaining two leases, covering the other three generating units, will be accounted for as operating leases.

The following table represents LIPA's minimum lease payments for the PPAs:

2002 Purchase Power Agreements

(in thousands)	Capital	Operating
Minimum lease/rental payments		
2003	$ 61,252	$ 28,320
2004	60,026	28,258
2005	58,671	19,086
2006	47,401	-
2007	56,208	-
2008 through2012	264,733	-
2013 through 2017	242,115	-
2018 through 2022	124,260	-
2023 through 2027	61,838	-
Total	$ 976,504	$ 75,664
Less: Imputed interest	376,633	
Net present value	$ 599,871	$ 75,664

Submarine Cable

LIPA, in 2002, entered into a capital lease for a submarine cable running between Connecticut and Long Island whereby LIPA will be entitled to up to 330 megawatts of firm transmission capacity. The owner of the cable has determined that several sections of the cable were not buried to depths required by its permits. The Authority is under no obligation to remit payment to the owner of the cable until such time as the cable becomes operable.

The owner of the cable is, however, seeking recovery of certain costs, which the Authority is disputing. This dispute is currently before the Federal Energy Regulatory Commission. The Authority is unable to determine the outcome of these proceedings, and any amounts that may be owed to the owner of the cable cannot be determined at this time.

As provided by LIPA's tariff, the costs of all of the facilities noted above will be includable in the calculation of Fuel and Purchased Power Cost. As such, these costs will be recoverable through the Fuel and Purchased Power Cost Adjustment mechanism.

Office lease
In December 1996, the Authority entered into a non-cancelable office lease agreement for the period January 1, 1997 through January 31, 2003. In January 2001, the lease was amended to include additional premises. As a result of the amendments, the lease expiration date was changed to January 31, 2011. The future minimum payments under the lease are as follows:

(in thousands)			
Year ended December 31,	2003	$	1,199
	2004		1,243
	2005		1,290
	2006		1,338
	2007		1,388
	2008 - 2011		4,613
Total			11,071
Imputed Interest			627
Net Present Value		$	10,444

Rental expense for the office lease amounted to approximately $1.2 million and $1 million for the period ended December 31, 2002 and 2001, respectively.

Note 14. Legal Proceedings

Shoreham Tax Matters
Through November 1992, Suffolk County, Town of Brookhaven, Shoreham-Wading River Central School District, Wading River Fire District and Shoreham-Wading River Library District (which was succeeded by the North Shore Library District)(collectively, the "Suffolk Taxing Jurisdictions"), levied and received real estate taxes from LILCO on the Shoreham plant. When the Authority acquired the Shoreham plant in February 1992, it was obligated pursuant to the LIPA Act to make PILOTs on the Shoreham plant beginning in December 1992. As part of the agreement between LILCO and the Authority providing for the transfer of Shoreham to the Authority, LILCO agreed to fund these payments. Prior to the Merger, LILCO charged rates sufficient to make these payments to the Authority. Both LILCO and the Authority contested the assessments on the Shoreham plant, claiming the plant was overassessed.

On March 26, 1997, a judgment was entered in the Supreme Court, State of New York, Suffolk County, on behalf of LILCO against the Suffolk Taxing Jurisdictions ordering them to refund to LILCO property tax overpayments (resulting from over-assessments of Shoreham) in an amount exceeding $868 million, including interest as of the date of the judgment. In addition, the judgment provides for the payment of post-judgment interest (the "Shoreham Property Tax Litigation"). The Court also determined that the Shoreham plant had a value of nearly zero during the period the Authority has owned Shoreham. This judgment was unanimously affirmed by the Appellate Division of the State of New York on July 13, 1998. Certain of the Suffolk Taxing Jurisdictions sought leave from the Appellate Division to appeal this judgment to the New York State Court of Appeals. Their applications were unanimously denied by the Appellate Division. New applications for leave to appeal were made to the Court of Appeals. On January 19, 1999, the Court of Appeals denied the motions. There is no further review in the New York State court system.

On January 11, 2000, the Authority, LIPA, and the Suffolk Taxing Jurisdictions entered into a Shoreham Settlement Agreement. Pursuant to the Shoreham Settlement Agreement, an amended judgment was filed, reducing the amount of the judgment and the Authority's PILOT claims to the greater of (i) $620 million, plus interest, less the principal of the Shoreham Tax Settlement Bonds paid with the surcharge or (ii) the amount required to fully satisfy the Authority's remaining debt service and related obligations in connection with the Shoreham Tax Settlement Bonds. The amended judgment is enforceable by the Authority or LIPA in the event, among others, that any portion of the Shoreham Settlement Agreement is declared invalid or unenforceable.

In April 2000, an Article 78 proceeding was filed by the Town of Islip, its Supervisor and the Supervisors of three other townships, against the Authority, LIPA, the Suffolk Taxing Jurisdictions and the County of Nassau. The lawsuit sought a judgment declaring illegal those provisions of the Shoreham Settlement Agreement providing for the repayment of certain tax certiorari judgments by imposition of a surcharge on electric rates. On August 18, 2000, the Authority submitted its papers in opposition to the petition. A hearing was held on October 5, 2000 in the Supreme Court, State of New York, Suffolk County. Supplemental memoranda of law were submitted on October 19, 2000. In a decision dated December 5, 2000, the Court held that to the extent the Shoreham Settlement Agreement imposes a surcharge on electric rates on Suffolk County ratepayers; the Settlement Agreement violates the Suffolk County Tax Act. The Suffolk County Tax Act provides that Suffolk County shall pay the full amount of a tax judgment against Suffolk County and the other affected municipalities and shall recover from such other affected municipalities their share of the judgment. By Opinion and Order dated October 7, 2002, the Appellate Division, Second Department, unanimously reversed the Judgment of Supreme Court and dismissed the petition. The Appellate Division determined that the Shoreham Settlement Agreement was lawful. Petitioners filed motions in the Court of Appeals seeking permission to appeal to the Court of Appeals. On January 16, 2003, the Court of Appeals denied the petitioners' motion. This case is now concluded.

Environmental

In connection with the Merger, KeySpan and LIPA entered into Liabilities Undertaking and Indemnification Agreements which, when taken together, provide, generally, that environmental liabilities will be divided between KeySpan and LIPA on the basis of whether they relate to assets transferred to KeySpan or retained by LIPA as part of the Merger. In addition, to clarify and supplement these agreements, KeySpan and LIPA also entered into an agreement to allocate between them certain liabilities, including environmental liabilities, arising from events occurring prior to the Merger and relating to the business and operations to be conducted by LIPA after the Merger (the "Retained Business") and to the business and operations to be conducted by KeySpan after the Merger (the "Transferred Business").

KeySpan is responsible for all liabilities arising from all manufactured gas plant operations ("MGP Sites"), including those currently or formerly operated by KeySpan or any of its predecessors, whether or not such MGP Sites related to the Transferred Business or the Retained Business. In addition, KeySpan is liable for all environmental liabilities traceable to the Transferred Business and certain scheduled environmental liabilities. Environmental liabilities that arise from the non-nuclear generating business may be recoverable by KeySpan as part of the capacity charge under the PSA. LIPA is responsible for all environmental liabilities traceable to the Retained Business and certain scheduled environmental liabilities.

Environmental liabilities that existed as of the date of the Merger that are untraceable, including untraceable liabilities that arise out of common and/or shared services have been allocated 53.6% to LIPA and 46.4% to KeySpan, as provided for in the Merger.

Environmental Matters Retained by LIPA

Long Island Sound Transmission Cables. The Connecticut Department of Environmental Protection ("DEP") and the New York State Department of Environmental Conservation ("DEC") separately have issued Administrative Consent Orders ("ACOs") in connection with releases of insulating fluid from an electric transmission cable system located under the Long Island Sound that LIPA owns jointly with the Connecticut Light and Power Company ("CL&P"). The ACOs require the submission of a series of reports and studies describing cable system condition, operation and repair practices, alternatives for cable improvements or replacement, and environmental impacts associated with prior leaks of fluid into the Long Island Sound. Compliance activities associated with the ACOs are ongoing.

In November 2002, a work boat, owned and operated by a third party, dragged its anchor, causing extensive damage to four of the seven cables of the 138-kilovolt facility and the release of a minimal amount of dielectric cable fluid into the Long Island Sound. Temporary clamps and leak abaters were promptly placed on the impacted cables and stopped the leaks. Permanent repairs are expected to be undertaken in the spring of 2003. The preliminary estimate of the cost to bring these cables back to full service is approximately $18 million. LIPA intends to seek recovery from third parties for costs incurred by LIPA as a result of this incident. The timing and amount of recovery, if any, cannot yet be determined. LIPA and CL&P maintain property damage insurance coverage for the cable system that LIPA believes will cover most of the repair costs. In any event, response and repair costs not covered by insurance or reimbursed by third parties will be shared equally by LIPA and CL&P. Additionally, LIPA has received notice from the NYISO that due to the cable outage certain credits may not be taken, the amount of which has not yet been finally determined, but could be considerable. LIPA will seek recovery of any such losses from the parties responsible for this incident.

Simazine. Simazine is a commercially available herbicide manufactured by Novartis that was used by LILCO as a defoliant until 1993 under the direction of a New York State Certified Pesticide Applicator. Simazine contamination was found in groundwater at one of the LIPA substations in 1997. LIPA has conducted studies and monitoring activities in connection with this herbicide and is currently working cooperatively with the DEC and others in this matter. The liability, if any, resulting from the use of this herbicide cannot yet be determined. However, LIPA does not believe that it will have a material adverse effect on its financial position, cash flows, or results of operations.

Superfund Sites. Under Section 107(a) of the federal Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA", also commonly referred to as the "Superfund Legislation"), parties who generated or arranged for disposal of hazardous substances are liable for costs incurred by the Environmental Protection Agency ("EPA") or others who are responding to a release or threat of release of the hazardous substances.

Metal Bank. In December 1997, the EPA issued its Record of Decision ("ROD"), in connection with the remediation of a licensed disposal site located in Philadelphia, Pennsylvania, and operated by Metal Bank of America. In the ROD, the EPA estimated that the present worth cost of the selected remedy for the site is $17.3 million. In June 1998, the EPA issued a unilateral administrative order to 13 Potential Responsible Parties ("PRPs"), including LIPA, for the remedial design and for remedial action at the site. LIPA cannot predict with reasonable certainty the actual cost of the selected remedy, who will implement the remedy, or the cost, if any, to LIPA. Under a PRP participation agreement, LIPA is responsible for 7.95% of the costs associated with implementing the remedy. LIPA has recorded a liability equal to its estimated cost representing its estimated share of the additional cost to remediate this site. The liability phase of the case was tried in the fall of 2002, which resulted in a finding of liability against Metal Bank in January 2003. At a March, 2003 conference before the federal judge, the court ordered that the second stage trial (determination of the final remedy) be held on November 1, 2003.

PCB Treatment Inc. LILCO has also been named a PRP for disposal sites in Kansas City, Kansas and Kansas City, Missouri. The two sites were used by a company named PCB Treatment, Inc. from 1982 until 1987 for the storage, processing, and treatment of electric equipment, oils and other materials containing Polychlorinated Biphenyls ("PCBs"). According to the EPA, the buildings and certain soil areas outside the buildings are contaminated with PCBs. Certain of the PRPs, including LILCO and several other utilities, formed a group, signed a consent order, and investigated environmental conditions at these properties. The work required under this consent order has been completed, and the PRPs, including LIPA, recently signed a second consent order that obligates them to clean up and restore the two contaminated properties. LIPA has been determined to be responsible for less than 1% of the materials that were shipped to this site. Although LIPA is currently unable to determine its precise liability for costs to remediate these sites, LIPA does not believe that this liability will have a material adverse effect on its financial position, cash flows or results of operations.

Mattiace Petrochemical Site. This site in Glen Cove operated as a bulked and drummed solvent retailer from the 1960s until 1987, and as a drum reconditioning facility from 1974 through June 1983. In 1988, EPA began remediating the heavily contaminated soil found at the site. LIPA was identified as a PRP by the EPA for LILCO's distribution of empty drums that may have contained solvent residues for reconditioning at the site and for the purchase of solvents during the 1980s. EPA is seeking to settle this matter with approximately 80 targeted PRPs for approximately $50,000 in discounted past remediation costs and $15 million in anticipated present value future remediation costs. LIPA's share of these costs is estimated at 3.6% based upon present allocations. A Joint Defense Group consisting of approximately 20 identified PRPs has been formed, of which LIPA is a member. Pursuant to active negotiations with EPA, the Joint Defense Group and others, have entered into a judicial consent decree settlement, which is expected to filed in federal court this spring. LIPA's portion of the settlement was approximately $466,000.

<u>Environmental Matters Which May Be Recoverable From LIPA By KeySpan Through The PSA</u>
Asharoken. In March 1996, the Village of Asharoken (the "Village") filed a lawsuit against LILCO in the New York Supreme Court, Suffolk County (Incorporated Village of Asharoken, New York, et al. v. Long Island Lighting Company). Although the Village's negligence claims were dismissed, the causes of action sounding in nuisance remain at issue. Specifically, the Village seeks injunctive relief based upon allegations that the design and construction of the Northport Power Plant upset the littoral drift of sand in the area, thereby causing beach erosion. The case was tried before a judge without a jury. The trial was completed in December 2002. The parties are scheduled to file post-trial briefs on March 31, 2003. Liability, if any, resulting from this proceeding cannot yet be determined. However, LIPA does not believe that this proceeding will have a material adverse effect on its financial position, cash flows or results of operations.

In a related matter, 132 residents of the Village commenced an action in March 2002 seeking monetary damages and injunctive relief arising out of the same facts and circumstances as the pending 1996 action.

The 2002 action has been discontinued without prejudice to renew depending on the outcome of the trial of the 1996 action.

Environmental Matters Which Are Currently Untraceable For Which LIPA Could Have Responsibility
Other Superfund Sites. DEC has notified LILCO, pursuant to the New York State superfund program, that LIPA may be responsible for the disposal of hazardous substances at the Huntington/East Northport Site, a municipal landfill property. The estimated response cost for remediating this site is $19.1 million. LIPA is currently unable to determine its share, if any, of the costs to investigate and remediate this site. In a recent (October 2002) tolling agreement with DEC, they contend to have a claim of over $15 million in past response costs, in addition to interest, enforcement and future costs.

The EPA and DEC notified LILCO that LIPA may be responsible for the disposal of hazardous substances at the Port Washington Landfill, another municipal landfill property. DEC is pursuing remediation. LIPA is currently unable to determine its share of costs to investigate and remediate this site. In a recent (November 2002) tolling agreement with DEC, they contend to have a claim of over $15 million in past response costs, in addition to interest, enforcement and future costs.

Other Matters
LIPA may from time to time become a party to various legal proceedings arising in the ordinary course of its business. In the judgment of the Authority and LIPA, these matters will not individually or in the aggregate, have a material effect on the financial position, results of operations or cash flows of LIPA.

Note 15. Subsequent Events

Additional Power Supplies
Subsequent to year-end, the Authority entered into agreements for the development of approximately 200MW of new generation capacity to be developed on Long Island. These units are expected to be available for the summer of 2003 and, an additional 50 MW to be constructed and in service for the summer of 2004. The 2003 facilities are to be constructed and operated by three different developers. One of the facilities is to be located in Queens County, New York and two in Suffolk County, New York. The single facility to be constructed in 2004 will be located in Nassau County, New York.

2003 Plan of Finance
The Authority has approved a plan of finance that it expects to complete over the next several months that includes various borrowings. The plan of finance is expected to include the following components: (i) the Authority plans to remarket its $27.3 million Electric System Subordinated Revenue Bonds, Series 8C, as fixed rate bonds scheduled to mature on April 1, 2010; (ii) the Authority plans to issue approximately $625 million of uninsured, fixed rate, senior lien bonds (the "Series 2003A & B Bonds"). The Series 2003 A & B Bonds will be issued to refund certain series of the Electric System General Revenue Bonds Series 1998A, 1998B, and 2000A that are currently insured by Financial Security Assurance ("FSA"). Subject to the planned refunding and defeasance of such bonds, FSA has committed to insure certain senior lien, variable rate bonds described below (the "Refunding VR Bonds"); (iii) in connection with the expiration of certain letters of credit supporting the Authority's $700 million Electric System Subordinated Bonds, Series 1 through 3, the Authority plans to remarket $600 million of such Bonds as subordinate lien variable rate or auction rate bonds, and refund the remaining $100 million with fixed rate senior lien bonds; the Authority plans to issue $200 million of fixed rate senior lien bonds to fund certain capital expenditures; and (iv) the Authority plans to issue approximately $600 million Refunding VR Bonds on or near June 1, 2003 to refund approximately $587 million Electric System General Revenue Bonds Series 1998A (2029

maturity, 5.50%). The Refunding VR Bonds are being issued in connection with the swaption entered into by the Authority in October 2002, which was exercised on February 3, 2003, as more fully described in Notes 5.